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MARKETING AGREEMENTS

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INTRODUCTION

Marketing agreement is commitment. A marketing agreement is a formal commitment arrangement between the cooperative and its member. It is a written statement of the rights and duties of member producers and rights and duties of the cooperative in marketing member's production through the cooperative. It obligates members to market their production from specified acreage or farm through the cooperative—and nowhere else. It obligates the cooperative to accept delivery. Title is transferred to the cooperative who has responsibility for marketing.

Recent Trends

Most recent application of marketing agreements has been to grain. Earlier usage has been with milk, sugar and citrus. The trend is toward increasing usage, especially as financing of farming and farm marketing becomes more complex. The gradual disappearance of open markets and increasing integration in food and fiber also encouraged the use of marketing agreements.

When Are They Necessary

A marketing agreement is necessary when the cooperative (1) wants to advance beyond a buy-sell operation. (It wants to move up to market management), (2) commits itself to operate in a marketing channel or system where the assurances of supply on a prescheduled specification and delivery basis is essential to getting and holding that market arrangement, (3) is expected to assume responsibility for how the member fares in the market place, and (4) finds its financial structure in jeopardy due to unpredictable member patronage.

For the producer, a marketing agreement is necessary when, he wants (1) higher price for his production than he can get by "playing the market" himself and (2) benefits of average seasonal pricing through pooling.

WHAT CAN MARKETING AGREEMENTS DO FOR COOPERATIVES?

1. Assure Member Support

Marketing agreements encourage members to continue to support their cooperative. The only legal place the producer member can deliver his production is to his cooperative.

Cooperative and non-cooperative business firms vie for the farmers' business in many rural communities. The non-cooperative firm is free to entice cooperative members away from their cooperative. The marketing agreement prevents the co-

operative member from being "nickeled and dimed" away or "contracted away" from his cooperative. It assures the cooperative that the member will deliver his production . . . it provides supply assurance.

2. Permit Planning

With a marketing agreement, the board of directors and management can more confidentially develop and execute long range plans. By knowing the quantity and estimated quality of product to be handled, the cooperative can more efficiently allocate resources, operate more efficiently, thus maximize returns to members. Plans can encompass all aspects of the business, not just the fiscal. Planning can be most effective when the cooperative is closed to new members when harvesting begins, and remain closed during the busy marketing period. This will give the cooperative a more accurate estimate of what will be handled during the marketing season.

3. Makes Costs Predictable

Since the marketing agreement permits more predictable deliveries, it also makes costs more predictable. This leads to a better cash flow situation and avoids financial hardship.

4. Allow Sounder Financing

With marketing agreements the board of directors and management have a better idea of the total volume of financing necessary to conduct business. In the short term, cooperatives know better how much money is needed and when. The financing can be arranged well in advance of needs thus minimizing interest charges. In the long term, marketing agreements permit sounder financing of expansion and remodeling.

5. Aid in Pricing

Knowing what volume the cooperative will handle allows it to pursue a more efficient pricing policy. Not only can it set a firmer level of price, but it also can avoid seasonal price dips. This advantage is multipled if marketing agreements exist between a local and a regional cooperative as well as at the producer level.

6. Permit Co-op to Forward Contract

Since the cooperative has a better idea of the amount of product its members will deliver, it can enter into forward contracts with buyers with assurance of performance. With marketing agreements cooperatives can precommit to forward contracts a higher portion of anticipated total supply on a grade specification and time schedule basis.

7. Enhances Cooperative's Prestige

If, as a result of marketing agreements, the cooperative does what is named above, it is more apt to reflect to the business world that it knows what it is doing. The image of the cooperative can improve not only in the minds of those who deal with it, but also in the eyes of employees, other businessmen and community residents.

WHAT CAN MARKETING AGREEMENTS DO FOR PRODUCER-MEMBERS?

1. Increase Returns

This results from the cooperative being able to do a more efficient job of handling and marketing.

2. Put the Job of Marketing in Hands of Those Who Have the Greatest Expertise

3. Assure the Produer an Outlet for His Production

4. Help Secure Production Financing

A marketing agreement with a strong cooperative is recognized by bankers as an indication of good management. It, therefore, aids the producer in his job of securing production loans.

5. Lets Producer Participate in the Pool Price

It allows the producer to participate in the average price for the season rather than "one-shot" pricing.

DURATION OF CONTRACTS

The duration of contracts vary according to the borrowed capital load. As a general rule, as the ratio of borrowed capital to equity capital increases, so does the initial duration of the contract. Where the borrowed capital requirement is minimal, the contract duration may be as few as two years. However, if borrowed capital represents a substantial portion of the total capital, the initial duration may be as much as ten years. Regardless of the initial duration of the contract, it continues in force unless cancelled by either party according to terms.

ITS EFFECTIVENESS

Marketing agreements are usually highly effective in fulfilling their purpose. Effectiveness depends upon the promptness and thoroughness with which the initial breech of contract is handled. If the members and the Board turn their back on the initial contract breech, then the contract will be breeched in greater frequency and severity. When this happens, the contract serves no useful purpose except to create distrust and confusion.

On the other hand, if the initial breech of contract is promptly handled by management and board of directors, then usually no other attempts at breeching the contract occur. The contract then completely fulfills its purpose.

When the contract is breeched, the board of directors and management must take action not only against the member who breeched the contract but also against the buyer. In most cases, the buyers are aware that they are purchasing a commodity that has been committed through the marketing agreement to a cooperative. In accepting delivery of such a commodity, they are hopeful that the board of directors and management will not take action against the member nor against them. In some instances, the buyers of such committed products accept delivery to purposefully destroy the cooperative. Prompt legal action by the co-op discourages other buyers from encouraging members to breech their marketing agreements.

The member who breeches his contract usually suffers great financial losses. Some have not only had to terminate the production of that product but have been forced to sell their farms—in some cases at great sacrifice.

Example of Non-Delivery

Item	Amount
Loss on Sale (Grower settled for less than co-op paid)	$10,500
Penalty assessed 400 acres @ $25.00	10,000
Court and legal costs	2,000
Total Cost to grower	$22,500
Plus loss of membership	

In this example the grower sold his crop for $10,500 less than what the cooperative could have gotten for him. Additionally, the producer was assessed a penalty of $25 an acre which was specified in the marketing agreement. This amounted to $10,000. The marketing agreement further specified that any member who violates the marketing agreement must assume all court and legal costs which in this case amounted to $2,000.

The member suffered a total loss of $22,500 for failing to deliver one year's crop according to the marketing agreement. Additionally, the marketing agreement specified that "Should the grower breech this contract it is also understood that the grower will no longer be eligible to sell to or through the association." Consequently, he suffered the loss of membership. If he continued to do no better marketing his crop than he was at the time he breeched his contract, he can expect to sell his production for less money than the cooperative could bring him. Consequently, the loss of membership is more critical to the producer than the penalty assessment or the payment of court and legal costs. Members who have violated their marketing agreements learn to regret their action. They learn that cooperatives are able to get higher prices and protect growers' rights better than members acting alone.

WHY ARE THEY NECESSARY

What is happening in agriculture that makes marketing agreements more

necessary than ten or fifteen years ago?

(1) Farmers are more dependent for income upon the market place rather than government programs.

(2) Prices are more volatile. Prices can move in one day what took one year during the heavy supply, price support era. Selling at the "right" or "wrong" time makes a lot of difference to the farmer. The farmer faces increased risk in general.

(3) Agriculture is becoming more industrialized. The incidents of ownership and contract integration is increasing. Production no longer stands uniquely separated from marketing. There is increased effort to tie production and marketing together in an increasing variety of ways. Cooperatives cannot compete in an increasingly industrialized agriculture without reliable sources of supply. Marketing agreements provide supply assurance.

(4) Our modern day food business requires sizable investments in processing and marketing equipment and personnel. These must be operated near capacity to minimize costs. This can be most efficiently achieved by cooperatives by having a reliable source of supply. Likewise, marketing agreements serve as a protection of large and growing investments in farming by providing market assurance.

(5) Food retailers and institutional suppliers are interested in dependable, long-term sources of supply. They also desire variety and product quality. To satisfy these requirements of the trade, cooperatives themselves must have some control over quality and quantity and when farmers deliver. The assurance of supply allows the cooperative to do a better job of merchandising to get producers top dollar. Cooperatives cannot make wise marketing decisions without total producer-member commitment to be cooperative. The cooperative cannot effectively commit to the market, without first having raw products committed to it.

(6) Today, export is where the action is. But importing countries are no longer satisfied with buying grain and other products at the last minute on the open market. They cannot rely on it. They have been caught short. Now they want to negotiate 3 to 5-year or even longer contracts. The ability of cooperatives to compete in export is determined by their ability to commit to such contracts. Producer commitment in the form of marketing agreements determines this ability.

(7) In the long run, delivery of production by the member is more critical to cooperative success than increasing investments of equity capital. Consequently, the marketing agreement, in part, substitutes for equity capital, while at the same time serving as collateral for borrowed capital. Marketing agreements lead to sounder more efficient financing and pricing policies.

(8) Commitment makes business and financial planning, and carrying out of the plan, possible. It makes costs and results more predictable.

PROVISIONS OF MARKETING AGREEMENTS

Marketing agreements usually consist of a dozen or more separate provisions. These provisions include:

1. Identification of What is to be Delivered

This paragraph identifies the product and the quantity to be delivered, usually in terms of total production or by acreage, pounds or other units. If the product is identified by acreage, then further identification by county, farm number, field number, and variety is recorded.

2. Definition of Delivery

Delivery is usually completed when the member's product is received at the cooperative. This may occur when the grain is dumped at the elevator, milk is pumped from the truck to milk plant, or cotton received at the gin. However, delivery does not always entail physical transfer of the product from the producer's farm onto the cooperative's premises. Delivery may be completed when the producer stores his grain in commercial storage and obtains a negotiable warehouse receipt in the name of the cooperative. The receipt is then taken to the cooperative. Delivery may also take place for products in farm storage when the producer granted an exclusive option to the cooperative to purchase the products so stored. In such an arrangement, the product cannot be delivered to anyone else and actual delivery takes place when the product is harvested on the farm.

3. Rules for Handling and Establishing Terms of Trade

The cooperative makes rules and regulations governing the method of weighing, handling, sampling, quality analysis, storage and delivery and the producer agrees to be bound by such rules and accepts the quality analysis. Usually the cooperative reserves the right to reject any nonmarketable product that was intended for delivery.

The cooperative usually reserves the right to purchase commodities in the open market to cover sales commitments in the unlikely event of widespread crop failures.

4. Pooling Method and Method of Payment

A marketing agreement with a cooperative generally involves the concept of pooling returns. In pooling, the cooperative makes as large an initial payment as possible at the time of delivery. The specific payment rate is set by the board of directors. Subsequent payments are made to reflect value differences of the products of different producers. Final payments are distributed after all the commodity in the pool has been sold by the cooperative and the expenses incurred in pool transactions and overhead are deducted. The marketing agreement will state the various bases by which the board of directors may establish pools.

With some annual crops, the marketing agreement may set forth an option to the grower whereby he may decide to defer initial or progress payments until after January 1 of the following year. This must be done at the time of delivery. After this option has been exercised, the producer cannot change his mind. He may, however, choose to defer payment on some lots and not on others.

5. Financing the Cooperative

Cooperatives normally build capital stock in one of two ways: (1) by member purchase of stock of a specific amount per acre, bushel, hundred-weight or ton of product marketed, and (2) by retaining and allocating to individual producers net margins at the end of the year. The marketing agreement will generally specify how such retains and net margins are to be handled. An aspect of the agreement will be that the producer agrees to include such retains as a part of his income in compliance with State and Federal tax laws.

6. Identify Creditors

Under this provision the cooperative, under certain conditions, assumes and agrees to pay loan indebtedness of grower. These conditions are made known to the cooperative up to the grower's net proceeds from the delivered product. In order for the cooperative to assume this responsibility, the grower is required to notify it of any or all ownership interests, liens and other incumbrances against the product before or at time of delivery.

7. Setting Quantity Requirements

To protect the cooperative from high operating costs due to inadequate volume, the agreement can set forth the minimum quantity at which the contract becomes binding upon the association and member. This provision is especially helpful in the first year of operation so as to prevent the cooperative from starting business too soon with too little volume. The agreement also usually specifies that any member holding an agreement is not required to produce the product. A marketing agreement should never be reason for continuing to produce. The principal objective of any grower who enters into an agreement is to obtain the advantages of cooperative marketing and other services connected with it.

8. Setting Penalty for Failure to Deliver

The marketing agreement sets forth the penalty of so much an acre, or other production unit, to be assessed upon the grower for failure to deliver. The agreement specifies costs, premiums for bonds, expenses and fees, including attorney's fees, to be paid by the member if litigation becomes necessary. The agreement specifies that the grower loses his right to sell to or through the cooperative if the contract is breached.

9. Defining Duration and Renewal of Contract

The agreement sets forth the duration of the contract in number of years. Following the initial specified duration, the agreement continues in force unless cancelled by either party in writing on or before a date specified annually. Cancellation does not (1) affect uncompleted sales or transactions, (2) release either party from unpaid indebtedness, (3) relieve grower from delivering products subject to prior agreement, nor (4) relieve the cooperative from handling and marketing the member's product under agreement.

10. Limitation of Obligations to Written Substance

This provision is included to point out that the contents of the articles of incorporation, the bylaws and the marketing agreement, constitute the entire agreement between the cooperative and the member. In the formation of any cooperative, there are certain oral and other promises advanced by enthusiastic solicitors or other interested parties. The agreement declares that promises not contained in the official papers of the association are invalid.

11. Requires All Members to Sign

This provision specifies that each grower who delivers products to the cooperative is required to sign a marketing agreement. If the grower is a business partnership, each partner must sign. Similarly, both tenant and landlord must sign if a tenant intends to deliver the landlord's share of the crop. If the grower is a corporation, the agreement is to be signed by an officer showing his title. The important point is that no grower may be a member without signing a marketing agreement.

12. Provides for Cooperative Signature

In addition to the grower's signature, an official of the cooperative (usually the president of the board of directors) is required to sign the agreement before it becomes binding.

MARKETING AGREEMENTS BETWEEN LOCAL AND REGIONAL COOPERATIVES

Marketing agreements differ from *cash sales* in: (1) the time the marketing decision is made, (2) the certainty of a price, and (3) the time when payment is received. In a marketing agreement the producer's marketing decision is made prior to harvest—usually at the time production decisions are made.

In a marketing agreement, a price is not specified at time of delivery. A common misconception is that the producer will receive the average market price for the year. Knowledge by the cooperative of how much product it will receive and market on a committed basis at opportune times allows it to do better than the annual average price.

Thus, a producer would also have to be much better than average at "playing the market" year after year to do better in the cash market than under a mar-

keting agreement. Under a marketing agreement, the producer receives part payment at time of delivery. Successive payments follow throughout the year as each pool is liquidated. The final payment is made when the entire pool has been sold.

MARKETING AGREEMENTS AS A SOURCE OF COOPERATIVE MARKET POWER

Commitment, pooling, and vertical integration are cornerstones for building a market power base into cooperative marketing of farm products. The evidence of commitment is the marketing agreement. Once commitment is achieved, pooling follows and vertical integration becomes a feasible economic alternative.

Among cooperatives performing similar marketing functions, cooperatives with marketing agreements usually have superior marketing capability and market performance than those without marketing agreements. The reasons for this are noted in the sections setting forth what marketing agreements can do for cooperatives and members. Primarily, marketing agreements provide the cooperative greater supply and market management opportunities. It advances the cooperative from selling to marketing.

Through the resulting strengthened supply and market management, greater equity is achieved in costs and income allocation among members. The cooperative can also economically engage in market development, achieve greater market stability and, in general, improve the performance of the subsector through greater management control and technical efficiency.

These impacts of marketing agreements, which members have with their cooperatives, may be viewed with alarm by those unfamiliar with cooperatives and cooperative marketing. Marketing agreements usually lead to higher net prices to members than without such agreements. This is mistaken by some as undue price enhancement. The higher net price arises from relatively greater cost efficiency in the committed system rather than monopoly pricing power.