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Comment: Edwin Nourse's "The Place of the Cooperative in Our National Economy"

Joseph D. Coffey

Nourse saw the proper place of agricultural cooperatives as that of a "competitive yardstick" with the objective to keep other forms of business competitive—not to supersede them. The cooperative was to be an "economic architect, not commercial Napoleon." Cooperative success was not to be measured in terms of the "size of its membership or volume of its operations," but rather by occupying certain strategic points and setting the standard of competition that would ensure both the farmer and the consumer efficient service at true long-run costs. If investor-owned firms (IOF) were efficient in a particular sector, cooperatives should not divert their capital and effort to that sector. Furthermore, once cooperatives have been successful in their role of stimulating competition, "they may be well advised in entirely terminating operations. . . ." In short, the cooperative was a vehicle for improving the functioning of the free market economy.

In light of cooperatives' lofty but presumably profitless place, it is ironic that Nourse emphasized that the cooperative "is a hard-headed business, not an ideological crusade." One might want to ask Nourse: How can a hard-headed business exist as an unrewarded yardstick? Who's going to take the write-down of assets from terminating operations? Who's going to pay for keeping a "stand-by capacity" in mothballs waiting to see if market inefficiencies of IOFs arise? Who's going to turn away business of members in order not to displace IOFs? Who is going to fund the R&D of "demonstrating a superior method of processing or distribution?"

Joseph D. Coffey is vice president, Southern States Cooperative, Richmond, Virginia.

The problem, of course, is that playing the yardstick role generates a public good that benefits society and the cooperative membership (exclusive of the members' investment in the cooperative), but the benefit can't be captured by the cooperatives' coffers. How have farmer cooperatives resolved this dilemma of being pure but broke or profitable but heretical? Have they become paupers or prostitutes?

Farmer cooperatives have not forsaken the yardstick role. Petraglia and Rogers' recent study found that where cooperatives have been involved in food marketing, they have been successful in their competitive yardstick role. Even in the dairy industry, where cooperatives hold a dominant 76 percent share of marketing, Parliment, Lerman, and Fulton found that cooperatives performed significantly better than IOFs, but that their earnings were not higher than IOFs. Although I don't have rigorous regression results like those from Connecticut, my own observation has convinced me that the presence of cooperatives does promote competition and improve the workings of the market.

Farmer cooperatives have not become "commercial Napoleons." Net saving before tax and extraordinary items as a percentage of sales of the largest 100 farmer cooperatives, according to unpublished estimates provided by the Agricultural Cooperative Service (ACS), has averaged only 1.0 percent and return on equity averaged 8.6 percent during 1980-90. I keep tabs on the performance of the 10 largest regional farm supply cooperatives. Their return on sales for 1980-90 averaged 0.8 percent and return on equity averaged 6.0 percent.

These returns are modest. Indeed as we note below, returns have not been sufficient for cooperatives to maintain their market shares in the traditional farm supply and marketing areas. Returns have been totally inadequate to generate sufficient balance sheet strength to be a player in the growing food sector. As Rogers and Marion (pp. 71-72) observe: "Within food and tobacco manufacturing, cooperatives appear to have little market power. And when compared with the largest 20 and 100 investor-owned food and tobacco firms, the size and market power of cooperatives is like a mosquito on an elephant's rump."

Farmer cooperatives have not become "too big for their britches." Cooperatives do, in Nourse's terms, "occupy certain strategic points and . . . set a . . . plane or pace of competition." Cooperatives are the leading first handler of farm products and leading supplier of production inputs. Cooperatives, if they were to combine their seed operations, would have the world's fifth ranking seed company. Cooperatives have some 6,600 of the 8,000 major farm supply retail stores and own the world's largest fertilizer company. Five of the top 11 feed manufacturers are cooperatives.

But, according to ACS, during the 1980s the overall market shares of cooperatives for farm supplies and marketing fell from around 30 percent to around 25 percent. The cooperatives' share of grain marketing at the origination level dropped from the mid-40s to the mid-30s. Cooperatives' britches are shrinking.

The rapid consolidation of the agricultural input and product markets is worrisome. According to Marion and Kim, national four-firm concentration ratios of food manufacturing industries increased an average of 23 points during 1977 to 1988, with mergers and acquisitions accounting for two-thirds of the growth. They note (pp. 426-27) that:

Archer Daniels Midland (ADM), Cargill, and ConAgra were major participants in mergers. . . . ADM used mergers to become the leading firm in soybean, cottonseed, and wet corn milling. ConAgra employed mergers to become number one or two in flour milling, beef packing, broiler processing. Cargill was a major participant in mergers in flour milling, soybean milling, and beef packing. . . .

As a result of the mergers during 1977 through 1988, ADM, Cargill, and ConAgra have become enormous commodity conglomerates with strong positions in most of the industries in which they are involved. ConAgra, for example, in addition to being the nation's number one flour miller and number two broiler processor and beef packer, is also the number one slaughterer of lambs and turkeys, the number two hog slaughterer, a leading processor/distributor of branded processed meats (Armour and Swift brands), and also has shrimp and catfish operations. From one end of the retailer meat case to the other, ConAgra has a presence. ConAgra has developed these positions very quickly through a series of mergers.

Although cooperatives hold a strategic position in agriculture and are much larger today than when Nourse was writing, they are dwarfed and indeed threatened by the galloping concentration of the global conglomerates. The annual sales of the top 20 food companies are about \$250 billion, or tenfold the sales of the top 20 major regional cooperatives' sales of \$25 billion. The grain market is dominated by global giants, such as Cargill, Continental, ConAgra, ADM, and Ferruzzi, who have combined annual sales of \$84 billion. The leadership in pesticides and seed is in the hands of deep-pocketed global pharmaceutical giants. Meat packing is highly concentrated among the top four firms.

The issue is not only the conglomerates' dominance of specific markets such as grain marketing, seed, and meat packing, but of the integration back into production.

Cooperatives will have to create a better alternative to contracting/integration, or they eventually will be squeezed out of the marketplace. In Nourse's day, IOFs and cooperatives were involved in marketing or manufacturing, but not production. But today, the global giants, such as Cargill, ConAgra, and Ferruzzi, are integrated food companies involved in the entire food chain. Farmer cooperatives, with some exceptions such as Gold Kist in poultry, have limited involvement in controlling production of farm products.

The increasing complexities of production inputs, economies of scale, and benefits of branded products are fostering a strategy of contracting and integration that is virtually complete in broilers and is gaining in swine and vegetable production. What's next? Dairy? Beef? Soybeans?

Contractees are provided packages of inputs and access to markets. Production by independent producers outside the integrated/contractual system is much riskier because of a lack of access to the market and to the expertise. The bottom line is that, unless cooperatives are creative and offer a better alternative, more and more farm production will be tied up under a contractual relationship and less and less will be available under the open market where most cooperatives participate.

I'm not preaching gloom and doom for cooperatives. I see an important place for cooperatives in the future. However, that place is more proactive than a yardstick, and it will take more, not less, than the modest 1 percent pretax net of the 1980s to create an attractive alternative to agricultural industrialization by global conglomerates. There is no security on this earth, only opportunity.

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