

A Note on the Strategic Alliances

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When a producer group is thinking about forming a New Generation Co-operative (NGC), they may encounter several problems. One problem is that a producer group often lacks sufficient resources to form a successful value-added processing facility on its own. A second problem is lack of expertise, such as processing or marketing, which are necessary for value-added activities.

The purpose of this article is to discuss the ways in which a producer group can address the problems of lack of capital and lack of expertise. The first section discusses two ways that an NGC can access outside capital. The second section suggests how a strategic alliance may alleviate the lack of expertise as well as capital.

Outside Investment

One way for an NGC to address the issue of access to capital is by inviting outside investment. This can happen through the sale of preferred shares or by investment directly at the producer level.

Preferred Shares

The Saskatchewan *New Generation Co-operatives Act* allows nonmembers to purchase preferred shares in an NGC. The investment in preferred shares and investment by members in equity shares represents the total equity in an NGC (described in Figure 1). Preferred shares may be issued to members or nonmembers. An NGC may offer several classes of preferred shares, all of which carry no par value. The formula for determining the value of no-par value shares is described in the organization's Articles of Incorporation.

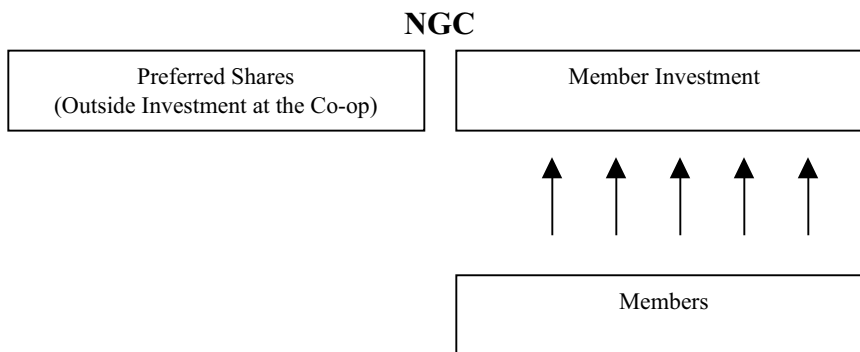


Figure 1: An NGC with Investment by Preferred Shareholders

Holders of preferred shares may be entitled to elect up to 20 percent of the NGC directors. If the class of preferred shares has voting rights then any one shareholder can hold up to 10 percent of the total preferred shares. This may be a problem if members are unwilling to forgo some control to nonmembers. It is possible to structure a class of preferred shares with no voting rights. If the class of preferred shares does not have voting rights, then any one shareholder can hold up to 25 percent of the total preferred shares. However, this also causes a problem—would people be willing to invest without control?

A second challenge with preferred shares is determining the rate of return. The rate of return can be fixed or it can be tied to the profitability of the co-op. If the rate of return is fixed, then the preferred shareholders have no incentive to influence the

business of the co-op. This may be good if the co-op management is successful and does not need to be monitored. However, if management is poor, then the co-op may benefit from pressure by preferred shareholders to improve performance. Moreover, investors may not want to invest if the fixed rate of return is too low.

If the rate of return is tied to the profitability of the co-op (a fluctuating rate of return), then preferred shareholders have an incentive to encourage the co-op to maximize its profits and therefore maximize the return to preferred shareholders. While members can benefit from the co-op's profitability (through patronage dividends), the benefit may come at their own expense, at times, if the co-op raises profits by offering a lower product price.

This tension between the goals of the shareholders and the producers can be a significant problem in situations where preferred shareholders earn a return based on profitability. This can lead to demands by the preferred shareholders for greater control and transformation of the co-op to an investor-owned and -controlled firm.

Investment at the Producer Level

A second way to access outside capital is for investment to occur at the producer level. The nature of the agreement between a member and an investor would be determined by the two parties, independent of the co-op and other members. The advantage of this arrangement is that the interests of the investor and the member are aligned—if the member is profitable, the investor also benefits. Investing at the producer level is a way of bringing in capital without creating the tension outlined above. Figure 2 (next page) illustrates this type of arrangement.

Strategic Alliances

Producers tend to be experts in production, but they may lack the expertise to process and market their product. One way an NGC can access necessary resources is by forming a strategic alliance with a partner firm or firms. A strategic alliance is an

association between people or organizations that provides mutual benefits to both parties. The benefits of a strategic alliance may include access to capital, excess processing capacity, processing expertise, or access to existing markets.

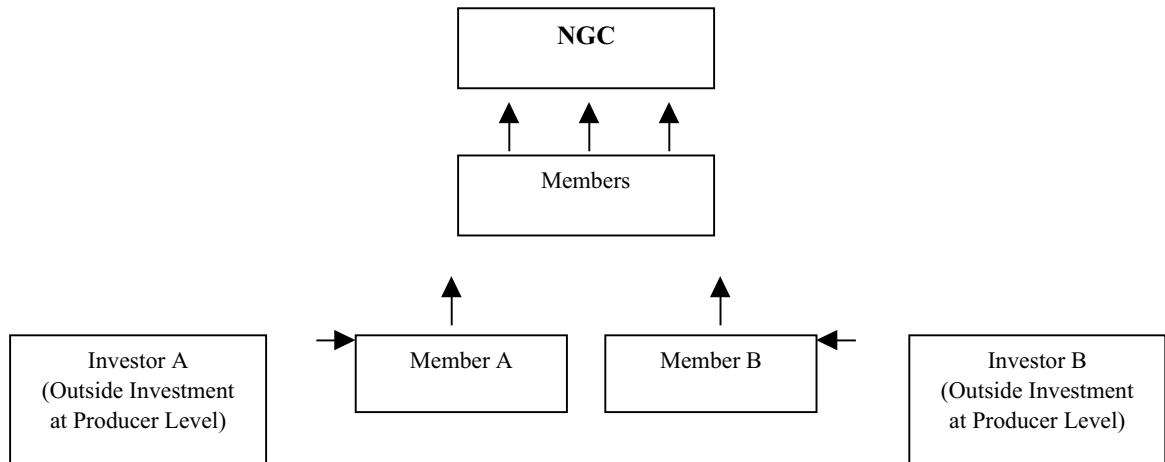


Figure 2: Outside Investment at the Producer Level

Before forming a strategic alliance, it is desirable for producers to organize as an NGC. Collectively, as an NGC, producers have more bargaining power in the alliance than they would individually. It is also desirable for the partner firm that the producer group forms an NGC. An alliance with an NGC eliminates the processor's need for individual contracts with each producer. The delivery contract is built into the NGC's By-Laws of Incorporation. By-laws are not easily renegotiated. This means that the delivery contracts with producers in an NGC are more enforceable than individual delivery contracts would be. Aligning with an NGC group, therefore, would mean that the processor is more likely to receive the quantity and quality of product agreed to.

There are a variety of ways an NGC might structure a strategic alliance. One way is for an NGC to invest in an existing business. A second way is for an NGC to partner with another firm or firms to form a new business entity.

NGC Investment in an Existing Processor

It may be desirable for an NGC to partner with an existing processor or other type of business. This type of arrangement enables the NGC to process its product and the processor to fill excess processing capacity and/or to access capital. This type of arrangement is illustrated in Figure 3.

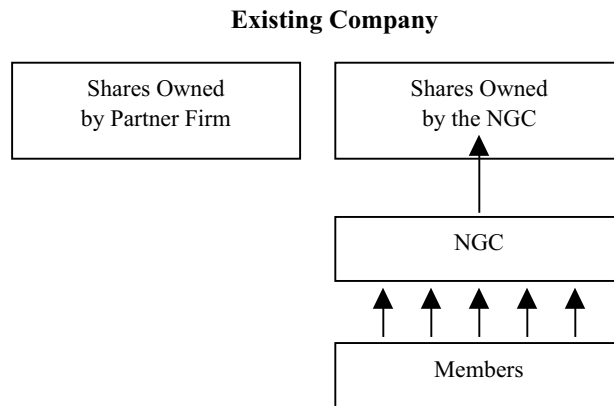


Figure 3: Alliance between NGC Producer Group and an Existing Company

The number of shares owned by the NGC may reflect the processor's excess processing capacity. One example of this type of strategic alliance is the relationship between US Premium Beef and Farmland National Beef Packing Company.

Example: US Premium Beef and Farmland National Beef Packing Company

Farmland National Beef Packing Company is the fourth largest processor of beef in the United States, and is a subsidiary of Farmland Industries. US Premium Beef (USBP) is a co-operative representing producers in all segments of the beef industry.

USBP and Farmland National Beef Packing Company formed an alliance in 1997, when USBP purchased an undisclosed number of shares in Farmland National Beef

Packing Company. USPB formed the alliance to avoid the high costs of building a new plant. USPB wanted to have equity ownership interest and equal control with its partner. This would allow USPB to develop its own ideas while protecting its shareholders' interests.

Farmland National Beef Packing Company was one of several processors eager to form an alliance with USPB, which could fill the packer's excess processing capacity and offer an assured supply of high quality beef.

New Business Entity

A second way of constructing a strategic alliance is to form a new business entity, such as a corporation. An NGC may partner with a firm or firms that offer such things as financial support, marketing or manufacturing expertise, or established markets. Figure 4 illustrates a new corporation formed from an alliance between an NGC, a processing firm, and a marketing firm. As a corporation, the profits generated by the new business entity would be allocated to the NGC and the partner firms in proportion to investment. Trilogy Ltd. is one example of this type of alliance.

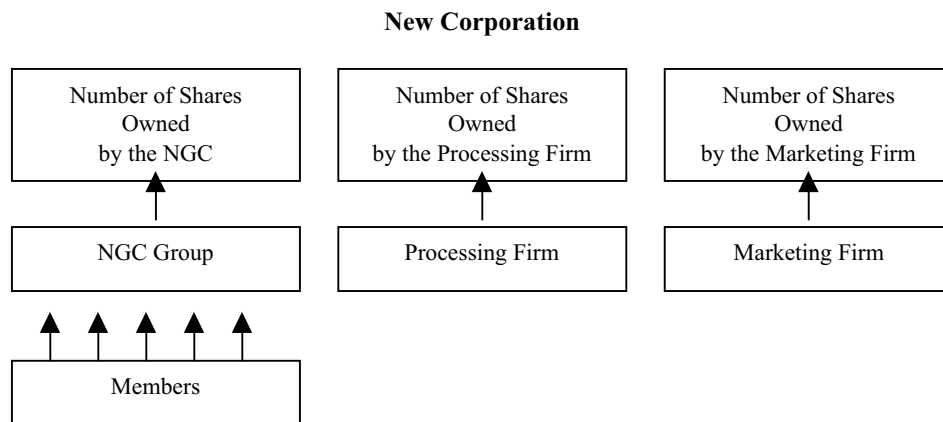


Figure 4: Alliance between NGC Producer Group and Expertise Groups

Example: Trilogy Ltd.

Trilogy Ltd. is a Manitoba-based company that is preparing to produce egg products such as extended shelf-life liquid eggs, precooked egg patties, omelettes, and egg substitutes for the Canadian market. This new organization is the result of a strategic alliance between the Manitoba Egg Producers Co-op (an NGC), Michael Foods, and Canadian Inovatech. Each firm invested one-third of the cost of developing Trilogy.

The Manitoba Egg Producers Co-op Ltd. is an NGC owned by 115 egg producers in Manitoba. The co-op offers a consistent supply of quality eggs to Trilogy. Canadian Inovatech, Canada's largest processor of egg products, will break the eggs at its Winnipeg plant and process them in an adjacent plant. Michael Foods is a food processor from Minnesota with access to established markets for processed egg products.

Trilogy offers mutual benefits to each party. For the Manitoba Egg Producers, partnership with Canadian Inovatech and Michael Foods creates a chance to share the risks and benefits of processing and adding value to their product