

## **New Generation Co-operatives**

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The term New Generation Co-operative (NGC) is the name given to the roughly 200 value-added processing, closed-membership co-operatives that have emerged, first in North Dakota and Minnesota and more recently in neighboring states and provinces, during the past decade. The new co-operatives are being formed by producers involved in emerging niche markets, such as bison, Tilapia fish, and edible beans, as well as by producers of traditional commodities, such as dairy, corn, soybeans and durum wheat. Case studies of three NGCs are presented at the end of this paper.

NGCs should perhaps be called the Newest Generation Co-operatives. In both Canada and the US, agricultural and rural co-operatives have emerged in waves. The first wave occurred during the early part of this century when agriculture and agricultural markets were in their infancy. Farmers formed co-ops in reaction to the oligopolistic practices of input suppliers and farm product handlers and processors. A second wave of co-op formation occurred during the 1930s and 1940s, largely in response to a lack of service provision – whether it be in the financial, retailing, telephone, or power generation sectors – that occurred as investor-owned firms turned their attention to more lucrative urban markets. The latest wave of co-ops – the NGCs – represent the efforts of a younger generation of farmers to tackle the challenges of deregulated agricultural markets and specialized market niches.

The reasons behind the formation of the NGCs are as diverse as the markets in which they operate. In some cases the need for market information and coordination appears to be the driving force; in others the impetus seems to be a need to restructure existing markets to provide producers an increasing share of the consumers' food dollar. In addition, the impact of NGCs extends beyond the farm gate, as people in rural communities look to NGCs as a development strategy that will boost rural disposable income, employment, and population (James).

The value-added focus of NGCs represent a departure from the broad objectives of commodity and input marketing of many older established co-operatives. Rather than acting as clearinghouses for products, NGCs are closed membership co-operatives restricted to accepting a predetermined amount of a specific product. Tradable delivery rights require members to deliver a certain amount of product to the co-operative and require the co-operative to accept this amount (Harris, et al.).

More specifically, two elements distinguish NGCs from traditional co-operatives: delivery shares and restricted membership. The different membership and financial structure stems from the processing focus of the NGCs. The efficient capacity level of the plant determines the amount of product that members can deliver to the processing facility. Membership is restricted to those producers who first purchase delivery rights to the processing facility (Harris, et al.).

To allocate the right of delivery among members and to raise capital, the co-op sells delivery shares. Each share entitles a member to deliver one unit of farm product (e.g., one bushel of durum, one bison) to the co-operative. The purchase of a share also obligates a member to deliver one unit of the farm product. The membership shares thus create a contract between members and the co-operative that stipulates the amount the member must deliver to the co-op and the amount the co-op must purchase (subject to the product meeting quality requirements).

All members need not hold the same number of shares, although there is often an upper and lower limit to the number of shares a member can own. Producers must fulfill contract obligations with their own product or purchase product elsewhere for delivery to the plant. In the event that producers are unable or unwilling to meet their contract requirements, the co-operative purchases the required amount and charges the cost against the members' account. The members' dividends reflect the charge.

The initial price of each share is determined by taking the total amount of capital the co-operative wishes to raise for start-up and dividing it by the number of units of farm product that can be absorbed by

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the processing facility. In general, the NGCs have followed recommendations to raise between 30 and 50 percent of their total capital requirements as member equity. Equity drives are held to solicit support and sign-up investor-members.

Remaining capital requirements are met through debt equity or the issue of preferred shares. Preferred shares enable contributions to be obtained from the community or other interested parties. Holders of preferred shares do not have voting rights and there is often a limit on the amount of interest paid on these stocks (for example, in North Dakota the limit is legislated at eight percent).

Because members have financed a substantial portion of the capital of the co-operative up-front with an equity infusion, a large portion of the earnings generated by the co-operative can be returned to the members at the end of the year. At this time, net earnings are calculated by taking the total revenue generated from the sale of the value-added product and subtracting the total expenses of the co-operative. Allowance for a contingency fund is also made. The earnings are then divided among members in proportion to the amount of raw product they deliver.

After the initial equity drive, shares can be traded, pending board approval. The share prices in the operation period reflect the returns members expect to receive from the co-operative. Future expansion of the co-operative is financed in the same way as the co-operative was originally financed; that is, members must invest their money up-front through the purchase of delivery shares. North Dakota Pasta Growers is an excellent example of a co-op that has pursued this expansion strategy (Rustebakke).

#### **CO-OPERATIVE TRANSFORMATION: INTERNAL AND EXTERNAL PRESSURES**

The formation of NGCs in the latter part of the 20th Century is the outcome of a complex set of pressures and forces that are both internal and external to co-operatives. The external forces revolve around the changes occurring in the larger agricultural industry of which co-operatives are part. The internal forces hinge on the incentives created within co-operative organizations and the effect these incentives have on the actions of co-op members and management. The external pressures are examined first.

##### ***External Pressures***

The agriculture industry is undergoing a tremendous transformation – a transformation that is often referred to as industrialization (Boehlje, Drabenstott). As agricultural production becomes more predictable and controllable, agriculture takes on the characteristics of factory production and of the industrialized system of product sourcing and marketing. Key elements of the transformation include: markets are less commodity driven and more product driven; production is more capital intensive; decisions made by firms at all levels of the market are increasingly interdependent; price and production risk are replaced with risks surrounding relationships and food health and safety; and information becomes a prime source of control and power. These changes have resulted in increased vertical coordination and integration; in addition, firms are more and more being asked to deliver products of a consistent quality at the appropriate time.

The case study of Warburton's Ltd. Bakery illustrates a number of the key elements of the move from traditional agriculture to the new agriculture. This case clearly shows that wheat can no longer be considered an undifferentiated commodity. Consumer tastes have changed so that top quality loaves of bread can be sold at a premium. Since different varieties of wheat produce different qualities of bread, different varieties have different values in end-use. One consequence of this change is that the production and handling stages are not independent of the retail stage – if farmers do not segregate their varieties or if the elevator companies do not maintain varietal separation, then Warburton's is unable to realize the value at the retail level. This value, however, can be created and maintained by coordination. Coordination, by its very nature, requires the involvement and co-operation of other parties – in this case, the farmers, the elevator companies, and the Canadian Wheat Board (CWB). To ensure this involvement and co-operation, contracts are used. Information is a key component of the coordination. Finally, trust plays a critical role in ensuring the benefits of coordination are obtained. Concerns about trust now become a key aspect of relationship risk – the worry that contract terms will be altered or that the party with which you have committed significant resources is no longer in business.

How do these changes affect agricultural co-ops? Historically, farmers have used co-operatives to provide control over marketing and input supply. The agricultural co-operatives that farmers formed in the past were adapted to the larger agriculture system of which they were part. For instance, spot markets and

generic commodities characterized traditional agriculture; correspondingly the traditional co-operative sold generic products to members on demand (i.e., whenever farmers wanted them). In traditional agriculture, farms carried out many activities – mixed farms were common until roughly 30 years ago, and even specialization (an example would be a move to produce only pigs) meant carrying out multiple functions (in the case of hogs, for instance, the standard model until recently was the farrow-to-finish operation). Co-ops also took on this multiple activity role, serving a diverse membership by offering a wide variety of crop inputs and handling or processing a wide variety of farm products.

A common feature of agricultural co-ops is that they are concentrated at the input supply and first-handler level (Rogers and Marion). This pattern is consistent with a view of the world in which the product chain stages in agriculture are conceived as independent – precisely the way in which traditional agriculture was viewed. At the farm production level, price and output risk were major concerns – and government addressed these concerns with policies directed specifically at these problems. Typically co-ops were important supporters of these policies.

Finally, market power – derived mostly from the wealth and physical assets owned by large IOFs – was a concern in traditional agriculture. Co-operatives were one of the mechanisms by which greater competition was introduced into the market. Indeed, the co-operative has often been billed as the “competitive yardstick” (Cotterill, Torgerson et al.). To provide countervailing power, co-ops themselves used “bricks and mortar,” investing heavily in storage, handling and processing facilities.

If co-operatives adapt themselves to the larger structure of which they are part, then the changes in agriculture that are currently underway mean co-operatives will also change, and in a very specific way. What will be the corresponding structure of co-operatives? The answer is that co-operatives will begin to adopt elements such as contracting, they will begin to focus on very specific products and they will increasingly engage in activities at numerous levels of the supply chain.

These elements have already begun to emerge in the form of NGCs. Indeed, the structural form adopted by the NGC is well suited to the new agriculture. The vertical integration inherent in the co-operative form allows for a more systems focus, rather than a focus on each separate link in the chain. And the up-front purchase of delivery shares provides a high degree of commitment by both the co-op and each member, thus reducing concerns about opportunistic behavior and relationship risk. In short, NGCs can be seen in part as an evolutionary adaptation to the changing environment of which they are part. NGCs differ from traditional co-ops in precisely those ways that are required to better operate in an industrialized agriculture.

### ***Internal Pressures***

An evolutionary view of co-operatives also sheds light on the internal pressures facing co-ops. Co-operatives are not static entities. Indeed, co-ops are often thought to move through a life cycle. The new organizational structure represented by NGCs is a response to pressures developing during this life cycle.

The life cycle of a co-op begins at the time of its formation. Most commonly, co-ops were formed when farmers took action to make markets more competitive and to provide goods and services in situations where they would not otherwise have been provided.

In their early stages, co-operatives were formed around a relatively homogeneous group of farmers, often operating in a common geographical locale, with common grievances and visions. These conditions provided a relatively strong sense of member ownership, control and commitment, as well as differentiating the co-op from its investor-owned firm (IOF) counterparts, which in turn enabled the co-ops to play the role for which they were formed. .

These features of co-ops in their start-up phase – fairly narrow focused set of activities, relatively homogeneous membership, common grievances among members, and differentiation from IOFs – typically begin to erode as the co-operative matures. Membership becomes more heterogeneous as farmers branch into new areas and as farmers separate into those working full-time on the farm versus those with off-farm jobs. Common grievances fade and decline as the initial market failures that gave rise to the co-op disappear. In their place, other grievances appear that are often directed towards the co-op. Co-ops expand their operations into new areas of activity, in part because of competitive pressures to provide the same service as IOFs – thus making the co-op and the IOF more and more alike – and in part because of a desire by co-op management to extend their influence.

As this maturity process continues, a number of internal pressures in the co-op begin to build. These pressures or problems – which are a direct consequence of the waning ideology, the increasing member heterogeneity, the lack of common grievances, and the loss of differentiation from IOFs – typically result in a greatly reduced sense of ownership and control by the members over the co-op. These so-called property rights problems – so named because they refer to a lack of sense of ownership – are classified as follows (see Cook (1995) for a more detailed description).

- The Free-Rider Problem – Since the economic benefits of co-operatives arise through the use of the co-operative, little incentive exists for members to invest in the co-operative. The result is that members will only invest as much as is required for them to patronize the co-operative. This reluctance by members to invest directly in their co-operative means co-operatives are expected to rely more heavily on debt than IOFs and/or to be chronically short of capital (Knoeber and Baumer).
- The Horizon Problem – Co-operatives are prone to inefficiencies because of the limited patronage horizon of co-operative members. Since members can only receive a return on their investment through patronage refunds when they actually use the co-operative, they will tend to support activities that maximize short-term rather than long-term returns. This problem is not present in IOFs, because the trading of shares allows the expected future earnings of long-term investments to be reflected in the value of the company (Porter and Scully).
- The Control Problem – Because co-operative shares are not traded on the open market, co-operative share values cannot be used as a convenient performance gauge; the result is that operational inefficiencies can go unobserved. As well, widely dispersed ownership, especially in large co-operatives, provides individual members with few incentives to monitor the performance of their co-operative.
- Portfolio Problem – The lack of tradability in co-op shares also means members cannot adjust their investment portfolio to reflect their own risk preferences. Consequently, members will attempt to direct the activities of the co-operative in a direction that better matches their own risk-return trade-off.
- Influence Costs Problem – The dual role of the member as owner and user creates specific problems for management. Because of this dual role, co-operatives often have substantial latitude in the decisions they can make. This wide latitude can lead to attempts by groups of members to steer the co-operative to positions that will benefit them personally. The need to ensure member support means managers must constantly work to build consensus, an activity that is often costly – particularly when members have highly diverse interests. Capital constraints and the horizon problem also make management more difficult (Cook 1994).

As these property rights problems become more and more severe, co-ops find that they must respond in some way to remain viable organizations. Cook (1995) argues that much of the organizational adaptation that has occurred within traditional co-ops – examples include seeking outside equity from the public trading of co-op shares to joint ventures with IOFs to the large number of mergers occurring among co-ops – result from pressures arising from property right problems.

The rise of the NGCs can also be seen as an institutional adaptation to these property right problems. The sense of ownership and control in a NGC is much greater than in a traditional co-op. In part this greater sense of ownership is because of the tradable delivery rights that can fluctuate in value. It is also a result of a more homogeneous membership, which in turn is a consequence of the narrow focus of the co-op., and a clear differentiation of the co-op from an IOF (the NGC returns profits from processing, while an IOF does not (Zeuli and King, 1998; Fulton, 1999)). This greater sense of ownership means that the free rider problem, the horizon problem and the portfolio problem are largely eliminated. While the control and influence costs remain an issue, they too are reduced, largely because of the narrow focus – the processing of a specific commodity – of the co-op (Cook 1995).

## SUMMARY AND DISCUSSION

NGCs can be viewed as the outcome of a process by which co-operatives and farmer-owned enterprises adapt to changing internal and external environments. The external environment in which co-ops operate has changed as the industrialization of agriculture has proceeded. Internally, a reduction in traditional member commitment and the increasing importance of well-defined property rights to structure members' behavior have resulted in a need for new structural features.

In both cases, the changes have created an advantage for the NGC structure. For instance, the need for a more systems approach to agricultural production, processing and marketing can be met by the vertical integration inherent in the co-operative form and concerns about relationship risk can be addressed through the creation of delivery shares. Internally, tradable delivery rights result in much better specified property rights, while the focus on a single commodity results in fewer control and influence costs. As well, member commitment is enhanced as a result of the NGC differentiating itself from IOFs by virtue of the fact that the NGC offers members a value-added investment opportunity.

Interestingly, the adaptive response represented by NGCs came not from the existing traditional co-ops but from a new co-operative model. This pattern should not be surprising, since existing organizations often find it difficult to change their direction or their structure. Indeed, property right problems themselves create incentives in existing organizations that make it difficult for them to adopt new structures. For instance, the free rider problem and the horizon problem may limit the incentive that members have to push for organizational change. In other cases, influence and control problems result in certain groups within a co-op being able to pursue their vested interests and preserve the status quo. Ideological positions can also restrict change.

Consequently, organizational change often has to come from outside. The rise of NGCs is an example of this change from outside. In the early 1990s, the development of NGCs was seen as a marginal activity – NGCs were not viewed as being “real” co-ops and many traditional co-ops attempted to appropriate the “new generation” moniker for themselves. The founders of NGCs also saw themselves as outside the traditional co-operatives. In a number of instances, NGCs were formed because a group of farmers felt that their traditional co-op was not responding quickly enough to the changes occurring in agriculture.

Although NGCs emerged outside of the traditional co-operatives, they are nevertheless having an impact on the traditional co-ops. As Cook (1995) notes, some traditional co-ops have recently tried to mimic elements of an NGC by adopting base capital plans as they struggle with the incentive problems caused when member investment is not linked to member business. The traditional co-ops have also experimented with allowing members to invest directly in a specific portion of a co-op's value-added activities. A good example of this is Harvest States, who in 1996 gave producers an opportunity to invest in “equity participation units” in Harvest States' food processing operations (Erickson).

At a more fundamental level, NGCs are part of a whole new co-op model. The proposed United Country Brands – the co-op that would have been created had the merger between Harvest States and Farmland proceeded – would have created an umbrella co-operative with well-defined, single purpose fingers or individual co-operatives under that umbrella. Members would have been able to choose which components or “fingers” to invest in and do business with. Eleven to fifteen strategic business units were planned. Members would have had the opportunity to convert the individual fingers into NGCs.

NGCs are clearly no longer seen as organizations on the fringe. The NGC model is now viewed as a serious organizational structure, both among farmers wishing to form new co-ops and more traditional co-ops looking for ways to adapt. NGCs are also viewed as legitimate by people outside the co-op sector. Commercial banks, for instance, are increasingly interested in funding NGC operations, while governments see them as a tool for industry development, particularly in niche areas where coordination of primary production and processing is critical.

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## **WARBURTON'S LTD. – AN EXAMPLE OF THE NEW AGRICULTURE**

### **KEY POINTS**

- Change from a commodity to a differentiated product
- Changing consumer tastes
- Interdependence of production and marketing stages
- Contracts
- Access to information
- Trust and relationship risk.

Warburton's Ltd. is a century-old family firm and Britain's largest independent bakery, producing more than 3 million loaves of bread a week. Warburton's bread is known to be high-quality – it retails at twice the price of a regular loaf. To guarantee this quality, Warburton's has always used Canadian Western Red Spring (CWRS) wheat. However, in the late 1980s, they began to notice a decline in quality, which threatened their ability to attract premium prices for their bread. Their research revealed that particular varieties of CWRS – specifically Teal, Pasqua and Columbus – worked best in their bread-making system, producing bread better suited to their customers' tastes.

To ensure that they would obtain only these desired varieties, Warburton's began discussions with the Canadian Wheat Board (CWB) to use "identity-preserved contracts" to source specific varieties of wheat. The contracts that were agreed to are administered by Agricore (formerly Manitoba Pool Elevators) and Paterson Elevator Co. Warburton's specifies the amount of wheat it requires – well over one hundred thousand tonnes annually – and the elevator companies are responsible for obtaining it from Manitoba farmers through production contracts. Warburton contracts are awarded annually to farmers who have a reputation for growing consistently good quality CWRS crops.

Under the contract, farmers agree to produce a particular variety. Crops have to be grown from certified seed and the farmer must employ good practices to grow the crop and to store and protect the harvest. The producer also submits a report on weather conditions, use of inputs and crop yield, along with a sample of the wheat. If the elevator company is satisfied, they agree to purchase the entire crop. In reality, detailed tests on every sample are not practical, so trust and reputation are very important – contracts tend to be awarded to long-standing members and customers. In return for meeting these standards, farmers receive a \$20 per tonne premium over the regular CWB price for identical grain. This premium is paid in cash, direct from Warburton's, along with the regular CWB payment.

For their part, Warburton's accepts all the contracted wheat that meets the agreed-upon standards. They buy direct from CWB and are charged more to cover any additional administrative or logistical costs, particularly in the handling. Shipments of Canadian wheat are exported to Warburton's every six to eight weeks, and the elevator companies have to ensure that the wheat is "identity preserved" – i.e., maintains the correct characteristics and remains separate from other varieties – through the entire grain-handling system. Warburton's pays a management fee to the elevator companies for administering contracts and preserving the identity of the wheat through shipment.

Warburton's has set up a research lab and pilot bakery in Brandon, MB where they conduct their own quality tests, refine their baking technology, and experiment with new wheat varieties and combinations. The technical centre is also in constant contact with the elevators and the producers as they approve shipments based on their analysis of the harvest sample and the farmer's report.

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## **U.S. PREMIUM BEEF**

### **KEY POINTS**

Example of a focus on a single activity

Growing importance of non-geographical factors

Importance of coordination and information in providing extra value in the system

Role of contracts

Strategic alliance with a large traditional co-operative as an important element. Farmland provides access to the next stage of marketing and does not overly control the decisions of USPB.

U.S. Premium Beef (USPB) is a co-operative that “provides U.S. beef producers an opportunity to retain ownership of the beef they produce from the ranch to retail”. The co-operative began operations on 1 December 1997. By July 2000 over 1,350 producers from 33 states had marketed more than one million cattle through USPB.

A key feature of USPB is that producers are paid for the animals they sell on the basis of a value-based pricing grid. This grid provides for premiums and discounts based on how each animal that is delivered compares to pre-determined criteria. Producers selling through USPB receive individual carcass data free of charge. The value-based pricing grid and the individual carcass data have been identified as part of the reason for the increase in the quality of the cattle delivered to USPB in 1999.

USPB members come from all segments of the beef industry, including purebred and commercial cow/calf producers, backgrounders, farmer-feeders, and commercial cattle feeders. There is no geographical restrictions as to where members are from and members are free to determine where their cattle are fed – USPB cattle have been fed in over 300 yards in 11 states. A transportation credit of up to \$0.55 per cwt is provided to members (this credit represents the cost of trucking for a distance of approximately 110 miles from the plants in Dodge City and Liberal, Kansas). There are no restrictions on the breed of cattle sold to USPB, although the cattle are limited in the percentage of Brahma or dairy they can contain. Members can receive advice and consultation on genetics and herd and financial management from USPB field staff.

To assist producers in their management decisions, USPB is encouraging producers to purchase and use electronic identification tags (EID) by rebating 50 per cent of the tag cost. The EID system allows members to record animal health history (including injections and site information), allows feedlots to track daily weight gain and to project when animals will be ready to market, and allows Farmland National Beef (FNB) plants to provide individual carcass data to the feedlots and the members.

All producers who sell cattle through USPB must become members. Membership, however, does not mean the producer is a stockholder. Stockholders are those producers who have purchased delivery shares; each share purchased commits the member to deliver one head of cattle. Delivery shares can be leased or sold to other producers.

USPB and Farmland Industries jointly own FNB, the fourth largest and the only farmer-rancher owned beef processor in the U.S. FNB markets products under four branded labels – Certified Angus Beef, Farmland Black Angus Beef, Farmland Certified Premium Beef, and the Kansas Steak Company – to domestic and international customers. The Kansas Steak Company markets further processed and value-added products – primarily portion-controlled steaks – to restaurants, mail order catalogs and foodservice and retail customers. This focus on a brand name is important. FNB’s CEO, John Miller, indicated in a recent interview that the profit margins on Black Angus Beef are 20 per cent higher than on no-name beef.

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**U.S. PREMIUM BEEF** (continued)

Producers selling through USPB receive an initial payment equal to 85 per cent of the live pay weight average cash price from the previous week, less the beef check-off and a unit retain of \$12 per head. The final payment is made to the producer the week after delivery when the plant yield and the grid payments have been calculated. Producers selling through USPB also receive a patronage dividend based on the profits earned by USPB. An important source of profits for USPB is its share of profits from FNB. As an example, in the fiscal year 1998 (September to August), members received on average a grid premium of \$7.47 per head, with the top 25 per cent of USPB producers receiving a grid premium of \$26.03 per head. Patronage dividends for the 1998 fiscal year were \$10.14 per head, of which 40 per cent was distributed in cash. The remainder of the dividend was retained in the co-op in the member's name. Patronage dividends for fiscal 1999 were \$17.99 per head. The unit retain, along with interest, is currently being paid back annually.

In response to requests from producers, USPB held a northern membership and registration drive in 2000. To secure the right to purchase stock in a potential expansion offering, interested producers had to become a \$500 lifetime member and pay one dollar per head of cattle they were would be interested in delivering. The drive was successful, with 609,000 registrations from 12 states (each registration represents one head of cattle). The money raised will be used to conduct a feasibility study in the fall of 2000.

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## **AMERICAN CRYSTAL SUGAR**

### **KEY POINTS**

As the first New Generation Co-operative (NGC), American Crystal Sugar's unique strategy has served as a model for NGC formation and development

Evidence of efficiency gains related to NGC characteristics such as the Quality Payment System

Entering a later phase in maturity, American Crystal Sugar is now facing issues surrounding the transfer of member equity

Owned by approximately 2,900 grower shareholders in the Red River Valley of North Dakota and Minnesota, American Crystal Sugar is the largest sugar beet processor in the U.S. American Crystal Sugar was formed in 1973 when the existing investor-owned firm exited the industry. Faced with unique problems surrounding value-added processing, such as relationship risk and capital acquisition, American Crystal Sugar pioneered the New Generation Co-operative (NGC) model. This original NGC model included principles such as restricted membership and tradable equity shares that link producer capital contributions with tradable delivery rights. These NGC features enabled American Crystal Sugar to invest in improved plant equipment and increase plant capacity. Within four years American Crystal Sugar nearly doubled its beet acreage.

In 1979, American Crystal Sugar introduced the Quality Payment System which links payment to shareholders with the quantity of recoverable sugar produced. The Quality Payment System dramatically changed growing practices and resulted in improved plant efficiency and increased grower income. The NGC structure also enabled the introduction of techniques that reduced spoilage losses such as splitting piles, forced ventilation and huge deep-freeze storage sheds to keep beets frozen well into the spring, preserving millions of dollars worth of sugar. Tradable delivery rights, restricted membership and quality payment systems are now the basis of the New Generation Co-operative model.

American Sugar Crystal has grown through partnerships with other co-operatives and corporations in the sugar industry. A partnership between American Crystal Sugar and two other co-operative organizations, Minn-Dak Farmers Co-operative and Southern Minnesota Beet Sugar Co-operative, led to the formation of United Sugars Corporation. United Sugars Corporation is the largest marketer of beet sugar in the U.S. In addition, American Crystal Sugar is a member of Midwest Agri-Commodities marketing co-operative and has developed a joint venture with the corn sweetener company ProGold. In 1998, American Crystal expanded beet-slice operations and constructed a molasses desugarization facility. American Crystal Sugar also expanded sugar beet acreage in 1999 through an increase of 61,500 shares of preferred stock.

Having been in business for over 25 years, American Crystal Sugar now faces structural issues related to generational change. As the founding members retire and a second generation of farmers is sought, American Crystal Sugar must transfer the equity of its retiring membership to new members. Since the value of tradable delivery rights is determined by the market, the current price reflects the expected future value of the share. Therefore, the benefits the new members gain is limited to a competitive price for their product plus any growth in the value of shares beyond the expected future value. The high cost of delivery rights in relation to returns may inhibit the entrance of new members. Likewise, the transfer of member equity may result in 'neo-horizon' problems. Since new members do not expect to see returns on their shares, they will tend to support activities that maximize short-term returns on the price they receive for their product rather than long-term returns.

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[www.crystalsugar.com](http://www.crystalsugar.com).

**SPRING WHEAT BAKERS****KEY POINTS**

Thoroughly investigated all the options for value-added spring wheat processing before engaging in a business development strategy

Large geographic distribution of its members allows Spring Wheat Bakers to access the highest quality wheat

Instead of locating inside its member region, the manufacturing plant is strategically placed near the largest consumer market

Formed in March of 1996, Spring Wheat Bakers (SWB) is a new generation co-operative of approximately 2,700 spring wheat producers from across North Dakota, South Dakota, Minnesota and Montana. SWB, formerly United Spring Wheat Processors, manufactures frozen dough and frozen partially-baked products at its plant in McDonough, Georgia.

SWB pursued a business development strategy different from previous value-added co-operatives. Because of the diverse value-added opportunities for spring wheat, SWB choose to explore all the possibilities for value-added production. By garnering a reputable steering committee of leaders in value-added processing, including Mike Warner from the board of directors of American Crystal Sugar and wheat growers associations in the region, SWB was composed of experienced and knowledgeable leaders from the beginning. On the basis of this credibility and an increasing dissatisfaction with falling commodity prices, SWB assembled a supportive membership ready to invest in the exploration of the options for value-added spring wheat production. During a membership drive, producers were asked to invest \$5,000 each to establish membership with the co-operative. An initial installment of \$200 in seed money was used to conduct industry analyses and locate a CEO. The remaining \$4,800 was placed in an escrow account; the interest on this money funded the business planning stage and hired executive management.

Following a year of research, SWB unveiled a business plan to enter the frozen dough and partially-baked bread industry. Market analysis revealed a growing market for frozen dough and partially-baked products as a result of increasing consumer demand for a greater variety of bread choices and the lack of skilled bakers. In addition, many of the bakeries experiencing the strongest growth are dependent on spring wheat to meet quality specifications. SWB also saw the frozen dough and partially-baked product industry as alluring because it is not dominated by any one large player or groups of players. In a market with strict quality standards, the large geographic distribution of grower members allows SWB access to the highest quality wheat.

After the announcement of an official business plan and an equity drive in the fall of 1997, SWB choose a strategic location for its manufacturing activities. A site near Atlanta, Georgia was selected based on favorable population growth and consumption trends and competitive transportation rates. Given the higher cost of transporting the final product in relation to the raw material, the manufacturing plant was located near its largest consumer market rather than the source of the raw product. As a result of the equity drive, SWB was able to open its first plant without debt in June of 1999.

Continued on next page

**SPRING WHEAT BAKERS (CONTINUED)**

Since then SWB has formed an alliance with Rich Products Corporation, an international food marketing company based in Buffalo, NY. As part of the alliance, a specialty bread produced by SWB will be sold in Perkins Restaurants. In an industry that is highly dependent on quality and quantity controls, SWB hopes to capitalize on its core strengths of integrated supply chain management and strategic alliances.

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