

Perspectives from the Center

Is the Co-op Model Broken?

by Bob Cropp and Anne Reynolds

Over the past two years we have heard far too many stories about cooperatives failing and facing financial difficulties. The biggest story was the bankruptcy of the nation's largest cooperative, Farmland Industries. And then there were stories of cooperatives converting to other business forms, mainly to LLCs.

For example, South Dakota Soybean Processors — a cooperative formed in 1993 — converted to an LLC; then the Dakota Growers Pasta Company — another new generation cooperative that began pasta production in 1993, and frequently held out as being a very successful cooperative — converted to a C-corporation. These are just a few of the many stories.

In October, two Washington D.C. hearings addressed the viability of the cooperative model. One session, held by the Senate Judiciary Committee, looked at the power of monopsony buyers in the dairy industry, specifically focusing on a few dominant buyers of milk from dairy producers and/or from their dairy cooperatives (namely Dean Foods and a 2001 merger of Dean Foods and Suisa Foods that now controls almost 70 percent of the milk supply in New England). Hard questions were also raised about dairy cooperatives. U.S. Senator Patrick Leahy (D-Vermont), the ranking member of the committee, addressed the alliance between Dairy Farmers of America (DFA) and Dean Foods, whereby DFA is the sole supplier of raw milk. He also raised an issue with the alliance between Land O'Lakes and Dean Foods that grants a licensing arrangement for Deans Foods to use the Land O'Lakes brand name nationally on several dairy products.

The second hearing — held by the House Agricultural Committee — focused on whether structural changes are needed in the cooperative business model to help agricultural cooperatives to remain a vital cog in the engine of America's rural economy. (Look for an excellent summary of this hearing in the November/December issue of USDA-Rural Business-Cooperative Service's publication, *Rural Cooperatives*.) The consensus was that agricultural cooperatives remain very vital to farmers, and that cooperatives will continue as an important force in rural America. At the same time, it was agreed that cooperatives must change if they are to continue as this important force. There was no consensus on just what these changes should be...

Why are these hearings being held, with their discussion of the need to change the cooperative business model? What is different today from the days when many of the traditional cooperatives were first organized, from 1900 to 1940? To be brief, two major differences have come about. First, when these earlier cooperatives were organized farmers had diversified farming operations and yet operated farms of similar size. Conversely, today's farmers are far from homogenous. Co-op membership ranges from relatively small farmers to those with large, specialized operations. And farmer-members' needs, demands and expectations vary widely.

Second, the value chain for the food and fiber produced on our nation's farms and ranches is becoming increasingly coordinated, influenced by very large and powerful firms. The five largest food retailers account for nearly 40 percent of total retail food volume. With this increased coordination and concentration in the retail food industry, cooperatives must meet the challenge with the size and logistical capability to serve national markets.

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ANNOUNCING... director LEADERSHIP workshops 2004

For info: www.wisc.edu/uwcc/ or ph. 608.262.3981
Workshops run from 9:30am to 4pm, with registration from 9-9:30am

Positioning your cooperative for the future

January 29, Wintergreen Hotel [(608)254-2285]
60 Gasser Road Wisconsin Dells, WI 53965
Learn about ways in which cooperatives are reacting to the dynamic global marketplace. Whether it is information on mergers or strategic alliances, on raising equity or on determining alternative methods to redeem equity, this workshop will help you grasp the basics and understand complex issues.

Improving your financial I.Q.:

The Basics of Financial Statements, the Role of the Audit, and Equity Capital Management

March 10, Barron County Office Complex [(715)537-6250]
410 E. LaSalle Avenue, Barron, WI 54812
An overview of the basics of key financial statements and the directors' annual audit and fiduciary responsibilities. Other topics include equity capital management, sourcing outside equity capital, and equity redemption alternatives.

Enhancing your director leadership skills

March 15, Pippin Conference Center [(608)647-6186]
Melvill Hall, UW-Richland, 1200 Hwy. 14 West
Richland Center, WI 53581
The responsibilities and duties of directors as well as board evaluation, improving board and manager relationships, evaluating the co-op manager, and using policies to guide board decision-making.

Evaluating major capital investments

Comfort Suites, 1951 Bond St. [(920)499-7449]
Green Bay, WI 54303
Will focus on a case study of a co-op that is considering investing in a new plant. It will illustrate the significance of decisions regarding sourcing outside equity capital, measuring potential returns from major capital investments, and the impact such investments may have on a cooperative's financial statements. While specific to agriculture, the case study's lessons easily transfer to other industries.

Co-ops 101 Training

For Co-op Enthusiasts

This series of workshops was organized by UWCC and sponsored by Williamson Street Grocery Co-op, with support from Mifflin Street Co-op and Regent Market Co-op. Classes met at Madison's Willy Street Co-op.

Session I (Jan. 22) included a general overview of cooperatives, including a description of the co-op model, when it should be used, and how co-ops have helped communities.

Session II (Jan. 29) covered the actual components needed to start a co-op, conducting a feasibility study, outlining a business plan, the legal structure of cooperatives, and keys to success and potential pitfalls.

A second series of workshops will be offered March 25 and April 1. Contact Lynne Olson at Willy Street Co-op (608-251-6776) for more information.

The UWCC offers workshops on a variety of cooperative topics, including board leadership, financial management and decision-making, strategic planning, board evaluation, and how to start a cooperative.

For more information, please contact the UWCC office at 608-262-3981 or reynolds@aae.wisc.edu.

Brown Bag Series

New Initiative Launched

UWCC has successfully launched a new initiative called the Brown Bag Series, with two Brown Bags scheduled this past semester.

Kim Zeuli, Assistant Professor at the Department of Agricultural & Applied Economics, University of Wisconsin-Madison and Senior Faculty Associate at UWCC, presented "A New Framework for Analyzing the Role of Cooperatives in Rural Development" on September 25. Elisabeth Howard, a graduate student in the Department of Agricultural and Applied Economics, University of Wisconsin-Madison, gave a talk on "Cooperatives in Local Food Systems" on November 20.

The series highlights informal presentations as a way to share new research on cooperatives in an easy-to-use and easy-to-understand format. The idea is to use the research to generate a stimulating discussion on cooperative issues. Both Brown Bags were well attended, with over 30 people at each event.



To receive future Brown Bag announcements contact Kim Zeuli at zeuli@aae.wisc.edu

Perspectives

Continued from page 1

Why are these two major changes at the farm and market levels causing cooperatives to convert to LLCs and C-corporations, and to enter into various strategic alliances with other cooperatives and investor-owned firms alike? A major reason is the challenge to the traditional model in sourcing adequate debt and equity capital. Indeed, it takes a lot of capital for traditional cooperatives to be able to add value to their goods by further processing their raw commodities so as to meet the needs of large food buyers. Net margins at many traditional cooperatives are not adequate to grow the cooperative business and to responsibly retire old equity.

Capital demands don't stop there, and funds needed for organizing and start-up of new generation cooperatives can be very prohibitive. And even the most successful new generation cooperatives find it challenging to meet their growing

equity capital needs as their success can lead to larger and larger markets, simply because their farmer-members may have reached their limits on their ability to invest or to provide all of the needed raw commodity for the larger market. Finally, the capital requirements for farm operations are ever-increasing, limiting farmers' abilities to invest in either traditional or new generation cooperatives.

So what does an LLC have over a cooperative? After all, cooperatives are permitted to seek outside equity capital, such as through the sale of preferred stock. On the other hand, the legal limit on annual maximum dividends (8 percent for most states), the prohibition of investor participation in governance, and various tax issues all stack up to limit the co-op's ability to raise capital.

Similarly, LLCs may also operate under cooperative principles, with farmers controlling the business. Unlike co-ops, however, investors in LLCs may participate in governance also, and net income may be passed through for single taxation as either patronage refunds or returns on

investment. Various new cooperative incorporation laws that address this capitalization issue have been passed (the Wyoming Cooperative Law in 2001, and the new Minnesota cooperative law in 2003) or are being considered (Wisconsin and Iowa, for example). These laws maintain at least 50 percent farmer control on the board of directors, allow investors to serve on the board, and permit the establishment of patronage and investor pools for returning net income. The success of this model is yet to be tested.

The downside of converting to an LLC, or to the adoption of these new cooperative laws, is the loss of Capper Volstead protection and the reduced opportunity to obtain debt capital from CoBank. The House hearing addressed both of these concerns, and the debate is far from over regarding whether the cooperative model is broken. Does the model require rather major legislative changes at the federal level (Capper Volstead Act, CoBank lending authority, for examples)? At the state level (state incorporation laws)? Additional hearings and debates will continue to evolve this important issue.



l to r: Philip Strowman, A. Colin Cameron, Olivia O. Parry.

The Dane County Co-op Forum has been revamped and restyled for the fall of 2003. It is taking an approach that will encourage networking, as well as be entertaining and stimulating.

The informal DCCF organization brings together the many diverse co-ops and credit unions of Dane County, Wisconsin. Formed to help the co-op community explore new ideas, innovations, and ways to support each other, members have found that by working together they can share strategies, build networks, and strengthen the co-op community.

In its inaugural year, DCCF held three discussion forums and funded a full-page advertisement in the *Wisconsin State*

Journal promoting the county's 100+ cooperatives and credit unions.

Since then, DCCF has held discussions and sessions on a variety of topics and areas of interest. Group Health Co-op of South Central Wisconsin, Homestead Co-op of Mount Horeb, Union Cab Co-op, and Williamson Street Co-op, are just some of the local co-ops that have made presentations.

UWCC staff and our faculty associates have made presentations on the history of cooperatives in Wisconsin and the status of cooperatives in Nicaragua and Africa. And DCCF has hosted many cooperative leaders from Wisconsin and beyond, with speakers from California, New York,

Canada, and Scotland sharing their co-op stories.

This past fall, DCCF held two sessions. The first, on September 11, featured Margaret Bau, Cooperative Development Specialist for the Wisconsin branch of the USDA Rural Development Program. She spoke about her recent tour of the flexible manufacturing networks of northern Italy, which segued into broader discussion about "cooperation among cooperatives."

The other fall session, held October 16, introduced humor and theatrics as educational tools in the pursuit of cooperative knowledge. An original play by Greg Lawless, based on an academic bulletin that he had written earlier, was presented to a delighted audience. "Historical Foundations of Cooperative Philosophy: The Musical" took the teachings of ten historical co-op thinkers and gave a face and a personality to their words. It was a great way to end the year in the Dane County Co-op Forum tradition, a tradition that will continue to link co-op members and leaders for years to come.

The next newsletter will detail our late-January hosting of delegates from Mondragon Cooperative Corporation, a system of co-ops located in the Basque country of Spain.

Dane County Co-op Forum Local Group Revived

by Judy Turpin
Undergraduate Student
UW-Madison CALS

For more information on DCCF contact Greg Lawless or Ashwini Rao (see p. 6).

International Visitors

by Bob Cropp



Professor Bruce Jones (UW-Madison Dept. of Agricultural & Applied Economics) speaks to study group at farm of Bob Topel, VP, Foremost Farms, USA (9/13/03).

Study Group from Ireland Makes it an Annual Event

In 1999, Bob Cropp, Professor Emeritus and former UWCC director visited Ireland, where he spoke at a co-op conference and met with Seamus O'Donohoe, Vice President of the Irish Co-operative Organisation Society (ICOS). The Society's "Dairy Director Training Programme" covers director responsibilities, co-op management, the capitalization of co-ops, major issues impacting co-ops in Ireland, and more.

To earn the Diploma in Corporate Direction, enrollees attend eight modules; the final one includes a visit to the U.S. to study our country's dairy co-ops and the U.S. dairy industry. Mr. O'Donohoe and Bob together organized the U.S. study portion of the program, to be held concurrently with the World Dairy Expo, held each fall in Madison.

The 9/11/01 World Trade Center tragedy postponed the Society's first scheduled study trip, so Bob maneuvered the 8th module to the January 2002 annual U.S. Dairy Forum, held in Arizona.

A second study group visited the Center during the 2003 World Dairy Expo. Besides 22 director-students, the group included Seamus O'Donohoe and Mary Johnson, both from ICOS, and Dr. Patrick G. Enright, College Lecturer at the University of Cork. Here from Sept. 29-Oct. 2, the group visited a local dairy farm and the World Dairy Expo, and attended these seminars at UWCC:

—*Trends in U.S. Cooperative Development*; Bob Cropp, UWCC

—*U.S. Policy Positions on Global Aspects of Dairy Marketing*; Bill Dobson and Tom Cox, both in the Dept. of Agricultural & Applied Economics, UW-Madison

—*The Cost of Milk Production*; Bruce Jones, Dept. of Agricultural & Applied Economics, UW-Madison

—*The Power & Strategies of Food Product Buyers in the U.S.*; Don Berg, Land O'Lakes, Inc.

—*Approaches to Marketing Strategy by U.S. Dairy Co-op*; Dave Fuhrmann and Jim Kasten, both at Foremost Farms USA

—*Control and Representation Structures in U.S. Dairy Co-ops*; Bob Cropp, UWCC, Bob Grabarski, Alto Dairy Co-op, and Ed Brooks and Bob Topel, both at Foremost Farms USA

—*U.S. Dairy Co-op Debt & Equity Financing Instruments*; Gary Sloan, CoBank

—*Dairy Co-op Restructuring & Rationalization*; Mark Furth, Assoc. Milk Producers

—*Aspects of Strategic Planning, Resourcing & Implementation*, Seamus O'Donohoe, ICOS

—*Value-added Co-ops*, Greg Lawless, UWCC

The UWCC hopes to again host a group of ICOS director-students in 2004.

Visitors from Jalisco and Guadalajara, Mexico

Two Mexican delegations, including six dairy cooperative boards of directors from Jalisco and a faculty group from the University of Guadalajara, visited Wisconsin the week of November 10th. The groups came to study Wisconsin's dairy co-ops and dairy system, in an aim to help farmers in Mexico stay competitive by improving production, developing cooperative organizations, and targeting new niche markets.

Bob Cropp, Professor Emeritus and former UWCC director presented a seminar on agricultural cooperatives, focusing on the history of co-op development in the U.S.; how co-ops are controlled, managed and financed; how cooperatives are organized; the existing business scope of cooperatives; and the structure and business activities of dairy cooperatives.

Anne Reynolds, UWCC's Interim Director presented the various research, technical assistance, and educational programs provided by UWCC.

The group also visited with the Wisconsin Department of Agriculture, Trade & Consumer Protection regarding their assistance to and regulatory role in agriculture.

Other UW-Madison sectors rounded out the group's study visit: the Center for Dairy Research presented their activities in dairy product development and dairy processing technology for the cheese industry, and the Babcock Institute and Dairy Science Department discussed dairy cattle nutrition, reproduction, farm management, and milk quality.

Current Co-op News on UWCC Website

www.wisc.edu/uwcc

The University of Wisconsin Center for Cooperatives' website offers hundreds of articles, reports, directory listings, and cooperative links from around the world.

We also offer a free **e-mail News Service** that's updated at least once a week. To subscribe to **Co-op News from UWCC**, go to the UWCC home page and look for instructions (www.wisc.edu/uwcc).



Another Successful Farmer Cooperatives Conference

by Kim Zeuli

Reading major newspapers lately, one might think that the agricultural cooperative sector was in real trouble. The stories about Farmland and Agway bankruptcies, governance issues plaguing Ocean Spray, and the conversion of successful cooperatives to investor-owned firms, have many feeling grim about the future of our farm cooperatives.

In contrast, the Sixth Annual Farmer Cooperatives Conference (*Executing Vision and Strategy with Success*) highlighted plenty of cooperative success stories. Each year, co-op directors and CEOs, government representatives, financial and legal professionals, and cooperative scholars meet at the Farmer Cooperatives Conference to think broadly and critically about the future of agricultural cooperatives. The UWCC established this conference series in 1998, with financial support from Farm Foundation, to provide a forum for the exchange of ideas on a timely set of issues affecting the agricultural cooperative sector.

Over 150 cooperative leaders from the US, Canada, and the UK helped create a dynamic 2003 program. Speakers representing thirteen of the nation's most successful cooperatives provided powerful presentations. Conference sessions highlighted: the importance of making decisions quickly; the challenges associated with closing local plants and branches; how to achieve growth with a diverse and large membership; non-traditional equity arrangements; and how to create a strong brand name.

In the summary presentations, Mark Hanson, an Attorney at Lindquist & Vennum law firm, highlighted four keys to successful cooperatives: leadership, a solid and focused business plan, an efficient capital structure, and member liquidity.

Sixth Annual Farmer Cooperatives Conference

Executing
Vision & Strategy
with
Success

October 30-31, 2003
Kansas City, Missouri

Find a full post-conference summary, program, and presentations on our website:
<http://www.wisc.edu/uwcc/farmercoops03/index.html>

Hanson also advised cooperatives to distinguish between an income business model, in which earnings are distributed, and a growth business model, in which earnings are reinvested. Co-ops need to understand where their capital is coming from—not through assumption, but by close observation.

Mike Maranell, Senior Vice President at AGP, identified three main “take-home” concepts from the conference:

1. It is important to understand the “purpose” of a business, particularly “your” business.
2. The success of execution depends on the following key ingredients:
 - a clear vision of what you want the business to look like in the future;
 - a formalized, strategic plan that involves multiple stakeholders;
 - alignment of the board of directors and management; finding the right people for co-op leadership positions.
3. The cooperative system will continue to evolve.

Forestry Cooperatives:

What Today's Resource Professionals Need to Know

A National Satellite Conference

Broadcast on November 18, 2003, and hosted at approximately 49 sites in 22 states, the conference was sponsored by the Local Forest Cooperatives Working Group—a joint venture of the University of Minnesota, the University of Wisconsin-Madison, UWCC, and the USDA Forest Service with funding from USDA CSREES.

The conference was meant to help professionals gain an insight into the forestry cooperative model; learn first-hand from different forestry co-ops set up in various states; and determine when the co-op model is appropriate. The level of participation nation-wide indicates a growing interest in forestry co-ops. UWCC will continue to play a role in providing research and outreach in this area.



Conference information and materials can be found at <http://www.wisc.edu/uwcc/forestcoops/index.html>

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uwcc mission & vision statements

MISSION:

The University of Wisconsin Center for Cooperatives' mission is to study, promote and research cooperative action as a means of meeting the economic and social needs of people.

VISION:

The University of Wisconsin Center for Cooperatives will be the leading source of information on cooperatives, cooperative research and educational programming geared to enhance cooperative action and enterprise.

information services

Cooperative Library:

608-262-9488, Room 106 Taylor Hall.

UWCC Home Page:

<http://www.wisc.edu/uwcc>

UWCC Cooperative Listserv:

e-mail subscription requests to: reynolds@aae.wisc.edu

UWCC website for young cooperators:

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