Navigating Change

Consolidation trends and issues in spotlight during 2017 Farmer Co-op Conference

By Lynn Pitman
Senior Outreach Specialist
University of Wisconsin Center for Cooperatives
email: pitman@wisc.edu

20th ANNUAL FARMER COOPERATIVES CONFERENCE

Mergers, consolidation and the shifting policy landscape for agriculture were among the key topics examined during the 20th Annual Farmer Cooperatives Conference in St. Paul Minn. Almost 180 agricultural cooperative leaders and others who work with co-ops attended the conference, held Nov. 2-3.

Consolidation: pros and cons

Many cooperatives have pursued consolidation to adjust to changes occurring in production agriculture and the increased competition of global markets. Speakers shared their perspectives on the trade-offs that cooperatives must weigh when making decisions about mergers and strategic alliances.

Mergers during the past 20 to 30 years were primarily defensive and driven by financial considerations, said Keri Jacobs, assistant professor at Iowa State University. As the consolidation trend has continued, however, other factors may also be at play, she observed.

As farm operations grow in size, the suppliers and wholesalers that support them will also often need to grow. Mergers typically are pursued to support growth in farm size by increasing efficiencies in outputs, administration and operations. Mergers can make strategic assets available to a broader membership, creating greater value.

Courtney Brener, the new director of the University of Wisconsin Center for Cooperatives, addresses the co-op leaders who attended the 2017 Farmer Cooperative Conference. Photos courtesy UW Center for Cooperatives

Jacobs suggested that the perception that "everyone else is doing it" can also contribute to merger pressure. While the explosion in co-op consolidations has reduced the number of cooperative

Consolidation expands markets for Danish co-op

Continuing a tradition of offering an international perspective on cooperative issues, the 2017 Farmer Cooperatives Conference provided a look at consolidation and market expansion in Denmark.

Niels Jensen, a sixth generation dairy farmer, chairs the board of the DLG Group, a farm supply cooperative that has $7.8 billion in annual revenue and does business in 18 countries. Formed in 1898, DLG today is the product of many mergers and acquisitions. It has more than 26,000 Danish farmer members.

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During the past several years, DLG has been divesting non-core investments that were made during a period of international expansion. The co-op has renewed its focus on its farm supply, nutrition and service and energy businesses in Europe.

Jensen stressed that cooperatives need to deliver member earnings and the same service levels as larger corporations if they are to survive. Cooperatives like DLG have continued to deliver value to their owners, despite long-standing concerns among some that cooperatives have lost their relevance and effectiveness, he said.

Since Danish agriculture exports two-thirds of its production, cooperatives must have the volume and international presence to ensure the continued success of their farmer members, Jensen said.

Because the cooperative needs both large and small farmers to function, DLG remains organized on a one-member, one-vote basis, Jensen noted. The voting membership elects a board of representatives, which elects a 12-member board, including three employees.

firms, the number of locations often does not change significantly, because local cooperative locations continue to operate as branches of the new cooperative entity, she noted.

While mergers may make it more difficult for the remaining independent co-ops to maintain a presence in the retail market, Jacobs suggested there may be good reasons not to merge. While being bigger may contribute to a co-op's survivability and efficiency, bigger is not necessarily "better." The financial metrics of merged cooperatives can vary, and improvements are not guaranteed by growth.

Member perceptions of growth, she observed, can have significant financial implications for the co-op if members feel that it is "just another big business" and no longer belongs to them.

Smaller cooperatives may be able to stay financially strong by focusing on core business strategies that deliver a set of member benefits without trying to be "everything to everybody." Smaller cooperatives may also foster innovation and good governance because it is easier for members to actively engage and align leadership with member interests.

Cooperative leadership tends to see growth as the basic value proposition, said Jacobs. In the face of consolidation pressures, co-op leaders need to move beyond a narrow definition of value. Expanding enterprise practices to accommodate all member interests is difficult, she said. Members need to understand whether their equity is being used in a way that provides benefit to them.

Jacobs suggested that a co-op look

at what it does well, examine the range of its member interests and consider the value that consolidation can deliver to its member-owners. It is important that co-ops keep in mind the essential role they continue to play in providing market power and access to producers.

Food-chain benefits and consolidation

Rich Sexton, professor at the University of California-Davis, took a broader look at the impact of consolidation in the food-supply chain. He suggested that, on balance, the efficiency gains of vertical integration occurring through consolidation are beneficial. The gains help to offset the upward pressure on food prices as global demand expands.

These consolidation benefits for consumers have more complex implications for farmers. Sexton described research that has quantified the market power concentration in the food manufacturing, meat production and retail food sectors. More concentration in these sectors means fewer local selling options for producers. Many producers are locked in to buyers through the widespread use of contracts, further reducing producer options.

Agricultural cooperatives have been effective intermediaries in the marketplace because their farmer-members have similar needs for inputs and they pool their crops for marketing. As demand for a more diversified range of agricultural products and production practices increases, however, cooperatives need to evolve to accommodate changing consumer demand, Sexton said. Finding a path to support small farms and rural economies without diminishing the benefits of consolidation and vertical integration efficiencies will be a policy challenge.

Scale in grain marketing

The Comark Grain Marketing and Equity Marketing Alliance cooperatives were both the results of mergers pursued to achieve the advantages of scale. The two cooperatives merged last August to form Comark Equity Alliance (CEA), one of the largest federally licensed marketing groups under a single license in the United States.

CEA is owned by 28 member-cooperatives that formerly owned Comark and Equity, Alan Woodard, the co-op's CEO, explained. The larger size makes the co-op more "bullet-proof," he added.

The co-op's "umbrella" now covers 161 locations in Oklahoma, Kansas and Texas. Member-cooperatives have assigned their grain licenses to CEA, which sets bids and discounts, pursues arbitrage opportunities and merchandises commodities. Centralizing these functions has allowed for efficiencies and access to expertise that has benefited the local member-cooperatives and enhanced their opportunities, said Woodard.

As part of the merger agreement, the cooperative reduced the board size to eight members, consisting of general managers from local co-ops and CEA's chief executive. The local cooperatives remain responsible for maintaining relations with their producer-owners.

Woodard said that transparent communications can promote the alignment of the goals between member-cooperatives and CEA. Prior to the merger, the local cooperative members of Comark and Equity Governance did not fully recognize the benefits that were being delivered. Other post-merger priorities include the development of good governance practices and better strategic decision-making about future commodity diversification.

Merger follows member growth curve

Mid-Kansas Cooperative Association (MKC) was created through a merger in 1965, and it has continued to grow through 12 subsequent mergers and six acquisitions, including three greenfield sites. A variety of partnerships support its core businesses, which include grain, agronomy, energy, feed and risk management.

MKC operations have needed to follow the same growth curve as its members and the sector overall, explained Allen Wegner, the co-op's board chair. Growth has resulted in greater people resources, increased industry relevance and the renewal of assets. Customers have benefited through better services, products and market access.

Post-merger challenges have included customer communication and consistency of services, human resource management, building a common culture and the increased importance of good strategic planning, said Wegner. He noted that managing perceptions and communications is all-important in the merger process.

It is important that leaders keep in mind the essential role that a co-op continues to play in providing market power and access to its producers.

Networking among co-op leaders and experts (above and below) during the annual Farmer Co-op Conference helps co-ops benefit from the experiences of other co-ops facing similar challenges.

Local control concerns halted merger

Tennessee Farmers Cooperative (TFC) is a federated cooperative that owns six retail operations and partners with Winfield United (a Land O' Lakes subsidiary) to deliver agronomy services and provide financial services for local cooperatives. CEO Jim McWherter and Board Chair Kenneth Nixon described the path of a merger proposal that, ultimately, was not approved by membership, despite a lengthy development and outreach effort.

Although TFC had experienced strong overall financial results the past several years, the local member cooperatives were experiencing significant variations in their markets, their product mix, their size and financial performance. Discussions about strategic repositioning, including talks at statewide manager meetings, led to the formation of the System Study Team in 2014.

The team developed five different operational consolidation options, all of which reflected the need to safeguard \$160 million of farmer equity, \$135 million of local equity and to produce benefits for members. Feedback from local co-op managers to these options led to the development of another proposal, which called for a new retail cooperative that would combine the net assets of TFC and its member-co-ops.

The proposal maintained farmer ownership and control, showed positive financial projections and positioned the co-op for future growth by remaining relevant to the market, McWherter and Nixon said.

The proposal had unanimous support of the TFC board and was presented at member board meetings and a special session at the annual meeting in 2016. However, the plan died due to lack of support during a series of follow-up meetings. Answers to many of the questions triggered by the complexity of merging 55 member co-ops plus TFC, including the selection of new leaders, were not available.

McWherter and Nixon suggested that the loss of local control and identity was a significant factor in failing to gain the support of local boards. There was also concern about conflicting regional differences, as well as the risk that a major change might "kill the goose that laid the golden egg." Because the study team had not prepared a "Plan B" to keep the process moving forward, the merger effort ended, despite the continued interest in the possibility of such a structural change.

Follow-up discussions have continued, however, focusing on other possible changes within the cooperative. TFC is owned by 60,000 members, but members are not required to be actively farming or to conduct a minimum amount of business with the cooperative. Since members do not share the same exposure to financial risk through their business with the cooperative, McWherter and Nixon suggested that a very diverse set of member interests may have contributed to the failure of the merger proposal.

Farm Credit sector merger

Mark Cade, chair of Compeer, a recently merged Farm Credit System co-op headquartered in Sun Prairie, Wis., provided a perspective on mergers and membership in the credit sector. Compeer was formed in July 2017 through the merger of AgStar Financial Services, Badgerland Financial and Farm Credit Services. A member of the Farm Credit System, Compeer now has more than 43,000 member-owner clients.

The three cooperatives agreed that the merger would not proceed unless approved by all three. A nominating committee put forward a single, small slate of directors as part of the merger

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Snapshot of policy developments in flux

Political and policy developments can strongly influence the market conditions and member needs that drive agricultural cooperative priorities. The conference provided perspectives on possible impacts of these emerging policy trends.

Observing that "We're not in Kansas anymore," Chuck Connor, CEO of the National Council of Farmer Cooperatives, called for reinforcing relationships with key allies and engaging in grassroots advocacy to broaden the coalition for agriculture. Issues related to cooperative taxation, immigration reform, the new Farm Bill and trade are some of the priorities for NCFC in the coming year.

The Farm Bill development process includes financial analyses on possible policy impacts at the farm level. Joe Outlaw, co-director at the Agricultural and Food Policy Center (AFPC) in Texas, described how his organization develops these assessments for the House Agriculture Committee.

Outlaw noted that the unexpected, sustained drop in commodity prices is stressing many farm operations, but he doesn't expect the new Farm Bill to change significantly from the current (2014) Farm Bill. Commodity advocacy groups will need to work together to optimize Farm Bill agricultural programs through compromise on individual commodity programs, he advised. The 2018 election cycle may mean that a new bill may not go into effect until fiscal 2019.

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vote. This was done to avoid the cumbersome process of whittling down three cooperative boards that totaled 45 directors. The CEO of the new entity, if approved, was also identified prior to the vote.

The merger proposal faced tough questions during membership meetings, said Cade. But it was eventually approved by all three cooperatives.

An increasingly competitive credit market led the institutions to consider the merger, Cade said. The merger has not only expanded benefits for clients and employees, but has also supported major investments in financial technology and resulted in greater diversification of the co-op's loan portfolio.

Three of Compeer's 17 board directors are appointed, as required by the Farm Credit System. The remainder are member-clients who are elected by voting members in Illinois, Minnesota and Wisconsin.

A nominating committee identifies eligible board candidates, who must be voting stockholders and agricultural producers. Stockholders that are business entities may appoint individuals whose eligibility is determined by their ownership, or interest, in the corporate entity as well as the other director requirements.

Part of the merger process has involved equalizing the capital within the three associations. In the future, Compeer expects to run a cash patronage program, with about a 20-percent return to member-owners. As in any merger, the integration process is ongoing and will take more time to fully complete.

Merger passes on second try

When a 2015 merger proposal between South Dakota Wheat Growers and North Central Farmers Elevator was very narrowly defeated, Hal Clemensen, board president of Wheat Growers, said that the board did not expect that the question would be revisited. However, continuing changes in market conditions led the boards to introduce a new proposal in 2017, which was approved by the members of both cooperatives.

Wheat Growers is a grain and agronomy co-op with 40 locations that serve 5,100 member-owners in South and North Dakota. After the merger is implemented, the new entity will have 62 locations with 7,400 members. It will be a member, not a stock, cooperative.

It is important that members be active producers, observed Clemensen, so that cooperative initiatives — such as the merger — better align with the interests of current patrons. Wheat Growers requires members to be actively farming and to have conducted at least $5,000 in business with the cooperative during the previous fiscal year.

This is not a difficult threshold to reach for active producers. Wheat Growers' 5,100 members are part of a larger group of 17,000 equity holders, many of whom are retired and no longer use the cooperative.

Membership is determined at the account level, and voting member status is annually determined on the basis of each account's activity. Members also include business entities, which may designate a voting representative. Some challenges exist with this approach, because a patron's member status may change from year to year, and patrons who hold equity in the cooperative may not be able to vote.

However, the result has been a membership of more active and engaged agricultural producers who support a cooperative that is more aggressive in the marketplace, said Clemensen. This also provides a layer of protection against a potentially hostile takeover. Without such membership requirements, decisions by a membership that included all equity holders might have been different.

Clemensen stressed that an active membership also depends on member education programs. The next generation of farmers needs to understand the contributions that cooperatives can make to ensure the success of their farms, he added. ■

Editor's note: The 2018 Farmer Cooperatives Conference will be held Nov. 8-9 in St. Paul, Minn.