INTER- AMERICAN INSTITUTE FOR COOPERATION ON AGRICULTURE -IICA

COOPERATIVE CHALLENGES AND OPPORTUNITIES WITH INCREASED MARKET ORIENTATION AND GLOBALIZATION

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Agricultural Cooperative Service
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Events during recent years have reinforced how the food system continues to challenge cooperatives and their members to identify alternative ways to profitably produce and market agricultural products. The globalization trend, evidenced by negotiations over the North American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT), continues to present producers with a wide array of problems, issues and opportunities at home and abroad.

Cooperatives with strong market awareness and solid strategic plans should emerge as innovative competitors in the complex, diverse, and ever-evolving agricultural industry.

As emerging democracies work toward developing market oriented systems, there will be considerable new opportunities for the cooperative community in the USA and elsewhere to play a role in the development process. Democratic reforms offer potential for increased trade and hold promise for cooperative development educational activities in former Eastern Bloc countries and other developing nations.

Talk presented to Conference on Rural Development, Inter-American Institute for Cooperation on Agriculture, Bogota, Columbia, June 29, 1993.

When we speak of cooperatives, we are talking about businesses that are owned by the people who use them. They are voluntarily owned and controlled by members who share in benefits in proportion to the use made of the organization's services. These cooperatives are typically organized by agricultural producers or consumers to purchase inputs, needed household items or other services. They are also organized to market farm crops or livestock profitably for members. Please note that I am not referring to farm production cooperatives. Such cooperative farms have not been successful in our country and remain outside our discussion today. Rather, I am speaking of cooperatives that are organized by independent farmers to provide themselves needed services.

Farmers and their cooperatives can expect to compete in a dynamic agricultural market place for the remainder of the 1990s. Cooperatives that remain well-informed and positioned to deal effectively with a rapidly changing agricultural sector should be able to capitalize on opportunities and thrive, rather than just survive.

The role of my agency, the Agricultural Cooperative Service, in the Department of Agriculture is to promote knowledge of cooperative principles and practices, and use of the cooperative form of business as a viable option for agricultural producers and

other rural residents. The following remarks about how cooperatives are adjusting to a dynamic industry are based on this perspective.

U.S. Cooperative's Adjustments to Industry Dynamics

Farm operators in the USA are busy keeping their cooperatives on the cutting edge of unprecedented changes in production agriculture and in the makeup of market channel participants. A new global food system is emerging. With it, we see changing ownership patterns of food processors and distributors and new challenges to the producer-owned segment of the industry. An adaptation or rationalization process among farmer-owned businesses is occurring as farm leaders position cooperatives for the future. Accompanying this rationalization process is a revisiting of cooperative principles, practices, and organizational structure.

The purpose of our discussion is to provide some insights to the development of cooperation among U.S. farmers and some of the challenges they are addressing in the new global agriculture. It's often useful to compare and contrast development of cooperatives in other parts of the Western World with one's own country for lessons to learn and for insights to decision processes.

First, here's a bit of background to set the stage for the current assessment. Cooperatives grew in the early part of this

century as a structural response by farm operators because they were many in number and relatively small in size compared to businesses they dealt with to buy supplies and to sell products. The changing market structure of agriculture, a prime motivator in early organizing efforts associated with the emergence of commercial agriculture, remains today the underlying rationale for cooperative efforts by farm operators. Farm operators also organized because services were not available to them in their rural communities, or because those services were not available at reasonable costs.

Cooperatives became established in the early days as a series of farmer movements matured and found their future in economic organizations. A broader social purpose was embraced early in those organizing efforts -- popularly called the "cooperative movement" -- to improve one's individual position, community, and the competitiveness of the capitalistic economic order through self-help organizational activity based on democratic principles. Each of these ingredients is very much a part of the fabric of cooperative organizations today and can be expected to continue in the future.

The 1920s represented a heyday in organizational activities. Not only were cooperatives organized in virtually every commodity sector and most communities, but state cooperative laws were enacted under which new cooperatives could incorporate. Federal

laws were also approved. Key among these was the Capper-Volstead Act of 1922 that allows farmers to organize for marketing purposes without the act of organizing constituting an antitrust violation. The Cooperative Marketing Act of 1926 authorized exchange of price and other information between various levels of cooperatives in a federated system. It also established a unit in the U.S. Department of Agriculture -- now in its 67th year -- that would conduct research, technical advisory assistance, and an information/education program on cooperation.

It is significant that not all cooperatives were organized according to the same school of thought during this period. These philosophies gave rise to structural differences. In the Midwestern region, local cooperatives were organized in communities for supplying farm inputs, and/or for marketing commodities such as grains, milk or livestock. They were often viewed as providing a competitive yardstick that kept investor-oriented firms (IOF's) honest. This gave rise to a large number of locally owned cooperatives that often federated at the regional and interregional level. In other parts of the country, notably the West Coast, cooperatives were organized on a regional basis as direct membership organizations. The admonition of the day according to this school was to organize by commodity, not by community, to achieve dominance and orderly marketing objectives. Many of the cooperatives in fruits, vegetables, nuts, cotton, and other specialty crops have been organized on this basis.

Even the vast development of cooperatives during this period was not enough to forestall the catastrophic impact of the Great Depression of the 1930s. This gave rise to Federal price support programs that are the focus of international discussions today. To a certain extent, these Federal farm programs mitigated or lessened the dependence of producers on self-help efforts through various forms of group action.

Significantly, two laws were passed in the 1930s that greatly expanded the use of cooperatives for services. These were the Farm Credit Act of 1933 that provided a foundation for the cooperative farm credit system, and the Rural Electrification Act of 1934 that provided for bringing electricity to rural areas on a cooperative basis. The Agricultural Marketing Agreements Act of 1937 also aided cooperatives by establishing Federal marketing orders as a method of assuring orderly commodity marketing.

Finally, the Agricultural Fair Practices Act of 1967 reaffirms producers' rights to engage in collective action in pricing their products, and protects them from discriminatory practices by food processors in farmers' conduct of their organizational affairs.

Organizational Status Today

Today we find 4,494 agricultural cooperatives involved in farm inputs, marketing, and related services that collectively did $90.8

billion worth of gross business in 1991 and $76.6B in net business volume. The difference represents business conducted between cooperatives so we don't do double counting.

It is no news to many of you, I'm sure, that agriculture went through its most difficult time in the mid-1980s since the Great Depression. A number of our regional cooperatives entered this period with too much debt, and paid the price. After considerable downsizing, paying down long-term debt, and other repositioning, the cooperative sector has emerged leaner, with stronger balance sheets and improved earnings, and in a stronger position to compete in the 1990s. When certain sectors are in the doldrums, cooperatives tend to suffer with their farm members. Cooperative income was very low from 1982 to 1986 and has since recovered but has yet to reach the levels of 1980, which was a record.

To give a perspective on size distribution by sales category and capitalization levels, we can compare cooperatives for the years 1980 and 1991, our latest year for which complete data are available. Please note that nearly 3,800 cooperatives or 85 percent of all agricultural cooperatives in 1991 had sales under $15 million annually. These are the locally owned cooperatives in communities throughout the USA that we discussed earlier. But, they represent only 16 percent of total cooperative sales. While numbers of cooperatives in the other sales categories are smaller, they represent increasing proportions of total cooperative

business. The number of cooperatives in $100 million-999.9 million range has held its own during this period of rapid consolidation among the smaller locals.

When it comes to balance sheets, we can note that the smaller cooperatives are generally financed more conservatively with an average net worth (equity) to total assets ratio of about 55.5 percent. By contrast, the largest 100 cooperatives, which includes all of the large federated regionals and a number of direct membership regionals have improved their ownership capital from an average of 29 percent in 1980 to 37.8 percent in 1991. We did not see a lot of mergers and consolidations in the 1980s among regional organizations. We are seeing more attention to cooperative mergers and joint working arrangements in the 1990s.

As is frequently the case, cooperative presence in markets is measured by their relative share of marketing or farm input activity. Our agency attempts to compile these figures to give a look at direction and penetration. On the farm input side -- again focusing on the 1980s, it can be noted that cooperatives maintain significant positions in fertilizers, petroleum, and farm chemicals. We like to think this farm input distribution system -- integrated from oil refineries and fertilizer ingredient mines -- is second to none. Cooperatives are a smaller factor in seeds and feed, and are almost non-existent in the sale of tractors and other farm machinery. Due to federal acreage reduction programs, total

volumes of farm inputs have been reduced in recent years. Data suggest that some of this has occurred in areas where cooperatives are best organized.

On the marketing side, cooperatives have continued to grow in handling of perishables such as milk, fruits and vegetables, and cotton, but have regained some ground in grains. The percentage of market penetration in livestock is low and falling.

These figures suggest a very dynamic situation in American agriculture. Indeed, we may characterize this period as one of significant change in the economic organization of agriculture. Cooperative and other farm organization leaders are groping to get handles on the direction of emerging forces and to adapt their systems to the long haul. It is a process that challenges the very foundation of the agricultural industry and coincidentally the future role of farm operators as entrepreneurs. I will devote the remaining time to some of these forces and to just how cooperatives are attempting to rationalize their systems to deal with them.

How Cooperatives Are Adapting

The advent of more market-oriented farm policies beginning with the 1985 and continued with the 1990 farm bill has necessitated adjustments and adaptation on the part of all market channel participants. The shift to more global markets and the

continued ability of agriculture to outproduce itself has translated into more mature markets and more price volatility. This is a double edged sword for farmer-owned cooperatives. On the one hand, the fact that markets are not growing as fast as they once were and that firms in their respective industries are consolidating puts pressure on existing cooperative structure to adapt itself to the new market realities. Increased volatility on the other hand means cooperatives are more subject to widely fluctuating inventory values and to the willingness and/or ability of members to finance their organization.

Adjustments in the cooperative community can be identified in several different areas: belt-tightening, mergers and consolidations, becoming least-cost operators, strengthening balance sheets, more attention to strategic planning, closer examination of value-added options, and where possible, consideration of more diversification. Let's elaborate on a few of these to give a better picture of what is going on.

When we speak of maturing markets, we are essentially saying the economic pie is no longer growing. We, therefore, see an increasing battle over trade share, i.e. trying to get a bigger piece of the pie! One of cooperatives' first reactions has been to trim costs in an effort to become lean and mean competitors. This has meant spinning off nonproductive assets, reducing staff, and generally attempting to position the organizations as survivors.

If costs are still too high and equity revolvements to previous owners cannot be maintained, then recognition is given to the fact that the cooperative is no longer viable as presently structured and that other organizational options must be considered. These include dissolution, consolidation with other cooperatives, acquisition of adjacent businesses, or as a last resort liquidation of the businesses through sale of assets. Inevitably, cooperatives are giving much more intense attention to strategic planning efforts. Among other things, this involves developing intelligence and knowledge of competitors' strengths and weaknesses. Since cooperatives are farmer driven, close examination is given to how cooperatives can work together in closer liaison with neighboring cooperatives in replacing strategic assets or in joint marketing activities. This inevitably strengthens the entire farmer-owned system and exploits scale economies and efficiencies available to them.

Increased volatility in markets associated with more market-oriented policies has brought much closer attention to financial management. As stated earlier, this has meant an increase in the equity part of the balance sheet, which demonstrates that members have more at risk, and bankers are more comfortable in providing loan capital to cooperatives. Cooperatives have also adopted more effective risk management policies and tools. For example, more emphasis on cooperative pooling rather than the more typical buy/sell trades in grains. Another is adopting appropriate hedging

policies so cooperative members are not subjected to drawer or speculative trading on the part of management. Another strategy is "just-in-time" deliveries so inventory levels are kept to a minimum. All of this, of course, means that as businesses cooperatives have become more cost conscious, and are using the latest in computer technology in their operations.

For some organizations, attention has been given to diversification as a means of evening out risk of a down market from participation in one particular sector. Farm input cooperatives, as an example, may look to more involvement in marketing of members' products. They are also providing more professional services to members on a fee basis such as agronomic specialists who help determine fertilizer and chemical needs for controlling weeds and pests, or feed formulation and animal health specialists. These services recognize the more complex and highly regulated world in which farming is conducted.

Alternatively, consideration is given to serving as a franchisee of certain business activities such as a convenience store operated in association with a gas pump, a restaurant, a lawn and garden center, muffler shop, or similar enterprise. In many small rural communities cooperatives are one of the few remaining businesses. Expansion into these additional services can have a community revitalization impact. A key question, yet unresolved, is whether this business is conducted on a patronage basis or is

simply looked upon as unrelated business. Presently, such enterprises are being conducted under both scenarios. I would be remiss if I did not mention that engagement in business on a noncooperative basis often has an unintended consequence of converting the "corporate culture" of the cooperative more toward an investor-oriented firm (IOF) over time. This is a pitfall that must be closely watched by cooperative leaders since there is a difference between cooperatives and other businesses that may be owned by farmers.

Another strategy used by cooperatives is to grow their cooperative into value-added processing on the marketing side of the business. The facts are that engaging only in commodities as distinct from value-added marketing is more subject to price risks as markets ebb and flow. Furthermore, marketing margins tend to be larger as the product is transformed and moves closer to the consumer. A number of our more successful marketing cooperatives escaped the agricultural depression of the 1980s because their earnings from value-added marketing held up. In fact, a number actually grew market shares during this period. Examples are Sunkist Growers, Ocean Spray Cranberries, and Welch Foods, all marketers of fruit drinks, jams, jellies, or related products. Many of the value-added marketing programs are also oriented to the growing food ingredients markets for industrial uses and away from home food preparation for institutions, hotels, restaurants and the like.

It is clear the food system attempts to shift burdens of carrying inventories to the weakest link in the food chain. Farmers can position themselves through cooperatives so they are not necessarily saddled with this burden. In some cases, this emphasizes cooperatives' role in coordination of the marketing system from the producer forward in the market channel through use of contractual arrangements or partnerships with other food marketers. In other cases, it can be achieved by cooperatives' linkages among themselves to achieve market presence and strength, and ability to charge for market balancing services that are performed for the market.

One of the newer strategies used by marketing cooperatives is to limit memberships to the size of the processing plant and/or business. The mechanism for doing this is frequently the use of contractual delivery rights and the base capital plan for financing the cooperative. Where brand name development occurs, these delivery rights may even take on a value themselves. Cooperatives establish an internal market for the transfer of these rights among existing or prospective members. This strategy allows members to benefit from the market niche and to earn returns more commensurate with their investments and product value.

Future Issues Facing Cooperatives

In discussing the "state of the union" among American cooperatives, I do not want to leave the impression that they have solved all their problems or have come to grips with some of the more perplexing issues facing them. It is almost redundant to say today that the pace of change in the food industry is accelerating. Cooperatives developed as a pragmatic solution to structural problems facing farm operators, and that problem-solving approach continues as producers attempt to develop original market power for themselves or countervailing power to other more dominant elements in the food channel.

In closing my discussion with you, I want to raise several issues that are front burner for consideration.

First, we have to look at farm operators and how their needs are changing. Unlike your country and continental Europe where land holders have a historical and traditional role as a gentry or a respected occupational class, American farmers have never received comparable recognition or rewards for their productivity and contribution to society. In part, this is due to the vastness and diversity of agriculture as it spans thousands of miles and different types of production agriculture. But it is also linked to farm policy that has encouraged an abundant supply of pure and wholesome food, but has not included a farm structures policy. As

a matter of fact, discussion of farm and market structure has been an anathema the past 12 years. During this period, production agriculture has become more diverse in ownership patterns. While this is often couched in terms of the emergence of a bimodal agriculture with relatively few large-scale farm enterprises producing the vast majority of production, and an increasing number of smaller part-time farmers, the middle tier of farm families seeking to earn a livelihood are under intense pressure. Also, we have the specter of large corporate farming/processing/marketing combines such as Tysons, Murphys, Carroll Foods, ConAgra, Cargill, among others, that are engaged in production agriculture and that some would classify as "farmers."

It comes down to a question of what type of economic organization of agriculture we really want in our respective countries. For a continued role and presence, cooperatives must be built upon the foundation of the best farm operators who want to be part of a farmer-owned system. The alternative as we are finding is that they will be consumed in an "industrialization" process. Obviously, cooperatives are not needed by large-scale corporate producers, or by contractual piece-wage growers. Cooperatives as an institution, therefore, have a lot hanging on the outcome of this basic question.

A second issue concerns the increasing value added to food beyond the farm gate and the fact that 46 percent of food

expenditures in the U.S. today goes to the food service industry. Much of this is for convenience. But the even more disquieting development is in the biotechnological revolution in which food ingredients and substitutes for things such as sugar, fat, and fibers, etc., are being synthesized and marketed. It has been suggested that to deal with this development, cooperatives must either invest more in research and development technology, develop alliances with ingredient firms, or be ready to acquire and/or license such new technology. We may only have seen the tip of the iceberg so far.

Finally, we see the continuing need for vigorous planning. If the pace of change is changing and at a more rapid rate, as we think it is, then planning and the development of flexibility within organizations takes on increased importance. Many of our most successful cooperatives find that if they concentrate on doing what they do best, they have their best opportunity for continuing success. But that assumes effective management of costs and an intelligence system that identifies their niche and role in the global food system. With strong balance sheets, well positioned structure in terms of services to farmers in enterprise management as well as traditional farm input and marketing services, and orientation to the unique user-owned attributes of cooperatively owned businesses, farmer-owned cooperatives have a significant and continuing role in agriculture in the year 2000 and beyond.