

Adopting a Cooperative Approach to Local Economic Development¹

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According to a report in the *New York Times*, rural America is experiencing economic and demographic decline (Egan 2002). The purpose of this essay is to examine the causes of this decline, and then to suggest one possible way that rural economic developers, farmers, government officials, researchers, and other interested parties can work together to reinvigorate rural communities. A caveat is required. The research reported here was conducted primarily in the American Midwest. The audience for this journal is located primarily in the American Southeast. The trick will be to reinterpret the findings of this research focusing on the Midwest in order to find relevance for rural communities in North Carolina and the Southeastern region of the United States.

There are a number of political and economic forces undermining rural communities, leading to farm consolidation and rural economic decline. There has been a secular decline in the number of farms and a growing concentration of agribusiness ownership since the Second World War. However, these trends accelerated during the 1980s because of the Farm Crisis. During the 1970s, grain markets in the USSR and China opened up. Farmers were encouraged to borrow money to expand production to meet this increased demand. However, in the early 1980s, the Federal Reserve Bank raised interest rates to slow inflation. Farmers with large loans could not make their loan payments, forcing banks to foreclose on many farm loans. In addition to the Farm Crisis, farmers have also

been put under growing pressure by the vertical integration of production in the agricultural sector. A few large firms such as Cargill, ADM, and other firms control an increasingly large proportion of the farm input and processing sector. For example, ConAgra, another giant agribusiness, owns commodity processing facilities as well as brand names such as Butterball, the popular turkey trademark. Hence, ConAgra owns portions of the value-chain from the "farm gate to the dinner plate." Under these increasingly monopolistic conditions, farmers are less able to negotiate a fair price for their harvested commodities.

Farmers also have to confront what Cochrane (1993) calls the "technological treadmill." Improved farm technology in the twentieth century translated into increased productivity, and hence, commodity supply. As the supply of commodities increased, it acted to suppress farm prices. With very small profit margins, the farmer was forced to increase output in order to make a profit. Output could be increased by enlarging the size of the farm, and / or by using more sophisticated and expensive technology. The technological treadmill results in a tendency towards larger farms in order to amortize the costs of increasingly capital-intensive farm operations. As a result, the least successful farms go bankrupt or are sold off to neighboring farmers. Many farmers forced off the farm due to consolidation moved away from their home community to find gainful employment. The tendency to-

wards larger farms necessarily leads to fewer farmers in a community.

Farm consolidation is therefore a key process in rural community decline. What we are trying to do is to help reduce farm consolidation and population out-migration. We propose to accomplish this by working on rural economic and community development strategies that unite, not just farmers—although they're certainly the core of what we're trying to do—but farmers and the non-farm rural population. We would like to get them to work more closely together because traditionally, farmers and their non-farming rural neighbors have not talked to each other. It is our idea to promote rural economic development that helps farmers and the non-farm population work together to improve conditions within an entire region. We believe we can develop a plan focused on value-added agriculture, where commodities will be processed locally, generating higher on-farm profits while creating local jobs and tax revenues. Certainly, one way of organizing producers to accomplish this is through a concept called *New Generation Cooperatives* (NGCs). For many farmers, the word co-op is a little problematic, suggesting something "anti-capitalistic." Let me suggest to you, however, that farmers who are involved in NGCs are very market-oriented, they just happen to enjoy being capitalistic with their neighbors.

This paper discusses value-added agriculture that can be pursued through the cooperative business model. If you attended this conference yesterday, you received a good primer on "value-added agriculture." Today, I am going to give you my perspective on that same topic, emphasizing the role of different cooperative structures in that process. Most of you likely know that the traditional farm cooperative is not a particularly efficient business model. Therefore, this essay will discuss how NGCs differ from the traditional co-ops, comparing their respective benefits and costs. I will then report on a survey of NGCs that we recently completed. I will conclude by directing you to

some other resources that should allow you to supplement the information I present today.

"Value-added agriculture" is one of those familiar catch phrases that have ambiguous or multiple meanings. The question is: What does it actually mean? If we take some of the standard commodity grower scenarios, we know that once the farmer sells a given commodity, he ceases to have any further concerns about it (Figure 1). Hopefully he has received a fair market price, which is debatable under today's market circumstances. Now, as the commodity moves along the so-called value chain from the farmer to the consumer somebody else is making money from that commodity. Somebody else is adding value to the commodity, whether by simply shipping it from point A to point B, or actually transforming it. Somebody else is adding value—earning profits that are not being earned by the farmer—as the commodity is transformed and moved towards the consumer. What we are suggesting is that we can keep more commodity-derived money in the local community by processing commodities locally. This will allow the farmer to reach up the value chain and engage in the processing and distribution of this commodity. The key is that as the farmer moves up the value chain he moves closer to the consumer—and to increasing returns on his investment. Ultimately, value-added agriculture is about increasing the

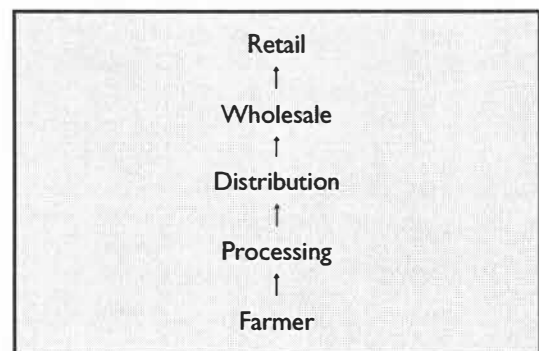


Figure 1. Value-Added Agriculture

farmers' profits.

The key step is for the farmer to move into processing. This poses a number of specific challenges. First, there is the problem of raising start up capital. Some of these processing facilities can cost several hundred thousand dollars to tens of millions of dollars. Very few farmers have that kind of money sitting around that they can invest in such a venture. Any kind of processing facility, of course, has inherent legal and tax issues such as how to incorporate the enterprise, how to distribute profits, or how to manage liability issues. Any successful business has to conduct marketing studies to identify the product and the market that the nascent firm is about to enter. There is the issue of technical expertise, environmental issues and management expertise. This is clearly beyond the capability of any single farmer, both with respect to cost and expertise. A potential solution to these various obstacles is for individual producers to invest in a special variant of the producer cooperative—the so-called *New Generation Co-op*.

Let us take a look at how this NGC differs from other, more familiar, institutional forms

(Figure 2). First, we have the issue of membership. A traditional cooperative usually has an open membership policy. You pay your membership fees and you're able to join. By contrast a new generation co-op has a closed membership policy. Now, that sounds perhaps a little bit exclusionary, but there are important reasons for limiting membership. The size of traditional cooperatives can vary from several hundred to over ten thousand members. They can be extremely large, a situation that can cause anonymity among members. In many ways, it is no different than belonging to the National Geographic Society. One seldom, if ever, meets other members. In contrast, the average NGC will have only several hundred people, with the largest having perhaps as many as two thousand members. The cost to join a traditional co-op can be fairly nominal, perhaps several hundred dollars. A new generation co-op, on the other hand, requires a substantial up-front investment. The usual approach is to buy shares, with a single share costing from \$1,000 to, perhaps, \$5,000. There will also be a minimum requirement that you purchase maybe two or three shares. Now, why is this

Issue	Traditional Co-op	NGC
Membership	Open	Closed
Size	10,000+	500 to 2,000
Cost to Join	Membership Fees \$100	Shares at \$5,000+
Delivery Rights	Not Usually	Always
Liquidity of Investment	Not Usually	Shares Traded on Open Market
Expected ROI	< 8%	10 to 20%
Mindset	Commodity Grower	Entrepreneur (Risk)

Figure 2. Comparing Cooperative Structure

important? Well, with a traditional co-op there is often a problem of members not patronizing their cooperative—the so-called “free rider” problem. If farmers can get a better price somewhere else, they’ll sell it to the processor who’s offering a better price. This means less revenue for the co-op.

In the case of the NGC, a farmer is given a guaranteed price and he can sell an amount of commodity in proportion to the number of shares that he owns. Therefore the NGC member is assured a market and guaranteed a price. There is also an obligation, of course, that if for some reason the commodity is not of the appropriate quality or if there is crop failure, that co-op member still has to deliver; so he may actually have to purchase commodities on the open market and sell them to the co-op. The point is that there is a much greater commitment between the producer and the co-op.

Liquidity of investment is a real problem for traditional co-ops because once you invest in one, it is difficult to get your money back. With a new generation co-op, the shares that you buy are tradable or sellable so it’s a much more liquid, more flexible arrangement. Expected return on invested capital is much higher for a new generation co-op. There is, of course, also some risk involved. This requires a very different mindset, with farmers having to think in a more entrepreneurial fashion. There are many states now with a legal structure known as a limited liability partnership. This means that the non-farmers can actually invest—so local business folks can invest in the processing facility. They do not have the same voting rights as the producers do, but they can expect the same returns on investment.

What are some of the benefits of NGCs? Well, certainly there are economies of scale at work. NGC members can raise start-up capital more easily, but there’s also the sharing of risk. NGCs provide a guaranteed price in the market. As more and more processors dominate the market, perhaps farmers are feeling squeezed out, and what a new generation co-

op does is to provide a guaranteed market for a portion of the farmer’s harvest. NGCs also provide what Robert Putnam (2000) calls social capital. Some communities feel as if things are not the way they used to be. People are too busy. They are not interacting with one another the way they used to. They don’t know their neighbors any more. Evidence suggests that membership in a NGC tends to reinvigorate these feelings of trust and “knowing,” if you will, within a community. So we have collaboration and cooperation between farmers, but we also have farmers and the non-farming community working together as well.

There are, in addition to quality of life and income issues, economic multiplier effects on the community (Leistritz and Sell 2001). We are referring to the construction of a new processing facility, which would contribute to the local tax base. The NGC will also create new jobs. The quality of jobs is certainly an open question, with some high paying white collar jobs, but typically also many low paying jobs. This is an issue that must be dealt with, by the community, up front. Last, but certainly not least, let me again suggest the issue of risk. While a higher return is expected, there is also significant opportunity for financial loss. A farmer must evaluate the possibility that he might lose 5 to 10 thousand dollars on the venture. He must begin to think more like an entrepreneur. He should also know that small businesses have a typical 5-year failure rate of around 50%. So if you’re going to become an entrepreneur, you should expect a higher rate of return but you should also expect to confront higher risks. That poses the question of how to mitigate these risks. Answering that question is a central feature of my research.

Next, I would like to report on a survey we conducted on NGCs in the United States. We asked the following questions: How can we help new generation co-ops be more successful? How can we ensure that farmers are going to get a positive return on their investment? Now, as a geographer, I am interested in

regions and regional differences. One of the questions that I wanted to ask was: How applicable is this model outside the core region where they typically occur, namely, the upper Midwest? Is there something about the local culture out there that facilitates the creation and operation of such institutions? We also have to be aware that we are talking about farmers—500 to 1,000 farmers—getting together and working together to process commodities. It turns out that there are some other companies already doing that, for example, behemoths such as ADM and Cargill. These are enormous, multinational agri-businesses. Farmers have to understand the global market if they are going to compete.

This is a very serious challenge that we have attempted to help farmers address in several ways. We have organized conferences—very much like this one here. We have written case studies that discuss examples of successful and failed attempts to use the NGC model. We have an edited book that discusses the underlying theory and applications of cooperative enterprise. We have also gone out to organize producers. Mary Holmes, a colleague at the Illinois Institute for Rural Affairs, has been instrumental in organizing five producer groups, two of which are actually investing in ethanol processing co-operatives in the state of Illinois. We have also surveyed NGC members to gain a better understanding of why they were inspired to invest several thousand dollars in a NGC.

Allow me to briefly address this survey and give you an overview of what is occurring here. We know overall that the number of farmers in the United States is in decline, and with them the number of open membership cooperatives in the United States—from around 8,000 in 1970 to approximately 4,000 today. Fully half the open membership co-ops have disappeared during this time period. On the other hand, the number of closed membership NGCs has increased dramatically—mostly in the Midwest, but there has also been significant growth on the west coast, and evidence that the NGC con-

cept has diffused eastward too. Folks in North Carolina might say: “are there other commodities being processed in the Midwest that might be applicable to North Carolina?” Well perhaps there are.

The single most common type of NGC is a corn processing cooperative producing ethanol. You might be aware that the gas additive MTBE (methyl tertiary butyl ether), which was originally used to replace lead in unleaded gasoline, has been found to be carcinogenic. Ethanol provides a similar function in raising fuel octane, but it does so in a more environmentally friendly fashion. Hence, there will be increased demand for ethanol as a gasoline additive. The ethanol farmers are merely getting on the “additive” bandwagon. There are also wheat co-ops, with wheat farmers selling wheat to their own co-op and producing bread (Carter 2000). So, farmers are becoming bread makers. Wheat farmers in North Dakota are making pasta. Hence, some wheat farmers are also becoming pasta growers. Turkey farmers in Iowa are processing them to meet Subway’s requirements.

There are egg-producing NGCs. There is, for instance, a cooperative in Renville, Minnesota, where members sell corn to their own poultry facility. Their chickens eat the corn, lay the eggs, the eggs are broken on site and sold to Pillsbury and McDonalds in the form of liquid egg, shipped by tanker truck into the twin cities. So if you’re in the Midwest there’s a good chance that if you have an Egg McMuffin it came from one of these farmer co-ops.

This large increase in new generation farmer cooperatives begs the question: Where are farmers getting the money to achieve this? Based on our survey, about 50% of the startup capital is coming from the farmers themselves. Remember, we are talking about a processing facility that might cost 20, 40 or even 60 million dollars, with farmers themselves raising somewhere around 40 to 50 percent of that startup capital. Once farmers raise about forty percent of a project’s capital requirements, they can expect to generate strong interest from both private lend-

ers and local community leaders—offering tax and other local development assistance. We asked the board of directors of these co-ops: “What were some of the factors contributing to your success?” We asked them on a scale of 1 to 5—with 1 being unimportant and 5 being very important—to what they attributed their success? Their answer was: markets and marketing perception; availability of experienced, professional managers; and the availability of local capital. These are the primary factors contributing to co-op success. They also said that marketing the product and attracting members to participate—recruiting farmers, who are very independently minded individuals—is a big challenge, a *very* big challenge.

So let me move to the conclusion. What is the potential for new generation co-ops? I believe there is great potential. I believe they can help producers achieve, as a group, objectives they could not achieve as individuals. What we have discovered is that farmers truly do have an entrepreneurial mindset. There are now examples of fledgling NGCs in the American Southeast. For example, two NGCs are exploring the potential for a soybean processing facility in North Carolina—the Grain Growers Cooperative is headquartered in Zebulon, North Carolina and Tidewater Soybean processors is located in Pantego (Associated Press 2002; USDA 2002). Farmers in Virginia are studying the potential for producer-owned ethanol processors (Virginia Farm Bureau 2002). Farmers in Georgia are investigating the feasibility of a pork-processing cooperative (Sunbelt Pork Coop

2002). Farmers across rural America are actively exploring how they can reach up the value chain to improve on-farm income and the economic vitality of their surrounding communities.

However, I cannot overstate the importance of a NGC hiring a professional manager. Many farmers believe they can do it themselves, and we have case studies to show that occasionally they can, but often they fail because they do not know the market and/or they do not have the time to devote to full-time management. The challenge of running a farm, working in an off-farm job *and* raising a family is usually too much for one person to handle. With the NGC, farmers must confront the fact that they will face increased risk for increased return on investment. A professional manager will help reduce this risk. I want to emphasize this point with a few successful examples from our case studies: Golden Oval Egg—a corn co-op selling feeder chickens and liquid eggs; Mountain View Harvest—a wheat co-op making bread; US Premium Beef - 21st Century Alliance with pinto beans, dairy, flour and tortillas, and so forth—successes, each and every one of them. With that, let me say thank you very much.

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