

# NEW GENERATION CO-OPERATIVES

## Part of a Revitalization Strategy for Rural Communities

by Roger Herman & Murray Fulton

New generation co-operatives provide a model for groups of agricultural producers to pool their resources so that they can capture a portion of the value chain extending from the farm gate to the dinner plate. Put simply, farmers are evolving from producers of agricultural commodities such as wheat or cattle, to producers of food such as pasta or steaks by becoming involved in the value-added processing of those goods. New generation co-operatives (NGCs) have become very popular in the American Upper Midwest states and are slowly gaining attention in Canada.

This article explores the relationship between new generation co-operative development and CED. After outlining the NGC model we review the development process successfully employed in North Dakota and Minnesota. From this experience, it is clear that while NGC development is not necessarily CED, CED is nonetheless an important factor in the development of NGCs.

### NEW GENERATION CO-OPERATIVES

New Generation Co-operative is the name given to the roughly 200 value-added processing, closed-membership co-operatives that have emerged in the past decade, first in North Dakota and Minnesota and more recently in neighbouring states and provinces. The new co-operatives are being formed by producers in such emerging niche markets as bison, Tilapia fish, and edible beans, as well as by producers of dairy, corn, soybeans, durum wheat, and

other traditional commodities. 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 co-ordination appears to be the driving force; in others the impetus seems to be a need to restructure markets in order to provide producers with 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.

The value-added focus of NGCs represents 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 pre-determined 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.

More specifically, two elements distinguish NGCs from traditional co-operatives: delivery shares and restricted membership. The different membership and financial structure stems from the NGCs' focus on processing. 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.

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 bi-

son) 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).

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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 the processing facility. In general, the NGCs have followed recommendations to raise 30-50% of their total capital requirements as member equity. Equity drives are held to solicit support and to 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 have limited or no 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 8%.)

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.

Shares can be traded after the initial equity drive, pending board approval. The share prices in the operation period reflect the returns that 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. Dakota Growers Pasta Company is an excellent example of a co-op that has pursued this expansion strategy.

#### **SUCCESSFUL NGC DEVELOPMENT**

It is clear that NGCs will not spontaneously develop. NGC development is a process requiring the involvement of a network of external agencies. To understand how such a development process can work, it is helpful to review the experiences from North Dakota and Minnesota. Likewise, such a process does not occur in a vacuum, and therefore examination of the environ-

ment or context for this development is equally revealing. While NGC development has spread beyond these two states, North Dakota and Minnesota are still home to a disproportionate share of these organizations and offer vivid examples of the results that a concerted and co-ordinated effort can make.

Just why NGC development has been so common in these two states is not a simple question to answer. There are many factors behind the phenomenon. In part, it is attributable to the common ethnic background of farmers in these two states and a long experience with co-operatives. There is the success of the early sugar co-operatives that were structured as NGCs, not to mention state governments which, regardless of political affiliation, were not hostile to co-operatives. Taxation regulations and the Capper-Volstead exemption from anti-trust legislation have clearly influenced the selection of the co-operative model (or the Limited Liability Company model) over other organizational forms.

While these factors help explain the organizational form taken by the farmer-owned enterprises that have developed, other factors are required to explain the formation of farmer-owned enterprises in the first place. Part of the reason lies in the economic and social conditions in which farmers found themselves during the late 1980s and the early 1990s. Simply put, the economic hardships of this period and the continuing decline of rural areas led farmers and rural residents to search for activities that would encourage economic activity. However, while this was important, it was not the sole factor. Similar economic conditions existed in other states during the same period and in Canada during a somewhat later period. Yet, farmer-owned enterprises did not form in nearly the same numbers in these other geographical areas.

An important factor responsible for both the formation of farmer-owned enterprises and their subsequent incorporation as co-operatives is the development support provided by state governments and other co-operative organizations. While space does not allow a detailed and comprehensive comparison of

the development support provided in North Dakota and Minnesota relative to other areas of Canada and the U.S., there is no question that the level of support in these two states has been higher.

The Centre for Cooperative Development in North Dakota and the St. Paul Bank for Cooperatives in Minnesota are examples of this development support. Interestingly, the purpose of the Centre for Cooperative Development is not solely co-operative development, but is rather rural business development. It is largely this focus that has led to the development of farmer-owned enterprises. These enterprises, in turn, have chosen the co-operative as their organizational form largely because of some of the inherent advantages it has over other forms. While tax advantages, anti-trust exemptions, ethnic considerations, and previous co-op experience have resulted in a preference for co-operative enterprises, these factors do not appear to have been the root cause of the development.

Development support in North Dakota

and Minnesota takes a variety of forms. Some of this support is in the form of development officers who work closely with groups that are exploring options. Other support comes from resources provided by the state for feasibility studies and business plan development. Still other support comes from the financial sector, whether it is the state banks or the St. Paul Bank

for Cooperatives, which not only stand ready to provide financing, but also assist the development of proposals for ventures with a strong potential.

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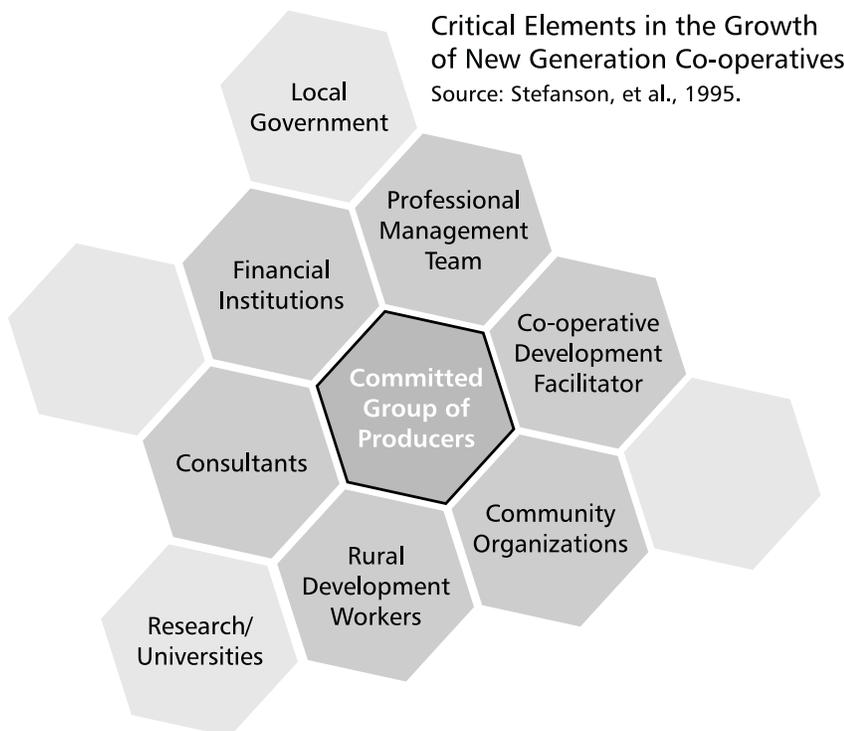
for Cooperatives, which not only stand ready to provide financing, but also assist the development of proposals for ventures with a strong potential.

One of the important factors in the support is the wide variety of organizations that are involved. Development support is not seen as the purview of only one organi-

**NGC DEVELOPMENT & CED**

At first glance, the development of NGCs does not appear to fit very well within a discussion of CED. A review of the characteristics of CED, as presented by the Canadian CED Network, quickly disqualifies NGCs. For example, CED is characterized by inclusiveness rather than the exclusiveness typical of NGCs. In CED, the benefits are to the community at large rather than to the specific member/owners of NGCs. However, while NGC development and CED are not the same thing, they are closely related. The general processes of both types of development are similar and an overall CED approach needs to be in place in order for NGC development to occur.

The diagram on this page offers a sense of the various pieces and relationships present in successful NGC development as described earlier. The processes and relationships are best described as a network rather than a linear chain of events. Typical components of a CED initiative could easily replace some, or all, of the labels on the depicted components. In such a case, a NGC development strategy might form a single component of a larger CED initiative and would be dependent on the various other components for viability. In both cases the various pieces have multiple relationships and roles. The strength or integ-



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analysis, co-operative theory, and community development. Widely published in his field, he is the author, co-author, and editor of numerous journal articles as well as a number of books and reports, including *Canadian Agricultural Policy and Prairie Agriculture*; *The Changing Role of Rural Communities in an Urbanizing World*; *Co-operatives and Community Development*; *The Economic Importance of the Co-operative Sector in Saskatchewan*; and *Co-operatives and Canadian Society*. Contact Murray at (tel) 306-966-8507, (e-mail) Murray.Fulton@usask.ca, and visit the website of the Centre for the Study of Co-operatives at [coop-studies.usask.ca](http://coop-studies.usask.ca).

rity of the whole model is dependent on these multiplicities. Lack of this type of comprehensive framework helps explain why NGCs have not developed more quickly in other jurisdictions.

When an NGC development strategy is part of a larger CED initiative it can help to revitalize a rural economy. A recent study of the U.S. Department of Agriculture revealed that new generation co-operatives are having significant positive impact on rural communities in various states of the U.S.A. This impact includes the benefits to the community of decisions made locally by people with a vested interest in that community. It also includes a renewed self-help attitude. The study identifies the various multiplier effects ranging from increased tax base, to increased local retail sales, to the creation of additional new businesses. Such activity spins off the construction of new homes, schools, and other community facilities, and the cycle continues. The study also identifies the enhancement of social cohesion in addition to the economic benefits.

Is this possible in other rural economies? Only if all the pieces required are in place and accessible, and if the agents involved in driving such an initiative co-ordinate their activities in true CED fashion.

NGC development can contribute to the revitalization of rural economies when such efforts are a component of a larger CED strategy. A variety of external agencies need to form part of such a strategy and their efforts need to be appropriately co-ordinated. NGC development is not the same as CED. When it *is* part of CED, experience has shown that the development of NGCs can have a significant positive impact on the host community. 

#### RECOMMENDED READING

We base our description and analysis of new generation co-operatives primarily on the following sources, and

strongly recommend them to readers for further information. For a fully referenced version of this article, please contact the authors.

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