Quentin Burdick Center for Cooperatives

Bloomquist Lectureship Series 2000

New Generation Cooperatives and the Future of Agriculture

FEATURED PRESENTER:

Bill Patrie

Director

Dakota Cooperative Development Center and the North Dakota Rural Electric Cooperative's Rural Development Division

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QUENTIN BURDICK Center for COOPERATIVES

Dept. of Agribusiness & Applied Economics
NDSU Dept. #7610
PO Box 6050
Fargo, ND 58108-6050

Located at
NDSU's Barry Hall, Suite 400
811 2nd Ave N
Fargo, ND 58102

www.ag.ndsu.edu/cooperatives

NDSU NORTH DAKOTA STATE UNIVERSITY

(Patrie began his address with a poem he wrote reflecting his thoughts on the current situation facing farmers)

The Young Farmer

The young farmer looks at the rain outside and searches for the remote,
That thing can hide.
Sinks into a chair, elbows on his knees
And clicks on the ag news on the old tv.
The reporter talks with a dreary tone ... "beans, corn, wheat are all down."
Argentina's crop looks good, Brazil's is fine,
Australia's rains came at just the right time, the safety net is gone.
It's every man for himself and he tosses the remote on the tv shelf.
He walks through the kitchen and pushes open the door,
The rain is heavier now, it is beginning to pour.
He runs across the muddy yard and the rain hits his face and it hits it hard.
The truck door shuts like banging tin
And the rain on the roof makes a noisy din.
The engine starts with a soft little bark.
He pulls on the lights. It's still half dark.
And drives to town, sixty miles away,
Parks his truck in front of an office building that is mostly gray.
Sits down in a chair in a waiting room
Painted off-white colors of a newly built tomb.
When his name is called he choked back a sob.
This is the first time he has ever asked for a job.

Good news! I am glad for this opportunity to share good news with farmers. It is also good news to those of you who sell services to farmers and care about their well-being. The good news is this: through intelligent and courageous cooperation the farmers of North America can redesign the agriculture and food

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production system. In this new world which we will design together, farmers will be prosperous, rural communities will thrive and the consumers of food products will trust us. Even in the depths of this current farm depression, I believe in opportunity—opportunity so bright it's nearly blinding.

Bad news – I also bring bad news. The bad news is this: If we do not redesign the current system, the production of commodities in North America by family farmers will be slowly but largely displaced by commodities produced in other parts of the world. While this scenario does not mean the loss of the food industry in North America, it does mean the end of traditional farming as we have known it.

Why? Why can't farmers raise commodities like they use to? Many reasons can be given, but they can be summed into three categories—public policy, perfect competition and technology.

Public policy – Public policy is in part aimed at insuring that national populations have enough to eat at prices people can afford. If the general public in United States and Canada cannot be made to fear hunger in real ways as a consequence of losing farms, or if they cannot be made to fear high prices, they will allow the loss of the farms.

I do not suggest that Europe or Asia will ever allow the loss of farms and the consequential reliance on imported commodities—they have seen food they couldn't afford or no food at all. But U.S. and Canada are different—our vast and fertile lands under the skilled hand of our industrious farmers have more than fed us all, and we have historically relied on exports to carry away commodities we could not consume ourselves. Hunger and high food prices are not top of the mind issues in the United States or Canada.

Our two nations are democracies--representing overwhelmingly urban populations. Over time, public policy will reflect the "will" of the people. It is only "over time" because in fluid democracies the public, "will" can never be precisely known, and the electorate allows contradictions within positions. Public opinion is often wave-like, surging and retreating on any given issue, but the shoreline for agriculture is moving in the direction of less importance. To restate the bad news related to public policy regarding agriculture—If over time, commodities can be imported into the United States and Canada cheaper and equally reliable to our own farmers' production, public policy will allow it to happen. Agriculture can cry wolf—but if the wolf does not come after numerous warnings, our cries will simply be ignored by the electorate.

The theory of perfect competition – The marketing price of a commodity will (over time and with competition) decrease to the production cost. It has been my observation that farmers have frequently produced and marketed below their cost of production since market prices could not be known at the time of planting or breeding. Even two years of successive losses may not deter a farmer from attempting to produce a commodity without a reasonable profit. But over time, bankers will refuse to lend if profitability is based only on emergency or disaster payments.

Technology – Technology, likewise is a threat to our current agricultural system. Technology was the fountainhead of our prosperity. Farmers invented and adapted their way to extremely proficient farms. In the 1930s one United States farmer could supply 9.8 persons in his own country and abroad. By 1994, one farmer could supply 129 people in the United States and abroad. It was technology that

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made this possible, the steam engine for shipping by boat and rail, barb wire, the internal combustion engine, electricity, rural electrification, plant and animal genetics, herbicides, pesticides, portable refrigeration, radio, television, communication technologies, jet engines, and the Internet.

Technology no longer belongs to only those North American farmers with the capital to buy it and apply it. Trans-national corporations have nearly unlimited sources of capital to purchase, develop and employ technology where ever they can make the most money. Trans-national corporations currently control the food system in the United States and Canada. Our national governments, and governments worldwide, respond to the needs of these companies by developing strategies that can produce commodities at the lowest worldwide prices. As farmers, there is something bothersome about this system of commodity production at the lowest price. Perhaps it is the genetic memory of European serfdom.

Adjusting the current system – Many in both of our countries believe the system only needs modest adjustment. Both nations puff out their chests as protectors of the farmer—suggesting either trade barriers or collective marketing strategies that are designed to give "their" farmers an advantage. They define external enemies and promise to fight them. By defeating these enemies, it will be better, they say, for their farmers.

Many national farm and commodity groups weigh into the arguments of who is right and who is at blame by separating out their constituents or commodities for preferred treatment. All of this amounts to a din of voices childishly quarreling in the pilot house of the "Titanic". The passengers on this ship need to quit quarreling and change direction.

Toward more perfect competition – The quarreling has been over direction. The assumed direction is that government actions should be targeted to helping farmers compete in the world market. The question has been " how?" If we could assume for a moment that farmers could agree on the "how", what would they win? Farmers would become lowest cost producers at the highest possible volumes. This way out leads back in!

How to give farmers the ability to compete is, in itself, an absurd question. Farmer competition is near perfect and cannot be made much better—in fact, farmers want their governments to make it less fair. Farmers currently compete with other farmers. Farmer to farmer competition is based on individual ability to reduce production costs and increase prices. Individuals then seek to cooperatively compete through organizational advantages of size, supply, control, government support, regulations and customer perceptions and preferences.

The beneficiary of this robust competition is not the farmer. Try as they might to fix the "system through adjustments" that make the competition "fairer" or to "level the playing field," most farmers will not likely survive the price competition that is coming. Some processors will survive and thrive, some marketers will be profitable. Most of the current participants in the world food system don't need to change much to survive. It is ironic that only farmers, and those who sell to farmers, must change the system to preserve a place in it for themselves.

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Help from regional cooperatives not enough – Farmers own large regional cooperatives that market commodities or provide inputs. It is natural that they look to these organizations to find ways to continue to farm. These organizations are trying to gain efficiencies that can benefit the farmer. Regional cooperatives are trying consolidations and mergers, acquisitions, and seeking public investors, to gain maximum operating efficiencies to lower farmer input costs or increase per bushel margins. Some are experimenting with value-added manufacturing. In spite of these serious efforts, commodity production will not be enough for a farmer to live on. All farmers, and the regional cooperatives they own, must understand the difference between leaner and meaner and economic starvation.

Handling and processing plants not enough – Economic starvation can occur even in a land of apparent plenty. The sight of a processing plant that buys commodities was, at one time, a welcome sight. A main line railroad terminal that could load unit trains was a sign of progress. Commodity handling and processing facilities were signs of investment in the infrastructure of agriculture--an encouragement to keep on farming because farmers believed their products were needed. In North Dakota, three companies raced to build sunflower crushing plants. Sunflowers were worth $12 per hundred weight. The plants now crush other oil seeds in addition to sunflowers and offer $6.80 per hundred weight to get all the sunflowers they want. Sub-terminal elevators are still going up in North Dakota, while wheat prices fall.

When the last production side efficiency is gained, and the processor can get commodities cheaper at another location, they will leave. The kill plants for cattle used to be in Chicago at the rail heads, until IBP discovered it was cheaper to buy cattle near the feedlots. Each town used to have a bakery until it was found to be cheaper to ship bread by truck. Textile mills moved from the North Eastern part of United States to the South where the cotton was grown and taxes were cheaper, only to leave for the Philippines and Malaysia, where it became cheaper to make clothes.

The lesson to be learned from observation is that having a processing plant built in your neighborhood, that is not owned by farmers, is a sure signal that you are expected to be the low cost producer. Instead of raising commodity prices, it may lower them. I have personally seen profitable processing plants for milk and potatoes closed, with limited resale value, so a company could gain a greater processing margin somewhere else.

Food headed toward perfect competition – I have more bad news that is related to information technology, the Internet and brand names. Advertising and brand name identification was once a way to secure markets. Service was another. The Internet may well eliminate those traditional ways of market differentiation. The Internet and information technology will likely change how people buy food products. Shopping for groceries will get easier, and with the aid of computing capacity inherent in the Internet, the consumer will force food companies into near perfect competition. A buyer will, at the touch of a button, be able to select from dozens of brands, which is the best performer at the best price, and have it shipped directly from the factory to the kitchen door, without having read the label. The brand name and logo may even be eliminated to avoid cluttering your computer’s memory capacity with unnecessary information.

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Doing two things at once – I said I came with good news, so how do farmers get out of this mess? Think differently! They must do two seemingly contradictory things at once. They should worry about all of the passengers as human beings and design a system that will save as many as possible. Collectively, farmers should not refuse to act because they cannot save everyone.

Turning the ship – In the pilot house arguments, the prow of the ship never changed course because we could not move the rudder. While declining in percent of the Gross National Products of our two countries, Agriculture is still a huge economic sector. Turning this sector in a new direction requires a great deal of force on the rudder—more force than farmers have. They must find ways to make the rudder easier to turn. How can they do that? Ocean going ships have massive rudders. With millions of gallons of water flowing by the rudder, the rudder itself is hard to turn. Ocean going ships have a trim tab on the rudder which is really just a very small rudder itself. By turning this small rudder, it catches water and pulls the main rudder in the direction you wanted to turn, thereby steering the ship.

New generation cooperatives the key to changing direction -- The trim tabs in agriculture and the food system are new generation cooperatives. New generation cooperatives will demonstrate a way to gain significant economic advantages for farmers and increase system wide efficiencies and accountability in the information age. By this demonstration, others will want to go there and add their pull to turn the main rudder.

Example of opportunity – So where is the brightly lit opportunity? I have compared the dollars received per bushel for Western Canadian Amber Durum, by Canadians, # 1 Hard Amber durum by United States producers and members of Dakota Growers Pasta (DGP). These are the average actual dollars paid to producers in North Dakota and Manitoba on a per bushel bases in US dollars adjusted for currency exchange rates and transportation differentials:

Year	USA	Canada	Dakota Growers	DGP vs USA	DGP vs Canada
1994	4.67	4.92	5.95	+$1.28	+$1.02
1995	5.75	5.04	5.80	+$0.05	+$0.76
1996	4.53	4.28	6.52	+$1.99	+$2.24
1997	4.91	4.44	6.74	+$1.83	+$2.34
1998	3.00	2.94	6.64	+$3.64	+$3.70

Source, Manitoba Agriculture, North Dakota Wheat Commission, USDA Ag Statistics, Dakota Growers Pasta Company's, 1998 annual report.

Why does vertical integration work? Vertical integration in the pasta industry by farmers allows the accumulation of profits at whatever level they may be occurring, whether it's in the production of durum, the milling process, the manufacturing process or the distribution process. In the example of

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the new generation cooperative used above, the net return per bushel to new generation cooperative members fell only 10 cents from 1997 to 1998 even though the price per bushel paid to non-members in the United States fell $1.91. That 10 cent drop may have been due to the increased competition and price reductions in the sale of pasta.

Discipline required to achieve success – While this good news is simple, achieving these results are complex. Vertical integration through a new generation cooperative requires several disciplines that many farmers find difficult.

Equity investment – The first discipline is an equity investment proportional to the patronage of the cooperative. The farmer must purchase one equity share for every single unit of production they intend to deliver. The equity investment is at risk and can be lost. The farmer is the owner of the company, and under the cooperative structure, must elect a board of directors who hire management and run it. Food companies are not simple to direct.

Production contracts – The second discipline requires a commitment to produce to a specified quality and volume and to deliver to the processing facility. This is a binding contractual obligation between the member and the cooperative he/she owns. The entire processing capacity of the facility is supplied by members who have contracted to raise the commodity to be processed.

Rewards – These two disciplines of equity investment and contractual marketing obligations create exciting business rewards.

Share appreciation – The most impressive of these rewards is the appreciation of share values. The initial share price paid by producers in the new generation cooperative in the example above was $3.85. That entitled and required the investor to deliver one bushel for every share owned. Should a farmer wish to discontinue farming or raising durum, they have the right to sell that share to other eligible farmers. These shares can appreciate or depreciate based on actual earnings. The trade value of the share is usually 7 or 8 times actual earnings. In this case, the new generation cooperative needed additional durum without additional money and authorized a 3 for 2 share split. Even after that split, shares that cost $3.85 are trading at $14 to $15. The share trading price has continually appreciated even though there have been two subsequent offerings to raise additional equity at lower than the trading price. Original members have purchased most of the new equity offered.

Single taxation – A second benefit of these disciplines is single taxation. The cooperative passes through its earnings to the members in the form of patronage for durum, thus avoiding federal corporate income taxes on the value added converting durum to pasta.

Efficiencies – A third benefit is reduced procurement costs and associated efficiencies. Scheduling can be done to insure timely and uniform delivery to the mill, reducing the need for on-site inventory storage and carrying costs. Quality is also assured, allowing the company to sell product in advance of production knowing that the quality grain will be there.

Alliances – A fourth benefit of this structure is the ability to form alliances with manufacturers and marketers already in the business. Cotton growers in Texas bought a denim plant from a brand name

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manufacturer and contracted back with that company to operate the plant and market the blue jeans. It reduced the tax burden of the plant, assured a consistent supply of cotton and provided better bottom line numbers to both the cooperative growers of cotton and the denim manufacturer.

Examples of alliances – There are two examples in the corn syrup business of these alliances. Minnesota Corn Producers Cooperative at Marshall, Minnesota have accepted a preferred stock investment in their company by Archer Daniels Midland and Pro-Gold of Wahpeton, North Dakota has signed a management and operating agreement with Cargill.

The United States' fourth largest beef packer, National Beef, which is owned by Farm Land Industries, sold an ownership position to US Premium Beef, a cooperative made up primarily of beef feedlot operators. In this case, Farm Land Industries is a traditional federated cooperative and U.S. Premium Beef is a new generation cooperative. Both cooperatives have reported better earnings as a consequence.

Questions – Several questions gnaw at most farmers about new generation cooperatives:

1. Is it a good investment of my money? Or, more recently, where will I get the money to invest?

2. Will I be trapped in my uniform marketing agreement if commodity prices spike?

3. If this is a good idea, why haven't the big companies already done it?

Answers – The answers may have to be experienced to be believed but here is what I have found:

1. Wise investment? Dakota Growers Pasta Company reported a 28% average return on equity in 1998. Farming generally returns 2% or less. There are examples of losses, however it appears that investments in successful new generation cooperatives will earn more than a comparable investment in land or equipment and is more likely to appreciate. Money is not easy to come by, but corn growers who built Pro-Gold in Wahpeton North Dakota raised $51,000,000 and attracted another $49,000,000 from sugar beet cooperatives.

2. Trapped at below market prices? It could happen but is not likely. We know that privately owned companies sometimes pay more for a commodity than it is worth as a finished product and then make up those losses by paying less than it is worth some other time. It all works out over the long pull.

3. Why haven't the big companies already done it? Big companies are like big ships, they are slow to turn. Organizing from scratch without any fixed assets is easier than liquidating or acquiring them. New generation cooperatives have the advantage of picking and choosing among appropriate technologies, facilities, locations and markets, existing companies don't. New generation cooperatives can form alliances easier than existing competitors. New generation cooperatives have active investors who care about the long term viability of the business rather than passive investors who want the highest quarterly earnings possible.

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Invisible opportunities – Bright opportunities can still be invisible to many farmers and farm services suppliers because of perception problems. The farmers' ability to see and seize business opportunities in the food system is restricted by how they perceive themselves. Ocean Spray was started by dairy farmers in New England trying to find a use for boggy farm land. They no longer see themselves as dairy farmers. Canadian farmers may be blinded to opportunities because of existing marketing and political structures, self-perceptions and most of all by the inability to imagine. Albert Einstein said,

"The human being experiences himself, his thoughts and feelings as something separated from the rest--a kind of optical delusion of our consciousness. This delusion is a kind of prison for us, restricting us to our personal desires and to affection for a few persons nearest us. Our task must be to free ourselves from this prison by widening our circle of compassion to embrace all living creatures and the whole of nature in its beauty."

(The Fifth Discipline by Peter Senge, p. 70) Imagination is more important than science, economics or politics. It is through our imagination that we create a new way to accurately view the current reality.

Barriers – Farmers everywhere are blinded by their inability to imagine, and seek instead the comfort of known barriers. Cattle press up against fences, people build their houses next to the highway by-pass even if it is built three miles from town. The space between those homes and the existing city residents will be filled in later. When asked to imagine the future for agriculture, our first thoughts go to known structures. They don't have to. Columbus proved that the earth was round by first imagining that it was, and assuming that you could get to the west by sailing east. He didn't focus on the edge of the earth.

Imagine – Imagine with me that farmers reverse engineer the food system in North America. They look at those parts they want to own, those they want to lease, and those parts that can be provided by alliance partners. Through imagination, farmers can see clearly all the way to the human beings eating food. Now that farmers can see these people, they can learn from them, listen to them, talk to them, and eventually, get to know them as fellow human beings. Now that we know each other as persons rather than demographic data sets, we can buy goods and services from each other with a great deal of trust. Their success is ours and ours is theirs. Imagine that no one can come between you and your customer unless you let them. Imagine that you are not afraid of the future but look forward each day to the opportunities you will discover—imagine what you will find!

Opportunities – Bright opportunity markers are flashing like neon lights--in beef, in dairy, in cereal grains, even in the potential to attract people to live in the rural places of this continent and share their lives with us. The information age is upon us and it is freeing us from the prison of the industrial age. For the first time in the history of the world, we have escaped the barriers of structures both physical and political. Information collapsed the Berlin wall, it will reunite Cuba with the Americas, and it will bring Farmers of the world together to build a new food production system. Information is the carrier of truth. I have come to tell you good news. Agriculture will not die, but will be reborn. What this new system of food production will grow up to be in the next century depends on what you imagine it will be. And that is the truth.

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Roger Johnson (North Dakota's Agriculture Commissioner), and Dr. Keith DeHaan (a livestock consultant) contributed the perfect competition theory. Peter Senge is the source of the trim tab idea and the quote from Albert Einstein. Theologian Martin Buber taught me that people are never "its" (or demographic sets) and customers are always people--of equal importance to the producer (I and Thou). Porras and Collins taught the sustaining power of "vision." Rich Karlgaard helped me see the power of the Internet to free us from the prison of distance.

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And finally, thanks to the thousands of farmers who believe and invest in new generation cooperatives and make them work. You are the reason for the object of success.

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Bill Patrie

Patrie is currently the president of the Rural Development Finance Corporation, a statewide development corporation and a trustee of the Renewable Resources Research Institute, a multi-state technology development corporation.

Patrie grew up on a north central North Dakota farm near Fessenden, North Dakota. He received a B.A. degree in political science with a minor in religion from Anderson University in Anderson, Indiana and a Master's degree in public administration from Ball State University in Muncie, Indiana. He directed the North Central Planning Council in Devils Lake, North Dakota, and was the economic development director for the state of North Dakota for five years. Patrie has been involved in the start-up of numerous value-added cooperatives in North Dakota.

Bill and his wife Marcia have three children—Katie, Ben, and Rachel—and live in the Missouri River Valley north of Bismarck.

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