

NGCs Cooperatives Editorial:

New Generation Cooperatives (NGCs)

Section I - Introduction

Contained in this executive report is a clear formula for farmers to regain control of their destiny. This formula is outlined in the "New Generation Cooperative (NGC)."

The basic philosophy provides for the farmers to band together under a corporate type structure and share in the value added profits of their crops by cutting out all the middlemen.

The NGC provides for the farmers to maintain their independence while sharing their value-added profits.

There have been many federal reports outlining the possible and real field success stories of these NGCs. However, by adding a biodiesel plant with one dollar a gallon government subsidy to a NGC offers substantial opportunities to these farmers never realized before by any other startup NGC and greatly reduces the risk of failure of this type of organization.

It must be clear to all of the perspective investors/farmers of the NGC that when a biodiesel plant is added to the soy or canola crushing plant, a whole new set of value-added factors become available to the NGC. Value added includes the elimination of the "middle man" that extracts profits along the processing train i.e. storage, transportation, processing oil & animal feed, storage again, transportation to distributors, distributors & packaging, retailers, and sales back to farmers and other consumers. There are also many local and federal biodiesel programs that either exist or will become legislation soon such as state mandates, biodiesel subsidies, federal USDA low cost loans and direct grants for alternative fuels.

All the programs directly add substantial value to the soybean/canola crushing/biodiesel NGC never before realized by any previous farm cooperative. Furthermore, the initiators already have the infrastructure to support a soybean crushing plant. i.e. 130 acres of industrial property with permits, railroad spurs, supporting structures, electric utilities, and most importantly, they have an operating biodiesel plant on the site that currently has a 5 million gallon per year production capacity that can easily be expanded at minimal cost to 30 million gallons per year and the expertise associated with the production and marketing of biodiesel.

NGCs Cooperatives Editorial:

Besides the value added profit motive and the availability of federal and state government sponsorship and grant programs there are also several other extremely important advantage for members of the NGC as follows:

- 1) It provides its members total local sustainability, independent of world crisis
- 2) The NGC member will always have fuel to run its tractors and food for its farm animals regardless of wars, embargoes, peak oil shortages or even lack of US refining capacity caused Mother Nature (hurricanes, floods, etc.) or other causes. The NGC member is indirectly acquiring an insurance policy protecting him against unstable world conditions.
- 3) NGC members must remember that the U.S. possesses only 2% of the known world oil reserves, however, the U.S. burns each day 25% of all the oil produced in the world. This is not a sustainable equation. The U.S. imports over 60% of its oil each day mostly from unstable countries, which can cause unimaginable chaos in the U.S. fuel supply even with minor developments.
- 4) The NGC member will feel secure by removing himself from this unstable supply and also help the U.S. become more energy independent. As the NGC expands its production so does the value of its units (shares).

As in any corporation, the shareholders who invest the initial funding and bear the greatest risks also receive the highest rewards. After the NGC is operating the units will appreciate in value. Therefore, if the NGC should decide later to use equity financing for expansion, the units then sold will bear a much higher price.

Section II - Philosophy of New Generation Cooperatives

(Incorporating a Crushing Facility with a Biodiesel Production Plant)

New Generation Cooperatives (NGC) is different from conventional cooperatives in both concept and operation. In fact, its differences outnumber their similarities.

These differences and similarities will be outlined in this report NGC differ from conventional cooperatives with regards to:

- 1) Basic Philosophy,
- 2) Membership,
- 3) Delivery Rights,
- 4) Value-Added objectives,

NGCs Cooperatives Editorial:

- 5) Dependence on Local Leadership,
- 6) Equity Entrance Requirements,
- 7) Require Equity of the Member's Patronage and a Member's Equity,
- 8) Negotiability of Equity Shares, and
- 9) Up Front Investment Requirements to Solve the Horizon Problem.

Each deserves comparison with conventional cooperatives.

1) Basic Philosophy

A NGC is basically an extension of the farm firm. The extension provides a value-added function that individual farmers cannot efficiently perform alone. As such an extension, incentives are provided to the farmer to invest in, provide quality raw materials for, and make active inputs into the management of "our" business. Moreover, the objective of the business is to provide a substantial portion of the farmer's income from the NGC's residual revenue after expenses have been paid at the end of the year. For example, one NGC pays the farmer/investor only 60% of the market price of his grain at the time of delivery with all the rest held until the residual revenue is determined at the end of the year. Note that the NGC's objective is to pay the farmer for the value he adds to his raw materials and not to accumulate earnings for plant expansion. In fact, if expansion is sought, it is financed the same way the NGC was originally funded, i.e. with equity fund drive supplemented with debt financing.

Therefore, at the end of the year the farm receives not only the balance of the 40% for their crops but also all the value added profits including their share of the biodiesel sales from the biodiesel plant.

Contrast the above philosophy with that of conventional cooperatives. Characteristically, conventional cooperatives retain some portion of the members' patronage dividends for several years to grow the business. When eventually paid, those dividends are at face value and are unrelated to the enhanced value of the expansion they helped to finance. Clearly the basic objectives of the two types of cooperatives are radically different.

2) Membership

The above allude to this distinguishing difference - a close membership. A closed membership means just that, either the farmer takes an equity position in the NGC or he is not a player. There is no middle ground. A farmer is either in or not.

NGCs Cooperatives Editorial:

The difference in membership dimensions clearly segregates NGCs from other cooperatives. In some respects NGCs are very similar to privately held firms with regards to this characteristic.

3) Delivery Rights

This section should really have the heading of "Delivery Rights and Obligations." This is to say, the farmer not only buys the rights but also is obliged to deliver a predetermined value of the commodity in question. This feature is one of the keys of success of the NGC. An assured supply is obtained during the fund-raising drive. The maximum number of delivery rights is determined by the size of the plant needed to be efficient. That size of investment is divided by the value of raw materials (thereafter referred to as feedstock it will require in order to determine the per share price of the membership delivery rights. If the farmer fails to deliver his assigned amount of feedstock after the facility is operating, the NGC can buy it on the open market and charge it to his account. This contractual relationship clearly links the farmers to the NGC as the value-added extension of this business.

The delivery rights dimension of the NGCs is not only essential for the efficient operation of the value-added facility but also is highly attractive to the farmer who sees it as the opportunity to enhance his income. Neither of these features are characteristic of the relationship of the farmers in conventional cooperatives.

4) Value-Added Objectives

As stated above, NGCs exist to add value to agricultural commodities. NGCs are a deliberate creation that enables farmers to capture additional revenues from successive stages of the marketing channel. NGCs are an effort by farmers to reap the benefits of vertical integration and gain more control in the marketing of their commodity with the expressed goal of increasing profits.

As contrasted with multi-commodity conventional cooperatives, this enables NGCs to concentrate on one commodity. With this specific focus comes the opportunity to become both: 1) technically efficient, 2) a marketing specialist. General-purpose cooperatives have limited opportunities for both.

5) Dependence on Local Leadership

Solid local leadership is absolutely essential for NGCs to be successful. When it means is that a group of producers must have the collective will to create the new business and support it. Given the specific focus of these value-added, single

NGCs Cooperatives Editorial:

commodity enterprises, members of the local group are likely to have a number of things in common. Local dealers must be willing to not only commit considerable resources to the venture but also be willing (and have the ability) to persuade their peers that the NGC is a good investment. Obviously, this is a more difficult task at the NGC's inception than after it has established its track record. The NGCs must have these champions of the cause.

6) Equity Entrance Requirements

Up front equity investments by farmers in NGCs clearly differentiate them from conventional cooperatives. Since a given number of units to be processed are associated with a unit of equity investment, farmers purchase as many units as fit their operations. Usually 30 to 50% of the investment cost of the NGC is raised in this manner.

7) Require Equity of the Member's Patronage and a Member's Equity

As mentioned above, a member's equity in a NGC entitles that member to deliver a specific quantity of the commodity to which value will be added, usually via processing. This constitutes a given proportion of the plant's capacity and hence its potential residual earnings. Since a member's patronage dividend is a proportional amount to those residual earnings, equality is maintained between patronage and equity.

8) Negotiability of Equity Shares

Most NGCs are likely to out live their members. Hence, some method of disposing of their equity shares must be available to investors. This has been done by making them negotiable. Over time, the share prices can be expected to reflect the earnings capacity of the NGC for providing its value and function. In light of the fact that the equity shares carry with them delivery rights and obligations, the potential field of buyers is likely going to be limited to producers of the selected commodity. Although limited experience has been obtained with regard to equity share transactions, NGCs initial sales suggest an appreciation in value as the prospects for future residual earnings increases (Cropp, 1996; Lawless, 1996)

Summary of Concepts

In many respects NGCs are unique organizations. Their value-added focus and the equity investments required of a close membership make them somewhat unique in concept.

NGCs Cooperatives Editorial:

Role of Initial Managers

Two items mentioned above bear repeating. First, the overriding or special handling motivation for NGCs is economics. The desire to make a profit by adding value through processing is the "engine" behind NGCs. As such, the profit motive must be strongly held by the farmers who produce the basic commodities. Second, these producers must have the will to make major investments themselves and persuade peers to do likewise. No external stimulus can substitute for that will.

Not only do individual producers need to have that will but also it must be transformed into a group will. This comes in two stages; the first must characterize the planning group.

Differences must be ironed out in orders for that group to go forward with the feasibility study (especially when obtaining its funding) and the subsequent business plan. The second expression of will must be manifest in the equity fund drive. If one-third to one-half of the cost of the NGC is obtained from the sale of memberships during delivery rights the project will have a high probability of the remainder being funded successfully with debt capital. Motivated, determined producers are clearly an absolute necessity for project initiation.

Feasibility Studies, Business Plans and Other Requirements

Feasibility studies and business plans are, at best, forbearers of the economic reality to come. If well prepared, such analyses will assist the establishment of a successful business in a high competitive world. Not only must the plans be well prepared but also the business, when established, must be managed by astute businesspersons. The fact that the new value-added firm is an NGC does not provide any protection from the competitive forces that will constantly provide challenges.

Historical Note:

The Minnesota Corn Processors Experience

Minnesota Corn Processors was established as a cooperative in 1980. The corn wet milling plant began operations in 1983. Farmers who were disillusioned by corn prices established this cooperative. They banded together, investigated the possibilities of owning their own corn processing plant. By selling their corn to

NGCs Cooperatives Editorial:

themselves, they could increase the value of the corn processed, thereby controlling their own destiny while providing the net return on their investment.

The members have agreed to limit membership based on the capacity of the plant. Additional membership and capital stock have been sold in recent years to finance growth. In 1991, after several years of profitable operations at near the 15,000,000-bushel capacity, the Board of Directors announced plans to built a second plant in Columbus, Nebraska. Two years later, the capacity of the plant was doubled and in 1995, \$285-million was spent to upgrade the plant in Marshall to produce high fructose corn syrup. In 2003 the two plants milled 131-million bushels of corn produced by over 2,400 members. The plants also refined ethanol.

The Minnesota Co-op was so successful that ADM offered to purchase the Co-op, which ended up with some litigation because Co-op members did not want ADM to purchase it.

This editorial is the only editorial by Joseph LaStella that was not nationally published; it was only given to state and federal organizations and selected industry participants. Many thanks to the Tennessee Valley Authority, North Dakota State University, Government of Alberta Agriculture and Rural Development, Missouri Department of Agriculture, Iowa State University, and many others who have created many of the concepts contained in this unpublished report.