Understanding Cooperatives: Agricultural Marketing Cooperatives

Cooperative Information Report 45, Section 15

UNITED STATES
DEPARTMENT OF
AGRICULTURE

RURAL BUSINESS–
COOPERATIVE SERVICE

MAY 1998

DEVELOPED BY
MARC WARMAN
TRACEY L. KENNEDY

Marketing cooperatives are found in every region of the United States and handle most types of farm product.

A marketing cooperative is a business organization owned by farmers to collectively sell their products. It allows producers to accomplish collectively functions they couldn't achieve on their own. Most agricultural producers have relatively little power or influence with large agribusinesses or food companies that purchase their commodities. Joining with other producers in a cooperative can give them greater power in the marketplace. In addition, cooperatives can give producers more control over their products as they make their way to consumers by allowing them to bypass one or more middlemen in the market channel. Farmers capture more of the returns that would otherwise go to others.

WHAT CO-OPS DO

Agricultural marketing cooperatives perform many functions. They may assemble the products of a number of producers into larger lots to facilitate more efficient handling and more competitive sales, and then grade and ship these lots to market. Some marketing cooperatives perform first-stage processing such as ginning cotton or hulling nuts while others vertically integrate by processing products for the consumer or industrial markets.

Marketing cooperatives enable producers to 1) correct market failure where prices are too low or buyers have left the market; 2) provide a service not available otherwise; 3) gain market power (negotiating power) against much larger buyers; 4) spread risks and costs; and 5) have enough volume to operate a processing plant efficiently or enough to meet the demands of buyers.

Marketing cooperatives are found in every region of the United States and handle most types of farm product. Tht importance of these cooperatives to particular commodity sectors varies. Cooperatives account for 86 percent of total farm value of all milk marketed in the United States; 41 percent of the cotton; 40 percent of the grains and oilseeds; and 20 percent of the farm value of all fruits and vegetables.

Agricultural bargaining cooperatives are a special type of marketing cooperative. They negotiate with buyers, usually processors, on behalf of their producer-members for price and other terms such as quality and timing of delivery. Representing large volumes of products gives bargaining associations more market power and allows them to be more effective in negotiations than individual producers. These cooperatives usually do not own the farm commodity and usually do not physically handle the product. Farmers sell directly to processors at the price negotiated by the cooperative. Bargaining cooperatives are most common in processing fruits, vegetables, specialty crops, dairy, and sugar beets.

Bargaining cooperatives are most common in processing fruits, vegetables, specialty crops, dairy, and sugar beets.

How Co-OPS Are Organized

Marketing cooperatives may be classified according to how they are organized, which is usually based on membership affiliation, control, and often, area covered. There are three main types of organizational structure: centralized, federated, and mixed.

In centralized cooperatives, membership is made up of individual producers. Control and product volume flow from producers directly to the cooperative. Patronage refunds flow from the cooperative back to the producer. These cooperatives usually serve a local area or community. Their functions are often limited to the first few steps in marketing, such as assembly and grading. A few centralized cooperatives are larger, operate in several States, and provide more complex functions, such as food manufacturing. Most cooperatives are centralized.

Federated cooperatives have local, centralized cooperatives as members, which in turn are owned by local producers. Federated cooperatives are often quite large and cover wide geographic areas. Control rests with the local cooperatives that make up the federation.

The federation sometimes acts only as a sales agent for its members. In some cases, cooperatives provide the more complex manufacturing functions.

Finally, a small number of cooperatives have structures which combine centralized and federated features and have as members both individual producers and local cooperatives. These are usually large organizations structured to fit unique situations in their particular industry.

How Co-OPS Operate

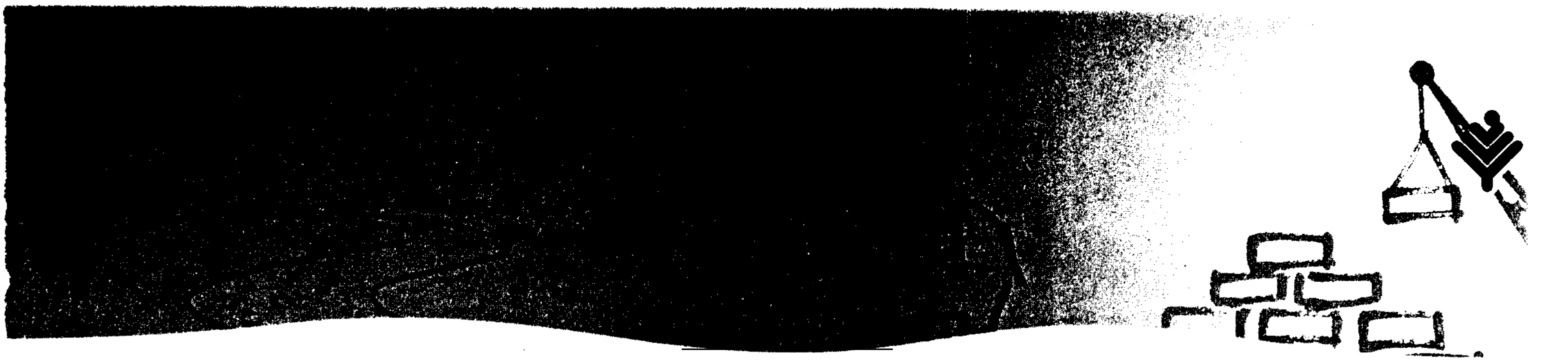
Although a few cooperative auctions and commission agents exist, most cooperatives have traditionally acquired and marketed commodities in one of two ways — buy/sell or pooling.

Buy/Sell. This method is the way most noncooperative agribusinesses operate. The producer is paid cash at the time of delivery to the cooperative. The cooperative resells the product after grading, sorting, packing, or performing other types of value-enhancing activities. After the cooperative resells the product, any profits are returned to producers based on the amount of business they have done with the cooperative.

One problem with buy/sell is that it reduces the flexibility of the cooperative in making marketing decisions because it does not know far enough in advance how much product will be available. Thus, it may be difficult to respond to buyers in the market.

This problem is greatly reduced by the use of marketing agreements or forward cash contracts which allow the producer to contract with the cooperative for future delivery. The cooperative can better plan a marketing strategy knowing how much product will be available. These contracts can take several different forms and have different terms concerning pricing and delivery. All contracts obligate the producer to deliver an agreed amount of product to the cooperative.

The buy/sell method of marketing pays producers for their product at time of delivery rather than later when marketed. Non-cooperative firms also use



this method to acquire and market products, but cooperatives offer their members an assured market and distribute back to the members any earnings from operations.

Pooling. Cooperatives also use "Pooling" in marketing. The production of members is "pooled" or marketed together (it may or may not involve the physical mixing of product). All marketing decisions are made by a pool manager. After deducting operating costs from the pool proceeds, the average net price is paid to the members. Some pools pay adjustments for quality and others for transportation. Pooling is a way to share risk, expenses, and revenue with other producers.

A producer will usually receive an "advance payment" upon delivering the product to the pool. As the product is marketed, the costs of operating the pool are deducted and "progress payments" are made to pool members. A final "equalization payment" reflects both the remaining proceeds from the pool and any differences in the quality of product delivered by individual producers. In this way, producers receive an average price for their commodities, which is often higher than prices they would have received using the buy/sell method.

Producers also benefit from the risk being spread among all members of the pool and from the ability to use the marketing expertise of the cooperative. The cooperative is more effective in the market as a result of having a known volume and quality of product to market; and it therefore can experience some degree of market power.

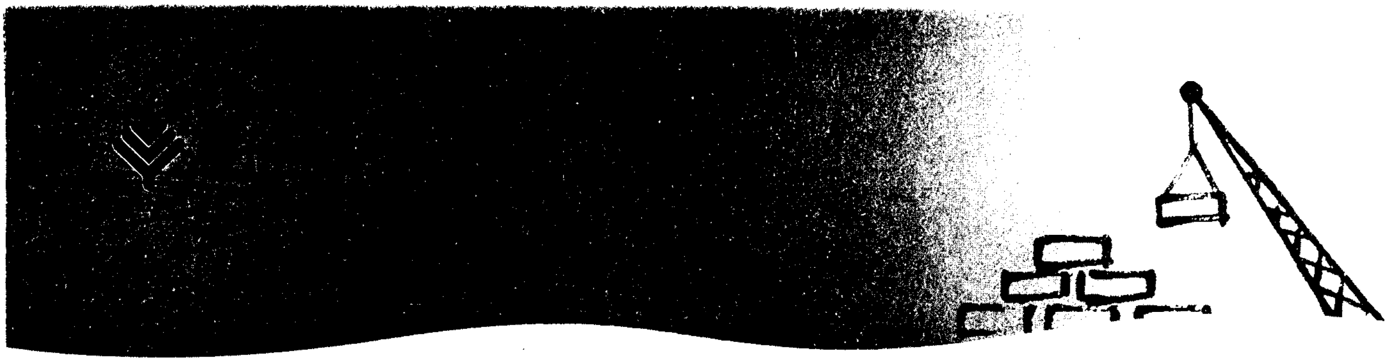
VARIATIONS

Many variations allow marketing cooperatives to meet specific goals or respond to specific situations.

Marketing Agencies-in-Common (MACs). This a strategic alliance among marketing cooperatives-similar to federated cooperatives-which join to market under a common agreement. MACs serve as marketing agents for their members to achieve economies of size in marketing like or complementary products. Member cooperatives retain operational independence in other areas. MACs also share large costs associated with developing brand names and provide a way to acquire and sell nonmember product to expand product lines. MACs can operate in domestic or export markets. The agency will usually have exclusive rights to sell members' products in some or all markets.

Export Trading Companies (ETCs). An ETC is a marketing agency-in-common formed specifically for the joint exporting of products. Cooperatives, investor-owned companies, commodity associations, and others can be part of an ETC. Under the Export Trading Company Act of 1982, ETCs can apply for an export certificate of review (COR) which provides limited antitrust immunity. While cooperatives currently have limited antitrust immunity under the Capper-Volstead Act, the COR provides a measure of protection when noncooperative firms are included in the ETC. Since 1983, 45 agricultural marketing cooperatives have received antitrust preclearance to jointly export their products in 13 ETCs.

Pooling is a way to share risk, expenses, and revenue with other producers.



MACs serve as marketing agents for their members to achieve economies of size in marketing like or complementary products.

Cooperatives have used ETCs to increase their negotiating strength (and their market power) with foreign buyers, improve profit margins by bypassing intermediaries, facilitate foreign market development by spreading the cost among members, and manage the risks associated with international trade.

New-Generation Cooperatives. These are cooperatives with special ownership and operational features designed to allow producers to capture a greater share of the returns from the value-added activities. Keeping these value-added activities local also aids the rural economy by generating jobs.

The special ownership and operational characteristics of new-generation cooperatives are significantly different from those of more traditionally structured marketing cooperatives. First, new-generation cooperatives typically sell stock that have delivery rights and obligations for a specific quantity of product. These delivery rights result in the cooperative's membership being open only to those who purchase the stock.

Second, producers often must make a substantial, up-front investment to purchase stock and delivery rights in a new or existing new-generation cooperative. Over time, delivery rights may increase in value. However, producers normally have the right to sell their membership and delivery rights to other qualified producers and capture the increase in value.

In many traditional cooperatives, membership is open to anyone wanting to sell product and usually requires little or no up-front investment. Examples of new-generation cooperatives include Dakota Growers Pasta Company, North American Bison Company, and American Crystal Sugar Company.

For more information about marketing cooperatives, contact:

U.S. Department of Agriculture
Rural Business-Cooperative Service
1400 Independence Ave., SW,
Stop 3250
Washington, D.C. 20250-3250
Voice: 202-720-7558
Fax: 202-720-4641
E-mail: coopinfo@rurdev.usda.gov
Website: http://www.rurdev.usda.gov

This circular is one in a continuing series that provides training information and presentations for education resource persons who may or may not be familiar with the cooperative form of business. This series provides the basic background material they need, in a form that can be readily adapted, with limited preparation time, to a lecture or other presentation.

For a complete listing of the series, write to RBS—Cooperative Services, U. S. Department of Agriculture, Education and Member Relations Program Area, STOP 3253, Washington, DC 20250-3253.