

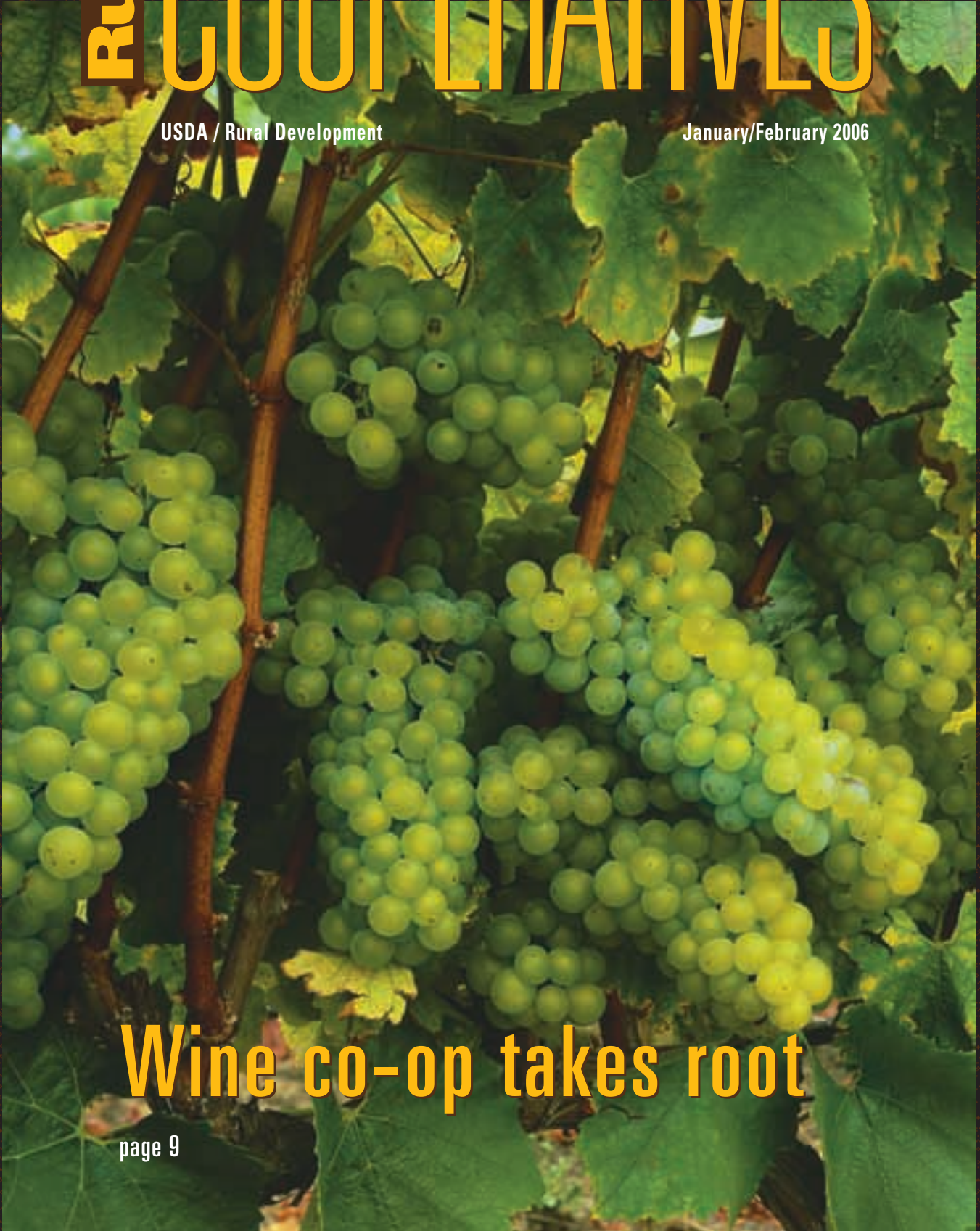
Rural COOPERATIVES

USDA / Rural Development

January/February 2006

Wine co-op takes root

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Working Together

Editor's note: guest commentary is provided by Jerry Kozak, CEO of the National Milk Producers Federation (NMPF). The views expressed do not necessarily reflect those of USDA or its employees. For more on NMPF, see page 16 of this issue.

Those involved in agricultural production are accustomed to being buffeted by the ups and downs of the commodity pricing cycle. Farmers, who are at the tail end of the production chain, often feel this price volatility the most, making it hard for them to plan for the future.

Three years ago, at a time when milk prices were at a particularly painful low point, the nation's dairy cooperatives pooled their resources toward an industry-funded self-help program to help strengthen and stabilize farm-level milk prices. This initiative, Cooperatives Working Together (CWT), was unprecedented in several respects.

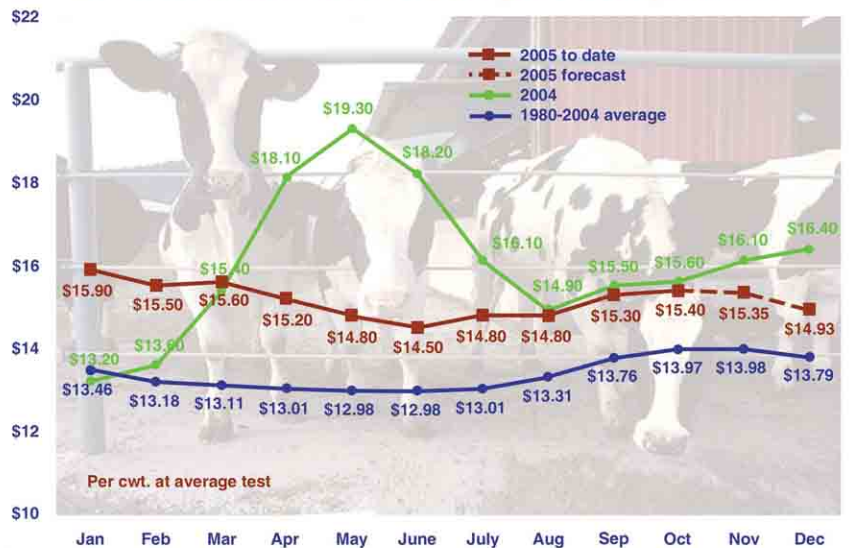
First, a farmer-led program to reduce supply had never been tried by a major commodity sector. Dairy, which is the second-highest-valued farm product (behind beef), is a diverse, \$25 billion industry, and has tens of thousands of producers. Like many agricultural products, dairy has a mandatory USDA-managed checkoff to fund demand-building programs. But supply-focused efforts to improve prices had never been organized voluntarily by farmers across the country.

Second, the collection and management of funds for CWT had to be undertaken through the Capper-Volstead protections afforded to farmers and their marketing cooperatives. A supply-reducing initiative such as this could only be operated under a cooperative legal structure.

Perhaps the biggest challenge, given the unprecedented nature of this program, was whether co-ops as well as individual farmers would pay money to start up an untested, unproven venture. It is difficult to ask farmers suffering from the lowest prices in a generation to kick in money on a novel, untested program.

In the summer of 2003, however, a critical mass of co-ops, handling more than two-thirds of the nation's milk supply, banded together to collect five cents per hundredweight from their members' milk output. These co-ops were joined by several hundred farmers who independently signed up for CWT. Together, the five cent membership fee raised more

All-Milk Price: 2005 and 25-year Comparison



than \$50 million in the program's first 12 months.

That money was used on three supply-reducing programs: a reduced production program, wherein interested farmers could bid to be paid for reducing their milk output for a year; a herd retirement program, wherein farmers again could submit bids to sell out their entire milking herds; and an export assistance program, where member co-ops could submit bids to CWT asking for bonuses to facilitate the overseas sales of cheese and butter.

Milk prices rallied in the latter half of 2003, thanks in part to CWT's supply-reduction activities. The program was renewed in 2004, and the membership dues were again used on a herd retirement program and export assistance. Milk prices throughout 2004 stayed above historical averages, thanks once more to CWT's efforts to keep a lid on the growth in supplies through herd retirements and cheese exports (see chart).

In 2005, the program was renewed a second time, with nearly 75 percent of the nation's milk supply paying the nickel-per-hundredweight assessment. Nearly 45 cooperatives now are participating in the program, along with hundreds of individual farmers.

CWT recently completed its third herd retirement program, removing 64,000 cows, or the milk equivalent of nearly 1.2 billion pounds, which is 0.7 percent of the nation's annual milk output. By comparison, the two previous herd retirements, in 2003 and 2004, removed 83,000 cows.

The U.S. marketplace will be challenged by more milk output in 2006, as two years of above-average prices have helped to stimulate additional production. CWT has budgeted significant sums to help keep commodity cheese and butter prices above crisis levels by using its export assistance

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By Dan Campbell



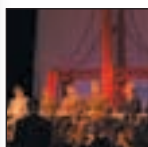
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A vine laden with Chardonnay grapes awaits harvest. See page 9 for a look at how wine grape growing is making a comeback in North Carolina. Photo contributed by Rodney Lough, a prize-winning photographer who specializes in outdoor photography. See more of his work at: www.theloughroad.com.



Making the Grade

Off-grade potatoes now have a home thanks to Keystone dehydrator plant

By Dan Campbell, Editor

Standing in a steady drizzle under a steel-gray October sky, Cory Schlegel and several other men are peering at the gauges on a control panel, trying to find the kink that has interrupted the flow of gas under the road to the new Keystone Potato Products plant. The huddle takes place on a giant landfill, the final resting place for trash from all over the Northeast. Decomposing garbage is the source for the methane gas that

provides fuel for the steam Keystone needs to process fresh spuds into 40-pound bags of dehydrated potato flakes.

The culprit for the power interruption ultimately proves to be a defective switch that shut down one of the blowers that drive methane gas into and through the underground pipeline that leads to the plant, located near the town of Hegins in the Appalachian Mountains of eastern Pennsylvania.

When the methane gas system shuts down, the plant's back-up propane burners kick on, so the potatoes keep rolling. "But we hate to have to use the propane because of the higher cost," explains Schlegel, the plant's general manager. Indeed, it was the availability and economics of a low-cost, waste-to-energy power source that was the lynchpin for getting this \$12 million project built.

There's a lot riding on the outcome of the effort. This plant could play a major role in determining whether Pennsylvania's fresh-market potato industry stabilizes and grows or continues to contract. The Keystone plant — the only one of its kind east of the Mississippi River and outside Maine — was built so that growers here could stop dumping their off-grade potatoes or giving them away for cattle feed.

"For our industry to be viable in fresh markets, we need to have a market for our off-grade potatoes as well," says Keith Masser, president of Pennsylvania Cooperative Potato Growers Inc., one of the nation's oldest co-ops, and the largest of 42 stockholders in the LLC that was formed to build and operate the plant. Masser is also president of the Keystone board and runs his family potato farm and a large packing house (Serman-Masser) in nearby Sacramento, Pa. Masser is the second biggest stockholder in the LLC.

In the early 1950s, about 100,000 acres of potatoes were planted in Pennsylvania. "Today we grow less than 12,000 acres," says Masser, whose family grows about 600 acres of spuds. "Our decline has gone out West."

Competing with the NW

Producers in the Pacific Northwest dominate America's potato industry, and growers there have long had the advantage of access to processing plants where they can sell their off-grade potatoes. This has given them a consider-

able marketing advantage, Masser says. He's long been convinced of the need for a plant like Keystone in the East — ever since returning to the family farming operation in the late 1970s after several years working in the paper industry for Proctor & Gamble.

Buyers in the East typically have to pay about 12 cents per pound more for fresh potatoes than do their counterparts in the West, he notes. To offset that differential, a cheap source of energy was needed for a processing plant. Attention was first focused on one of



Potatoes are steamed during the dehydration process at the new Keystone Potato plant near Hegins, Pa., which uses power from methane gas piped in from a nearby landfill. USDA photo by Dan Campbell; Facing page: photo courtesy U.S. Potato Board

the half dozen or so small co-generation power plants located in the region that burn waste coal to produce electricity.

"The coal industry wasn't as efficient in the past, so a lot of good coal went out with the rock deposited in waste piles that built up over the past century. There's still a lot of energy in it," Masser explains. These co-generation plants use steam turbines to generate electricity, but just blow off the excess steam as a useless byproduct.

The original idea was to build the plant next to one of these co-generation plants and use that waste steam for run-

ning the driers, peelers and blanchers. "We pursued that idea aggressively, but the logistics just didn't work out."

Part of the problem was that to maintain the steam pressure required, the potato processing plant would have had to be located virtually next door to the co-generation plant — not exactly an appetizing prospect for a food factory. Further, there was concern about how long the coal supply at any one of these plants would last.

With methane gas, the supply will last as long as the landfill is in operation, and probably even long afterwards. So, the co-op found 83 acres of land adjacent to a landfill where a methane-collection system was already in place, but the gas was just being flared off. A contract was negotiated with the CES (Commonwealth Environmental Systems), the private company that operates the landfill, and the county agreed to sell the adjacent land. Project backers then went to work to form the LLC and line up financing.

Stimulating a stagnant economy

Local government agencies and the state have backed the Keystone project both as a way of shoring-up the state's potato industry and to create industrial jobs in a region where the coal industry has long been fading and the garment industry has almost entirely migrated overseas.

But it took several unsuccessful attempts before a strong enough application and business plan were developed to win a Value-Added Producer Grant (VAPG) from USDA Rural Development. The VAPG grant was considered essential to making the project fly.

"The second time we failed to get the USDA grant, our then-state agriculture secretary asked me what kind of help the state could supply to make it happen," Masser recalls. "I told him we needed about \$50,000 to hire someone who could work for a year to develop a really strong application." The state

department of agriculture came through with that grant, and Schlegel — a manufacturing-process engineer and a home-town boy — was hired away from Alcoa Aluminum to go to work on the application package.

In 2001, the revised application — predicated on the use of methane gas to power the plant — was approved by USDA, and Keystone was awarded a \$450,000 VAPG. As a matching grant, Keystone members had to put up a like amount of equity. The money was used for everything from attorney fees to incorporate the business to start-up capital. Another huge boost came in the form of a \$1 million grant from Pennsylvania for an on-site wastewater treatment plant (the grant was actually awarded to an intermediary, which in turn is leasing the treatment plant to Keystone). A well was drilled for an on-site water supply.

The state also kicked in with \$1.75 million in low-interest loans for machinery, land and the building. Keystone borrowed \$5 million from a local bank, with the rest of the money coming from member equity investment.

Higher-value products eyed

Schlegel says he hopes to produce 8 to 10 million pounds of dehydrated potato flakes this year, and to double that amount within the next couple of years. Most of the plant's initial sales are being made to buyers who repackage Keystone's product into smaller packages and sell it under various private labels.

The extremely depressed potato prices in recent years (although 2005 saw some improvements) resulted in big carryover inventories of dehydrated potatoes, which has put a damper on flake prices.

Keystone is targeting the food-ingredients industry, where dehydrated potatoes can be used for just about anything, from breads and rolls to ice cream. The ultimate goal is to expand production

into higher-profit-margin foods, such as fresh-cut French fries. Masser says it doesn't take an economic genius to see why: it takes six pounds of raw potatoes to make one pound of dehydrated flakes that sell for 40 cents a pound, whereas one pound of fresh potatoes can nearly yield one pound of French fries that sell for 50 cents a pound.

Keystone is working with the National Agri-Marketing Association at Penn State University to identify the most promising value-added products to pursue. About 10,000 square feet in the plant has been allocated for produc-



Eye to eye: Cory Schlegel samples a delivery of new spuds. Perfectly good, but off-grade, potatoes that were once used for livestock feed in eastern Pennsylvania can now be processed into value-added foods. USDA photos by Dan Campbell

ing such products.

The plant's business plan calls for pulling raw product from a 600-mile radius, although sky-high fuel and trucking costs have currently shrunk that radius, says Schlegel. The rise in fuel prices actually costs Keystone's competitors in the West far more. "A fuel increase that costs us an extra 1-2 cents per pound will cost them 7-8 cents per pound," Schlegel says.

In addition to off-grade fresh-market potatoes (usually kept off the fresh market due to small size or superficial blemishes), another source of raw supply is Pennsylvania's large potato chip industry. The state is home to about a dozen major and minor chip fryers, and those plants frequently reject loads that arrive with a flesh color that will not fry to the

food-maker's specifications. As with the other off-grade potatoes, these are perfectly good spuds, just not quite what the potato chip makers require. But Schlegel says they work fine for him.

Shake-down cruise

Like most new plant start-ups, there have been a number of bumps in the road and a learning curve to master during the plant's start-up cruise, Schlegel says. The plant began operating in mid-May, but it took most of the summer to perfect the process to produce a superior product.

"This is a unique operation for this part of the country," Schlegel says. "We couldn't just run around the corner for answers every time we ran into a problem." The equipment supplier, Idaho Steel Products, has been a big help, as has been the ability to consult with others who had experience in potato processing, says Schlegel.

"I thought the learning curve would be shorter than it was," Masser says. "But by mid-September, we had pretty well learned how to dehydrate our type of potatoes. Out West, they are

doing mostly Russet Burbanks, with high solids content." But that's not a variety Keystone handles very often. "We struggled with the process after the blanching and cooling. But we kept at it, and developed a formula that reconstitutes and tastes better than the product of our competitors."

"It's not as simple as cooking a potato, peeling it and drying it," Schlegel adds. "There are many little things to watch to get the right time, temperature and consistency. But we've made huge progress."

The landfill-gas component has been the most complex and challenging part of the start-up project, Schlegel says. "It's a custom, hybrid system — not off the shelf. Everything had to be designed and engineered from scratch. So we've had bugs to work out."



Coal mining (such as this operation near Heginns) and textiles once dominated the region's economy, but have been on a decline, making it crucial to preserve the area's agricultural base, co-op members say. Inset (above): a country church is neighbor to the Sterman-Masser potato packing plant. Inset (below): the main street in Heginns.

USPB promotion effort enlists celebrity spokespod

The potato may be America's favorite vegetable, but it has had to scrap a bit more in recent years to maintain that status, due in part to the popularity of the Atkins and South Beach diets, which make scant use of the tuber.

Keith Masser, president of the Pennsylvania Cooperative Potato Growers, says he believes the impact of those diet crazes on the market has already largely passed. But he sees a much bigger challenge for the industry in the ever-increasing trend toward consumption of convenience foods that can be prepared in a hurry — never the strong point of the potato, although considerable product development is taking place to address that demand.

Helping the industry spread messages about the nutrition of the potato is the United States Potato Board (USPB), established in 1971 by a group of potato growers to promote the benefits of eating potatoes. Today, this cooperative industry effort represents 6,000 potato growers and handlers across the nation. Recognized as an innovator in the produce marketing industry, the Denver-based USPB was one of the first commodity groups to promote its product generically and to develop a nutrition label approved by the USDA and FDA.

USPB is funded through a small assessment on grower production, which generates around \$9 million annually.

USPB recently acquired the services of a celebrity spokesman — or spokespod — who is playing an important

role in helping to educate children about potatoes: Mr. Potato Head. Yes, the venerable, ever-flexible, face-changing toy that has entertained children for more than half a century is helping kids learn that potatoes are an important part of a healthy, balanced diet.

Through nutritional education programs such as this, consumer public relations and retail programs, foodservice marketing and export programs, USPB strives to educate consumers, retailers and culinary professionals about the convenience, good nutrition and versatility of potatoes.

"The potato is a nutritional powerhouse, loaded with fiber and essential vitamins and minerals," says USPB Chairman Ray Meiggs of Camden, N.C. He notes that a 5.3 ounce potato is a great source of vitamin C; is an excellent source of potassium when eaten with the skin; contains only 100 calories; has less than 10 percent of the daily value of carbohydrates and is a good source of fiber when eaten with the skin.

As evidence that the industry's Healthy Potato Campaign is having an impact, USPB cites a recent survey showing that 4 percent more consumers in 2005 agreed that "potatoes are a good food for the health of consumers" than in 2004. There was a like increase from 2004 to 2005 in the number of consumers who reported serving potatoes at home the previous week. ■



For the first year, the plant is operating every other week, running 24 hours a day with two 12-hour shifts. That means that the work is half-time for the 20 hourly workers (there are also five full-time managers). That has made it difficult to retain workers.

A major warehouse distribution center has been developed about 10 miles north of the plant, which is proving to be a major source of competition for

hourly workers. When the plant converts to a full-time schedule, it should greatly help with the labor issues, Schlegel notes.

He works closely with the co-op to order supplies needed to keep the plant running at optimum level. To help the plant succeed, co-op members have been willing to sell product to the plant for less than they can get elsewhere.

High fuel/shipping costs is a major reason for a regional supply close to the major markets of the Northeast, Masser says. He notes that it costs about \$9.50 per hundredweight to ship potatoes from the Northwest to the East Coast. "But we can grow them here for \$8 per hundredweight — less than the cost of the freight. It wouldn't make sense to lose production here." ■

Fruits of Their Labor

Co-op winegrowing takes root in North Carolina

By Bruce Pleasant
Business Programs Specialist
USDA Rural Development/North
Carolina

Before Prohibition in the 1920s, North Carolina was the nation's leading wine-producing state, with Muscadine and Scuppernong wines dominating its industry. But that all changed with Prohibition, which lasted longer in the South than in most other parts of the nation. Combined with low prices for table grapes, most vines were ripped out or left to die, says Margo Knight, executive director of the North Carolina Wine and Grape Council.

While California's wine crown is in no danger of being lost, winegrowing is steadily making a comeback in North Carolina, which currently ranks 12th among the states for wine production. Interest in wine grapes has been fueled in part by declines in the state's textile, tobacco and furniture industries, which once dominated the region's economy.

Data compiled in 2003 indicates that 1,000 jobs and \$84 million are directly related to wine production in North Carolina. While the ultimate economic impact wine has on the state's economy has not been determined, Knight believes that it is significantly higher than the \$84 million estimate. A new study has been commissioned to measure the economic impact with certainty, which should be completed this April.

Old North State Winegrowers Cooperative Association (ONSW) in Mt. Airy, N.C., was incorporated in 2001, and is currently the only co-op among the state's 52 wineries. When ONSW started, there were only 22 wineries, which provides some idea of the burgeoning wine industry in North Carolina.

Cooperative members have pooled resources to take advantage of economies of scale and marketing opportunities not available to small independent growers. ONSW has members from nine counties, so the



Wine ages in the barrel room of the Old North State Winegrowers Cooperative Association (ONSW) in Mt. Airy, N.C. Wine production is steadily making a comeback in the state, contributing \$84 million to its economy in 2003. USDA photo by Bruce Pleasant; grape photo courtesy Shelton Vinyards

impact of the winery reaches at least as far as their member vineyards.

Look for the co-op label

When ONSW bottled its first wine, the label chosen by the co-op was “Carolina Harvest,” reflecting the pride the members had in North Carolina-grown wine. After a year of marketing the brand, the co-op made a bold move by changing its brand to “38 Vines” for its 38 charter members.

The label change was suggested by a team of MBA students at Wake Forest Babcock School of Management to make the wine appealing to out-of-state markets. Each bottle now tells the story of the cooperative and explains the significance of the brand name.

The Wake Forest MBA students were the winning team responsible for developing a new marketing plan for the cooperative winery.

“It was the best thing that happened, and it was the worst thing that happened to us,” says Gray Draughn, president and general manager of the cooperative. After a year of marketing, they had to start from scratch to gain brand recognition. However, as they have expanded, the co-op’s new brand has gained recognition. This year, the co-op’s Chardonnay took a double gold medal in the state fair wine competition.

Capitalization and growing pains

Managing growth can be a welcome problem to have, but it has also caused some pitfalls for the ONSW cooperative. One of the biggest challenges the cooperative has faced has been raising capital.

Most members are small producers who must make substantial up-front investment in their vineyards, with a 2- to 3-year waiting period before generating any income from a harvest, says Doug Thomas, treasurer of the Winegrowers Association. “As a result, the membership is limited as to how much additional capital it has to invest into the cooperative.”

The cooperative structure has been both an impediment and an avenue for financing their facility and operations. Cooperative members have one vote regardless of vineyard size. To meet the need for more capital, the members voted to assess themselves each \$7,500. In addition, each member pays a fee of \$1 per vine, with a 250-vine minimum. The vineyards range in size from 250 to 6,500 vines, which represents from about 1/3 to 10 acres. There are about 54,000 vines planted by cooperative members.

The cooperative did not have a sales staff that could service a wide geographic area, so it contracted with a wine dis-

tributor to expand its market. Expanding the markets and distribution of the “38 Vines” brand into new geographic markets is essential, given the number of wineries in the Yadkin Valley region, according to Thomas.

However, their first attempt to obtain a distributor failed after one backed out on a deal. At this point, the co-op was left with excess product that could not be moved quickly enough to free capacity. This past year, the cooperative dedicated more capacity to custom crushing for other wineries and for its members who wanted to bottle wine under their own labels.

Growth has outstripped the capacity to process wine. The inability to take equity when they leave the cooperative has hindered member investment. This has prompted the board to consider converting from a cooperative status to a stockholder corporation that would allow producers to recover their equity in the entity. However, the board tabled any proposed entity change, but will revisit it again in 2006.

Key help from USDA, N.C.

The cooperative has benefited from a number of grants. It has used business/cooperative programs of USDA Rural Development and has obtained funding from other state and private

Location, location, location

The ONSW winery is located in the heart of downtown Mt. Airy — a town of about 8,500 in the foothills just south of the Virginia border. It is not unusual to see tour buses dropping off passengers to visit any number of places of interest in this tourist-friendly town.

Mt. Airy is the boyhood home of actor Andy Griffith, and is believed to be the basis for the fictional town of “Mayberry” from the Andy Griffith TV show. The “Mayberry” theme and nostalgia are evident all over town.

Mt. Airy holds two festivals annually: Mayberry Days and Autumn Leaves. These are two big weekends for the cooperative, as the festivals draw nearly a quarter of a million visitors to the area. This is in addition to the 78,000 visitors who signed the guest register at the town’s visitor center in 2004.

Located in a three-story, 26,000-square-foot mercantile building constructed in the 1890s, the winery has a “vintage” (no pun intended) look, with oak floors and decorative tin ceilings. The winery is complete with a tasting room, gift shop and restaurant. The building is owned by the Old North State Winegrowers Foundation, a nonprofit organization that leases the facility to the cooperative.



Don Knotts and Andy Griffith confront town drunk Otis Campbell. The co-op’s winery is located in Mt. Airy, the boyhood home of Griffith and the inspiration for the fictional town of Mayberry. Photo courtesy TAGSRWC Archives

foundations as well. To assist with the renovation of the building, the Old North State Winegrowers Foundation received a \$200,000 grant from the Appalachian Regional Commission, a federal-state partnership.

In 2002, the town of Mt. Airy received two \$99,000 Rural Business Enterprise Grants to purchase bottling equipment and renovate the buildings, that would in turn be leased to the cooperative. In 2003, the Winegrowers Foundation obtained the building with an \$829,000 loan guarantee from USDA Rural Development through the North Carolina Agricultural Finance Authority. NCAFA also provided the cooperative a \$525,000 loan for working capital, which was also guaranteed by USDA Rural Development.

In 2004, the co-op's application for a zero percent Rural Economic Development Loan of \$210,000 was selected for funding. However, because of the liens placed in connection with the Business and Industry Loan Guarantees from USDA, the co-op was unable to use the zero percent interest loan for start-up expenses, but the majority of the co-op's working capital needs had already been met by the NCAFA loan. This past September, the

cooperative was awarded a Value-Added Producer Grant of \$150,000 for working capital to market its wine. This grant will be used to purchase inventory and supplies as well as to cover marketing expenses associated with sales staff salary.

Member assets

As with most cooperatives, every member brings something to the table. Renovating an old building to make it suitable for a winery and restaurant required many resources. One member who is an iron worker furnished the wrought iron railing and gate for the tasting room. The decorative railing is functional as well since alcohol laws require separation between the tasting room and other parts of the winery.

The sprinkler system for the building was provided by a member who has a fire protection business. Another member who is a restaurant owner helped the cooperative purchase "gently used" restaurant equipment at auction for about 10 percent of the cost of new equipment.

One cooperative member is a musician who has lined up bands for festivals and events for the winery. Other members volunteer time in the bottling room or assist with wine tastings in the

tasting room or at festivals.

While the Old North State Winegrowers Cooperative winery got off the ground with help from USDA, it has been the members who have volunteered their time and money that will make this cooperative venture successful. Though the cooperative faces many of the same, and some unique, challenges as most cooperatives, the cooperative members will continue to pool their financial and strategic resources to exploit their strengths in an industry that has been reborn in North Carolina. ■

Expanding the markets and distribution of the co-op's "38 Vines" brand into new geographic markets is essential.

Roses planted at the end of each row of vines aren't just for looks; they attract the same pests that attack grapes, and thus serve as a natural bell-weather. Photo courtesy Shelton Vineyards

Yadkin Valley Wine Bar “takes off” at Charlotte airport

By Bruce Pleasant

Editor’s note: Pleasant is a business programs specialist for USDA Rural Development in North Carolina.

As with many wineries, the members of the Yadkin Valley Winegrowers Association (YVWA) in North Carolina are constantly looking for new ways to add value to their grapes. The processing of grapes into wine will yield 10 times more than grapes sold in bulk. While that comparison is somewhat misleading (since there is much expense associated with operating a winery), production of wine nonetheless results in greater returns to grape growers.

In 2004, the YVWA received a Value-Added Producer Grant from USDA Rural Development for working capital to market wines of member wineries through a retail wine store at the Charlotte-Douglas International Airport. Buddy Norwood, YVWA vice president and manager of the Yadkin Valley Wine Bar, says the store would not have opened without the \$250,000 working capital grant received from USDA in 2004. The store was only one of two such airport stores in the country when it opened in March, 2005.

But the idea is apparently catching on. A wine-tasting bar has since opened at Virginia’s Dulles Airport in suburban Washington, D.C., and other airports have plans to add wine-tasting bars. *The Wall Street Journal* (WSJ) recently included an article on airport wine sales, which featured the North Carolina wine bar. “With people spending more

time at airports — Americans took 633 million domestic trips last year, according to the Bureau of Transportation Statistics — this gives weary travelers something to do. It’s a great way to promote local wines,” the WSJ wrote. “Isn’t everybody always looking for a last-minute present at the airport? What could be a better and more interesting present than a bottle of local wine?”

The revenues generated at the North Carolina airport



wine bar help support the nine member wineries, including a cooperatively owned winery with 38 charter members in some of the most rural counties in the state. The store is an extension of the tasting rooms of the member wineries, reaching a customer base that they would never otherwise tap.

Supreme Court ruling impacts local wineries

The Yadkin Valley Wine Bar has enjoyed remarkable success since opening in March of 2005. Visitors from other states and abroad can taste and purchase Yadkin

Valley Wines and take them home or send them as gifts.

In March, the Supreme Court ruled that it is unconstitutional to prohibit interstate wine shipment to states that allow wine to be shipped within their borders. Since the Supreme Court ruling, the Yadkin Valley Wine Bar has noticed brisk increases in out-of-state shipments. Most go to Florida or New York because of their popularity as travel destinations from the Charlotte airport.

However, the ruling did not necessarily mean that wine can now be shipped to all parts of the country. One state, Louisiana, responded



The association’s wine bar opened at Charlotte-Douglas International Airport with the help of a VAPG from USDA Rural Development. USDA photos by Bruce Pleasant

to the court ruling by enacting legislation to prohibit intrastate shipping previously permitted, effectively blocking the shipment of wine into the state. Of the remaining states, only nine do not allow interstate wine shipments, primarily because they do not permit any wine shipping at all.

Ultimately, the Supreme Court decision should open new markets for North Carolina wineries.

More incremental returns for producers

Wine bar traffic is directly proportional to the traffic in the airport, Norwood says, with afternoons on Wednesday through Friday being the busiest time. The store also does good business with vacation travelers on Saturdays.

The wine bar is on track to sell over 13,000 bottles this year. Norwood says, "it's remarkable how close we have come to our sales projections." The average price per bottle is actually \$3 higher than projected, due to the number of tastings sold and the amount of wine sold by the glass. The average bottle of wine sells for around \$15. Tastings generate \$18 per bottle while wine sold by the glass generates \$23 per bottle.

The requirements of the store are minimal. At 600 square feet of retail space, the \$400 per-square-foot annualized sales compare favorably with the \$300-\$400 average for most retailers at the airport. Typically, most travelers expect to pay more for food and other items within an airport.

However, the prices of members' wine are the same as they are in a grocery store or at the winery. Visitors to the Yadkin Valley Wine Bar may be greeted by a winemaker or owner of any one of the nine member wineries, each of whom work about 2 days per month at the airport store. These representatives provide an enormous amount of goodwill in addition to staffing for the store, Norwood says. Their presence at the wine bar usually results in a spike of their own label. "If a customer asks for a recommendation of a good Chardonnay, they are expected to push their own," Norwood notes.

Yadkin Valley wine designation

California has its Napa Valley, but North Carolina has its Yadkin Valley, thanks to a new designation that recognizes

the unique climate and soils of the valley that are beneficial to growing wine grapes. This designation was granted in February 2003 by the Treasury Department's Alcohol and Tobacco Tax and Trade Bureau, a process that took 2 years.

With the designation, all wines marketed as Yadkin Valley wines must contain 85 percent grapes grown in the Yadkin Valley region. This designation is important to area wineries because it creates interest and helps establish the region as a wine destination.

Margo Knight, executive director North Carolina Wine and Grape Council, says having that designation is a key point in the growth of the state's wine industry because it helps develop a "sense of place" for wines of the region. Unlike wineries scattered across a wide area, a number of wineries in an area encourages tourism.

"Then it becomes a critical mass," according to Knight. Many will make a day trip to visit several wineries but

would not travel to visit just one. While applications for other designations are in process, Yadkin Valley is currently the only designated appellation in the state.

In addition to becoming acquainted to Yadkin Valley wines, visitors to the "Yadkin Valley Wine Bar" can receive complimentary passes for tours and tastings at member wineries. Visitors can also obtain maps and brochures that will direct them to each of the wineries in the Yadkin Valley.

Value of VAPGs

While the airport store still is a relatively fresh concept, it appears to have been very successful for the YVWA. The airport wine bar is a good example of how, through the assistance of a USDA Value-Added Producer Grant, agricultural producers were able to start a new venture that would not have been possible otherwise.

"The Value-Added Grant Program helps North Carolina farmers transition from tobacco and other crops to grapes which yield a greater return per acre," says John Cooper, state director for USDA Rural Development in North Carolina. "I look for this venture to be the start of a trend which will "take off" at airports across the country."



The airport wine bar sold about 13,000 bottles of wine last year. The average price per bottle was \$3 higher than projected, reflecting the higher price paid for wine ordered by the glass or for tasting.

Voice of experience: co-ops are resilient

By Scott A. Yates

Editor's note: this article is reprinted courtesy the Capital Press, which covers agriculture in California and the Northwest United States. Yates is that publication's Washington state staff writer. He can be contacted at: syates@capitalpress.com.

The question itself was revealing, but according to Dennis Bolling, the answer is: "Yes, cooperatives do have a future."

Speaking at the Joint Northwest Co-op Council's annual meeting in Post Falls, Idaho, the president and chief executive officer of United Producers with headquarters in Columbus, Ohio, said anybody wanting to investigate the future of cooperatives should think about shutting down. That's what happened to his company.

"If your co-op closed tomorrow, would your members start it up again?" he asked the roomful of cooperative directors and managers.

He related the saga of the Midwest livestock cooperative that got caught in a ponzi (pyramid) scheme, which resulted in \$140 million worth of damages. The house of cards involved individuals showing banks duplicate cattle inventory as part of receiving financing.

Two banks lost over \$50 million. The cooperative lost \$12 million. And that doesn't count the "boatload" spent on attorneys during litigation.

"We were rocking and rolling with litigation," Bolling said. "I was a little overwhelmed when I came on the board. How do you think directors of ours felt? 'And, oh, by the way, here's the 50 pounds of legal stuff I have to go through with you.'"

That "legal stuff" will increasingly be part of the future of cooperatives. That means directors will increasingly be responsible for ensuring due diligence was performed "when it hits the fan."

And don't think it can't happen to you, Bolling told the group. It's a myth to think that what happened to United Producers couldn't happen to any cooperative out there. "We are a litigious society... [but] it is not just a matter of being sued. It is a matter of positioning for the future," he said.

Bolling has taken a business lemon and turned it into lemonade by helping the directors understand what is necessary to survive. The future, Bolling said, is a fast-paced one

that has agricultural commodities dealing with the leading edge of science over problems like BSE, bird flu and other phytosanitary issues.

And that doesn't even address the question of getting bigger, which he said shouldn't be confused with needing to grow.

"We simply had to handle more widgets. We couldn't stay competitive if we didn't grow," he said.

But for the farmers his cooperative serves, the real value to the operation, as revealed in a survey, was the company's presence in the marketplace.

"Which is a good thing, because the equity is gone," he said, referring to the bankruptcy loss.

"Co-ops can't be hobbies, habits or the Church in Wildwood," Bolling wrote on one of his power point displays.

Co-op progressing under Chapter 11

Editor's note: this backgrounder supplied courtesy United Producers.

United Producers Inc. (UPI), originally formed in the 1930s, is a multi-state livestock marketing, lending and related services cooperative headquartered in Columbus, Ohio, governed by a 17-member board. UPI currently serves over 70,000 patrons in about a dozen Midwest states.

In 2001, UPI was victimized, along with several banks, cattle producers and agri-businesses, by a third-party cattle-fraud situation. The perpetrators are serving time in federal prison. UPI suffered significant losses coupled with legal expenses from related litigation.

UPI filed for Chapter 11 on April 1, 2005, to reorganize its business and have a forum to ultimately deal with the litigation. Subsequently, in early October of 2005, UPI's Plan of Reorganization was confirmed by the Court. CoBank continues to provide financing for the cooperative's operations.

UPI's core business continued intact during this time-frame. UPI markets nearly 4 million head of livestock and has a loan portfolio of over \$50 million. Sales volume approaches \$1 billion. Additionally, risk management and production coordination, including a Managed Beef Alliance, are provided to the cooperative's membership.



Sam Roberts, beef technologies coordinator for United Producers Inc., applies a new electronic identification ear tag designed to track cattle back to their place of origin. Photo courtesy United Producers

A model created in the 1930s, it largely went on the same way for 65 years. Only recently have co-ops been forced to adapt for the 21st century.

Bolling said it would be a mistake to think the cooperative structure isn't alive and well. Farmers are forming co-ops right and left, which suggests the model is healthy. In Ohio, four new livestock cooperatives were formed recently.

"We are feeling pretty happy because we are the big fish, but farmers have formed these related co-ops because they are dealing with issues or needs we weren't addressing," he reminded co-op managers and directors.

In addition to dealing with the producer, the input provider, the slaughterhouse, the wholesaler and the retailer, today's cooperative has to address the consumer, who is king.

"The challenge for us is how do we connect the farmer further up the food chain," Bolling said.

Although farmers can accomplish a lot on their own, he said, a cooperative can effect more change. But co-ops of the future will need market position, financial capital and leadership to compete. "We are going to have to address economic performance, structural alternatives and intentional leadership," he said.

In the process, it's likely co-ops will have to change entrenched policies. For instance, 5 years ago, the United Producers board would have reacted in horror to the idea of entering into a formal supply agreement with a packer. Now it has one.

"We're competing on a much different plane. Our competition is not other co-ops like us," Bolling said. "In reality, our competition is our customer, the packing companies." ■

Leaders evaluate risks of serving

Listening to speakers at the Joint Co-op Council Annual Meeting and Educational Seminar talk about the obligations faced by directors of modern farming cooperatives raises questions about why they serve.

Talk to a few directors from various boards and one of the first things they mention is the obligation to give back to the community. For many, it is a responsibility that has been passed from parent to child.

But to paraphrase an automobile ad of the 1990s, this isn't your father's cooperative. Once a quiet backwater of American business, co-ops are finding themselves on the cutting edge of finance, science and society. More is expected of directors, and more risk is involved.

Hence the need for educational meetings where directors learn that litigation is only a lawsuit away. Mark Hanson, a lawyer for Lindquist & Vennum in Minneapolis, which works with cooperatives, agreed agriculture is more litigious nowadays, but still much less than any other sector of the economy.

"I think, unfortunately, the rural lawyers have changed. They are more willing to sue," Hanson said.

So is serving on a board worth taking the risk? Wade McClean of Co-op Supply Inc. in Northern Idaho said you owe it to the community to help out.

Donald Heikkila, on the Co-op Supply Board in Northern Idaho, said it's all about being able to sleep at night.

"I'm not so much concerned about personal liability. All the decisions we make are based on good, sound judgment, and I think we all have a clear conscience that our vote is not only in the best interests of the cooperative, but of its members," said the 25-year veteran.

Tim Butler, on the Wilco Board in the Willamette Valley, said as owners of the company, it's important to be involved in the company. Sure, litigation is possible, he said, but "Board members have made those decisions before me, and now it's my turn to make those decisions, and in 5 or 10 years, it will be somebody else making the decisions. It has to be done."

Besides, said Bud Dyk, on the board of Midstate Cooperative in Ellensburg, Wash., it's important to know how a cooperative actually operates. He said he was pretty naive when he first became a director and called his 9 years on the board a good challenge. Some risks are worth taking.

"I always wanted to give back, and this is one way to do it. Yes, there is a risk, but you have to weigh it with what you're doing," he said. ■

— **Scott A. Yates, *Capital Press***

Trade, Farm Bill, co-op structure challenges eyed at dairy conference

By Dan Campbell, Editor

How important are the World Trade Organization talks for U.S. dairy cooperatives and their members?

“Either we have a place at the table, or we’ll be on the menu,” is how Jerry Kozak, CEO of the National Milk Producers Federation (NMPF), put it in his address to the joint annual meeting of NMPF, the United Dairy Industry Association and National Dairy Promotion and Research Board in December.

NMPF lobbying efforts have been based on the stance that there can be no dairy trade deal if the European Union makes only incremental cuts in its subsidies and import tariffs, which are much higher than those in the United States, he stressed. Still, the industry’s very willingness to even discuss possible reductions in a 50-year-old support program — under which the U.S. government pays more than \$4 billion annually to support the dairy industry — represents something of a shift toward greater flexibility on free trade.

And how much is at stake for producers as the 2007 Farm Bill takes shape? “Either we get our ducks in a row, or we’ll be sitting ducks,” Kozak warned, noting that agriculture is bracing for farm program reductions and that the dairy industry needs to be united and proactive to keep the budget ax from swinging its way.

Environmental issues — including potentially stricter air and water quality controls — will play a part in the Farm Bill debate, Kozak said. Food security and the war on terrorism, animal wel-

fare and product standards and labeling will also be in the mix more so than in past Farm Bills.

Another fundamental challenge facing producers comes from “people outside the industry who would like to dismantle the cooperative business structure,” he said. This would have “extremely serious consequences for farmers and the industry,” Kozak continued. “Now is the time to rally around the cooperative structure and take advantage of the magic of cooperatives and the Capper-Volstead Act. We need to take advantage of cooperative unity for the benefit of all producers.”

CWT & market gains

As sobering as those thoughts were for the 1,100 or so producers and guests gathered at the meeting in San Francisco, there were also many achievements in 2005 to look back on

and cheer. After three successful bidding rounds of the CWT (Cooperatives Working Together) program, 74 percent of the nation’s milk production is enrolled in this industry self-help effort to stabilize on-farm milk prices by better balancing supply and demand. In 2006, the CWT focus will likely shift from voluntary herd reductions to boosting the export-enhancement component of the program, Kozak noted.

NMPF Board Chairman Charles Beckendorf said the 5 cents per hundredweight producers contribute (on a voluntary basis) toward the CWT program is “the best nickel you could ever spend.” Last year, CWT removed 900 million pounds of excess milk from the market, he noted.

Dairy Management Inc. CEO Thomas Gallagher recounted gains in dairy research and promotion, many of which were achieved through invest-

Jerry Kozak, left, and the senior staff of the National Milk Producers Federation (NMPF), hosted a lively “town hall” meeting, during which producers could quiz them about any NMPF program. USDA photos by Dan Campbell





ment of producers' Dairy Checkoff dollars. Topping the good news on the nutrition front was the revised U.S. Dietary Guidelines, which keep dairy as its own food group and boosts the recommendation from twice-daily to thrice-daily consumption of dairy foods for adults and children.

Yogurt was the retail star for the industry in 2005, with sales that climbed 6 percent, to 2.87 million pounds, and is becoming "a 'growth engine' for the industry," Gallagher said.

The big news for fluid milk consumption continues to be sales gains in schools and fast food outlets, achieved primarily by replacing cardboard milk cartons with flavored milk in single-serve, plastic bottles. Indeed, several times during the meeting, the image of the single-serve, cardboard milk carton was flashed onto video screens as a symbol of an industry that in the past was sometimes too slow to adapt to modern



A Grip on Success

Gardner recalls odyssey from 'failure' to gold medal victor

By Dan Campbell, Editor

When Jason VanderKooy left his dairy farm near Mount Vernon, Wash., in late November and headed to San Francisco for the joint annual meeting of three major dairy organizations, he went expecting to learn more about the state of the industry and what is being done to strengthen it. But one thing VanderKooy never expected was to wind up in the hammerlock of Olympic gold medal Greco-Roman wrestling champion Rulon Gardner.

Yet there he was, up on stage in front of 1,100 producer delegates, nose-to-nose with Gardner as the champ demonstrated the techniques he used to defeat Russia's supposedly invincible Aleksandr Karelin. It's been called "the miracle on the mat," and some sportswriters consider Gardner's victory the greatest upset in Olympic history.

Karelin had easily defeated Gardner in a prior match in 1997, throwing Gardner to the mat three times — including a head-first landing which caused a spinal crack (diagnosed years later). Gardner said it seemed everyone in Sydney, Australia, wanted to see the legendary Russian win again — the crowd, the sponsors and even the officials. But as he has on so many other occasions in life, Gardner fooled the odds makers, who had made him as much as a 2,000-1 underdog. He did so by drawing on the qualities that got him into the Olympics: perseverance, dedication, determination and heart. Gardner said he also used some of the techniques dairy farmers must master "to make cows do what you want them to do, not what they want to do."

So was VanderKooy scared up there in the vice-like grip of the champ?

"Nah, Rulon is really just a big teddy bear," said VanderKooy, safely back home on the 1,000-cow dairy farm he operates with his brother and father. After all, when you make your living herding 1,200-pound Holsteins around your farm, doing mock battle with a 265-pound wrestling champ seems almost tame!

VanderKooy, 30 and a member of the Northwest Dairy Association cooperative, says his wife, Shelby, volunteered him for the "match" by grabbing his arm and hoisting it in the air when Gardner asked for someone to help him demonstrate how he achieved his impossible dream. VanderKooy says Gardner's message — about never giving up even when the odds are stacked against you — resonates with producers who know that feeling all too well.

"We're facing more pressure all the time on our farm from environmental regulations, urban growth and rising energy prices and costs in general that just keep going up," says VanderKooy, who farms 1,000 acres of corn, alfalfa and grass in addition to milking his herd three times daily. "We just have to keep looking for ways to get better."



Washington state dairyman Jason VanderKooy, left, was "volunteered" to serve as Olympic champion Rulon Gardner's wrestling foe.

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consumer food preferences, nearly costing the industry a generation of milk drinkers.

Halting slide of fluid sales

Gallagher said fluid milk sales have been in a 21-year downward slide. Why? “Decades of offering milk in cardboard boxes that kids needed a fork to open.” He disagreed strongly with

those who say the best the industry can hope for is to halt or slow the slide, and he predicted that with the right products, fluid milk can once again become a “shining star” of market growth for dairy producers.

Need evidence? Dairy producer investments in foodservice and school partnerships have led to the introduction of milk in plastic bottles at

McDonald’s and Wendy’s restaurants across the country, and milk in plastic bottles in 3,500 schools today, compared to just 400 schools during the 2003-04 school year. Based on incremental sales increases, if milk in plastic bottles were offered in all schools and major fast food chains nationwide, sales could increase by an additional 1 billion pounds — a 1-percent increase in per

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“One of us”

Many farm conferences include an inspirational speaker on their agenda, and Gardner filled that role at the joint meeting of the National Milk Producers Federation, United Dairy Industry Association and the National Dairy Promotion and Research Board. As a farm boy who grew up on a Wyoming dairy, Gardner knows well the daily battles farmers face, and the strength they draw from rural values and work ethic.

Building hay stacks and shoveling manure taught him hard work and discipline, he said, recalling how he worked until midnight during sweltering summers and milked cows in frigid winter temperatures after the family’s barn burned down. His upbringing also taught him the value of family and neighborliness, such as when his family’s neighbors all pitched in to harvest the Gardners’ barley crop so that they could watch him wrestle in the Olympics.

“He’s one of us,” one delegate was heard to remark.

Despite being somewhat hoarse from shouting a day before at a wrestling event where he had coached, Gardner recounted what it was like growing up with learning disabilities that put him in special education courses where it sometimes seemed as if he was expected to fail. “I’d get pulled out of class every day and fall further behind. My family helped me deal with the frustration — they showed me that I could be successful if I gave 100 percent.” When school counselors said he could never go to college, his mother responded: “how dare you limit my son’s potential” and refused to take their advice, he recalled.

Other kids would make fun of Gardner for being a poor reader and slow to learn in other subjects. After he won the gold medal, many of them who had treated him so cruelly said they were sorry. “Why did you do it? You could have destroyed me,” Gardner said. But he instead used those jeers to motivate himself to success.

Gardner says his wrestling skills were developed with a large measure of help from the Sunkist Kids Wrestling Club, founded by Arizona citrus grower Art Mortori, who named the club after the Sunkist Growers citrus co-op, of which he is a member. Sunkist Growers has been a regular contributor to the youth program, which has produced more than 150

wrestlers who have earned spots on U.S. World and Olympic wrestling teams since 1976.

Against all odds

Gardner made it to a small college, majoring in dairy management, and later transferred to the University of Nebraska, where he earned a teaching degree in physical education. He had been told he didn’t have the stuff needed to get an education degree from a major university, especially one like U.N. where the academic requirements for teaching majors are rigorous. But he worked with tutors daily and continued to wrestle, winning his biggest match of all: for his college degree.

He was also told he’d never land a spot on the Olympic team, and would certainly never earn a medal. But the naysayers learned just how wrong they were when the big farm kid so few had believed in was standing up on the block, the gold medal gleaming around his neck as the Star Spangled Banner boomed across the public address system.

Gardner’s time to bask in the glory was almost cut tragically short, when he was lost and nearly died in a blizzard while back home on the farm. He followed a frozen river and sheltered between two boulders, where he survived 18 hours at 25 degrees below zero. His body temperature dropped so low that the emergency medical technicians who treated him said there was no way he should have lived through the ordeal. Gardner lost the middle toe of his right foot to frostbite, but managed to come back again to compete in the 2004 Olympics in Athens, where he took home the bronze medal.

Gardner offered these tips for success from his own life experience that he believes can help most people, regardless of their specific circumstances:

- get back to the basics;
- turn negatives into positives;
- enlist the help of others;
- train hard every day;
- always take care of business;
- aim even higher after a crisis;
- don’t rest on your laurels.



capita fluid milk consumption.

That trend could pick up steam as the nation's two soft-drink giants — Coke and Pepsi — edge more into the dairy sector, with products such as Bravo Milk Slammer. To consider the potential impact on sales, Gallagher noted that Coke has a fleet of trucks second in number only to United Parcel Service that deliver products daily nationwide. They also maintain more than 2 million vending machines that can sell milk. The industry's hope, of course, is that those types of products take market share from soft drinks, not from traditional milk products.

Dairy producers need to keep pursuing strategic partnerships with suppliers, manufacturers and the food service industry, Gallagher said. Retail cheese sales, which for many years have driven dairy industry market gains, were flat last year. This could be a prime area where producer/processor partnerships could help spread the risk for developing new products, such as snack cheeses and cheeses for the Hispanic market, he noted.

Looking at the dairy ingredients market, there is no bigger need than for a worldwide research and promotion effort to develop nutritional information for dairy whey that will help marketers better compete with soy-based food additives, he said.

Sending large volumes of milk to balancing plants to “turn into powder for the government to buy, then dump on the market is not growing the business,” Gallagher said.

Innovation and passion critical for cheese gains

Lou Gentine, CEO and chairman of the family-owned Sargento Foods in Wisconsin, told how the small company his father started in 1953 to fill a market void for consumer-size packages of Italian cheeses grew into a company that today annually sells 3 billion pounds of cheese worth \$550 million — 3 percent of the U.S. retail cheese market. To put it in farmer-friendly terms: it takes the milk from 160,000 cows each year to supply the raw product for Sargento cheeses, he said.

Sargento cheeses are produced at four plants in Wisconsin that employ 1,200 workers. One reason for the firm's rapid growth was good timing: Sargento went into business just as the market for pizza and some other Italian foods began to soar. But its success is also due to the innovation and passion his family and its employees have for producing cheese, Gentine said. Among the elements of the company's statement of values is to: “Hire good people and treat them like family.”

U.S. cheese sales have grown 300 percent since 1953, far out-shining stagnant or falling fluid milk sales during most of those years, he said. However, since it takes 10 pounds of milk to make one pound of cheese, that has not necessarily been a bad trend for dairy producers, Gentine said.

He sees cheese and yogurt as providing the biggest opportunities for dairy sales growth, and urged producers to “ride the winner,” saying their research dollars should be invested in developing new cheese products.

But innovation is not cheap, Gentine stressed. He described a process that involves consumer surveys, concept development and testing, product development and further testing, building or adapting plants and equipment and costly product launches (including advertising, promotion and slot-



With a reduced-scale Golden Gate Bridge as a backdrop, NMPF staff fielded questions ranging from the workings of the CWT program to the outlook for the 2007 Farm Bill.

ting fees). Total costs can run from \$10 million to \$40 million to launch a new food product, “and there is no guarantee of success.”

Gentine said he thinks branded advertising does more for the industry than generic advertising, saying generic ads are based on convincing consumers that all cheddar cheese (for example) is the same, which means they compete only on price, and that tends to drive the market down.

He urged producers “to support innovation” and to consider increasing fees for the Dairy Checkoff program (no such proposal is currently being pursued by the industry). Asked if he would also support a Cheese Checkoff for processors to pay, Gentine said his company already spends 20 to 25 percent of its income on innovation and promotion. “When we build our own brand, we also build the dairy industry.”

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Foreign Affairs

Co-op leaders share strategies for pursuing global markets

By Stephen Thompson, Assistant Editor

Like other markets, agricultural trade is becoming increasingly international. Hence, dealing with the globalization of agricultural commerce was the theme of the 2005 Annual Farmer Cooperatives Conference, held Nov. 7 and 8 in Minneapolis.

As barriers to international trade, capital flow and communication come down, U.S. cooperatives today are facing up to the necessity of building business relationships outside of our borders to remain competitive. Presenters at the conference, sponsored by the University of Wisconsin Center for Cooperatives, offered hope and useful suggestions for participating in the international business arena. But none of them said that doing so will be easy.

Participants may have felt that they left the gathering with more questions than answers; the picture they were presented was one of increasing change — offering new opportunities, but also greater risk and uncertainty.

Now what?

Terry N. Barr, chief economist with the National Council of Farmer Cooperatives, presented co-op leaders with this question: “The market in which you had prepared to compete no longer exists! Now what?”

Barr argued that world markets are changing quickly and drastically, that “the rise of China and India is the most important economic force in the world,” and that the continued growth of those countries will result in massive changes to the world economy. He said that customers are taking advantage of increasing competition to demand more services and better quality. Lower transportation costs and increasingly efficient communications are breaking down barriers not only to the flow of goods and services, but to capital and knowledge as well. In fact, capital moves more quickly than physical goods.





As a result, said Barr, U.S. ag cooperatives will have to participate in riskier overseas markets, make new partnerships with foreign firms, and even invest in overseas ventures to properly serve their members.

“Farmer cooperatives must be willing to forge ties with foreign firms to compete in the markets of today and tomorrow.”
— Terry Barr

Unfortunately, the huge reductions in transportation and communications costs that have encouraged more Asian imports into the U.S. market have not stimulated as rapid a growth in U.S. exports.

While large volumes of imported goods from Asia send many dollars overseas, those dollars often don't return as payments for U.S. exports. A combination of factors has created this

situation. The government of China has provided significant stimulus to investment over consumption and uses high tariffs on imported goods to protect domestic industries, such as agriculture. At the same time, the income and purchasing power of the Chinese consumers is low and their savings rates are very high.

As a result, the money American consumers spend on foreign goods is used to purchase U.S. financial assets, such as Treasury bonds and other securities. Barr pointed out that this is part of a conscious growth strategy on the part of many Asian governments to promote demand for their exportable goods in the United States and other regions, rather than rely on internal-demand growth.

With export income being channeled into purchases of U.S. securities and assets, Asian countries help keep U.S. interest rates low. Access to debt at lower rates further encourages American consumers to buy more consumer products, including imported goods. But it also means that the consumption patterns of Asian consumers don't reflect the same benefits: deprived of much of the export income, they are discouraged by high tariffs from raising their standard of living by

purchasing imported goods, such as agricultural and other products from the United States. Thus, both Asian consumers and American farmers are missing out on much of the potential benefit of globalization.

Net ag-exporter status ending

As a result of this changing world market, the United States' status as a net agricultural exporter is coming to an end, Barr said. The problem, he continued, is not in the commodities sector — although bulk exports have fallen. Rather, high-value products are tipping the scales.

U.S. exports of high-value agricultural products are actually rising, but, said Barr, they are not rising fast enough to offset the rising imports of such items as horticultural products and other high value agricultural goods. Meanwhile, commodity exports from Brazil and other sources are continuing to increase, and agricultural production continues to consolidate.

Barr believes that the result will be a growing trend on the part of producers to attempt to break out of commodity markets through product differentiation — whether by product attribute, delivery capability, or some other distinct value added to the product. The use of new life-science technologies will offer one route, resulting in new food and energy products, as well as new pharmaceuticals and other health products.

Serving consumer markets offers another route, but it is an avenue fraught with complications. Barr pointed out that trends in the consumer sector are toward goods that are customized to individual markets — no longer can a firm expect simply to introduce products into one market that have been designed for another.

In addition, retail outlets are consolidating rapidly — the Wal-Mart phenomenon — and food processing companies are consolidating in response, while at the same time diversifying their product lines, using brand names and private labels to meet the demands of various markets.

The implications of Barr's presentation were clear: farmer cooperatives must be willing to forge ties with foreign firms to compete in the markets of today and tomorrow. Such relationships may take many forms, from straight client agreements to joint ventures.

The most important international markets for agricultural products are also among the most difficult to deal with: China and India, together having 38 percent of the world's population. The economies of both countries are developing rapidly, and growing middle classes are demanding more and more processed foods. Joint ventures are the most obvious avenue for market participation in these countries.

China and India erect high tariff barriers to agricultural imports, and have laws that prevent foreign firms from participating by themselves in their domestic markets. This means that American cooperatives seeking to break into those markets will have to develop joint ventures with Chinese and Indian firms.

How co-ops can compete

Barr listed the implications of these trends for farmer cooperatives. To compete, he said a co-op must understand what it does better than anyone else — that is the value that it offers in any business relationship. It must know the market value of what it “brings to the table” in any potential agreement — and what it would cost its potential partner to duplicate it.

And it must approach the international market from a position of strength domestically: “Deploying scarce capital resources and capital in the world market should not take precedence over domestic strategies,” he said. “You need to have an integrated strategy.”

Cooperative management boards of directors must develop ways of continually finding and evaluating potential joint partnerships, Barr emphasized. This must include communicating with customers and suppliers about their own global strategies to identify emerging opportunities and risks.

Further, they must be aware of how changes in domestic farm and international trade policy will affect their position in the marketplace, and be ready to respond.

Behind the curve

Elizabeth Hund of Rabobank told the gathering that the U.S. agricultural economy is “behind the curve” in comparison to that of Europe. She pointed out that the Netherlands, with only a



Doug Wilson, CEO of Cooperative Resources International, a livestock breeding co-op, makes a point during the Farmer Cooperative Conference in Minneapolis. He is flanked by DFA's Don Schriver and co-op attorney Mark Hanson of Lindquist & Vennum. USDA photo by Stephen Thompson

small fraction of the farm acreage of the United States, holds the second-largest share of the world ag export market, with 10.6 percent compared to the United States' 15.5 percent share.

Hund said that the U.S. share of the market is falling, while European countries gain, because the European producers are exporting high-value, value-added goods. She agreed with Barr that international joint ventures, while involving difficulty and risk, offer important opportunities to U.S. cooperatives: “If you can't beat 'em, join 'em!”

Other presenters gave the audience

some examples of successful international collaboration. John Johnson, CEO of CHS Inc., told the gathering about that co-op's experiences with international joint ventures. CHS has a well-established, highly profitable relationship with the Japanese corporation Mitsui — one of the largest publicly traded corporations in the world. Johnson said that the impetus for the partnership came about by accident: a subsidiary of Mitsui, Wilsey Foods, was

considering acquiring some of the same smaller companies at which CHS subsidiary Holsum Foods was looking.

In addition, it was a large customer of CHS products. Both companies decided that a partnership would avoid duplication and provide new opportunities.

The partnership agreement between CHS and Mitsui was signed in August 1996, at which time CHS had \$350 million in annual sales, with \$8.5 million in profits. Nine years later, says Johnson, the partnership has paid off big for the cooperative. Ventura Foods now has \$1.2 billion in annual sales. Profits have increased more than 800 percent, to between \$60 and \$70 million in profits, making for a 25-30 percent return on members' equity.

Johnson presented a joint grain-marketing effort in the

Pacific Northwest, called United Harvest, as an example of the synergies achieved by the partnership. Mitsui had a global portfolio of customers for American grain, while CHS had access to the grain at the source. Both firms each had an export facility in Washington State — Mitsui at Vancouver and CHS at Kalama — both on the Columbia River. Both firms needed to build new terminals for large, single-cargo shuttle trains to feed those facilities — an innovation at the time.

Mitsui at first planned to build shuttle terminals, but turned the task over

to CHS with its superior expertise in that field. The result, said Johnson, was a venture that paid off for both parties.

Making it work

According to Johnson, the secret to making an international partnership work is a good working relationship between top leadership officials. He noted that differences between Japanese and American cultures make for different management styles, which must be taken into account and adapted to.

“Here in the U.S., we’re used to doing things by Robert’s Rules of Order, with an up-and-down vote,” he said. “In Japan, everybody discusses the issue until a consensus is reached.” He said that this resulted in misunderstandings, in which the Japanese believed a decision had been made while the Americans still anticipated a formal resolution.

Other problems, said Johnson, included ambivalence by older CHS members who remembered being at war with Japan during World War II. However, a trip by the cooperative board of directors to Mitsui Headquarters in Japan helped cement cordial relations. Johnson emphasized that personal relationships between top management must be cultivated, and that he, as CEO of CHS, regarded his ability to call and discuss issues directly with the president of Mitsui as essential.

The CEO of Growmark, Bill Davisson, presented his perspective on another kind of international partnership: having co-op members in other countries. Davisson discussed Growmark’s acquisition of bankrupt United Cooperatives of Ontario (UCO) assets in 1995, saying that the similarities between UCO and Growmark in structure and core business were a good fit, and gave Growmark the opportunity to expand into an area more or less contiguous with its area of operations in the United States.

Problems with the merger included dealing with UCO’s bankruptcy, anti-trust regulation in both the United States and Canada, and issues result-

ing from differing business regulations and statutes, including UCO’s commercial dealings with Cuba, which are forbidden to U.S. firms. Cultural issues, including dealing with French-speaking members and Canadian attitudes toward the acquisition of a Canadian business by a U.S. firm, also posed obstacles to success.

Paperwork on an order must be flawless with foreign customers, or they may think the exporter is ‘trying to pull a fast one on them.’

— David Fuhrman

Personal relationships help

Like Johnson, Davisson emphasized the importance of establishing personal relationships — which in this case involved getting Canadian and U.S. leaders and employees together and allowing them to discover how much they had in common.

Another Growmark acquisition involved gaining a 44-percent interest in MaltaCleyton, Mexico’s second-largest feed company. In the MaltaCleyton case, Growmark bought into an investor-owned, non-cooperative firm. The purchase gave Growmark an entry into a growing market for grain south of the border through a financially sound investment.

Risks and challenges included a very different political and cultural situation from those of Canada and the United States, which might have complicated a

relationship with a Mexican cooperative.

Davisson concluded that, when contemplating international partnerships, cooperatives must be true to their basic principles and assiduous in calculating risks and benefits. If they choose to establish a relationship, they must carefully monitor the results.

Relationships must be carefully nurtured, he said, and local attitudes and issues must be continually taken into account.

Gaining access to technology

Dairy Farmers of America used a joint venture with international partners to gain access to new technology and develop new markets at home, Don Schriver, DFA executive vice president, told the conference. DFA, one of the largest milk marketers in the world, represents nearly one third of U.S. milk production, but had not developed new fractionated products, leaving it with limited outlets for its members’ production.

“Basically,” said Schriver, “we had conventional dairy products, dried milk powder and the government.”

DFA attacked the problem by starting a joint venture in 2000 with Fonterra, a multinational dairy company owned by 13,000 New Zealand dairy farmers that is the largest exporter of dairy products in the world. The venture, called DairiConcepts, combines DFA’s U.S. production capabilities with advanced technology developed by Fonterra, to produce dairy and cheese ingredients for processed food manufacturers.

Items produced by DairiConcepts include various proteins, fats, dairy-derived artificial flavors, milk- and cheese-based modified powders, powders for infant formula and adult nutritional beverages and preparations, and hard Italian cheeses. Many of its products are used in the manufacture of convenience foods such as snacks, ready-to-eat meals, sauces, soups and baked goods.

The partners initially each contributed about \$25 million to the ven-

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Bye-Bye Business Judgment Rule?

By Donald A. Frederick
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Cooperative directors owe a fiduciary duty to the membership to exercise their authority in the best interests of the association and all of its members. In lawsuits claiming directors violated their duty, courts have routinely applied the “business judgment rule.”

In its simplest terms, the business judgment rule provides that a board action is protected from challenge if there is a good business justification for the decision and it isn’t fraudulent or an abuse of discretion. When the business judgment rule is applied, the burden of proof to establish the impropriety of the decision is on those challenging it.

But in today’s environment of heightened concern over the diligence of directors, courts may begin looking for another standard for measuring director conduct. In a recent decision involving a suit against a housing cooperative and most of its directors, the appellate court said the trial court should have applied a “reasonableness” test, and the burden of proof should be on the directors to prove their actions were indeed “reasonable.”

Case facts

In 1974, an apartment building on Wisconsin Avenue in the District of Columbia was converted to a housing cooperative. The cooperative association financed the purchase with money

borrowed from the developer who had owned the building, and signed a 30-year mortgage repayment agreement with the developer. A pro-rata share of the mortgage obligation was assigned to each housing unit in the building, based on the relative value of the units at the time. Contracts between the cooperative and its members required the members to make monthly payments on their share of the mortgage, which the cooperative used to pay its monthly obligation to the lender.

The contracts between the cooperative and its members permitted the members — at their option — to prepay their mortgage obligation. Over the first 20 years of the mortgage, a small minority of the members prepaid their obligation.

By the mid-1990s, the developer was bankrupt and his assets were controlled by a bankruptcy trustee. The cooperative had several unresolved claims against the developer. The cooperative had a cash reserve comprised in large part of payments from members. It struck a deal with the bankruptcy trustee to pay off the remaining balance due on the mortgage, less a negotiated amount for its claims against the developer.

After this deal was completed, the directors made two decisions which led to a lawsuit. First — since the mortgage that was the basis for the contracts requiring special monthly payments from the members no longer existed — the board voted to forgive the amounts remaining on those notes. Second — since there were no notes to forgive in the case of the members who prepaid their obligation — the board deliberated at length over whether the coopera-

tive should pay a rebate to those members on the theory that they had overpaid. After consulting with legal counsel, the board determined it had no equitable basis to justify the rebates and so voted not to use cooperative funds to pay the proposed rebates.

Two members who had prepaid their obligation, including one person who was a director at the time and had argued and voted for rebate payments, sued the cooperative and the other directors for breach of contract and breach of fiduciary duty. They asked for monetary damages equal to the amount they alleged they would have saved had they not prepaid their obligation and been treated the same as the other members, including the other directors.

Trial court applies business judgment rule

Both sides of the case moved for summary judgment, a decision by the court that they will prevail even if the facts are interpreted favorably for the other side. The trial court denied the motion of the unhappy members and granted the motion of the cooperative. First, the court said the unhappy members hadn’t shown it any provision of their contract with the cooperative that could have been violated by the cancellation of the notes covering the mortgage.

As to breach of fiduciary duty, the trial court referred to the business judgment rule and concluded there was no evidence that the board acted hastily or irresponsibly. Thus, a jury could not rationally conclude the board engaged in any misconduct subjecting the cooperative to liability.

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Largest 100 agriculture co-ops post strong margins in 2004

Top 100

By David Chesnick, Ag Economist
USDA Rural Development

The rapid rate of change impacting the nation's 100 largest agricultural cooperatives slowed considerably in 2004 from the previous several years. It was not only a year of stabilization, but of strong performance, as the top 100 ag co-ops posted record gains in sales and margins (table 1), based on USDA's preliminary survey results. Total operating revenue for the top 100 jumped 19

percent, to \$70 billion. All co-op commodity groups reported increased revenue. Dairy and diversified cooperatives led the way, accounting for two-thirds of the total revenue increase.

Gross margins were up 28.4 percent, reaching \$6.9 billion. The largest increase was in the dairy sector, which accounted for 61.5 percent of the total jump in gross margins for the top 100 co-ops. Fruit/vegetable and rice were the only sectors to record a decline in gross margins. Despite higher sales for

these two sectors, fruit/vegetable and rice cooperatives paid a higher cost of goods sold. Thus, it appears likely that these cooperatives returned more to their members up front, rather than as patronage later on.

Operating expenses also jumped 24.2 percent, to \$5.4 billion. Dairy co-ops again had the biggest jump in operating expenses, which increased \$859 million. That jump accounted for nearly three-fourths of the top 100 co-ops' total increase in operating expenses.

Table 1—Consolidated Statement of Operations, 2003-04, Top 100 Cooperatives; values in \$1,000

	2004	2003	Difference	% Change
Revenues				
Marketing	53,529,034	43,833,692	9,695,342	22.1%
Farm Supply	15,957,236	14,504,208	1,453,028	10.0%
Total Sales	69,486,270	58,337,900	11,148,370	19.1%
Other Operating Revenues	733,875	653,915	79,960	12.2%
Total Operating Revenues	70,220,145	58,991,815	11,228,330	19.0%
Cost of Goods Sold	63,344,425	53,638,947	9,705,478	18.1%
Gross Margin	6,875,720	5,352,868	1,522,852	28.4%
Expenses				
Operating Expenses	5,450,743	4,388,502	1,062,241	24.2%
Net Operating Margins	1,424,977	964,366	460,611	47.8%
Other Revenues (Expenses)				
Interest Expense	(424,624)	(398,052)	(26,572)	6.7%
Interest Revenue	18,722	25,582	(6,860)	-26.8%
Other Income	212,961	345,594	(132,633)	-38.4%
Other Expenses	(194,017)	(119,278)	(74,739)	62.7%
Patronage Revenue	164,601	96,985	67,616	69.7%
Net Margins from Operations	1,202,620	915,197	287,423	31.4%
Non-Operating Rev. (Exp.)	(47,716)	(44,709)	(3,007)	6.7%
Net Margins	1,154,904	870,488	284,416	32.7%
Distribution of Net Margins				
Cash Patronage Dividends	291,403	285,044	6,359	2.2%
Retain Patronage Dividends	502,570	383,756	118,814	31.0%
Nonqualified Noncash Patronage	30,055	7,296	22,759	311.9%
Dividends	19,172	18,937	235	1.2%
Unallocated Equity	194,009	114,182	79,827	69.9%
Income Tax	117,695	61,274	56,421	92.1%
Total Distribution	1,154,904	870,488	284,416	32.7%

Operating margins soar \$1.4 billion

Operating margins for the top 100 shot up a whopping 47.8 percent, to \$1.4 billion. Leading the increase were poultry/livestock cooperatives, a reversal of fortune from 2003, when poultry/livestock cooperatives were the only commodity group to post operating losses. In 2004, top 100 cooperatives in this sector had operating margins of \$238 million, a 634-percent jump from the year before.

Fruit/vegetable and rice cooperatives saw operating margins decline from 2003 to 2004, mostly due to lower gross margins. However, fruit/vegetable cooperatives still posted solid operating margins of \$204 million. Rice cooperatives continue to operate with tight margins.

Despite lower total debt levels, interest expense for the largest 100 agriculture cooperatives increased 6.7 percent, to \$425 million. The dairy sector saw interest expense climb 32.8 percent, to \$71 million. Poultry/livestock cooperatives also saw interest expense rise from \$9 million in 2003 to \$37 million in 2004.

“Other revenue,” including interest income and revenue from operating sources not directly related to operations, was down 37.6 percent, to \$232 million. Nearly all co-op commodity groups except for cotton, diversified and grain saw other revenue decline. “Other expenses” were up 62.7 percent, to \$194 million. The largest increase in other expenses occurred in the diversified and poultry/livestock cooperatives.

Patronage refunds received from other cooperatives were up 69.7 percent, to \$165 million. However, 78.3 percent of that total increase was due to dairy cooperatives, which received \$72.4 million in patronage refunds for 2004. Fruit/vegetable cooperatives were the only commodity group to see patronage refunds decline.

The 100 largest ag co-ops suffered a 6.7-percent increase in non-operating expenses, which ended 2004 at \$48 million. These non-operating expenses or

revenues are usually one-time situations, such as accounting changes or gains and losses from discontinued operations.

Net margins were up 32.7 percent, to \$1.2 billion. Leading the jump were poultry/livestock cooperatives. They moved from a net loss of \$67 million in 2003 to net margins of \$150 million in 2004. The largest decline in margins occurred in the fruit/vegetable cooperatives, which declined 28.2 percent, to \$154 million.

Assets up 5.5 percent

Assets for the nation's 100 largest agriculture cooperatives were up 5.5 percent (table 2) in 2004. Driving the increase were current assets, which climbed 8.3 percent and ended 2004 at \$12.7 billion. Nearly all commodity groups had an increase in current assets, with the exception of diversified cooperatives. Current assets for diversified cooperatives dipped 0.1 percent, to \$3.4 billion.

Cash assets had the largest percentage increase, jumping 23.4 percent, to \$1 billion. Cotton, dairy, grain, poultry/livestock and sugar cooperatives all had higher cash balances in 2004. Poultry/livestock cooperatives had the largest increase, \$127 million.

Accounts receivable were up \$410 million, to \$5 billion. All commodity groups experienced an increase in accounts receivable. However, it is more likely a result of higher sales than a collection issue. This is illustrated by the “days sales in accounts receivable” ratio. This ratio divides accounts receivable by the average daily sales. A higher number will indicate the longer it takes to collect on sales. This average value for all cooperatives dropped from 28.1 days to 26.8 days.

Inventory for the top 100 co-ops was up \$133 million, to \$5.3 billion. Diversified and grain cooperatives were the only commodity groups that had declining inventory levels. As with accounts receivable, most of the inventory buildup is likely a reaction to

higher sales.

Total investments were down a slight, 0.7 percent, to \$3.4 billion. The drop in investments was mostly due to investments in other cooperatives, including cooperative banks. Diversified, grain and poultry/livestock cooperatives accounted for nearly 85 percent of the total drop in cooperative investments.

By contrast, investments in other businesses were up 3.2 percent, to \$1.4 billion. Dairy, diversified, farm supply and grain cooperative accounted for about 99 percent of the total increase in non-cooperative investment.

Modest investment gain for co-op fixed assets

Investments in fixed assets were up 0.4 percent for the largest agriculture cooperatives in 2004. The average amount of fixed assets purchased was \$12 million, up from \$10 million in 2003.

Other long-term assets were up \$338 million, to \$2.4 billion. Dairy cooperatives accounted for nearly the total increase.

Total liabilities were up 5.3 percent, to \$15 billion. Driving the surge were current liabilities, which were up 9.9 percent, to \$9.6 billion in 2004. Total long-term liabilities were down 1.8 percent, to \$5.7 billion.

Despite higher overall liabilities, debt was lower in 2004. Short-term debt was down 2.2 percent, to \$2.2 billion, and long-term debt less current portion was down 3.8 percent, to \$4.5 billion.

The decline in short-term debt was mostly due to diversified and grain cooperatives. Diversified cooperatives had a large increase in their cash flow from operations and were able to pay off some of their outstanding short-term loans. They also appear to have transferred some of their working-capital financing to vendors in the form of higher accounts payable.

Grain cooperatives seem to have shifted some of their working capital

loans to longer term debt and member liabilities. All the other commodity groups had higher working capital loans.

Accounts payable jumped 10.7 percent, to \$3.5 billion. Most of the increase was in the dairy and diversified groups. It is interesting to note the jump in accounts payable for diversified cooperatives. Generally, accounts payable are used for short-term financing of inventory. However, diversified

cooperatives actually reduced the amount of inventory carried. This indicates they were funding more of their operations with accounts payable. On the other hand, cotton and sugar cooperatives were the only commodity groups with lower accounts payable.

Members payable and patron and pooling liabilities were up for nearly all co-op commodity groups. Generally, these are amounts owed to members/patrons for commodities marketed

through the cooperative. Higher sales of member commodities will correspond with higher member/patron liabilities.

The only exception to this was rice cooperatives. Despite higher sales, member/patron liabilities were down 31.6 percent.

Other current liabilities were up 13.8 percent. All commodity groups had higher "other" current liabilities.

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Table 2—Combined Balance Sheet, 2003-04, Top 100 Cooperatives; values in \$1,000

Assets	2004	2003	difference	% change
Current Assets				
Cash	1,039,778	842,342	197,436	23.4%
Accounts Receivable	5,017,090	4,606,763	410,327	8.9%
Inventory	5,253,630	5,120,194	133,436	2.6%
Other Current Assets	1,416,470	1,185,499	230,971	19.5%
Total Current Assets	12,726,968	11,754,798	972,170	8.3%
Investments				
Cooperative Banks	264,958	281,697	(16,739)	-5.9%
Other Cooperatives	1,389,468	1,451,779	(62,311)	-4.3%
Other Investments	1,792,428	1,737,674	54,754	3.2%
Total Investments	3,446,854	3,471,150	(24,296)	-0.7%
Net PP&E	6,482,415	6,456,628	25,787	0.4%
Other Assets	2,447,885	2,110,172	337,713	16.0%
Total Assets	25,104,122	23,792,748	1,311,374	5.5%
Liabilities				
Current Liabilities				
Total Short-term Debt	2,151,072	2,199,392	(48,320)	-2.2%
Accounts Payable	3,470,214	3,134,431	335,783	10.7%
Member Payables	701,620	569,528	132,092	23.2%
Patron and Pool Liabilities	1,668,822	1,415,441	253,381	17.9%
Other Current Liabilities	1,585,597	1,392,734	192,863	13.8%
Total Current Liabilities	9,577,326	8,711,526	865,800	9.9%
Long-term Debt				
less current portion	4,506,261	4,683,228	(176,967)	-3.8%
Other liabilities and deferred credits	1,145,948	1,069,691	76,257	7.1%
Total noncurrent liabilities	5,652,209	5,752,919	(100,710)	-1.8%
Total liabilities	15,229,535	14,464,445	765,090	5.3%
Minority interest	908,701	944,740	(36,039)	-3.8%
Member equity				
Preferred stock	967,812	945,293	22,519	2.4%
Common stock	176,689	174,714	1,975	1.1%
Equity certificates and credits	6,337,951	6,047,219	290,732	4.8%
Unallocated capital	1,483,434	1,216,337	267,097	22.0%
Total equity	8,965,886	8,383,563	582,323	6.9%
Total liabilities and equity	25,104,122	23,792,748	1,311,374	5.5%

Measuring cooperative performance

By David Chesnick, Ag Economist
USDA Rural Development

This financial analysis views the nation's 100 largest agriculture cooperatives, taken as a whole. To get a better picture of the cooperative landscape, this section will focus on performance measures. Selected average ratios are used for this analysis (table 1). The average ratio is used to mitigate the effects of the largest cooperatives on the performance measurements. The average ratio gives equal weight to all cooperatives and provides an additional perspective on the performance of the nation's largest agriculture cooperatives.

Liquidity measurements are used to judge short-term stability of a business. In this analysis, we use the current and quick ratios. The current ratio is current assets divided by current liabilities. This provides an insight into how well the cooperative can meet its current obligations.

The quick ratio is similar to the current ratio except that inventories are excluded from the current assets. Inventory is usually considered the least liquid of these assets. Thus, excluding them from this analysis may provide a more accurate picture of liquidity.

There was no change in the average current ratio for all of the top 100 cooperatives. However, there were variations within the different commodity sectors. Diversified, fruit/vegetable, poultry/livestock and rice cooperatives had some loss in their liquidity, as both current and quick ratios fell. The one exception was the diversified cooperatives, which improved their average quick ratio due to lower inventory levels relative to other current assets. All other commodity groups showed improved liquidity.

Leverage ratios

Leverage ratios provide insight into the use of debt to finance the cooperative. Debt-to-equity examines the percentage of assets held by outside interests. The average debt-to-equity ratio for the top 100 co-ops remained relatively steady from 2003. There were variations within the commodity groups, but the variations were substantial with the exception of cotton, poultry/livestock and rice.

Substantial changes would be those that move more than 1 percentage point. Both cotton and poultry/livestock reduced their reliance on outside financing by 3 percentage points. Rice co-ops, on the other hand, showed a jump in their average debt-to-asset ratio, moving from 47 to 51 percent.

Long-term debt-to-equity focuses more on the long-term stability of a business. For all cooperatives, the average long-term debt-to-equity improved dramatically, moving

from 81 percent to 67 percent. Grain cooperatives were the only commodity group to rely more on long-term debt than on equity. Their ratio went up from an average of 46 percent to 51 percent. This also could be a concern due to an increasing trend since 2001 to use more debt relative to equity for long-term financing of the cooperative.

Of course, the use of leverage can be beneficial if the business can generate more margins than it costs to service that debt. The times-interest-earned ratio examines how many times margins can cover interest expense. While interest expense went up for most of the largest agriculture cooperatives, net margins seemed to increase more. The average times-interest-earned ratio increased from 3.3 times to 3.9 times.

Rice and sugar co-ops had declining average values of times-interest-earned. Rice showed the largest average drop, falling from 9.3 to 4.0

Efficiency ratios

Efficiency ratios show how a business uses its assets to generate sales. The average local asset turnover for the top 100 increased from 3.2 to 3.5 in 2004. This suggests that, on average, every dollar invested in assets generates \$3.50 in sales. With the exception of fruit/vegetable cooperatives, all other commodity groups were able to generate more revenue on the assets they employed.

Fruit/vegetable cooperatives slipped from 2.4 to 2.2 times. However, this was due to the restructuring of one cooperative. Excluding it, the average local asset turnover actually increased from 3.5 to 3.6 times.

Fixed asset turnover focuses specifically on how well the cooperative business uses its fixed assets to generate sales. Similar to the average local asset turnover, higher sales lifted most fixed asset turnover ratios. The average fixed asset turnover for the top 100 cooperatives rose from 16.2 to 17.9 times. Only cotton cooperatives had a lower ratio. Cotton cooperatives' average fixed asset turnover fell from 22.2 to 21.1 times.

One cotton cooperative made a large purchase of fixed assets in 2004. So this decline may be temporary if the investment can generate higher sales in future years.

Profitability ratios

While cooperatives are generally considered "not for profit" enterprises, they do need to generate enough margins to compensate for their members' investment. Therefore, profitability ratio trends that show margins eroding can indicate that a cooperative is heading for trouble.

The gross margin percent gives an indication of the pricing strategy of the cooperative. If a marketing cooperative is

paying too much for its member's product or a supply cooperative isn't charging enough for its products, there may not be enough gross margins left to cover operating expenses.

The average gross profit margin of the top 100 co-ops fell from 14.7 percent to 13.9 percent in 2004. This is a good time to point out the influence of some of the largest cooperatives within the top 100 database. Looking at table 1, the increase in total sales for all cooperatives exceeded the increase in total cost of goods sold. This resulted in a cumulative gross profit margin increase from 9.1 percent to 9.8 percent in 2004. This is in direct conflict with the average gross profit margin.

The top 10 cooperatives generate 58 percent of total operating revenues for the top 100. Therefore, while the overall picture has been rosy, there is cause for concern with the top 100 cooperatives. The average gross profit margin has been slipping during the last 5 years. In 2000, the average gross profit margin was 15.2 percent and has declined almost every year since then.

Looking at the gross margins trend doesn't tell the whole story. While it is true that the gross margins have declined over the past 5 years, if the cooperatives are becoming more efficient in the use of their assets and other inputs, the lower gross margins wouldn't hurt a cooperative. Therefore, members could benefit upfront from the pricing strategy of the cooperative. Higher efficiencies will show up in higher net margins.

The net margins percent looks at net margins divided by total operating revenue. For the largest agriculture cooperatives, the average net margin percent fell 0.1 percentage point, to 1.6 in 2004. Fruit/vegetable, rice and sugar co-ops averaged the largest decline in net operating margins, each declining between 1 and 2 percentage points. However, these three commodity groups experienced a substantial jump in net margins in 2003. The slide in 2004 still left them with an average ratio of just under 2 percent, which is higher than the overall average ratio for the top 100.

Poultry/livestock co-ops had the largest increase in net profit margins. They had a net loss of 1.1 percent in 2003, but improved to 2.1 percent net margin in 2004.

Return on assets & equity

Return on assets looks at net margins before interest and taxes are deducted. This looks at the total return for

all interested parties, including debt holders and government. The average return on assets for all top 100 ag cooperatives increased from 6 percent in 2003 to 6.3 percent in 2004. However, fruit/vegetable, rice and sugar all had declining average return on assets.

The fruit/vegetable co-op sector fell from an average of 14 percent to 8.3 percent, while rice fell from 10.9 percent to 6 percent in 2004. These two commodity groups had the largest average decline. Sugar fell from 5.6 to 4.8 percent.

There was a substantial jump in the average return on assets for cotton and poultry/livestock cooperatives. Cotton cooperatives increased from an average of 13.3 percent to 17.3 percent, while poultry/livestock cooperatives increased from 0.7 percent to 7.4 percent.

Return on member equity measures the return only to equity investors. In other words, interest and taxes are deducted from net margins. The difference between the return on assets and return on member equity illustrates the effect of leverage.

For example, the average return on assets in 2004 was 6.3 percent while the average return on member equity was 11.8 percent. This 5.5 percent difference represents returns to members for using outside financing

where the cost of borrowed funds was less than the returns generated from those funds. The average return on member equity fell from 13.3 percent in 2003 to 11.8 percent in 2004.

Co-ops in good shape

Overall, the largest agriculture cooperatives are in good shape. There has been some decline in their gross margins, but efficiencies have been able to keep net margins from sliding too far. The level of debt has been reduced.

However, the use of credit and member payables helped fund operations. This leverage has given most members of the largest agriculture cooperatives higher returns on their investment than they would have received if they had been able to invest the total amount. Nevertheless, it is important to keep in mind that much of the outside funding is located in the current account. As long as operations continue to show improvement, this should not be too much of a concern.

However, if operations should fall short for some cooperatives within the next year or two, there could be a further shake up in the top 100 agriculture cooperatives. ■

Table 1—Selected ratios, 2003-04, Top 100 Cooperatives

	2004	2003
Current Ratio	1.35	1.35
Quick Ratio	0.73	0.73
Debt-To-Assets	0.64	0.63
Long-Term Debt-To-Equity	0.69	0.81
Times Interest Earned	3.85	3.31
Local Assets Turnover	3.48	3.24
Fixed Assets Turnover	17.89	16.19
Gross Profit Margin Percent	13.89%	14.72%
Net Margin Percent	1.63%	1.75%
Return On Total Assets	6.28%	5.97%
Return On Members Equity	11.83%	13.29%



Idaho Straw Value-Added Committee

Southern Idaho

About the group:

The Idaho Straw Value-Added Committee (SVAC), led by Grant 4D Farms, consists of an 86-member steering committee of wheat and barley growers in the southern and eastern third of Idaho. The group is pursuing the formation of a cooperative or producer-owned Limited Liability Co. (LLC) to develop advanced harvesting, storage, pre-processing and transportation systems to supply straw to industrial processors. The systems are being designed to meet the industry standards that growers and suppliers have to comply with to supply feedstock for ethanol and other bio-products.

Business objective:

The committee's objective is to have member-growers supply nearly 1 million tons of high-quality straw annually to a cellulose ethanol biorefinery. Iogen Corporation, a Canadian firm partially owned by Royal Dutch Shell, is considering the construction of such a refinery in Idaho. Current plans call for a facility capable of processing 600,000 to 800,000 tons of straw annually, with an output of approximately 55 to 65 million gallons of ethanol.

If the committee is successful in forming a cooperative and meeting its production goals, farmers could collectively earn an additional \$25 million to \$30 million annually, by selling straw products to Iogen. This Idaho industry could produce up to 65 million gallons of ethanol beginning in 2009. This emerging technology not only would invigorate and revitalize Idaho's rural agricultural economy, it would also contribute to the nation's energy security.

Key players:

The Idaho Wheat Commission, a grower-funded market development agency, funded a 1995 study to quantify the tonnage of straw available across Idaho. Building upon the base knowledge that more than 2 million tons of straw was available for development, the commission conducted several outreach programs to raise awareness of the unused asset. Interested Idaho growers were informed and, working with a variety of groups — including the National Association of Wheat Growers, the Idaho Grain Producers, the Idaho Wheat Commission and the U.S. Department of Energy's Idaho National Laboratory (INL) — began exploring new markets. These efforts culminated in a "straw tour" of Idaho, during which Iogen — as an invited participant — saw the potential of a plant in southern Idaho.

USDA VAPG funding:

The availability and suitability of Idaho straw — as well as numerous logistical issues associated with harvesting and delivering the required 800,000 tons of straw annually — were serious impediments to successfully locating a bio-refinery in Idaho. Growers decided to seek a USDA Rural Development grant for a feasibility study on whether they could supply a large bio-refinery. Grant 4D Farms, serving as lead for the project, was awarded \$450,000 through USDA's Value-Added Producer Grant (VAPG) program for planning purposes, including a feasibility analysis, marketing and business operations plans. This initial funding was supplemented by \$475,000 in cash and in-kind contri-

butions by project partners, including Iogen, Diamond Z Corporation, Trinity Trailer Corporation, MacRae Custom, D&L Custom, KM Custom and CaseIH Corporation.

The technology:

Iogen, with a significant investment from Petro-Canada, began producing the world's first cellulose ethanol fuel for commercial use in 2004. After looking around the world, it identified southern Idaho as one of the best locations for a straw-to-ethanol facility. Idaho's assets include a highly productive and relatively dry climate, as well as proximity to INL's energy research center.

According to Iogen's Maurice Hladik: "Iogen is an enthusiastic participant in what is probably the most serious and practical research effort into new fundamental approaches of harvesting and transporting massive amounts of feedstock for the cellulose ethanol industry. The cooperative approach by Idaho farmers that took the lead on this initiative, along with USDA, the Idaho National Laboratory and the private sector, has proven to be a highly effective combination of diverse resources and skills to yield such practical results."

Iogen officials say their long-term plans call for siting additional bio-refinery facilities in biomass-basins throughout North America and other continents. Other public and private groups have expressed a similar belief that cellulose ethanol will be viable wherever sufficient quantities of feedstock are available. Consequently, producers of wheat, corn, sugarcane, switch grass and other commodities throughout the

United States will have opportunities to access a new market as cellulose bio-refining comes of age.

Collaborative efforts:

Under this partnership, growers and other collaborators have identified and resolved issues related to the quantity and quality of straw to be harvested, use and condition of existing harvesting equipment, alternatives for storing straw and transporting it to a potential biorefinery. The University of Idaho

ethanol at its Ottawa, Canada, demonstration plant.

Business model:

At this point, the committee has not determined the business structure best suited for the value-added business in Idaho. However, it is looking at several possibilities, each of which would require early negotiations and full integration into Iogen's biorefinery operating plan to be successful. Models include:

- A new-generation (closed) cooperative

Apart from these dealings, Iogen is working with investors to secure financing to build a biorefinery. The company is also working to qualify for loan guarantees made available for new energy technologies through provisions of U.S. energy legislation enacted by Congress in 2005. Current development plans call for an investment of approximately \$300 million for the cellulose ethanol plant plus cogeneration and enzyme facilities.

Importance of USDA backing:

"The USDA Rural Development grant provided the boost we needed to demonstrate how ideal Idaho is for siting a straw bio-refinery. Even more important, the VAPG is helping to demonstrate that cellulose-based ethanol has a place in the nation's energy portfolio," says Grant 4D Farms owner Duane Grant. "With this seed money, Idaho farmers demonstrated the feasibility of locating a bio-refinery in Idaho. And in 10 years, we'll look back and recall that receiving USDA's grant was the pivotal turning point in our push to launch the cellulose ethanol industry in Idaho. Thanks to the VAPG, we have demonstrated that we can consistently supply straw on an industrial scale to a commercial bio-refinery."

Major challenge/opportunity facing co-op:

The major problem facing producers is how to best assemble, store, prepare and deliver nearly 1 million tons of straw that would be required by a cellulosic ethanol facility each year. The availability and cost of the feedstock, the lack of confidence in the conversion technology and the hesitancy of financial backers to lend capital are still seen as barriers to this business venture. But, with USDA's assistance and the persistence of Idaho farmers, these barriers are being overcome.

Other challenges, revolve around the successful launch of the cellulose-based ethanol industry. Significant technical and political issues remain to be addressed. Iogen is clearly the world leader in this area, and through ongoing

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The Idaho Straw Value-Added Committee is pursuing the formation of a producer-owned co-op or LLC to supply a proposed ethanol plant that would produce fuel from straw. Here, growers celebrate a milestone in the effort, when they hauled two truckloads of Idaho straw to Ottawa, Canada, where it was processed into ethanol. Photo by Maurice Hladik

characterized and quantified aspects of feedstock production. Southern Idaho farmers worked with INL and others to understand and resolve issues related to harvesting, storing and pre-processing the feedstock; to protecting the integrity of the straw while in temporary storage; and to clarify methods to transport biofeedstock in compliance with a refinery's product specifications.

Iogen has already participated, as an end-user, to demonstrate the technology necessary to successfully convert the straw into fuels and chemicals, and to define the requirements of the receiving biorefinery. As part of the feasibility project, Iogen successfully processed two 20-ton loads of Idaho wheat and barley straw into cellulose

that follows a model successfully proven in other agriculture businesses (such as sugar processing co-ops). Members of the cooperative would purchase stock in proportion to the quantity of straw each member would sell to the processor. An advantage of this arrangement is the economic benefit that could be broadly shared, co-opting the broader grower community in the success of the venture and increasing the assurance of a sustainable supply of straw.

- A closely held stock company that raises initial investment capital by selling stock to a limited number of investors or entities currently involved in agricultural production in southern Idaho.

An Art & Science

Revised co-op development curriculum gets test drive in Madison workshops

By Jane Livingston

Editor's note: Livingston is a Maine-based freelance communicator and marketing consultant who specializes in cooperatives. mejane@gwi.net.

It may not be happening as rapidly as some would like, but it's happening. The co-op model is catching the attention of people outside 'the usual cast of characters.' In fact, the 21 cooperative development center-members of CooperationWorks! have seen requests for assistance triple in the past three years.

"Cooperatives may be one of the best kept secrets in America, but we're working to change that," says Audrey Malan, executive director of CooperationWorks!, whose member-centers serve people in 45 states.

Interest in the co-op business model is coming — as it always has — from entrepreneurial types who want to be in business for themselves, but who lack the capital or other resources to do it. Others simply prefer to share the risks and rewards of business ownership. Increasingly, interest in co-ops is coming from economic development loan funds, financial institutions, government officials, community nonprofit organizations, religious congregations and chambers of commerce.

"Too many development groups and business educators still don't know enough about the cooperative business model," Malan says. "Yet the potential for cooperative enterprise to play a role in economic development is enormous



"Too many development groups and business educators still don't know enough about the co-op business model," says Audrey Malan, executive director of CooperationWorks!, seen here leading a workshop in Madison. Opposite page: Workshop participants gather for a class photo. Photos by Eric Bowman, NW Co-op Development Center

as communities struggle to find solutions to shared challenges in agriculture, energy, affordable housing, health-care, childcare, senior services and the creation and retention of good jobs."

Development practitioner may hold key

Cooperative business development holds great promise, but it's a tall order to fill. An effective development practitioner is often the key to helping a group of people implement sound business practices *and* help them engage in running their business in a truly cooperative way.

"It can be a big challenge to start a cooperative, especially for those new to it," says Malan, who worked as a cooperative business development practitioner in Washington state prior to taking the reins at CooperationWorks!

"In its formative stages — typically a

two-year process — a co-op can be sabotaged by its lack of information, access, skills or experience. Co-op development specialists can make the difference, from providing technical business assistance to helping people learn how to recognize and act on business opportunities.

"This can range from demonstrating how to operate a business in a democratic and professional way, to linking co-op members with community partners and surfacing co-op leadership. A skilled co-op development practitioner is a valuable community asset."

Accelerating skill development

To accelerate and increase professional competence of co-op development practitioners, CooperationWorks! has revised its training program. In two intensive, five-day sessions held in Madison, Wisc., during May and

November, 31 participants test-drove the revised program. Afterward, participant evaluations were highly positive.

Anne Reynolds, assistant director of the University of Wisconsin Center for Cooperatives, was a consultant for the CooperationWorks! 2005 training program, called 'The Art and Science of Cooperative Business Development.' "We used the theme of 'art and science' to acknowledge that cooperative development is both," she says.

"You're seen as an expert in some sense. Like a scientist," Reynolds continues, "you have privileged information. Only your role is not to be the leader; it's to identify and develop leadership. But it's even more. It is also to help the whole cooperative group work together. You have to be a good facilitator, but you also must have the informa-

tion they expect you to have. That's what makes the role so complex."

tion they expect you to have. That's what makes the role so complex."

The training program grew from a planning committee comprised of co-op experts from around the country. It offered participants a mix of classroom work and more experiential learning.

Participants are engaged in detailed case studies during which small groups

explore the nitty gritty of several successful cooperative enterprises. A well-planned menu of site visits allowed trainees to question and observe how the principles and values of cooperation are practiced "on the ground."

"It was a very thoughtful process," says Margaret Bau, cooperative development specialist for USDA Rural Development in Wisconsin, who was on the planning committee and a trainer in the program. "We asked current cooperative development practitioners, co-op attorneys and accountants to identify 'the perfect training.' We got all kinds of great ideas, then winnowed them down to what was manageable."

Session One concentrated on the 'science' of co-op development. It employed comparative business models; critical development steps (including

items thinking and conflict management.

Understanding group dynamics

Understanding the group dynamics of cooperatives is an evolving field, notes Bau, who has helped a number of homeware workers' co-ops emerge in

"The group dynamic can bring synergy, or tear things apart."

—Margaret Bau



recent years.

She speaks highly of the program's team development and the focus on working effectively with groups.

"The group dynamic can bring synergy, or tear things apart," Bau observes. "We can learn what to be aware of, what to look for, how to respond. We can take what we learn back to all the co-ops we work with, and become bridges for all this valuable experience — from the successes to the start-ups."

"Even though I've been doing co-op development for 7 years, the training was a growing experience," Bau adds. "We did some internal conflict awareness and resolution...that hit home because it was paired with case studies and site visits."

Participant Eric Bowman, of the Northwest Cooperative

Development Center, was impressed by the caliber of trainers, the substance of program content and the flexibility and diversity of its delivery. "Practitioners have some of the same challenges, and we can use some of the same techniques to mitigate them," he says. "This program increased my ability to understand the needs of groups, to anticipate pit-

falls and to cope better with the inevitable. And it gave me the bigger picture of how our center fits into the national system. This is a very important time for us to be paying attention to one another.”

Sharing information, insight, resources, challenges and strategies to advance cooperative enterprise is the reason CooperationWorks! was created. Its member centers have developed nearly 400 new rural businesses, owned and controlled by more than 47,000 members and created 5,800 new jobs. Investment in these co-op businesses exceeds \$900 million.

USDA provides support

The centers receive core funding through the Rural Cooperative Development Grant program of USDA Rural Development, and use it to provide critical services to those seeking to start or strengthen a cooperative enter-

prise. New co-ops generate new tax revenue, new jobs and new wealth for rural America.

For example, Minnesota alone — one of the states where co-op impact data has been measured — employs nearly 80,000 people in cooperatives, and generates about \$11 billion in total direct, indirect and induced impact. And because they are locally owned, these cooperatives' patronage dividends returned to owners generate another \$600 million in economic impact.

Many in the co-op world are seeing this as a time of tremendous opportunity for cooperatives to help strengthen local and regional economies. CooperationWorks! President Bill Patrie agrees. “As people find ways to work together for mutual benefit,” says Patrie, “they are reaping huge economic and social rewards. Cooperation is one of the most powerful development tools in America.”

Patrie, Malan and others often point to electric co-ops as examples of how the business model benefits rural people. These co-ops were created by farmers and ranchers, who wired rural America in the early days of electricity when rapidly growing investor-owned utility companies didn't see enough profit in those sparsely populated areas.

In contrast to recent corporate scandals, Malan says “electric cooperatives —transparent businesses owned by their members — stand as a beacons of light, integrity and high economic and community value. Clearly, cooperative businesses are an effective development strategy. To make them work, we need effective cooperative business development professionals.”

For more information on CooperationWorks!, go to: www.cooperationworks.coop, or contact them at (307) 655-9162; e-mail: cw@vcn.com.



The Madison Principles

Professional standards for co-op development practitioners revised

Editor's note: The principles were first written by members of CooperationWorks! in Madison, Wis., in 1995, and were recently revised to reflect the consensus of co-op development practitioners.

1. Cooperative developers subscribe to the highest level of ethics and shall declare any conflict of interest, real or perceived, so that they can be a credible source of objective feedback and an articulate advocate of the project as needed.
2. There are essential development steps that must be taken in a critical path to success.
3. An enthusiastic group of local, trustworthy leaders is a prerequisite for providing technical assistance. The effective cooperative developer nurtures that leadership by helping them shape a vision that will unite members and provide ongoing training.
4. Cooperatives only work when they are market driven; the cooperative developer works to ensure that accurate market projections precede other development steps.
5. Member control through a democratic process is essential for success. Success also depends on the commitment of the members' time, financial resources and loyalty to the cooperative.
6. There must be tangible benefits for members.
7. The cooperative's products and services must generate sufficient revenue so the effort can be financially self-sustaining. Provisions must be made to share any surplus equitably.
8. Each cooperative responds to its unique economic, social and cultural context; as a consequence, each cooperative is different.
9. Cooperative developers link emerging cooperatives with established cooperatives to facilitate mutual communication and learning.
10. Cooperatives are tools for development and promote social empowerment and economic goals.
11. Applied appropriately, cooperatives have value to all population groups and for all businesses and services in the public and private sectors.
12. Opportunities for human cooperation exist throughout the world. Cooperative development transcends national boundaries.





How does your local farm supply co-op rate?

Beverly L. Rotan, Ag Economist,
USDA Rural Development



as your cooperative fared better, about the same or worse compared to cooperatives with similar sales, product mix, etc. Comparisons with other cooperatives using trends and industry norms

may help to determine whether your cooperative is doing well or poorly.

The two tables below contain average financial data compiled from a survey of 263 cooperatives for 2003 and 2004. Fill in the blanks and compare these benchmarks with your cooperative's financial data. How's your cooperative doing?

Compare your farm supply cooperative¹ with averages for cooperatives with similar functions.

Measure/Item	Unit	Size (2003) ^{2,3}				Size (2004) ^{2,3}				Your	
		Small	Medium	Large	Super	Small	Medium	Large	Super	cooperative	
Sell farm supplies only	Number	65	38	22	9	52	43	27	11	_____	_____
Total assets	Mil. dol.	1.9	3.8	8.0	15.7	1.6	3.7	7.5	16.5	_____	_____
Long-term debt	Thou. dol.	23.8	274.5	574.8	1,895.2	80.7	201.8	495.2	1,611.2	_____	_____
Total liabilities	Thou. dol.	559.2	1,326.7	3,257.8	6,334.6	485.6	1,279.0	2,956.3	6,835.2	_____	_____
Total sales	Mil. dol.	2.9	6.6	13.9	28.7	2.7	6.4	14.4	30.9	_____	_____
Total service revenue	Thou. dol.	73.3	189.0	363.7	718.7	35.7	175.8	190.5	709.0	_____	_____
Total revenue	Mil. dol.	3.0	6.9	14.4	28.8	2.8	6.7	14.8	32.2	_____	_____
Net income (losses)	Thou. dol.	26.7	109.4	266.1	219.9	49.9	170.3	340.1	863.1	_____	_____
Labor of total expenses	Percent	55	53	54	53	55	52	55	54	_____	_____
Patronage refunds received	Thou. dol.	⁴	18.2	45.2	389.3	20.9	61.2	118.6	362.7	_____	_____
Liquidity ratios											
Current	Ratio	1.96	1.53	1.37	1.38	1.98	1.57	1.45	1.36	_____	_____
Quick	Ratio	0.98	0.78	0.74	0.58	0.94	0.78	0.81	0.63	_____	_____
Leverage ratios											
Debt	Ratio	0.30	0.35	0.41	0.40	0.30	0.35	0.40	0.41	_____	_____
Debt-to-equity	Ratio	0.43	0.53	0.69	0.68	0.43	0.53	0.65	0.71	_____	_____
Times interest earned	Ratio	2.73	4.20	5.03	5.57	5.16	6.34	7.19	6.47	_____	_____
Activity ratios											
Fixed asset turnover	Ratio	7.69	6.37	6.25	6.49	9.14	7.42	6.64	7.11	_____	_____
Total asset turnover	Ratio	1.56	1.73	1.73	1.83	1.72	1.73	1.92	1.88	_____	_____
Profitability ratio											
Gross profit margins	Percent	17.96	16.45	16.95	17.71	17.22	15.53	17.69	16.47	_____	_____
Return on total assets before interest and taxes	Percent	2.42	3.95	4.52	7.08	4.16	6.01	5.84	6.83	_____	_____
Return on total equity	Percent	2.82	6.00	8.06	11.67	6.22	9.35	11.67	11.93	_____	_____

¹ 100 percent of sales were generated from farm supply sales.

² Small = Sales are \$5 million or less; medium = over \$5 million to \$10 million; large = over \$10 million to \$20 million; and super = over \$20 million.

³ There were 263 cooperatives surveyed in both years.

⁴ Less than \$1,000. This may be because of write-offs due to regional's demise.

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Compare your mixed farm supply cooperative¹ with averages for cooperatives with similar functions.

Measure/Item	Unit	Size (2003) ^{2,3}				Size (2004) ^{2,3}				Your cooperative	
		Small	Medium	Large	Super	Small	Medium	Large	Super		
Market farm products and											
sell farm supplies	Number	10	8	21	22	10	8	21	22	_____	_____
Total assets	Mil. dol.	1.5	2.7	8.2	19.3	1.8	2.9	7.9	19.7	_____	_____
Long-term debt	Thou. dol.	144.6	318.0	736.5	2,678.7	108.0	309.2	598.4	2,732.0	_____	_____
Total liabilities	Thou. dol.	515.8	1,208.8	3,350.7	9,317.6	651.6	1,298.4	2,928.0	9,268.1	_____	_____
Total sales	Mil. dol.	2.8	5.9	13.7	37.9	2.9	6.4	13.7	43.7	_____	_____
Total service revenue	Thou. dol.	125.7	345.8	607.4	1,524.7	109.8	340.8	707.1	1,340.6	_____	_____
Total revenue	Mil. dol.	3.0	6.3	14.6	40.1	3.1	6.8	14.7	45.9	_____	_____
Net income (losses)	Thou. dol.	42.2	98.9	243.6	766.3	44.6	103.5	274.8	825.4	_____	_____
Labor of total expenses	Percent	54	50	51	54	51	50	52	50	_____	_____
Patronage refunds received	Thou. dol.	28.0	65.4	49.7	283.4	30.0	30.0	132.9	351.6	_____	_____
Liquidity ratios											
Current	Ratio	2.12	1.50	1.40	1.34	1.94	1.49	1.41	1.35	_____	_____
Quick	Ratio	1.17	0.80	0.67	0.76	1.05	0.78	0.73	0.77	_____	_____
Leverage ratios											
Debt	Ratio	0.34	0.45	0.41	0.48	0.37	0.45	0.37	0.47	_____	_____
Debt to equity	Ratio	0.52	0.81	0.69	0.94	0.59	0.82	0.59	0.89	_____	_____
Times interest earned	Ratio	6.87	3.35	3.89	4.18	3.84	3.80	4.89	4.21	_____	_____
Activity ratios											
Fixed asset turnover	Ratio	7.21	7.23	6.37	7.03	7.46	7.96	6.59	7.67	_____	_____
Total asset turnover	Ratio	1.84	2.18	1.67	1.96	1.66	2.33	1.73	2.22	_____	_____
Profitability ratio											
Gross profit margins	Percent	12.88	14.63	14.20	14.58	13.41	14.81	13.93	13.54	_____	_____
Return on total assets before											
interest and taxes	Percent	3.45	5.43	4.11	5.88	3.54	5.19	4.64	6.25	_____	_____
Return on total equity	Percent	6.95	10.35	7.07	10.69	5.87	10.42	7.73	10.91	_____	_____

¹ 50 to 99 percent of sales were generated from farm supply sales.

² Small = Sales are \$5 million or less; medium = over \$5 million to \$10 million; large = over \$10 million to \$20 million; and super = over \$20 million.

³ There were 263 cooperatives surveyed in both years.

32 states receive \$21 million in renewable energy grants

USDA Rural Development has awarded 150 applicants with almost \$21 million in grants for renewable energy and energy efficiency projects in 32 states. "Enhancing America's energy independence is at the core of President Bush's comprehensive national energy policy. That makes energy conservation and clean, renewable sources of domestically produced energy more important than ever," Agriculture Secretary Mike Johanns said in announcing the grants.

"Renewable energy is also a major growth area for American farmers and a top priority for USDA. Energy conservation and renewable fuels are good for the environment, the economy, and farmers' bottom lines."

Johanns made the announcement prior to a Farm Bill Forum in Salt Lake City that was part of the nationwide listening tour to gather input from the public on farm policy.

The renewable energy and energy efficiency projects involve a wide range of wind, solar, biomass, geothermal and

conservation technologies. For example, Wasatch Wind LLC will receive \$500,000 in funding for phase-1 of a wind energy generation project to be located at Spanish Fork Canyon, Utah. Combined with matching funds, the USDA grant will result in the construction of a 1.5-megawatt wind generation tower, the first of 10 towers planned for the site.

Synthetic Energy, Inc., of Ketchum, Idaho, will use its grant of \$199,863 to purchase wind turbines to power a commercial hydrogen generator. ■



Send items to: dan.campbell@wdc.USDA.gov

Co-ops generate \$210 billion, employ 500,000 Americans

Cooperative businesses in six key sectors are major contributors to economic growth, generating more than \$210 billion in annual revenue and employing more than half a million Americans, according to *Cooperative Businesses in the United States: A 2005 Snapshot*, a report issued by the National Cooperative Month Planning Committee. The survey identified 21,367 co-ops in six sectors: agriculture, credit unions, farm credit lending, electric utilities, food and housing. Together, these co-ops serve nearly 130 million members, or 43 percent of all Americans.

“This report confirms the considerable economic power of America’s cooperative businesses,” said Charles E. Snyder, CEO of the National Cooperative Bank and 2005 chair of the Planning Committee. “Cooperatives are an important part of the economy, operating in almost every industry. They range from small storefronts to FORTUNE 500 companies.”

Snyder noted that the actual economic impact of cooperatives is greater than is reflected in the report, since data on some sectors was not easily obtainable. Among those not



Food co-ops were one of six co-op sectors in a new study that counted 21,367 U.S. co-ops with 130 million members.

included in the report were telecommunications co-ops, some consumer co-ops and most purchasing co-ops.

The \$211.9 billion in annual revenue generated by co-ops in the six sectors studied represents nearly 2 percent of the U.S. economy, as measured by gross domestic product. Total employment was 537,898, with aggregate payroll of \$15.1 billion. Left out, however, was total employment of the food and grocery sector and the total payroll of the agriculture and farm credit sectors. These gaps in the data mean these numbers are lower than the actual numbers.

Among the findings by sector:

- Agriculture co-ops have gross business volume of more than \$111 billion per year and 2.8 mil-

lion members.

- The Farm Credit System has approximately \$125 billion in assets and \$96 billion in loans outstanding.
- Credit unions have \$668 billion in assets, \$443.5 billion in outstanding loans and more than 86 million members.
- Electric utility co-ops serve 37 million people and more than three-quarters of the U.S. land mass.
- Food and grocery co-ops generate \$33 billion in annual revenues while retail food co-ops alone pay back an estimated \$4 million a year to their members.
- Housing cooperatives have combined budgets in excess of \$11 billion and make an estimated \$1.2 billion in property improvements each year.

In part because the co-op community is so diverse, there is no reliable data covering all cooperative businesses and their economic impact. Past estimates on the number of U.S. co-ops have ranged as high as 40,000. The new report is the start of an effort to develop new estimates of the economic impact of all cooperatives. Legislation has been proposed that would make \$500,000 available to expand this effort.

Engel to succeed Sims as CoBank CEO

CoBank CEO Doug Sims — under whose leadership the bank nearly tripled its assets, from \$12 billion to \$31 billion — will retire June 30. Sims has been the bank’s CEO since 1994 and has 37 years of service with the

Farm Credit System, of which CoBank is a part. He will be succeeded by Robert B. Engel, who joined the bank in 2000 as president and chief operating officer.

“We’re fortunate to have had two such exceptional individuals on the bank’s management team for the past 5

years,” said O. J. Roy Orton, board chairman of Denver-based CoBank, who predicted a smooth transition. “Under Mr. Sims’ leadership, the bank has maintained consistently strong financial performance and expanded its capacity to serve a broader base of customers and businesses in U.S. agricul-

ture and rural America.”

Sims managed the bank through 15 mergers and acquisitions, the opening of its first representative office outside the United States and its first issuance of preferred stock, which brought \$500



Doug Simms (left) is retiring in June as CoBank CEO and will be succeeded by Robert Engle. Photo courtesy CoBank

million of new investment capital into the bank.

Sims is chairman of the Farm Credit System's Presidents Planning Committee and co-chairman of HORIZONS, a system-wide customer research and strategic planning initiative. He is the current chairman of the National Council of Farmer Coopera-

tives and past chairman of the Graduate Institute of Cooperative Leadership, Lutheran Family Services of Colorado and the FarmHouse Foundation. He is also a member of the Finance Governors of the World Economic Forum and a founding member of the Center for Corporate Excellence in Vail, Colo.

Engel has nearly 20 years of banking experience, primarily with HSBC Bank USA, and 8 years of accounting experience, including an agribusiness specialization, with KPMG and Deloitte & Touche. During his 14-year tenure at HSBC, he served in a variety of management and credit positions, including chief credit officer, before being named chief banking officer. Engel serves on the board of directors for the Federal Farm Credit Banks Funding Corporation, Farm Credit Leasing Services Corp. and Financial Partners Inc. He also serves on the board of trustees for Niagara University, and is a recipient of the Ellis Island Medal of Honor.

“We have confidence in Mr. Engel's experience, expertise and leadership,” Orton said. “He has a deep understanding of CoBank and our customers, as well as a proven track record of

implementing strategic plans and positioning CoBank for success.”

CoBank, part of the \$135 billion U.S. Farm Credit System, specializes in providing financial and leasing services to cooperatives, agribusinesses, Farm Credit associations and rural communications, energy and water companies. The bank also finances agricultural exports.

DFA's Hanman, Schriver retire; Rick Smith named new CEO

Two top executives at Dairy Farmers of America (DFA), headquartered in Kansas City, Mo., retired Jan. 1. CEO Gary Hanman and Executive Vice President Donald Schriver are both ending careers with DFA and its predecessor co-ops. They were key players in the creation of the co-op and built it into the nation's largest dairy co-op, accounting for just under one-third of the nation's milk supply. Both will continue to advise DFA on various programs and projects. Rick Smith, who had been president and chief operating officer, has been named as the new CEO.

“DFA was created by dairy farmers, who wanted to take control over their

Largest 100 agriculture co-ops post strong margins in 2004 *continued from page 27*

Long-term debt lower

As mentioned earlier, long-term debt was lower in 2004. All commodity groups had a large decrease in long-term debt, other than dairy, farm supply, grain and rice cooperatives. Grain cooperatives had the largest jump in long-term debt — larger than dairy, rice and farm supply co-ops combined. Grain cooperatives' long-term debt increased \$74 million, to \$458 million.

Diversified cooperatives had the largest decline in long-term debt levels, which dropped \$141 million, to \$1.7 billion. Diversified cooperatives held 31.7 percent of total outstanding long-term debt.

“Other liabilities” and deferred credits were 7.1 percent higher, climbing to \$1.1 billion. Fruit/vegetable coopera-

tives were the only commodity group that saw other liabilities and deferred credit decline.

Twenty-three top 100 cooperatives have minority interest. Minority interest represents the amount of interest minority-share holders have in a subsidiary of a cooperative that is the subsidiary's majority share holder. In 2004, minority interest fell 3.8 percent, to \$909 million. Most of this decline is attributed to diversified cooperatives.

Total equity was up 6.9 percent, to \$9 billion. Thanks to near record earnings, every commodity group posted higher equity in 2004 than in 2003. The largest agriculture cooperatives retained 70 percent of their after-tax net margins in both allocated and unallocated equity. This is up from 62 percent

in 2003.

Allocated equity in the form of stock and certificates was up 4.4 percent, to \$7.5 billion. The only commodity group not to show an increase was grain cooperatives, which saw stock and certificate values fall 1.8 percent, to \$808 million.

Unallocated equity jumped 22 percent, to \$1.5 billion. Unallocated equity is generally used as reserve for the cooperative. In 2004, several fruit/vegetable cooperatives had net losses along with some higher taxes. The unallocated equity absorbed these negative effects, thus causing a decline of 10.4 percent in the fruit/vegetable unallocated equity accounts. The other commodity groups all showed positive growth in their unallocated equity. ■



Gary Hanman



Rick Smith

destiny in a rapidly changing business environment, and Gary Hanman helped us make that a reality,” said Tom Camerlo, DFA board chairman and a dairy farmer from Florence, Colo. He saluted Hanman for “building a marketing cooperative that can compete on a global level, while providing a grassroots structure that ensures dairy farmer input and control. We look forward to building on that legacy for the benefit of our farmer members.” DFA today markets and processes milk for 21,946 dairy farmer members in 49 states.

A native of north-central Missouri, Hanman, 71, has been CEO of DFA since its creation in 1998. From 1975 to 1997, he served as CEO of one of DFA’s predecessor cooperatives, Mid-America Dairymen, Inc. (Mid-Am) of Springfield, Mo. Schriver has also served in his position since DFA’s inception, and had led Ohio-based Milk Marketing Inc. prior to then.

Smith entered the dairy industry in 1982 when he joined Dairylea Cooperative Inc. as vice president and general counsel. In 1988 he became CEO of

Dairylea, the Northeast’s leading agricultural service and milk marketing organization with 5.5 billion pounds of milk marketed annually for 2,500 dairy farmer-members.

“We are delighted to have a proven dairy leader like Rick Smith to take DFA into the future,” said Camerlo, “He understands the dairy industry, the DFA organization and, most importantly, the priorities of the dairy farmer members whom he serves.”

In August, Smith, who had served on DFA’s management team since January

2001, was promoted to president and chief operating officer of DFA. In that position, he had oversight over all business operations, including economic and marketing analysis; member, government and public relations; human resources; fluid marketing operations; value-added manufacturing; accounting/treasury; and legal and risk management functions.

James Andrew to lead USDA rural utility program

Agriculture Secretary Mike Johanns has welcomed James Andrew as administrator of USDA Rural Development’s rural utilities program. Andrew will administer Rural Development’s electric, telecommunications and water programs. In 2005, those programs provided over \$5.5 billion in investment to rural America. Johanns said Andrew is a strong leader who “brings a wealth of knowl-



James Andrew, with his family members, is sworn in as the new administrator of the utility programs of USDA Rural Development by Agriculture Secretary Mike Johanns (left). USDA photo

edge and expertise to the position.”

Andrew was nominated by President Bush on Aug. 25 and was confirmed unanimously by the Senate on Nov. 10. A former president of the National Rural Electric Cooperative Association, Andrew served on the board from 1988 to 2004. As president, he led the association’s effort to overhaul education and training programs for member co-ops. A graduate of the University of Alabama, he is a former small business owner and banker and helped to manage a family farm. Andrew began his

involvement with rural cooperatives in 1968, when he became director of marketing for Georgia Electric Membership Corporation. Later, he was elected to serve on his local electric cooperative board and remained a board member for 25 years.

AMPI dedicates rebuilt plant, solidifies future in industry

Associated Milk Producers Inc. (AMPI) dedicated its rebuilt butter churning and packaging plant on Dec. 6. The plant, nearly destroyed by a fire in December 2004, occupies much of a city block in the south central Minnesota town of New Ulm, located in the heart of AMPI’s seven-state membership area.

Minnesota Governor Tim Pawlenty and a host of local, state and federal officials were on hand to congratulate AMPI members for reinvesting in the Minnesota dairy industry. Following last year’s fire, the cooperative’s board of directors chose to rebuild the facility, signaling a long-term commitment to Midwest dairy farmers and the butter business. “Minnesotans are strong people who are resilient in the face of loss,” Pawlenty said. “The return of this plant is tremendous news for the hardworking dairy farmers of this region and the whole Minnesota economy. It’s yet another promise of the bright future that lies ahead of us.”

Churning and packaging butter is one way AMPI dairy farmers add value to their milk. “This plant will enable us to further diversify our milk marketing business, offering a complete line of dairy products to customers,” said Mark Furth, AMPI general manager.

During plant reconstruction, AMPI gradually increased production as packaging equipment was rebuilt. Production at the plant is near pre-fire capacity. “Rebuilding gave us an opportunity to improve our butter packaging equipment and plant. This butter plant is now more efficient, enabling us to increase overall vol-



State and co-op officials and employees gather for the grand re-opening of AMPI's butter plant in New Ulm, Minn., one year after it was devastated by a fire. Photo courtesy AMPI

ume,” Furth said. “This plant will help us improve our farmer-owned business.” AMPI has about 5,000 members who annually market more than 5 billion pounds of milk.

Basin Electric CEO says nation must develop new power supplies

Despite many uncertainties, it is time for the nation to move forward and build new power supplies for the future, says Ron Harper, CEO and general manager of Basin Electric Power Cooperative in Bismarck, N.D. Speaking at the co-op's 2005 annual meeting, Harper said Basin Electric — a consumer-owned, power generating and transmission co-op — must continue to manage its energy destiny, which translates into economic opportunity and well-being for its region. Basin Electric provides electricity to 121

member rural electric systems in nine Western and Upper Midwest states.

“We build plants because our members need the power. Our membership is growing, our region is growing and we must grow to meet the demands (for electricity),” Harper said. “As we move forward in our resource development efforts, we are seeking to understand the benefits of all

the various types of generation technologies, including nuclear. It is our time to make the tough calls and break new ground to ensure a bright future for our region.”

Basin Electric's power requirement projections show a demand for electricity growing at a rate of 3.1 percent between now and 2019. “That growth equals the need for 927 megawatts of generating capacity to meet that member demand,” Harper said. The co-op is moving ahead on new projects, even though there are many uncertainties, such as environmental regulations.

“One concern I have is for our continued ability to burn coal,” he said. “There are many that would prefer coal not be used as a fuel source for any industrial purpose. They have discounted the benefits of low-cost and reliable

energy to this nation's economy.”

Fortunately, he continued, there's a continuing strong recognition of the benefits of coal as a generation fuel by policy makers and those who believe low-cost and reliable energy is important.

Harper said coal gasification will be a part of our energy future. “A great deal of the energy bill is focused on gasification and its benefits for the continued use of coal,” he noted. The environmental community supports gasification



Basin Electric Cooperative CEO Ron Harper says the nation faces a crucial need to develop new energy sources. Photo courtesy Basin Electric

because it provides an option to deal with carbon dioxide emissions, he said. However, gasification technologies are not yet available to reliably generate electric energy. Dakota Gasification Co., a Basin Electric subsidiary, has been successfully operating the nation's only commercial-scale coal gasification plant for more than 20 years.

Idaho Straw Value-Added Committee *continued from page 31*

work at its Ottawa pilot plant, is making consistent progress at resolving technical constraints. As this new technology requires a large initial investment to construct a facility, Iogen may face difficulty securing sufficient private investment capital to launch the first plant.

Idaho's growers face challenges and opportunities. First among the challenges is capitalizing the equipment required to bale, handle and transport the straw. Initial estimates are that growers will need to acquire baling

equipment costing about \$7 million, tractors costing about \$11 million, and handling and hauling equipment totaling an additional \$13 million. Certainly, farmers in the area already own or have access to some of the required equipment, but without question, significant investment will be required.

Perhaps the greatest opportunity offered to farmers, other than that of a brand new ag market, is the opportunity to make tremendous gains in productivity over time. Assessments conducted as

part of the VAPG indicate that by shifting from a bale system to a modified loaf system, growers can significantly lower per-ton straw harvest costs. Additional modifications to the transportation system promise further improvements in efficiency. Put simply, there will be ample opportunities for farmer ingenuity to fine-tune the collection system.

For more information, contact: Duane Grant, Grant 4-D Farms; (208) 531-5149, (208) 431-0006 (mobile), grant@pmt.org ■

Court dismisses lawsuit aimed at Farmland officers

By Alan Borst, *Ag Economist*
Cooperative Programs
USDA Rural Development

Twenty-nine former officers and directors of Farmland Industries Inc. are no longer in jeopardy over a possible \$300 million payment that had been sought by creditors in the massive bankruptcy case. On Nov. 16, U.S. Bankruptcy Judge Jerry Venters of the Western District of Missouri dismissed the lawsuit brought by J.P. Morgan Trust Co., the liquidating trustee in Farmland's bankruptcy. Venters ruled that J.P. Morgan had failed to include any allegations in its complaint that showed bad faith by the officers and directors.

In January 2005, J.P. Morgan filed a lawsuit against the former officers and directors, including former CEO Harold Cleberg and former Executive Vice President (and later CEO) Robert Honse, charging in four counts that the agricultural cooperative's leadership was negligent

in performing their fiduciary duties by:

- Recommending, approving and constructing a fertilizer plant in Coffeyville, Kan.;
- Evaluating and approving the acquisition of SF Services, a company in North Little Rock, Ark.;
- Making or approving decisions to take on "catastrophic debt";
- Approving a \$700,000 bonus that was accepted by Cleberg.

In a fifth count, J. P. Morgan charged the directors with corporate waste by approving the allegedly undeserved bonus for Cleberg.

The lawsuit sought payment of more than \$300 million that would be distributed to about 60,000 unsecured creditors, including many farmers.

Venters dismissed all of the plaintiff's counts except one alleging that Cleberg breached his duties by accepting the bonus and the fifth count.

J.P. Morgan has decided not to pursue the two remaining counts because Venters ruled in October that

the plaintiff was responsible for paying the legal fees of the defendants, based on Farmland's bylaws and statutes in Kansas, where Farmland was incorporated. The case was closed in mid-December, when the 30-day window for J. P. Morgan to appeal expired.

Unsecured creditors were scheduled to receive payments in mid-December to cover interest owed to them by Farmland. One of the defendant's attorneys reported that all unsecured creditors would receive 100 cents on the dollar, plus interest. Unsecured creditors have so far received anywhere from 94 cents to over 100 cents on the dollar, depending on the category of their claims.

Farmland descended into Chapter 11 bankruptcy in June 2002 after acquiring debt of almost \$2 billion and suffering from weak fertilizer sales. The former Fortune 500 company was the biggest U.S. agricultural cooperative, and in 2001 had more than 600,000 farmer members, 14,000 employees, and \$11.8 billion in revenue.

"I have long felt that there should be recognition of risk with new technologies and as a result there should be a sharing of the risk," Harper said. "I am pleased that the (recently passed) energy bill provides the opportunity for the sharing of risk." Basin Electric's fuel of choice is coal, according to Harper, because it is abundant in the region and meets the Cooperative's mission of being a reliable energy provider to members.

The movement to deregulate the power transmission system continues, and Harper questioned if there will be a benefit to the end-use consumer.

Blue Diamond has record sales

Members of Blue Diamond Growers received a 43-percent pay boost for their 2004 crop of almonds, which follows a 35-percent price increase for the 2003 crop. According to the California

Ag Statistical Service, 2004 crop industry returns averaged \$2.21 per pound.

"As a CPA, businessman and almond grower, I appreciate the value of business measurements and cost controls. Blue Diamond is a master at both," Board Chairman Howard Isom said during the co-op's 95th annual meeting in Modesto, Calif. Isom said it is the duty of board members to "make sure every product pays its own way."

Isom reported a record sales year of \$615 million, attributing the company's success to an "intelligent, informative marketing strategy that does not react to overnight market swings or rumors. We are virtual business partners with major users globally and we are able to calculate projected

demand into our sales plans and systematically schedule sales by variety, product and availability."

By the end of this decade, California's almond crop is expected to swell to 1.5 billion pounds, he noted, saying that members' long-term profitability will be enhanced by higher margins derived from Blue Diamond's branded product line.

Blue Diamond's consumer product business alone has doubled to \$100 million in the last 3 years and is expected to double again by the end of the decade. Its branded Nut Thins cracker line sales increased 43 percent in 2004-05, while Almond Breeze non-dairy beverage sales grew 128 percent during the same time.



South Dakota co-ops merge

The 600-member Farmers Union of Pierpont and Bristol has merged with the larger Four Seasons Cooperative. "It's hard for a small co-op to compete in today's world," Steve Cameron, manager of Farmers Union Oil Co. in Pierpont, told the *Aberdeen (South Dakota) American News*. "So we decided to be part of a bigger one."

Four Seasons, of Britton, also has operations in Amherst, Claremont, Doland, Hecla and Redfield. Four Seasons will not have a presence in Bristol. The Farmers Union service station there has been sold. Little change

is expected in Pierpont, where Four Seasons will offer agronomy services, as did Farmers Union, the *American News* reported.

USDA commits \$1.2 million for entrepreneurial outreach

USDA is providing \$1.2 million to a dozen 1890s Land-Grant Universities to support technology and business development assistance in rural communities. "The 1890 colleges and universities play a key role in providing technical assistance and business development leadership to rural minority communities," Agriculture Secretary Mike

Johanns said in announcing the grants. "USDA's partnership with these outstanding institutions significantly advances President Bush's commitment to enhance educational opportunities, encourage entrepreneurship and create jobs in rural America."

The 1890 Institutions have some of the finest agricultural science and business education programs in the nation and, in partnership with USDA, they have devoted significant resources to business development and technical assistance in local communities.

At the University of Arkansas-Pine Bluff, for example, funding will be used

Legal Corner *continued from page 24*

Appellate court applies reasonableness test

The District of Columbia Court of Appeals reversed the lower court decision and sent the case back to that court for trial, *Willens and Niederman v. 2720 Wisconsin Avenue Cooperative Association*, 844 A.2d 1126 (DC 2004). The appellate court focused on the fact that the notes in question were from the members to the cooperative, not the developer. It said that the cancellation of the outstanding notes "...was conceptually equivalent to the distribution of corporate assets — the uncollected future payment on the notes — to shareholders of the corporation. Significantly, it was a disproportionate distribution. ...the minority of members who had already paid off their own promissory notes in full did not receive their proportionate share of the corporate assets being distributed; they received nothing, in fact. Meanwhile, the majority of members whose debts were still outstanding (including the...directors other than Willens) received more than their proportionate share of the distribution; collectively, they received all of it..."

The appellate court noted that directors have a duty of loyalty, which means they must act in the best interests of *all* of the members (court's emphasis). The court held that a showing by the unhappy members that the directors treated

some members, including a majority of the board, more favorably than other members was by itself enough to overcome the cooperative's motion for summary judgment. Then the court said that where the directors have a personal interest in the decision, the trial court should not apply the business judgment rule. It should apply a "reasonableness" test and shift the burden to the directors to prove that they fulfilled their fiduciary duties. The court concluded that it was not finding that the board acted unreasonably under the circumstances, only that it will have to convince a jury that its actions were reasonable.

The court also held that the cancellation of the notes may have contradicted a bylaw provision requiring distributions of corporate reserves to be in proportion to the ownership interests. As bylaws are a contract between the cooperative and its members, the trial court also erred in granting summary judgment on the breach of contract claims.

Conclusions

The court did not question the deliberateness or the integrity of the directors, and noted that the board had relied on the advice of counsel in reaching its decisions. Nonetheless, the court found that because a majority of the directors had an interest in the issue before the board and voted for a policy that favored some members, including them-

selves, over other members, they forfeited access to the business judgment rule.

Because member-directors of a cooperative are users and investors in the association, they will rarely be voting on matters in which they are personally totally disinterested. Under the approach of this court, even if they exercise thorough due diligence in arriving at a decision, they may be forced to defend and prove that their decision was reasonable if it favored one group of members over another. This may be especially true if they are in the favored group.

While this may be consistent with the growing concern about directors exercising their authority in a responsible manner, it places a burden on cooperative directors that often doesn't apply to the outside directors who populate many non-cooperative boards. For example, a determination to drop a money-losing line of business or close an unprofitable facility will likely impact different groups of members, and directors, differently.

Cooperative leaders and advisers will need to be vigilant in making sure both board and management decisions are as equitable as possible. And when a decision that discriminates among the members is made, the strongest possible justification for the decision should be reflected in the minutes and other written records supporting that decision. ■

for business enterprise creation, specializing in technology-based products and services. Funds will also be used to establish a business incubator that will house a dozen or more new and start-up businesses. Southern University and A&M College in Louisiana will receive funds to provide outreach and technical assistance to entrepreneurs, businesses and cooperatives in four rural communities and parishes.

Florida A&M University will receive funds to provide business and economic development outreach to eight rural counties in northern Florida. A complete list of the grants is available at: <http://www.rurdev.usda.gov>.

Chesapeake Fields Institute launches equity drive

Chesapeake Fields Institute Inc. (CFI) is launching an equity drive to raise \$1.4 million to purchase property for an agriculture business park/visitor center. The nonprofit organization works to help farm families increase profits and educate citizens on the important role agriculture plays in their community's health and economy.

CFI's work has resulted in the development of a community-based food system enterprise that is owned locally, operated with environmentally sound practices and which promotes both human and economic health through its educational entities. This 501(c)(3) nonprofit organization completed market research and feasibility studies to identify marketing opportunities for locally grown grains and oil seeds. It located several niche markets and is completing its fourth year of shipping specialty identity-preserved soybeans to Japan. In 2004 this project added \$60,000 above commodity-priced beans to the local economy.

CFI launched the for-profit Chesapeake Fields Farmers LLC in 2003, which has developed a line of artisan breads, soy and popcorn snacks now marketed in the Chesapeake Bay area. Chesapeake Fields Farmers Cooperative Inc. was incorporated in August as the crop production arm of CFI to give farmers a way to increase their profits through whole-grain sales

and value-added products. The common mission, *preservation through profitability*, links the three Chesapeake Fields organizations together, but they are three distinct entities, each with its own function, purpose, mission approach and leadership.

Chesapeake Fields' three entities have the common goal of developing an agriculture business park to house their operations and develop a visitor center to tell agriculture's story. The visitor center could be a key economic business-driver for the Delmarva (Delaware and Eastern Maryland and Virginia) region's destinations and attractions.

"Since its inception, CFI has recognized a need for a significant multiplier



CFI President John Hall, left, and Kent County (Maryland) Commissioner and grower Roy Crow review the visitor center site plan. Photo courtesy CFI

to educate citizens of the importance and value of preserving and investing in America's existing farmlands," explains John Hall, CFI's president.

For more information, visit: www.chesapeakefields.com, or call (410) 810-2082.

CHS reports record sales and income

CHS Inc. reported record net income of \$250 million for fiscal 2005, marking its second consecutive year of record earnings and the highest ever recorded by a U.S. agricultural cooperative. In 2004, CHS earned \$221.3 million. Fueled by higher energy prices, net sales of \$11.8 billion in 2005 also set at

record for the second straight year. That compares to \$10.8 billion in sales for fiscal 2004.

CHS Chairman Michael Toelle, a Browns Valley, Minn., producer, said that — based on the record earnings — CHS expects to return a record \$151 million to owners in cash patronage, equity redemptions and preferred stock, beginning in January.

"During my nearly 30 years with this organization, I can't remember a year in which we made so many pivotal decisions," John Johnson, CHS president and CEO, told the 2,500 members and guests who gathered for the cooperative's annual meeting in Minneapolis.

Key business decisions included: investing \$325 million in its Montana fuel refinery to yield more gasoline and diesel from crude oil; expanding its role in renewable fuels manufacturing with an investment in US BioEnergy; selling its Mexican foods production business (which had a loss of \$16.8 million) to instead focus food manufacturing efforts in its Ventura Foods LLC joint venture and in supplying grain and grain-based ingredients to other food companies; and supporting the conversion of the cooperatively owned CF Industries fertilizer joint venture into a publicly traded company, of which CHS remains both a minority owner and (through Agrilience LLC) a customer. CHS earned \$9.6 million for its sale of shares in CF Industries.

Strong refining margins, combined with improved performance by CHS lubricants, contributed to the highest energy segment earnings in company history. The company's Ag Business segment — consisting of its grain marketing, country retail locations and 50 percent ownership in the Agrilience LLC — earnings were up 46 percent.

CHS Processing operation results were down 55 percent. Within that segment, earnings increased for the co-op's 50 percent ownership of the vegetable oil-based food manufacturer Ventura Foods. However, earnings in oilseed processing declined due to weak crush margins; wheat milling results fell due to overcapacity and soft demand. ■

program to help clear the market. Cheese prices have not lingered below CWT's target level of \$1.40 per pound since the program began. As 2006 begins, and butter prices begin to sag, CWT has also facilitated the sale of butter for the first time.

Apart from helping to improve the economic situation for every dairy farmer in the country, CWT has helped to counter nay-sayers who said farmers wouldn't be willing to work collectively on such a program. As traditional government-run farm programs face the

twin pressures of federal budget limitations and potential World Trade Organization restrictions, self-help programs such as this will be an important tool for dairy farmers in the future.

— **Jerry Kozak, CEO**
National Milk Producers Federation

Foreign Affairs *continued from page 23*

ture, Schriver said. However, later financing was fully secured by the venture's own assets, with no guarantees by the partners. DairiConcepts currently has annual sales of about \$400 million.

Reducing transportation costs

Another successful DFA alliance is with Ireland-based dairy processor Glanbia PLC. DFA was looking for ways to deal with surplus milk production in the Southwest, the transport of which out of the region was costing at least \$40 million per year.

Glanbia is a major international cheese manufacturer, with annual sales of more than 2.3 billion euros. It is the largest cheese producer in the Northwest United States and a major producer of lactose, whey protein and other bulk dairy products. DFA entered into a cheese making venture called Southwest Cheese Company LLC.

Unlike the DairiConcepts venture, DFA is not involved in a direct relationship with Glanbia, but instead shared participation through an agreement with other American cooperatives, including Select Milk Producers, representing dairy farmers in the Southwest. DFA holds a 30 percent share in Southwest Cheese, while Glanbia controls 50 percent.

Governance of the venture reflects the ownership split, with three board members from Glanbia and three from the co-ops.

The \$190 million Southwest Cheese processing facility, in Clovis, N.M., began operations in December, and is

expected to generate \$350 million in sales annually while processing 7 million pounds of milk per day.

Changing negative product perception

None of the conference presenters portrayed working in the international marketplace as easy. David Fuhrman, president of Foremost Farms USA, said that the export market continually presents challenges. Foremost exports mostly whey, beginning with the 1984 acquisition of a firm already engaged in that business. Its largest whey customer is China.

Fuhrman says that the co-op had to overcome a negative reputation of U.S. whey, because of the tendency of U.S. producers to "dump" inferior whey product on foreign markets, while keeping high-quality product for domestic sale. Other challenges include packaging the product to protect quality over the long distances and less than ideal conditions of overseas transport.

Paperwork on an order must be flawless with foreign customers, said Fuhrman, or they may think the exporter is trying to "pull a fast one." In addition, local cultural quirks can add problems. In Mexico, for example, entry into ports is sometimes complicated by requests for bribes. In China, "negotiations never seem to end," he said, adding that Chinese customers often look for ways to deduct from the agreed price even after delivery.

Regarding quality, said Fuhrman, "Expectations are not the same as specifications," meaning that customers may not be satisfied even if the product

meets the letter of the agreed specifications. While the firm receives complaints about less than 1 percent of its product sold domestically, it gets complaints on about half of its overseas shipments. In such an instance, he said, "The customer is always right."

Overall, exporting product is "tedious, time consuming, and leaves no margin for errors," Fuhrman said. Despite the problems and the fact that the co-op receives less than 1 percent of its revenues from exports, exporting has been profitable, and has improved Foremost's overall business.

Capper-Volstead & foreign trade

USDA Rural Development Cooperative Programs law specialist Donald Frederick explained how the Capper-Volstead Act's limited anti-trust protections affect cooperatives which accept foreign producers as members. Frederick said that Capper-Volstead is silent about whether non-domestic producers may join a U.S. co-op, but that legal rulings and precedents have endorsed such relationships.

Given the increasingly concentrated and global economy, large buyers are the ones with substantial market power, Frederick noted. They can negotiate down prices paid to farmers by playing farmers in one country against those in other countries who produce the same product. Foreign members in farmer marketing cooperatives and alliances with foreign producer associations are important tools for creating economic balance in the markets of the 21st century. ■

Dairy knowledge in short supply in Congress

U.S. Rep. Devin Nunes, who grew up on a Tulare, Calif., dairy farm, said he has his work cut out for him representing the dairy-intensive San Joaquin Valley in the Capitol, where it often seems that “there are only about three people who understand U.S. dairy policy.” That was brought home to him when, after just two weeks on the House Ways and Means Committee, he was named as its designated dairy expert.

“That’s kind of scary,” said Nunes, whose Fresno-based district is the nation’s largest agricultural district (based on farm income). “Few people in Washington understand agriculture, and fewer still understand dairy.”

There are “strong feelings in Washington to throw out” the existing dairy program, and “that sentiment seems to be growing,” he warned. It will take a strong coalition to defend the program, Nunes said, praising NMPF for its efforts to bring the dairy industry together on the legislative front and for its accomplishments with the CWT program.

Nunes said he is sponsoring a bill that would provide up to \$300 million to help spur growth of the U.S. MPC (milk protein concentrates) industry, and is supporting another bill that would impose a tariff on imported MPCs until the U.S. MPC industry is better established.

The United States needs to look closely at what New Zealand did in building and subsidizing MPC plants — a strategy which Ireland and Holland have followed suite on, Nunes said. If the United States does not do something similar, it will put its dairy industry at a disadvantage, he warned.

Nunes also spoke of the energy crisis facing the nation, noting that renewable energy — even growing as rapidly as it is — can do only so much to relieve the need for oil. He expressed the fear that without more action, “someday we may be back to milking cows by hand.”

He recounted a trip to Alaska to tour

a region where new oil fields could be tapped — a proposal that has sparked a bitter fight with wilderness advocates. Nunes described flying for two hours over the region without ever seeing a single animal or person. Out of this vast region, Nunes said drilling would occur on just 2,000 acres, but would produce enough oil to fill the Alaska pipeline for 30 more years and meet 5 percent of the nation’s annual petroleum needs.

Nunes agreed with one questioner that the lack of new U.S. oil refineries is part of the problem, but he said this mostly contributes to short-term oil price spikes. The main long-term cause, he said, is still over-reliance on Middle Eastern oil.

Pacific Rim seen as world economy hot spot

Jeff Thredgold, noted economist with Thredgold Economic Associates in Utah, provided a lively, wide-ranging outlook on the national and global economies. He disputed those who say the U.S. economic recovery has been a “jobless one.” Small business creates most new jobs, and was largely responsible for 2.2 million new jobs created last year, he said. U.S. worker productivity was up an average of 3.7 percent the past three years, the highest growth rate in 50 years. Further, he continued, the nation has enjoyed 10 consecutive quarters of economic growth exceeding a 3 percent annual rate, after inflation.

Just 12-14 years ago, the U.S. economy was “a bloated dinosaur — the Germans and Japanese were kicking our tails,” Thredgold said. “Today, we have a re-charged, flexible, dynamic economy.”

The Internet has been a tremendous boon to business, he said, helping to reduce the cost of doing business globally by \$1.25 trillion during the past 3 years.

The economy is increasingly rewarding those who attain higher education, Thredgold said, noting that in 1980, college graduates averaged 25 percent more income than those with only a

high school education. By 2005, college graduates made 85 percent more, on average.

Thredgold said the world economy is doing well, having grown 4 percent, after inflation, last year, and is poised for similar growth in the coming year. Two-thirds of world economic growth in the next 20 years will likely occur in the Pacific Rim nations of Asia, he predicted.

Japan still accounts for 60 percent of that region’s economic output, and it was clearly the economic victor of the 1980s, Thredgold said. However, he called Japan the “economic basket case of the 1990s.” Japan has lately been making some progress in restoring its economy (thanks mainly to increased exports to China), but Japanese banks are still saddled with \$500 billion in bad loans. The Japanese national debt is 150 percent the size of its economy, vs. 63 percent in the United States. He called that the worst debt level in the history of the world. Japan’s salvation has been its people’s \$13 trillion in savings, he noted.

China’s economy has grown an average of 9 percent, after inflation, during the past 25 years, the largest sustained gains in history, although that growth occurred from a very low starting baseline, Thredgold said. China’s economy is so hot that one in four major building cranes in the world have been working in Shanghai, which he said has been described as “New York on steroids.”

Virtually all of that growth, however, has been along China’s east coast. The interior of the nation is still home to about 850 million struggling farmers, and 115 million Chinese people are constantly on the move looking for jobs, Thredgold said.

India (while still saddled with massive poverty) now has the largest middle class in the world and has more IT graduates annually than any other nation, Thredgold said.

Europe is struggling along with “pathetic” 1 percent annual economic growth, he said. ■

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Rule changes should ease applying for USDA co-op grant programs

By Peter Thomas, USDA

USDA Rural Development's Cooperative Programs experienced another successful year in 2005, and I hope your co-ops did too. As we begin 2006, I want to discuss some changes in a couple of our funding programs that help agricultural cooperatives in rural America: the Value-Added Producer Grant (VAPG) and Rural Development Cooperative Grant (RCDG) programs. Due to increased Congressional support for fiscal 2006, the VAPG program was appropriated \$19.5 million, the RCDG program received \$4.5 million and an additional \$1.5 million was appropriated to assist minority producers.

Rural Development is making changes to both programs in an effort to make them more accessible and to improve their overall administration. These changes were developed from applicant input, which included surveys and teleconferences regarding program requirements and administration. Comments from Rural Development field office employees were also considered, as they work directly with the program applicants.

One of the most immediate changes in the Value-Added application process is the opening of the application window. The application window opened Dec. 21, 2005, and will close March 31, 2006. Not only does this provide producers with an extended application

period, the window was timed to meet the demanding time schedule of agricultural producers.

In past years, this process began during the spring, with applications due during the summer. However, this year it was published during the winter, when most producers are not in the middle of their planting or harvesting.



Idaho wheat and barley straw may someday be processed into ethanol, aided by a VAPG from USDA Rural Development. For more on this project, see page 30. Photo by Maurice Hladik

For the first time ever, USDA Rural Development has also established procedures to allow applicants who submit substantially complete applications by the deadline to submit any forgotten or incomplete items after the application deadline. An electronic application template is also available to assist applicants in submitting a complete application. Our goal is to have a significantly higher percentage of completed applications, ensuring that all eligible projects have the opportunity to compete for these critically important grants.

Based upon applicant feedback, we also increased the maximum amount of grant award for working-capital funds, from \$150,000 to \$300,000. In addition, a separate allocation of funds up to \$1.5 million is available for grant requests of \$25,000 or less. These grants are designed to assist agricultural producers who need just a few dollars to aid in their value-added venture.

Many of the same positive changes made in the Value-Added program will be introduced in the Rural Cooperative Development Grant program. Once again, based upon applicant feedback, we intend to open the FY 2006 Rural Cooperative Development Grant program application process much earlier in the fiscal year.

We will also introduce procedures to allow applicants who submit substantially complete applications by the deadline to submit any forgotten or incomplete items after the application deadline and will make an electronic application template available.

Much of the duplication of program requirements that appeared in previous applications has been eliminated.

We believe these changes will significantly improve the application process and allow for the awarding of more grants. As always, our state and national office staffs are available to answer any questions. Happy New Year, and best wishes for a healthy and successful 2006.



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