The Cooperative Form of Business: a Competitive Advantage
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Those of us living in rural America have many aspects of our lives intertwined into cooperatives. An overview of the cooperatives my family’s farm does business with will illustrate the complexity of the farm/coop relationship. The following table shows the cooperatives our farm business and home interact with on a regular basis.

<table>
<thead>
<tr>
<th>Cooperative</th>
<th>Type</th>
<th>Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agstar</td>
<td>Service</td>
<td>Equipment leases, loans</td>
</tr>
<tr>
<td>Hills-Beaver Creek Coop</td>
<td>Service</td>
<td>Purchase crop inputs, propane, &amp; market crops</td>
</tr>
<tr>
<td>SWMN Coop, Luverne</td>
<td>Service</td>
<td>Purchase crop inputs &amp; market crops</td>
</tr>
<tr>
<td>Rock County Coop Oil</td>
<td>Service</td>
<td>Farm fuel &amp; tires</td>
</tr>
<tr>
<td>Rock Co. Rural Water</td>
<td>Service</td>
<td>Water provider</td>
</tr>
<tr>
<td>Splitrock Telecommunication</td>
<td>Service</td>
<td>Satellite TV</td>
</tr>
<tr>
<td>Sioux Valley Southwestern</td>
<td>Service</td>
<td>Electricity provider &amp; long distance telephone service</td>
</tr>
<tr>
<td>Ampride-Luverne</td>
<td>Service</td>
<td>Vehicle fuel &amp; c-store</td>
</tr>
<tr>
<td>CORN-erStone Coop, Ethanol plant</td>
<td>Added Value</td>
<td>Increase value of corn</td>
</tr>
<tr>
<td>Golden Oval, a cooperative owned egg producer</td>
<td>Added Value</td>
<td>Increase value of corn</td>
</tr>
<tr>
<td>Coop Country Elevator</td>
<td>Service</td>
<td>Corn delivery for Golden Oval</td>
</tr>
<tr>
<td>South Dakota Soybean Processors</td>
<td>Added Value</td>
<td>Increase value of soybeans</td>
</tr>
<tr>
<td>Minnesota Soybean Processors</td>
<td>Added Value</td>
<td>Increase value of soybeans</td>
</tr>
<tr>
<td>Blue Mound Soy</td>
<td>Added Value</td>
<td>Specialty Soy Foods</td>
</tr>
<tr>
<td>MinnWin II</td>
<td>Investment</td>
<td>Wind generators</td>
</tr>
</tbody>
</table>

This table has one more layer of cooperative activity. All of the service cooperatives and some of the added value cooperatives do business with the regional cooperatives. These are Land O’ Lakes, CENEX Harvest States, and Farmland.
I recently finished a term as a director for CORN-erStone Cooperative. And, I was the first Board Chairman of Agri-Energy, LLC, the ethanol plant of which CORN-erStone is majority owner. I currently am a director for MinnWin II and Blue Mound Soy cooperatives.

My working with cooperatives and involvement in starting new cooperatives led me to my current position with Land O’Lakes Farmland Feed.

**Background:**

Why has cooperative business become such an important part of life in rural America?

A quick look at the past will help us understand our present a little better. For many years, or maybe even decades, the ironclad rule for success was:

**HARD WORK = SUCCESS**

For most, the phrase “hard work” meant back breaking, physical activity. As time went along it became apparent that in addition to working hard, we had to work smart. So the new buzzword became:

**DIVERSIFY**

We were advised to “not put all our eggs in one basket.” If one enterprise came up short, the other enterprise(s) would carry the load. This worked pretty well for awhile. A guy could handle 160 acres, 10 cows, 10 sows, and 100 chickens along with a few sheep to keep the place “mowed”. But then incomes started slipping, farmers found out they couldn’t get all the work done if they got bigger in everything so the new buzzword became:

**SPECIALIZE**

The emphasis was to focus on one enterprise and become as good as you could. The farm magazines, production consultants, and anybody who knew anything about agriculture told farmers to become the:

**LOWEST COST PRODUCER**

Production volumes of almost all commodities increased, prices went down, margins got narrower and the obvious answer was to:

**GET BIGGER**
And if that didn’t generate enough extra income then you got even bigger by out bidding your neighbors on cash rent or making your livestock operation so large that the neighbors that used to be your friends are now passing around petitions to restrict the operation of your farm.

While the operation of a few very large farms may work, it does not bode well for rural America. Maybe there’s another way to keep our rural economies humming. Our grandfathers’ generation worked together to form service, supply, marketing, and produce processing cooperatives to meet their needs. If a lot of individuals could work together interdependently (cooperatively) then, today’s producers can figure out a way to:

**WORK TOGETHER INTERDEPENDENTLY**

It takes *creative thinking* to come up with ideas and develop plans that will invite farmers to pool their capital into a processing facility. They *need to be politically active* to assure that states and communities are open to construction of new facilities and don’t set up unreasonable barriers to the success of the project.

**Operating as a cooperative:**

Operating on a cooperative basis means first of all that the organization exists for the benefit of its members. The return on capital is usually limited because the purpose is to either market products and return the proceeds less selling expenses, or to provide a service or product to patrons at the lowest possible cost. The business conducted with non-members should not exceed the business done with members. Benefits of being part of the cooperative are returned to the members on a patronage basis rather than an investment basis. With cooperatives democratic member control uses the one-person-one-vote system.

**An example:**

The “MINNESOTA MODEL”

The “Minnesota Model” is the term used to refer to how the Minnesota State government paved the way for the development of Minnesota’s ethanol industry. Several years ago key state officials in the legislative and executive branches could see a possible way of stimulating rural development. Minnesota produces fantastic corn crops and imports all of its petroleum products. Ethanol was a way of making corn into fuel. Ethanol blended into gasoline also showed promise as a way to improve air quality in the more metropolitan parts of the state. The state knew that for a new industry to succeed, a market was a must. The *Oxygenated Fuel Statute* was put in place to require all gasoline to be oxygenated and ethanol was the oxygenate to be used in most cases. To provide ethanol to blend into Minnesota’s gasoline would require several new plants to be constructed. An *Ethanol Producer Incentive* program was put in to place that would pay 20 cents per gallon for up to 15 million gallons a year for 10 years for each plant.
This forward thinking by our state government has resulted in enough ethanol plants across Minnesota to now provide the gallons of ethanol it takes to oxygenate our gasoline statewide. Most of these plants are owned entirely or partly by new generation, closed cooperatives. Some are owned cooperatively by farmer-producers but structured as Limited Liability Corporations for various legal reasons. Several thousand Minnesota farmers have shared ownership in 12 of the 13 ethanol plants in our state.

AGRI-ENERGY, LLC:

The ethanol plant in Luverne, Minnesota was initiated in 1995 through discussions that included a design and engineering firm, city officials, and interested farmers. With encouragement and informational support from the design firm, logistical support from the city, and innumerable hours of volunteer time from the interested farmers a fledgling, new-generation cooperative was formed. An equity drive that lasted well over a year resulted in the formation of CORN-erStone Farmers Cooperative and a pool of equity that was not big enough to build a new plant.

Several months of “checking out possibilities” led to negotiations that resulted in the formation of AGRI-ENERGY, LLC. The new LLC was composed of an ownership blend that resulted in CORN-erStone owning about 64% of the LLC and the remaining ownership split evenly between two investors that both happened to have corporate legal structure. The city of Luverne came forward with a tax increment-financing program that made it possible to secure financing through a central Minnesota banking company. Local banks also assumed some sub-ordinate debt to complete the project.

Construction proceeded in August of 1997 with completion in fall of 1998. The plant has operated profitably since. After some equity transfer the ownership is now at about 70% CORN-erStone, 22% one investor partner, and 8% the other investor partner. This ethanol plant has been successful because a cooperative, two corporations, and a city government, with the assistance of a management company, were able to use a state program to help secure private financing so the plant could be built!

**Competitive Advantage; Rewards & Challenges:**

**Reward:** The obvious reward is financial success. The farmers who invested in CORN-erStone have enjoyed a very good return on investment. The 2.6 gallons of ethanol and 17 pounds of DDGS(dried distillers grains with soluble) that each bushel of corn becomes results in over $4.00 of sale value. With corn currently under $2.00 per bushel the processing doubles the gross sale value.

The ethanol plant in Luverne processes about 6 million bushels of corn per year. This adds about $15.8 million more cash flow to the local economy over what would be added if that 6 million bushels was exported out of the area. Taking Minnesota’s 13 plants times $15.8 million per plant yields over $205 million for the state. Many of the ethanol plants in Minnesota process considerably more than 6 million bushels of corn per year. The “Minnesota Model” is working!
Challenge: The farmer’s risk increases when he assumes ownership of further processing. The cooperative ownership is tied to a grain delivery agreement that is very “tight”. The farmer is at risk for both the capital invested in the plant and the grain delivery. If plant profits decline, the farmer can actually be paid less than market value for the grain. In this plant’s case the two LLC corporate partners do not have a grain delivery agreement. Trying to work out fair profit distribution with disproportionate risk was challenging.

Reward: There is some improved understanding between town and farm people because of mutual benefits from the new business and spin-off business the plant creates.

Challenge: The tax increment financing required the plant to be built in the city limits so the city could provide utilities. Not all nearby residents appreciate the odors that fermenting corn to make ethanol can generate. This has resulted in substantial unforeseen investment to try to reduce odor emission. Had there not been city involvement, the plant could have been located in a more remote area.

Reward: It has been rewarding for farmers to be able to work side-by-side with successful business people from other arenas. There have been some take-home business ideas gleaned from getting to know new people.

Challenge: The inherent differences in business structures of the partners can present some special challenges for the individuals who find themselves in leadership positions. In corporate business structure, positions of leadership are obtained through accumulation of control of money and/or people. In cooperative business structure positions of leadership are obtained and maintained by getting and keeping the support of a majority of the membership through democratic process. This can result in people with quite different personalities having to work together on a board.

Reward: Many producers working together are able to afford the services of professional, experienced management, marketing, and consulting-type services. Individual farmer/producers often tend to let emotion rule important financial decisions about their businesses. The boardroom setting with professional management helps maintain a “business” decision-making environment.

Challenge: The ethanol plant LLC board in this case is composed of 4 coop directors, one person from each corporate partner, and one person from the management company employed to manage the plant. This has created some challenges and the possibility of perceived conflict of interest exists. The owners of the management company also are part owners of the marketing companies that market the ethanol and distillers grain. Part of the management contract is that the management company provides the general manager for the plant. It is possible for it to appear to be difficult for the general manager to always act solely in the best interest of the plant when questions about the marketing services are raised.
**Discussion:**

It is interesting that many of the challenges mentioned are the result of the “blended” business structure. As structural complexity increases there are also increasing levels of necessary corporate interaction and contractual restrictions that affect the way the business operates.

Organizers of new projects are obliged to gain as much understanding of the pro’s and cons of various legal business structures as possible. It is possible to work together “cooperatively” using other structures such as limited liability companies, limited liability partnerships, etc. It is relatively easy and inexpensive to set up a new business entity, but remember, it is quite complicated and often expensive to change the legal structure of an existing business entity.

The basic characteristics of member equity, democratic control, limited liability of ownership of further processing, and/or access to services give the advantage to cooperative structure. With cooperatives the owners (patrons, stockholders) are the customers who receive the benefits (services, profits, dividends, patronage).

**Conclusion:**

I hope that this discussion has been helpful. The learning curve I climbed while we were forming CORN-erStone resulted in a sort of “conversion” experience for me. I had always been somewhat ambivalent about cooperatives until I started promoting CORN-erStone cooperative. I was the one in our group who did a lot of the paperwork with attorneys, accountants, and others. As I came to understand the intent of the laws that make cooperatives possible, I began to appreciate their structure and mission more and more.

I now devote my work time to my position with Land O' Lakes Farmland Feed LLC. I am proud to be a part of the regional cooperative’s effort to respond to change.

My work with Land O' Lakes Farmland Feed now gives me opportunity to work with cooperatives all over western Minnesota, Nebraska, and the Dakotas. I get to work with some groups of farmers who have formed pig production cooperatives. My formal training as a veterinarian and my experience from working with CORN-erStone has proven to be a great combination. Being able to understand the mechanics of pork production and the dynamics of group, cooperative ownership is very helpful in choosing ways to help these farms improve their performance.

Farmers’ working together cooperatively is the best hope we have of keeping farm families farming profitably. Through my involvement in added-value cooperatives and my work with Land O' Lakes Farmland Feed I continue to work to help keep as many families farming profitably as possible.