

# New Generation Partnerships: Is the Future Co-operatives?

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Concepts related to the initiation and structure of cooperatives, specifically New Generation Cooperatives, will be presented in this paper. Discussion of the relevance of New Generation Cooperatives (NGC) for the hog sector in North America, and specifically Canada will be presented.

## ■ Cooperatives

In Alberta very few individuals are not related, in some way, to cooperatives. Cooperatives exist in retailing (food, clothing, farm supplies), housing and farm output marketing throughout the province. In the agriculture sector the genesis of cooperatives has traditionally been for two reasons:

- collective action was required to bring economic balance under control, usually in response to low commodity prices
- collective action is required to countervail market power and provide missing services when markets fail (Cook, 1995).

The initiation of cooperatives, or first stage in cooperative life cycle is, thus, defensive in nature. Cook (1995) has proposed that the second stage in the life cycle concerns the survival of the entity. Based on vast American experience, if the cooperative was initiated in response to low prices it has a low chance of survival, but if it was initiated in response to market failure then the organisation usually survives, with some success. With the success comes the third stage in the life cycle, a stage that results directly from the ill-defined property rights associated with open membership in traditional cooperatives. Cook (1995) has defined the property rights issues that arise as follows:

- Free Rider problem- members and non-members use or benefit from cooperative resources without benefiting from/paying for the full profits/costs.

- Horizon problem - disincentive to invest in long term growth given a lack of well defined rights
- Portfolio problem - members can't adjust cooperative asset portfolio to match personal risk preferences
- Control problem - divergence of interests between membership and management
- Influence costs problem - diverse activities of cooperatives lead to groups within the co-op having different 'stakes' in decisions.

Given the existence of these serious problems in the cooperative, arising from the economic success of the organisation, the fourth stage in the organisation life cycle is driven by the need to develop strategies to deal with the property rights issues. Options for dealing with the issues become:

- exit - liquidate or restructure as investor owned firm
- continuation - usually requiring the infusion of outside capital in the form of debt
- transition - often to a new model, in some case the New Generation Cooperative.

In the fifth stage of the cooperative life cycle action is taken. In Canada we have seen UGG and the Saskatchewan Wheat Pool list themselves on the Toronto Stock Exchange as publicly traded companies to generate capital. In 1997 UGG sold a significant share of their business (45%) to the American multinational Archer Daniels Midland and ultimately merged with Agrico in mid 2001 (Archer Daniels Midland has ended up with a 25% stake in the new company Agrico United). In the dairy sector Dairyworld, a dairy cooperative operating in the West and Maritimes was sold to Saputo, an investor owned dairy processor from Quebec in January 2001.

NGCs are a form of business enterprise that bears closer comparison to an investor owned firm than to a traditional cooperative in many ways. The fundamental difference between traditional and new generation cooperatives is the linking of producer capital contributions and product delivery rights (Harris, Stefanson and Fulton (1996)). In essence, a group of producers of the same commodity form a company that engages in the marketing or, more commonly, further processing of the commodity. They either own the processing capacity or develop a strategic alliance with an existing processor. Capital is raised from members on the basis of their commitment to deliver certain quantities (and qualities) of product to the cooperative. The NGC requires up front capital investment and commitment from members. Membership is usually closed to originating members. Some of the issues of comparison between NGCs, traditional cooperatives and investor owned firms are presented in Table 1.

**Table 1. Comparison between traditional cooperative, new generation cooperative and investor owned firm**

In terms of overall structure the NGC has the potential to eliminate the Free Rider, Horizon and Portfolio problems and reduce the Control and Influence problems of the traditional cooperative. This implies a business model with the potential for long term success.

Within Canada there are two NGCs in Manitoba currently existing (ostrich and egg). Legislation was enacted in 1999 to allow the creation of NGCs in Saskatchewan (a model being applied by the Canadian Goat Marketing Cooperative Ltd.). Although perhaps not the classic case of an NGC, the most talked about issue has been the durum wheat growers interest in developing a NGC for pasta production (Prairie Pasta). Troubles with the Canadian Wheat Board have encouraged the interested producers to join up with an existing NGC in the US. Currently, legislation has been adopted by the Alberta Legislature and the regulations are being written to allow for the creation of NGCs in this province as early as April 2002.

## ■ **New Generation Cooperatives and the Hog Sector**

Within the North American food sector there have been enormous structural changes over the past 10 years. Hogs are no exception. For the hog sector some of these changes have emanated from the environment external to the hog sector and some have emanated from within the hog/pork sector. The rapidity of the structural change has likely generated some discomfort on the part of participants within the hog/pork sector. The question is whether or not there is a role for New Generation Cooperatives as players within the evolving sector.

### **External Environment**

While not attempting to describe all of the recent trends in the global agrifood system there are some key factors that are changing the ways everyone does business. In simple terms the major forces of change in the agrifood system relate to the following issues:

- Government Support and Risk Management
- Supply Chain Management
- Food Safety/Quality.

### ***Government Support and Risk Management***

In spite of the recent increases in government support, due to poor prices in most developed countries the longer term trend is for reduced government support. This is particularly true for commodity specific programs. The international trade agreements that the U.S. and Canada participate in are

pressuring for decoupled forms of intervention (decoupled from production decisions) and programs that are broadly available to the entire agricultural sector (to avoid distortion of commodity production patterns by subsidy). For producers in any particular commodity sector this may imply an increased need for personal risk management.

### ***Supply Chain Management***

Global competitive pressures on agrifood businesses, including food retailers, have encouraged an environment where competition is stiff. Firms are concerned with their bottom lines and with longer term consumer loyalty. There is significant growth in the development of private label products (Loblaw's President's Choice products are an example of the high end of private label products as opposed to the store brand generic products that proliferated in the early 1980's). The question is: *Who will produce the private label products?* Sometimes the traditional food companies are loath to participate in the production of product that will directly compete with their branded products. At the same time branded product suppliers are looking for tighter and tighter linkages with suppliers throughout the marketing chain. They desire tighter linkages to reduce transaction costs (by the ability to directly specify production attributes).

### ***Food Safety and Quality***

Consumers are becoming progressively more concerned about the quality of their food supply system. This has been exacerbated by the Mad Cow scares but is also contributed to by consumer misunderstanding of the role of genetic modification. Identity preservation will become a significant pressure on the system over the next few years both for raw commodities and retail consumer food products.

### **Internal Environment**

The entire hog/pork sector within North America has been undergoing a major structural change over the past ten years. It is even difficult to unscramble what is cause and what is effect. The types of structural change can be classified under the following categories:

- Structure of the hog producing sector
- Organisational structure for producers
- Structure of the slaughtering sector

### ***Structure of the hog producing sector***

In simple terms the number of farmers engaged in hog production has been decreasing at a fast pace. At the same time the number of large growers has

been increasing and the number of small growers decreasing at an even faster rate. Some of the relevant statistics for the U.S. and Canada are presented in Tables 2 & 3.

**Table 2. Number of hog producers in Canada & USA, 1992-2000**

Year	# of Producers		Small Producers		Large Producers	
	Canada	U.S.	Canada (1 - 77 head)	U.S. (1 - 99 head)	Canada (2653+ head)	U.S. (2000+ head)
1992	27920	248700	14907	150800	537	3800
1993	26860	225210		137500		4160
1994	25750	207980		124600		4630
1995	24930	182700		108800		4750
1996	22234	157450	10013	96000	864	4980
1997	20150	140890	8906	84900	890	5570
1998	18760	134380	8556	62370	930	6685
1999	16720	98610	7367	52880	971	7175
2000	13920	85700	5582	47500	948	6890

**Table 3. Average hog price in Canada & USA, 1992-2000**

Year	Canada \$/cwt Ontario	U.S. \$/cwt
1992	59.87	41.60
1993	68.95	45.20
1994	65.77	39.90
1995	68.49	40.50
1996	85.73	51.90
1997	84.82	52.90
1998	54.88	34.40
1999	54.43	30.30
2000	73.48	40.50

At the same time as producers have exited the industry there has been some relocation of producers from traditional areas of hog production in both countries. The share of North Carolina in U.S. hog production has increased from 6 % to 10 % since 1992 (while overall U.S. hog production increased by

5%). In Canada, Manitoba's share of hog production has risen from 15 to 22% with a larger percentage increase in national production. In both cases the increases in production in the two regions of the countries have not been without controversy.

### ***Organisational Structure for Producers***

The difficult times in the hog sector have had some broad implications for how hog producers organize themselves in each country. During the 1990s in Canada, the single desk selling powers of provincial marketing boards have disappeared. In the U.S. there has been major restructuring of the national producer organisation, NPPC. With some rancour, the national generic advertising campaign (*the other white meat*) was disbanded. The generic advertising activities of the Canadian hog industry are modest and fragmented across the country.

### ***Structure of the Slaughtering Sector***

Any simple search of newspaper articles in North America over the past ten years brings up innumerable articles about closure or plant relocations in the hog slaughtering industry. Canada has seen US packers buying up plants in the traditionally 100% Canadian owned industry. Within Canada some processors have extended their reach (the purchase of the Red Deer plant by a Quebec processor) while others have quietly or not so quietly exited the business. In the U.S., Smithfields has grown significantly from a struggling processor in the late 1970's to a multinational with plants in the U.S., Canada, Poland and France. They own the largest slaughtering plant in the world in North Carolina and slaughter about 20 % of America's hogs (as of January 2000). Smithfields has made inroads in Canada through purchases of J.M. Schneider plants and diversified in the U.S. through partial ownership of IBP, to name only a few of their transactions.

In both Canada and the U.S. there have been significant changes in the way hogs are sold. In Canada in the early 1990's many hogs were sold by auction or through formula prices (often linked to the U.S. or to Ontario). Numbers published for Ontario show 74% of the Ontario hogs being sold on the auction in 1996 while in 2001 that number had dropped to 27%. By last year the vast majority of hogs were sold on contract. Numbers for the U.S. suggest that as late as 1994 71% of the hogs in the U.S. were sold on the spot market, in 2001 that number has dropped to 17.3%. The dramatic downturns in hog prices evidenced in 1998/1999 may have contributed to the movement to contract hogs as a way of minimizing price risk for hog producers.

## ■ Cooperatives and American Hog Producers

Since the disastrous prices of 1998/1999 there has been a resurgence of interest in developing hog cooperatives in a number of locations in the U.S. These ventures clearly fall within the New Generation Cooperative model although not all of them initially were set up to process hogs through shared or new facilities. Some were initially only involved in marketing hogs. The publicly available statements from organizers of the various new organisations resonate with comments on the need to 'move up the value chain' and to 'restore the profitability of independent producers'. There seems to be a strong desire to move away from a perceived trend towards fully integrated production processing units. (Smithfields, the large multinational hog processor also raises about 12% of U.S. pigs). Data presented in Table 4 identifies some of the smaller cooperatives that have been created in the past few years in the U.S.

**Table 4. Characteristics of some US new hog cooperatives**

<b>Name</b>	<b>State</b>	<b># of Members</b>	<b>Year</b>	<b>Processing</b>
Prairie Farmer Cooperative	Minnesota	73	1999	New facility open 2001
Family Quality Pork Processor	Nebraska	105	1999	processing
Iowa Premium Pork Co.	Iowa	1400	1998	Joint venture
Family Farms Pork Cooperative	Missouri	250	2001	New facility

It is also worth mentioning another cooperative, the Central Kentucky Hog Marketing Association, which was created in 1991. Although a small cooperative, with only 25 members, the cooperative never turned hogs away even when prices were at the ultimate lows. The cooperative has grown in terms of pork produced but the membership has remained at the same size. Members of this cooperative were instrumental in the development of the national Pork America cooperative. In the U.S. Pork America has been created with the assistance of the NPPC and the U.S. D. A.. It represents producers in 17 states covering more than 30 producer groups. At last count the cooperative would account for 10% of U.S. hogs marketed. The cooperative is investing in slaughtering facilities, most recently a plant that has been closed by another processor. Pork America has been created to assist in 'increasing market access for independent hog producers and to allow them to participate in

additional levels of the marketing chain to increase their net returns'. A strategic study identified two keys for success of the new venture:

- The organization must be market driven
- Pork America must be a significant market player (become a large player).

Producers themselves feel that the cooperative has potential due to leveragable assets in hog production ( capital investment per cwt is higher in hog production than in hog processing). Not surprisingly Joseph Luter, Smithfield Foods chief executive has predicted that the cooperative venture will fail (Matson and Gehrke, 2000)

## ■ Conclusion

Cooperatives remain a potent force in the international agrifood business. In many ways New Generation Cooperatives are one legitimate reaction to the external market pressures facing the hog and other agrifood industries. Individual producers would have some capacity to share some market risk and extract higher profits if they 'move up the value chain'. Tighter links between various elements of the food distribution system are likely to be increasingly important in the future. New Generation Cooperatives, with closed memberships, and detailed quantity and quality delivery restrictions may provide one way of satisfying wholesaler, retailer demand for tight quality and traceback requirements. Contracting hog production with tight quality restrictions is, of course, another solution to the external forces.

To a certain extent the establishment of NGC firms in the hog market is a reaction to a desire to own the farm or their own enterprise on the part of hog producers. (There seem to be few cooperatives being established in North Carolina at the moment). Certainly there are legitimate fears in the U.S. over the long term viability of small to middle sized hog operations. An organization called the Fresh Air Pork Circle Cooperative was established in 1999 in Iowa. Grey (2000) reports that the organization had mixed success. Members found it difficult to organize themselves and to raise even modest sums of capital necessary to hire a marketing consultant. However, the organization survived and provided a sense of community for producers that were feeling beleaguered by the market. At least in the case of one cooperative some members have joined because individually each farmer wasn't large enough to even be offered a contract by one of the big processing firms. Innovative niche market development and establishing non traditional market linkages ( trying to establish direct links with large city restaurants, for example) to increase the value added from production are goals that are achievable through NGCs. It is clear that in some cases the creation of cooperatives in the U.S. was coincidental with major players closing plants in certain parts of the U.S. The

existence of a plant that could be taken over by a cooperative made the decision somewhat easier. However there are as many examples of new cooperatives being established and building a processing plant from scratch (perhaps no more costly than upgrading deteriorating older facilities).

New Generation Cooperatives are a significantly different form of business enterprise than traditional cooperatives. Up front commitment and investment are significant requirements of the business. In spite of legislative ease and some support from provincial and national agriculture ministries it is likely that Canadian producers would only seriously move in this direction if they became dissatisfied with the contracting arrangements that have become the norm in the Canadian hog industry.

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