



# Investing In Your Co-op's Future

## Key finance, marketing issues examined during Farmer Co-ops Conference

**By Lynn Pitman, Outreach Specialist**  
University of Wisconsin Center  
for Cooperatives

*Editor's note: Many of the presentations made during the Farmer Co-op Conference are posted online at: [www.uwcc.wisc.edu](http://www.uwcc.wisc.edu). That website will also carry periodic updates about the next conference, which will be held Nov. 6-7, 2014, in Minneapolis.*



How does an agribusiness cooperative provide value to its member-owners? The more than 160 people who attended the 16th annual Farmer Cooperatives Conference in Minneapolis in November were able to explore that perennial question from a variety of viewpoints.

### **Investing for the long term**

Capitalization presents unique challenges for agribusiness cooperatives,

and a discussion of alternative opportunities for finding capital launched the conference this year. Ronald McFall, a partner with the Stoel Rives law firm, provided a review of debt and equity instruments through the lens of securities laws. Changes to the safe harbor exemption for securities registration may present an opportunity for cooperatives to expand their securities offerings, he noted. The exemption's ban on public solicitations will not apply if sales are made only to accredited investors and if reasonable



steps have been taken to verify accredited investor status.

Carl Casale, president and CEO of CHS Inc., provided insights into the capitalization strategies for this Fortune 100 cooperative. Strong earnings growth has supported the expansion of CHS' global reach. The co-op now is seen as a "tier-one" supplier by its customers. By becoming a strong international player, CHS has made its owners relevant to the global market.

The challenge for CHS, he said, is to continue to build the permanent capital

needed to invest in assets that are beyond the reach of an individual farmer. Casale, a veteran of the 90-day cycle that drives a publicly traded company, contrasted those investor-driven demands to the "long view" that cooperatives can take by virtue of their "patient capital" equity structure. But sourcing cooperative permanent capital can be challenging.

Many cooperatives use earnings from non-members as a source of permanent equity to support growth. Casale noted that cooperative businesses can run into trouble if they stray from their core business. Because CHS members are responsible for 70 percent (and trending upward) of the co-op's earnings, non-member business is not seen as a source for equity growth.

Debt, especially in these times of low interest rates, presents another source of capital for growth. However, market volatility makes liquidity very important. Allocated member equity is an important part of a healthy balance sheet, but it can't be considered permanent equity. While the co-op is not obligated to return the equity, the expectation among members is there. CHS has chosen to use "no-call" preferred stock offerings to build the permanent equity portion of its balance sheet.

Jeff Stroburg, president and CEO of West Central Cooperative in Iowa, described his co-op's approach to growth equity. West Central began offering a dividend-bearing stock in 2005. It is one of four different types of allocated stock that the co-op issues to provide flexibility in both revolving patron equity and maintaining equity for growth.

Qualified allocated equity is retained by issuing a class of revolving patronage stock. It is redeemable into the dividend-bearing stock after 7-10 years. The dividend on that stock is currently 8 percent and is available for redemption any time, subject to board approval. It is only issued to revolve patron equity and cannot be purchased.

To provide an incentive to members to keep their equity invested in the co-op, West Central sets the rates based on maturity date. Dividends are taxed at the capital gains rates and are not subject to self-employment taxes. The dividends are sourced from non-member business, which provide a way in which members can also directly benefit from this revenue source.

The program must be managed to balance liquidity needs to meet potential redemption activities against the needs for working capital. Stroburg mentioned the potential feasibility of a public market for cooperative stock, which would provide holders of the stock liquidity independent of the cooperative.

### **Changing ownership structure**

Ireland's Glanbia Cooperative Society illustrates another approach to balancing outside investment, growth and the optimum deployment of owner equity. Michael Boland, professor at the University of Minnesota, provided background on the co-op, which was created through the merger in the 1990s of two dairy cooperatives.

Each cooperative had owned a value-added firm, and when the cooperatives merged, so did these firms, creating Glanbia plc (a public limited company, which is equivalent to a publicly traded company in the United States). Glanbia Cooperative Society was the largest shareholder in Glanbia plc, which is an international marketer and manufacturer of cheese and other consumer dairy products, sports nutrition products, protein and micronutrient products, as well as farm supplies.

In 2008, when the European Union announced that milk quotas would be repealed in 2015, a large number of dairy co-op members began to push for expanded processing facilities to accommodate an expected increase in farm production. However, this conflicted with Glanbia plc's focus on

value-added, high-margin production, which did not require large amounts of milk for its markets and which were increasingly located outside of Ireland.

The pressure to return earnings to shareholders and for debt servicing from earlier expansions, as well as the demand for equity retirement payments (for both retiring and current farmers) also created competition for a share of the earnings.

In 2010, members narrowly rejected a proposal to acquire the Dairy Ireland division of Glanbia plc, dilute its membership stake in the plc to 10 percent and use the cash raised to build dairy processing and agricultural assets. Those opposed to the proposal did not

restructuring was to increase processing capacity in Ireland, benefitting Irish farmers. While co-op member control

the tax treatment of cooperatives).

The impacts of domestic policy on agribusiness continued to be explored



*Co-op capitalization strategies were discussed by a panel of (from left): Ronald McFall, of the Stoel Rives law firm; Jeff Stroberg, president and CEO of West Central Cooperative; and Carl Casale, president and CEO of CHS Inc. Photo Courtesy University of Wisconsin. Ireland's Glanbia Cooperative Society (GCS) was discussed to provide an example of another approach to balancing outside investment, growth and the optimum deployment of owner equity. The co-op's cheese innovation center is seen on facing page. Photo courtesy GCS*

“In situations this complex, the trust between the CEO and the board chair is critically important because it encourages frank discussion and makes sure there are no surprises.”

want to give up their control of the plc and to lose the potential returns on investments they had made in it.

The plc's stock price continued to rise, and in 2012 the co-op and plc announced a new proposal. Glanbia plc would form an LLC with the co-op for a joint venture to build a dairy processing plant in Ireland, controlled by the Glanbia Cooperative Society. To help finance the plant, the co-op would sell a portion of its plc holdings, ending its majority position. Proceeds would also be used to pay off long-term debt and retire equity. The plan was finally ratified at the end of 2012.

Boland interviewed Glanbia Co-op board chair, Liam Herlihy, about the restructuring. Herlihy noted that the challenge was the trade-off involving control of the plc vs. value that could benefit members. A major goal of the

of the plc has been diluted from 55 percent to 41 percent, the vote was ultimately successful because it gave something to everyone.

In situations this complex, the trust between the CEO and the board chair is critically important because it encourages frank discussion and makes sure there are no surprises. Herlihy also noted that outside directors were an important addition to a board, bringing in skill sets that are needed for growth.

### **Policy landscape**

Chuck Conner, president and CEO of the National Council of Farmer Cooperatives, said efforts to simplify the tax code will continue to be contentious. A preliminary plan floated by the Senate finance committee called for a repeal of Section 199 deductions, but not Subchapter T (which describes

with a panel discussion on ethanol, moderated by Michael Weaver, a partner at the law firm of Linquist & Venum. The panel included Jim Miller, vice president at Growth Energy, which represents ethanol producers and supporters; Greg Krissek, manager at Kennedy and Coe, a consulting firm; and Rick Schwarck, president of Absolute Energy, which owns an ethanol plant in Iowa. The panel members presented their views about the positive effects of the ethanol mandates on the agricultural economy.

### **What's ahead for economy?**

A look at the increasing impact of China on U.S. agriculture and agribusiness cooperatives was provided by Dermot Hayes, professor at Iowa State University. Historically, the Chinese have compensated for their

geographical constraints — such the relative scarcity of good farmland in the eastern part of the country — through intensive labor on marginal lands and a diet that wastes very little. As the country grows and becomes more prosperous, this strategy has become increasingly challenging.

China's current leadership has been open to a more free-market approach to agriculture. Continued increases of imported soybeans, corn and livestock — the production of which is considered an inefficient use on much of its agriculture land — would allow rural populations to move to urban centers and bolster the workforce there. China's growth has already had a



substantial impact on Midwest U.S. agriculture. Hayes said that due to this demand, and for other reasons, the economic outlook for Midwest agriculture remains very strong.

Joseph Mahon, economic analyst with the Federal Reserve Bank of Minneapolis, said that the domestic economic situation for agriculture continues to be positive. Federal Reserve District 9, which encompasses

## The long view of a changing world

By John Shutske, Associate Dean

College of Ag and Life Sciences, University of Wisconsin

Last month, I had the opportunity to be in Minneapolis for a couple days at the Farmer Cooperatives Conference hosted by the University of Wisconsin Center for Cooperatives. I was particularly interested in an after-dinner presentation on the first night, which touched on the major challenges that the world faces in feeding a growing global population.

Steve Radelet, who recently joined the faculty of the School of Foreign Service at Georgetown University following his service as chief economist for USAID, discussed *"The Great Era of Global Development."* Radelet talked about the worldwide economic and human progress during the past 50 years, which has been unprecedented in human history. In just 20 years, billions of people have been lifted out of poverty and hunger.

In just 20 years, billions of people  
have been lifted out of poverty  
and hunger.

But most inspiring was Radelet's discussion of the role that democratic ideas, leadership accountability and economic freedom have played in the progress made by developing countries.

Not all countries have equally participated in these past few decades of progress. And this progress could face significant setbacks, or even be derailed, by a major global conflict or environmental catastrophe. But ideals of freedom, democracy, accountability and transparency do clearly work. This discussion reminded me that we see many of these principles and ideals embodied in the work of cooperatives.

Radelet's discussion has also inspired me to think about the role of land-grant universities, such as ours. President Abraham Lincoln signed the Morrill Act of 1862, leading to the formation of our colleges that housed agriculture programs and other educational, research, and eventually extension programs. He and leaders before him clearly understood that education was, and remains, an important pillar to freedom and democracy.

As our world continues to progress, we will need to adapt in entirely new ways because of issues such as climate change, emerging human (and animal) health concerns, and the continued forces and implications connected to a more globalized economy.

I am confident, however, that our science and educational programs will keep pushing forward. It is also clear that the role of cooperatives and the ideals that Radelet described as being so successful in improving the human condition have only upside growth potential. ■

most of the Midwest, weathered the recession better than other regions, in part because of the strength of the agricultural sector.

Overall, the 2014 forecast for the 9th District is similar to 2013, with the economy likely to enjoy a moderate recovery. Farm income has remained steady, and while crop prices overall are down, land values and rents are still climbing, Mahon said.

## **Global and consumer-driven impacts**

Molly Jahn, a professor at the University of Wisconsin-Madison, looked at future demand trends and the likely impacts on production agriculture. Farm output in 2008 was 158 percent above production in 1948, and now food systems can meet the needs for global per capita caloric sufficiency. But evolving pests and diseases constantly challenge these gains, and continual research is needed to keep up. Furthermore, the current food system is causing critical resource degradation in many areas.

Noting the historical correlation between civil instability and food prices during this time of increased

There are a variety of strategies to deal with these challenges, including agricultural innovations that increase crop resiliency, productivity and efficiency, as well as reduce greenhouse gas emissions. Carefully matching crops to environments, for instance, can optimize nutrient and water use.

Cooperatives are uniquely positioned to play a role in this shift. There is a developing need for tools that allow producers to manage more complex sustainability trade-offs, Jahn said. By aggregating and sharing producer data, cooperatives can create knowledge-based assets that will support sustainable outcomes for all.

## **Consumers putting more demands on industry**

Christine Walsh, vice president with Point Zero Retail, a research and marketing agency, talked about sustainability from a consumer-demand perspective. Producer cooperatives have focused on operational efficiencies rather than the influence that consumers play in the market place. Consumers are more engaged than ever, and the transparency that they expect from producers of their food is no

comparative product information for making purchasing decisions. These include more information about nutrition, production methods and sourcing. Producers need a variety of strategies to meet consumer demands for information at the retail level.

## **“Pretty big data”**

Data, whether used to inform consumers or to assess the trade-offs in complex decision-making, represent a critical asset for co-ops. Knowing where data comes from, and how it is captured, is important. George Olney, chief operating officer of iRely, a provider of enterprise software for commodity management, described the process of implementing new data collection software systems. These new systems are also the basis of potential data-sharing arrangements that could support metrics, risk management and trend analysis.

Larry Romuald, treasurer of Cooperative Resources International (CRI), a livestock breeding co-op, described the implementation of one such system. The co-op has been using a patchwork of old software programs that was not keeping pace with the co-

“By aggregating and sharing producer data, co-ops can create knowledge-based assets that support sustainable outcomes for all.”

agricultural productivity, Jahn said that maximizing productivity does not always equate to food security. Jahn said her work with the International Commission on Sustainable Agriculture and Climate Change has focused on developing recommendations to help balance agriculture-induced climate change, food needs for a growing global population and climate constraints on food production.

different than the transparency that they expect from other businesses or government, Walsh said.

She reminded the audience that agricultural producers are not being “picked on.” Consumer demand for information about issues they care about spans many sectors and will likely only grow.

Walsh highlighted several new tools now available to consumers that provide

op’s growth or the increasing complexity of its domestic and international operations.

CRI identified important strategic capabilities that could only be met by new enterprise software systems, and that would justify the substantial time and budget commitments required for implementation. The three-year project will be launched in the spring of 2014. ■