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New Generation Cooperatives

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Market Report	Yr Ago	4 Wks Ago	4/21/00
Livestock and Products, Average Prices for Week Ending			
Slaughter Steers, Ch. 204, 1100-1300 lb Omaha, cwt.	$65.20	$72.83	$74.48
Feeder Steers, Med. Frame, 600-650 lb Dodge City, KS, cwt.	78.56	93.99	92.51
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg.	82.63	98.18	99.45
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt.	98.81	112.46	116.90
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt.	32.75	42.00	49.00
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd.	*	62.50	67.41
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt.	105.00	*	125.60
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt.	*	79.00	*
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt.	150.00	170.00	170.00
Crops, Cash Truck Prices for Date Shown			
Wheat, No. 1, H.W. Omaha, bu.	2.67	2.73	2.81
Corn, No. 2, Yellow Omaha, bu.	1.95	2.05	2.06
Soybeans, No. 1, Yellow Omaha, bu.	4.55	4.99	5.25
Grain Sorghum, No. 2, Yellow Kansas City, cwt.	3.34	3.59	3.54
Oats, No. 2, Heavy Sioux City, IA , bu.	1.29	1.35	*
Hay, First Day of Week Pile Prices			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton.	122.00	105.00	85.00
Alfalfa, Lg. Round, Good Northeast Nebraska, ton.	42.50	85.00	47.50
Prairie, Sm. Square, Good Northeast Nebraska, ton.	62.50	*	55.00

* No market.

New Generation Cooperatives (NGCs) are farmer-owned cooperative organizations generally characterized by an involvement in value-added processing activities and a linkage of producer capital contributions to product delivery rights. Although the earliest NGCs were established in the North Central United States, particularly in North Dakota and Minnesota, interest in this organizational form has spread to other regions of the country because of the perceived success of many of these cooperatives. Recently, NGCs have been involved in traditional value-added activities such as corn sweetener production, sugar beet processing, pasta production and hog operations, as well as activities related to emerging niche markets such as bison processing, tilapia production, organic milling and speciality cheese processing. Producers generally form NGCs to develop new value-added products in order to access a greater share of consumer food expenditures.

A distinguishing feature of NGCs is the direct link between producer capital contributions and product delivery rights. Each member of an NGC contracts with the cooperative to deliver a particular quantity of product annually, and must purchase equity shares in proportion to this contracted quantity. The member must meet this contract requirement either by delivering his or her own product or by purchasing product from other producers for delivery to the cooperative, except under unusual occurrences such as a crop failure. The contract also provides the member a guaranteed market for the product because the cooperative is obligated to purchase the quantity specified by the contract, subject to quality restrictions.

Organizers of an NGC usually conduct an equity drive to obtain support for the cooperative and to sell equity shares to prospective members. Organizers must determine the total capital necessary to purchase and operate the processing facilities, and they typically will seek to raise from 30 to 50 percent of the total capital requirements by selling membership equity shares and the associated delivery rights. The initial price of an equity share usually is set by dividing the amount of start-up membership equity by the quantity of product that will be processed by the cooperative each year. The remaining capital needs are met by bank loans or the issue of preferred shares, the latter of which allows the cooperative to obtain equity contributions from the community or other interested parties. However, because delivery contracts are tied to membership equity shares, membership in the cooperative is limited to producers planning to deliver product to the processing plant. Owners of preferred shares do not hold voting rights, and the return on their shares generally is limited.

Once the NGC is in operation, the earnings from its processing operations are distributed to members at the end of the year in proportion to the quantity of product each delivers. In addition, after the initial equity drive, member equity shares generally are tradeable, subject to approval by the cooperative's board of directors. The value of the shares will depend on the returns members of the NGC expect to receive over time, based on the revenue the cooperative receives from processing and marketing the product. A member who sells equity shares, and the corresponding delivery rights, will experience a capital gain or loss, depending on the share price.

Economists have contended that the linkage of capital contributions and delivery rights, and the existence of appreciable, tradeable equity shares have eliminated the free-rider and horizon problems in NGCs. The *free-rider problem* may exist in a traditional cooperative because ownership by itself carries no benefits; instead the cooperative's earnings are distributed to members on the basis of patronage. Consequently, individual members of the cooperative do not have an incentive to invest in it although investment is fundamental to the organization's success. In a NGC, the distribution of earnings is tied to ownership because of the link between member equity shares and delivery rights.

The *horizon problem* arises when an investor's claim on the earnings generated by an asset is expected to terminate before the end of the asset's useful life. As a consequence, the investor is likely to underinvest in the asset. The horizon problem also may occur in a traditional cooperative because of the distribution of earnings according to patronage. Members may tend to under-invest in assets, particularly assets with long-term payoffs, if they believe a significant proportion of the benefits will be realized after they retire from farming. This problem is avoided in NGCs because future earnings are reflected in the value of tradeable equity shares.

Despite these advantages, the NGC organizational form is not without drawbacks. The need for significant up-front capital contributions tied to delivery rights establishes financial barriers to new membership. Substantial appreciation in the value of equity shares also has created barriers to exit for retiring members, who may have difficulty finding younger farmers who can afford to purchase their shares. These problems have stimulated the creation of leasing arrangements by which newer members may lease delivery rights from older ones. In addition, some NGCs facilitate membership by allowing new members to purchase shares over a period of several years.

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Note: This article is based largely on Andrea Harris, Brenda Stefanson and Murray Fulton, "New Generation Cooperatives and Cooperative Theory," *Journal of Cooperatives,* 11 (1996), pp. 15–28, and Jeffrey S. Royer, "Cooperative Organizational Strategies: A Neo-Institutional Digest," *Journal of Cooperatives*, 14 (1999), pp. 44–67.