New Generation Cooperatives: *Case Study*

21st Century Alliance: Building Value-Added Agribusiness

by Roger Brown

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Introduction

To create a successful business in an unfamiliar industry is difficult. Likewise, changing a cultural environment from one of independence to one of interdependence is also a challenge. It might seem impossible to create a new business in an unfamiliar industry that requires a large group of independent-minded investors to work cooperatively for success, yet it can be done and is being done.

This case study examines the 21st Century Alliance and how it has helped farmers, mainly in Kansas, increase the scale of their operations through value-added agribusiness. In just three years of operation, the Alliance has led to the formation of six New Generation Cooperatives (NGCs) and one Limited Liability Company (LLC). It is also worth noting that the NGCs include relatively diverse agriculture products. The Alliance, at its core, is made up of a relatively small number of dedicated people working diligently to extend the value chain for farmers, also known as Ag Producers, and, as a result, to improve rural economies. It is best described as an entrepreneurial agribusiness organization that is both focused and flexible in its business start-up activity.

The Alliance focuses on identifying the critical issues in a new venture and resolving those issues to ensure that a new business has a reasonable chance of succeeding. Addressing issues to improve the business is an ongoing process. Those projects that fall short during the feasibility process are scrapped. Flexibility is demonstrated by an openness to considering unique approaches to making a business work such as growing product in one state and processing it in another. The key is whether the business can achieve its ultimate financial objective for the membership.

Background

The 21st Century Alliance organization is headquartered in Manhattan, Kansas—a location that is roughly at the center of America's "breadbasket." Kansas is proud of its farming heritage. According to the Kansas Department of Commerce and Housing, more than 90 percent of the state's land is used in agriculture, and the industry pumps $10 billion into the state's economy. It usually ranks number one or two nationally in wheat acreage harvested, wheat yield per acre, total production, and total value of wheat crop harvested. In 1998, farmers in Kansas produced 495 million bushels of wheat, representing 19.4 percent of the total U.S. wheat production (U.S. Census Bureau 1999, 688). Even so, this success cannot hide the fact that agriculture in Kansas

This case study was prepared with the assistance of Chris Williams, Vice President of Operations for the 21st Century Alliance. Any observations and opinions presented in this report are those of the author.

has undergone profound changes in the last two decades. The farm crisis in the 1980s stressed the farms in Kansas and neighboring states. The struggle continues and can be seen in the continued decline in the number of farms between 1992 through 1997 (Table 1). The difficulty in earning a living by farming has resulted in farm consolidations and a shift to additional employment outside the farm.

Table 1. Farms and Principal Occupation

Kansas	*1992*	*1997*
Number of Farms	63,278	61,593
Principal Occupation of Farm Operators		
Farming	39,324	34,979
Other	23,954	26,614

Source: USDA, National Agriculture Statistical Service

The advent of value-added agriculture has required a shift in the mindset of American farmers. In the early history of the United States, farmers were interdependent, relying on each other to harvest, butcher, and even entertain. Gradually, they became independent through the advances of technology. With each purchase of new and better equipment, the American farmer became more independent to the point that even large families were no longer necessary to run the operation. The technology brought efficiencies and higher productivity that allowed for the creation of a culture of independence among the farming community, but it also created bumper crops that affected price.

To counteract the oversupply and price vulnerability, the government provided support to the farmers. This created a level of dependence on the government but allowing farmers to remain independent in the farming operation. The loss of government support and continuing low prices has resulted in the need for a new equilibrium in the farm community. This need has resulted in the recreation of interdependence in rural communities as farmers seek to capture the value of the finished goods that are produced and marketed from their low priced commodities. This move back to interdependence is not easy because it not only requires an uncomfortable level of collaboration and sharing but it also may require staggering levels of capital and technical knowhow that are not available. The business model created by 21st Century Alliance facilitates the creation of interdependency and the attainment of resources necessary for farmers to own processing and or marketing operations related to their raw commodities.

The 21st Century Alliance was formed to identify new opportunities for farmers so that they could control some of the risk and volatility of their farm operations and become more profitable in the process (Williams and Merrett 2000). The Alliance has approximately 650 members, and its role is one of an entrepreneurial institution supporting farmers in their effort to start new agricultural related business. It is steadfast in its role of assurance that the new business be sound and of acceptable risk. A process is followed to build ideas into viable ventures. Ideas that cannot be supported with producer commitment, acceptable risk, sufficient capital, and qualified management are rejected.

The Formation

The formation of the Alliance and its initial operation are best described by Merrett and Williams (2000) in *A Cooperative Approach to Local Economic Development*. They detail how in 1995, as a result of the Kansas Association of Wheat Growers and the Kansas Corn Growers Association, the 21st Century Alliance was formed to raise venture capital. The purpose of the capital was for the purchase of processing facilities, product development, and marketing studies. The goal was to raise $1 million by recruiting 2,000 ag producers and requiring each to pay $500 to become members of the Alliance. The recruitment of members was not limited to Kansas farmers but included neighboring states as well. Although the target of 2,000 members was not reached, the organization was ready to seek business opportunities at a subscription of just fewer than 600.

By 1997, the patient search for the right opportunity yielded a flour mill in Rincon, New Mexico. The 21st Century Grain Processing Cooperative (GPC) was formed to own and operate the mill. The mill had failed under previous ownership due to a lack of quality wheat in the area. Under new ownership by the GPC, high-quality wheat would be shipped by rail from Kansas, Oklahoma, and Texas. The location of the mill made it ideal for marketing product to cities like Albuquerque, El Paso, and to the population in Mexico.

In order to purchase the mill, a stock sale was initiated to raise $5 million. A producer could participate by investing $5,000 in a share that included an obligation to deliver 2,850 bushels of wheat. Approximately 375 Alliance members invested a total of $3.2 million in the venture. This was enough equity capital to allow for the purchase and renovation of the mill and so by June of 1998 the mill began operation under GPC ownership. Thus, the 21st Century Alliance's first value-added agribusiness had been launched.

Continued Success

As of January 2001, the Alliance has established six value-added enterprises of which four process agricultural products. The two other processing enterprises are still in some stage of development. They have also established a grain-merchandising group. All four of the processing entities in operation are NGCs, but the grain-merchandising group was organized as an LLC. The NGCs include one grain mill, one dry bean processing facility, and two dairy operations (Table 2).

Table 2. Organizations Created by the 21st Century Alliance

Name	*Location*	*First Production*	*Organ.*	*Product*	*Members*	*States Represented*
21st Century Grain Processing Cooperative	Rincon, NM	June '98	NGC	Flour mill	360	KS, NE, OK, PA, TX, CO
21st Century Bean Processing Cooperative	Sharon Springs, KS	Fall '99	NGC	Dry edible beans	50	KS, CO, NE
21st Century Dairies Cooperative: Washington County	Linn, KS	March '99	NGC	Milk	96	KS
21st Century Dairies Cooperative: Ladder Creek	Tribune, KS	Dec. '99	NGC	Milk	101	KS, IL, CO, NE
21st Century Ag Fiber Procurement Cooperative		Under review	NGC	Fiberboard	120	KS
21st Century Grain Merchandising, LLC	Manhattan, KS	July '00	LLC	Grain Merchandising	3	KS
Great Plains Corn Processing Cooperative	Plains, KS	Development stage	NGC	Corn Masa Mill	82	KS

Source: 21st Century Alliance.

Grain Processing

Sales in the year 2000 were $5 million. The market for the mill's wheat flour continues to build and, with it, the cash flow is increasing. The mill currently produces 17 truckloads of flour per week compared with three trucks per week in 1998. Thus, the business is growing and it appears to have a bright future. Even as management recognizes the burden of interest payments on loans as an obstacle. These loans were needed to create the business; however, servicing this debt expense has severely affected cash flow. Now, as sales grow, the ability to service debt has improved. An additional stock sale was considered at one time in order to replace debt with equity and, thus, reduce interest payments. No stock sale is planned at this time, probably due to the increased revenue from the business.

Dairies

The two dairies were developed simultaneously but are located in different regions of the state. The first Alliance dairy facility to start production was the 21st Century Dairies Cooperative: Washington County. This is a 1,500 cow facility with 100 participating producers. The other dairy, 21st Century Dairies Cooperative: Ladder Creek, began production in December

1999, just 10 months after the Washington County facility. Remarkably, from the initiation of the stock sale for the Ladder Creek Dairy to first production took only 11 months. More than $2 million in equity was raised from 100 investors. The Ladder Creek facility milks approximately 2,500 cows.

This is a difficult economic time for dairies throughout the country, and the two Alliance dairies have had to cope with low milk prices. In order to cope and compete, costs must be reduced. Two major expenses are debt and feed. In both cases, the structure of an NGC allows for control of the situation by issuing additional equity to reduce debt and by reducing the cost of feed. Even though business is tough at the moment, this is a business that the Alliance likes, and, in fact, it is looking at an additional dairy opportunity.

Dry Beans

The bean cooperative is the first Alliance agribusiness to provide dividends to its members, and it has been able to return most of the original investment. The 21st Century Bean Processing Cooperative is located in Sharon Springs, Kansas, but includes producers from Colorado and Kansas. This cooperative marketed 165,000 cwt. in 1998, its first year of production. The co-op is now looking to expand its marketing effort on a national scale.

The Alliance Organization

The Alliance organization includes the members, a governing board, professional management and staff, and consultants as needed. Alliance membership includes ag producers from nine states, with the majority residing in the state of Kansas. The size of the membership fluctuates between approximately 650 and 750 members. Members have an opportunity to invest in each of the new businesses as it develops.

Management of the Alliance is the responsibility of the CEO, Vice President of Operations, and the Alliance Board. The board is composed of nine members with diverse backgrounds and skills but all possessing excellent credentials and leadership. In addition to extensive experience in various types of agriculture, the current board has experience in finance, marketing, and grain logistics. Board membership is for three years and is staggered in order to maintain continuity. Membership on the board is not limited to residents of Kansas; it currently includes a resident of Colorado and of Nebraska. There is a conscious effort to maintain a broad representation of skills and background on the board. As part of the selection process, a nominating committee of at least two members interviews candidates before nominating them to the full board at the annual meeting.

The CEO of the Alliance is Lynn Rundell, who also is the general manager of the 21st Century Grain Processing Cooperative that processes wheat in New Mexico for its members. The CEO leads the strategy of the organization specifically by seeking to identify and develop new opportunities and by playing a significant role in communicating the vision of the alliance to members, prospective members, ag groups in neighboring states, and industry. Chris Williams is the Vice President of Operations and has primary responsibility for the oversight of operations and for interfacing with external entities. The administrative staff includes a secretary and an accounts manager. The Alliance shares office space with the Kansas Association of Wheat Growers.

Consultants are an important part of the organization. These consultants are retained to provide technical expertise in key business activities. Skills and extensive experience in value-added agribusiness areas such as marketing, strategic planning, food processing, business development, and trade with Mexico are available within the organization (21st Century Alliance 2001a). This and other expertise are utilized in the service agreement that is put in place to do feasibility and business planning for new businesses. This expertise is also used in improving and building businesses to become more profitable.

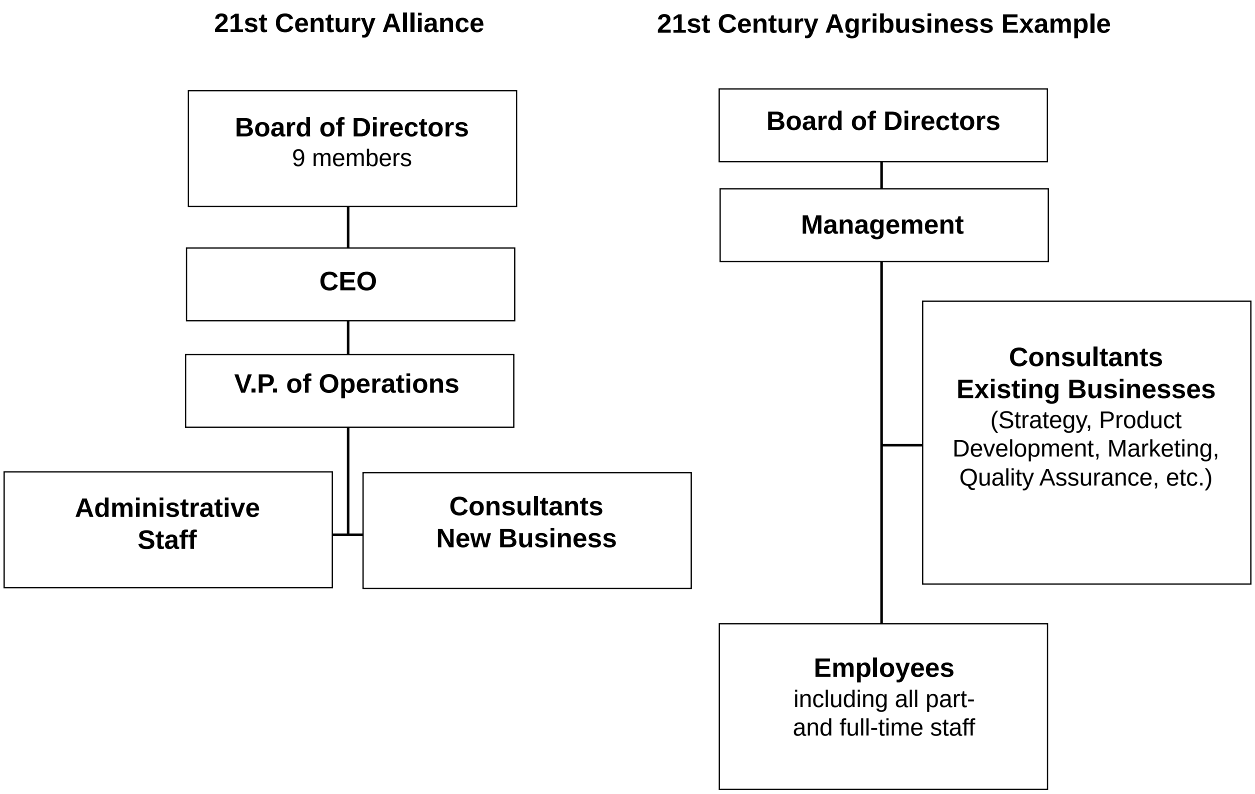
The organization's agenda includes four key elements:

1. An aggressive pursuit of new opportunities – Currently, the Alliance is actively researching four potential businesses.
2. A reduction in the risk of failure by doing the homework on the venture. A process is in place to fully investigate the merits of new ventures, recognizing that more fail to be launched than are launched. At the annual meeting it was pointed out that it is better to spend a little money up front to identify the risk than to spend a lot of money and fail.
3. The monitoring and refining of business plans of ongoing businesses – Management monitors the existing business metrics as well as the market and competition.
4. A spirit of cooperation to enhance business opportunities and promote a new approach to agribusiness – The alliance seeks business relationships across state and country borders to improve profitability.

Members pay $100 per year, which creates an annual pool of $70,000. The Alliance also creates revenue through a 6 percent service fee generated from the sale of stock in each new venture. These funds allow the Alliance to carry out its role as an entrepreneur which specializes in the creation of value-added agricultural businesses, specifically by providing venture capital and business start-up expertise. According to Williams, Vice President of Operations, the mission is to "provide profitable agricultural business opportunities for our members."

The board focuses on strategic issues but remains open-minded to any opportunity presented. This is evident in the type of value-adding efforts launched to date and the apparent lack of self-imposed boundaries such as site location, type of product, and the legal organization form. The board meets when necessary to review and make decisions on ongoing projects. It also meets annually to specifically address strategy. Key questions addressed include (1) How are we doing? and (2) What should be our business focus, including the choice of industries and specific projects? In the first three years, the emphasis of these meetings dealt primarily with financial survival but, since then, the strategy is more about growing the ag economy (Williams 2000).

Figure 1. Organization Chart



Source: 21st Century Alliance.

The Process

The process begins with an idea about a new business venture. These ideas can be top down (management) or bottom up (ag community). The overall model is that most ideas come as bottom up proposals, but, in some instances, there is a natural progression to generate new business from existing business. An example of a top down idea that surfaced was the possibility of manufacturing cheese in conjunction with the newly created dairy businesses (Williams 2000). This would be a natural value-added fit to the dairies. Due diligence was performed without the more traditional approach of first obtaining a high level of interest from investors. Flexibility is necessary in every step of the process because the best course of action is highly dependent on the situation. The key point is to ensure that the right leadership is in place prior to any idea being investigated by the Alliance. This usually requires five or six committed producers who can eventually be the core of a Board or a committee in a value-added business. Until the leadership issue is resolved, the Alliance does not spend resources on the concept.

Business concepts that receive a positive recommendation at the first presentation to the board are then investigated in more detail. A governing board is created that usually includes the ad hoc committee as its core. Articles of Incorporation are written, and the Alliance works with the group to prepare a Development Service Contract. This Development Service Contract details the work to be done leading to start-up and the relationship with the 21st Century Alliance. The agreement covers items such as due diligence, marketing, engineering, financing, and related requirements for partnerships. The alliance will make the arrangements for all necessary activity. Consultants are used in the feasibility and start-up activities. The work performed during the due diligence phase helps define the risk and solutions to problems. For various reasons many projects do not pass this stage.

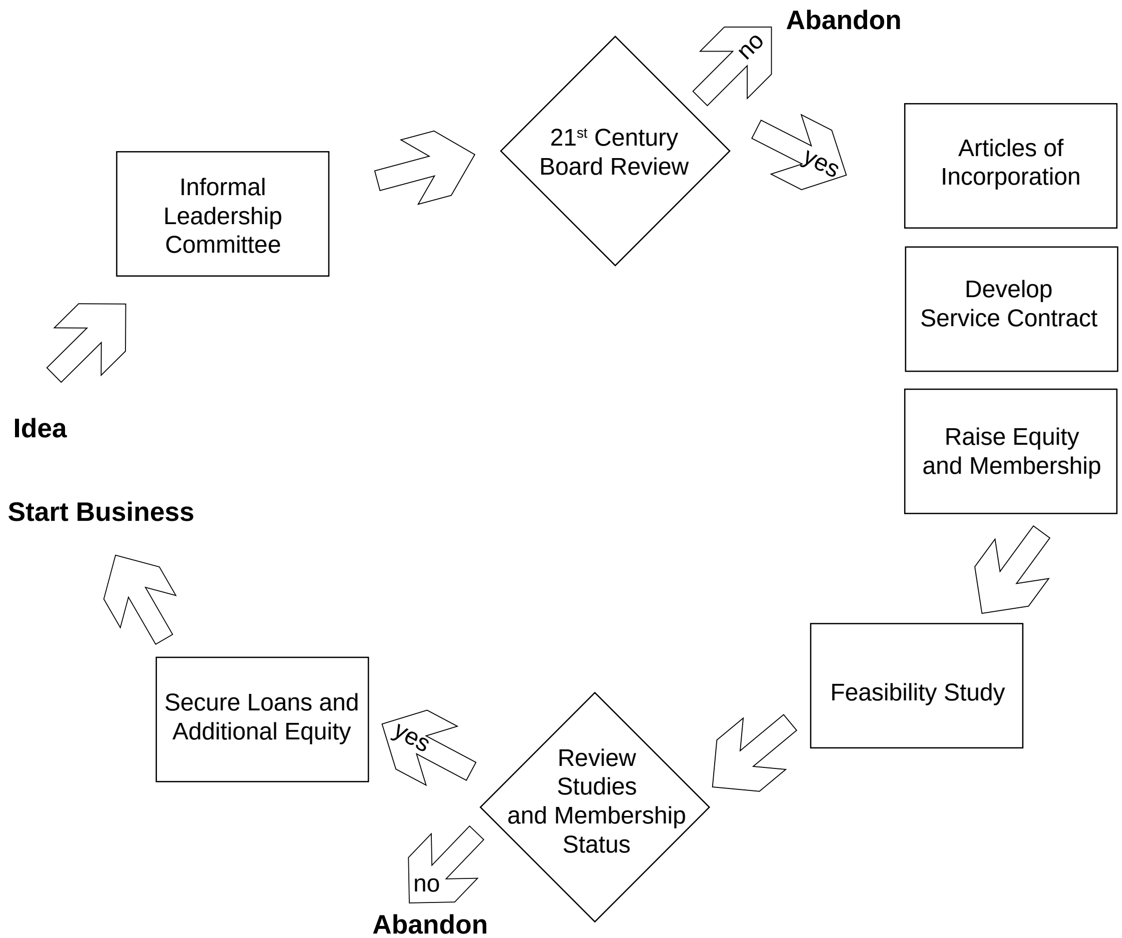
A feasibility study is then conducted to determine the probability of a successful business. If the feasibility study is positive, then the next step is to initiate the creation of a formal organization for the business. Projects that still look favorable after feasibility work move to the final hurdle of capital formation and the membership drive. Actually, the work to raise money and membership begins after the first positive review. This is because it takes a tremendous amount of time and effort to collect the necessary resources, and it is worth the risk to begin before the feasibility work is complete. The new organization, NGC or LLC, must raise equity capital to cover 40 percent of the venture.

In the final stage of the process, a contract is prepared that outlines the financial arrangement, including the type of financing and the terms of reimbursement to the Alliance. In the case of a stock sale, the Alliance will take a modest percent (6 percent) of the sale as a service fee. The service fee is the means of reimbursement for the business development activity financed by the 21st Century Alliance.

The membership drive will determine the level of commitment in terms of equity and feedstock delivery commitment. In addition to the capital raised through equity, the value-added entity will likely need to secure loans if a processing facility is required. It is important to find banks with lending experience in the type of commodity or process being developed. Clients of the Alliance look to local banks and to Farm Credit to service loan needs.

The form of incorporation depends on the circumstances of the business. If feedstock delivery is critical, then the NGC form will be most suitable. The Alliance works with one legal firm that specializes in incorporation issues for agriculture entities. This firm has a high level of interaction with the board of the newly formed, but yet to be incorporated, organization. The board and law firm jointly decide on the best legal organization form. The key point is that the project dictates the type of organizational structure.

Figure 2. Commercialization Process



Source: 21st Century Alliance.

Another very important decision is whether to buy an existing facility or build on a Greenfield site. For instance, the first venture for the Alliance involved the purchase of an existing wheat mill in New Mexico as opposed to building one in Kansas. The Alliance recognized that the struggling New Mexico mill was a victim of poor-quality wheat and, therefore, offered an opportunity for improving the quality of wheat and flour. The subsequent purchase and supply of high-quality Kansas wheat made the mill profitable. Recently, the American Institute of Baking promoted this mill as the industry flour model for others to emulate.

The dairy ventures did not have the option of buying existing facilities. This business developed from the recognition that rich forage material was available in the state for dairy cows. This recognition resulted in the construction of two new dairies because the facilities had to be near the majority of the forage material that is produced for the cows. The decisions such as where to locate and whether to build or buy an existing facility are based on sound business principles.

Impact on the Community

It is too early in the processing history to have measurable data on the impact of the new businesses in the various communities; however, the work of the 21st Century Alliance should not only help the ag producer members, but also the member's respective communities. For instance, the Ladder Creek Dairy employs approximately 30 people, most of whom live locally. The shift workers earn up to $1,800 per month (Griekspoor 2000). According to Griekspoor, officials in the towns of Tribune and Oakley claim that the Ladder Creek facility provides local economic benefit as a result of the new money. The construction phase alone required 80 workers at a cost of $10 million.

The advent of the NGC dairies creates a special kind of dairy by being much larger than the traditional family dairy while still being farmer owned. According to Don Reith, manager of the Washington County Dairy Cooperative, the NGC dairy improves the quality of life of the employees because the size of the operation allows employees to work normal shifts as compared with the traditional dairy farmer who works long days ("The Farmer-Rancher Paper" 2000).

Strategic Issues and Future Plans

The strategic emphasis on value-added agribusiness for its membership is apparent. In addition, the geographic context of this emphasis is much broader than just the state of Kansas. The "big picture" is to build market share and product value by forming alliances with co-op entities in other states. A network of statewide alliances, similar to 21st Century Alliance, could foster value-added enterprises for respective members and also work across the alliances to share expertise, gain leverage, and, thus, increase value. Currently, the Alliance is considering the opening of an office in Nebraska to widen the exposure to value-added opportunities. In addition, the 21st Century of Michigan is being organized, which will then become a partner with the 21st Century Alliance.

The Alliance growth strategy has a strong focus on creating or acquiring businesses related to the existing portfolio as well as implementing needed changes to existing businesses to improve profitability. Three strategic initiatives can be identified:

1. Expanding commodity direct marketing opportunities

   The direct marketing opportunities include increasing the market share of the dry bean industry and gaining new opportunities in grain merchandizing business.

2. Acquiring and/or building processing facilities of existing businesses

   This initiative is to capitalize on the learning curve by expanding its business portfolio with businesses similar to the existing ones. For example, processing businesses being investigated include a dairy, a tortilla manufacturing company, and a corn flour milling plant.

3. Lengthening the value chain through forward integration

   A cheese processing facility is being considered to add additional value to the dairy business. (21st Century Alliance. 2001b)

At the recent 21st Century Alliance annual meeting, an overview of external and internal considerations were reviewed in the form of a SWOT analysis. SWOT is the acronym for strengths, weaknesses, opportunities, and threats.

Strengths

Some of the strengths recognized include the fact that the farmer starts with a strong base in the value chain by controlling the land and providing the unprocessed resource, better known as a commodity, to the value chain. This strong position at the beginning of the chain, including the ability to control the quality of products, creates a logical scenario for the farmer to continue the control of each additional value-added process to the original product.

An additional strength lies in the blend of the current economic climate and the spirit of the producer. The economic climate can be summed up by failure of the system to create adequate commodity prices and by a decreasing consumer confidence in the integrity of the food supply. Starlink is just one example of a failure in product integrity. The situation creates strength for enterprising farmers and NGCs by allowing such individuals and entities to distinguish themselves from the masses and build a reputation of quality.

Weaknesses

The size of the Alliance is a hindrance to growth and overall profitability. Six to seven hundred members is not enough for the level of the Alliance’s operation. This membership is the source for capital needed to increase the equity position in existing operations and for equity in new ventures. Not all members share the same desire to invest in certain businesses, so this is an added strain.

An NGC is typically regional in its resources, which can lead to a relatively narrow focus in marketing. This focus around resources has been described as a production emphasis when a customer emphasis is what is really needed. The wheat mill is an example of a situation in which the decision to open new markets has steadily improved sales and the profitability of the business.

Opportunities

The possession of land is both a strength and an opportunity for ag producers. The large corporations cannot duplicate the farmer system, so competitive opportunities exist for the local ag producer to capture niche markets. The opportunity to build business from this asset base is very clear but it requires a change in mindset from the contract production mode to a different horizon on the value chain.

Threats

A key threat is the inability or unwillingness to move from independence to interdependence in value-added operations. It takes hard work, precious time, and the acceptance of a different type of risk to lengthen the value chain. Without the cooperative approach, it is likely that farmers will remain as price takers as they service contracts for various commodities.

Lessons Learned

The Alliance is relatively young, but its aggressive style of working to achieve its objectives has created much experience in a short amount of time. It is constantly refining its practices to improve with each venture. Fortunately, there has not been a major breakdown in the process, and the Alliance management is comfortable with the outcome of the work to date. The number of start-ups is impressive and may relate to a philosophy of being open-minded and to the discipline of investing time and energy on the front-end of a project to define the opportunity. In other words, doing the homework. A case in point is the purchase of a New Mexico mill by Kansas's wheat farmers. The overriding objective was to add value to Kansas farmer's wheat, and the best way to do this was to own a processing mill in New Mexico and to move the wheat to the mill. The key points are to be able to define for the members the opportunity as it relates to agriculture and then the profitability of the project. If both fall short of expectations, then the wise decision is to abandon the concept and to move on to the next one.

The experience of operating new businesses has highlighted the issue of servicing debt and, in general, the issue of being undercapitalized. Owner equity has tended to make up about 30 percent of the capital as opposed to a target of 40 percent (Williams 2000). These issues have impacted the wheat mill and the dairies. Alliance management recognizes the importance of achieving an equity capital target before launching a business and intends to meet the stock sale objective on new businesses in the future (shareholder meeting).

The author notes a possible weakness in the overall entrepreneurial process of the Alliance. As mentioned earlier, the Alliance retains 6 percent of the stock sale proceeds but does not own any part of a processing facility. Its stock sale commissions are used to fund new business development; therefore, the Alliance must continually add new businesses in order to generate new funds. This may be an issue since some businesses appear to have been launched prior to achieving the stock sale target.

In conclusion, the success of the Alliance has resulted in a search for growth into new areas, both geographic and product line. The Alliance will continue to consider ventures outside the state of Kansas and to seek vertical value-added opportunities in the form of processing farm production. It also is putting more effort into horizontal value-added opportunities such as grain merchandising so that production from farms achieve maximum value. This is the age of the 21st Century Alliance.

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