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New Age Cooperatives and Their Role in Rural Development: USDA–Rural Development Program

by Michael Doherty¹

Since the early 1980s, there has been an increase in the adoption of a well-known business structure from the past: cooperatives. Within the Midwest, these cooperatives initially addressed the needs of agricultural producers. More recently, however, there has been a resurgence in the development of consumer-focused cooperatives in rural areas. This report explores the development and adoption of the cooperative business model in more recent times in the Midwest, and the ways in which cooperatives are addressing some of the problems in today's rural communities.

Early on in the development of the Midwest's business community, farmers and merchants reached back to a model created by a group of small-scale craftsmen in England to compete with large manufacturing firms. In the Midwest, it was farmers, not craftsmen, who adopted the concept, and, with support from state and federal legislation, gave themselves a way to develop the agricultural industry according to their own needs and values. Through cooperative businesses, farmers had a hand in the policies of the marketing and supply companies that they depended upon by becoming owners of such firms. Evidence of this cooperative-business movement and the role it has played in rural development is found in many Midwestern communities.

Grain elevators, present in nearly every rural community, are the most visible reminders of the early use of cooperatives to provide the necessary channels and organizations to move agricultural commodities to market, and to bring therequired inputs (fertilizer, seed, and chemicals) to farms. Farmers in the surrounding areas created these businesses by investing in cooperatives. They wrote legally binding documents that defined how the cooperative would serve them and the financial commitments required of

cooperative members. They also served on the boards of directors of these businesses.

The networks formed by cooperatives played a lead role in developing farm organizations such as the Farm Bureau and the Farmers Union. The primary role of these businesses, owned and governed by customers, however, was to give farmers the services they needed to succeed in their enterprises at a fair price and with direct representation.

Borrowing from the success of the agricultural cooperatives, rural residents formed electrical cooperatives to gain the power infrastructure needed to improve their lives and businesses. Owned by residents and administered by a board comprised of customers, these cooperative businesses not only made the availability of electrical power a reality for remote areas, but also gave rural residents control over an important resource.

The cooperative way of doing business was extended to the banking industry. Cooperative credit unions were formed—many of which still serve communities today. These financial institutions, because of the cooperatively owned structure, must keep lending rates as low as possible with policies and procedures open for inspection by customers.

Even local hardware stores in rural areas are often part of a regional cooperative. Operating on the national level, regional cooperatives give locally owned hardware stores the same volume discounts and shared management services that franchised hardware stores enjoy. Such advantages are crucial for these stores to compete with large stores.

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Layout by JoAnn Kennedy.

Shared-Service Cooperatives

Rural Americans have long depended on community services provided by schools, small businesses, churches, and local governments. Recent years, however, have brought substantial shifts in the shopping patterns of rural residents. In previous times, residents found their needs satisfied on the local main street. Today, people from non-metro localities may travel to large discount outlets (Walzer and Crump 1996-1997). As this trend toward bedroom communities continues, rural communities are in danger of losing their consumer and producer services. The loss of these services reduces rural economic growth and the viability of rural communities (USDA-RBS 1995)

The loss of these businesses is part of a downsizing trend that involves a restructuring of businesses. Driven by economic survivability, businesses focus solely on their most profitable enterprises and contract non-essential services. Downsizing has made businesses more profitable, but it has also increased their dependency on readily available and affordable marketing, printing, and advertising services from other firms. Likewise, American households have restructured, and now depend more than ever on the availability of affordable household services such as day-care facilities, house-cleaning, emergency health care, grocery stores, convenience stores, and restaurants.

Shared-service cooperatives have been formed to provide households and businesses with these types of services. These cooperatives have several structural and operational characteristics different from those of other businesses. The private businesses, community organizations, or consumers that patronize the shared-service cooperatives also own and govern them. For example, a group of independent hardware stores that jointly purchase wholesale supplies through a cooperative also own a share of that wholesale business. In exchange for their contribution of ownership capital informing the cooperative, they obtain control over the organization through a democratically elected board of directors. If the business suffers from insufficient profits relative to its needs for working capital, the members are responsible for setting user-fees that generate the additional capital.

Many examples exist of the recent growth in shared-service cooperatives that serve small- and intermediate-size businesses. One of the most common is craft marketing cooperatives. States such as North Carolina, Kentucky, and West Virginia have recognized the potential for at-home production of handicrafts in rural economic development. In Camden, North Carolina, over 120 active craft producers, mainly women, have succeeded in using their marketing cooperative, Watermark, to sell more than \$600,000 a year

in products through a combination of retail and mail-order sales in the U.S. and abroad. Watermark's success in marketing local handicrafts has provided many members with additional income, while allowing the women to remain at home with their children.

An additional benefit of the cooperative has been to provide women who serve on the board of directors with business experience in administering Watermark's financial affairs. In other cases, craft cooperatives have operated purely retail outlets and depend on members to manage the stores on a daily basis.

A similar example of cooperative craft marketing is occurring in Iowa, where producers of hand crafted furniture from across the state have banded together to develop a shared-service advertising cooperative to provide themselves with a centralized means of advertising their product and, eventually, a retail outlet. In states such as West Virginia and Kentucky, state agencies have assisted in financing and organizing craft cooperatives. These aggressive marketing programs have succeeded in making craft cooperatives an integral part of the states' rural development efforts.

Shared-service cooperatives can take many forms and can be applied to nearly any situation in which either families or small business owners have an opportunity to provide themselves with additional services by banding together. For example, in Greenville, South Carolina, and Nashville, Tennessee, small, independently owned restaurants have formed cooperative associations to share the costs of large advertisements -- that would have been too expensive to afford individually.

As families struggle to balance the demands of child-raising with workplace demands, cooperatives have been formed to provide working parents with child-care services. These cooperatives are popular, not only because of the need for high-quality day care and nurseries, but also because the cooperative structure ensures that parents have direct input into the management standards and decisions about educational supplies and equipment for the facility. As with all other cooperatives, it is critical to their success that parents serve on a board of directors and share in the administrative duties of budgeting, planning, and management training. Through cooperatives, families in small towns have access to day-care services that otherwise may only be available in a larger community.

Shared-service cooperatives are also being formed to provide community services that might not otherwise exist in small

towns, or are in danger of being phased out in the face of increasing overhead expenses and decreasing tax revenues. Examples include hospital cooperatives such as the Wisconsin Health Cooperative that shares medical services and equipment among 21 member hospitals in rural Wisconsin.

The growing population of retirees in the Midwest has accelerated the formation of housing cooperatives once found only in large urban areas. These cooperatives offer retirees an alternative to moving to resort communities while, at the same time, allowing them to retain and build equity where they live. In 1994, for example, 54 couples in Frankfort, Michigan, moved into a specially designed housing cooperative for the elderly. This cooperative provided older residents in the city (pop. 1,500) with the comfort and convenience of a retirement community without having to relocate. The Wisconsin Rural Housing Cooperative was formed in 1970 as an extension of rural electric cooperatives. Its purpose is to network and partner with other organizations to educate communities on using local resources to solve housing problems.

Another group of shared-service cooperatives includes cooperatively owned grocery stores in rural areas. Once the domain of natural and organic food stores in largely urban markets, some small rural towns, such as Colfax, Illinois, use the cooperative model to retain a local grocery store. In the case of a grocery store cooperative, members of the community work together to develop a business plan and to buy shares of stock, becoming part owners of the store. Proceeds from the stock sales provide the business with start-up capital to either build a new store or to renovate an existing structure. Once the store is up and running, it functions as any other grocery store, except that customers have input into the store's pricing policies through a board of directors. As with any grocery store, sufficient profits must be retained for working capital, renovations, repairs, and business expansion. For these cooperatives to be effective, the members must be prepared to support the cooperative by purchasing their groceries from the store.

Value-Added Cooperatives

A "new wave" of cooperative formation is occurring, particularly in the upper Midwestern states. Many of these new cooperatives are being referred to as "value-added." Their purpose is to recapture profits generated by further processing of agricultural commodities such as soybeans, corn, sugar beets, hogs, and cattle. As value is added to those commodities through processing, profits are returned to the farmers, rather than to a sole proprietorship or investor-driven corporation.

An earlier generation of agricultural cooperatives was formed by farmers to buy supplies wholesale and/or to provide farmer-members with services such as crop storage and grading. These traditional cooperatives dot the landscape throughout the Midwest. They are called "open" cooperatives because they attempt to include as many members as possible in order to keep the price of supplies as low as possible. Typically, in these types of cooperatives, the membership fees or required stock purchases are small and affordable for nearly all producers.

The so-called "New Wave" cooperative movement has been dominated by value-added cooperatives, many of which have been formed in the Midwest during the past 15 years. These cooperatives have many unique features. From the outset, they are designed to process agricultural commodities into higher-valued food products. They are capital intensive and may require a substantial financial investment from the producer-members. The members

may be required to sell a fixed portion of their crop to the cooperative for further processing, and producers must be willing to allow profit to be retained by the processing facility for working capital. In some cases, the value-added cooperatives have found it necessary to enter into joint ventures with non-cooperative businesses in order to obtain the marketing expertise and contacts required for successful ventures in the highly competitive market of food products. In return, the producers share in the profits of the venture.

The following are examples of value-added cooperatives:

- Minnesota Corn Processors Cooperative, whose members invested \$5,000 to \$25,000 each, in return for a share of the profits gained from the manufacture of corn sweeteners and ethanol.
- Dakota Growers Cooperative in Carrington, South Dakota, operates a \$41 million computerized plant that mills durum wheat and converts it into pasta for more than 1,000 wheat growers.
- American Crystal Sugar, on the North Dakota-Minnesota border, processes sugar beets into refined sugar.
- An organic soybean marketing cooperative, formed by 21 local producers in Iowa, collects, stores, cleans, and grades edible soybeans for shipment to Tofu processors in Japan.

Business Retention and Value-Added Cooperatives

A major trend affecting rural communities has been the loss of local value-added processing as a result of changing corporate structures and investment objectives of the food processing industry. Farmers in some areas of the Midwest have taken a long-range view of their communities and have realized that the loss of these processing facilities translates into fewer jobs for their offspring; greater economic dependence on a two-crop system of production; and, ultimately, the demise of their business community. Because of these long-range concerns, farmers have formed value-added cooperatives whose primary purposes are to retain nearby processing facilities for some types of crops and/or livestock. Without the processing facilities nearby, those commodities would no longer be produced locally. These “alternative” commodities and their associated processing plants assist farmers in two ways: (1) by retaining a more diversified array of crops to reduce risk of crop failure and price fluctuations and (2) by spreading profit risk between their farms and the processing facility.

In addition, the nearby processing plants provide jobs for the next generation. An example is the formation of the Iowa Turkey Growers Cooperative that took over ownership of a recently closed Louis Rich slaughtering and processing plant. This cooperative allows local turkey producers to remain in business and, at the same time, gain more control and governance over their livelihood.

In central Indiana, the Indiana Family Farms cooperative project is in the process of renovating a hog slaughtering plant in Anderson, Indiana, resulting in the rejuvenation of a once family-owned plant that had been closed. In central Minnesota, a group of farmers had lost their nearby sweet corn processing plant. They entered into a joint venture resulting in construction of a sweet corn processing facility that markets bagged sweet corn to grocery stores across the United States.

Many key factors have interacted to fuel the growth in the creation of value-added cooperatives in the Midwest. These factors result from macro-level changes in the farm and rural economy, but others are more closely tied to business cycles and technological change.

Many Midwestern farmers, because of limited opportunities to own or rent farmland adjacent to their operations, find that their only opportunity for higher income is from either passive investments or from off-farm income. This situation has fueled the desire of agricultural producers to develop income-generating opportunities related to their farming operations.

Ironically, another business factor fueling the formation of value-added cooperatives has been the rapid consolidation and conglomeration of food processing companies. Although these large companies are highly efficient and profitable, they are also driven to meet high expectations on the part of investors, while leaving abandoned processing plants in their wake. In many cases, local farmers have been willing to capitalize cooperatively owned processing plants with higher risk or lower initial rates-of-return than demanded by market-driven investors in exchange for local control and being one step closer to the end-user—the consumer. In other cases, local farmers have leaped at the opportunity for solid profits in niche markets overlooked by large investor-driven food processing companies.

The growth in value-added cooperatives and the incorporation of the value-added concept in the business plans of major regional cooperatives in the Midwest have caught the attention of universities, nonprofit organizations, and state and federal agencies. In Iowa, the Department of Economic Development has developed a “Rural Action!” program to explore agriculture-related economic development opportunities. The Center for Cooperatives at the University of Wisconsin supports a dynamic electronic discussion group among cooperative managers and development professionals around the world. In Indiana, the Office of the Commissioner of Agriculture administers a “Value-Added Grant Program” that distributes \$400,000 per year for research into value-added projects and opportunities. Nonprofit organizations such as the National Cooperative Business Association and the Cooperative Development Foundation based in Washington, DC, provide support for the development of cooperatives in many states.

At the federal level, the U.S. Department of Agriculture has increased its focus on the cooperative development movement. The USDA–Rural Development Program now includes free technical assistance from Cooperative Development Specialists who assist rural communities and producers in analyzing the viability of forming cooperatives, and the Rural Development loan program has recently added special provisions for the issuance of loan guarantees for the purchase of stock in newly formed cooperatives. The USDA also has two grant programs: (1) a Cooperative Development Grant program that assists nonprofit organizations and universities to form cooperative development centers, and (2) the Fund for Rural America that includes a grant program specific to the formation of value-added cooperatives.

The cooperative business structure will continue to give rural residents and rural businesses a means to develop and retain the industries and services needed to keep their communities viable. State and federal agencies, combined with local research institutions and nonprofit organizations, can enhance this movement through expanded support to assist others in adopting this valuable business structure.

To obtain further information on cooperative formation and sources of financing, contact the USDA Rural Development office for Cooperative Services in Bloomington, Illinois, at (309)454-2658, or at the central office in Champaign at (217)398-5247.

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Additional Information on Cooperatives is available from:


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