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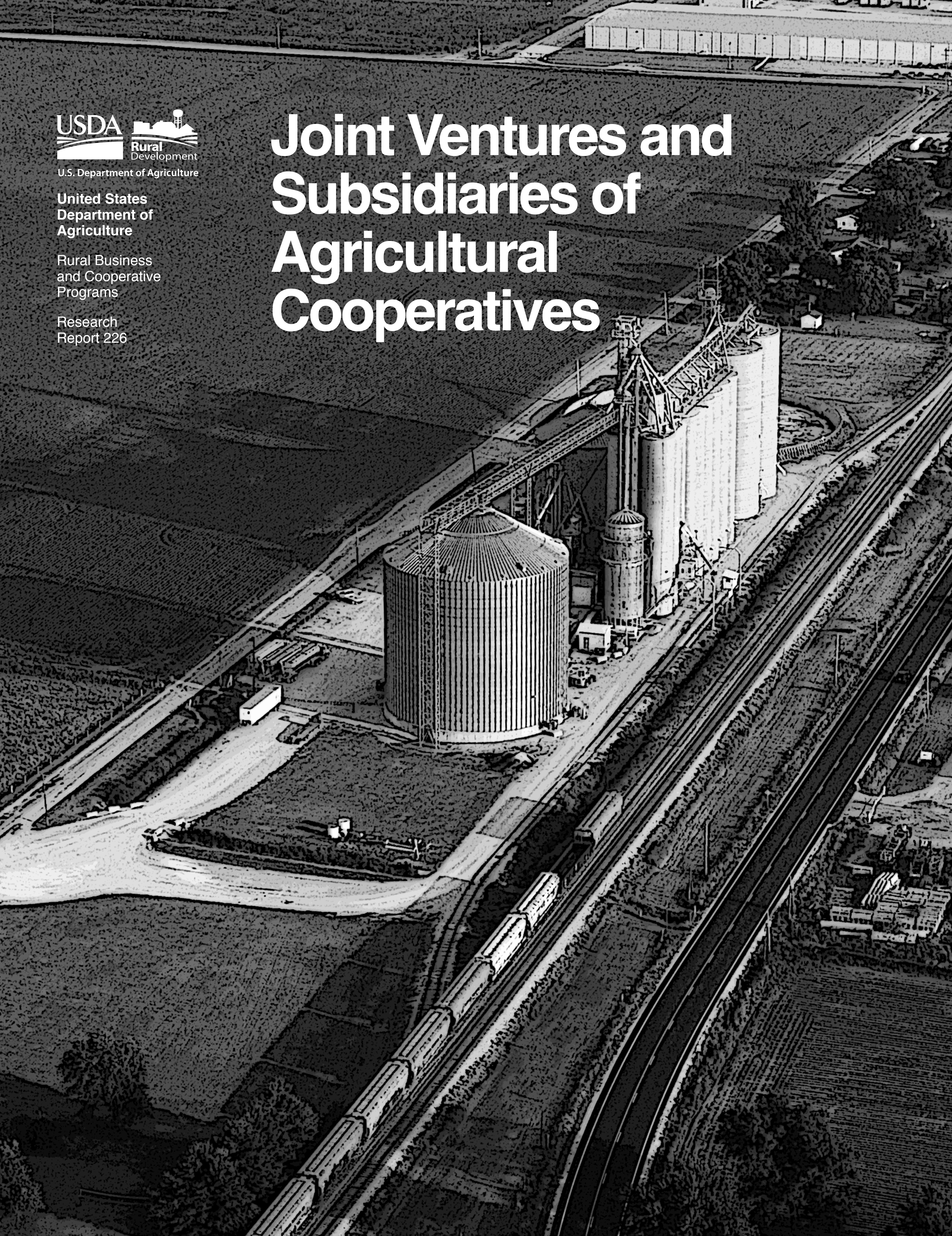
Rural Business and Cooperative Programs

Research Report 226

Joint Ventures and Subsidiaries of Agricultural Cooperatives



Abstract

Agricultural cooperatives participate in joint ventures or establish subsidiaries to accomplish various objectives, such as scale efficiency, to improve market access, or to share capacity and expertise. The limited liability company (LLC) is the form of business organization most frequently used by cooperatives to establish joint ventures and wholly-owned subsidiaries. Cooperatives participate in joint ventures with other cooperatives and non-cooperatives. Cooperative ventures are related to, or value-added extensions of, their core businesses.

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On the cover: The Co-Alliance Reynolds facility in White County, Indiana, which is part of Co-Alliance LLP, a venture of five farmer cooperatives. Photo courtesy Co-Alliance LLP

Contents

Highlights

Many agricultural cooperatives establish joint ventures and wholly-owned subsidiaries to obtain business advantages, such as sharing expertise, reducing costs, or improving market access. This study extends previous research by providing information about partners in joint ventures and on the types of jointly owned businesses.

- A survey in 2010/11 identified 185 cooperatives that reported 317 business ventures (209 joint ventures and 108 wholly-owned subsidiaries).
- Limited liability companies (LLCs) are used in 240 ventures.
- Cooperatives participated with other cooperatives exclusively in 92 joint ventures, exclusively with non-cooperatives in 57, with both types of business partners in 26 such arrangements, and in 34 cases, the status (co-op or non-co-op) of partners were not reported.
- Ownership is usually 50-50 in two-partner joint ventures.
- Most of the reported ventures involve farm supplies, grains, and oilseeds.
- Common types of joint ventures formed by agricultural cooperatives include processing, agronomy, fuel distribution, grain marketing, and purchasing associations.
- Joint ventures are sometimes organized for short-term purposes, such as preparing for mergers.

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Agricultural cooperatives operate in highly competitive markets where success depends on achieving efficient business operations. A strategy for achieving competitive efficiency is to work with other cooperatives or firms in a joint venture company. Many cooperatives also increase their volume of business through wholly-owned subsidiaries.

Since the mid-20th century, many high-value product marketing associations, regional grain/farm supply, and large dairy cooperatives have established joint ventures and subsidiaries. Large cooperatives participating in international trade have formed import/distributorships in foreign countries to improve market access (Reynolds). During many decades, dairy cooperatives established joint ventures for sharing resources and expertise (Frederick 1987).

Local grain and farm supply cooperatives traditionally worked together by organizing large regional federations to vertically integrate input or commodity processing operations, including access to export markets. In recent years, many of the federated regional cooperatives have either closed or scaled back their operations, although remaining ones have expanded their operations to fill this gap. Some local cooperatives reported that the demise of Farmland Industries in 2003 motivated them to organize joint ventures for sourcing farm inputs and marketing grain.

Starting in the mid-1990s, the limited liability company (LLC) combined the advantages of the single-tax status of partnerships with the limited liability of corporations without being an incorporated entity. An LLC has fewer regulatory constraints compared to cooperative, corporate, or other forms of partnership (Frederick 1998). In addition, an LLC accommodates joint ventures between cooperatives and non-cooperative firms, and outside (nonmember) investors. Widespread use of LLCs for ventures was identified in a USDA survey of agricultural cooperatives in 2007. These cooperatives reported involvement in 382 ventures, with 312 established as LLCs (Eversull).

The extent of joint venture activity between cooperatives and non-cooperatives had not been recently studied in USDA research, prompting another survey of venture participation in 2010 (Hulse). The 2010 survey missed cooperatives with year-end annual reports in the 3rd quarter of the calendar year. However, respondents that reported being in ventures in the 2007 survey and that were missed in the 2010 mailing were contacted by telephone in 2011 to update their information about involvement in ventures.

Previous USDA surveys of ventures by cooperatives had not requested the names of these businesses and their specializations. The telephone survey in 2011 asked 2007 respondents to identify their ventures by name, specific type of business, and composition of partners between cooperatives and non-cooperatives. The telephone survey was extended to include respondents from the 2010 survey that reported being in joint ventures to identify the names and types of businesses organized jointly. The telephone survey resulted in 185 cooperatives reporting the composition of partners between cooperative and non-cooperative, the names, and types of joint ventures. Results of the 2010 survey by mail and the telephone survey in 2011 comprise a distinctive “2010/11 survey” which is summarized in this report.

General Results

In the 2010/11 survey, 185 agricultural cooperatives reported being in 317 ventures, with 108 (34 percent) being wholly-owned subsidiaries and 209 (66 percent) being joint ventures. Identifying trade names of these joint ventures is important for determining an accurate count of them. Several cooperatives participated in the same joint ventures. There were 382 ventures originally reported, with 48 duplicates reported by more than 1 cooperative (these are netted out in table 1).

Another group that was removed from the total count of ventures is condominium grain storage service. This type of service is frequently organized as an LLC with individual members of a cooperative. The cooperative is like a managing partner who handles the grain and, over time, transfers the ownership share of the condominium storage from farmers who no longer need it to those who do need it (Ginder). This type of service is not comparable as a business entity of cooperatives and non-cooperatives in owning and operating joint ventures; hence, they were excluded from the tally of 209 joint ventures. There were 17 reported condominium joint ventures (table 1).

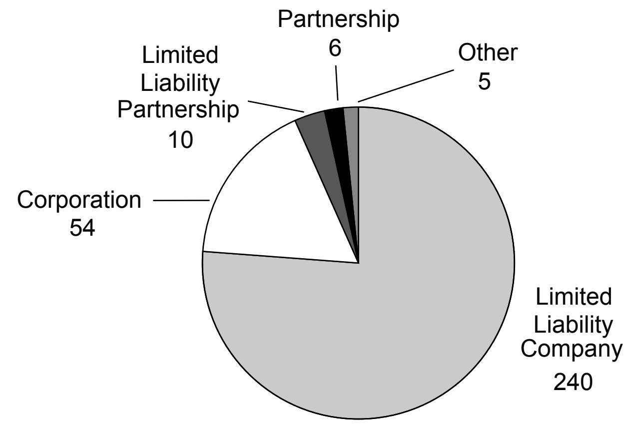
Organizational Forms

The survey specified five different organizational forms that can be used to establish ventures: LLC, Corporation, LLP (limited liability partnership), Partnership, and Other (see Glossary). Organizational form was reported for 315 ventures (Fig. 1). Cooperatives can be used as a form to establish a joint venture of two or more cooperatives. However, this option was not listed in the survey to avoid conflating them with federated cooperatives that are a separate type of business system from joint ventures. Only five cooperatives reported the "other" category as the form of their venture, but one of them is a purchasing association of cooperatives that was incorporated as a cooperative. The LLC form was by far the most frequent method used to establish ventures, with 240 reported (Fig. 1). Two ventures were not identified as to form of organization.

Table 1—Agricultural cooperative ownership of ventures, 2010/11.

Cooperatives reporting	185
Ventures reported	382
Less:	
Duplicates reported	48
Condominium grain storage	17
Net number of ventures	317
Wholly-owned subsidiaries	108
Total joint ventures	209

Figure 1—Organizational form for separate business ventures, 2010/11



Joint Venture Partners

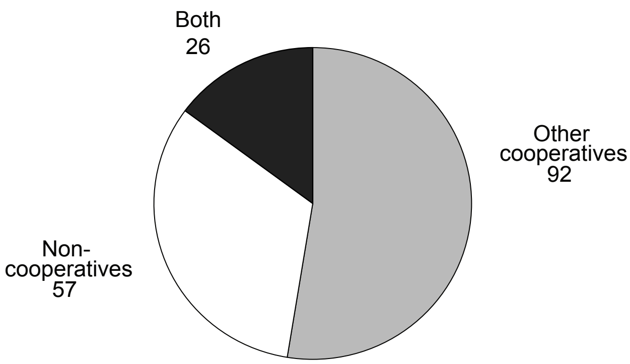
Most joint ventures reported in this survey involve cooperatives partnering with other cooperatives. Out of 175 joint ventures, 92 included all cooperative partners (fig. 2). Many local cooperatives that operate in adjacent membership regions will form joint ventures as an alternative to merging, or as a preliminary stage to an eventual merger (Hudson). The survey found that joint ventures with more than three partners were predominantly composed of cooperatives. Joint ventures for purchasing associations and common marketing agents usually reported between 5 and 15 cooperative members.

Business relationships are common between cooperatives and non-cooperatives, and, in some cases, these lead to joint ventures. By contrast, two or three cooperatives working together can merge their organizations as an alternative to forming a joint venture. A merger alternative is not available in business relationships with non-cooperatives unless one organization buys out the other.

The survey counted 57 joint ventures with a cooperative partnering with non-cooperatives. In only three of these joint ventures are there more than one non-cooperative partner (fig. 2). Most of the 26 joint ventures with both cooperatives and non-cooperatives involve three or four partners, with the highest having 7 partners.

Six of the joint ventures by cooperatives have foreign companies as partners and are involved in international trade or processing outside the United States. In addition, four ventures located outside the United States were reported as being wholly owned subsidiaries of cooperatives. However, this survey did not have as high of a response rate from many of the major cooperative exporters as it did from those in the local grain and farm supply sectors. It is likely that cooperatives have many more joint ventures with foreign companies than identified in this survey, considering that a 1991 survey of cooperative exporters found 18 that had foreign partners (Reynolds).

Figure 2—Composition of joint venture partners with cooperatives, 2010/11



Many of the joint ventures with both cooperative and non-cooperative partners frequently own and operate businesses such as unit-train grain loading, feed mills, or fertilizer distribution. These ventures benefit participants by specializing in a particular service while each partner operates independently. Some joint ventures in the grain and farm supply sector combine all business activities and services under one trade name.

Ownership Shares

A cooperative's share of ownership in a venture is important for control or influence on the management of it. In this survey, joint ventures that involved physical capital for processing, storage, or unit-train loading reported five or fewer partners. For these types of joint ventures, most respondents specified the exact percentage of shares owned by all partners. In contrast, share of ownership for purposes of control are less crucial in joint ventures that coordinate such services as purchasing and marketing. In these kinds of joint ventures, there are typically numerous partners and start-up capitalization is relatively low. Ownership shares are usually equal for all partners or may vary slightly over time, based on volume of use by each partner.

Figure 3 shows the ownership share of cooperatives in 253 joint ventures. Many of the 107 cooperatives reporting more than 49 percent ownership on the survey subsequently reported that they held exactly a 50-percent share. Note that duplicate joint ventures are not removed from these data because the point of reference is on individual cooperatives that participate in joint ventures.

Types of Cooperatives Establishing Ventures

The number of joint ventures and wholly-owned subsidiaries with ownership by different types of cooperatives are reported in table 2. Duplicate joint ventures and condominium storage ventures are included. As in 2007, most of the cooperatives participating in ventures are in the farm supply and grain industries.

Categorizing Ventures

Joint ventures can be categorized based on the business purposes they are organized to accomplish. A telephone survey was used to identify joint ventures by trade name and business specialization but the same information was not collected for wholly owned subsidiary ventures. Different types of cooperatives, as reported in table 3 and presented in fig. 4, establish joint ventures that either parallel or extend the business activities that are characteristic of their particular industry.

Figure 3—Percentage share of ownership by cooperatives in joint ventures, 2010/11

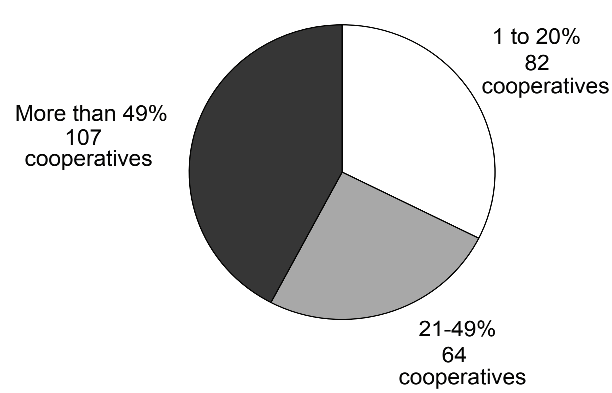


Table 2—Participation in ventures by type of cooperatives, 2010/11.

	Cooperatives reporting	Joint Ventures**	Wholly-owned Ventures
Farm Supplies	70	135	41
Grains & oilseeds	71	104	13
Dairy	14	16	26
Fruits & vegetables	9	13	7
Livestock	5	1	6
Other*	16	11	15
Total	185	274	108

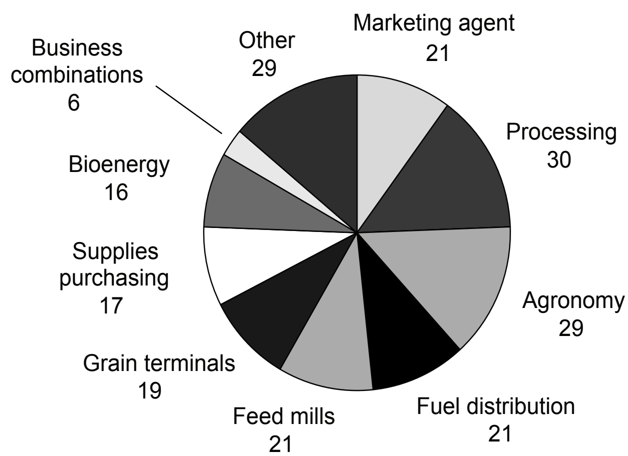
* Includes cooperatives in nuts, cotton, tobacco, sugar, dry beans, fish, and services.
**Includes duplicate joint ventures and condo storage ventures.

Table 3—Joint ventures by type of business operation, 2010/11.

Processing	30
Agronomy	29
Fuel distribution	21
Feed mills	21
Marketing agent	21
Grain terminal	19
Farm supply purchasing*	17
Ethanol & biodiesel	16
Business combinations	6
Other	29
Total	209

* Purchasing agent for multiple types of farm supplies.

Figure 4—Joint ventures by type of business operation



There are 30 agricultural processing and packing joint ventures identified in the survey, not including bio-energy. Dairy processing accounted for 16 of these joint ventures. Five joint ventures do fruit packing and four process grains and oilseeds. One cooperative is involved in three egg-packing joint ventures; another has a textile manufacturing venture with foreign partners, and one cooperative reported having a grass seed processing joint venture.

Farm supply cooperatives are often involved in joint ventures in their region to improve services for members and in some cases to serve nonmembers. Cooperatives have actively combined their agronomy operations with other cooperatives and non-cooperatives, reporting 29 such joint ventures. A joint venture is categorized as "agronomy" if its activities extend beyond coordinated purchasing that typically involves shared operations for shipping, storage, and delivery. There are 10 joint ventures exclusively involved with fertilizer and 2 each that specialize in either seed or chemicals, while 15 of them have combined fertilizer and agricultural chemical businesses.

Fuel distribution was organized in 21 joint ventures. Four of these joint ventures specialized in retailing propane. Most of the other 17 joint ventures are involved in purchase, storage, and distribution of petroleum and diesel fuel. Three cooperatives reported having wholly-owned subsidiaries for propane that had originally been organized as joint ventures with rural electric cooperatives.

Feed mills are a business where local cooperatives have sustained their competitiveness by combining either their ownership in a mill or in coordinating operations from multiple locations. The survey identified 21 feed mill joint ventures. It is important to note that a large regional cooperative is a partner with local cooperatives in 10 of these ventures.

A marketing agent joint venture is often referred to as a marketing agent in-common. This type of venture provides a means for cooperatives to combine their member products into larger lots for marketing. Of the 21 reported marketing agent joint ventures, 18 of them involved grains and feed products, with 1 each for marketing eggs, dairy products, and fruit.

Unit-train grain loading terminal elevators are another business that benefits from having partners in multiple locations. The survey identified 19 grain terminal joint ventures, of which 8 involved cooperatives partnering with non-cooperatives. One of these involved two partners with equal ownership in a port elevator.

Farm supply purchasing joint ventures are similar to common-agent marketing businesses with the difference being that the former are buyers for member inputs while the latter manage sales for member products. Both types of businesses do not involve a large investment in plant and equipment. Therefore, they have low overhead costs. Farm supply purchasing must operate with a relatively high volume of purchases in order to have direct dealings with manufacturers. For this reason, of the 17 joint ventures identified in the survey, all have more than 5 partners and 1 has over 20 partners.

The survey identified 16 joint ventures involved with bioenergy, however, their involvement as both owner and supplier of corn and oilseeds varied. A few cooperatives own equity in ethanol joint ventures but indicated that they do not regularly deliver grain to the plants. Four of the bioenergy joint ventures are biodiesel producers.

Six joint ventures involve partners with ownership in entities that combine all grain marketing and farm supply services under one trade name. Four of these ventures include cooperatives partnering with one non-cooperative that represent different multinational agribusiness companies. When operating with non-cooperatives under a new trade name, cooperative identity may be diminished and lost for future generations of farmers. Two of these business-combination joint ventures exclusively have cooperatives as partners.

The "Other" category includes two to four joint ventures in each of such business activities as consulting, equipment leasing, lending, safety and regulatory compliance, transportation, laboratory testing, research, livestock breeding and management services for convenience stores.

Joint Venture Turnover

Turnover in joint ventures is defined in this report as actions that change cooperatives' participation in joint ventures within a time period. One type of turnover involves cooperatives forming and dissolving joint ventures. A different type of turnover involves cooperatives entering into, or exiting from, joint ventures.

Comparisons between the surveys of 2007 and 2010/11 indicate substantial turnover in joint ventures. There were 134 cooperatives that reported being in joint ventures in both 2007 and 2010/11; 61 of them changed their involvement with joint ventures during that time-span. In a period of 3 or 4 years, between 2007 and 2011, 17 cooperatives were involved in 43 additional joint ventures. Over the same period, 44 cooperatives were involved in 55 fewer joint ventures. The increases are a combination of new formation and entering already established joint ventures. Likewise, decreases include both dissolutions of joint ventures and exiting by partners.

Many local grain and farm supply cooperatives establish joint ventures with other cooperatives in their region as a precursor to a merger. This practice accounts for most of the joint ventures that were reported as closed between 2007 and 2010/11.

Another strategic use of joint ventures by cooperatives is to spawn new businesses. Regional cooperatives often partner with smaller, local cooperatives to develop or expand services to farmers that preserve member ownership and control. As mentioned earlier, three farm supply cooperatives reported having joint ventures with rural electric cooperatives to start propane-distribution businesses. In these three cases, the farm supply cooperatives eventually bought out the shares of the rural electric associations. In general, joint ventures with partners that operate in different stages of the supply chain, or in different industries, are more likely to either sustain the partnership or have one partner eventually withdraw under conditions of mutual benefit. This type of joint venture dissolution contrasts with buyouts in which one partner will use the acquired business as a competitive resource against former partners.

In a historical context, several previous joint ventures between cooperatives and multinational grain processors/exporters eventually ended in the latter buying out the former. Examples of cooperatives that were in joint ventures and ended up being bought out include the grain division of Farmland Industries and Minnesota Corn Processors. Currently, many cooperatives are achieving efficiency from this type of joint venturing. Such joint ventures may provide benefits so long as cooperatives maintain awareness that multinational agribusinesses may not regard such partnering as a long-term relationship.

Conclusions

The availability of the LLC form of organization since the mid-1990s has offered cooperatives a relatively low-cost way to form ventures in comparison to incorporation. The LLC has also made it easier for cooperatives to joint venture with non-cooperatives.

Ownership share of joint ventures by cooperatives is dependent on the type of business and number of partners. Partners in joint ventures generally aim for equal participation. Joint ventures for purchasing or marketing coordination tend to have more than five partners, and share of ownership is less important than in capital-intensive businesses with two or three partners.

Among several types of joint ventures, agricultural processing had the highest participation. Within the processing type, 16 out of the 30 reported joint ventures involved dairy product manufacturing.

Most of the recent activity in joint ventures is reported by cooperatives in the farm supply and grains sectors. The types of businesses they organize in joint ventures are agronomy, fuel distribution, feed mills, grain terminals, bioenergy, and agents for purchasing and marketing.

As farmers are steadily increasing their acreage to produce grains and oilseeds, they expect their local cooperative to stay competitive on costs and access to markets. Cooperatives in grains and oilseeds and farm supplies are using either mergers or joint ventures to increase efficiency. Many joint ventures among local cooperatives are precursors to mergers.

Joint ventures are often transitory, intended to meet short-term goals of improving efficiency and market access. While many of them lead to mergers, others may dissolve or result in an eventual buy-out by the partner with the most financial assets. In contrast, some of the larger cooperatives have participated in joint ventures to spawn new businesses. Regional cooperatives often participate in joint ventures with local cooperatives for new business formation. Rural electric cooperatives have participated in propane distribution joint ventures with farm supply cooperatives for helping with the start-up of those businesses.

Joint ventures by cooperatives cover a range of different businesses. They can offer several benefits in size efficiencies, experience in partnering that leads to merging, and in helping start-up new businesses. Cooperatives may benefit from joint ventures when they have clear and realistic objectives and an accurate understanding of risks.

Glossary

Corporation – A business that is incorporated under a State's statutes as a separate legal entity from its owners that offers limited liability and is subject to taxation of profits from which distribution of earnings to owners are also treated as taxable income to them.

Partnership – An unincorporated business under State law that is not taxed on earnings distributed to partners as taxable income to them, but it lacks the limited liability of a corporation so that all partners are jointly liable for the debts of the partnership.

Limited Liability Company (LLC) – An unincorporated business under State law that operates like a partner ship,except each partner's personal financial exposure is limited to his or her investment in the business.

Limited Liability Partnership (LLP) – An unincorporated business under State law that operates like a partnership,that offers limited liability to equi ty investors who are not responsible for partnership management and has man aging partners who are liable for each other's actions and debts.

Joint Venture – A business that is organized by two or more businesses for collaborative deci sions and the sharing of profits and losses. A joint venture must adopt a legal form such as corporate or LLC.

Wholly owned subsidiary –	A business that is owned solely by another business and must adopt a legal form such as corporate or LLC.

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Rural Business–Cooperative Service (RBS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The cooperative segment of RBS (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs. RBS also publishes research and educational materials and issues *Rural Cooperatives* magazine.