

Good-to-Great Local Farm Supply and Grain marketing Cooperatives

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Research on Cooperatives

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Motivation for the Research

- Low and declining profitability of local co-ops
- Desire by local cooperatives to know more about profitability
- Popularity of various books such as *Built to Last* and *Good to Great* on how to build a high performing business.
 - *Good to Great* is a useful way to think about these cases
- ACCC had a symposium on this topic in 2006.

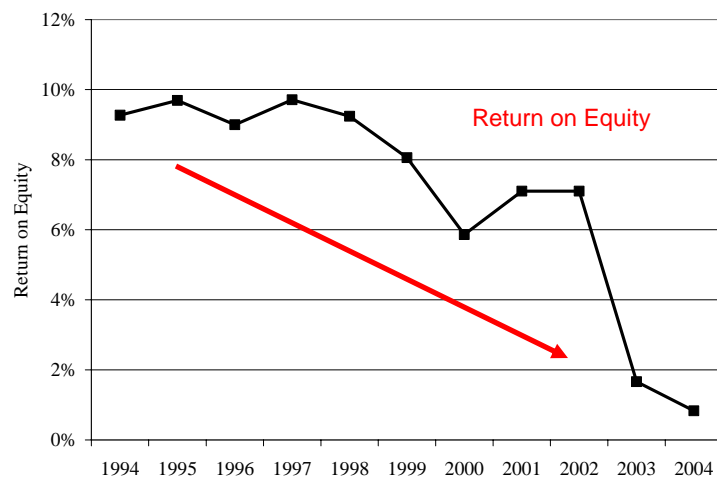


Builds Upon Prior Research

- Industry effects matter (NCERA 194, 2003)
- Industry effects dominate firm effects in agricultural and food firms (AJAE, 2005)
- Firm effects matter in local co-ops (NCERA 194, 2005; JAAE 2007)
 - Management and board policy are important.



The Problem



Objective

- Can you be a great local co-op?
- What makes a local co-op great?
- First, identify what makes them great and then study the reasons why.



Application of these concepts

- We looked at a database of over 650 grain marketing and farm supply cooperatives
- Sought to determine whether
 - Some co-ops could repeat their performance
 - Do “good” co-ops remain “good” co-ops over time?
- The answer is
 - It depends!
 - But yes, some “good” co-ops remain good co-ops over time



Return on Assets and Equity

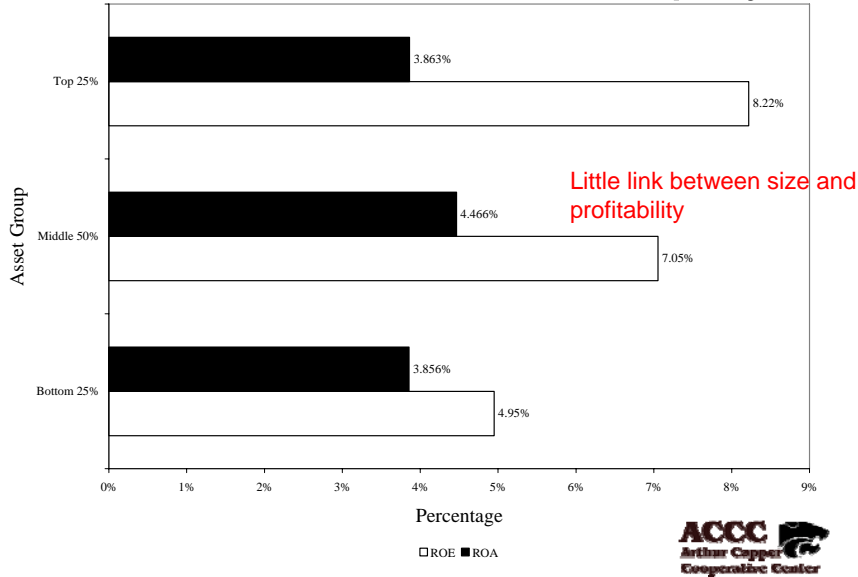


Table 5.1 Persistence of Profitability Ranking for ROE, 1995 to 2003

Denotes the Number of Periods (out of 9) that a Cooperative Ranked

Percent	9	8	7	6
Top 25	15 ^a	15	21	27
Middle 50	11	46	63	96
Bottom 25	1	12	9	31

^a Denotes the 15 cooperatives were able to rank in the top 25 percent in all nine periods

Table 5.4 Number of Cooperatives in the Nine Classes for ROE

		Ending Performance, 2001-2003		
		High (25%)	Medium (50%)	Low (25%)
Beginning Performance, 1995-1997	High (25%)	Sustained High Performers 71 (10.9%) ^a	Declining High Performers 72 (11%)	Fallen High Performers 20 (3.1%)
	Medium (50%)	Rising Moderate Performers 76 (11.7%)	Steady Moderate Performers 175 (26.9%)	Declining Moderate Performers 74 (11.4%)
	Low (25%)	Turnarounds 16 (2.46%)	Rising Underperformers 78 (12%)	Chronic Underperformers 68 (10.4%)

^a denotes that 71 cooperatives ranking in the top 25% in 1995 to 1997 and 2001 to 2003. The 10.9% denotes this as a percentage out of 650 cooperatives.



Table 5.8 Average Financial Measures by the nine Classes in Table 5.4

Group	Beginning Performance	Ending Performance	Average ROE, %	Average Size in Assets (mil \$)	Median Size in Assets (mil \$)	Average Value Created Index, %	Average Net Margin, %	Average Debt Ratio, %	Average WACC ^a	Average Income to Assets, %
Sustained High Performers	High	High	14.77%	14.88	6.65	4.10%	4.02%	26.54%	7.78	8.53%
Declining High Performers	High	Medium	10.15%	9.3	5.92	-0.91%	2.94%	25.92%	7.96	6.21%
Fallen High Performers	High	Low	5.77%	9.52	8.42	-5.61%	1.41%	34.81%	8.35	3.70%
Rising Moderate Performers	Medium	High	9.95%	10.33	4.82	-1.22%	2.80%	28.52%	7.95	5.87%
Steady Moderate Performers	Medium	Medium	6.79%	10.06	5.87	-3.64%	1.97%	25.49%	8.00	4.23%
Declining Moderate Performers	Medium	Low	3.30%	7.80	5.27	-5.89%	1.08%	25.82%	8.04	2.43%
Turnarounds	Low	High	9.50%	12.73	9.05	-11.60%	0.28%	48.22%	8.62	1.42%
Rising Underperformer	Low	Medium	2.70%	9.00	5.32	7.43%	0.89%	28.92%	8.36	2.16%
Chronic Underperformer	Low	Low	1.36%	5.20	3.41	-11.63%	0.09%	31.70%	1.76	0.32%

^a -Weighted average cost of Capital



Top Performers

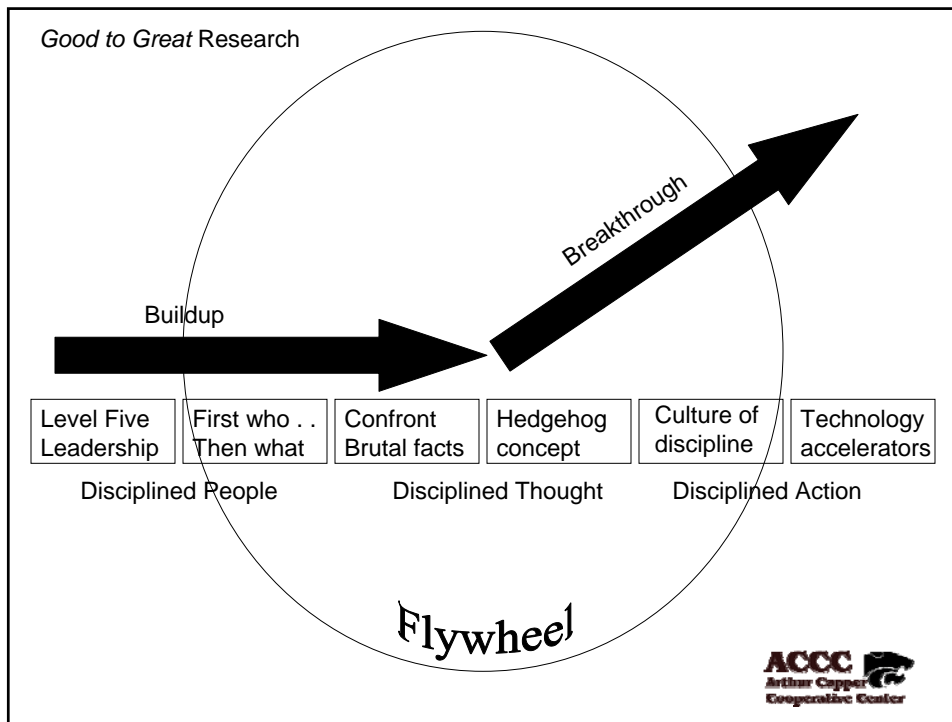
- Invariant to asset size
- Good asset turnover ratio
 - Implies greater efficiency in generating a unit of sales per a unit of assets
- High return on sales
 - 3.43% to 5.79%
- Invariant to capital structure
 - Little difference in equity-to-assets
- Geography matters!
 - Illinois, Iowa, Minnesota, and Wisconsin had the majority of high performers
 - Less variability in profits AND greater profits
 - Great Plains co-ops had lower profits AND greater variability
 - We are in the wrong region!



Why do they remain “good”?

- ACCC research on these co-ops point out the following.
- Outstanding leadership
 - Long-standing managers with a strong board
- They are the best at generating revenue from their employees.
 - Excellent sales to labor expense ratio
- Passionate about cost control
 - Fanatical about cost control
- They know what their economic engine is
 - Grain marketing and acres planted
- Location helps
 - Weather!
- Every co-op we studied had competition!





Level 5 Executives

- All of these leaders can do good things.
 - Some can do better than others.
 - Potential exists in most people.
- Level 5 leaders exist everywhere.
 - Need coaching or a mentor to make them realize they can do it.
- Quiet, shy, modest, and have ambition for the organization and not themselves.

First Who . . . Then what

- Getting right people is first step. Then vision, strategy, organizational structure, and tactics.
- Discipline in people decisions
 - “When in doubt, we don’t hire. We keep looking.”
 - “We limit growth based on our ability to get the right people.”
- “We hire people who fit.”



First Who . . . Then what

- “I expect our employees to do more with less . . . Also, I push the idea of ‘No mistakes’.”
 - When you know you need to make a people change, act.
 - First be sure you don’t simply have someone in the wrong seat.
- “We put our best people on our biggest opportunities, not our biggest problems.”



Confront the Brutal Facts

- Path to greatness means confronting the brutal facts about your current reality.
- Path to greatness also means maintaining unwavering faith that you can and will prevail in the end.
- Create a climate where truth is heard
 - Lead with questions, not answers
 - Engage in dialogue and debate, not coercion
 - Conduct autopsies without blame
 - Build red flag mechanisms that turn information into information that cannot be ignored.
- Do not need to spend time motivating people. If you hired self motivated people, the task becomes to not 'de-motivate them' by ignoring the brutal facts.
- Virtually all of these co-ops had brutal facts to confront in the past

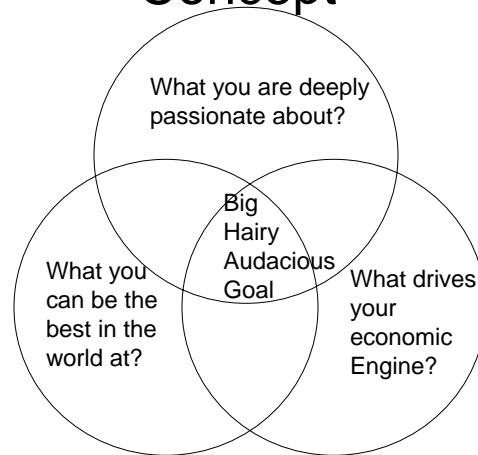


Disciplined Thought: Hedgehog Concept

- Foxes view the world in all its complexity.
- Hedgehogs simplify the complex world in one simplifying concept or vision or basic vision.
 - “We focus on running efficiently.”
 - “We don’t chase other people’s prices. We are usually the price leader in our trade area.”
 - “Grain marketing is our economic engine.”



Three Circles of the Hedgehog Concept



Grain marketing
And cost control

What is your Big Hairy Audacious Goal?
Increasing profitability to P>P75 level?



Three Circles of the Hedgehog

- Understanding of what you can be the best at
- Understand the drivers of your economic engine
 - One denominator (cash flow, efficiency ratio)
 - “Labor efficiency is our driver.”
- Research says it takes about four years to establish a hedgehog concept
- Industry does not matter – hedgehog is a a firm effect.



Three Circles of the Hedgehog

- “We execute. We push very hard in the grain department to be ready for harvest and the agronomy department pushes very hard to ready for the crop production season.”
- “It all comes down to acres planted.”
- Economic engine is grain marketing
 - They do have competition
 - They are passionate about grain marketing.
 - Sought to increase market share within their trade territory



A Culture of Discipline

- Self disciplined people who take disciplined action fanatically consistent within the hedgehog.
- It requires people who adhere to a consistent system; yet it gives people freedom and responsibility within the framework of that system.
- The more an organization stays within their hedgehog (intersection of the three circles), the more opportunities for growth.
- Many “lifetime” opportunities exist.
 - Several co-ops passed on opportunities until the price was right

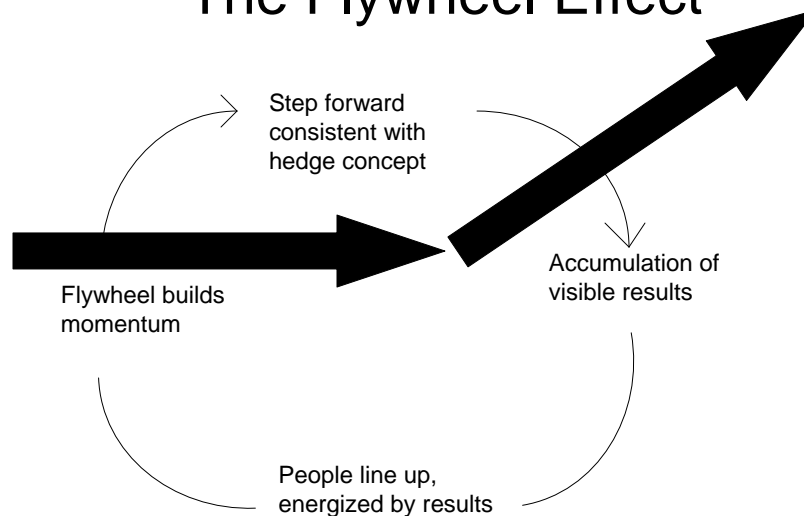


A Culture of Discipline

- “Stop doing” lists are more important than “to do” lists.
- “. . . To have good people but to work the assets and people hard. For example, instead of covering 20,000 acres per year per RoGator application unit, we try to get 40,000 acres. We can afford more machines, I just don’t want more.”
- “Directors are expected to complete the Director Development Program.”
 - Attend other industry meetings.
- “We do not spend a lot of time discussing past history and past numbers.”



The Flywheel Effect



Flywheel and Doom Loop

- They look dramatic and revolutionary from the outside but feel organic or vanilla to people inside.
- There is no dramatic transformation or miracle that occurs instantly.
 - Slow, steady process
- Organization pushes on a flywheel which takes a lot of effort but once it moves, you build momentum.
- Good-to-great companies did not understand until after the fact what had happened.
- Little time was spent on alignment or motivation.
 - Right people were already in place and hedgehog was understood by everyone.
- Several of these local co-ops have made huge strides.
 - Easy to spot the flywheel in the data once you identified the co-op and looked at it closely.



What's next?

- Continue to discern why some co-ops remain good co-ops over time
- Reinvestigate patron life cycle research and its impact on equity redemption policies
- Continue to link the results with outreach activities with local co-ops

