

Ag Consolidation Creates Pitfalls, Possibilities

By Michael Lindsay and Derek Devgun

The agricultural sector is not immune from the pressures that have brought significant consolidation to the U.S. and global economy. Scarcely a month goes by without another announcement of a large merger or significant joint venture in agriculture or an agriculture-related industry. The proposed acquisition of IBP by Smithfield or Tyson — or perhaps someone else — is just the latest in the wave.

And this trend is playing out almost across the board within the agricultural sector. Dairy, livestock, meatpacking, grain and even food retail and agricultural supply have all been affected.

This trend could create a competitive threat to cooperatives. One of the major reasons for the “urge to merge” is the perceived efficiency that can be attained from combining operations — in effect, the promised economies of scale of running two formerly independent enterprises with lower overhead, as well as new cross-marketing opportunities. Co-ops that have struggled to find the capital to fund growth in their businesses now face the prospect of leaner and meaner competitors — which underscores the need for cooperatives to continue to find inventive ways to raise capital.

In addition to stronger competitors on the selling side, mergers can reduce the overall number of

buyers of co-op products, reducing a co-op’s negotiating power. The U.S. Justice Department has looked carefully at whether consolidation among buyers in recent agribusiness mergers might result in lower commodity prices to farmers — at a time when farm-level prices are already low.

But co-ops need not only to be mindful of the threats that consolidation poses; they must also seek out the opportunities. Co-ops are uniquely positioned to take advantage of the opportunities that the merger wave continues to create. Though agricultural co-ops provide a guaranteed outlet for their farmer-owners’ production, they also provide something more — the possibility of additional income by participating in the value-added processing that takes place in the farm-to-table chain. (See related stories on new generation cooperatives.) The co-ops that thrive are those that are responsive to their members’ needs, and whose members are sensitive to the market pressures facing their co-op.

Co-ops can benefit their members in many different ways. Co-ops can enter into joint ventures or strategic alliances with each other — or, where appropriate, with investor-owned companies. In some circumstances, a co-op may most benefit its members by combining with another co-op. Headlines from the last few years demonstrate that relationships between

cooperatives (and sometimes investor-owned companies) are indeed being formed. (See related article on Dairy Farmers of America.)

Indeed, the notion that farmers should be allowed to combine for mutual benefit is the foundation for the Capper-Volstead Act. Farmer-owned co-ops that are eligible for favorable Capper-Volstead treatment are more able than other entities to consolidate and form joint ventures and strategic alliances.

But, historically, farmer-owned co-ops have not availed themselves fully of the advantages offered. This is especially true of “niche” co-ops — those that exist to serve a narrowly defined need of their members; they may want to be on the lookout for business opportunities that complement their existing businesses. Since the cooperative ag sector is less integrated than other sectors, co-ops should continue to explore these possibilities.

Because of the public debate over consolidation in agriculture and several controversial mergers, members of Congress have proposed legislation that could place limits on the ability of agricultural co-ops to merge and enter into strategic alliances. Over the last two years, these proposals have ranged from creating a special counsel for agricultural affairs within the Department of Justice, to providing the Department of Agriculture with a stronger role in reviewing and challenging agribusiness mergers,

to imposing a moratorium on agricultural mergers exceeding a certain size. Some of these proposals would exempt co-ops — others would not. Co-ops need to watch this area carefully, both to defend themselves and to seek opportunities.

Whether consolidation is ultimately good or bad, it is definitely real, and it will continue to bring both pitfalls and possibilities. Now, as perhaps never before, co-ops need to pay attention to the developments in their industry and protect themselves and their members' interests.

Michael Lindsay and Derek Devgun are attorneys in the Agriculture and Cooperatives Practice Group at Dorsey & Whitney LLP (www.dorseylaw.com), and represent cooperatives of all sizes and from a variety of industries.

This article was published in the NCBA Cooperative Business Journal dated December 2000.