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# Foundation of cooperatives



The ownership and reward system of a cooperative are very different than a for profit enterprise.

- A for profit business usually exists to serve a market that is emerging or already exists – an opportunity to generate a financial return
- Cooperatives have usually been formed as a reaction to a failure of for profit businesses to deliver required goods or services at a satisfactory volume or price.
  - Electricity, phone service, drinking water

*Cooperatives are designed to provide the members with a good or service, not a return on investment.*

# Foundation of cooperatives



- Cooperatives succeed or fail, endure or dissolve, based on how well they deliver a good or service.
- Net margins are the rules of the game, not the object of the game.

John Kenneth Galbraith, in his 1952 book *American Capitalism* said that “*In the classic liberal economy, goods and services are provided and prices set by free bargaining. Modern economies give massive powers to large business corporations to bias this process, and there arise ‘countervailing’ powers in the form of trade unions, citizens’ organizations and so on, to offset business’s excessive advantage*”.

(Wikipedia <http://www.economyprofessor.com/economictheories/countervailing-power.php>)

- Some people may think cooperatives sort of form themselves as citizens’ organizations that address a market place failure

# Cooperative business model



In my experience there is nothing polite in the birth of a cooperative. The first emotion I usually encounter is **anger**.

**What happened to the free press?** North Dakota has lost any semblance of a free press. One party controls the politics and they are in turn controlled by wealthy individuals and corporations. There is no free press.

**Monopolies don't care about truth.** They have, as they often say, a right to their point of view. Those without money don't have that right.

**How long must we suffer the indignity of being lied to with our own money?**

# Cooperative business model



Aristotle said in “Nicomachean Ethics and Politics” “Anybody can become angry-that is easy, but to be angry with the right person and to the right degree and at the right time and for the right purpose, and in the right way-that is not within everybody’s power and is not easy”

The age old response to brutal market manipulation has been cooperative formation. The building blocks of a new cooperative business model are found in the language used to describe the cooperative of the past:

**Definition** A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically controlled enterprise.

# Cooperative business model



**Values** Cooperatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity.

**Principles** The Cooperative principles are guidelines by which cooperatives put their values into practice.

## **1<sup>st</sup> Principle: Voluntary and Open Membership**

Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination

## **2<sup>nd</sup> Principle: Democratic Member Control**

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions.

# Cooperative business model



## **3<sup>rd</sup> Principle: Member Economic Participation**

Members contribute equitably to, and democratically control, the capital of their cooperative.

## **4<sup>th</sup> Principle: Autonomy and Independence**

Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

## **5<sup>th</sup> Principle: Education, Training and Information**

Cooperatives provide education and training to their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives.

# Cooperative business model



## **6<sup>th</sup> Principle: Cooperation among cooperatives**

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, and regional and international structures.

## **7<sup>th</sup> Principle: Concern for the Community**

Cooperatives work for sustainable development of their communities through policies approved by their members.

*Deeply rooted but ready for change.*



# A new look at the cooperative business model



I will stay rooted in the cooperative principles but in my view, the cooperative business model needs to change in two ways.

- 1. The generation and utilization of equity**
- 2. Creating and maintaining a captive market for its goods and services**

## **Equity**

- Cooperative businesses treat retained patronage credits as equity of the cooperative
- It is this retained patronage credits that make cooperatives easy takeover targets by investor owned firms or other cooperatives who simply promise to pay out those capital credits immediately, or in some cases, provide more than the allocated credit

*Retained patronage credits don't work well for new starts or significant expansions*

# A new look at the cooperative business model



## **Investment from members**

- Some cooperatives raise funds by selling debt instruments to their members
- They don't have Federal Deposit Insurance Corporation guarantees and the members' money is at risk.
- The success of this equity capital technique rests on how strong the cooperative is and how financially solid its members are.

## **Preferred stock**

- Some cooperatives sell preferred stock to non members.
- The ability to sell stock is once again based on the strength of the cooperative
- Small start ups can be successful selling preferred stock to community development corporations
- Large cooperatives need to guarantee a solid dividend payment

# A new look at the cooperative business model



CHS, the largest cooperative in the United States sells Preferred Stock on Wall Street and is paying 6% dividends.

In 2012 CHS had sales of 40.6 billion with net earning of 1.26 billion and will be returning \$600 million in cash.

Year	CHS Net Sales
2012	\$40.6 Billion
2011	\$36.9 Billion
2010	\$25.3 Billion
2009	\$25.7 Billion
2008	\$32.2 Billion
2007	\$17.2 Billion
2006	\$14.4 Billion
2005	\$11.9 Billion
2004	\$10.9 Billion
2003	\$9.3 Billion
2002	\$7.2 Billion
2001	\$7.5 Billion
2000	\$8.2 Billion

# A new look at the cooperative business model



## **Selling marketing or purchasing rights**

- Model of “new generation” cooperatives
- Members invest in the cooperative prior to patronage
- That right to market or to purchase through the cooperative can be transferred to another eligible member at a price usually approved by the board.
- CALAMCO (California Ammonia Cooperative) is a good example of this type cooperative equity
- In new generation cooperatives there are no “free riders”
- Only have patronage business with investor members - sometimes called “closed” cooperatives

# A new look at the cooperative business model



## **Creating captive markets**

- Traditional “open” cooperatives either buy or sell to any farmer who wishes to use the cooperatives’ service.
- Investor owned firms compete aggressively with the cooperatives

Kenneth Galbraith’s analysis in 1952 still seems right today “massive business corporations still have power to monopolize markets by driving the little guy out”.

In some cases a few big businesses form an oligopoly and keep prices high by keeping the little guy out. This phenomena is referred to as a red ocean strategy where the last company standing is the one with the lowest cost of operation.

*The ocean is red with the blood of competition.*

# Blue ocean strategy



A new theory is emerging led by authors W. Chan Kim and Renee Mauborgne called “Blue Ocean Strategy” subtitled How to Create Uncontested Market Space and Make the Competition Irrelevant.

## **Key points to a blue ocean strategy:**

- BOS is the result of a decade-long study of 150 strategic moves spanning more than 30 industries over 100 years (1880-2000)
- BOS is the simultaneous pursuit of differentiation and low cost
- **The aim of BOS is not to out-perform the competition in the existing industry, but to create new market space or a blue ocean, thereby making the competition irrelevant**
- BOS offers systematic and reproducible methodologies and processes in pursuit of blue oceans by both new and existing firms
- BOS covers both strategy formulation and strategy execution

# Blue ocean strategy



- The three key conceptual building blocks of BOS are: value innovation, tipping point leadership, and fair process
- While competitive strategy is a structuralist theory of strategy where structure shapes strategy, BOS is a reconstructionist theory of strategy where strategy shapes structure.
- **As an integrated approach to strategy at the system level, BOS requires organizations to develop and align the three strategy propositions: value proposition, profit proposition and people proposition**

## **Creating new market space**

- Cooperatives have done this for years
- Create market space that is only theirs to serve
  - Rural electric cooperatives

# A new look at the cooperative business model



**Integrated approach to strategy at the system level-develop and align the three strategy propositions: value proposition, profit proposition and people proposition**

**Value** In a cooperative, value is the direct measurable and sometimes immeasurable benefit the cooperative provides to its members

**Profit** When the demand of the cooperative for profit exceeds the direct and measurable member benefit (value) those two propositions are not in alignment

**People** Not everyone can work in a cooperative, it takes people who can put others ahead of themselves.

**Break through idea** What if the source of permanent equity financing was the members themselves?



# A new look at the cooperative business model



## **Dakota Growers Pasta Cooperative**

- New generation cooperative that sold delivery rights for all of the bushels it would need, sized to its mill and manufacturing capacity
- Cooperative expanded and sold additional delivery rights at slightly higher prices in two additional equity campaigns
- Dakotas Growers has been converted to a “C” corporation and is now owned by Glencore

<b>Year</b>	<b>USA</b>	<b>Canada</b>	<b>Dakota Growers</b>	<b>DGP versus USA</b>	<b>DGP versus Canada</b>
1994	4.67	4.92	5.95	+1.28	+1.02
1995	5.75	5.04	5.80	+0.05	+0.076
1996	4.53	4.25	6.52	+1.99	+2.24
1997	4.91	4.44	6.74	+1.83	+2.34
1998	3.00	2.94	6.64	+3.64	+3.70

# A new look at the cooperative business model

## CALAMCO

### California Ammonia Cooperative

- Farmers own one class of shares and Simplot owns a second class of shares
- It is a new generation cooperative and dividends are returned based on patronage, not investment.
- CALAMCO shares trade readily and cooperative officials point out that retiring farmers have little problem selling their purchasing rights

Year	Return	Stock Price	%ROI
2011	\$56.12	\$20.00	42.0
2010	\$48.20	\$20.00	36.0
2009	\$69.96	\$18.00	55.0
2008	\$43.22	\$18.00	36.0
2007	\$39.09	\$16.00	36.6
2006	\$27.50	\$15.00	27.5
2005	\$23.50	\$14.00	25.2
2004	\$27.00	\$14.00	28.9
2003	\$39.75	\$10.00	49.7
2002	\$7.15	\$10.00	55.7
2001	\$49.40	\$9.00	82.3
2000	\$14.49	\$9.00	24.2

# A new look at the cooperative business model



## **Here is the Magic**

- A cooperative can sell either delivery rights or purchase rights to member investors where the patronage dividend represents a healthy return on investment – available to only the member investor and not the general population.
- This strategy provides the needed capital for the expansion or acquisition and guarantees the cooperative either a captive supply or a captive market (Blue Ocean Strategy).
- As cooperatives grow in size and the need for equity they are tempted to find non member investors.

# The Feasibility Study



## **The Central Question**

Is it economically feasible for subscribers to own and operate a daily newspaper in North Dakota?

## **Why the discussion got started**

- Current news sources dominated by the support of one political party.
- Potential political ties leads to unbalanced news reporting.

# The Feasibility Study



## **11 elements to the feasibility study**

1. What has been the roles of newspapers in North Dakota facilitating political discourse?
2. What does the market look like? What are the characteristics of the other ND publications: what is their distribution, circulation, frequency, etc.
3. What are the trends in both nation and international newspapers.
4. What are the innovative technologies impacting all aspects of the newspapers business (both positive and negative)
5. What will be the demand for content?
6. What distribution means – electronic and/or paper, will be economically possible, how will they be possible?

# The Feasibility Study



## **11 elements to the feasibility study**

7. What will be the role of advertising?
8. What reaction should a reader owned daily newspaper expect from an existing daily and weekly paper?
9. How would the public react to a reader owned paper? How much market could be captured?
10. Can a reader owned newspaper achieve non profit status?
11. Can a subscriber owned newspaper be economically viable?

# The Feasibility Study



## **Timing and Cost**

- 90 -180 days for \$30,000 - \$60,000
- Remember, these are estimates

## **How does this learning get put to use?**

- Steering committee is the center point and responsible for collecting and disseminating information to the larger, interested group.
- Once the feasibility study is complete, the steering committee makes the decision whether or not to move forward.
- If moving forward, the steering committee is dissolved and an interim board of director is formed to create the cooperative and shepherd it through the membership campaign.

# The Feasibility Study



## **After the feasibility study comes the business plan**

- If feasibility study done well, business planning process can be as little as 60 days.
- Can be less expensive than feasibility study, \$15,000 - \$45,000 depending on professional consultation.

## **Launching the cooperative**

- Membership/equity campaign to garner investment.
- Campaign typically takes 90 days.
- If financial goals are met through campaign, cooperative is launched.

*This isn't a new idea. There are existing cooperatively owned publications and entities that will fund them, out first step is to determine feasibility in North Dakota.*