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The Cooperative Business Model as an Economic Development Tool: Lessons from Nebraska

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Many rural areas face the challenges of keeping their communities economically and socially vibrant in the face of declining populations and a loss of essential community businesses. The Nebraska Cooperative Development Center (NCDC) at the University of Nebraska–Lincoln (UNL) provides direct technical assistance to those cities in rural areas of Nebraska that want to build or preserve a business. The uniqueness of the NCDC approach is that all the businesses assisted are developed and organized as multiple owner establishments, primarily cooperatives (co-ops) and Limited Liability Companies (LLCs). Cooperative ownership may include a few people or more than 100, depending on the type of business created.

In the past, the cooperative business model has rarely been considered as an option for entrepreneurial development in rural areas, although Merrett and Walzer (2001, 2004) discussed the roles that New Generation Cooperatives can play in capturing value-added in small communities. This report will discuss instances where the group-owned business concept has been applied to business creation in rural Nebraska and the reasons why it has succeeded. The term *cooperative* is used in general terms that include any type of *group-owned* business.

NCDC is a part of the Department of Agricultural Economics at UNL and was started in 2000. From 2000 through 2013, NCDC worked on more than 100 business development projects, including the marketing of value-added agriculture products, the marketing and distribution of local foods, and the establishment of community-owned retail stores on main streets in rural towns.

The Business Model

The *cooperative business model* has many appealing components that make its use in rural areas easily accepted and embraced (USDA Rural Development 2012). The cooperative model concentrates on the *user owned*, *user controlled*, and *user benefited* concepts of business activities (USDA Rural Business and Cooperative Development Service 1995). The idea of people working together for a common cause, especially in small towns, is nothing new. Adapting that shared responsibility concept to a business creation model is a fairly easy transition to make. Farmers and ranchers work together to market their production to a variety of customers. This shared business model approach allows a group of producers with similar products to potentially enter a niche market that they as individual operations would not have the capacity to do. Through pooling of their production, the growers are better able to enter a market as well as supply that market throughout the year, as opposed to an individual farmer running out of product due to demand part way through the marketing year. Products involved range from beef, pork, chicken, goats, fish, ostrich, and dairy products, to fruit, grapes, wine, and colorful woody florals, to hay, nuts, edible beans, and organic grains.

Other projects using the cooperative model have included grocery stores, variety stores, convenience stores, cafés, clothing stores, hunting and recreation stores, and various trade associations (NCDC 2014). A cooperatively owned retail outlet often results from a lack of individuals in a community with an interest and/or resources to own the retail outlet independently. Small town businesses are often "family owned" businesses. If the family does not have the next generation to take over the business, the result can be that the business closes. A cooperatively owned business can solve the succession problem so common with many privately owned businesses. Since the co-op or LLC is perpetual in existence, and ownership shares can be transferred or passed on, the business can outlive the originators without difficulty. Multiple owners in a retail business situation provide a built-in customer base. The business is owned and controlled by those who use it most. Investment in the business is to obtain access to its services rather than as an investment with hopes of appreciation in value. Hopefully, the owners make special efforts to patronize the business in which they share ownership.

Even though the NCDC has not been asked to assist with worker-owned or housing co-ops in Nebraska as of yet, these two cooperative models are being used in other states (USDA Rural Business/Cooperative Service 1996). A business with several long-time committed workers could conceivably be transformed into a worker-owned co-op as a part of a succession plan. Modular home parks and apartment buildings are also potential housing co-ops.

Marketing Together

The primary goal of the NCDC since its inception has been to provide direct technical assistance to emerging cooperative groups. For several years, the NCDC has worked with agricultural-based groups who banded together to market their production. Most groups were seeking ways to capture additional value from the marketing chain, traditionally going to various entities that provide services to the value chain. Marketing co-ops and LLCs were formed and were intended to assume the roles of the businesses to provide processing, transportation, marketing, advertising, and other services, but to also attempt to capture the perceived value inherent in being a "family farm."

North Star Neighbors (2014) is an LLC made up originally of about a dozen family farms in a rural area of east-central Nebraska. The farm families raised a variety of animals that had been marketed through traditional channels. The members of the LLC recognized they had value in the standards that they employed to raise their livestock, but this value was lost in the traditional food marketing system. As a group, they chose to raise their animals without antibiotics or artificial growth stimulants. Instead, the animals were raised on grass and open lots, and were fed non-GMO (genetically modified) grains and forages.

To capture the value of the growing and feeding practices, the LLC had to take over transportation and delivery, harvesting, processing at approved USDA-inspected facilities, marketing, advertising, and retailing of their products. As standards for themselves as growers were formulated, they developed the capacity to fill a meaningful market and attract consumers with a desire to buy the types of food produced by North Star. The LLC began by marketing meats at a farmers' market, and it grew from there. As they grew and developed, they began to deliver to their customers individually as well as marketing in larger venues such as other farmers' markets and eventually the Nebraska Food Cooperative. North Star Neighbors is the primary method for marketing all of the animals and related products produced by the members of the LLC.

The ability to preserve the identity of the products grown and to capitalize on the added value of those products versus "commodity" meats, poultry, dairy, grains, nuts, and other locally grown foods has been one of the drivers for cooperative marketing. Sharing their resources and the risks of the business is why they come together.

Other groups have followed a similar path of development. These include farmer/rancher co-ops and LLCs marketing meats, poultry, nuts, organic grains, decorative plants, and other products all following the same basic premise in development. They had a shared desire, shared beliefs, similar products, and the willingness to invest in the business as a vehicle for marketing their products.

Heartland Nuts N' More Cooperative (**www.heartlandnutsnmore.com**) and the Nebraska Woody Florals Cooperative (**http://nebraskawoodyflorals.com/wp**) are two examples of growers who banded together to aggregate product into a quantity large enough to enter a market that individual growers would have difficulty accessing themselves. Shared investment of resources both physical and financial allowed them to create businesses to market their production so that growers could see a return on their investment in growing the crop. Have these businesses been the major source of income for any of the growers?

No, but they have added a profitable revenue stream to add to their other farm operations.

Another group with a shared passion to create opportunities for small farmers raising and marketing locally grown foods created the Nebraska Food Cooperative (NFC) (**https://www.nebraskafood.org**). This business structure is unique in that it includes not only the approximately 36 farmer members growing the food but approximately 1,000 consumer members as well. This model brings together a marketing co-op and a consumer co-op into one operation. The NFC exhibits more of the "social" aspect of co-ops than many other production co-ops. Farmers and consumers together endorse natural and/or organic foods and a strong belief in sustainable practices for both farmers and consumers. The NFC is loosely defined as an *online farmers' market* through which farmers post their available production during an order cycle and consumers go online to place their orders with individual farmers. The co-op is then responsible for the aggregation and delivery of the food from the farmer to the consumer, which costs both the farmer and consumer a fee. The NFC is what is now commonly called a food hub and connects farmers and consumers for the benefit of all. In this case, the farmer has another market for his or her products; the consumers have a location to buy specific types of foods for their household; and the entire process helps keep the food dollars circulating in the local economy.

Cooperatively Owned Community Retail Stores

Another area of cooperative ownership that has gained considerable interest in the past few years is the community owned/cooperatively owned retail store. Most often, these community efforts result from the closing of a business due to several factors unrelated to the viability of that business (such as retirement, health problems, and relocation). These retail stores on main street are viewed as essential businesses for the community and contribute to the vitality of the area.

Typically, as word comes out about the impending closure of the business, efforts are made to find a new buyer through various venues. The decision to work toward cooperative ownership is often seen as the last chance to save or reopen the store. We see increasing incidences of shared ownership of mainstreet businesses in Nebraska, some as co-ops but many as an LLC or another organization. For example, LLCs own the only restaurant in town, the local movie theatre, a convenience store/gas station, and variety stores that resulted from a national chain leaving rural Nebraska. There has been considerable interest in using a co-op to own the local grocery store in several rural towns. Nebraska is a rural state. The desire to keep or start a grocery store in a community is most often tied to distances traveled to buy groceries. Two communities were faced with nearly an 80-mile round trip for groceries. Interestingly, both of these community efforts—Circle C Market (**www.circlecmarket.com**) and Wolf Den Market (Ridder 2007)—were initiated by students as part of a class project in high school. One of the first cooperative projects in which the NCDC was involved was helping the only community in an entire county establish a grocery store to add to the vitality and sustainability of the community as well as to reduce the miles traveled for supplies.

Launching and Sustaining a Project

The first step is to focus the business vision on one primary overriding concept on which the steering committee can agree. Early in the formation stage of the steering committee, it is useful to talk about the reality of the time needed to conceptualize the business. Building a business will take a significant commitment of personal time during the next one to three years.

A key strength of the multi-owner or cooperative business model not seen in other businesses is the power of a group of people working together, sharing their individual talents and experiences, toward building a successful business.

As the committee does due diligence on behalf of the larger community, it is important to have a planned process to report the overall findings of the committee to potential users as the work is being completed. Since the time frame for development is often a year or longer, reporting progress to potential members keeps them involved and connected. The communication between the committee and the potential users of the business might be a combination of face-to-face meetings, newsletters, e-mails, or direct mail. Especially important is to maintain contact with potential owner/investors to keep them involved and excited about the possibilities for the new business. Not informing people about progress allows the ever present "rumor mill" to close that gap.

Business Capitalization

Multi-owner businesses, such as co-ops and LLCs, are largely self-capitalized through the sale of memberships/shares of the business to willing investors. Undercapitalization of a business is one of the main causes of failure in start-up businesses ("Undercapitalization" 2014). Undercapitalization can cause an immediate problem with cash flow. The decision by the steering committee as to how much is needed to fully capitalize the business as well as the level of capitalization considered adequate to move forward (indicating an agreement to borrow the remainder) is one of the toughest decisions they will make.

The Good, the Bad, and the Ugly

Not all co-ops that have organized and started have continued over the long term. As discussed earlier in this report, organizing and running this type of business is not easy. It takes a significant commitment of time. The time involved is intensive in the development stage, but that intensity continues in some respects in the ongoing operation of the business (see "Common Causes" 2014 and Scott 2014). One example is a pork marketing co-op that was formed involving about 30 family farm operations. They all had similar growing operations, similar genetics in the animals for consistency of products, and a shared desire to capture value from the marketing chain. The co-op was attracting a solid following locally, had a potential market in Mexico for some products, and was developing their own "branded" meat products. After about five years, the group tired of the tremendous amount of time they all spent in running this business. Much of the marketing and leadership was focused on a couple of key growers, one of whom developed some medical problems. Eventually, they decided to close the business.

Another co-op was formed around an underutilized resource that was prevalent in their local area. The Sandhills of Nebraska are blessed with many groundwater-fed lakes that are located on large cattle ranches. Many of these lakes contain a naturally occurring population of perch. A perch marketing co-op of cattle ranchers was formed as a method to capture and add value to a resource at their fingertips. The co-op identified a market in the Great Lakes region as well as local outlets for their products. The co-op members again assumed the roles of harvesting, processing, packaging, transportation, quality control, marketing, and delivery. As demand increased, they could not develop a practical way to harvest large amounts of wild perch from the lakes since some of the lakes were 400 acres in size. Fish farming experts from other parts of the U.S. were brought in for advice and consultation, but the problem was not solved. With the lack of ability to gather a sizable quantity of product, they decided to cease operations.

There are also examples where undercapitalization and poor business planning doomed the business nearly from the start. A grocery store was opened in a community by non-community members simply because the building space was available. The grocery store concept was solid, but the community was not the driving force in the business creation. The store was designed to be run largely by volunteers, and the share price was set very low ($50) so that "everyone can afford to join." Following the membership drive, the organizers had about $3,000 with which to try to open a small grocery store. As financial needs became apparent, board members loaned the business substantial sums of money to keep it afloat. The store shelves were never well-stocked; the volunteers grew tired of running the business; and they ran out of money. The store eventually closed and the co-op disbanded.

Another example is an LLC that opened a retail space in a large city to provide local growers access to a large market. The NCDC did provide some technical assistance to the group but resigned from the project when it became clear that good practices were not being followed. Membership in the LLC was low, and investment did not provide sufficient capital to give the business a solid start. An ideal location was identified, but the cost of the location was beyond the reach and scope of the proposed business. Against professional advice, the manager who was also an owner, signed a contract for the location with the idea "if you build it, they will come." There was not enough business to sustain the market at that location; the manager/owner loaned tens of thousands of dollars to the business without board input; and eventually he lost it all. There was no concrete business plan agreed upon by all the members.

A final example of what not to do is found in someone trying to use the cooperative model as a personal business. (This has been attempted more than once.) The NCDC was not involved in the formation of the business but became aware of it after it was organized. Two family members established the co-op, with the bylaws designating them as permanent President and Vice President of the board. They then enlisted and sold memberships to growers of the product to utilize and market in the co-op. Members were expected to not only volunteer at the co-op facility but to sell raw ingredients to the co-op. Capitalization was largely done via grants that the co-op had received from state and federal government agencies. Once the grants and member investments were gone, the business closed.

Conclusions

The cooperatively owned business strategy is but one approach to entrepreneurial development in fostering growth and vitality in rural communities. It is a viable model that capitalizes on the power of people to shape their futures. Cooperative ownership of a business can help provide essential business services to a community. The cooperative business can serve as a vehicle for regional development that adds income for producer/growers who want to access a value-added market. The shared business ownership gives the users control of the business, the benefits provided by the business to themselves and their community, and a share of ownership in a business which they find to be important to themselves and their families. Growing a cooperative business from scratch can be a success, but experience tells us that key principles and steps in the development process are critical to helping achieve that success:

1. Get the right people on the steering committee. People who will commit the time and represent potential owners, not just themselves, for the long haul. Business creation in this model typically takes one to three years.

2. Focus the variety of ideas into one primary business purpose. Get everyone on the same page. There has to be one major market that the business will enter. Without that primary business purpose, all else fails.

3. The steering committee will set up subcommittees to “divide and conquer” the due diligence needed to create the business concept. The steering committee members must trust one another to do the work and believe that the work of others is valid.

4. Create a start-up budget of initial “one-time expenses,” a budget for the first year of operation month by month, a long-term budget (years two through four or five), and an exit plan.

5. Share the general findings of the committees to the potential users/owners of the business as the work is developed through community meetings, direct mail, or other means. Don’t let the rumor mill contaminate your process.

6. Hire the appropriate attorney and accountant who fit the business plan. If that expertise is not found locally, find it elsewhere.

7. Adequately capitalize the business before deciding to initiate the business through the marketing of ownership shares.

8. Select a well-trained board of directors to run the business on behalf of the group of owners.

9. Hire the best manager possible. Undertake a professional job search.

10. Capitalize on the power of a group of people to own, use, and run a business for the benefit of all.

For more information on starting a co-op, see NCDC (2014) and USDA Rural Development (2014).

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