

# Cooperatives as Marketers of Branded Products

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Few agricultural marketing cooperatives have nationally prominent brand names. Instead, they tend to concentrate in commodity-oriented markets, which can be attributed to the cooperative principles—user-benefit, user-financed and user-control. However, these structural disadvantages can be overcome. Due to the user-benefit principle, cooperatives often have seasonal product availability and/or limited product lines; they also suffer from the horizon problem, lacking the structure to provide long-term returns to members who invest in brand building. The user-benefit principle can be converted into an advantage by using the cooperative identity as a marketing strategy, and the horizon problem can be remedied by implementing a delivery-rights system. Cooperatives' limited access to capital is attributable to the user-financed principle. Joint ventures, legislative reforms to expand cooperatives' sources of equity capital and preferred stock offerings can be used to overcome this constraint. The homogeneous nature of cooperative boards is attributable to the user-control principle; it gives rise to the principal-agent problem. Forming subsidiaries or joint ventures to market branded products can remedy this situation, with the boards composed of individuals with expertise in branded products.

In 2002, revenues of the forty largest agricultural cooperatives totaled \$57.4 billion (National Cooperative Bank 2003). However, only a limited number of these cooperatives have nationally prominent brands—Borden, Land O'Lakes, Ocean Spray, Sunkist, Welch's, and Blue Diamond.

Why do so few large agricultural marketing cooperatives have nationally prominent food brands? Several have branded food products with strong regional recognition; however, the basic structural characteristics of cooperatives appear to inherently impede brand building. These characteristics relate to the cooperative principles—user-benefit, user-financed, and user-control.

## The Importance of Branding

Many agricultural marketing cooperatives have opted to engage in vertical integration and process their members' commodities into value-added food products. There are two basic strategies for competing in the processed food industry: cost leadership with branded or private label products, and differentiation in either the mass market or niche market(s) (Porter 1985). Although differentiation can be achieved by providing superior service or having unique distribution channels, it often requires a brand that is well-recognized by the target market.

Competition for space on grocery shelves and the consumer's dollar is fierce. Gallo (1999) noted that Hardesty is extension economist, Department of Agricultural and Resource Economics, University of California, Davis.

advertising and promotion are critical to marketing food products in the U.S.; he attributed the high levels of marketing expenditures to three forces: the food market captures a large share of consumers' income relative to other categories, consumers continuously make food purchasing decisions, and food is one of the most highly branded categories in the U.S.

Marketing activities can be very costly. Kraft Foods introduced Philly Snack Bars regionally in 1999 with a \$4.7 million campaign using television, print, public relations and sampling; it then expanded distribution nationwide, spending \$11.6 million from just January through June, 2000 (Reyes 2001). Furthermore, branding requires a long-term investment; significant consumer awareness cannot be achieved with an intermittent, short campaign.

Some cooperatives have accepted the challenge to develop national brands. Diamond of California, whose membership consists of walnut producers, recently launched its Emerald brand. The Emerald product line consists of fourteen snack-nut products, including single nut varieties and sweet and savory glazed-nut combinations. The cooperative's marketing campaign includes television and print advertising and sponsorships of athletic events.

Alternatively, some cooperatives acquire companies and/or rights to brand names. Dairy Farmers of America (DFA), the nation's largest dairy cooperative, purchased the Borden and Elsie brand licenses for cheese in 1998 to build its market share in branded retail cheeses. The New York-based cooperative, Pro-Fac, marketed its members' pro-

cessed fruits and vegetables through a long-term supplier relationship with Curtice Burns, whose brands included Comstock and Nalley's. In 1994, Pro-Fac purchased Curtice Burns and renamed it Agrilink Foods. In 1998, it purchased Dean Foods Vegetable Company, including its Birds Eye brand. Unfortunately, Pro-Fac's highly leveraged position forced the cooperative to sell a majority interest in Agrilink (renamed Birds Eye Foods) to Vestar Capital Partners (Pro-Fac 2004).

Many agricultural marketing cooperatives have chosen a cost-leadership strategy. For example, California-based Pacific Coast Producers manufactures canned fruit and tomato products, and juices, fruit cups and gels as a private-label supplier. It invests in production facilities to continuously improve its efficiency and product quality.

#### **Previous Studies of Cooperatives' Marketing Efforts**

It is a common belief that agricultural marketing cooperatives advertise less extensively than their IOF counterparts. Gruber, Rogers, and Sexton (2000) investigated the validity of this belief using advertising-expenditure data from 1987. The data set involved 49 food product markets that each contained at least one agricultural marketing cooperative. Their model was based on the Dorfman-Steiner condition: the advertising-to-sales ratio, at the optimum, is equal to the price-cost margin times the advertising elasticity of demand. *Ceteris paribus*, firms with low price-cost margins will have lower advertising-to-sales ratios.

Among the firms that advertised, Gruber, Rogers, and Sexton calculated mean advertising-to-sales ratios of 1.87% for cooperatives and 2.97% for the IOFs. The cooperatives averaged a 31.5% price-cost margin, while the IOFs' average was almost twice as much (62.2%), and the comparable averages for the cooperatives and IOFs that did not advertise were 21.4% and 37.5%, respectively. Whether or not they advertised, IOFs had higher price-cost margins than did cooperatives.

Gruber, Rogers, and Sexton's empirical analysis was consistent with the Dorfman-Steiner condition; it confirmed the importance of the price-cost margin as a determinant of advertising intensity. Their findings also suggested that being a cooperative actually had a positive estimated effect on advertising intensity; however, this result was only weakly

significant. They concluded that cooperatives tend to concentrate in commodity-oriented markets.

This conclusion was also consistent with previous research conducted by Rogers (1993) using data from 1982 for the 100 largest agricultural marketing cooperatives and the 20 largest food IOFs. He determined that agricultural cooperatives held their highest advertising shares in food products that had low value-added ratios, low product differentiation, were commodity-based, and had a high proportion of unbranded sales. Previous studies by Boynton using 1979 data (1982) and Combs and Marion using 1977 data (1984) found that cooperatives are low users of advertising.

#### **Structural Elements of Cooperatives That Impede Brand Building**

Cooperatives' tendency to concentrate in commodity-oriented markets and, hence, have limited branded market presence, can be attributed to their structural characteristics. The basic cooperative principles—user-benefit, user-financed, and user-control—create challenges for cooperatives seeking to build their brands. Cooperatives marketing branded products have to be especially resourceful in building their brand identities.

#### *The User-Benefit Principle*

Cooperatives operate for the benefit of their user-members. In many cases, producers belong to a cooperative to have a "home for their product." The resulting focus on processing and marketing member deliveries can cause a cooperative to have seasonal product availability and/or a limited product line. Year-round presence and a broad product line on grocery store shelves are necessary to maintain brand awareness among consumers. However, members of cooperatives have expressed disapproval when their cooperative sources nonmember product. Sunkist's Board approved a new marketing strategy which involved purchasing lemons and grapefruit from South Africa and Chile to leverage its well-known brand into Asian markets only after lengthy discussion and much resistance; members were concerned about competition from the imported fruit. To maintain its position as the citrus market leader, Sunkist needed to be a competitively priced, year-round supplier of a full line of citrus products (Smith 2004).

Cooperatives' net margins are distributed to their user-members primarily in proportion to their patronage rather than as a return to members' investment. This structural feature gives rise to the "horizon problem." Cooperatives engaged in brand building must make significant investments in product development and marketing, with corresponding reductions in member proceeds over several years. However, the patronage-based earnings structure enables new members to join the cooperative and reap the benefits of the investment without having contributed. Furthermore, members often compare their cooperative's returns with commercial prices for their commodity. Significant brand-building expenses can cause a cooperative's returns to be uncompetitive in the short term, causing losses in membership.

#### *The User-Financed Principle*

For many agricultural marketing cooperatives, member retains are the primary source of equity. Although investment in marketing is necessary to gain distribution on grocery store shelves and consumer awareness, their members are often reluctant to provide significant equity capital or build reserves for investing in their cooperative's marketing program. Part of their reluctance is attributable to the horizon problem discussed above. However, members also often face cash flow constraints that lead them to urge their board members to maximize cash patronage payments by minimizing member retains, which results in underinvestment in intangibles such as advertising and development of multiple distribution channels.

Ocean Spray was the leading cooperative advertiser in Gruber, Rogers, and Sexton's data set, although it ranked number 44 among all of the food companies in 1987. More recently, the cooperative suffered low returns for several years despite having a 54% market share as the number one brand in the unrefrigerated juice aisle (Aoki 2004). Soft drink giants Pepsi and Coca Cola have aggressively developed their strengths in the uncarbonated drink market with their acquisitions of the Tropicana, Minute Maid, and Gatorade brands, and now own nearly 75% of that market. In 2000, Ocean Spray lost its exclusive distribution agreement with Pepsi for its lucrative single-serve juices since 1992 when Pepsi purchased Tropicana and violated the no-compete clause. Ocean Spray no longer has a network to dis-

tribute its products in convenience stores, vending machines, and cafeterias—markets where growth opportunities are the greatest. Industry consultants have also pointed out that Ocean Spray does not have the financial resources to out-advertise its rivals (Aoki 2004).

#### *The User-Control Principle*

The third major principle that cooperatives operate under is user-control. The boards of agricultural marketing cooperatives are made up almost exclusively of producer-members; only 4% of the agricultural cooperatives responding to a 2003 USDA survey had outside directors (Reynolds 2004). The homogeneity of the boards of most agricultural cooperatives creates the "principal-agent problem," in which the principals (producer members) lack the business expertise to provide adequate control of their agent (management).

In a recent study regarding the failure of the Rice Growers Association of California, its board was found to be ill equipped to scrutinize the business decisions it was charged with overseeing (Keeling, 2004). In particular, producer board members usually lack the marketing expertise needed to provide effective oversight of their cooperatives' brand building strategy.

#### **Overcoming Structural Disadvantages**

Recent experiences of several cooperatives provide examples of how the structural disadvantages created by the cooperative principles can be overcome.

#### *The User-Benefit Principle*

The success of CROPP/Organic Valley illustrates how the user-benefit principle can be converted into a branding asset. The marketing cooperative was formed in 1988 with seven members in Wisconsin to market organic produce, but quickly shifted into dairy products. Its membership has grown to 665 producers in twenty states. It markets dairy, juice, eggs, and meat products under the Organic Valley brand; sales increased from \$15 million in 1998 to \$122 million in 2003 (Organic Valley 2004).

CROPP/Organic Valley differentiates itself by promoting its cooperative structure, identifying itself as "a cooperative of small organic family farms." Instead of relying on traditional mass-

marketing approaches, it uses "guerrilla marketing" to maximize its limited marketing funds. Its milk cartons profile local members and large storyboards featuring its members are displayed in grocery stores (Organic Valley 2004).

CROPP's strategy connects its member-producers with consumers who have moved from a price/product orientation to a value/experience orientation. In a national survey of 2,031 consumers conducted in 2003, 69% reported that they were more likely to purchase food produced by farmer-owned cooperatives than food produced by other types of companies. Additionally, 64% agreed that food produced by a farmer-owned cooperative was of better quality than food produced by other types of companies (National Cooperative Business Association 2003). The cooperative identity can provide an ideal positioning for cooperatives marketing certain foods, such as organic foods and grass-fed beef, to consumers concerned about food safety and environmental stewardship.

The difficulties in brand-building created by the user-benefit principle can be addressed by requiring members to own delivery rights. Delivery rights are a two-way contract obligating a member to deliver a specified amount of farm product to the cooperative as well as requiring the cooperative to accept the specified amount from the member. Delivery rights are marketable; their price fluctuates according to the cooperative's performance and earnings potential.

When the cooperative Dakota Growers Pasta Company was formed in 1993, its delivery rights were marketed at \$3.85 each to raise capital. During its second year of operation (1995), it produced about 100 million pounds of pasta under its Pasta Growers brand and generated a profit of \$ .46 per share. In 1999, its delivery rights were selling for \$10 each (Kotov 2000). The delivery rights appreciated in value to reward founding members for their risk taking, even though the cooperative sold additional delivery rights to double its processing capacity.

Marketable delivery rights can remedy the horizon problem created by the user-benefit principle. They raise capital for investing in brand building and they restrict the benefits of the brand building to the users of the cooperative who hold them. Delivery rights can generate a current return to members through the cooperative's higher earnings for its branded products, as well as a long-term return from the appreciation in their value.

### *The User-Financed Principle*

Cooperatives can overcome the capital constraints associated with the user-financed principle. Joint ventures are often effective in extending limited financial resources. Naturipe, the oldest and largest strawberry marketing cooperative in the U.S., expanded its market access by joining forces with Global Berry Farms, LLC (GBF). GBF's other partners are MBG/Michigan Blueberry Growers Association (another cooperative), and Hortifrut (a privately held company based in Chile). GBF is reshaping the berry category by marketing strawberries, blueberries, raspberries, and blackberries year-round under the Naturipe brand. By marketing 100% of their production through GBF, Naturipe's members have a more secure and broader customer base.

Although DFA acquired the Borden brand, its primary strategy with value-added products is to participate in joint ventures. Given the highly competitive nature of the U.S. dairy industry, DFA strategically selected 13 joint-venture partners who can profitably manage plants across the nation while DFA supplies the milk. For example, it manufactures and packages Frappuccino for the North American Coffee Partnership and a full range of cheese and salsa dips for Frito-Lay. While such joint ventures do not provide DFA with the returns possible from developing brands on its own, they do ensure long-term, reliable access to markets for members' raw products—with considerably less investment in brand development.

A joint venture was the motivation for the Wyoming Processing Cooperative Statute, which was passed in 2001 to facilitate equity-capital formation in cooperatives. Mountain States Lamb and Wool Cooperative spearheaded the reform because its producers lacked sufficient capital to purchase a 50% interest in B. Rosen & Sons, a lamb-products processor and marketer. The new statute enabled Mountain States to be considered a cooperative while being organized similar to a Limited Liability Company with favorable passthrough taxation (Hanson 2002). Mountain States has two classes of members: patron members, who have rights and obligations of delivery of lamb to the cooperative; and nonpatron members, who are strictly investment members. The lamb is marketed under the brand developed by Rosen, Cedar Springs.

Preferred stock is also a potential financing

source for large cooperatives. CHS, Inc., the largest agricultural cooperative in the U.S. and a Fortune 500 company, completed an \$86-million offering in January, 2003 of Perpetual Preferred Stock, which is now traded on the NASDAQ. CHS is striving to increase the earnings share from its processed-food business from 25% to 50%, although its members have stated that redemption of their retains are too slow. In January, 2004, CHS distributed an additional \$13 million of preferred stock to its members instead of redeeming their equity retains with cash payments; its members can choose to hold the stock or sell it (Garrison-Sprenger 2004). Thus preferred stock offerings, along with joint ventures and legislative reforms to allow investment by nonproducers in cooperatives, can be used to relax the constraints created by the user-financed principle on cooperatives building their brand.

#### *The User-Control Principle*

As previously noted, the homogeneous composition of agricultural marketing cooperatives can create significant governance challenges. The cooperative National Grape supplies grapes to Welch's, its wholly owned processing and marketing subsidiary, and uses a dual-board structure. The thirteen producer members on National Grape's board elect Welch's board, which consists of four National Grape directors, two executive officers of Welch's, and four outside professionals. This dual-board structure enables Welch's to focus on product development, manufacturing, marketing, and sales of packaged goods (Amanor-Boadu et al. 2003).

Joint ventures can also alleviate the governance problems attributable to the user-control principle. CHS structured subsidiaries for its numerous joint ventures with IOFs. No producer members sit on the boards of these subsidiaries; the boards consist of CHS's management and the executive officers of its joint venture partners. The board of the Global Berry Farms joint venture has a similar composition, along with a public member. Such board members have considerably more expertise in marketing branded products than producer-members.

#### **Conclusions**

Cooperative principles create obstacles to cooperatives' brand-building efforts, but they can be overcome. Several cooperatives, including Na-

tional Grape, DFA, and CROPP/Organic Valley, have used nontraditional structures to develop, or to have access to, strong brands for their cooperatives. Additional research is warranted to identify alternative approaches used by cooperatives abroad, particularly in Europe and Australia, where cooperative brands are relatively strong. As the U.S. food industry becomes increasingly consolidated, it becomes critical for agricultural marketing cooperatives to reassess their competitive strategy to ensure that they are positioned to compete effectively in the future.

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