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Impact of the Farmland Bankruptcy on Oklahoma Cooperatives

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Motivation

Farmland Industries, a federation of 1,700 independent farm cooperatives, filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code on May 31, 2002. Oklahoma cooperatives, the subject of this study, held approximately \$46 million in Farmland stock that was ultimately declared to be valueless. Some of the Farmland stock balances held by Oklahoma cooperatives stemmed from Farmland's acquisition of Union Equity, an Oklahoma based regional cooperative, in the early 90s. Because of this converted regional equity, Farmland stock represented a higher proportion of local Oklahoma cooperative's total assets relative to cooperative in other states. The Farmland bankruptcy left Oklahoma's cooperatives with a major decision of loss allocation. In addition, the local cooperatives lost access to services and business partnerships. The Farmland bankruptcy also negatively impacted the local cooperative's image and left the board and management with significant member communication challenges. This study investigates how Oklahoma cooperatives responded to the Farmland bankruptcy.

Background

The federated cooperative structure has come under recent scrutiny. Recent studies have questioned the future need of regional cooperatives with the expansion in size of local cooperatives through mergers. At one time, when the transport of supplies was limited and local cooperatives were small and isolated. Regional cooperatives were developed to fill the needs of locals as they could centralize purchasing and distribution for locals, provide an infrastructure for supply transport and marketing, lobby, provide

financing and risk management services, as well as employee training and benefit systems (Hogeland). Today, many local cooperatives are large enough to provide many of these services themselves. This essentially reduces the regional to a pure supplier of inputs.

Hogeland (2002) noted that the relationship between local cooperatives and regional cooperatives was changing from a standard service model to a more specialized model. The author observed that the local cooperatives are increasingly viewing their regional cooperatives as being another service provider rather than an integrated system. In response regional cooperatives have begun to specialize toward their comparative advantages. Zeluli (2003) provided similar observations on the need for regional cooperatives, pointing out that some local cooperatives are as large as regionals were in the late 1950's.

Regardless of its long-term future, the historic federated cooperative system has created a financial link between the local and regional cooperatives. When regional cooperatives such as Farmland Industries experience losses, local cooperatives face decisions on how the loss will be allocated to their members. Alternatives include writing down member allocated equity, temporarily reducing unallocated reserves and offsetting the loss against future patronage or permanently offsetting the loss against unallocated reserves. The cooperative can also use a combination of these strategies. Each of these options has different tax implications and financial implications for both the cooperative and their members (Barton 2003). Cooperative members who did business in past years tend to bear the impact of the loss when the cooperative reduces

allocated equity. Future patrons, and members anticipating equity redemption tend to be impacted when the cooperative reduces unallocated reserves.

Objectives and Methods

In order to better understand the impact of the Farmland Bankruptcy and how Oklahoma cooperatives responded to the challenges associated with the bankruptcy a survey addressing these issues was distributed to Oklahoma cooperative managers. The survey elicited information about past reliance on Farmland, financial impact of the farmland loss, the cooperative's decision on loss allocation, impact of the bankruptcy on member attitude, image and competitiveness and replacement sources of technical assistance.

Data

At the time of the Farmland bankruptcy, 71 local cooperatives operated in Oklahoma. Of those cooperatives 63 held a significant amount of Farmland equity (>\$20,000). The other eight cooperatives were either very small or had no investment in Farmland. This survey was distributed to these 63 cooperatives, and 34 completed surveys were returned giving a 54% response rate. The respondents represented 71% (25 out of 35) of the subset of cooperatives that held more than \$500,000 in Farmland stock. The survey elicited information from the cooperative managers about their plans for allocating the Farmland stock loss, their past reliance on the services of Farmland, current relationship with regional cooperatives and other agribusiness firms and reaction of their members to the Farmland situation.

Financial Impact

The responding cooperatives reported an average loss of \$915,000 resulting from the elimination of Farmland stock from their balance sheets. On average Farmland stock represented 74% of the total \$41.8 million in allocated equity of the cooperatives.

Seventy-four percent of the managers responding indicated that their cooperative had made a decision on loss allocation (Table 1). Among this group, 91% indicated that they planned on reducing the value of member stock. The average this reduction was 58% of the current stock value. Slightly over 5% of the managers who had reached a decision indicated that they would reduce unallocated reserves with the balance indicating a combination approach. The managers who indicated that they had not reached a decision on loss allocation were asked about their tentative decision (Table 2). Their reported tentative loss allocations were almost identical to the managers reporting final decisions.

Table 1: Loss Allocation Decisions by Oklahoma Cooperatives

| Percentage Respondents | Action | Average | Median | Mode |
|-------------------------------|---|----------------|---------------|-------------|
| 91.43% | Reducing Member Stock | 58% | 42% | 100% |
| 5.71% | Permanently Offset Unallocated Reserves | 100% | 100% | 100% |
| 2.86% | Other Action | N/A | N/A | N/A |

Table 2: Tentative Loss Allocation Decisions by Oklahoma Cooperatives

| Percentage Respondents | Action | Average | Median | Mode |
|-------------------------------|---|----------------|---------------|-------------|
| 94.29% | Reducing Member Stock | 71% | 67% | 100% |
| 5.71% | Permanently Offset Unallocated Reserves | 100% | 100% | 100% |
| 0% | Other Action | N/A | N/A | N/A |

Operational Impact

Despite this large balance sheet impact the majority of the responding managers did not indicate that the Farmland bankruptcy would impact their cooperative operations (Table 3). Thirty-five percent of the managers indicated that the Farmland bankruptcy might make a merger with another cooperative more likely. Only 23% indicated that it would make the cooperative more likely to delay the purchase of additional fixed assets with the same percentage indicated it had impacted their ability to meet member needs. Only 25 percent of the respondents indicated that the Farmland situation could impact their market share and less than 14% indicated that it could make the bankruptcy of their cooperative more likely.

Table 3: Manager Perceptions on the Financial Impacts of the Farmland Bankruptcy

| | Average | Median | Mode | High |
|---|----------------|---------------|-------------|-------------|
| The bankruptcy will make merger or consolidation with another cooperative: 1 “no more likely” – 5 “much more likely” | 1.69 | 1 | 1 | 4 |
| The bankruptcy will make the expansion of our trade territory: 1 “no more likely” – 5 “much more likely” | 1.37 | 1 | 1 | 4 |
| The bankruptcy will make the sale of assets: 1 “no more likely” – 5 “much more likely” | 1.37 | 1 | 1 | 5 |
| The bankruptcy will make the purchase of assets: 1 “no more likely” – 5 “much more likely” | 1.29 | 1 | 1 | 3 |
| The bankruptcy will make delaying the purchase of assets critical to our operation: 1 “no more likely” – 5 “much more likely” | 1.69 | 1 | 1 | 5 |
| The bankruptcy has led the cooperative to consider bankruptcy: 1 “no more likely” – 5 “much more likely” | 1.14 | 1 | 1 | 2 |
| The bankruptcy has affected your cooperative’s ability to meet members’ needs and offer favorable prices: 1 “very little” – 5 “very much” | 1.34 | 1 | 1 | 4 |
| The bankruptcy has impacted the local market share of your cooperative: 1 “very little” – 5 “very much” | 1.40 | 1 | 1 | 3 |

Customer Relations Issues

In contrast to their responses on financial impact the responding managers indicated that the Farmland situation did impact their cooperative image (Table 4). Eighty-six percent of the responding managers indicated the Farmland situation had hurt the image of their cooperative. Forty-six percent indicated it had made it more difficult to attract new members. The respondents also indicated that the Farmland situation had created difficulties with member relations. Ninety-one percent of the respondents indicated that farmers had a limited understanding of how the Farmland losses would impact their cooperative. Seventy-four percent indicated that it had increased member concerns over the future viability of their cooperative. Sixty-nine percent of the managers also indicated that the Farmland situation had negatively impacted the sense of unity among cooperatives. Two final questions explored how the responding managers rated the Farmland situation in comparison to other management challenges. Forty-nine percent of the managers rated the Farmland situation a moderate to extreme challenge. On average, the managers reported that they had dedicated 10% of their time to issues relating to the Farmland situation during the past year.

Table 4: Summary of Questions on Cooperative Concerns about Future Continuity, Image, and Competitiveness

| | Average | Median | Mode | High |
|--|---------|--------|------|------|
| To what extent has the bankruptcy increased your members' concern about the future viability of your cooperative: 1 "very little" – 5 "very much" | 2.46 | 3 | 3 | 5 |
| To what extent has the bankruptcy made it more difficult for your cooperative to attract new members: 1 "very little" – 5 "very much" | 1.71 | 1 | 1 | 4 |
| To what extent has the bankruptcy affected the sense of unity among cooperatives in Oklahoma: 1 "very little" – 5 "very much" | 2.40 | 3 | 3 | 5 |
| To what extent has the bankruptcy affected the image of cooperatives in the market place: 1 "very little" – 5 "very much" | 3.34 | 3 | 3 | 5 |
| How well do you think members understand how the Farmland bankruptcy and losses impacted their local cooperative: 1 "very little" – 5 "very much" | 2.11 | 2 | 2 | 4 |
| In comparison to other challenges your cooperative management has faced, how would you rate the Farmland bankruptcy: 1 "minor challenge" – 5 "major challenge" | 2.37 | 3 | 3 | 5 |
| What Percentage of your time do you feel you have spent resolving issue presented by the Farmland bankruptcy? | 10% | 5% | 10% | 90% |

Business Relationships

The services that Farmland provided have been split over time into various joint ventures with other regional cooperatives as well as non-cooperative firms. Joint ventures activities impacting local cooperatives includes Country Energy, ADM/ Farmland Inc., Land O' Lakes/ Farmland Feeds, and Agriliance. Country Energy was formed in 1998 between Cenex Harvest States (CHS) and Farmland, this LLC held the majority of the local cooperative fuel and petroleum business. CHS publicly announced it was going to buy Farmland's share of the LLC in 2001, and all fuel and petroleum business is now done under the CHS company name. ADM/Farmland Inc. was formed in April of 2001.

ADM leased and operated Farmland's grain facilities in the mid-west from Farmland.

The facilities were eventually acquired by ADM after the Farmland Bankruptcy. Land O' Lakes/ Farmland Feeds was formed in 2000 combining the feed operations of the two regional cooperatives. Land O' Lakes owned 92% of this venture which under Land O' Lakes control. Agriliance was farm input joint venture between Farmland, Cenex Harvest States and Land O' Lakes. Cenex Harvest States bought Farmland's ownership in the company on April 30, 2004 and the venture continues under Cenex Harvest States (50%) and Land O' Lakes (50%) ownership.

Survey questions elicited information about the local cooperatives past business relationships with Farmland and Farmland affiliated joint ventures and their on-going activities with the surviving ventures (Table 5). While Farmland's regional grain terminals represented their most visible presence in the state, Oklahoma cooperatives marketed less than a third of their grain through the Farmland/ADM venture. ADM's grain market further eroded after Farmland's demise. Survey respondents named such companies as Schouler, ConAgra, Peavey, Cargill, and direct selling to flour mills as their new source of companies to which they market their grain. The Land O'Lakes Farmland Feed venture also saw a decline in business share from 46% to 32% after the bankruptcy. Survey comments suggested that Oklahoma cooperatives had shifted to regional firms such as Evergreen Mills, Shawnee Mills, Stillwater Mill, Sunglo and Acco. The Farmland/CHS Country Energy joint venture demonstrated a different pattern having a strong market share (74%) prior to the bankruptcy and with cooperative managers indicating an increased share of business subsequent to the bankruptcy.

Table 5: Local Cooperative Business Relationships Prior to and After Farmland Bankruptcy

| | ADM/Farmland Grain | Country Energy | Land O'Lakes Farmland Feed |
|---------------------|--------------------|----------------|----------------------------|
| Prior to Bankruptcy | 31% | 74% | 46% |
| After Bankruptcy | 24% | 80% | 32% |

Business and Consulting Services

In addition to its farm supply and marketing functions, Farmland Industries was a source of consulting and business assistance services. Managers were also asked about their past use of consulting and business assistance services from Farmland Industries and how they were currently obtaining these services. Sixty-three percent indicated that Farmland personnel had assisted with feasibility and merger studies. Forty-four percent had used Farmland resources for assistance with strategic planning. Outside consultants appeared to be the most popular replacement for the business assistance services formally offered by Farmland with 63% of the respondents checking that option. Forty-six of the respondents indicated that university faculty and cooperative extension services were now providing the assistance and services formally provided by Farmland. Thirty-four percent of the responding managers indicated that they had called on other regional cooperatives. Other responses included internal employees (22%) and industry organizations (11%).

Overall Impacts

Managers were also asked ““In the long term, how do you feel the Farmland Industries bankruptcy will affect the overall performance of the cooperative you manage?” As Table 6 indicates, the respondents signified that they were largely unconcerned with the long-

term negative impact, with 8.57% choosing “there will be a large negative long term impact in our cooperative.” The largest number of respondents, 52%, felt that “there will be little long term impact in our cooperative.” And the final 37% of respondents felt that “there will be no long term impact.” One respondent actually wrote in below that line that there would be a positive long-term impact. The final two questions on the survey were open-ended questions asking managers to describe the changes the cooperative “has made or will make to address the challenges associated with the Farmland bankruptcy,” and what they feel was the “greatest challenge faced by the cooperative in dealing with the Farmland bankruptcy”. The overwhelming response to the first question was that cooperatives will never again rely on a single supplier for all of their needs. Instead they will take competitive bids and treat the patronage from regionals as a bonus rather than a deciding factor. Managers indicated that the greatest challenge associated with the bankruptcy was explaining the equity write down to their members.

Table 6: Managers Perception of Long Term Impact

| No Long Term Impact | Little Long Term Impact | Large Negative Long Term Impact |
|------------------------|----------------------------|------------------------------------|
| 37.14% | 51.43% | 8.57% |

Summary and Conclusions

The bankruptcy of Farmland Industry had a large impact on the balance sheets of Oklahoma cooperatives with the stock represented over 70% of allocated equities. At the time of the survey, the vast majority of managers had allocated or planed to allocate the Farmland loss to their members by reducing (writing down) the value of member stock with an average write-down percentage of 58%. Despite the large balance sheet impact managers did not indicate that the Farmland situation had a major impact on their financial viability or ability to meet their members needs. The major impact reported by the managers was the damage to the cooperative image, ability to attract new members, and other member relations issues. With the exception of petroleum sales, Oklahoma cooperatives did not have a particularly strong business relationship with Farmland entities prior to the bankruptcy and managers indicated lower volumes subsequent to the Farmland dissolution. Most cooperative managers did make use of Farmland's business consulting services. Other outside consultants, university faculty and personnel from other regional cooperatives are the most popular replacements for these services.

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