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Cooperative Innovation: The Case of Team Marketing Alliance, LLC

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Abstract

With rising volatility in agriculture, farmers increasingly need to manage volatility and elevated risk. This case illustrates the experience of four Kansas cooperatives that combined their efforts to develop risk management services for their members through a jointly owned LLC, Team Marketing Alliance (TMA). TMA's unique approach to risk management helps producers mitigate output price risk, lock in input purchases and ensure revenue coverage through crop insurance. This case can be successfully used in undergraduate and graduate courses, and in extension seminars focused on agribusiness strategy, risk management, and farmer cooperatives.

Keywords: Farmer cooperatives, risk management, agribusiness strategy

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IFAMA Agribusiness Case 17.1 B

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Cooperative Innovation: The Case of Team Marketing Alliance, LLC

We used to do our own grain marketing, but with the amount of volatility today, it just became a task that took a lot of supervision. TMA is able to fill our need for a risk manager that is constantly informed on current market development, future outlook, and, most importantly, is a partner we trust.

-Kansas grain farmer, customer of Team Marketing Alliance, LLC

Introduction

Volatility in agricultural commodity markets has surged. Before 2008, commodity price movements were fairly calm. However since 2008, commodity prices have swung to historically high levels and have also experienced sharp drops—all of which has occurred in a short amount of time. These steep changes were especially acute in 2008, when the price of corn shot up from \$5 to nearly \$8 per bushel in June, and then plummeted to below \$4 per bushel by December, 2008. Many other steep price swings in other commodities and crop inputs were also experienced, which were largely driven by anticipated changes in carry-over stocks due to supply and demand shocks tied to extreme weather events and the U.S. and global economic and financial crisis.

Volatility persists in commodity markets and is not likely to go away anytime soon because of numerous developments including the globalization of the agri-food system, exceptionally low interest rates and extreme weather events. As a result, farmers must continue to manage this volatility. But, do they have the tools and knowledge necessary to do so?

Risk analysis and risk management are now receiving growing attention from participants at every stage of the agri-food supply chain. This is particularly true for farmers of various sizes who now must add yet another skill to their repertoire—risk management. While certainly some farmers have an excellent grasp of how to manage their operation's risk, there are likely plenty who need help in this area of rising importance.

Some farmer cooperatives have recognized the rising demand for these risk management services. The ability of cooperatives to mitigate farmers' risks becomes an increasingly important aspect of their overall value proposition to their farmer-owners. Consequently, progressive cooperatives are in continuous search for new and unique ways to assist producers in decision making through offering beneficial tools and services in risk analysis and risk management.

This case study illustrates the experience of a group of Kansas cooperatives who joined their efforts in developing risk management tools and services for their members through a company they wholly own together, Team Marketing Alliance, LLC (TMA). TMA helps farmer-members mitigate output price risk, lock in input purchases and ensure revenue coverage through crop insurance.

The primary objectives of this case study are: i) to discuss the evolution of TMA from creation to its current status today, ii) to examine the benefits to farmers and to the four co-ops that wholly own TMA, and iii) to identify and discuss strategic issues facing TMA. The case is based on the information from interviews and personal interactions with TMA management, farmer-members of cooperatives as well as TMA reports and presentations.

Background and Overview of TMA

In the mid-1990s managers of four cooperatives in central Kansas joined around the concept of centralized grain marketing for gaining efficiencies through economies of scope and scale. At the start, the cooperatives found that the concept of marketing grain as a team proved beneficial to partner co-ops. Through sharing labor and knowledge in working together, these cooperatives enjoyed increased selling power, operational efficiencies, diversification of territory, increased patron opportunities due to larger size, risk management programs, and patronage. With the success and growth of this concept, a separate company, wholly owned by the four cooperatives, was formed called Team Marketing Alliance, LLC (TMA). This structure has been commonly referred to as a “marketing agency-in-common” (Reynolds 1994).

For these cooperatives, TMA is exclusively utilized as a consolidated grain marketing division for these four local cooperatives handling all merchandising, logistics, accounting and e-commerce through its office. Today, TMA is wholly owned by four central Kansas cooperatives: Farmers Cooperative Elevator Co, Halstead, KS., Cooperative Grain and Supply, Hillsboro, KS., Mid-Kansas Cooperative (majority owner), Moundridge, KS., and Farmers Cooperative, Nickerson, KS. Together, these cooperatives own 52 country elevator facilities for the handling of bulk grain and one ethanol plant. Farm-marketing programs are initiated by a team of origination specialists on TMA’s staff who all strive to fulfill TMA’s mission statement: *"To provide a grain marketing service that links the Producer to the End User giving the greatest value to both parties."*

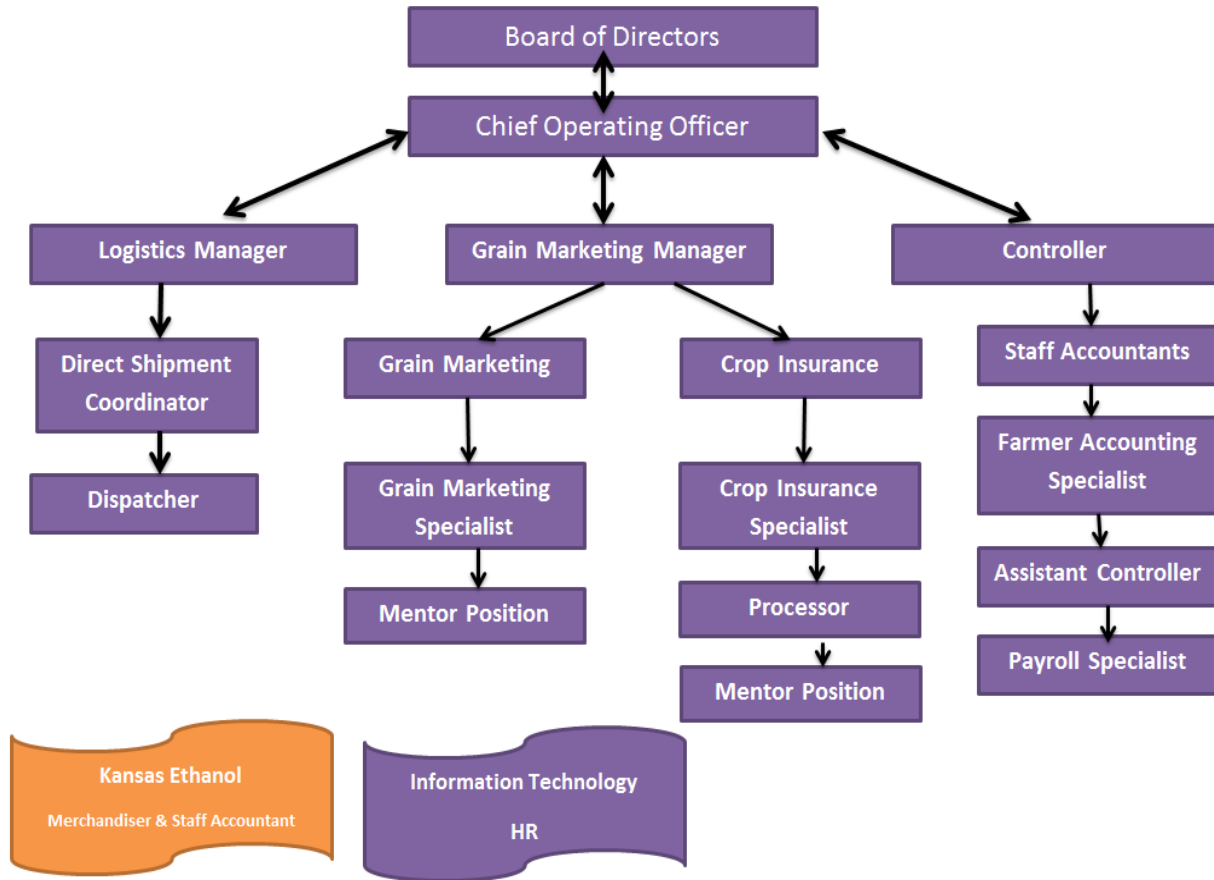
All profits earned by TMA during the year are passed back to the four local cooperatives at year-end on the basis of use. During the year, a put thru charge is paid to each elevator for bushels handled along with storage. These profits are then distributed back to the cooperative patron-members per each cooperative’s patronage allocation and equity redemption program.

The long-run strategic direction for TMA is set by its Board of Directors (Exhibit 1). There are four board members who are the CEOs of the local cooperatives that own TMA. In addition, there are four associate board member who are assigned from each cooperative's Board of Directors. Even though Mid-Kansas Cooperative is the majority owner of TMA, the CEO of Mid-Kansas Cooperative cannot unilaterally decide TMA’s future growth or strategic direction. On all voting issues, the majority owner must have the support of at least one minority owner vote. Conversely, the minority owners cannot vote together against the majority owner.

Below the Board of Directors, are TMA’s 20 employees which include: a Chief Operating Officer, a grain marketing manager, four grain marketing specialists, four crop Insurance specialists, a crop insurance processor, a person in charge of logistics and transportation, six support and accounting staff, and two TMA employees at Kansas Ethanol. Responsibilities and

activities of employees include: marketing and hedging of grain inventories, providing warehouse licensing for elevators, providing financing for grain receivables and inventories, providing uniform patron grain contracts and programs, arranging logistics and transportation for local elevators, overseeing training for grain grading and customer programs, providing grain origination assistance and programs, and maintaining separate accounting and financial statements.

Exhibit 1. TMA Organizational Chart

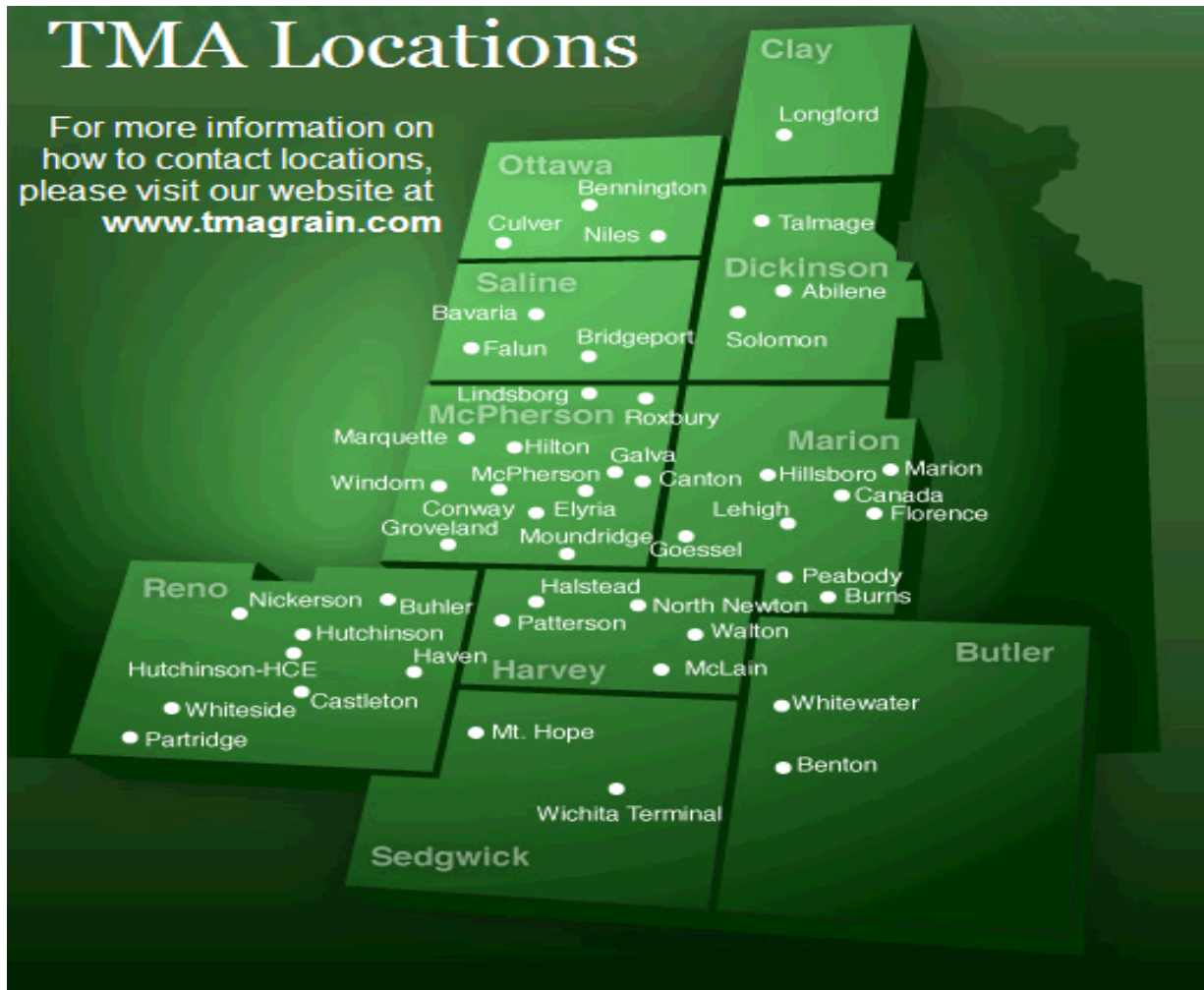


The geographic footprint of TMA covers ten counties in central Kansas (Exhibit 2). In 2012 TMA insured over 260,000 acres, received gross crop insurance premiums of 10 million dollars, and contracted over 9 million bushels of fee based contracts. TMA’s warehouse licensing and close relationships with farmers in central Kansas allow them to manage the inbound logistics of grain origination effectively.

While TMA has done a fair job managing outbound logistics, their expanding geographic footprint has put pressure on TMA’s ability to manage these logistics effectively and efficiently. The primary reason is because TMA relies solely on trucking as a means of transporting grain. In addition to the logistical challenges of coordinating over one hundred truck fleet, the reliance

on truck transportation limited TMA's marketing options. To address this problem, one of TMA's owners, Mid-Kansas Cooperative, has partnered with CHS Inc. to provide the equity capital to build and operate a high-speed shuttle loading facility which upon completion will load 110-car trains bound for export facilities. This facility will be operated as its own LLC, and this newly created LLC will become the fifth member of TMA.

Exhibit 2. TMA Locations

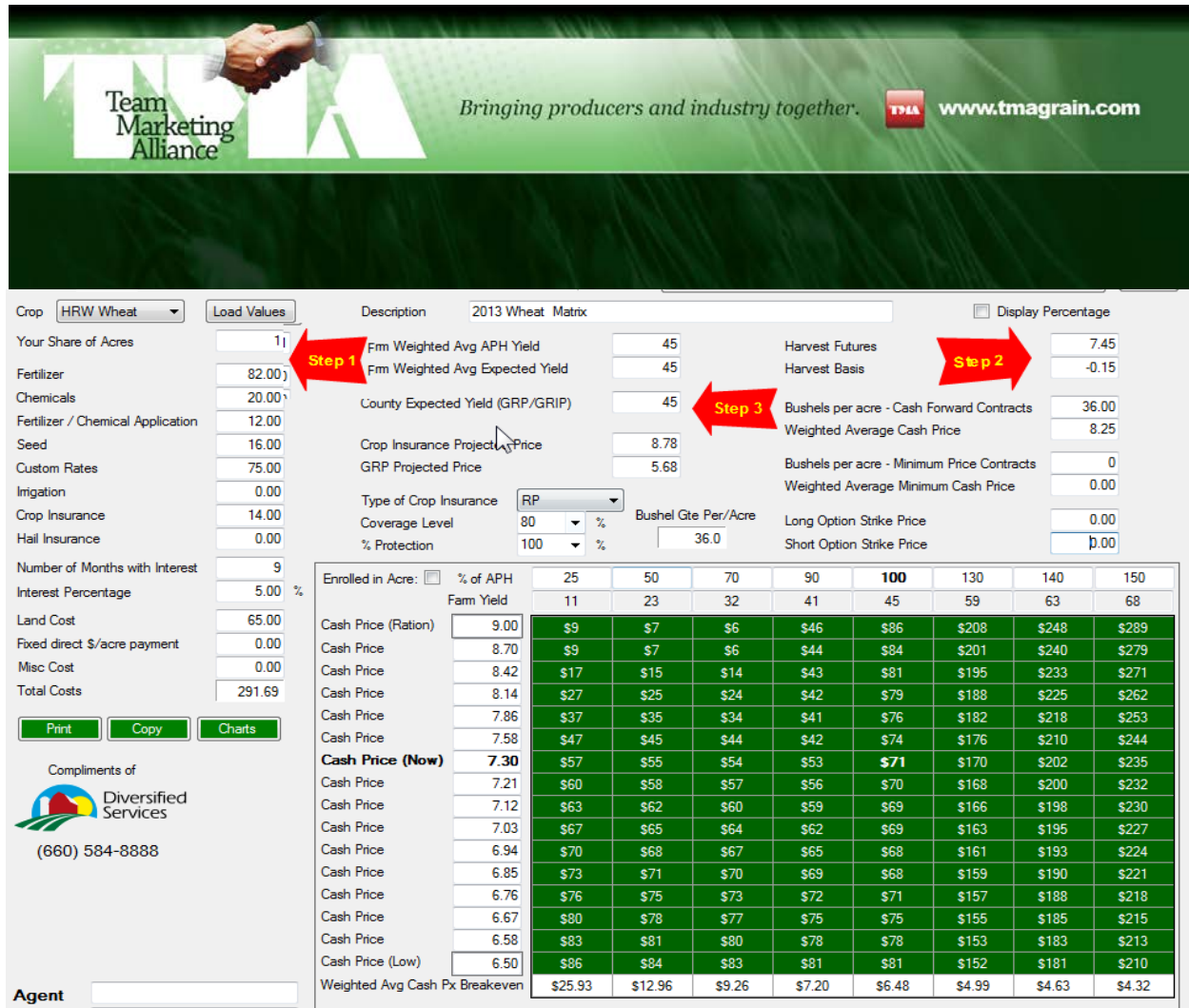


TMA's Approach to Creating Value in a Turbulent Time

TMA creates value for their member-farmers through a unique risk management tool. With heightened volatility in the agricultural marketplace, farmers need ways to manage many types of risks. TMA's unique approach to risk management helps farmers' control their production risks by locking profits. More specifically, the value proposition for farmers is through a profit based, risk management approach that can utilize contracts to lock in (1) input purchases; (2) grain sales; and (3) crop insurance.

The best way to illustrate TMA’s approach to risk management is through their profit matrix. An advantage of the profit matrix is that it is a straightforward way to show a producer what type of profit per acre they can lock in based on their input, grain and crop insurance decisions. While different types of crops can be shown in the profit matrix, for explanation purposes a hypothetical wheat farm profit matrix is used (Exhibit 3).

Exhibit 3. Screenshot of TMA’s Profit Matrix



The profit matrix has two axis of information that determine the realized profit per acre, which is reported in the middle of the matrix. The vertical axis shows various cash price levels. Across the top horizontal axis are varying levels of farm yields. In addition, the farm yield as a percentage of the farm’s APH (actual production history) is shown at the top (so in the case of this hypothetical farm, 45 bushels per acre of wheat is 100% of the farm’s APH). Finally, because the

farmer's cost is known, the cash price needed to breakeven can be presented along the bottom row. For example, at 68 bushels per acre, the farmer needs a wheat price of \$4.32 to breakeven. The breakeven prices along with the profits per acre reported in the matrix are all dependent upon the specific profit based decisions made by a farmer. These decisions create a tailored profit matrix for a farmer. Of course, there are many different decisions that could be made that would result in very different profit per acre figures. To keep things tractable for the purposes of this case study, the hypothetical wheat farmer is used again. So, the illustrated example (Exhibit 3) reflects three key decisions: (1) reporting and locking in input costs; (2) locking in revenues through grain contracts; and (3) minimum revenues from production through crop insurance.

The first decision pertains to input costs and purchase commitments. Step 1 pertains to the upper left-hand corner of the illustrated example (Exhibit 3) which shows the cost per acre figures that a farmer must provide from their own records. In addition, the farmer may be able to lock-in input prices and input quantities purchased through contracts with their local grain, oilseed and farm supply cooperative. For example, Mid-Kansas Cooperative offers 12-month fertilizer contracts to their farmer-members, which allows their farmer-members to lock in fertilizer prices. With regards to the other input costs, all of the price risks are assumed to be incurred by the farmer.

After entering their input cost information, next is to market their grain. Step 2, in the upper right hand section of the example (Exhibit 3) shows multiple ways in which farmers can market their grain through TMA. These options include hedging, using the options market, minimum price contracts or forward contracts. One advantage for farmers using futures to hedge or lock in grain prices is that the farmer does not pay for any margin calls as TMA handles all margin calls.

The final and third step is to determine their crop insurance coverage. Numerous crop insurance options, such as crop revenue coverage to multiple production insurance policy to catastrophic risk protection, are available to the farmer. It is up to the farmer to decide how much they are willing to spend for the insurance, and how much coverage and protection that they need. In Exhibit 3, the hypothetical wheat farmer's APH is 45 bushels per acre and the wheat farmer decides to purchase an 80 percent revenue protection policy, which insures 36 bushels per acre. With this amount of the wheat crop insured, 36 bushels per acre is also the amount of grain that a farmer would market in Step 2.

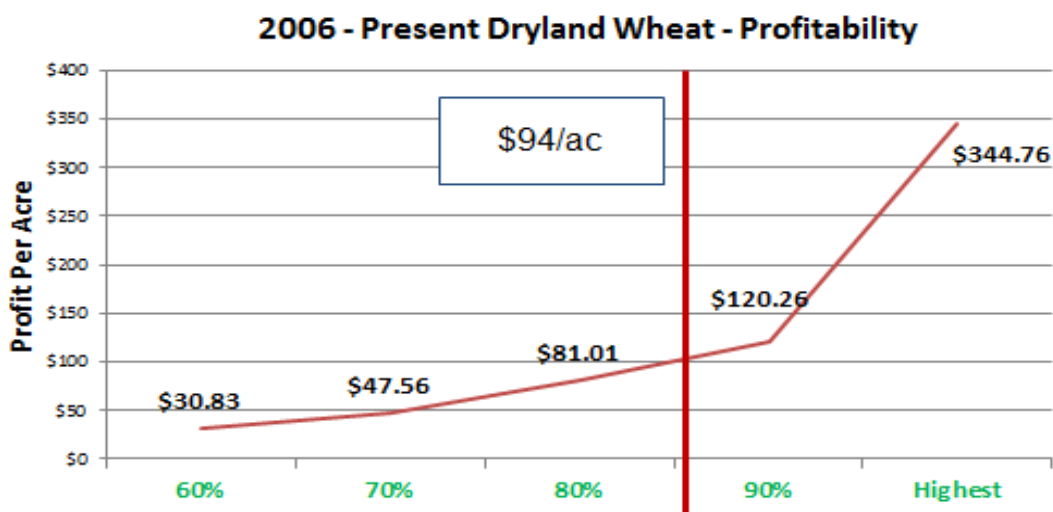
Following all of these steps helps the farmer realize the value of TMA's profit based risk management approach. Being able to lock in profits is clearly valuable in today's volatile times, but there is another advantage of TMA's risk management approach. Producers have to process a lot of information when making farm level decisions and the profit matrix allows producers, along with TMA's guidance, to coherently synthesize this information and make the most profitable decisions possible. Ultimately, this value is illustrated in the profit matrix because it synthesizes all of these decisions in a profit per acre number.

These profits per acre numbers vary because of the impact of varying yields and prices. For example, in the illustrated example (Exhibit 3), if the hypothetical wheat farmer produced their APH of 45 bushels per acre and the cash price at harvest ended up being the current cash price of \$7.30 per bushel, then the realized profit per acre would equal \$71. Now, holding yields

constant, if cash prices were to rise, then profits per acre would rise. Conversely, if cash prices were to fall, profits per acre would fall to a minimum of \$68 per acre at a price of \$6.85 per bushel. Below that per bushel price, crop insurance payments would flow to the farmer and actually raise their profits.

Knowing where profits could potentially fall is valuable, but having information on the likelihood of these profits per acre numbers would also be valuable. To provide this additional information to the farmer, TMA tracks and shares historical profits so that producers can see where current profits are relative to the past. To make it more tractable for a producer, this historical information is shown in a graph that illustrates the probability of a particular profit per acre opportunity (Exhibit 4). For example, if a hypothetical wheat farmer had the opportunity to lock in \$94 per acre of profit, there would be about a 15 percent chance that profits may go higher. In effect, this figure is a cumulative distribution function or CDF graph. Using this historical information and figure is another way TMA provides value to their producers.

Exhibit 4. Cumulative Distribution Function (CDF) Graph of Historical Profits: Dryland Wheat Example



Other cooperatives do provide similar risk management services to their farmer-owners. Examples of cooperatives helping their members through unique programs include Key Cooperative in Iowa with their AgroMetrix program and Harvest Land Cooperative in Minnesota who link crop input purchasing decisions with grain marketing decisions. While these as well as other cooperatives approach to risk management is different than TMA, the motivation is still the same, providing valuable information to farmers.

Value Proposition for Producers of Varying Size¹

Approximately 40 to 50 percent of TMA's current customer base utilizes some aspects of its risk management approach. The proportion of customers utilizing all three steps to lock in profit per acre is ranging between 10 to 15 percent. Approximately 85 percent of current customers utilize TMA's marketing services including new crop Hedge-to-Arrive (HTA) contracts, cash grain contracts, options, and various over-the-counter contracts.

While there are many value propositions TMA brings to producers, there are also some important realized value differences for producers. Namely, producers of differing sizes do receive and perceive a set of different values. For purposes here, producers are segmented by total number of acres tied to TMA's risk management approach of purchasing inputs, selling grain and purchasing crop insurance. In particular, medium to large sized producers (1,000 acres to 5,000 acres) and very large producers (5,000 acres or more) can extract similar values as discussed above as well as some different benefits. Namely, medium to large sized producers primarily gain value from TMA's ability to absorb margin calls and marketing knowledge. Out of top 200 accounts, 70 percent use TMA's grain marketing services. Very large producers could easily hire their own risk management employee, but utilizing TMA's expertise effectively puts a risk management employee, and even full staff, on the farm without all of the human resource issues that are associated with managing an employee and/or staff. Finally, all producers gain from economies of scale in the purchasing and selling of products as well as TMA's exceptional customer service.

The medium-to-large size farm operators clearly state they receive value from TMA's ability to absorb financing costs as well as their marketing knowledge. One medium-to-large size farm operator stated, "Having to pay for margin calls with my own funds has somewhat been a deterrent for me implementing my own hedging strategy. However, with TMA as a partner, they are willing to cover those margin calls for me because it will ultimately benefit my farm's profitability." The farmer also stated that TMA being much larger than his farm in terms of grain available to market helps lower the interest rate of using debt to finance these margin calls.

Another medium-to-large size farm operator and a new member of TMA stated that marketing knowledge was what attracted him to TMA. "Working with a TMA field marketer at my kitchen table is what sold me on using TMA's risk management services. Their knowledge and profit matrix tool clearly shows the value risk management can bring to my operation." The farmer also stated that while he has a personal relationship with one TMA field marketer, he knows that the entire staff of TMA share insights and discuss agricultural market developments. "In many ways, working with TMA is like employing a risk management division for my farm," stated this new customer of TMA.

In fact, having access to a "risk management division" is an advantage for very large farmers, too. While very large farmers might have the scale and resources to hire their own risk managers,

¹ Within the scope of this case the value to farmers is assessed based on perceptions of farmers who use TMA services. The financial information of TMA clients is not publicly available.

some have stated they will not when they could use TMA's risk management expertise. One very large farmer, which is also a fairly new customer, stated, "We used to do our own grain marketing, but with the amount of volatility today, it just became a task that took a lot of supervision. TMA is able to fill our need for a risk manager that is constantly informed on current market development, future outlook, and, most importantly, is a partner we trust." In many ways, this very large farmer feels that TMA is like a person on his farm's payroll, but with less work to manage.

Finally, two benefits were noted by all farmers regardless of size. First was TMA's holistic approach to risk management. That is, the approach of coupling the grain marketing, insurance and input purchase decision together really helps mitigate market volatility and locks in profits. The second benefit is TMA's commitment to exceptional customer service. One farmer stated, "TMA goes above and beyond the call of duty because that will ensure their future just as much as it will ensure mine. Bottom line, they need me just as much as I need them."

Challenges and Forward Looking Strategic Issues

Through its progressive and comprehensive producer risk management programs, TMA was able to enhance the value to the members of four partner cooperatives. With elevated volatility in agricultural marketplace, risk management services are much needed and demanded by producers. TMA's unique approach to locking in profits combined with exceptional one-on-one client service helped the company to develop a strong relationship with farmers. The company is known widely throughout central Kansas and is well respected for the value it offers to its clients.

While TMA has enjoyed much business success to this point, there are a number of strategic issues that they must address. Below are a set of strategic issues that have been identified:

Strategic Issue #1:

In central Kansas, TMA was the first to employ a profit based risk management approach for their farmers. The question then becomes: how to leverage the momentum from the first-mover advantage, gained through the profit matrix approach to risk management, and to develop long-term sustainable competitive advantage?

Strategic Issue #2:

While TMA is not a cooperative, they operate on a cooperative basis because they are wholly owned by four cooperatives. So, how will TMA continue to grow but maintain the benefits of cooperative structure?

Strategic Issue #3:

There is a growing number of younger more business minded farmers who are characterized as being well-educated and willing to adopt new technology and risk management practices. How

will TMA extend the value proposition to make it appealing to new demographic of farmers while continuing to serve the needs of traditional clients?

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