Strategic Commentary from The Hale Group, Ltd.

Strategic Initiatives

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Discover.

Analyze.

Strategize.

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Success Factors for Farmer Cooperatives

An Interview with Douglas D. Sims, Chief Executive Officer of CoBank

Doug Sims joined CoBank as President and Chief Operating Officer in 1988 and assumed his current position as CEO in 1994. Prior to joining CoBank, Doug served as the President and Chief Operating Officer of the Farm Credit Bank of St. Louis.

Bob: Doug, what are the characteristics of highly successful farmer cooperatives that set them apart from those that aren't as successful?

Doug: It comes down to several key factors, but one of the most fundamental is a positive working relationship between the Board of Directors and the management team. It concerns me greatly when the Board of Directors wants to separate themselves from management or management wants to separate themselves from the board. My observation of publicly traded companies indicates that the CEO and his top team are all part of the larger team with the board. When you have that kind of teamwork in the boardroom, you'll find that these organizations are usually more successful.

Bob: How do you develop teamwork between the CEO and the board and yet preserve their distinctive roles and responsibilities?

Doug: When I became CEO of CoBank, we had a lengthy discussion about the role of the board and the role of the CEO. The CEO has to be so comfortable with that relationship that the board feels they →

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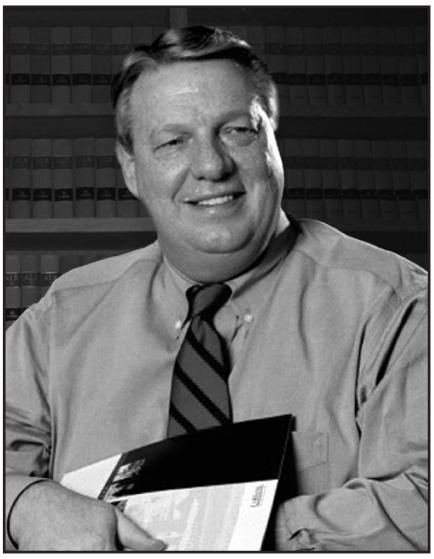
Doug Sims

can ask any question and probe any area from a strategy and policy point of view, but understands that the CEO's responsibility includes the operational and implementation side. And, I think that many cooperative boards and management do not have that discussion at the beginning of their relationship.

Bob: Have the principles that you hammered out twelve years ago when you became CEO remained in place even though you've had a significant turnover on your board?

Doug: In these twelve years, our board has turned over 100% and those principles have stuck for three reasons. First, we have a very well documented board operations manual that explains the different roles clearly and simply. Second, we have a director orientation program for all new directors coming onto the board where the chairman articulates these principles. Third, we refer to these principles whenever a board member or a staff member begins to wander into the province of the other.



Douglas D. Sims

Bob: If a cooperative has worked through this key issue, what else is critical to success?

Doug: Successful cooperatives are strategically focused. They have carefully defined what they are and what they aren't. They have a clear mission. They have a vision of what they will look like in three to five years. They know what they're trying to accomplish for their members. They have a value proposition that differentiates them from other businesses – not just other cooperatives, but also other businesses that they are competing with.

Bob: What distinguishes good strategic plans and bad strategic plans?

Doug: By a strategic plan, I'm not talking about a book; I'm talking about something that the new director or the new management team member can sit down and absorb in forty-five minutes. If somebody hands me a strategic plan in a 3-ring binder, it scares me to death. I contend that board members and employees can remember only about three to five things that will focus their efforts every day. The plan should describe the major initiatives the business will pursue to achieve its three- or five-year goals.

A critical component of strategic plans is financial benchmarks. Far too many businesses do not set financial standards for themselves. And, I'm not talking about comparing the cooperative to another cooperative. They must compare themselves to other businesses that compete in their same marketplace. If everybody in your industry has low leverage and you have high leverage, you can't compete in that environment.

Whenever I visit customers, I like to ask them how they measure success. I learn more from that answer than any other conversation I have. If they're wandering around in what I call "the soft stuff," I quickly realize they are not measuring themselves financially. If they're quick to talk about things like return on equity, return on assets, operating efficiency, leverage, patronage refunds in terms of a return on shareholders' equity, then I usually find a pretty successful organization.

Bob: What do you mean by the term "value proposition?"

Doug: First of all, the value proposition defines the core competencies and characteristics that set apart your business from others. How does your business differentiate itself from the company down the road, whether its a co-op or non-co-op? Every business must add value — first, to its members, but also, to its employees. If employees are not engaged, the members will not be engaged. Fully engaged employees create satisfied customers.

Bob: How do you measure satisfaction of customers – just through sales?

Doug: No. If customer dissatisfaction shows up in lower sales, it's too late. I'm going to use CoBank as an example. We use The Gallup Organization to

survey between 300 and 500 customers every year. We've done it for fourteen years. And, this isn't a questionnaire sent through the mail. This is a formally established interview with the person responsible for making the banking relationship decisions with the customer.

Bob: Do you track customer responses from year to year?

Doug: Absolutely. We've got trend analysis for fourteen years, and we know what drives it up and what makes it fall. When we first started to measure this, our ratings went up every year. But, then we got comfortable and it started to drop. It dropped because we were not being responsive in a timely way to problems that customers had. We made changes in the appropriate areas, and our customer ratings jumped right back up. And, Gallup can tell you what the difference is between satisfied customers, fully satisfied customers and loyal customers. And, customer satisfaction relates directly to profitability. Loyal customers are very profitable.

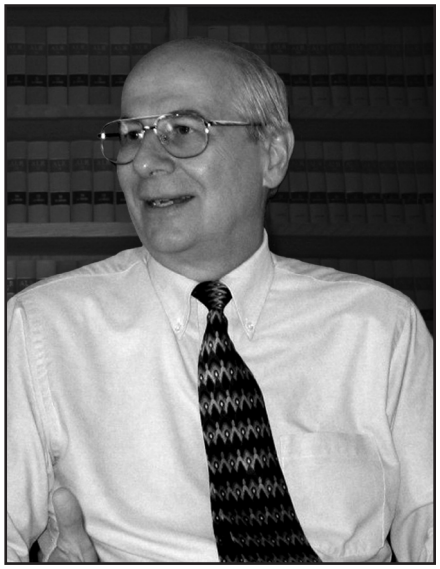
I'm a great believer of asking the questions that will help you understand how your customers view you. Too few business organizations of any kind ask that type of question.

Bob: So, Doug, how do you articulate the value proposition of CoBank?

Doug: Our focus is on rural businesses. We aren't trying to be a Bank of America or Citibank. Our focus is on the rural sector. It's about the focus, it's about responsiveness, it's about capacity, it's about dependability and its ownership. That's what makes us unique. We're focused on a very specific market. And, if we're not responsive and dependable to our customers, there's no need for us.

Bob: What's your response to concerns that farmer cooperatives are constrained in raising sufficient equity?

Doug: Some cooperatives are constrained in raising equity. However, the situation is not as clear-cut as you might suppose. Throughout my career, I've seldom seen a profitable, well run, financially disciplined business that couldn't attract capital when it needed it. One of CoBank's very successful customers has told me, "Doug, there would be absolutely no difficulty in my raising money to build a new facility. All I'd have to do is ask, and it would be there. And, that is because we have provided value to our shareholders in such a way that if equity were needed, they'd write a check."


Robert J. Ludwig

Now, I probably ought to qualify that generalization a bit. The co-ops that can do that most readily are those that have a pretty long track record of being a consistent, profitable business in which the shareholders have gained confidence over time. That does not always happen in some of the new startup co-ops, or in the highly capital-intensive, value-added food industries.

Bob: What are the differences between a successful cooperative and a successful publicly traded company?

Doug: One of the things that boards and managements have to get over, in my opinion, is that just because you're organized as a cooperative, doesn't mean you're different from any other business 364 days a year. The only difference is that on the 365th day, it's the farmers who get the profits.

Bob: Have cooperatives been reluctant to measure themselves by the same financial standards as other corporations?

Doug: I think they have, and it has a lot to do with the kind of skills you have on the Board of Directors. If you have skill sets that are used to looking at businesses in terms of their economic performance, they will demand this of the management team. If you have a management team that sets high standards for themselves, they want to be measured by →

commercial standards. But, if you are lacking in both of them, who is going to bring that to the table?

For each board I serve on, I insist that at least once every year or two we discuss, "What skill gaps do we have in this boardroom that we need to fill?" Then we look for those skills. Now, in some states, the co-op laws will not allow them to be on the board because they're not a member of the co-op. But, that doesn't mean the board can't bring consultants to the table and pay them on a retainer basis. However, if you use consultants, you can't waltz them into the boardroom on special occasions. They have to have a feel for the culture of the boardroom if they're going to be advisors to the board. And so, I contend the only thing that limits a co-op's ability to do that is its own willingness to do it.

Bob: In other settings, I've heard you talk about "patient capital." What do you mean by that?

Doug: That phrase comes from the treasurer of our bank, so I have to give him credit. Here's the concept. I contend cooperatives have an advantage over public and private firms because return on capital on a quarterly basis is an absolute must in order to continue to access capital for public corporations. Farmers will give the board and management of their co-ops more time as long as they have confidence that they're making the right decisions. I contend that's a healthier environment for a cooperative because you can think long term. You don't have to think short term.

People who invest in a cooperative are not investing to get a quick return on that investment, or necessarily capital gain. They're looking for something else. They're looking for access to markets. They're looking for information. They're looking for advice in their business. Certainly, they're looking for a successful business and a return, but contrast that with a public company where they're managed by share price on a quarterly basis. One of the advantages cooperatives have is that we can think long term. We don't have to think quarterly – our capital is more patient.

Bob: Is there a downside to patient capital?

Doug: Yes, definitely. Boards of Directors and top management can excuse poor performance and abuse the patience of co-op members.

Bob: How would you summarize the success factors for U.S. farmer cooperatives in the 21st Century?

Doug: My experience in lending to thousands of cooperatives over many years would suggest that the most critical factors are: a positive working relationship between the Board of Directors and top management, an appropriate mission, a clear vision, a focused strategy, a compelling value proposition, well-defined financial measurements, an objective measurement of customer satisfaction, a reasonable capital plan, and the right mix of skills in the boardroom. If your cooperative has those factors, I think you're well on your way to being a successful farmer-owned business – assuming you can execute.

About The Hale Group

The Hale Group is a consulting and advisory partner assisting companies develop fact-based strategies to contend with an evolving landscape. The underlying philosophy of the firm's efforts on behalf of its clients, and in collaboration with them, is to formulate strategies that enable clients to break through the market clutter and identify platforms for growth.

The Hale Group has developed proven processes and tools to help organizations gain perspective on the opportunities and challenges within an industry. The level of The Hale Group's participation can take many forms from addressing the overall process or an individual part of the process. However, in whatever capacity we participate, the desired outcome is for our clients to be successful.

Our products and services include:

- *Strategy*
- *Organizational Effectiveness*
- *Market Research*
- *Operating Efficiencies*
- *Opportunity Analysis*
- *Mergers & Acquisitions*

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