



South Dakota sheep in cell system (USDA photo)

Dakota Lamb Growers Cooperative

A Case Study

Prepared for the North Central Initiative for Small Farm Profitability

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Introduction

This case study is one of four in a series that are focused on so-called “new generation cooperatives,” or NGCs. While the first recognized NGC dates back to 1972, most were formed in the 1990s, and they continue to be formed today.

NGCs differ from traditional cooperatives in several ways. First, farmers invest significant dollars up front by purchasing shares in the business.

Second, each purchased share allows and obligates a producer to deliver a set quantity of raw product to the co-op.

Third, there are a limited number of shares, and in that sense the co-op is closed or limited to a set number of producers. This is intended to match incoming raw products to the capacity of the plant and the demand for the end product.

Finally, the ownership shares can be traded among farmers, and the price of those

shares may rise or fall, reflecting how much the farmers expect to benefit from their membership in the future.

Industry Profile

The U.S. sheep industry has experienced negative growth in inventories and revenues over the past several decades, and prices in recent years have been highly unstable. In 1974, there were 15.4 million head of sheep in the U.S. This number shrank to 6.7 million head as of January 1, 2002. Commercial production of lamb and mutton also continues to decline. Production of lamb and mutton was 217 million pounds in 2001, down 7 percent from 2000. (Jones, 2002)

Several factors are exacerbating recent declines—including increased imports and volatile prices that have been generally decreasing since 1997. The phase out of the National Wool Act (from 1993-1996)

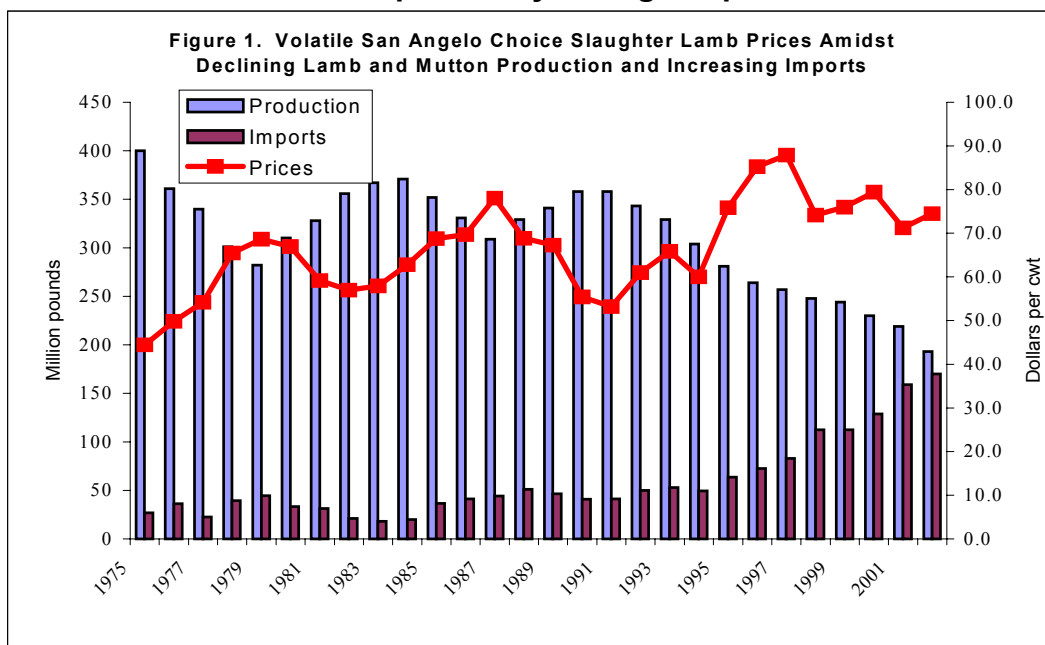
resulted in a loss of a guaranteed portion of income for sheep producers. Imports from Australia and New Zealand, which provide 98% of all U.S. lamb imports, have increased dramatically since 1994, partially due to the World Trade Organization (WTO) elimination of the tariff rate quota (TRQ) in November 2001 and the strong dollar. Food safety concerns related to scrapie (a degenerative neurological disease in sheep related to Bovine Spongiform Encephalopathy or BSE) may also be contributing to the lower consumer demand for lamb in the U.S. (Jones, 2002)

In attempts to stabilize the sheep industry, the USDA and the sheep industry launched a 3-year, \$100 million Lamb Industry Assistance Package in January 2000, which included four major elements: direct payments to producers, animal health, marketing and

promotion, and government purchase of lamb meat.

After the WTO decision to remove the TRQ on imports, the USDA’s Lamb Meat Adjustment Program was extended through July 31, 2003. This program allots \$42.7 million to boost the domestic sheep industry—the majority of which will be used for purchasing or retaining ewe lambs (\$26 million) and for

United States Sheep Industry/Foreign Imports Statistics



Sheep Industry Report to Congress/Economic Research Service/USDA, 2002

direct payments to producers for slaughter and feeder lambs (\$11.7 million). . (Jones, 2002)

Dakota Lamb Growers Cooperative

In 1995, the Valley Wool Growers Association, a group of small sheep farmers in east-central North Dakota, began to look into creating a producer-owned company to add value to their lamb operations. These farmers realized that they needed to shift to meat because their shearing costs were higher than what they could make for wool—partly due to the phase out of the Wool Act. With the help of Tim Petry from the North Dakota State University, these farmers secured a \$20,000 grant from the North Dakota Agriculture Products Utilization Commission (APUC) to fund a feasibility study on marketing lamb. The group also received about additional \$5000 from the Lake Agassiz Regional Council, the North Dakota Association of Rural Electric Cooperatives and local banks.

According to Petry, the North Dakota State University feasibility study indicated that capitalizing a slaughter/processing plant was not a good strategy given the small size of the group and their investments. Instead, the group decided to contract with Dakota Country Meats for custom processing of lamb. This partnership allowed Dakota Country Meats to expand their existing facility, and allowed the lamb producers to put their equity investment toward developing markets for their products. The group



Dakota Lamb Growers Cooperative Board of Directors (from left to right): Ole Erickson, Brent Stroh, George Hildebrant, David Merwin (CEO), Jim Ostlie (President), Jeff Strand (Vice President), John Davison (Sec/Treas.), Lvnn Stadheim.

officially incorporated as The Dakota Lamb Growers Cooperative (DLGC) in April 1999, located in Northwood, North Dakota.

In 1999, 126 lamb growers from North Dakota, Minnesota, South Dakota, and Montana each contributed \$100 seed money to the cooperative, which helped offset organizational costs and market research expenses.

Again, with the assistance of Petry, the group received an additional grant of \$58,000 from North Dakota APUC, which helped identify initial markets and do its first equity drive. In October-November, 2,000, the Cooperative recruited 104 members who purchased 7,880 shares of Equity Stock.

Membership in the co-op required a minimum investment of \$600 (\$100 in membership fees, plus a minimum purchase of 25 shares at \$20/share). One share required a member to deliver one lamb to the co-op.

The cooperative began market development in the fall of 2000. In January, 2001, they received a \$250,000 grant from the USDA's Lamb Industry Assistance Package. This money was earmarked for developing and marketing value-added natural lamb products. In September, 2001, the cooperative received a Value-Added Development Grant of \$144,000, and in November 2001 they received another APUC marketing grant of \$37,000.

Co-op leaders decided to begin a second equity drive in the fall of 2001. The original deadline for the drive, Dec. 31, 2001 was later extended until March 15, 2002. The 2nd equity drive offered 395 shares of membership stock at \$100 per share, and 12,000-20,000 shares of equity stock at \$30 per share. Each share obligated a member to provide one lamb per year.

In the second equity drive, subscribers who were not

currently members were required to buy a share of the cooperative's membership stock and at least 50 shares of equity stock (a minimum investment \$1600). Current members were not required to purchase membership stock, nor were they subject to a minimum purchase of equity shares. Members who were owed payment for lambs delivered were given the opportunity to receive shares instead of payment for their lambs.

The second equity drive attained its 12,000 share minimum to break escrow, and the co-op currently has 180 members and 20,000 shares subscribed. Co-op leaders hope to add another 8,000 subscriptions by the end of 2002 for a total of about 28,000. (Pates, 2002)

Financial Struggles

Unfortunately, the Cooperative incurred losses from the beginning. The second equity drive's offering circular reported losses of \$136,745 for the nine months ending Sept. 30, 2001. Cooperative leaders attribute losses to three main factors: 1) too much product went into frozen storage; 2) the co-op had high production costs because of low volumes; 3) processing costs were high.

Early sales were slower than expected, and it cost the co-op



DLGC's case-ready lamb

\$70 to have each lamb processed—almost as much as it was paying producers. Customers wanted boxed lambs rather than whole carcasses, and after a lamb is processed into separate cuts for shipment to retailers, about 12 pounds of trimmings are left over. . (Kram, 2001)

Inconsistent consumer demand and lamb breeding cycles create challenges for marketers and producers. Lamb is most popular on the East and West coasts and in bigger cities, where certain ethnic and religious groups eat lamb as a regular part of their diets. The market fluctuates around religious holidays in December and in the spring season, and orders from distant customers are very expensive to ship.. Lamb breeding is also seasonal, and various regions of the country manage sheep differently.

Marketing Strategies

From the beginning, the co-op's overall marketing strategy focused on filling a market niche for "natural" lamb— lamb that has not received any antibiotics or growth hormones from birth and is not fed animal byproducts. Up to this point, the co-op's natural lamb has been most successful in upscale supermarkets and natural food stores. DLGC made its first sales in March 2001 to Roche Brothers in Boston, an upscale retail grocery chain with 20 stores.

According to Dave Merwin, DLGC's CEO, by September, 2001, co-op leaders decided that they "had much more market than they had lambs." The cooperative's market analysis indicated that the current lamb market is relatively undifferentiated and not focused on customer needs—creating a great deal of potential for processed and value-added lamb products.

Although other meats compete with lamb, the co-op's marketing research indicated that a very small market share of the lamb industry could provide for a very viable and profitable cooperative. Moreover, Merwin believes that more customers will turn to natural meats due to recent concerns about scrapie and other diseases related to feeding animals with other animal byproducts.



Dakota Lamb Website

Ethnic Lamb Recipes on Dakota Lamb Website



Indian Lamb and Lentils



Rogan Josh (Indian Spiced Lamb)



Bulgur and Lamb Salad

After receiving the marketing grant from the USDA in 2001, the Board of Directors decided to go forward with a new marketing strategy that would target unfilled niches. The co-op's new marketing strategies include: 1) increasing sales to allow for more efficient operating; 2) marketing primals or full carcasses to get more revenue from each lamb; 3) using grant funds to develop processed and value-added products to use the cuts not sold to customers.

Co-op leaders estimate that "whole carcass" sales, which leave no remaining edible products to sell or process, will account for 30% of its revenues. Lamb leftover from boxed products will be marketed as fresh or sausage, lamb bratwurst, ground lamb, lamb sausage, and Merquez (an hors d'oeuvre). In addition, to deal with the challenges of the fluctuating nature of the market and breeding cycles, the co-op is shifting from a seasonal strategy to getting lambs to market year-round basis—timed in two-week periods.

Lastly, the cooperative is developing direct marketing strategies, including an internet website (www.dakotalamb.com) which will be used for direct

marketing to consumers. As part of the direct marketing strategy, members of the cooperative are planning to attend food shows to meet prospective customers and introduce new products.

Cooperative Make-Up

The Dakota Lamb Growers Cooperative is made up primarily of mid-sized sheep farmers. Since the co-op does not require members to report exactly how many head of sheep they have, providing exact numbers for co-op farm sizes is not possible at this point.

Jim Ostlie, DLGC Board President and sheep farmer, estimates that after the first equity drive, farm sizes ranged from 25-600 sheep, with an average farm size of 75 sheep. After the second equity drive (as of May, 2002), Ostlie says, the average DLGC farm size went up because new members had to purchase a minimum of 50 shares—which requires them to have at least 50 lambs. Although most of the co-op farms are diversified, a few original members increased their herd sizes between the 1st and 2nd equity drives, and recently more of the co-op farmers are focusing on sheep as their mainstay.

As of May 28, 2002, Dave Merwin estimated that the co-op's lamb production totals approximately 28,000 head with an average of 200 head per member. Jim Ostlie estimates that fewer than 10 of their producers have farms bigger than 500 head and the majority of their farms have 100-500 head. Ten to fifteen percent of their farmers, he estimates, have fewer than 100 sheep.

Nationally, the number of sheep operations is declining—although more slowly than the sheep inventory. The majority of U.S. sheep farmers are still quite small, but like the rest of the livestock industry, the sheep industry includes a few big operations that own a relatively large proportion of the animals.

For example, more than 80% of U.S. sheep farms are considered small farms (less than 100 sheep), but over 50% of the sheep and lambs are on farms that produce 1,000 head or more. In 2002, U.S. sheep breeding operations with 500 or more head comprised only 1.6 percent of the operations, but had 46.4 percent of the breeding sheep capacity. The meat packing industry has a similar structure. Since 1985, the number of plants with capacity less than 1,000 head has

declined steadily. In 2000, the 8 largest plants slaughtered 85 percent of all sheep and lamb. . (Jones, 2002)

Impact on DLGC Members

The DLGC members interviewed for this study were very positive about their experiences in the co-op. Although they were aware of some of the financial difficulties and marketing challenges the organization currently faces, they were still quite optimistic that the co-op would be a success in the long run.

Rodney Hickle, one of the founding members of DLGC, bought 50 shares when the co-op was first formed, and he also contributed some additional seed money. Hickle currently has 125 ewes and 250 cows and on his 6000 acre farm. He feels that his initial investment was small, since “stock didn’t cost too much at that time.” Along with the other wool growers who began the co-op with him, Hickle was looking for places to market lamb since wool was no

longer profitable.

Chris Veal, a farmer with 500 ewes and 1100 beef cows, joined DLGC in November 2000. Veal says that when Dave Merwin asked him to join, he was attracted to the idea of doing something “progressive and different from what others were doing.” More importantly, Veal says, he was “tired of being at the mercy of everyone else.” He wanted to “be on the front end of things, not the back end, and to have some control over his prices.”

In addition to stressing the advantages of having some say in decisions about production, prices, and marketing. Veal and Hickle both feel that the co-op is helping them financially so far. Hickle shipped his first lambs last year, and said he “got a great return for his investment.” Although he doesn’t know yet what his 2002 returns will be, he expects to do well this year too with his co-op lambs. Veal, likewise, says that “without a doubt, co-op membership has been an advantage” to him

financially.

Both farmers, however, also mentioned some of the problems the organization is having—and pointed out that there is some dissatisfaction among other farmers. Veal says that at times the co-op “doesn’t move enough lambs when farmers feel they should be” and that some farmers are unhappy about the slow sales.

The dissatisfied farmers, Veal believes, don’t understand the challenges of starting up a business co-op like DLGC. “It’s real slow growth,” Veal says, that is often par for the course when starting up a new venture. Unfortunately, more conservative farmers, Veal suspects, don’t understand that. Veal thinks that farmers in the western part of North Dakota, in particular, have “a real old way of thinking. They’re living way out there in the boonies. Everything’s horseback.” Eastern sheep farmers tend to be more progressive, Veal thinks, and therefore more comfortable with a new and inherently risky venture like DLGC.

Veal and Hickle both think that the DLGC Board of Directors and management keep a good line of communication with members—through monthly newsletters and frequent in-person interaction with members. Veal says “If you have an idea and you call up the CEO and tell him, he’ll try to make it work.” Moreover, he stresses, the management and Board treat us like equals.”



Showing Dakota Lamb Products at a Food Show (From Left to Right): CEO Dave Merwin, Director Lynn Stadheim, President Jim Ostlie

DLGC's Future: Challenges and Potentials

In spite of its early struggles, the prognosis for Dakota Lamb Growers Cooperative is looking up. In December 2001, the co-op was taking delivery of 80 lambs a week, but by May 1st 2002, it was delivering 200-220 lambs a week. Before the equity drive, the co-op was months behind on paying growers, but since the second equity drive, the co-op is current on paying farmers. . . (Pates, 2002)

The co-op recently switched to a new processor, Bridgewater Quality Meats, which has cut processing costs in half, according to Duane Cariveau, the business consultant for DLGC. Cariveau also says that Penn Valley, a natural sausage company in Chicago, recently began buying 1,000 pounds of DLGC "trimmings" (lamb leftover after prime cuts), which has drastically reduced the lamb in frozen storage, Cariveau believes that this business will lead to new customers in Chicago.

With added volume of sales, Merwin expects that lamb processing costs will drop to just over \$20 per animal—and shipping costs will drop with higher volumes as well. Moreover, Merwin thinks that new sausage lines, which will be ready for markets in the summer of 2002, will increase the value of the trimmings in storage by 25%, bringing more money to the co-op.

In spite of substantial start-up struggles and financial



Sheep grazing on south Dakota grassland (USDA photo)

difficulties, Dakota Lamb Growers Cooperative leaders are very optimistic about the future of their venture. Dave Merwin feels that recent government grants are giving struggling farmers some time and financial leeway to consider different strategies to survive and profit.

Tim Petry, who has followed the growth of DLGC since its formation, is also extremely positive about the potential of the organization to thrive in spite of the substantial challenges facing the sheep industry.

Although Petry doesn't think the recent government subsidies for the lamb industry are enough to completely turn things around—because they treat symptoms rather than causes of the sheep industry's problems. He feels that sheep farmers who target the right markets have a good chance of making it. Petry is confident that the natural lamb market is large and still untapped. He believes that the future lies in smaller, diversified sheep operations that focus on niche markets for natural lamb

and other value-added lamb products.

Merwin believes that focusing on natural lamb is important—but doesn't see it as a permanent marketing strategy. "Everybody can do that after a while," Merwin says. "The co-op will find permanence by being consistent in the quality and size of our product...these goals will be accomplished through better genetics, management, and incentives." Because they provide natural lamb year-round, Merwin believes, DLGC is unique. "We're doing something that nobody's ever been able to do before. If it was easy, they'd already have done it. We're pioneers."

Most importantly, the DLGC members interviewed for this study are optimistic that the co-op will be a success. Hickie says he has a lot of confidence in the DLGC Board of Directors. "We seem to be heading in the right direction. There's been a lot of bumps in the road, but if we keep a good board together, I think we'll make it."

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