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Keri Jacobs
Iowa State University, kljacobs@iastate.edu

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Co-ops managing through low margins

By KERI L. JACOBS*

The current environment for Midwest firms marketing corn and soybeans presents challenges for identifying margin opportunities. Rising grain inventories, a stable basis and hesitant selling by producers continue to depress overall grain margins.

Agricultural retailers, despite being faced with similar optics on the producer side — declining average net farm incomes, low commodity prices and tighter lending situations for some — are faring a bit better.

Quarterly data from agricultural cooperatives in Iowa illustrate the trends in margins that reflect these factors and are likely affecting grain merchandisers and agricultural retailers (Figure 1). For this group, average year-over-year grain product margins reported in the first quarter of 2016 came in at 1.4%, a substantial drop from gains reported in the first quarter of 2016, compared to the prior quarter’s 5% product margin.

Many cooperatives emerged from the 2012-13 period of high corn prices with strong balance sheets, particularly for working capital, and have been able to maintain that strength despite the recent margin environment (Table). The data suggest that cooperatives built significant working capital but are beginning to show signs of a trailing working capital-to-sales ratio. For most firms with a mix of grain and agronomy, a ratio in the 3-4% range is considered acceptable, with higher values indicating reserve strength.

As noted, sales are in a period of decline, and that shows in the slower sales-to-local equity measure. Long-term borrowing continues to be well below threshold leverage levels, and cooperatives’ capacity to service debt ensures that additional borrowing is unlikely to be a hurdle in the coming quarters.

Finally, most agricultural retailers are keeping an eye on credit challenges that may arise as their customers face tougher economic conditions. Current accounts receivable measures, including collection days, do not yet show signs of customer account issues.

Looking ahead, Midwest grain and farm supply companies will undoubtedly continue to face challenges managing grain margins and may begin to feel the effects of customer accounts receivable issues if production agriculture revenues and incomes continue to drop.

To date, data from Iowa suggest that cooperatives have strong balance sheets and are taking steps to help their member-producers manage through this period.