Fiber Profits

The Rest of the Story!

BY DARYL W. GOODRICH, JD

U.S. alpaca farms produce fiber. This is a potentially meaningful profit stream since alpaca is the quintessential fiber. Realizing this farmer potential, though, requires plans, choices and committed action.

Each year in farms across the nation, fiber sits on the sidelines. Fiber sales must be increased to turn this potential into cash. But alpaca competes with many other natural and synthetic fibers for consumer attention. A marketing strategy that builds consumer demand through branding, increasing awareness of product benefits and providing purchase incentives is customarily used.

However, it is difficult for most alpaca farmers to increase fiber profits with only this typical strategy. This is due to lack of economy of scale related to small herds and small fiber production and to some fundamental cost problems.

Relevant alpaca statistics are: (i) $25-$35 per alpaca shearing costs, (ii) up to $5.50 per pound U.S. fiber commercial sales price, and (iii) 5-6 pounds per alpaca fiber shear weight.[1]

The best commercial case (6 pounds fleece weight x $5.50 per pound) yields $33 gross income per alpaca. Clearly, this cash flow does not generate meaningful farmer profits with $25 to $35 per alpaca shearing costs.

Solely increasing raw fiber sales, therefore, will not increase farmer profits. Something else is needed.

Now—the rest of the story!

In the current fiber industry structure, farmers sell raw fiber to mills. Mills have pricing power since there are few mills and many farmers. Mills in turn sell finished products to retailers and consumers. Mills and retailers have pricing power since there are few mills/retailers and many consumers.

Mills make fiber more valuable by manufacturing it into finished products that consumers buy. This added value is much greater than the raw fiber value in the products. Agricultural commodities are typically worth more in the manufactured state than raw. He who captures the added value wins most of the profits.

When I was a director of the Alpaca Fiber Cooperative of North America, Inc. (AFCNA), I oversaw the manufacture of a prototype alpaca throw. Its product fiber value (product retail price less manufacturing costs) was over $24 per pound. Its consumer value was $18.50, assuming a $5.50 per pound commercial raw fiber value.

As alpaca product demand increases, mills and retailers sell more consumer products and farmers sell more fiber. Raw fiber prices, however, do not increase since farmers lack pricing power.

The estimated national annual alpaca fiber production in the U.S. is 750,000 pounds.[2] This can absorb increased demand for fiber for the foreseeable future. If demand outstrips supply, shortages will drive up raw fiber prices.

Photo courtesy of AFCNA

1. Alpaca Owners and Breeders Association, Build A Tent 11/19/10 Nashville Presentation.
2. Ibid.

Fiber sorting and grading begins the process from raw fleece to finished product.

However, the national herd growth rate will likely offset fiber shortages, keeping raw fiber prices from rising.

When fiber sales increase in this paradigm, mills and retailers make more profits from collecting more consumer value. And, farmer fiber sales proceeds increase, but profits do not. Shearing costs still are not covered!

Changing this fiber sales model easily increases farmer profits. Farmers must secure pricing power and capture the consumer value. In short—they must sell their fiber to the consumer in the form of manufactured products. This is the new fiber sales model.

This new fiber sales model emerges from the "strength in numbers" adage. Working together as a team, farmers no longer compete with one another. Teams achieve economies of scale and enable higher prices due to pricing power. There is one seller and many buyers when teams sell their manufactured products directly to consumers.

In addition, teams capture the consumer value. They manufacture consumer products from team member raw fiber by subcontracting to, or joint venturing with, privately owned mills. Teams sell their products to consumers.

Farmer fiber profits increase when team profits are distributed to farmers based on their submitted fiber amount. These patronage distributions are payment for submitted fiber.

This shift in business strategy gives farmers a bigger piece of the "pie" through pricing power. It also creates more "pie" by enlarging farmer fiber markets through value-added manufacturing.

New fiber sales model hallmarks:

a. **Pricing Power:** Pricing power enables higher sales prices. It increases fiber profits.
b. **Capture Consumer Value:** Manufacturing fiber into consumer products adds value. Profits are in this consumer value. Manufacturing and selling products increases fiber profits.
c. **Profit Distribution:** All profits are distributed to participants as payment for submitted fiber. Farmer fiber profits increase.
d. **Equal Treatment:** Participation, not farm size or influence, determines profit distribution.

U.S. antitrust laws, however, make it illegal for competitors in interstate commerce to collectively manufacture and sell their products. This had a chilling effect on farmers. So, in 1922 Congress gave farmers an exemption to this restriction with the Capper-Valstead Act, but only if they use the cooperative business model.[3]

Joseph Knapp, past administrator of the U.S.D.A. Farmer Cooperative Service, explains it this way: "The

farmer has been the greatest single beneficiary of the American cooperative, for it has given him a form of economic organization adapted to the peculiar conditions of his industry. Farmers individually have little power in the market place. Organized in cooperatives they can meet power with power. Without such organizations they would have to rest content with whatever service they could get; they would have no choice. Cooperatives have secured for them the benefits of other organized groups while preserving for them their status as individual concerns."[4]

Dallas Tonsager, U.S. Department of Agriculture Rural Development Under-Secretary, pulled it all together when he addressed the National Council of Farmer Cooperatives last year, "As you know, co-ops are a manifestation of all that is best about our free enterprise system and democracy. Simply put, you give marketplace clout to people who on their own would wield little power. In the case of farmers and ranchers, co-ops are the business vehicle which helps you gain the leverage you need to earn fair prices for the products in markets dominated by ever fewer, larger buyers. Your collective role in our rural economy is substantial, accounting for about 30 percent of our nation's farm economy."[5]

Cooperatives are a profound business strategy for U.S. agriculture. They can give alpaca farmers more pricing power and empower them to capture the profits in the big consumer product "pie." But that is not all they can do.

Cooperatives can also increase the competitive edge for alpaca farmers who are not participating in cooperatives. With the new fiber sales model, cooperatives compete with mills for fiber. Mills will have to pay a price that is competitive with the higher fiber value that cooperatives generate for their farmer members. Mills will no longer be able to play one farm against another to drive down prices. Farmers will have the option to receive cooperative profit distributions or sell to mills.

Charles Ling, U.S.D.A. Cooperative Program economist, explains, "Subject to the same market disciplines and supply-demand-price dynamics as any business, the presence of the cooperative challenges other market participants to operate efficiently and thus strengthens the competitive market mechanism."[6]

Cooperatives are not just theory. They are a reality!

The U.S. Department of Agriculture reports 2,389 farmer cooperatives existed in 2009 with a $170 billion annual gross business volume.[7] Oklahoma wheat producers are a profit success story example.

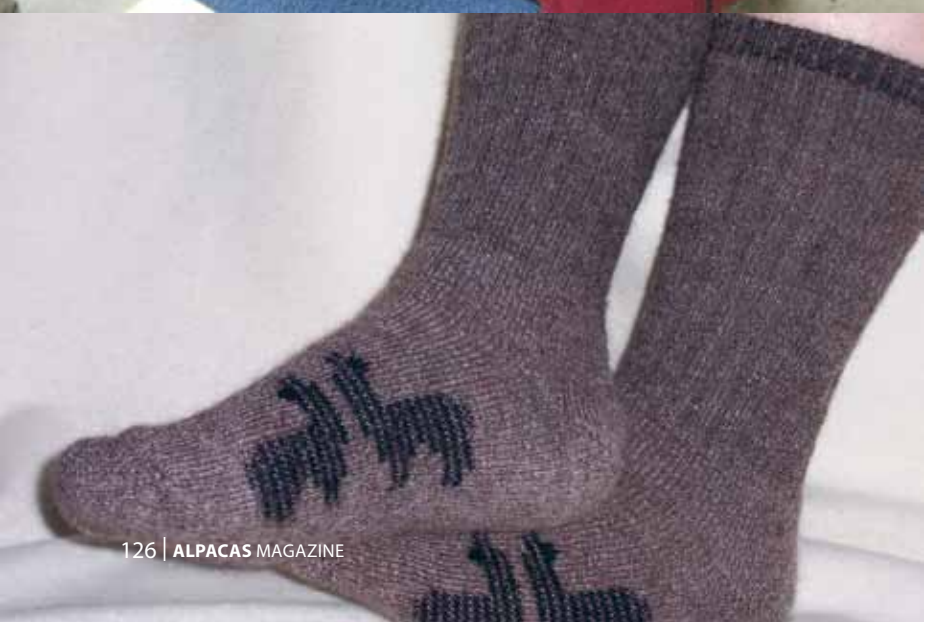
They wanted to increase their profits. "After careful study of information and research… [they] opted to pursue production of a frozen, self-rising dough products plant."[8] Frozen, self-rising pizza crust, for example, is a big seller. In 1999, they set up a cooperative, Value Added Partners, Inc., to run this business.

"The co-op, as originally designed, was to provide wheat producers the opportunity to expand their customer base through vertically integrated processing. It also would allow producers to capture a larger share of the profit margins through the further processing of their wheat.

"VAP's dough and bread product markets continue to grow, and it has the capability to produce almost any imaginable type of bread product."[9]

3. *The Capper-Volstead Act: Opportunity Today and Tomorrow,* by Barnes, Ondeck, Jenkens & Gilchrist, PC. This paper was presented at the National Council of Farmer Cooperatives' National Institute on Cooperative Education, Annual Conference, Pittsburgh, PA 1997. Its internet link is: www.uwcc.wisc.edu/info/capper.html.
4. *Are Cooperatives Good Business?* by Joseph Knapp. Harvard Business Review 1957 Vol.35, No.1 (Pg 60).
5. Dallas Tonsager presentation to the National Council of Farmer Cooperatives 6/17/10 in Washington, DC. Its internet link is: www.rurdev.usda.gov/SupportDocuments/6-17-10NCFCfinal.pdf.
6. *What Cooperatives Do,* by Charles Ling. *USDA/Rural Cooperatives* magazine, March/April 2010 Vol. 77, No. 2 (Pg.6).
7. Cooperative Statistics 2009, USDA Service Report 70.
8. *Sweet Smell of Success—Oklahoma Wheat Producers Use USDA Financing To Launch Frozen-Dough Bakery,* by Sally Vielma. *USDA/Rural Cooperatives* magazine, November/December 2003 Vol. 70, No. 6 (Pg. 20).
9. Ibid.

AFCNA's line of finished products ranges from yarn to socks to sweaters.



Cooperative hallmarks:

a. **Strength In Numbers:** Profits increase when farmers combine capital and resources to do what one farmer cannot do alone—manufacture and sell consumer products.

b. **Pricing Power:** Working together removes competition among farmers. The cooperative is the only seller. Working together empowers farmers to sell their fiber to consumers as finished products. One seller and many buyers gives the cooperative pricing power. Higher sales prices increase profits.

c. **Farmers Benefit:** Farmers as the cooperative owners receive all the profits as payment for their submitted fiber. Farmers thus capture the consumer value added to their fiber when products are manufactured and sold, plus the raw fiber value.

d. **Economies of Scale:** Profits increase when farmers combine their fiber. Cooperative large volume processing and marketing spreads operating costs over more product units. Profits are then greater.

e. **Farmers Treated Alike:** Farmers' share of cooperative profits is based on their submitted fiber amount.

f. **Free Choice:** Cooperative participation is voluntary.

g. **Equality:** Farmer cooperative owners have equal voting power.

The rest of the story—by adding a farmer cooperative to the increasing of fiber product sales, farmer fiber profits can be increased.

The Fiber Committee of the Alpaca Owners and Breeders Association had the courage in 1998 to plant the seeds for a fiber industry change, in the form of a fiber cooperative to enhance farmer profits. The Committee worked with the U.S. Department of Agriculture to put together an economic model for this cooperative.[10]

The Alpaca Fiber Cooperative of North America, Inc. was formed by the Committee pursuant to this model and set free to operate under the governance of its farmer owner members. Its over 1,600 members are now growing national fiber sales and fiber profits for the members.

AFCNA is a purchasing and value-added marketing cooperative. The marketing division collects and sorts member fiber. It then manufactures products from this

10. Mary Reed, Chagrin Valley Alpacas, supplied this AFCNA start-up information in an interview by the author on 2/26/11. She was on the first AFCNA Board of Directors in 1998.

11. The internet link is: http://social.un.org/coopsyear.

fiber. The purchasing division obtains Peruvian and fiber artisan alpaca products. These products and AFCNA-manufactured products are then sold to retailers, member farm stores and consumers.

Cooperatives are fast gaining popularity worldwide. They are seen as a method of giving people greater control over their survival and economic destiny. They can serve farmer, family, employee and many other interests. The United Nations General Assembly has declared 2012 the International Year of Cooperatives, highlighting "the contribution of cooperatives to socio-economic development"[11] worldwide.

Note: *This article does not in any way provide or constitute legal, accounting or financial advice or opinion.*

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To learn more about AFCNA, including membership information, visit www.afcna.com.