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Developing a New Co-Owned Agricultural Business: How do we Start a Value-Added Firm?

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Steps in Developing a Co-Owned Agricultural Business

1. Define the Opportunity
2. Identify Organizers
3. Set Goals for the Business
4. Conduct a Preliminary Assessment of the Project
5. Initiate a Business Plan
6. Conduct a Detailed Feasibility Study and Revise Business Plan
7. Organize the Business Entity
8. Capitalize the Business
9. Implement the Plan

Diminishing government subsidies combined with globalization and increased competition are causing farmers to consider additional and alternative business strategies to increase profit. Common strategies have been to produce a specialized product (such as certified seed), vertically integrate into processing agricultural commodities (such as producing pasta from durum), or produce commodities that are new to the region (such as, vegetables). The resources needed to construct and operate a new agriculture business can be extensive, often requiring more capital, human resources, and risk exposure than one individual can provide or sustain.

An alternative is for farmers to pool their resources of capital, commodities, knowledge, and management skills to develop a business that captures economies of scale few farmers could build individually. A common question is how to shape an idea into a successful business; that is, how to organize investors, assemble needed resources, construct the facility, and initiate operation in response to a market opportunity.

The following discussion suggests a framework within which to consider developing a co-owned agricultural business, whether the firm will be organized as a cooperative, partnership, limited liability company, corporation, or some other business structure. Although the discussion implies an order in which to complete the steps, the sequence of events will vary according to the situation, such as size of the project or number of investors. The discussion also offers decision points in the process where the organizers will have to decide whether to continue to develop the business.

Since the specifics for each situation will differ, many issues are raised in the form of questions for the organizers to consider. Similarly, most of the steps end with the organizers having to decide whether to continue planning and developing their new business by proceeding to the next step.

The types of agricultural businesses being developed vary considerably and pose a broad range of questions. However, the **process of starting** a value-added agriculture business is perhaps most influenced by the expected number of investors. Is the business expected to involve many investors, such as a processing cooperative that may have hundreds of shareholders, or will it be a closely-held business that involves a relatively small number of shareholders, such as a group of neighbors who form a business to market their speciality crop? A primary difference between the two categories is the amount of time and effort necessary to prepare and present information about the planned business.

1. Define the Opportunity

Developing a new business often starts with an individual who recognizes an ***opportunity*** and contacts others who also may be interested in exploring the possibility. As the members of the group ***begin*** their discussions, they will share their perceptions about the opportunity and the industry. For example as they look to the future, the group members will likely consider their ***expectations*** about:

Market potential—Will consumers be willing to buy the product? In what form, when and where are consumers likely to want the product? Will they have enough income to afford the product? How might the market change over time?

Production practices—Are the inputs and services necessary to operate the business available? What technology can be used to produce or process the product? What resources do the organizers have available? What resources are available in the community? How might production practices change over time?

External factors—Which government programs, policies, and regulations will apply to the business? Which competitor offers a similar product or service? Is there access to information? How might the competition change over time?

Members of the group also may find it beneficial to describe their reasons for pursuing this business opportunity. Following such discussions, the group can decide whether the opportunity justifies proceeding with the project.

Discussions at this stage of the planning process are only preliminary. Organizers should expect to revisit these topics several times and gather additional information and analyze the issues more thoroughly each time. An extensive understanding of current and long-term market potential, production practices, and competition is critical in developing and revising the business plan during subsequent steps of the planning process.

2. Identify Organizers

The next step is for the members of the group to ***look at themselves*** to determine their level of ***interest*** in the project. How much ***time*** is each member willing and able to commit to the project? Does the group have enough time to make the project successful? How much ***cash*** are they willing to commit? What is their level of ***understanding*** about the potential business? An adequate interest and understanding, as well as a willingness to commit time and cash, are needed to start the project.

Depending on the size of the group, one or two individuals may be identified as the ***project champions*** to keep the project moving by arranging meetings, assuring that other members of the group are informed, making contacts with knowledgeable individuals, gathering information, promoting the idea of developing the business, and assuring that the planning process continues. The project champion may be the member of the group with the most interest and time to commit to the project, rather than the individual with the initial idea or the most available capital. An alternative to designating a project champion is to develop an alliance with an established group in the industry. Likewise, several individuals ***(a steering committee)*** could be identified to assist the project champion by reviewing progress, providing ideas, and assisting when necessary. These persons may be only temporary leaders who start the project. In many situations, they will be replaced by a permanent management team as the business develops. Additional issues the group may want to address include:

- Setting ***parameters for the project*** to define which ideas will be investigated; for example, will the group investigate establishing a feedlot for finishing cattle, or a feedlot for backgrounding feeders? Will the group focus on irrigated vegetable production for sale to wholesalers, or will the group package and distribute the produce for retail sale to consumers?
- Establishing a ***time line*** for each step of the process. Depending on the size and complexity of the project, developing a new business could take as little as nine to 12 months, or as long as three to five years.
- Determining the ***necessary level of commitment*** and ***progress*** to justify moving to the next step.
- Identifying ***sources of "seed money"*** to study the project in addition to the time and cash organizers are willing to invest to study the opportunity, are there other sources of seed money, and who will apply for that assistance? How will organizers be compensated for their investment of time and seed money if the business becomes operational? What are the disclosure requirements? Are there any limits on how this seed money can be used? Organizers may want to document their agreement.

3. Set Goals for the Business

The next step for the group is to set ***goals for the project***; for example, is the goal for the project to generate profit for investors, to provide employment opportunities in the community, or both? **If locating the business in another community or region will enhance profit, will the organizers choose greater profit or local economic growth? In many cases, major operations and markets can be successfully established outside the region to capture the markets. Profits are then "harvested" and returned to the investor's community where they can be used for other economic activities.** Goals are necessary. They are the basis for making future decisions. The group may ask itself, "From among our alternatives, which one will cause us to most effectively and efficiently reach our goal?" Goals also provide benchmarks for measuring progress.

It may be helpful to have each member of the group review (and share to the extent they want to) his or her career and personal goals. From these goals, each individual can specify some goals for the new business. "What is it that each one of us wants to get out of this business? Is it a return on investment? Is it a market opportunity for a commodity we already produce? Is it an opportunity to produce a different product or commodity? Is it an employment opportunity for one or more of the investors? Is it a strategy for managing our risk exposure? What is our vision for the business? What activities and what scale of operation do we envision for the business?" The answer to these questions will not be the same for each individual. Instead, the group will likely work toward developing a business that fulfills various goals of the group members.

Open and honest ***communication*** is a necessity for a co-owned business. Willingness to discuss goals may be an early indicator of the level of trust among group members, and how members of the group will interact when difficult decisions need to be made in the future. The process of setting goals for the business also may reveal who remains involved in the project. Some members may withdraw from the group at this time if they recognize that the business will pursue goals that are incompatible with their personal or career objectives. In addition, this step may be an opportunity to review the timetable for the project, as well as the tasks of the project champion and steering committee.

Setting goals also should include developing an initial ***mission statement*** for the business; that is, one or two sentences which summarize the business' goals and strategies for fulfilling them.

4. Conduct a Preliminary Assessment of the Project

The next step of the process is to conduct an informal, relatively low-cost (in terms of cash and time), preliminary assessment of the project. In addition to gathering information and surveying the interests of potential investors (but without creating much publicity and speculation), the group will want to consider issues related to production, processing, distribution, marketing, capitalization, and management. Gathering information from persons knowledgeable with the industry can be invaluable during this step. More specifically, the organizers will likely address the following issues:

- Scope of the business. What commodity, product, or service will the business produce? Will it produce a commodity, process a commodity produced by the investors, process a commodity produced by non-investors, perform one step in the processing sequence and rely on others to complete the process, or provide a service (such as marketing for a fixed percentage or fee) without ever taking title to the commodity?
- Market for the commodity or product. What is the market for the product? ***Who*** will be the customers, ***what*** do they want to buy, ***where*** would they want to buy, ***how much*** are they willing to pay, and ***how*** will the business be paid? Will the business sell on the wholesale market or to retail consumers? This step involves contacting potential buyers to ascertain their reactions and interests. Are there retail outlets interested in establishing a relationship with the business? What are the potential local, regional, domestic, and international markets? How might these markets change over time? Are they likely to expand or contract? What distribution facilities or network is available for marketing the product? The result of this initial market assessment may cause the group to revise the scope of the business.
- Competition. Which other businesses currently produce, or are likely to produce, a similar product or service? What appears to be their strengths and weaknesses? What strategies are they apparently using and how effective do those strategies appear to be? Are these firms likely to alter their production capacity or modify their product? Is there any opportunity to cooperate with an existing business? Is there any opportunity to form an alliance or joint venture with an existing business?
- Production technology. What are the current and potential technologies that the business can use? Is the technology proven? What inputs are needed? How much labor would be required? How much capital would be required? Are there any specific siting needs? Visiting comparable firms or meeting with representatives of businesses that offer the needed equipment, technology, and expertise is often an effective means of acquiring information. However, careful management is needed to control the time and cash committed to such visits.
- Availability of inputs. What inputs would the business need and what might be the availability of those inputs, now and in the future? Answering this question often requires visits with potential suppliers to ascertain their reactions and interests. For a business that will process agricultural commodities, this step may include a survey of producers to determine their interest in establishing a working relationship with the business. The survey also may request information about the amount of equity farmers would be willing to invest in the business, especially if the business may be organized as a cooperative. Additional issues to address may include who else may be interested in buying these inputs, and should the business enter into a long-term contract with the suppliers.
- Availability of workers. Is there an adequate number of workers available in the region with the skills necessary to meet the needs of the business? Does the community offer the services, educational opportunities, and other amenities necessary to attract an adequate workforce? Is the necessary level of management expertise available? The group may find that it will need to hire an experienced manager from another region of the country. The group also may need to hire other professionals (e.g. production specialist) on a consulting basis. These individuals do not need to be hired or retained at this time, but an understanding of their availability can be beneficial as the planning effort proceeds.
- Location and community infrastructure. Is proximity to inputs and markets critical for this business to be profitable. What is the perishability and transportability of the inputs and products? What types of roads, trucking and rail services, airports, communication systems, water resources, and waste disposal are needed for the business? What locations might meet these needs? What people and resources are available in these communities? What will be the criteria for selecting a location?
- Size of operation. What are the alternative sizes of operation for the business? What size is needed to match the expected scope of the business? What

- size of operation will best fit
- the expected market for the product? Which size offers the best economies of scale? What
- is the minimum size necessary to earn an acceptable rate of return? At what size are dis-economies of scale likely to be experienced? What size of operation are the communities and permitting agencies willing to accept?
- Capital needs. This issue is perhaps the most crucial to success. How much investment is required to develop, construct and begin operating the desired business? How much capital will be needed to continue operating the business in the future? An engineering firm may be able to help project construction costs. Is the necessary capital available? What rate of return would investors expect to receive? What interest rate would lenders likely charge? How quickly would the lenders expect to be repaid? Are there any opportunities for receiving financial assistance from federal, state or local governments?
- Organizational structure. Who will be allowed to invest in or become a member of the business; that is, who will be the investors? Do the investors not only have rights but also obligations? For example, an investor may have the right to share in the profits but also an obligation to provide a specified amount of raw product at a specified grade and at a specified time. What will be the minimum and maximum investment? Will members be producers, investors, or both? These decisions should reflect the group's goals. Will the business be organized as a corporation, limited liability company, limited partnership, or cooperative? Businesses intending to engage in farming activities will need to review the state's corporate farming laws to assure they are in compliance. If intending to organize as a cooperative, the group will need to decide whether a closed or an open membership cooperative will be proposed to investors.
- Government policies. Which local, state and federal government policies will impact the operation of the business? These policies may encompass a broad range of issues, such as labor law, environment regulations, taxation, economic development incentives, food safety concerns, and trade policies. What federal, state, and local permits are necessary?
- Risk Exposure. What are the risks associated with initiating and operating the proposed business including the uncertainty of market, technology, production, finance, government and management? What opportunities are available to manage these risks? If the business primarily will provide a service for its investors, such as marketing organization, will the business acquire ownership of the product or will the farmers retain ownership?

The preliminary assessment is not the last time organizers will consider these issues. They can expect to revisit, refine, and revise their vision as additional information becomes available and decisions are made during the planning process.

Decision

Does the preliminary information justify continuing to study the project by completing a formal feasibility assessment? Has an adequate general description of the project been developed so a detailed study can be conducted? Are the organizers still willing to work together? Will they support the business after it begins operating? These questions likely will be discussed and answered at a meeting of the organizers. If the responses are positive, the group is ready to move onto the next steps.

5. Initiate a Business Plan

The information already gathered and the results of the preliminary assessment can be the basis for an initial formal ***business plan***; that is, a general description of how the business will operate and market its product. The purpose of a business plan is to record decisions as well as organize information to be shared with investors, lenders, and regulators as part of disclosures, loan applications, and permit applications. However, the business plan will most likely be revised several times as new information becomes available and the business continues to be developed. This also may be the time to review and refine the mission statement.

Components of a Business Plan

- Overview of the Business and Industry
- Description of the Business, and its Commodity, Product or Service
- Production Strategy and Technology
- Market Analysis
- Site Selection
- Personnel Needs
- Ownership and Management
- Capitalization
- Future Opportunities
- Critical Concerns
- Financial Projections and Other Supporting Information

6. Conduct a Detailed Feasibility Study and Revise Business Plan

At the same time that a business plan is being prepared, the group will want to complete a formal ***feasibility study*** to determine the ***feasibility*** (cash flow) and ***profitability*** of the business. A feasibility study will include thorough ***financial*** and ***market analyses*** for the new business, including detailed revenue and cost projections. It should also analyze the impact changing conditions may have on the business' profitability ***(sensitivity analysis)***.

The feasibility study should be done by an unbiased company, person, or group and reviewed by an independent source. Many groups retain highly specialized professional firms or individuals (such as a ***consulting firm, an accountant, an economist, or a marketing specialist***) to assist in the market and financial analyses. However, decisions about the business must be made by the organizers, even though a ***consultant***, for example, has been retained to conduct the study or assemble the plan.

To help cover the cost of a feasibility study, some groups seek financial support from local and state economic development organizations. Other groups rely on the organizers and potential investors to provide some or all of the resources needed to complete the feasibility study. One strategy a few groups have used is to require individuals to provide "seed money" in order to be "qualified" to invest at a later time.

Preparing a business plan and feasibility study often causes organizers to reconsider some issues (such as scope of the business or size of the operation) as well as resolve additional questions such as:

- Will the new venture be limited to conducting business only with investors, or will non-investors also be allowed to conduct business with the new firm? This question assumes that the new business relates to the investors' other businesses; for example, a business that processes or markets agricultural commodities the investing farmers will produce.
- Do potential suppliers need to adopt new management practices in their farm operations to assure there will be a supply of commodities at the time, in the quantity, and of the quality needed by the business? Including such information in the business plan would help producers decide whether to invest in the new business.
- What method will be used to value the inputs that will be supplied by the investing farmers? For example, will the commodity be priced by an outside order buyer or by a purchasing agent employed by the business?
- How will the business market its product? A key component
- of the feasibility study is the **market study**. What is the current market structure and how might it change in the future? How might the number of customers, level of competition, and market environment evolve over time? Will the product be marketed to a single buyer based on preferred supplier arrangements, will the product be marketed to whoever provides the highest bid when the product is ready for sale, or will the

business market directly to consumers? The detailed feasibility study is an opportunity to r***eview and possibly revise the business' marketing strategies***. Some groups may find it helpful to retain a ***marketing specialist*** at this point in the planning process. This is a critical component of any business; no business can succeed without a market for its product.

- What will be the par value of equity stock shares? What will be the investors' obligations to supply inputs or agricultural commodities to the business? What will be the business' obligation to purchase the investors' commodities?
- How will the business be operated? An initial description of facilities and operating strategies is often developed at this point in the planning process.
- What contingency plans can be developed in preparation for unexpected events both problems and opportunities?
- Is the group ready to hire a manager at this time? Some firms, especially larger ones, begin the process by hiring a general manager or ***chief executive officer*** (CEO) as the first member of the permanent management team. This individual would take the place of the project champion and lead the effort of continuing to develop the business plan. Again, initial investors may be expected to provide much of the cash needed to pay this cost.
- How will ownership in the business transfer among investors? Will the business control who can acquire an ownership interest?

Market opportunities, revenue projections, distribution strategies, production practices and technology, operating costs, financing alternatives, alternative business structures, and human resource policies/strategies (such as training programs and a wage, benefit and incentive package) are all part of analyzing the project's feasibility . With this information, organizers can decide whether to proceed by comparing the business' projected performance to the group's goals.

Decision

Does the project appear feasible? Will it generate cash when and in the amounts needed to meet expenses? Will the business earn an acceptable rate of return for the investors? Will the business generate a rate of return comparable to other opportunities (including production agriculture or purchasing stock in food companies)? Will the business likely fulfill the goals set by the organizers? If the project appears to be reasonable, the next steps involve developing the formal business entity, capitalizing the business, and implementing the plan.

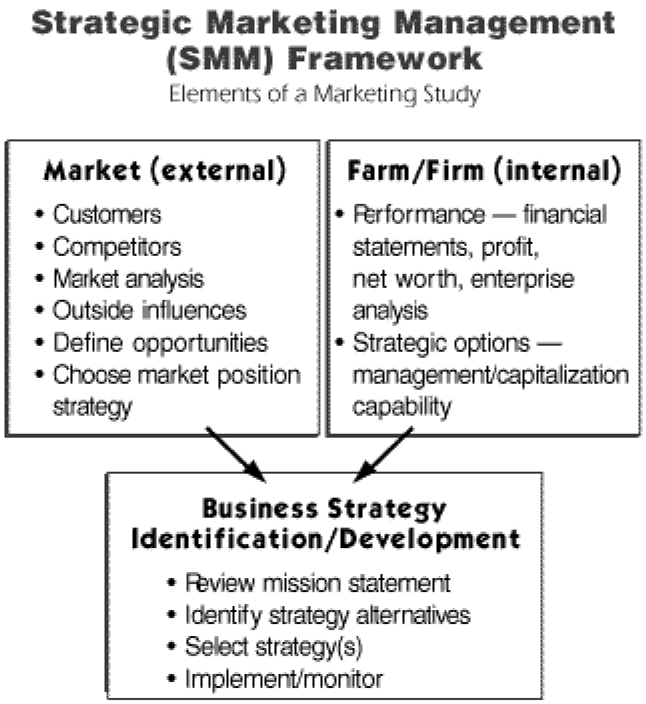
7. Organize the Business Entity

As the business plan and feasibility study are being completed, the organizers will want to develop a formal business structure. One question will be how to be organized as a partnership, limited liability company, corporation, cooperative, or some other form of business. The goals of the group, such as who will be the owner, who will control the business, what risk exposure are the investors willing to accept, tax considerations, and financing arrangements, are issues to consider in selecting a business structure. Competent professional advice can be invaluable in making this decision.

An ***attorney*** skilled in formation of agricultural businesses should be employed to help set up the prospective firm and organize a board of directors (if one is required), develop the business' information packages for potential investors, attend to needed legal requirements associated with promoting the business proposal, and obtain siting permits, construction contracts, and trademark registration. A ***financial advisor*** often is employed to assure that business reality is reflected in the information packages provided to potential investors. An ***accountant*** should be hired to establish an accounting system for the business.

The group is now ready, based on the business plan, to develop the information and disclosure documents (such as a prospectus) for potential investors and lenders. These documents must meet federal and state law filing and disclosure requirements, but may not contain the level of detail included in a thorough business plan.

- Retain professionals necessary to complete the project, such as a ***construction engineer*** or ***architect.***
- Preliminary construction plans could be started. This also may be the time to negotiate an option to buy or lease a site for the business, to begin the process of acquiring necessary government permits, and to initiate discussions with possible construction contractors. If not already hired, a permanent general manager or CEO should be recruited and in place by this point in the process to assist with the remaining steps of the developing the business. However in some cases, the organizers postpone hiring this person until the necessary capital has been raised during the capitalization phase.



8. Capitalize the Business

The business will likely use a combination of equity capital provided by investors and debt capital provided by lenders based on interest rates, risk, alternative investment opportunities, lending requirements, and investors' interest in the project.

Solicit equity investors. Formal documentation for the stock offering and loan applications will need to be completed; some of this will have already been developed as part of the business plan. Potential equity investors in the business must be identified. In the case of a cooperative, a series of information and sign-up meetings would be held to discuss the proposal and to sell shares. Sometimes it may also be necessary to provide information to the investor's lender. Provision for returning money invested if the membership target is not met within a specified time period must be clearly indicated.

Related questions may include

- How often will the investment opportunity be extended? Just once, or will investors have several opportunities to become involved?

- What will be the deadline for investing in the business? If the business will have a relatively small number of investors, will the time period for deciding whether to invest be extended for selected individuals?
- Will investors be required to pay the full amount immediately, or will they be expected to contribute only a portion of the investment with a commitment to provide the remainder at a later time?
- Will investing in the business also ***obligate*** the investor to do business with the firm (such as delivery a specified quantity of commodities to be processed or marketed)?
- How many investors does the group want to work with; what is the targeted size? Is there a minimum or maximum desired number of investors?
- Is there a minimum or maximum amount of investment per investor?
- Is there a minimum or maximum desired level of total investment? Will there be enough equity to sustain the business during a period of low profitability? Will investors be expected to contribute additional capital to sustain the business if necessary?

Decision

Is the amount of capital that investors are willing to contribute adequate to justify proceeding with the project? Does the group want to continue developing the business, or does it need to revise or abandon the proposal?

Now that they share ownership of a new business, the investors will likely meet (a stock or shareholders meeting), and if the number of investors justifies, elect a ***board of directors***. On the other hand, if there is a small number of investors, the entire group could function as a board of directors. The directors would assume the role of the steering committee.

Negotiate for debt capital. As commitments from investors reach specified levels, discussions can proceed with potential lenders regarding loan amounts, covenants, maturity, and price. Lenders will likely specify a level of equity for the individual investors before they will consider the loan application.

Organizers also often investigate state and local ***economic development assistance*** alternatives that could be used in capitalizing the new business. The assistance may be in the form of debt, operating subsidies, or equity. Important questions to ask include what are the disclosure requirements and will there be limits on how these funds can be used.

Based on the level of interest among investors, lenders, and government, the organizers may want to review and ***possibly revise the business plan.***

Decision

The success of capitalizing the business will determine whether the project moves forward to the next phase, be rethought, or abandoned. If the project organizers have been successful in obtaining the necessary equity capital, and if lenders have given approval to the needed loans, the project is ready to proceed with constructing, purchasing, leasing or contracting to acquire needed facilities. Alternatively, if either equity capital or debt capital has not been secured, project organizers must re-evaluate the project proposal and adapt it to fit available capital, or postpone or abandon the project.

Questions Investors Should Consider

Farmers and ranchers interested in forming an agricultural business also should ask at least five questions regarding the impact of that investment on their own farm and ranch businesses. The following five questions are based on a July 1996 publication, **Five Questions to Ask Before Joining a New Processing Cooperative,** North Dakota State University Extension Service. Frayne Olson, Burdick Center for Cooperatives.

- What are the potential returns from the business investment?
- What risks are the business exposed to?
- How will business investment influence the investor's farm/ranch operation? Will the business risk in the farm/ranch increase or decrease? Will the farm or ranch business be jeopardized if the investment in the agricultural business be lost?
- How will your lender view the investment?
- How will investment in the agricultural business impact your personal or business goals?

*Also see "How to Start a Cooperative." USDA Rural Business/Cooperative Service, Cooperative Information Report 7, September 1996.

9. Implement the Plan

The last step is implementing the plan, which includes constructing the facility and beginning operation.

Acquire Facilities

- *Location.* A site for the proposed business will need to be selected and acquired.
- *Construction Design.* An engineer, along with the CEO or production committee, will study selected sites and develop a final design for facilities.
- *Negotiate the Construction or Refurbishing Contract.* Will this include a bidding process?
- *Government Permits.* The business will need to apply for and acquire necessary federal, state, and local government construction and operating permits.
- *Business Contracts.* The business' management will want to negotiate necessary contracts with input suppliers and product buyers. A contract will not be needed for all suppliers and buyers; the primary focus may be on those firms whose long-term commitment is critical to the success of the business. For some businesses, negotiating an agreement to use

technology controlled by other firms is critical. Developing market opportunities and a distribution network is vital for all businesses. Negotiations also are an opportunity for the group to help suppliers understand how the suppliers can meet the needs of the business. In the short-term, construction contracts need to be finalized. Purchasing various insurance policies also protects the new business against loss from some risks.

Begin Operation

- *Hire the workforce.* Recruiting, hiring and training employees would be one part of initiating the business operation.
- *Prepare to Operate.* The CEO or management team will need to develop delivery schedules for inputs and inform investors and other suppliers to prepare for starting operations. Likewise, buyers of the business' product need to be informed that the production process is about to begin.
- Test production or processing facility and make necessary refinements.
- Move to full operation, including continuous monitoring of market opportunities, production practices, and the business' financial performance.

Summary

Developing a new business is an involved process, and one that may be complicated by the novelty of the product being produced and marketed or the number of co-owners. Although steps can be suggested, they will vary depending on the situation. Generally, developing a new co-owned business involves defining the opportunity, identifying the organizers, setting goals for the business, determining the market potential for the commodity, product, or service, conducting a preliminary assessment of the project, developing a business plan, conducting a detailed feasibility study, organizing the business entity, capitalizing the business, and implementing the plan. Continual reassessment and deciding whether to proceed are part of developing a successful new business. Careful analysis, thorough planning and matching the **market pace** can reduce errors and enhance the profitability and success of a new business.

Dedication

The authors dedicate this publication to the brave and courageous pioneering families who settled the North Dakota territory and those ancestors past, present and future who have continued this legacy as we embark on North Dakota agriculture's successful journey into the 21st century.

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