Evaluating Producers’ Value Added Business Plans

by Danny Klinefelter

Low margins and volatile returns are causing an increasing number of agricultural producers to explore ways to gain more control over the market for their products. Many of the value added activities being considered involve alliances along the value chain and pooling or more formal cooperative arrangements between a group of producers. Unfortunately, for every one of these efforts that succeed, another fails. This article looks at just a few of the questions that need to be considered in analyzing producers’ value added business proposals.

1. First and foremost, do they have a business plan that articulates their strategy and demonstrates the idea has been well researched? In addition to the typical components, does the plan realistically address the major “what ifs” and contingencies, including an exit strategy. A well defined vision is important; but, there is sometimes a fine line between a vision and a hallucination.

2. What are the business’s goals and objectives? What are the sales goals? What is the breakeven level of sales? What are the objectives and expectations in terms of market share to be gained? What are the financial objectives? Is the business expected to achieve a specific rate of return on investment by the end of a certain year.

3. What are the overall market trends and forces driving expectations. In other words, what is the social, political and economic environment they will be operating in and how will it affect the proposed venture? Great ideas can fail simply because they are implemented at the wrong time or in the wrong place. In analyzing trends and drivers it is important to recognize that the rate of change can be exponential rather than linear.

4. Are they going to be in the commodity or differentiated product business? If it is a commodity business, the only source of competitive advantage is to lower costs or be able to gain some market advantage, through price discounts on inputs, price premiums on output, or access to markets or contractual arrangements not available to others.

5. How is the market for their product(s) segmented? Has a profile been developed that identifies the primary and secondary customer groups for their product(s)? Who are their competitors? What business and marketing strategies do they employ?

6. If they are going to be competing in a product market, what is their value proposition and competitive advantage? As Jack Welsh is often quoted as saying, “If you don’t have a competitive advantage, don’t compete.” They need to demonstrate how they are going to differentiate themselves and capture the value they create. What is their uniqueness? How can existing resources be used more synergistically? Is what they plan to do replicable? How likely and quickly might their advantage be replaced by new developments? This is basically a question of how competitive and sustainable is the proposition?

7. If their value added proposition is simply taking on another step in the value chain, do they possess or have they lined up the management capability (and backup) and experience needed to successfully operate the venture. Simply assuming an
additional position in the value chain does not guarantee the same return or performance of the existing middlemen. There are skills, knowledge, relationships, and reputation (brand name or individual) that can determine the difference between success or failure.

8. Is there already excess capacity in the segment of the industry they are pursuing? If there is, they are inviting retaliation from the existing players. Who are the competitors, how strong are they and how are they likely to respond? A price war might totally change the venture’s prospects for success.

9. If an investment in equipment and facilities will be required, how flexible are those assets? Do the assets have an alternative use and a viable market if the venture is unsuccessful? Will they be owned or leased? If leased, what are the terms?

10. Can they provide the continuity and assurance of quantity, quality, and timing that potential buyers need? This may be seasonal if they have the ability to fill an off-peak niche.

11. If they are going to build a processing or handling facility, will it be of sufficient size and operated at a capacity utilization rate that achieves or exceeds competitors’ economies of scale?

12. Is the venture’s success dependent upon a single or a few buyers or suppliers of specific inputs? How viable are these critical partners and can they be trusted? Have they been involved in similar ventures with other producers and what is their track record? Will the arrangement involve a contract and, if so, what are the risks in the contract terms? How would a merger or sale of their principle customer/supplier affect the venture?

13. Does the business and it’s products have a registered/protected name? Do any food products have a Universal Product Code (UPC) and will product labels require nutritional analysis and labeling?

14. If the venture will involve food processing are there plans for implementing a HACCP program and trace back system to address food safety issues and liabilities?

15. If the venture involves exporting have they addressed the issue of ISO 9000 and/or ISO 14000 certification?

16. If they will be acquiring an existing business, what direct or contingent liabilities will be assumed? Would they be better off buying the firm’s assets rather than the business?

17. If a cooperative arrangement or alliance is involved and the venture requires a certain volume to be viable, what are the penalties if one or more of the participants decides to leave?

18. If the venture involves a legal structure with multiple investors is there a formal stockholder agreement or buy-sell? At a minimum it should address voting rights, the basis for valuation and transfer restrictions. Is there a repurchase provision or funding mechanism to protect the business while also providing investors some liquidity?

19. What are the risks and requirements associated with government programs and regulations? This includes everything from licensing, permitting, and compliance issues to the impact of subsidies and protection from competition in the form of tariffs or quotas. What are the risks and likelihood of changes in programs or regulations?
20. Are there state or local economic development incentives in the form of abatements, financing, exemptions, etc., that they could be taking advantage of? What are the penalties if the terms of these incentive programs are not met?

The importance of conducting a comprehensive analysis is compounded by the fact that in addition to financing the project, many lenders will also be financing the member producers equity investment. It is possible, therefore, that directly and indirectly they could end up financing 100 percent of the venture.

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