Should I Invest in Agricultural Start-up Business Ventures?

Ag Decision Maker
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Over recent decades farmers and others have had the opportunity to invest in a variety of agriculturally based business start-up ventures. Many of these have focused on business ventures just past the farm gate such as the processing of crops and livestock. Recently, some of these have focused on the production input side of agriculture.

Across the Midwest, the investment opportunities have ranged from biofuel businesses to meat packing facilities to pasta plants to egg-laying facilities to Brazilian agriculture to ammonia fertilizer production. Deciding whether to participate in these investment opportunities has become an important decision for farmers. The points discussed below can help you make the best decision for your situation.

1) How much can you afford to lose?

Don't invest more than you can afford to lose. One way of determining this is to assess the impact the loss would have on your farm business and your family. You should never use an investment to try to make up for a financial deficit in your farm business.

Some farm families set aside a certain amount of funds each year as "risk funds" to be invested in outside business ventures. Their view is that these funds are not essential for their family or business if the investment fails. But if it succeeds, the rewards are like "found money" that can be spent on a family vacation, invested in the farm business or reinvested in an outside business venture.

2) Can you assess the viability of the business ventures?

On any investment, you need to assess the potential for business success. Your exposure for assessing the investment often comes in the form of a presentation at a meeting and a disclosure document provided at the meeting. Although a lot of material is usually presented in a short period of time, you can increase your understanding of the business by taking notes, especially focus on jotting down questions about the business investment. There is usually a session at the end of the meeting where you can ask questions. Presenters are often willing to answer questions even after the meeting has ended. There is often a telephone number provided where you can call to ask questions or ask for further insight. Studying the disclosure document can increase your knowledge of the business.

Business start-ups often schedule a series of meetings at multiple sites or virtual events. So, attending another meeting can usually improve your understanding of the business and the investment. Although all of the meeting presentations cover the same topics, you may find several things that you missed during the first presentation by hearing it again.

You often have a period of time to make your investment decision after you have attended a meeting. You may discuss the investment opportunity with friends and neighbors whose opinions you respect. They may be able to provide you with a different perspective on the business and the investment opportunity. In addition, an outline, **Assessing Agricultural Processing Investment Opportunities**, www.extension.iastate.edu/agdm/wholefarm/pdf/c5-230.pdf, is available to help you think through the various aspects of the business. You can use this as a checklist of factors to consider in assessing the viability of the investment opportunity.

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3) Should you invest in an outside business or your own farm business?

You need to assess whether the financial payoff will be greater by investing in an outside business venture rather than investing in your own farm business. Farms are capital intensive businesses that require large amounts of money to operate efficiently. You should thoroughly assess the investment needs of your farm business before considering an outside investment.

The decision may depend on the stage of your farming career. If you are early in your career and building your farm business, you may want to invest in your business. Conversely, if you are in the latter stages of your farming career, investing in the outside business may be more feasible.

4) How will the investment impact your farm business?

Because many of the investment opportunities involve agribusinesses, the investment may impact your farm business by creating new markets or better markets for the products from your farm. Corn ethanol plants increased the corn basis for surrounding farmers. In addition, the demand for corn by the ethanol industry increased the prices of the entire grain complex.

Businesses that use biomass as a feedstock may create new markets for crop residues and perennial grasses. Investments in businesses on the production input side of the ledger may reduce input costs or produce higher yields. Research shows that, for farmer investors, these benefits are as important in making their investment decision as the financial return from the investment itself. Farmers early in their career may find that these outside investments may have a positive impact on their farm businesses over the rest of their farming career.

The outside investment may lower your financial risk by diversifying your income sources. Farmers traditionally achieved diversification by having multiple crop and livestock enterprises. However, in recent decades farmers have reduced the number of enterprises on their farms because of the benefits of specialization. Specialization has become important due to the increased complexity of farming and the need to be a low cost producer. Investing in outside business ventures is a way of diversifying income sources while continuing to specialize labor and management resources.

The investment may act as a type of hedge against low commodity prices. Livestock enterprises have traditionally served this purpose. When grain prices are low, income from the cropping system may be low, but the low grain prices increase the returns from the livestock enterprises. Farmers may use an investment in a corn ethanol business or other agribusiness venture for the same purpose. Of course, if ethanol prices are low there may not be much profitability in either corn production or ethanol production.

5) What is the business risk/reward profile?

All start-up business ventures have the potential for rewards but hold the risk of failure. Assessing the relationship between risk and returns plays an important role in your investment decision. Most investors focus on the risk side of an investment but don't assess the potential for and magnitude of returns.

The most sought after investments are those with low risk and high returns. However, these are rare and usually find sufficient investment quickly. Conversely, the investment opportunities you may see most frequently are those with high risk and low returns. These are not the ones in which you are interested in investing. The investments in which you may be interested in investing are the ones where the rewards match the risk (low risk/low returns, high risk/high returns).

A framework for assessing the risk/return viability of an investment is shown in Figure 1. Obviously the risk/return assessment is subjective and difficult to quantify. However, your ability to make an assessment of the risk/return profile is important in making successful investment decisions.

Figure 1. Investment assessment based on risk/returns profile

		Returns: Low	Returns: High
Risk	High	Poor	Moderate
Risk	Low	Moderate	High

Another aspect of the risk/return profile is to fit the profile to your investment needs and desires. Many individuals are not comfortable with a high risk investment, even if it may provide a high return, because they don't like the prospect of losing their hard-earned money. Conversely, some individuals like the prospect of going after a high return investment, even if the risk of loss is high.

6) Does the proposed business model fit your needs?

An important aspect of your investigation is to identify the form of the future payoff from the business. Is the business model designed to provide an income stream of returns annually into the future? This is often the model used for business ventures past the farm gate such as commodity processing. The typical business ventures of this type in recent years have been corn ethanol.

Conversely, many start-up businesses are created to be sold. The business model is to build the business as quickly as possible by investing the profits back in the business (rather than distributing to investors) and, after a period of years, selling the business to a large agribusiness company. Rather than receiving an on-going annual income stream as with commodity processing, these businesses create a one-time large payoff when the business is sold. At the core of this business model is often some form of intellectual property.

You need to identify the expected form of payoff from an investment. As a capital intensive business, farming tends to be high on wealth and low on cash. Many farmers prefer an investment that will give them an annual cash income stream rather than one with a potential big payoff several years down the road.

7) Can you sell your investment?

Traditionally, investors are accustomed to selling their investments at a time of their choosing. Investments that are traded on an organized exchange like the New York Stock Exchange allow ample opportunity to sell investments. However, an investment in a start-up business is usually not traded on an organized exchange. So an investor's ability to sell their investment (liquidity) may be severely limited. A seller may need to find a buyer and then negotiate a price. And then the transaction may need to be approved by the business. To improve the process, the business or a third party may provide the service of listing offers and bids of interested sellers and buyers. Even then, finding a buyer is especially difficult if the start-up business is not doing well. Conversely, if the business is doing well, the sale price you get for your investment may not be as high as if it were traded on an organized exchange.

For more information on business development, visit the Ag Decision Maker website, www.extension.iastate.edu/agdm/vdanalysis.html.

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