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Value-added Business Success Factors: Organizational Issues

There here has been a surge of interest in farmer-owned business ventures that seek to capture additional value from commodities past the farm gate. Some of these ventures have been very successful, some marginally successful, and some have failed. Supported by funding from the Ag Marketing Resource Center at Iowa State University, we conducted in-depth interviews with farmer-owned businesses to determine the key factors that influenced the relative success or failure of these ventures. A better understanding of why some ventures succeeded while others failed provides valuable insight for the success of future farmer-owned businesses. This article focuses on the role of organizational issues on business success.

Research method

To identify factors having the greatest impact on the success or failure of farmer-owned business ventures, a cross-section of seven farmer-owned commodity processing businesses formed since 1990 in North Dakota, South Dakota, and Minnesota were selected. Extensive interviews were conducted with individuals who played, or continue to play, an important role in the formation and operation of the business. This included leaders in the formation of the business, key members of the management team, selected board members, lenders, local leaders and others.

Research results

Most New Generation Cooperatives (NGC) were organized prior to the mid-1990s. Organizational structure was less important at that time than it is today. There were no viable alternative legal business structures for farmers that wanted to band together to form a new business venture to add value to their commodities. So, for a time, this structure met the needs of farmer-owned business ventures. It provided limited liability and pass through taxation. But many ventures realized that the business principles that served distribution and supply cooperatives well did not work for capital intensive processing ventures that characterized most NGC.

In the early to mid-1990s, many states passed legislation to allow agricultural ventures, as well as other types of ventures, to organize as limited liability companies (LLCs). It retained the principles of a traditional cooperative but removed some of the restrictions that made the cooperative cumbersome for farmer-owned processing facilities. The LLC retains key characteristics of traditional cooperatives such as limited liability and pass through taxation, but removes restrictions on non-farmer investors and membership delivery requirements.

Legal organizational structure - An early decision for a group organizing a farmer-owned venture is the legal organizational structure to be adopted. In recent years, most farmer groups have formed as an LLC or corporation (subchapter C). These are more favorable organizational structures than a traditional cooperative. An LLC offers similar advantages as an NGC with fewer restrictions on membership and purchasing inputs (no delivery requirements).

For other groups, a corporation was most appropriate by providing better access to capital from non-producer investors or equity funds. However, a corporation's earnings are taxed twice – once at the corporate level and again when distributed as dividends to the owners.

Although more options for organizational structure are available today, the traditional cooperative structure is still the model of choice for certain types of farmer-owned businesses. An example is the highly successful sugar beet cooperatives of North Dakota and Minnesota. Sugar beets and other specialized commodities that lack spot markets find the traditional NGC model preferable.

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Decision making - Another consideration when deciding on a business model is the seemingly cumbersome decision making process inherent in the traditional cooperative structure. All major decisions must be approved by the members in a one-member, one-vote process. Not only is the process cumbersome but there are issues of confidentiality. Some of the businesses we interviewed stated that some companies prefer not to do business with cooperatives because of confidentiality issues. For example, an agribusiness company might wish to discuss a joint venture project with a cooperative but prefer to have the information kept confidential until the details are worked out. However, maintaining confidentiality may not be possible with a cooperative where management and the board must obtain member approval. In any event, the LLC appears to be the preferred organizational form for most new farmer-owned businesses (e.g., new ethanol plants). Many businesses that were organized prior to advent of the LLC have subsequently converted to an LLC.

Board composition and training - A critical decision when organizing a new venture is the composition and size of the board of directors. Board members with previous board experience and appropriate business or industry experience is critical. Because farmer-owners seldom have sufficient experience or expertise in the production and marketing of processed products or experience in managing an organization as large or complex as a processing venture, including outside board members (board members from industry who may not be owners) is often desirable.

It is also important to conduct training for board members. This includes not only training for new board members but on-going board training programs as well. Just like the business itself, the board must make an investment in the form of on-going board training to maintain its industry competitiveness.

Board size and the meeting schedule should be manageable. Even an experienced and well-trained board of directors can encounter problems if the board size or meeting agenda is unmanageable. Two of the organizations we interviewed had boards of directors with more than 20 members. They suggested that their boards were too large. The desire for equitable representation of the business's farmer-investors often leads to large board size. However, this desire should not be allowed to jeopardize the board's ability to effectively lead the company.

Professional team - When making important business decisions, access to business, legal, financial, and industry expertise is critical. Early in the process, founding members should seek professional expertise. While retaining professional services can be costly for a start-up with little or no working capital, the importance of professional council cannot be over-emphasized. For some businesses, state assistance was available and pivotal in financing feasibility studies and business plans. Another business reported that their attorneys worked on a contingency basis during the early days of the organization. State and local economic development programs may be a good place to find access to, or funding for, professional services.

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