PB1759-First Things First - Initial Steps for Developing Value-added Cooperative Farmer Ventures

The University of Tennessee Agricultural Extension Service

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First Things First

Initial Steps for Developing Value-Added, Cooperative Farmer Ventures
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Foreword

This publication provides information for farmers who are considering a cooperative venture. The information discusses various steps and stages that farmers will likely encounter as they take a cooperative venture from an idea to a complete feasibility study. This document does not provide information beyond the feasibility phase. The information presented is based on various experiences developing farmer cooperative ventures in Tennessee and from numerous other cooperative development educational publications and resources. This is not intended to serve as a “how-to” guide. Rather, the information is intended to prepare farmers for the steps they will encounter and to assist them in navigating through the early phases of considering a cooperative venture.

Considering a cooperative farmer venture is a complex process that involves a wide array of issues, from strategic planning and group dynamics to state and federal security exchange and taxation issues. This publication does not attempt to address all of the intricate details of organization – it focuses on a description of various steps and phases that often occur between the idea stage to the feasibility stage.

This publication is prepared as part of the Center for Profitable Agriculture’s involvement in the Cooperative Development Initiative funded in part by a collaborative educational program from 2003 to 2005 with the Kentucky Center for Cooperative Development and the Tennessee Department of Agriculture.

Special appreciation is extended to Phil Kenkel of Oklahoma State University Bill Fitzwater Cooperative Center for his close assistance, cooperation and advice in the writing and review of this document. Appreciation is also extended to Delton Gerloff – UT Extension Agricultural Economics, Heath Hoagland – Kentucky Center for Cooperative Development, Wanda Russell – UT Institute of Agriculture Marketing and Communications, and Amanda Ziehl – UT Extension Center for Profitable Agriculture for their assistance in the review process and to Gary Dagnan – UT Institute of Agriculture Marketing and Communications for assistance with the layout and design work. Also, a special thanks to Dan Wheeler – UT Extension Center for Profitable Agriculture, Larry Snell – Kentucky Center for Cooperative Development and Joe Gaines – Tennessee Department of Agriculture for their leadership and assistance with cooperative development programs in Tennessee.

Rob Holland
Center for Profitable Agriculture
University of Tennessee Extension
Introduction

Many Tennessee farmers have developed successful value-added ventures over the years. Although the use and definition of value-added agriculture varies, an acceptable description includes processing, packaging and marketing agriculture commodities and farm resources in ways that allow farmers to benefit by receiving a greater share of the economic value returned to their farm commodities and resources. Adding value is the process of converting agricultural commodities and farm resources into products of greater value, increasing the economic value of an agricultural commodity or the process of increasing the consumer appeal of a commodity. Some peach and apple growers have developed value-added ventures by processing, packaging and marketing fruit cider, fruit jelly and fruit pies. Dairy farmers may add value by processing and bottling milk. Livestock operators may add value by composting farm wastes and marketing a packaged soil conditioner product.

The latest Agricultural Census shows that the number of Tennessee farmers adding value by participating in direct farm sales to consumers increased by 698 between 1997 and 2002. This 25.9 percent increase in the number of Tennessee farmers involved in value-added agriculture through direct marketing was paralleled by a 34 percent increase in the total value of agricultural products sold directly to consumers. That is, in 1997, the value of agricultural products sold by Tennessee farmers directly to consumers was $8,380,000; and in 2002, the value increased to $11,227,000.

While the number of value-added enterprises has increased, there is even a greater number of “would-be” value-added ventures that have not been implemented. Some farmers have been able to add value to their existing farm operations with relatively small capital investments. For example, on-farm commercial kitchens have been developed for less than $50,000 in initial start-up costs. However, other value-added ventures require significantly greater initial start-up investments. In fact, among the more common reasons that some value-added ideas have not been fully developed into new business ventures is the relatively large start-up capital investment required, the number of leaders involved and their commitment in the early phases.

For example, many corn and soybean growers have considered the potential of adding value to these commodities by manufacturing ethanol and biodiesel fuels. However, the mention of initial start-up capital requirements in the tens of millions of dollars, even in excess of $100 million, is simply more than most farmers want to invest by themselves.

The desire to add value to corn and soybean commodities through large-scale ethanol and biodiesel operations has been observed as a leading reason that new farmer cooperatives are being considered. That is, many farmers are looking to cooperative ventures as a way to collectively accumulate relatively large sums of start-up capital for value-added ventures. Value-added cooperative ventures also allow members greater influence over end products made from their commodities and, thus, offer a way to better influence the overall success of their farming enterprise.

While some do get involved with capital-intensive, value-added ventures from an investment position, it should be stressed that a primary motivation behind the formation of value-added cooperative ventures is the collective desire to move up the value chain and obtain a greater profit potential from the marketing of the value-added product rather than the raw commodity. It is worth
emphasizing that the ultimate profit potential of a value-added cooperative venture is essential for long-term success.

Among other factors, farmers may ultimately decide to develop a cooperative in order to acquire substantial amounts of start-up capital. While this may be the primary motivation for a cooperative, to increase the chances of business success and sustainability, the initial phases of developing a cooperative venture must be based on sound business principles, not just the motive of raising capital. Cooperative farmer ventures can be legally structured in a number of ways, including partnerships, corporations, limited liability companies or cooperatives. The specific legal structure of a cooperative venture should be considered during the initial planning phases. The actual determination of the best legal business structure may result from the feasibility study.

Processing Cooperatives

Since January 2005, organizers of cooperative farm ventures in Tennessee have an additional legal business structure to consider. Legislation passed in 2004 by the Tennessee General Assembly authorized the formation of a “processing cooperative,” which merges some characteristics of traditional cooperatives with some characteristics of LLCs (limited liability companies).

Starting a value-added cooperative venture is a complex undertaking. Oftentimes, cooperative farmer ventures start when a small group of farmers discuss a common need and then find themselves developing an idea of how to fulfill it. Depending on the situation, a new cooperative farmer venture may be met with excitement and enthusiasm or with significant competition and opposition. Similarly, new cooperative ventures may experience quick and easy or long and difficult capital drives. Developing a successful cooperative venture requires both objectivity and enthusiasm by many committed people.

The law allowing processing cooperatives in Tennessee dictates what must be done to legally organize such a business. As Tennessee farmers consider assembling processing cooperatives and other cooperative ventures, they encounter several phases of evaluation and development, long before the paperwork and legal documents must be completed. While there are no specific steps that will guarantee a successful venture launch, long-term success potential may be increased when farmers are aware of the phases they will likely encounter and are better informed about how to navigate through the development phase of the new venture.

Initial Development Steps

Although time-consuming, the steps of forming a cooperative farmer venture occur along a logical path. However, each group’s journey along the path can be very different and take various amounts of time.

Leaders involved with the development of new cooperative ventures must demonstrate a combination of expertise, enthusiasm, practicality, dedication and determination to see that the project is well-planned, developed and completed. The responsibility for early development of a cooperative farmer venture rests mostly with an emerging leadership group. Leaders begin by discussing their idea at one or more small group meetings with other prospective members. If the group supports the idea, the next step is to seek the advice of someone familiar with cooperatives and the cooperative development process.

Below is a list of 10 steps that the leaders of a developing cooperative venture should expect to encounter up to the phase of developing a feasibility study; many other organizational and development steps will follow the feasibility study. The degree to which each of these steps will be experienced will vary greatly from one group to another. Some of the steps described here will be combined for some groups. The list begins with the very informal phase of new venture development, where common needs naturally begin to be discussed in the community. The listing of 10 initial steps is followed by a more detailed explanation and discussion of each step.

- **Discussions of common needs** that could be addressed through cooperative ventures begin to surface in the community.

- An **informal, small-group meeting** should be planned where a few of the leading potential member-users convene to discuss issues and identify the economic need a cooperative venture might fill. This meeting could include a

1 Additional details of Tennessee’s Processing Cooperative law are available in a UT Extension publication titled Commentary and Overview for the Tennessee Processing Cooperative Law, (PB 1748). This publication is available on the UT Extension Web site at [http://www.utextension.utk.edu/publications/pbfiles/PB1748.pdf](http://www.utextension.utk.edu/publications/pbfiles/PB1748.pdf).
 logical combination of formal/planned presentations and open/unscripted dialogue.

- An **exploratory meeting** should be held with a larger group of potential member-users. This meeting could include a combination of formal/planned presentations and open/unscripted dialogue. This meeting should result in a clear indication of whether the idea should be pursued further.

- If the consensus of the exploratory meeting is that the idea is worthy of continuation, then a **steering committee** should be selected.

- The steering committee should then begin to **conduct preliminary industry analysis and assemble specific evidence of support** for the venture. This is often accomplished through a complete review of industry literature and a survey of prospective members to determine the potential use in the cooperative venture.

- The results of the steering committee’s study/survey should then be discussed at a **general meeting** with all potential members. At the conclusion of this second general meeting, the steering committee should evaluate the status of continuing the venture.

- If the consensus is to continue with the venture, the steering committee should develop a **project summary** that proclaims the mission and competitive advantage of the venture and estimates the potential number of members and the volume of business expected. The project summary should also include an analysis of costs and potential returns.

- After the project summary is developed, another **general group meeting** should be planned to discuss the summary. At the conclusion of this third meeting, the steering committee should evaluate the status of continuing the venture.

- If the consensus is to continue with the venture, the steering committee should embark on the development of a feasibility analysis.

- After the feasibility analysis is completed, the steering committee should call a **fourth general meeting** to discuss the findings/results.

**Discussions of common needs**

Many times, informal and unorganized discussions go on for weeks, months or even years before a true commonality is recognized. These informal discussions may be organized but may also occur coincidentally. Some of the most successful cooperative ventures stem from early discussions that surface without any organized campaign or agenda. This period for discussion of common needs is important to support building and helps substantiate a true economic need for a cooperative venture.

**Informal, small-group meeting**

Once “discussions” have surfaced and run their course through the community, a small group of key leaders should gather to bring leadership and substance to the discussions. The common needs should be further discussed and a core venture theme should begin to develop. While numerous, common needs often exist, it is important for a single issue to be identified and selected as the key theme or core venture for cooperative action. The initial, informal, small-group meeting should certainly begin to narrow the description of the economic need the cooperative might fill. This meeting should also begin to build trust among the leaders and should foster open, frank discussions.

**Exploratory meeting**

A cooperative venture should involve a group of farmers who adopt a common vision of what is to be accomplished. To gain a sense of interest from a larger number of farmers, an exploratory meeting should be held with potential members, investors and supporters. This meeting should, to the extent practical, target producers from the entire geographic region envisioned for the venture. A strong attempt must be made at getting the right people to attend. Various methods can be used to announce and promote the initial exploratory meeting. The leadership group should be heavily involved with planning the meeting, developing an agenda and selecting a moderator/facilitator.

The meeting should allow plenty of time for discussion and attendees should be encouraged to ask questions and express their views. While this exploratory meeting should have some parameters, it should also foster a good balance of brainstorming. Most all questions and issues are fair at this session, although answers may be delayed until more information is available. Various formats for the exploratory meeting are possible.
One approach is to have someone from the leadership discuss the mutual needs of the group and then have another member of the leadership group identify how a cooperative venture would address the needs. Another approach would be to have specialists/experts from the industry address the group and to have members of similar successful organizations discuss their experiences and the benefits and limitations of their organizations.

It is important that appropriate resource personnel such as Extension agents and specialists, lenders, business development professionals and agriculture leaders be involved. However, the focus of the meeting should be on producers and potential members. Resource personnel should serve in an advisory capacity.

Steering committee

If the consensus after the exploratory meeting is to continue with the cooperative venture idea, then a steering committee should be selected. The steering committee should be structured to be representative of all potential members of the venture. Members of the steering committee should have a very strong interest in the cooperative venture, should be well-respected within the community, have sound business judgment, should possess leadership skills and abilities and should be able to devote the needed amount of time to the effort. The character of steering committee members must also be considered. The steering committee must be made up of individuals who can be trusted and respected by other potential members. The steering committee should not consist of members who disproportionately represent a specific geographic area or a specific interest group.

Steering committee members become the first champions of the venture and often become the initial organizers and members of the cooperative venture’s first board of directors. The steering committee is usually made up of seven to 11 people.

One of the steering committee’s main roles is to keep potential members informed of their progress. The steering committee should consider identifying officers and should quickly determine their mission and the expected outcomes of their work. The precise mission and objectives of the steering committee may vary. For example, the steering committee of one cooperative venture might be charged with coordinating a specific feasibility study, conducting a survey of producers, raising capital or any combination of these.

Regardless of the scope of work expected by the steering committee, a written description of the committee’s work should be developed early after the committee is identified. Members of the steering committee should be prepared to volunteer a significant amount of time to the development of the venture. As a group, the steering committee should exhibit the following characteristics:

✔ enthusiasm and the willingness to work hard
✔ determination to succeed
✔ good communication skills
✔ flexibility and resiliency
✔ strong decision-making skills
✔ ability to mobilize and organize resources
✔ previous business and leadership experience
✔ knowledge of the industry
✔ ability to cooperate and work as a team

Conduct preliminary industry analysis and assemble specific evidence of support

Two of the initial key functions of the steering committee will likely be to conduct a preliminary analysis of the industry in which the proposed venture will operate and to secure evidence that there is sufficient interest by a critical mass of producers to support the cooperative venture.

A preliminary industry analysis should consider the common barriers to market entry, including proprietary technology, access to distribution channels, access to raw materials, cost advantages due to experience and technology and minimum efficient scale of production. These barriers are particularly significant for the food industry, which is characterized by a small number of large firms, a complex regulatory framework, high technological requirements and costs, and increasingly limited access to distribution channels. Producer groups must carefully select a market segment where these barriers can be overcome.

Regarding evidence of support by producers, formal surveys are one of the best methods of estimating potential membership in a cooperative venture. The steering committee should approve a questionnaire that will provide input on the most critical issues. The following list provides a broad idea of the information needed from the survey:

1. Potential level of participation in the venture (this should be in a quantified unit of measure typical for the industry/enterprise)
2. Experience and capabilities of potential members
3. Variety of products or services needed
4. Period of time when services are needed
5. Member/user locations
6. Familiarity/experience with cooperatives
7. Identification of special or unique needs

It is important to develop a written questionnaire. The process of developing a written questionnaire is oftentimes as valuable to the steering committee as the results. The precise method of implementing the survey will depend on a variety of venture-specific issues. If the group of potential members is small enough to justify a face-to-face survey, then this method may be the most preferred. Although it can be very time-consuming, face-to-face surveying can be very beneficial and provide observational data to the steering committee. Mail or telephone surveys are often considered most efficient, but these methods do not foster as much observational data nor provide a response rate as high as face-to-face contacts. Once a suitable questionnaire has been developed and implemented, the results should be summarized and prepared for discussion at a second general meeting.

**General meeting**

The results of the steering committee’s study/survey should be the primary subject of another general meeting with all potential members. In addition to reporting the results of the committee’s survey, this general meeting is also the time for the committee to present any other data, information or decisions that help narrow the focus of the group. The steering committee’s presentation at this group meeting is another opportunity for the entire group to discuss the future of the cooperative venture and make a decision about how to proceed. At the conclusion of this general meeting, the steering committee must be prepared to evaluate the status of continuing the venture.

**Project summary**

If the consensus at the end of the second general meeting is to continue with the venture, the steering committee should embark on the development of an overall business summary. The most basic function of developing the business summary is to determine and describe the fundamental purpose of the cooperative venture. The business summary will include a mission statement and listing of the competitive advantages of the venture, an estimate of the potential number of members and the volume of business expected. The business summary should also include an analysis of revenues, costs and potential net returns.

Discussions about conducting a survey of potential members and development of a project summary oftentimes cause great disagreement over which one should be done first. While this is a valid argument, it is difficult to give a “one-fits-all” answer. Some steering committees will find that the project summary is needed before the producer survey can be conducted. Others find that the survey is needed first. Others will develop a brief summary then conduct the survey before finalizing a complete summary. The possibility of conducting a pre-feasibility study should also be considered in the discussion of surveying and developing a project summary.

After the project summary is developed, the steering committee should evaluate the status of continuing the venture. If the consensus is to continue the venture, specific project and group dy-

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*It is appropriate for most groups to initially operate as an informal group. However, at some point the group may need to elicit “exploratory funds” from interested producers, apply for grant funds or contract with outside consultants or contractors. At this point the group may want to consider the formation of a legal entity. In some cases it is possible to begin formation of the actual cooperative organization. Other groups form a legal entity, such as a limited liability company, which will function through the formation phase and then be dissolved when the final organizational form is decided. Regardless of whether a legal entity is formed at this time, the group will want to begin to consider how exploratory funds will be raised, record-keeping procedures and tax implications. At periodic points during the organizational and consideration phases, the steering committee should evaluate whether the venture can be funded through producer capital. If the capital requirements exceed the amount that can likely be raised from producers, the group will likely need to consider, at that point in time, a legal business structure that will accommodate both producer- and investor-class equity investors.*
namics will likely determine whether the next step will be to conduct another general group meeting or to move directly into conducting a formal feasibility study.

**General group meeting**

If the decision is to conduct another general meeting to discuss the results of the project summary, the steering committee will present details of the possible cooperative venture and should allow potential members the opportunity to provide input and discussion about the planned business. The presentation of the venture summary should include the mission statement for the venture, clear definition of what the business will do, which specific products or services will be provided and an explanation of how the products fit in the marketplace (do they fill an unmet demand or do they have a unique competitive advantage). The steering committee must also present an estimate of the potential number of members and the volume of output needed to operate efficiently. Based on input from potential members during this third meeting, the steering committee should evaluate the status of continuing the venture. If the decision is to continue developing the business idea, the steering committee should prepare to embark on developing a feasibility analysis and formal business plan for the venture.

**Feasibility analysis**

A feasibility study will provide a model of the venture’s viability and probability of success. The feasibility study will also provide a majority of the significant information needed for a business plan. It also helps identify major obstacles before more time and money are invested in organizing the business. The feasibility study also provides an indication of how sensitive the venture is to various changes that it may encounter – changes in volume of inputs, volume of output and operating costs. For example, how well can the proposed venture respond to changes in sales, wage rates, operating efficiencies, interest rates and weather?

The feasibility study may take the form of a formal study conducted by a contracted, independent, third-party consulting firm or an informal assessment by members of the steering committee and various other leaders and advisors. If the decision is made for the feasibility analysis to be conducted by the steering committee, it is suggested that there be sufficient third-party input. Active third-party involvement from bankers, attorneys, accountants, Extension or others will help bring objective views and add credibility. The specific business venture considered will likely determine how the feasibility study is conducted and by whom.

For very large, complex and high capital-cost ventures, it is not uncommon for an independent, third-party feasibility study to cost between $25,000 and $100,000 or more. In these cases, the steering committee may find itself providing leadership to a significant fund-raising campaign to fund a third-party feasibility analysis rather than actually conducting a study and assembling a feasibility report. Cost estimates from outside contracting firms oftentimes scare steering committees into conducting the feasibility study on their own. In some instances, the steering committee is perfectly capable of conducting the
feasibility study. However, in most cases, at least some outside assistance will be needed – this may be for accounting, engineering, legal or specialized technical input and assistance. Some steering committees who have opted to take on the task of administering and conducting the feasibility study in hopes of saving money have found very little savings after considering the significant amount of time, stress, frustration and the costs incurred for specialized consultations.

Some feasibility studies can be developed by the steering committee, with very little or no cost, in a short period of time and can be very short documents. However, more complex projects may dictate that the study be conducted by a third-party consultant, could require months of preparation, may result in a lengthy report (100 to 200 pages) and could cost a significant amount of money.

The steering committee will need to consider how the funds needed to finance the study will be generated. The group should investigate the availability of grant funds and consider eliciting donations and contributions from potential members and supporters. If the group solicits or accepts funds it is essential that the contributors understand that the funds are “at risk” donations to help fund the feasibility study and that their contributions do not constitute an equity investment in the proposed business.

If a steering committee decides to hire an outside consulting firm to conduct the study, several things should be considered. First, steering committees should feel comfortable seeking a cost estimate for their study from at least two different firms/agencies and should prepare to interview the different firms to find out how well they can work together. A major feasibility study should not be negotiated over the telephone, nor should it be done without determining exactly what the study will include. A payment schedule and a contract should also be developed between the steering committee and the consulting firm. Once the steering committee starts shopping around for a firm to conduct its feasibility study, a variety of “options” of items, tasks and sections to include in the study will have to be determined. For example, some firms will develop a feasibility study that includes only engineering and site-planning analysis. Other firms may conduct a feasibility study that only includes marketing or financial analysis. A particular steering committee may need one or all of these types of analysis and may need additional studies too. A scoring worksheet to help steering committees evaluate a consulting firm according to certain criteria is available in Figure 1.

A steering committee should not assume what a consultant will include in the final feasibility report. The committee should be detailed and specifi-

<table>
<thead>
<tr>
<th>Figure 1. Scoring Worksheet to Evaluate Consulting Firm (*)</th>
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<tbody>
<tr>
<td><strong>Criteria</strong></td>
</tr>
<tr>
<td>Previous experience creating feasibility studies</td>
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<tr>
<td>Knowledge of the industry to be studied</td>
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<tr>
<td>Proposed interaction with the steering committee and prospective members</td>
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<tr>
<td>Reasonable cost</td>
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<tr>
<td>Degree of details when identifying what the study will include and how it will be prepared/presented</td>
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<tr>
<td>Verbal presentation/communication skills</td>
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<tr>
<td>Qualifications of the principal researchers or team that will conduct the study</td>
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<tr>
<td>Miscellaneous/intangible factors</td>
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<tr>
<td>Responsiveness and professionalism during the negotiating process</td>
</tr>
<tr>
<td>Total Score</td>
</tr>
</tbody>
</table>

ic when identifying what the feasibility report will include and the type of information that the report will provide. This is the case whether a consultant is used or not. The USDA has published a guide to assist agricultural cooperatives in completing a feasibility study. The guide\(^2\) presents important elements that should be considered when conducting a feasibility study and contains information on the steps involved in developing the study, how to evaluate and implement a study and tips on selecting and working with consultants.

Oftentimes, a feasibility study generates a large portion of the information needed to prepare a business plan. However, a feasibility study and business plan are different business planning tools, developed at different phases of the business development process. If the steering committee desires for the consulting firm to also develop a business plan, this should be discussed in advance.

A feasibility study is an analytical tool developed during the planning stages of a project. The study should include identification of various options and opportunities available to the business and should investigate the complex markets that the business is expected to face. The study should be finalized with a written report that documents the findings and shows how the business would operate under a given set of assumptions.

Sample contents of a feasibility study include:

- Introduction and scope of study
- Overview and description of the planned business
- Evaluation of alternative business structures (including organizational and operational structure)
- Evaluation of labor and management needs, availability and cost
- Results of the producer survey and supply analysis
- Technology analysis
- Transportation and processing analysis
- Marketing analysis
- Financial analysis
- Overall evaluation of feasibility

A detailed example outline of a feasibility study for a farmer cooperative venture is available in the appendix.

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Sources


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