Section 3

Overview

Section 3 of this manual guides you through the process of building your own business plan. The section is organized in the steps of building that plan as they are outlined in the long-standing and often used CIRAS publication *How to Write a Business Plan*.

Under each step of building the plan you will first be shown the applicable page or pages from *How to Write a Business Plan*. Immediately following, a sample of that page or pages composed for a fictitious processing company – perhaps similar to one you are contemplating – is provided as an example of what you might do at this stage of building your plan and putting it on paper. The not-real company compiled for this example is Cattle Producers Marketing Coop.

Then, following each portion of the business plan presented and the fictitious company's information that applies to it, you will find a variety of articles that address in-depth the topics included in that particular portion.

Request Page

This section should include a summary of the company's loan request.

Information to include:

1. Company Name
2. Dollar Amount Required
3. Month and Year the Loan Is Required
4. Purpose of the Loan and How Money Will Be Spent (Be specific.)
5. Equity
   Amount and type of equity. As owner how much cash will you invest, or what type of assets will you contribute?
6. Contact
   Contact person at the firm who is responsible for the proposed business plan.

Sample Request Page

Our only choice is to do what is best for our customers.
123 Format Way — Our Town, IA — (505) 319-7120

February 29, 2000

Kelly Sharp, President
First State Federal Bank
9110 Ledger Street
River City, IA 12345

Dear President Sharp:

1 Cattle Producers Marketing Coop is a producer's cooperative established to help more than 25 area beef producers:

- secure a higher percentage of the consumer dollar; and
- obtain a higher price for food, fiber and crafted items produced on family farms.

2 In order to fulfill its purpose, Cattle Producers Marketing Coop, headquartered in Bordertown, IA, is seeking a loan of $125,000 to assist with costs associated with the:

- purchase of processing machinery and equipment.

This equipment will be placed in Larry and Linda's Locker Plant in Bordertown. The owners will finance the purchase and will remain on staff to assist in operation of the business.

4 So far, 26 cooperative members of the coop have committed $260,000 in cash to this project, and the Bright County Development Corporation has agreed to
5 provide technical assistance of various types. The owner equity will be split equally between a down payment on Larry and Linda's Locker Plant and a down payment on purchase of processing machinery and equipment.

3 The requested financing will be needed in 90 days. To allow Cattle Producers Marketing Coop to take advantage of near term opportunities that may be crucial to long term success, financing is needed by July 1, 2000.

6 For additional information please contact:
Bailey B. Line, General Manager
Cattle Producers Marketing Coop
Mainstreet
Bordertown, IA 54321
Phone: (505) 319-7120; Fax: (702) 319-7020; Cell: (309) 702-5150
E-mail: GoCy@planright.com

The attached business plan outlines and explains all aspects of the proposed project.

Respectfully,

Bailey B. Line

Bailey B. Line, General Manager

Title Page

Items to include:

1. Company Name
2. Date
3. Contact Person

Sample Title Page

1 CATTLE PRODUCERS MARKETING COOP

2 February 29, 2000

3 Bailey B. Line

Table of Contents

Sample Table of Contents

Cattle Producers Marketing Coop Table of Contents

Executive Summary

This section should summarize the key elements of the plan critical to the success of the venture. This is the first exposure the lender will have to your idea, so the executive summary is more than just a condensation of the plan. The length may be 1-3 pages. Often the executive summary will be written after most of the business plan has been completed.

Points to discuss include:

1. Business Description
   Include name, address, plant or store description and brief history.

2. Product
   Give a description of the product or service. What differentiates your product from existing products? What features of your product will give you a competitive edge in the marketplace? What is the product's current state of development: do you need further R&D; do you have blueprints but no prototypes; is a prototype built and ready for production? What type of protection do you need: patents, trademark or copyright?

3. Market Data and Marketing Plan
   Who are the customers? Where are they located? What market niche will you serve? Who is your competition? What is the market (sales) potential? How will you sell or market your products?

4. Management
   Discuss the key persons involved in the business and summary of relevant expertise or past business.

Include these additional items if the business plan is for the purpose of borrowing money (This sample does not contain points 5-9.):

5. Summary of sources and uses of funds.

6. Loan repayment and break-even summary.

7. Explanation of why you need the money and how you will use it – be specific.

8. Explanation of the steps you will take if company is in a turnaround situation.

9. Discuss how you intend to repay the loan.

Executive Summary

1

Business Description

Cattle Producers Marketing Coop is a cooperative of 20 cattle farmers located in south central Iowa. The general manager of the cooperative, who is also a member and cattle farmer, is Bailey B. Line. Mr. Line is responsible for organizing the group three years ago when he decided to market his own products. The initial group consisted of three neighbors located within a 5-mile radius, but has since grown to 26 members in the three-county area of York, Jameson and Walnut counties. The group markets 85,000 head of cattle a year primarily to the TDA packing company. The group started with minimal sales of $10,000 the first year, beginning at a few local farmers markets. Marketing Coop now has 12 regular institutional accounts and 144 families that purchase product each month. Negotiations are presently underway with the nearby large special foods market that has potential to sell $100,000 worth of Marketing Coop products annually.

- See enclosed copies of letters from All Foods Markets, Inc., White Tablecloth Restaurant, the Brady family and others.

The Cattle Producers Marketing Coop cooperative gains sales through three avenues of commodity sales of live cattle, volume sales of free-range beef products and sale of beef products with service. Since its beginnings, Marketing Coop has used Larry and Linda's Locker Plant for slaughter and processing for all meat products. Larry and Linda's is a federally inspected plant located in Bordertown, IA.

Borrowing Money

Cattle Producers Marketing Coop is seeking to expand sales of beef products. The coop is purchasing on contract the processing facility, Larry and Linda's Locker Plant in Bordertown. The coop is seeking financing for equipment to place into an expansion of the facility. The new equipment will allow production of beef products to increase 25 percent, allowing increased sales to satisfy existing and anticipate demand. An equipment list is included in the financing section of this plan.

A 10-year loan at 8 percent interest is desired for financing of the equipment. Members of the cooperative have contributed $260,000 cash as equity. The money will be split equally among the purchase of the equipment and as down payment on the contract purchase of Larry and Linda's Locker Plant.

The financing for equipment is needed to meet increased demand for product. Some of the demand exists today and some is anticipated from increased marketing efforts. The expansion will increase capacity 25 percent, sufficient to meet demand for at least eight to 10 years, based on a controlled growth plan of this business. Cattle Producers Marketing Coop plans to increase sales to $500,000 by 2005.

2

Product

Currently, the company offers three basic lines:

- Its trademark free-range ground meat, roasts and steaks. These products are available tray ready, guaranteed lean and certified as 100 percent free

Notes

of hormones, preservatives, antibiotics or chemicals.

- Traditional raised and free-range cooked products sold at farmers markets and events and festivals in Iowa and Nebraska.
- Commodity grade live cattle as a means of handling producer overrun and as a method of moving cattle that required antibiotics during the growing process.

Also offered is a growing assortment of handmade items ranging from grandfather clocks of native oak and walnut to homespun yarns with natural dyes to original oil and watercolor paintings of local scenes.

3 Market Data and Marketing Plan

Marketing Coop has set the following marketing objectives and goals, which are the drivers for the planned expansion:

1. Improve the general net worth and well-being of the member/owners by providing a fair and steady market for the food, fiber and other handcrafted products raised and manufactured on their farms.
2. Increase sales to more than $500,000 over the next five years.
3. Maintain gross margins at or above 18 percent while adding product lines.
4. By 2003, be firmly established in processed and specialty markets.
5. Establish the company as a name that customers of all description associate with quality.

Marketing strategies have been set to help accomplish these goals. The strategies are broadly stated and so may appear to lack substance. The management team is in the process of establishing necessary tactics to implement the goals and accomplish the strategies.

1. Delivering high quality products that set themselves apart from others in taste and value.
2. Providing service, support and a slightly better price to our customers and dealers.
3. Maintaining gross margin at 18 percent or better.
4. Adding new products into the mix to maintain customer interest and boost sales volume.

4 Management

The management team is an experienced group of professionals who will add value to the business. Bailey Line will be general manager with responsibility for the organization of the coop group of producers and the processing plant. An experienced team will be used to manage the processing plant. Larry Cutter, the current owner of the processing business, will be the plant manager responsible for the purchasing function and for operation of the processing facility. His wife, Linda Cutter, will be the marketing manager. Linda brings experience in sales, in understanding of meats and meat quality and in customer service to the marketing function. All accounting and financial oversight will be provided by Tina Total. Ted Tobias will be the quality manager. He is experienced with government requirements such as HACCP, OSHA and EPA. He has responsibility to assure quality product is produced. He will also work with producers on a supplier quality program.

Executive Summary Worksheet

Business Description

The purpose of the business description is to help the reader understand the demographics of your company, the current status of your business and the future direction of your company.

Points to cover are:

1. Company History
   History of the company and its development, or information about how your idea developed.

2. Company Industry
   A discussion of the company's industry.

3. Legal Structure
   Details of the legal structure.

4. Employment
   Number of employees and their age distribution. Briefly discuss employees qualifications to do the work based on training, education and/or experience.

5. Mission/Vision Statement
   The mission statement of the business. Key elements of a mission statement include markets and geographic areas to be served, philosophy and values of the company and current and future products and/or services to be provided.

6. Current and Future Goals
   Discussion about where the company is today (current status) and where it wants to be (company goals). State goals quantitatively. Analyze your company in terms of strengths, weaknesses, opportunities, and threats (SWOT).

7. Company Products or Services
   Description of the company's products or services.

Sample Business Description

Business Description

Company History

1

Members of the cooperative are independent cattle producers and a custom meat processor, Larry and Linda's Locker Plant. It was organized when the custom meat processor was asked to process cattle for a consumer group in a city in the Midwest. The consumer group made agreements with individual farmers to purchase cattle that were raised in pastures as opposed to a confinement facility. Further, the consumer group insisted that use of antibiotics be restricted. The consumers believed that cattle raised in that manner would provide a safer, more flavorful product.

Demand for contract grown beef raised in the manner prescribed was steadily increasing – so much so that the processor would soon have to build new facilities or give up the business to competitors. Located on the main street of Bordertown, IA, a town of 1,200 population, the processor would have to build new facilities outside the community. At this stage of his life, he was reluctant to do so because of the amount of money he would have to borrow. In addition, he would be highly dependent upon a single group of consumers.

After watching Public TV's weekly program, "Market to Market," the custom meat processor learned of efforts of independent organic vegetable growers who formed a producers cooperative that enabled them to pool their limited resources to grow and market their products. He learned that there was a segment of consumers that would be willing to pay a premium for organically grown vegetable products that were identified as to where and how they were grown. This was similar to his own observations with the consumer group for whom he processed organically grown cattle.

It occurred to him that the producers for the buyers' group and he had a common interest and common concerns. If they banded together in a producer cooperative to raise and process high quality meat products, they could command a premium for their products. In controlling the product from the farm to the consumer, they could increase their income in two ways: 1) secure a higher percentage of the consumer dollar for themselves; and 2) obtain a higher price because of the premium consumers are willing to pay for their specially grown products. Also, since consumer prices for beef products fluctuate much less widely than commodity prices, the participating independent cattle producers would be more assured of year-to-year income stability.

Finally, he would feel much more secure by sharing the investment risk with others. In addition, having an adequate supply of cattle would allow the cooperative to target several consumer markets in various geographic locations so as not to be dependent upon a single segment in one geographic area.

In a series of discussions and meetings with independent beef producers in the area he found sufficient interest to build a facility of adequate size to process all the cattle they were able to raise. Throughout the process, industry experts and others that had organized similar cooperatives emphasized that the cattle raisers had to be proactively involved in all phases of the operation. In other words, raising and processing cattle for a highly specific group of consumers is

Points to Remember

1. Your information should be written in a clear and precise manner.
2. Double check your spelling. If using a word processing program, run spell check.
3. Every business plan should include an executive summary, which may be the last thing written.
4.
5.

a marketing system, not a processing system. Processing is but one step in that system. Larry and Linda's has operated for more than 20 years. The plant is federally inspected. Larry and Linda's does not process any deer meat for hunters and it specializes primarily in processing of beef. Beef processing accounts for 80 percent of business, while 20 percent is devoted to hogs and other animals such as buffalo.

Cattle Producers Marketing Coop was established in 1995 on the basis of offering the highest quality and value in its free-range beef farrowed and raised by the farmers of the greater Midlands area. Time-honored traditions have been passed down through the generations of producers who understand quality and purity of product. Concerned consumers were looking for food and fiber products that were produced with minimum chemical inputs and that could be identified with the face of the producer. These consumers were shopping. They wanted goods produced from real family farms.

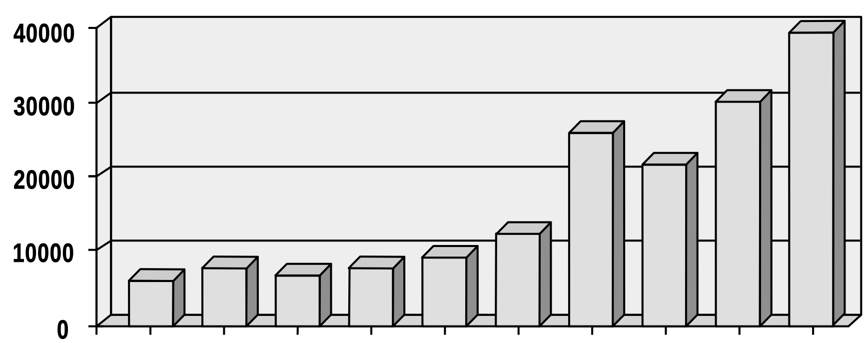
Marketing Coop answered the call – first with quality beef products, then adding other free-range meat products followed by pies and home baked breads. Constantly striving to supply what the concerned consumer is asking for, the group continually reviews what is available in the marketplace and what it sees other similar groups doing successfully in areas that are distant from the Midlands trade area. Improving on what is available and providing new products to the areas of need will assure our success in a market driven by consumer demand.

Marketing Coop has been hindered only by the lack of formal organization and working capital. Sales have grown steadily since the group first began attending area farmers markets together as a loosely knit group working under the banner of Golden Meadow Products. At this point, to move Cattle Producers Marketing Coop into a position to take full advantage of available niche markets, additional capital is needed to purchase and upgrade a facility, hire staff with marketing expertise and move larger volumes into the marketplace.

- See enclosed copy of letter of proposal from Larry and Linda's Locker Plant.

Gross Sales History

(Ten-year estimates of combined sales of independent producer working informally as Golden Meadow Products)



Past Performance

As a newly formed value-added cooperative, Cattle Producers Marketing Coop does not have a past performance record beyond the collective history of its owner/members who previously operated together on an informal basis as Golden Meadow Products.

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
$4,000	$5,500	$4,500	$5,350	$7,000	$10,050	$24,500	$20,000	$28,000	$37,500

The following sales figures represent the combined estimates of the individual sales experiences of the current owner/ members while working together as Golden Meadow Products.

	1997	1998	1999
Sales	$20,000	$28,000	$37,500
Gross Margin	$8,000	$13,000	$12,000
Gross % (calculated)	40.00%	46.42%	32.00%
Operating Expenses*	$11,000	$12,000	$16,000
Collection Period (days)**	0	0	15

*Note: *Persons providing estimates did not include wages for themselves, use of personal vehicles to transport goods to market or time spent by family members when totaling Operating Expenses.*

*** Collection Period estimates reflect that some owner/members began selling to restaurants and wholesalers on a net 30 days due basis.*

2 Company Industry

The meat industry is dominated by major packers, processors, food brokers with relationships to major institutional accounts and large grocery store chains selling their store brands of meat. A list of major competitors is not included here since they are so well known.

During the last two years, the beef industry has seen cattle prices drop to record low levels. This has led to groups wanting to start their own slaughter and processing operations. Marketing Coop is actually ahead of the competition since it has been in business since 1995. Besides the grass roots level of interest in starting their own operation, changing trends in the marketplace now make the idea of small specialty meat businesses more feasible.

3 Legal Structure

Cattle Producers Marketing Coop is a cooperative with members composed of independent cattle producers who plan to provide premium identity preserved beef products directly to the consumer. To accomplish this, they plan to create their own processing plant and will control marketing of their products from the farm to the consumer.

In addition to committing $5,000 per share, each member had to agree to the following in order to become and maintain ownership in the cooperative:

- Acknowledge that they are participants in a marketing system and, as such, they are responsible for producing a safe, consistent, quality product for the end consumer if the cooperative is to succeed.

- Deliver a specified number of cattle to the processing plant each year according to a predetermined schedule.
- Raise cattle according to prescribed methods.
- Open their cattle raising facilities to inspection.
- Agree to participate in at least one consumer marketing event each year.
- Attend periodic member meetings.

4 Employment

A beef processing facility will be purchased from Larry and Linda Cutter, owners of Larry and Linda's Locker Plant, by the members of Marketing Coop. It will employ state-of-the-art technology. Inasmuch as product safety will be a key aspect of their marketing effort, it is intended that quality control methods will exceed USDA standards. The plant currently meets all OSHA and HACCP requirements as well as waste discharge amounts. The plant will be capable of processing 10,444 cattle annually, or 40 per day, single shift, five days per week.

It is anticipated that the processing facility will require 15 employees, including 12 in production and material handling; one in maintenance; three in office and sales; one in management. Larry Cutter, the custom meat processor, will be general manager.

5 Mission/Vision Statement

The mission of Cattle Producers Marketing Coop is to provide increased and more stable income by raising, processing and marketing high quality beef products to consumers who are willing to pay a premium for these products.

6 Current and Future Goals

The goals of the company are as follows:

- Provide products to consumers that are consistently high quality.
- Raise cattle using humane and environmentally sound practices.
- Process beef using latest appropriate technology methods.
- Provide safe, off-farm employment at above average wages for rural based families.

7 Company Products or Services

- The company's trademark products are available tray ready, guaranteed lean, and certified as 100 percent free of hormones, preservatives, antibiotics or chemicals. This product line also includes diversification into a growing assortment of handmade items ranging from grandfather clocks of native oak and walnut to homespun yarns with natural dyes to original oil and watercolor paintings of local scenes.
- Traditional raised and free-range cooked beef products sold at farmers markets and events and festivals in Iowa and Nebraska.
- Commodity grade live cattle as a means of handling producer overrun and as a method of moving cattle that required antibiotics during the growing process.

How to Write a Vision and Mission Statement

What Is a Vision Statement?

A vision statement looks into the future at least five years and defines a desired future state – one that may not even seem possible today. An example of a vision was President John F. Kennedy's statement that America would put a man on the moon by 1969. It sure seemed unlikely at the time, but it motivated private industry and government agencies alike to marshal their resources, lay out a plan, then coordinate and cooperate to make it happen. In fact, although President Kennedy did not live to see it, on July 20, 1969, Neil Armstrong and Buzz Aldrin landed on the moon!

What Is a Mission Statement?

A mission statement defines what a company currently does – products or services, key business drivers (e.g. highest quality and on-time delivery), how the company competes in the marketplace, and perhaps even some corporate values (e.g. being a good neighbor in the community). It may involve some "stretch" or challenge, but a mission mainly looks from the present out only one or two years. The "stretch" should start the company moving in the direction of the mission.

What Is the Purpose of a Vision or Mission Statement?

Vision and mission statements are most commonly prepared as initial steps in the strategic planning process. The planning team develops the vision of the desired future state. Next, the mission is developed to describe current reality. The vision (what we want to become) and mission (what we are) are usually compared with a rather wide gap between present and future.

Another common application for a mission statement is the documentation required for ISO or QS-9000 certification.

How Is the Vision Statement Prepared?

It may be best to use the scenario approach. With dimmed lights, the group members close their eyes and imagine that they have been abducted by aliens and taken to another universe – and now they are returning after five years of absence. They are asked to imagine walking back into their facility for the first time in five years. What do they see? What are people doing? What is the general mood? What does the place look like in terms of furniture, equipment or processes? What is different from the last time they were there (five years ago)? What products or services are now available? Who are their customers?

Many other similar questions are shared with the group to help participants envision how their organization could look in the future. Group members are asked to write three- to five-word phrases, describing what they see, on sticky notes. After about five to 10 minutes, most people will generate many ideas. The sticky notes can now be grouped on large sheets of paper with topics (e.g. products, quality, cost, delivery, safety and environment, human resources). Once all the quality related ideas are posted by the word quality (and similarly for the other topics), the group is broken up with volunteers to distill the multitude of ideas into thoughts. An example might be: "XYZ's primary emphasis is on producing the highest quality products – our customers expect no less and we hold ourselves accountable to produce no less." These thoughts are then woven into a vision of the future.

How Is a Mission Statement Prepared?

A similar process is used to develop the mission statement. Instead of the scenario process, however, participants list phrases describing the current products and services, key business drivers, how the company competes in the marketplace and corporate values. Thoughts are grouped as before, then are developed and woven into the mission statement.

How Does this Fit into Planning?

After developing the vision and mission, the planning team may next conduct what is referred to as a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. Strengths and weaknesses comprise the internal analysis, which usually involves identification of strengths and weaknesses by functional area or department. Opportunities and threats comprise the external analysis, which usually involves identification of opportunities and threats by external factors (e.g. economy, labor, technology, governmental regulation).

SWOT Analysis

Factor, process, department, etc.	**Strength** (frequently internal to company)	**Weakness**	**Opportunity** (frequently external to company)	**Threat**

Next, the gap between vision and mission, plus the weaknesses and threats are analyzed.

Brainstorming is often used to list preliminary, broad objectives, which, when accomplished, will close the gap while addressing the weaknesses and threats. Objectives are the answer to the question, "What needs to be accomplished?" The next step is to identify one or more strategies for each objective. Strategies are the answer to the question, "How is this to be accomplished?" For each strategy, one or more SMART (Specific, Measurable, Attainable, Results-oriented and Time-based) goals are identified to support each strategy. For each SMART goal, a champion or leader and target date are selected.

The strategic planning team is wise to seek input at each step from others in the organization. Drafts might be publicized with the opportunity to make suggestions. When the final plan is completed, it is shared with the whole organization. By involving the whole organization, the probability of buy-in is greatly enhanced. After communicating the plan to all in the organization, follow-up meetings are scheduled for each member to report progress against SMART goals. This is the time to celebrate successes, but equally important, it is a time to identify barriers blocking completion of a goal.

The follow-up meetings are essential to success in implementing the plan. When all is said and done, the quality of the plan is meaningless – rather, it is the successful implementation that makes the difference between another year of business as usual and a leap toward the vision. Initially, the meetings should be held frequently – weekly or at least bi-weekly. The meetings assure people will be held accountable for the goals they helped to craft. In addition, by spending time on this vital function, management shows that the strategic plan is truly a high priority for them as well. As the group gets comfortable with the process, the follow-up meetings will take less time and can be held less frequently (e.g. monthly or quarterly).

Examples

The following examples are included to illustrate creation of vision and mission statements.

Vision

XYZ, Inc. is committed to seeking growth and prosperity by achieving a sustainable competitive share of our industry in the international marketplace and world economy. We will strive to reach our goals by meeting the needs and expectations of our customers with continuous improvements in quality, productivity, value, new product offerings and customer satisfaction.

It is our intent to develop quality partnerships with our employees, suppliers, customers and the community in which we operate. We wish to continually set standards of excellence, both personally and professionally, which exemplify our dedication to our goals and to the fulfillment of this vision statement.

Mission

XYZ, Inc. is dedicated first and foremost to the production of the highest quality products to meet the needs and demands of our customers while achieving an acceptable return on investment. This will be realized both internally and externally by continuous communication between management, employees, suppliers, customers and community, and by ongoing improvement of processes, systems, equipment and use of human resources.

We intend to expand our presence in the marketplace by the development of new products in our (list of major product) lines as well as by exploration of other opportunities for growth when presented.

Mission Statement Checklist

Items to Consider Does the mission statement contain this information?	Need to include? Yes	 No
1. A statement about the firm's type of business?		
2. Definition of the basic purpose of the organization?		
3. Top management's vision, values and priorities?		
4. Philosophy and values to guide future actions?		
5. Markets to be served?		
6. Geographic areas to be served?		
7. Company image?		
8. Current and future product mix?		
9. Statements relating to profitability?		
10. Statements relating to market share? Growth? Customers?		
11. Does the mission provide a direction for the business?		

The successful mission, if implemented and accomplished, should help your company grow and prosper.

Credit

Written by James R. Black, a CIRAS industrial specialist located at the Iowa State University campus office, who specializes in strategic planning, Kaizen and Constraint Management.

Legal Structures and Considerations for Businesses

When addressing cooperatives and corporations, the rules, regulations and manners of doing business that apply to one, may or may not apply to the other. It is best never to make assumptions. Cooperative law is a specialty field in and of its own, the same as corporate law.

While it is mentioned several times elsewhere in this chapter, it cannot be stressed enough: Any decisions regarding your business structure, business regulations and requirements and applicable tax matters must be discussed with your legal and business advisors. This manual attempts to give you working knowledge and vocabulary, but is not meant to advise you.

Any decisions regarding your business structure, business regulations and requirements and applicable tax matters must be discussed with your legal and business advisors.

Cooperatives

In many ways, a cooperative is like any other business; but in several important ways it's unique. A cooperative business belongs to the people who use it - people who have organized to provide themselves with the goods and services they need. A cooperative operates for the benefit of its members.

These member-owners share equally in the control of their cooperative - they meet at regular intervals, review detailed reports and elect directors from among themselves. The directors, in turn, hire management to manage the day-to-day affairs of the cooperative in a way that serves the members' interests.

Members invest in shares in the business to provide capital. The net – left after bills are paid and money is set aside for operations and improvements – is returned to coop members. Although not completely defined by statute or by tax law, operating a cooperative generally means adhering to the following principles:

- democratic control – one member, one vote – or at least not basing voting upon capital investment,
- subordination of capital, generally meaning that profits of the cooperative are not paid back based on the amount of the investment, but rather on the amount of patronage of business done for or with the cooperative, and
- preferences in liquidation based on patronage rather than investment.

Traditional cooperatives commonly are called open cooperatives, as they are cooperatives which any producer can join simply by bringing a product to be processed, marketed or handled by the cooperative. There is generally no up-front investment other than a nominal membership fee. Typically, there is no further commitment to further patronize the cooperative.

Types of Cooperatives

Producer-owned cooperatives are owned by farmers, producers or small businesses. Agricultural producers or crafts people organize cooperatives to process and market their goods, and to provide themselves with credit, equipment and production supplies. Similarly, retail stores or small businesses organize cooperatives to provide supplies or common services.

Consumer-owned cooperatives enable consumers to secure a wide array of goods and services. For example, they may offer health care, utilities, insurance or housing. They may buy and sell food, heating fuel, hardware and other consumer goods. Or, they may operate credit unions, child care facilities and funeral and memorial societies. Almost all consumer needs can be met by a cooperative.

Worker-owned cooperatives are businesses owned and controlled by their employees. Worker cooperatives may be found in almost any industry. Examples include employee-owned food stores, processing companies, restaurants, taxi cab companies, sewing companies, timber processors and light and heavy industry.

Value Added Cooperatives

In the last 20 -30 years, the value added cooperative model has been developed. This model has basic differences from the traditional cooperative model. The equity structure of the value-added cooperative is capitalized by members making a cash investment in stock or other equity of the cooperative. A traditional cooperative is internally capitalized through retained earnings or profits at the end of the year, commonly called "retained patronage" or through retaining a portion of the price to be paid to the producer upon delivery of the commodity to the cooperative, commonly called "unit retains." Retained patronage or unit retains also can be used to provide supplemental capitalization for a value-added cooperative; however, the primary capitalization is most often through a direct investment through the purchase of stock or other equities of the cooperative.

Value added cooperatives, in particular processing cooperatives, are typically financed based on maximizing the capacity of the processing facility. Accordingly, membership is generally restricted to the members who purchase stock and acquire the coinciding delivery rights. In other words, if a hog processing cooperative is organized to process 50,000 head, members would typically purchase stock and security coinciding with delivery rights for 50,000 head of hogs to be delivered to the cooperative.

If the cooperative is profitable and a nonmember producer wants to deliver his or her commodity to the cooperative, that nonmember producer would not be allowed to deliver to the cooperative unless he or she purchases equity and delivery rights from an existing member. There are two reasons for this structure: (1) the cooperative can assure it will have a fixed supply of the commodities that are the basis of the cooperative's business, thus allowing it to operate at 100 percent capacity; and (2) members who desire to leave the cooperative will have the opportunity to sell their equity and delivery rights to other producers. This is in contrast to the traditional cooperative model, where there is no incentive to purchase a member's equity in the cooperative, because, as a new member, you can typically participate in business with the cooperative without an equity investment.

The value added cooperative is structured to be capitalized by investment from producers. Value added cooperatives are also structured to pay out earnings annually, rather than retain earnings for many years or to a particular age of the investor.

Laws that Affect Cooperatives

Cooperative law is a specialty in and of itself. The following addresses the very general intent of early and existing legislation. The State of Iowa, as virtually every state, has laws that are very specific to cooperatives doing business in Iowa. The information provided here is for general reference only and is in no way intended to be complete or all encompassing.

In the beginning, no legal restrictions existed on the formation or activities of agricultural cooperatives. The passage by Congress in 1890 of the Sherman Antitrust Act and the Clayton Antitrust Act in 1914 applied to cooperatives engaged in interstate commerce, just as they did to other businesses. During ensuing years, cooperatives were attacked under many state and federal laws as being unlawful price-fixing conspiracies under the antitrust laws. The Clayton Act partially excluded labor and agricultural organizations from antitrust suit, but did not use the word cooperative, promoting a suspicion among farmers that acting through a cooperative might be a violation of the antitrust laws. Thirty-two years later, farmer leaders opened the door to modern farmer cooperatives in the U.S.

In 1922, Congress passed the Capper-Volstead Act, removing any doubt that cooperatives could legally negotiate sales for farmers or associations of farmers. Federal and state antitrust laws prohibit agreement among competitors that unreasonably restrain free enterprise. Together with the Cooperative Marketing Act of 1926, which permits cooperatives and their members to exchange virtually any kind of information regarding production and marketing, the Capper-Volstead Act provided the legal foundation for formation and operation of agricultural cooperatives in the U.S.

Antitrust Requirements

To be eligible for antitrust protection, a marketing cooperative must meet several organizational and operational requirements, including:

- Membership must be limited to persons actually engaged in the production of agricultural products.
- The association must be operated for the mutual benefit of the members as agricultural producers.
- The association must make decisions on the basis of one member/one vote or limit dividends on stock and membership capital to no more than 8 percent each year. The association may do both.
- The association may market products for nonmembers, however, the value of products handled for members must exceed the value of products handled for non-members.

Ownership

The ownership of an organization focuses on two characteristics: Who can participate as an owner of the business? What is the nature of the ownership interest?

In general, C Corporations, cooperatives, partnerships and LLCs do not restrict the maximum number of shareholders, partners or members. All of the entities may have different classes of ownership and voting rights. Cooperatives, however, usually restrict the eligibility of members and generally restrict voting to one member/one vote basis, subject to certain exceptions provided by state law. All of the entities generally have a perpetual existence unless limited in the organizational documents. However, a general partnership is terminated by agreement of the partners, upon a partner's death, bankruptcy, dissolution, etc.

Liability of Owners

The liability of owners who are part of an organization is a significant consideration in establishing a business. The general rule is that the shareholders or members of a C

Corporation, S Corporation, cooperative or LLC are not liable for the debts and obligations of the entity merely on account of their status as shareholder or member. A shareholder or member is always liable to the entity for any amount of unpaid subscriptions for stock or interests in the entity. In addition, contractual obligations between the entity and the shareholder or member for delivery of crops or livestock may also incur liability to the member or shareholder. As a general matter, the shareholder's or member's risk is limited to investment in the shares or his or her interest plus any contractual liability.

Corporations

There are two basic types of corporations: C Corporations and S Corporations.

C Corporations

C Corporations are owned by shareholders, who may be individuals or other business entities such as corporations or partnerships. The shares of a corporation's stock may be publicly traded on stock exchanges or over the counter, or may be closely held. For closely held corporations, shareholder agreements are often of critical importance in planning for management succession, control over the distribution of stock, handling fundamental disagreements between key stockholders, and in some cases, providing liquidity for shareholders. C Corporations are considered separate entities for most legal and tax purposes. Venture capital investors usually require C Corporation status for their portfolio companies for a variety of tax considerations. Thus, C Corporation status is usually recommended for entrepreneurs who seek to attract venture capital.

S Corporations

S Corporations are similar to C Corporations except that they are generally taxed as partnerships. This can present a considerable advantage if the corporation is expected to generate tax losses in its early years, or if the company ends up selling substantially all of its assets to an acquirer. In the former case, the shareholders may deduct their proportionate share of the corporation's losses on their personal income tax returns (subject to certain limitations). In the latter case, there will be one, rather than two, levels of taxation on the gain from the sale.

Limited Liability Companies

Limited Liability Companies (LLCs) are a hybrid that combines some characteristics of a corporation with other characteristics of a partnership. On the corporate side, the LLC offers limited liability for all of its members and the option of centralized management (which the LLC may choose not to adopt). On the partnership side, the LLC offers partnership tax status (similar to that offered by an S Corporation) with a great deal of flexibility in handling unequal contributions of capital, different classes of capital and customized operating agreements that the S Corporation cannot match. The price to be paid for this flexibility is that a customized operating agreement must be drafted to spell out the unique arrangements of the LLC, whereas corporations may often be formed with standardized documents.

Partnerships

There are three types of partnerships: Limited Partnerships, Limited Liability Partnerships and General Partnerships. Their key common element is there is no entity-level federal taxation of partnerships. These entities, like S Corporations, file a federal tax return that allocates the entity's income, deductions, gain and loss to its partners, who then must report such items on their personal tax returns. This generally results in tax savings, but may present hardships in years when the entity has taxable income but lacks cash to distribute to the partners to help them pay the tax on income. This problem, called "phantom income," may occur, for example, if a real estate asset is sold at foreclosure under circumstances where the lender writes off a portion of a loan made to the partnership, resulting in debt forgiveness income.

Limited Partnerships

Limited Partnerships have many of the same characteristics of Limited Liability Companies, but must include one partner (the general partner) having unlimited liability for the debts of the partnership. Special IRS rules govern whether a corporate general partner is sufficiently at risk to qualify the entity as a partnership rather than a corporation for tax purposes.

Limited Liability Partnerships

Limited Liability Partnerships (LLPs) are general partnerships that have elected LLP status under state law. Partners of an LLP have unlimited liability for their own actions taken in furtherance of the business of the LLP, but they do not have joint and several liability for the actions of their partners. LLP status is appropriate for businesses that traditionally have been conducted as general partnerships if the partners wish to limit their potential liability for each other's actions. Special rules govern the LLP election by partnership of licensed professionals.

General Partnerships

General Partnerships may be based upon the simplest of arrangements. No registration of general partnerships is necessary in most states, and the partnership agreement may be oral. If the partners do not have a detailed agreement, the Uniform Partnership Act, which is in effect in some form in most states, will supply numerous default rules that will govern the relationship of the partners. A more detailed partnership agreement may override these default rules.

Shareholder Agreements

It is usually prudent for the founders of a business to have an agreement in place that deals with such questions as: What if someone wants to sell his or her interest in the business to someone else? What if a founder dies, retires, declares bankruptcy or leaves the company to compete with it? What if the founders become deadlocked in matters basic to the conduct of the business?

The appropriate answers to these and other questions will vary depending upon the nature of the business, the interests of investors, the relative positions of the various founders, their respective personal circumstances and a number of other factors.

Counsel to the company can be helpful in identifying the questions that need answering and in suggesting possible answers. Sorting through these questions is unpleasant when the founders are focused on building a new enterprise; but it can be catastrophic if attention is deferred until the questions are no longer hypothetical.

For these reasons, it is good business for owners to develop and keep current a shareholders agreement that is appropriate to their circumstances. Although shareholder agreements technically apply to corporations only, the issues addressed in a shareholders agreement are just as pertinent to non-corporate organizations, such as limited liability companies and partnerships. These issues are frequently dealt with in the operating agreement (in the case of an LLC) or the partnership agreement (especially if the entity is a limited partnership). In those cases, care must be taken to avoid using “off the shelf” language that is inappropriate to the circumstances of the parties.

Tax Considerations

(The following does not constitute legal advice. Consultation with an attorney or another tax professional is strongly recommended.)

Tax considerations are often of critical importance in deciding upon a business structure and exit strategy. The basic tax considerations associated with various organizations focus on the tax treatment of income and losses, distributions of the owners, consequence of liquidating the business and the tax consequences of selling ownership interests.

General Partnership

A partnership itself pays no federal income tax. Partnership income is taxable, however, to the partners regardless of whether it is actually distributed or retained by the business. The partner’s share of the partnership income is taxed at the individual income tax rate applicable to the partner’s tax bracket. Losses from the business, as they are allocated to the partners, may be offset against other personal income.

Limited Liability Partnerships

Despite the limited liability provided to partners, LLPs are treated like general partnerships for tax purposes.

Limited Partnership

Limited partnerships are treated like general partnerships for tax purposes.

Corporations

In general, a corporation is subject to separate tax procedures and rates imposed by federal and state tax laws. Unlike a partnership, where income passes through to the individual partners, a corporation is separately taxed on its own income. Corporate taxation may result in “double taxation” since income received by the corporation is taxed at the corporate level, and any profits remaining after taxes are then available to be distributed as dividends, which are taxed again as personal income. This double taxation can be a distinct disadvantage of the corporate form of businesses. Larger corporations with many shareholders simply accept the disadvantages, but in smaller, closely held corporations, double taxation can be minimized. There are several planning possibilities, which can minimize such double taxation. They should be investigated.

Salaries

Whenever shareholders are officers or employees of the corporation, they may be paid salaries that are deductible as a corporate expense, and thereby compensated other than with divided distributions. Salaries are deductible to the extent that they are reasonable and necessary.

Loans

A small corporation may be structured so that a significant portion of its capital comes from loans to the business rather than investments made by shareholders. Having established sufficient equity capital, the remaining funds needed for the business may be raised through interest-bearing loans and such interest is deductible to the corporation as an expense. The interest paid to the creditor is individual income to him or her and is not subject to double taxation.

S Election

A small business corporation may decide to not be taxed at the corporate level, but to have its income (whether distributed or not) passed through and taxed pro rata to its shareholders. An S Election can also permit shareholders to take advantage of losses in the early stages of the business. In general, the following requirements must be met for a corporation to qualify: (i) there may be no more than 75 shareholders, (ii) shareholders must be natural persons, and cannot be another corporation or partnership, (iii) the corporation may have only one class of stock, (iv) the corporation cannot have a nonresident as a shareholder and (v) the corporation's foreign income and passive investment income may not exceed certain limitations. All shareholders must consent to the S Election by signing a statement of consent to be submitted to the Internal Revenue Service.

Limited Liability Company

A properly structured LLC may be reasonably certain it will be taxed as a partnership for federal income tax purposes. If an LLC is treated like a partnership, the members are required to declare their share of the LLCs income or loss on their individual income tax returns. Profits earned by an LLC are included in the individual incomes of the members whether such profits have been distributed or not, and the losses from the business, as they are allocated to the members, may offset a member's other personal income.

Cooperatives

Both exempt and nonexempt cooperatives may reduce or eliminate federal income tax on patronage source earnings at the entity level by distributing income to patrons on the basis of patronage (rather than investment). In this way, cooperatives may achieve a single level taxation (at the patronage level) similar to partnerships. Exempt cooperatives may also reduce federal taxable income by distributing nonpatronage sourced income to patrons. Distributions may be in cash or noncash form, but must be at least 20 percent cash in order to reduce the taxable income of the cooperative.

Additional Information

The following Web sites were frequently used as direct sources for materials included in this article and may provide further information for readers:

www.cooperative.org/primer.cfm
www.cooperative.org/success.cfm
www.bromsun.com/practice/buatxt.htm#ccorp
www.bromsun.com/practice/bubtxt.htm

Resources

Information was compiled using several sources, including:

Antitrust Laws*; USDA Agricultural Cooperative Service Information Report 100.*

Cooperative Principles and Legal Foundations*; USDA Agricultural Cooperative Service Information Report 1.*

Flocking Together, Marketing Associations Help Poultry Growers Boost Returns, *Farmer Cooperatives, August, 1993; February 1992 70th Anniversary of Capper-Volstead Act issue.*

Hanson, Mark J., Starting a Value Added Business – the Legal Perspective*; Lindquist and Vennum, P.L.L.P, Minneapolis, MN, from Illinois, New Generation Cooperatives, Institute for Public Affairs.*

Managing Cooperative Antitrust Risk*; USDA Agricultural Cooperative Service Information Report 38.*

The Capper-Volstead Act.

Business Description

Registering a New Business

A new business has many obligations, including collection of state and federal taxes on products sold. Therefore, it is necessary to register your business. The following steps and applications of rules are offered by the Small Business Development Center (SBDC).

Sole Proprietorship and Simple Partnerships

Record of the Trade Name (DBA-Doing Business As)

If the business uses a fictitious name, the record must be filled out. The form can be filled out at the courthouse of the town where the business will be located. The fee is typically under $10. A notary (one will be at the courthouse) must witness the signature.

Federal Registration—Form SS4

Most businesses need a Federal EIN, or Employer Identification Number, or FEIN. An EIN is required if the business has employees; the business sells to the government; the business is a partnership and in other specific situations.

The EIN is used to remit the payroll taxes withheld from the paychecks of the employees and for paying personal taxes based on business profitability. Your social security number may be used if an EIN isn't required; however, an EIN may be needed in the future, so it would probably be a good idea to have the number assigned. To acquire the EIN, use form SS4. The form may be mailed, or telephone application information is in the instructions.

Most federal tax forms can be found at your post office or local library. If they are not available, you can request them by calling 800-TAX-FORM. Call now to order a small business tax start-up kit, containing booklets with instructions for record keeping, payroll taxes, calculating business expenses and personal taxes paid on business income.

For most businesses, federal registration is simply a matter of IRS registration, but for some businesses, such as a store selling firearms, other types of federal registrations may be required.

State Registration

Collected state level taxes include such items as sales tax, automobile rental tax, gasoline tax, withholding state income tax from employee paychecks, personal state income tax and several others. The Iowa Business Tax Registration form handles the state registration. Your Federal EIN can be used for state identification purposes. This way, you will only need to keep track of one number. Call (800) 367-3388.

Please call the Iowa Department of Revenue and Finance for assistance with Iowa sales tax and/or personal and corporate taxes.

Special Permits and Licenses

The Iowa Department of Economic Development offers a free search service for Iowa special permits and licenses. Call (800) 532-1216.

Corporations

Articles of Incorporation

A form is used to ask the state to grant charter for corporations. Forms are usually written with the assistance of an attorney and filed with the Secretary of State.

Federal Registration

Federal registration (EIN) is required for all corporations. The process is the same as described earlier.

State Registration

This process is the same as previously described.

Special Permits and Licenses

This process is the same as previously described.

Other Registrations

City Ordinances for Home Occupation

Usually handled by the city planning department.

OSHA (Occupational Safety and Health Administration)

Once you have part-time or full-time employees, your facility must meet the OSHA safety code. Contact the Division of Labor at (515) 281-3606.

Unemployment Insurance

Each business is required to give a percentage of payrolls, for both part-time and full-time employees, to a state fund, which pays employment benefits. Rates are affected by how often an employer uses the system. For information, call (515) 281-5387, Division of Job Service.

Workers Compensation

Health insurance covering work-related injuries for both part-time and full-time employees must be purchased by the business. The coverage may be purchased through a regular insurance agency. Rates are calculated on standardized rates based on employees' risk of being hurt in job related accidents. Call the Industrial Commissioner at (515) 281-5934 for information.

Business Description Worksheet