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THE JOYS AND PITFALLS OF PRODUCER PROJECTS: LESSONS LEARNED

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In most commodity situations, prices decline over time, as we all know. The challenge is to find profits and efficiency within the constraints of the rural areas where we have our businesses. I grew up in South Dakota, but lived away from the state for twenty years. When I came back to help operate the family farming and ranching operations in 1994, I saw a different landscape from what I saw growing up and while being involved from a distance.

Christiansen Land and Cattle is located in south central South Dakota, as the geography transitions from the more reliable production environment in the eastern part of the state to the dryer grasslands in the western part of the state. It's a great area for small grains, row crops, and cattle—most years if it rains enough.

I became convinced that we at Christiansen Land and Cattle needed to analyze our strategies moving forward. It was during the time when Renville, Minnesota was the capitol of value-added ag projects, and many producers saw 521 co-op projects, or some other structure for value-add as the answer to shrinking production margins.

The benefits seemed to be obvious: move up the supply chain into some form of processing where the real profits are to be found. Get beyond the commodity treadmill. As a group of investors, risk would diminish; nobody would have to bet the farm. As a large group, we could also handle much larger projects than we could as individuals or small investor groups. And there were opportunities to learn about a new industry or segment, as well. Many of the projects had the need to fill board positions.

Some of us even were involved with models where the purpose was to develop several projects and offer them as choices to our producer members for investment. I was one of the founders of South Dakota Ag Producer Ventures, as an example. Kansas had 21st Century Producers; Iowa had AgVentures, Minnesota had FarmConnect, Illinois had Producer's Alliance.

Those were the joys. And there were pitfalls. There was a lack of capacity to conduct real due diligence. Many producers were struggling to keep their own operations going and didn't have the excess capital to invest. If there were hurdles during a start-up, investors were reluctant to send more money. We usually didn't begin with the end in mind—we didn't think of exit strategies. After all, in farming, we have lifestyle and lifetime ventures. Death is the exit strategy. We didn't know how to be good board members, how to carry out sound governance processes. We would show up and give it our best thoughts and efforts based on our expertise, thinking that the skills we had would be transferable to scales and industries far beyond our experience. Our naiveté was our strength and our weakness. We also weren't used to paying market rates for management expertise. Many times salary sticker shock would prevent us from recruiting appropriate management expertise; our ability to grow the business to attract further rounds of financing or buyers was constrained.

One example of several of these challenges is the six years a group of 40 ranchers spent owning and operating a high-end meat store in Kansas City. We made 3 Business-101 mistakes right from the start: we were undercapitalized, we spent too much on the store build-out, and we hired the wrong person to manage the project. But after we fixed the manager position problem, investors were unwilling to invest more capital, which prevented us from hiring another better manager to grow the business. One of the things the first manager did was to sign a 60 month pretty-iron-clad lease. We elected to stay open rather than negotiate our way out of the lease. This placed the burden on the board to manage the business. How hard could it be? Did I mention that the board members lived several hundred miles away? We ended up selling the corporation at a loss.

Financial losses may be negative, but that doesn't mean that the experience was negative. There are opportunities that value-added provides. Diversification, higher profit potential, growth—both in size and depth, and risk reduction because most projects don't require a large amount of capital from each investor. And, there is also diversification opportunity if you invest in more than one project, creating a sort of mutual fund, a portfolio of value-added investments. From a national rural perspective, there are more opportunities, which help bolster rural economies, and young people might have more opportunities within their own communities, thus stabilizing rural economies and creating sustainability.

Another example of opportunity is bio-ag. In this case, a biotech company that has a lab in South Dakota is using cattle to develop antibodies which fight immunologic diseases. Any biotech company which requires animal husbandry skills is a good fit for rural-based areas. Niche opportunities obviously aren't a diversification strategy for large numbers of producers, but they can be part of a spectrum of solutions.

So what, if anything, can the government do to help producers and rural areas? First of all, the focus should be on businesses and in industries that have sustainability, and the distinction between business incentives and economic development should be made. Ideally, there would be coordination of programs and collaboration between agencies and they would collaborate with private entities within the targeted industries as the initiatives are rolled out. A recent example would be the RBIC legislation in the last Farm Bill. Jurisdiction was shared by USDA and SBA, and it wasn't clear how the two agencies were going to collaborate to make the program available. At least not clear from the outside looking in. New Markets Tax Credits is another example. I've been involved with a couple of efforts to establish this program in agriculture and in rural areas. Because it is an incentive traditionally used in low-cost housing financing and CRA compliance, it wasn't a familiar application for the lending industry to use in agriculture, and the project where it could have been helpful couldn't take advantage of its benefits.

Another challenge is the measurement, monitoring, and accountability process. Which criteria should be used to screen applications for grants and assistance? If the dollars available are tied to the number of jobs created, for example, the possibility of gaming the system is introduced.

I believe that fostering entrepreneurship is one of the leverage points with the most mileage potential for building and sustaining robust economies. That means that there will be some failures. Even after the basic lessons are learned, there will be some failures. But failure is an indicator that risk is being taken, that innovation is being created.

There are plenty of low-interest loans available to start-ups. I don't think it should be government's role to be a banker. The gap in the financing spectrum in rural areas is in equity and providing true incentives. Some form of matching money, which is being done in the RBIC program, is an example of a public/private collaboration that does work.

Equity structure impacts business results. I see more and more value-added projects being formed as LLCs or LLPs rather than 521 coops, or straight coops. There are two issues I see with coops which suggest why this is happening. One is that venture capital is not going to put a large amount of capital alongside many smaller amounts and have the same say as they do. Investors with large sums of investment capital at risk want to have some control over how it is deployed. That is the way most of the business world works.

But almost as important is the disparity in experience and expertise between those who regularly invest large sums of money and those who are not conversant in larger-scale investment arenas. The quality of the thought process is uneven, and if there are challenges, uninformed bias can get in the way of managing through the problem successfully.

Finally, incentives such as tax credits and/or direct subsidies to encourage R&D and production of smart alternative energy sources would be desirable. Even underwriting the analysis needed to determine the leverage points to support as the renewable energy industry develops would be helpful. Another suggestion would be to link the funds to successful partnering between the academic communities and private enterprise.

To summarize, the bar must be set as high in rural America and within the ag sector as elsewhere. In order to do value-add we must bring added value to the table. We have to challenge ourselves to be willing to learn and grow in order to do that. We must be willing to pay for professional expertise. We need to properly capitalize projects and understand where public funding fits in the bundle. There are learning curves to be climbed, in developing business opportunities and in creating a culture that tolerates risk and some failure as an acceptable part of the process. This will take time.

We have made lots of progress in the last 20 years. Many of us have invested in several projects and have virtually created our own ag-focused mutual funds. We are realizing the benefits of diversification financially and we see the benefits of entrepreneurship to our communities. And we will continue to improve. We will be more involved in projects that are valued by the broader market, such as renewable fuels and biotech, projects that have the potential to contribute to the greater good as well as our own backyards. The key leverage points are entrepreneurship and collaboration among all stakeholders.