



# The Farmers' Cooperative Yardstick

## Conducting a Feasibility Study for Marketing Cooperatives

*Lionel Williamson*

Many Kentucky farmers are seeking farm income alternatives. Some are attempting to supplement farm income through producing and marketing horticultural crops. Others are looking to increased hay production and marketing to offset income lost from traditional agricultural cash crops. Still others are considering cooperatively marketing small animals and other crops.

No matter what enterprise they select, many of these farmers have one thought in common. They are looking at market cooperatives to market their products. Whether or not cooperatives can be successful in marketing will depend on several factors, including:

- the commodity produced,
- the number of farmers involved,
- the volume produced,
- operating capital requirements,
- competition in the marketing system,
- efficiency of competitors.

These factors are addressed in feasibility studies.

Simply stated, a feasibility study is a structured way to efficiently organize the information you need for confident decision making. The information included in the study will help you plan for the facilities, the financing, and the operations necessary to the proposed venture's success. Such studies are a valuable aid in a co-op's financial management. Besides helping determine co-op feasibility, such studies help existing co-ops acquire financial aid from lending institutions, plan for capital needs, and make decisions about expansion.

A feasibility study can be essentially divided into two parts:

- Market Determination examines facts about the proposed market and makes sales projections.
- Operations and Finance examines the co-op's savings potential. If you are interested in organizing a marketing co-op, no matter what product, remember: a cooperative is not needed if the function(s) it would perform are currently performed efficiently and effectively through existing marketing channels.

### Guidelines for Conducting Feasibility Studies

#### Part I: Market Determination

##### Step I. Identification of the Need

What basic need will a cooperative meet? Deciding what business the co-op will be in, and why, are important decisions in doing a feasibility study. A small co-op may be involved in more than one activity so deciding on what the central activity is (or what the central activities are) is crucial. The entire planning effort of the co-op is based on the perception of what business it is in and the needs being satisfied, whether the co-op's business is primarily merchandising, manufacturing, or service.

Concerns in identifying the need include:

- (1) Interest and urgency for organizing the cooperative.
  - Why is there interest now in such organizing?

- Who is the driving force behind this interest?
- What functions, goals, and orientation do the interested people have in organizing a co-op?

**(2) Potential members**

- Are enough potential members with needed experiences and skills available for the type of co-op being considered?
- Is there enough interest and commitment to proceed with organizing a co-op?
- Who else may be encouraged to participate?
- Are there supportive firms, agencies, and individuals to assist in the co-op organization and activities?

**(3) Potential farm product supply**

- Is there a history or past performance of product production?
- If production has been discontinued, why? Are the reasons valid?
- Is labor availability and/or trainability a possible problem?
- What is the projected production within the area?
- What is the market's growth potential? As the market grows, will the farm product supply capabilities also increase?

**(4) Type of organization needed**

- Is a co-op the correct organizational form given the product(s), membership, and management structure?

**(5) Type and size of facilities, including building, land, and machinery**

- Is suitable building and equipment available for rent or lease?
- Is the site accessible to transportation, waste, and sewage disposal facilities and utilities?
- Have the location, zoning (or other restrictions), space for expansion, tax considerations, utility restrictions, or special rate considerations been reviewed?
- Are there special procurement/storage/distribution needs and costs?

**(6) Management requirements**

- Is qualified management available locally?
- Can competent management be obtained?
- Are supervisory personnel available?
- Will management training be needed or provided?

**(7) Equity capital requirements**

- Can the proposed co-op be satisfactorily financed by its membership to meet its capital needs and payback capability?

**(8) Borrowed capital requirements**

- Will money be borrowed for site acquisition, facilities and equipment, or operating expenses?

**(9) Charges to membership for services or inputs**

- Can an assessment rate be obtained from the cash flow projection?
- What method will be used to charge the membership or deduct from sales tickets?

**(10) Type of marketing program, including both the sales program and the grading and packing program**

- Is there a demand for the product?
- How is this demand now satisfied?
- Do marketing and distribution facilities and techniques for the product exist?
- Who will the product be sold to?

**Step II. Unit Sales Projections**

Unit sales projections are necessary to accurately prepare a projected operating statement. These projections must realistically reflect the market situation and correspond with the co-op's marketing plans and goals. Two procedures are used for unit sales projections: a market potential study and a membership survey. Both provide valuable information when properly conducted.

**The Market Potential Study** estimates the unit volume of business for the immediate production region and the targeted market area. It is important for expansion projects because it will indicate whether enough market exists to support added capacity. The unit volume estimation is made by projecting trends from data published in federal, state, and county reports. The time and statistical expertise needed to make a market potential study often require the services of a professional market research firm or a land grant university's Department of Agricultural Economics. Information on market potential studies can also be found in Cooperative Extension publication AEC-46, *Conducting Cooperative Market Potential Surveys*.

$\text{Total Market Potential} \times \text{Co-op's Market Share (\%)} \\ = \text{Local Unit Sales Projection}$
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The most accurate unit sales projections are possible when information from both a membership survey and a market potential study is available.

**A Membership Survey (1)** informs members of the co-op's plans; **(2)** determines the market potential of members' production/participation; and **(3)** gains commitments and financial support from the members. It is particularly important in a new operation because a market share history has not been established.

**Part II: Operations and Finance**

**Step I. Capital Investment**

In examining the savings potential of a marketing cooperative, determine the capital to be invested:

**(1)** List the value of the land, buildings and equipment, and preparatory expense which is planned for beginning operations.

**(2)** Indicate the additional capital necessary to support a base level of (a) supplies and production inventories, (b) accounts receivable, and (c) other working capital.

(3) Add items in #1 and #2 to get the necessary Total Beginning Capital.

(4) Show planned capital investment during the first several years of operations.

(5) For each of those years show the expected cost of planning addition and replacement of land, buildings, and equipment.

(6) For each of the three years, indicate the additional capital to be invested in increased levels of inventories and accounts receivable.

## **Step II. Prepare a Projected Operating Statement**

(1) Indicate the unit volume of expected sales for each of the products or commodities to be marketed. (For some products dollar volume may be preferred to unit volume.)

(2) Calculate total gross income by month for each year.

(3) Project the operating expenses by month for each of the years of operation. Include all expenses relating to your co-op.

(4) After all incomes and expenses have been itemized, determine the operating savings. (Total Gross Income - Total Operating Expenses.)

## **Step III. Source and Use of Funds**

Prepare a source and use of funds statement showing (a) how funds are made available in the day-to-day operations by such means as operating savings, depreciation and decreases in current assets, and (b) how the operation utilizes funds to purchase fixed assets, increase current assets, and retire equity. The difference between the sources and uses indicate the co-op's debt retirement ability.

(1) Indicate the source of funds available at the beginning of operations.

(2) Indicate the use of funds to begin operation (this will be a transfer of the fixed assets purchases and working capital needed to start the co-op.) Note that due to the capital expenditure necessary to begin operation, the above number will usually be negative.

(3) Indicate the additional funds which will be acquired from member investment in stock and from lending institutions.

(4) Show how additional funds from member investment and lending institutions will be used in each year of operation.

(5) Subtract total funds made available from the co-op's operation from the funds needed to operate the co-op. The balance represents funds available for debt retirement. (When

funds from debt retirement are positive, the debt repayment ability of the co-op is determined. This information will help the co-op board plan debt retirement schedules. If the funds for debt retirement are negative, the co-op board would need to show the sources of additional funding.)

Because many of Kentucky's agricultural products have seasonal marketing, when co-ops analyze their monthly cash flow, they may discover increased need for funds from an external source. These cash flow projections may also highlight the timeliness of capital needs. A cash flow statement includes only cash transactions as of the date cash inflow or outflow occurs. Information provided by the cash flow statement is a basis for financial control and simplifies communications between the lender and the borrowing co-op.

Remember that a marketing cooperative may not be needed if the function(s) it would perform are being handled through existing outlets. Cooperative feasibility is best determined through a feasibility study which addresses such questions as: Is there an economic need for the co-op? What is its potential membership and business volume? What management skills and facilities are needed? What will operating costs be? Estimated capital needs? Sources of capital and method of operation?

The feasibility study would be conducted by a survey committee with appropriate assistance from the Cooperative Extension Service. The survey committee would present its findings to interested members who would then vote either to go ahead with organizing the co-op or to stop the organizational procedure.

## **What's Next?**

If the potential membership should vote to proceed with organizing the co-op, an organization committee would be appointed to:

- sign up members,
- obtain capital,
- draft legal organization papers,
- file the articles of incorporation,
- hold meeting of charter members to adopt bylaws and elect a board of directors.

The board of directors would then elect officers and make arrangements for opening business.

For additional information refer to Cooperative Extension publication AEC 43, *Guidelines on How to Start a Cooperative*.

*See your County Extension Office for the entire series of publications on agricultural cooperatives.*

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