Expanding your efforts

via innovative business arrangements

By Dr. John Foltz and Dr. Christine Wilson

The world is a place of constant change, and there is no question the rate is accelerating. As an industry, the feed and grain sector has not been immune to these changes. Roller-coaster commodity prices, consolidation among livestock and grain producers and among firms in the grain and feed industry, not to mention increased government regulation and changes in marketing, sources and uses of information due to the rise in use of the Internet are all examples of issues that have come to the forefront.

As an owner or manager of a feed or grain firm, you address these changes as best you can. Many firms attempt to address anticipated future changes through a strategic planning process, which has been discussed in this column before. One of the items that is often included in a strategic plan is how to partner with other entities to better achieve your firm's goals and objectives.

The reality of today's marketplace is such that few companies are shaping their industry by generating all the innovations by themselves. Rather than ignoring what others are doing in the marketplace, many business management experts believe that success in today's competitive business world requires keeping track of other companies' actions and understanding how those activities shape, enhance or even benefit a firm's own business.

Below are some of the options that are available to feed and grain firms, how they might apply in this industry and some of the pros and cons.

Strategic alliances

Many companies have chosen strategic alliances as a method to explore new avenues of business. It has become very common for firms to collaborate with one or more firms that produce complementary products, with suppliers, distributors and even competitors. According to a recent survey by Coopers and Lybrand, among the fastest growing companies in the United States, 48% more alliances exist today than three years ago.

Simply put, an alliance is a business-to-business collaboration. Businesses form alliances with the objective of creating competitive advantages for the firms involved. Alliances are formed for combined marketing, joint sales or distribution, design collaboration, technology licensing or shared production and research and development. These relationships can be vertical between a manufacturer, wholesaler or customer, horizontal between each of the preceding types of companies (i.e., between manufacturers, etc.), and they can be put together on a local, regional or global basis.

Oftentimes an alliance is temporary in nature, which may be an attractive trait to the two participating firms. Such a partnership fosters mutual benefits, but unlike a merger (discussed in more detail below), ownership remains with each of the respective parties — and the alliance exists only as long as it's advantageous to both. While flexibility is many times a benefit, this feature of a strategic alliance may also be one of its negative aspects. Because an alliance is not as binding as a partnership via something like a Limited Liability Company (LLC) or as permanent as an acquisition (both discussed below), the partners may not be as willing to devote the time, energy and resources needed for the alliance to become successful.

Carefully scrutinize where your firm is today, and where you want to be in the future. Perhaps, some of the options outlined can contribute to your success.

Alliances serve several purposes for firms. Businesses use alliances to achieve economies of scale and increase market penetration. In addition, alliances can be used to enhance competitiveness in a market, enhance product development or expand market development. Some firms use alliances to diversify product lines, spread risk or to create new businesses. Also, many times alliances may be used to avert competitive disadvantages.

Once you have made the decision to form an alliance, you need to establish what factors you're looking for in that alliance. You should develop search criteria for the ideal firm or firms with whom to join in your alliance. Your criteria should consist of clearly defined business objectives. In the grain business, an alliance might be utilized to develop an areawide website shared by several elevators in a region that can be utilized by farmers for marketing or gathering useful market information. Thinking more broadly, an alliance between an elevator and a local farm equipment retailer might be formed, to share advertising costs so as to spread these costs over a larger base of business. In the feed business, an alliance could be utilized to add a new product line to a local manufacturer's line of feed, where the benefits go beyond just purchasing the product.

Ed Risbee, author of The Art of Partnering, states that the key to alliances is to ask yourself, "Do I see the world as a zero-sum game — meaning for me to win, you have to lose? Or, do I see the world as full of possibility, where we can work together and build a bigger pie?" Risbee goes on to develop the concept of keeping track of your "relationship-values" in a strategic alliance. The thought here is that if your firm is to have a great relationship with another organization — you must create value for them. If you don't understand what creates value for them, or if you lose sight of the value they need, or if their needs change and you haven't learned their new needs, then you might be doing things that you think create value for them, but really don't.

Thus, Risbee suggests that firms engaged in strategic alliances do a quarterly "value update" with their partner. This update involves outlining the value your firm is getting from the alliance relationship, the value you think your partner is getting from the relationship, and your ideas on how you and your partner can improve the relationship. If your partner has done a similar analysis, you can trade papers and "compare notes," and make mutually beneficial adjustments.

Limited liability companies

Limited liability companies, or "LLCs," have been around since 1977, but their popularity as a form of business has increased in recent years. All 50 states have enacted LLC laws, and the flexibility associated with LLCs and their laws is what attracts many people. LLCs work well for new business ventures among corporate partners.

An LLC is a hybrid entity, bringing together some of the best features of partnerships and corporations. LLCs were created to provide business owners with the liability protection that corporations enjoy without the double taxation that occurs with the corporate form of ownership (meaning the business is taxed on its earnings, and then dividends paid to shareholders are subsequently taxed as well). In LLCs, earnings and losses pass through to the owners and are included on their tax returns.

There are four main benefits to forming an LLC:

1. Personal protection from business debts and claims (limited liability);

2. Flow-through tax advantages of a partnership — that is, profits or losses that flow through directly to the members;

3. Simplicity of operation without the statutory necessity to keep minutes, hold meetings or create resolutions as with a corporation;

4. Flexible distribution of profits and losses.

Despite their attractiveness, LLCs do have their disadvantages. Since this form of business is relatively new in some states, their tax treatment varies by state. If you plan to operate in several states, you must determine how a state will treat an LLC formed in another state. Although an LLC offers few restrictions and some substantial advantages, as when making any business decision, a consultation with a tax specialist and legal counsel is always a good idea.

Mergers and acquisitions

Generally a merger is a combining of two or more entities from which one business continues to exist. An acquisition, or takeover, involves the purchase of a business that continues to operate, but does so under the control of the acquirer. Mergers typically occur on friendly terms, while an acquisition may be either friendly or hostile (with hostile referring to an acquisition such as that of a publicly traded company, whereby the takeover attempt by the acquirer occurs through outright stock ownership or an offer to buy (tender) stockholders' shares).

Mergers and acquisitions (M&A) may result in horizontal integration meaning a combination of two or more firms in the same industry — for example a grain elevator merging with another grain elevator. Or, the result may be vertical (backward or forward) integration (combining two or more firms in different stages of production or marketing into one firm — for example, a hog operation purchasing a feed mill would be backward vertical integration), and may involve companies in related or unrelated industries.

As with the other strategies we have discussed, a merger or acquisition may fit well into your company's strategy. You might be thinking about diversification as a means for a growth strategy. Rather than starting a new division from the ground up, the advantages of a merger or acquisition may greatly outweigh those of a start-up.

Some of the reasons for M&A include many of the same reasons for pursuing a strategic alliance: to enter a particular market; to diversify your company's product lines; to obtain control of various aspects of production or marketing (a brand, new technology, or supply chain issues). Firms may also acquire other firms in order to increase market share and market control.

The cons of merger/acquisition work are such that an approach can be extremely complex and time-consuming (though probably not any more onerous than entering a business, market, etc. on your own). Such an approach involves meeting legal requirements, looking at tax considerations and considering possible government intervention.

Mergers and acquisitions are taking place throughout our economy, and the agribusiness industry has seen its share of such activity. Recent examples include the merger of Tyson Foods and IBP in the meat processing industry. In the grain industry, Cenex Harvest States Cooperatives was formed in 1998 due to a merger of Cenex, Inc. and Harvest States Cooperatives.

Cooperation, commitment and context

It is clear that some form of cooperation via strategic alliance or LLC may be beneficial to the business with a firm commitment to growth. Whether such an option looms in the future of your company depends on your situation, or context. Our counsel would be to carefully scrutinize where your firm is today, and where you want to be in the future, and perhaps, some of the options outlined above can contribute to your success.

For further information, you might want to look at the text *Building Strategic Relationships: How to Extend Your Organization's Reach Through Partnerships, Alliances, and Joint Ventures* by Juli Betwee et al. The book discusses how successful alliances are launched, developed and concluded. The authors draw from more than 200 interviews and 75 case studies of varied partnerships to provide perspective, guidance and detailed case examples that will help progressive partners achieve their goals in all phases of a partnership.

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