Questions You Should Answer Before Starting A New Dairy Processing Enterprise

by Brian M. Henehan, senior extension associate, Department of Agricultural, Resource, and Managerial Economics, (ARME) Cornell University[1]

Introduction

This set of questions provides a beginning point for an individual or group looking at starting up a new dairy business. These questions are not meant to include all of the factors needed to determine the economic feasibility of a prospective enterprise nor are they meant to comprise all of the elements of a detailed strategic plan which would be needed for the business. The questions provide a beginning and jumping off point for a more rigorous review of the necessary components of a successful business start-up. These questions should generate additional, more specific questions in the minds of those involved in analyzing the potential for a prospective dairy processing business.

We do not pretend to have all the answers to these questions. Those who are considering creating a new dairy related business will have to decide for themselves which questions are most relevant as well as ask any additional questions we overlooked. These questions will need to be answered to the degree of satisfaction determined by those taking the risks involved in starting the new enterprise.

My professional experience lies primarily in working with groups of producers who are already involved in or are looking at investing in new cooperative enterprises. However, most of the questions that need to be addressed in considering a new dairy processing venture are the same whether you are an individual entrepreneur, a group of investors, or a group of producers. Although there is a set of questions at the end which focus specifically on cooperatively owned businesses.

Consumer Demand

We start with the consumer. If there is not strong demand for the proposed product, it is highly questionable whether the project analysis should move any further. In production agriculture, we are capable of producing just about any product at a relatively low cost. The first set of questions revolve around consumer demand.

What is the trend for overall demand of the type of dairy product being considered? (growing, flat, declining)

---

[1] More information about the author can be found on the following website: *www.cals.cornell.edu/dept/arme*.
The author acknowledges comments on an earlier draft of this paper made by Craig Alexander and Jim Pratt, colleagues in ARME as well as content from materials developed by David Brown, senior extension associate in the Food Science Dept. at Cornell University.

Who are the consumers you intend to serve? (Demographics, geography, etc.)

What is the most relevant aspect of your product for consumers? (taste, convenience, packaging, etc.)

Will consumers be ***truly excited*** to purchase your product? At what price?

What quality and services will be required to effectively serve all customers involved as well as the end consumer?

What will make your product unique? What is your competitive advantage in the marketplace?

What type of risks are involved on the consumer side? (food safety, consumer acceptance, new tastes, new package, etc)

How will you manage these risks? Pre-testing products, consumer focus groups, etc.) How much exposure can you tolerate in regard to these risks?

Marketing

What market channels will be used (direct, food service, retail, etc.) and outlets? What relationships with buyers, brokers, distributors will you need to develop to operate within a given channel?

What resources (people, physical assets) will be needed to successfully promote, sell and market your product?

What is the total per unit cost of marketing your product? (sales, customer relations, promotion, shrinkage, slotting allowances, returned product, etc.)

How do your per unit costs and per unit prices compare to the competition?

What types of risks are involved in marketing? (new product introduction, new market entry, product liability, etc.)

How will you manage the associated risks at this level? (new product promotion, insurance, etc.) How much exposure can you tolerate in regard to these risks?

Processing

How will the product be processed or manufactured? By who?

How will quality be assured? (throughout whole processing/distribution system)

How will raw product be stored (milk, cream)?

What processing capacity will be needed? (space, sq. ft., refrigeration, receiving, loading, etc.)

What is the total cost of processing? (receiving raw product, manufacturing, packaging, sanitary regulations, etc.)

Where is the plant located? (in relation to producers, in relation to customers)

What is volume of raw milk needed for finished products? (yield, less shrinkage)

How will seasonality issues/balancing be handled? (use all the milk supplied, sell surplus)

How do per unit processing costs compare to the competition?

What regulatory costs will be incurred? (food safety, inspections, licensing, etc.)

What type of risks will be incurred in processing? (rejecting raw milk, product handling, safety, environmental, etc)

How will these risks be managed? How much exposure can you tolerate on regard to these risks?

Physical Assets Required

What physical assets will be required? (processing, storage, receiving, shipping, administration, distribution, marketing, etc.

Will the project involve purchasing real estate? (strategic location factors for: assembly, distribution or marketing)

Will the project involve construction or renovation? (typically project construction costs are underestimated and completion deadlines overly optimistic)

Will the project involve retrofitting an old processing plant? Why was the old plant decommissioned? (usually for good reasons: location, environmental, size, etc.)

Will new equipment be purchased? What is the relation of the supplier to the project? (arms length, investor, creditor, etc.) How proven is the processing technology?

What type of risks will be incurred in property/equipment purchasing? (cost overruns, operation hold-ups, plant safety, debugging new technology, environmental, etc)

How will these risks be managed? How much exposure can you tolerate in regard to these risks

Inventory and Distribution
How will finished product be stored and inventoried?

How much product shrinkage will through storing inventory and distribution?

What total shipping and distribution capacity will be needed? (volume over what time line)

How will product be distributed to customers? (own trucks, brokers, distributors)

What is the geographic distribution area to be served?

How do distribution costs compare to the competition?

What types of risks will be incurred in storage and distribution? (inventory valuation, product quality deterioration, etc.)

How will these risks be managed? How much exposure can you tolerate in regard to these risks?

Milk Supply
Is there a consistent, quality supply of milk available? (individual farmers, coop)

Are producers operating at lower than average production costs? Producing higher than average quality?

Will the enterprise participate in a federal or state order market pool? (component pricing, plant point pricing, etc.) What are the processor responsibilities of operating under the pooling arrangements?

How will prices/premiums paid to producers attract producers away from alternative buyers?

Will producers be committed to shipping milk to the new enterprise? (contracts, better deal, etc.)

What additional procurement costs might occur? (payments to producer security fund, shrinkage in transit, etc.)

What type of risks would be incurred at this level? (economic viability of producers, seasonal variation, etc.) How much exposure can you tolerate in regard to these risks?

Milk Procurement and Assembly
How will needed volume and quality of milk be procured? (own milk, other individual farms, cooperatives)

How will producers be paid and rewarded for quality? (Quality premiums, producer payroll costs, etc.)

How will milk be tested and hauled to plant? (own trucks, own testing lab., etc.)

What will the milk hauling costs be? (distance from producers, highway access, number of stops)
How will quality standards be enforced? (inspection, testing, who pays for rejected loads)

How will milk assembly costs compare to the competition?

What risks will be incurred in milk assembly? (contaminated milk, reliability of supply, reliability of haulers, receiving, etc.)

How will these risks be managed? How much exposure can you tolerate in regard to these risks?

Leadership and Organizational Issues
Is there effective leadership and commitment present to launch the project?

Is there a viable organizational structure to support the business? (proprietorship, corporation, partnership, cooperative)?

Is there an effective decision making capacity within the organization to make the tough decisions needed to create and launch a new enterprise within the necessary time line?

Does the organization have a well thought out, detailed business plan? (management, finance, marketing, etc.)

Does the organization possess the best information available for analyzing the potential for the start-up business?

What risks are associated with this area? (leadership commitment, succession, depth, etc.)
How much exposure can you tolerate in regard to these risks?

Management
What skills will be needed to manage the business? (plant operations, technology, marketing, etc.)

What compensation will be required to attract necessary management talent? (usually higher than anticipated, particularly in today's job market)

What risks are associated with this area? (management commitment, succession, depth, etc.)
How much exposure can you tolerate in regard to these risks? (whole project revolves around one individual, etc.)

Finance

How much capital will be needed for the initial start-up? (assets, operating budget, payroll, supplies, raw products, etc.)

Is there adequate capital available for start-up? (equity, debt)

What is the expected return on investment? High enough to attract investors or secure loan?

How "patient" are investors? (expected time line to achieve returns)

What risks are associated with financing this venture? (level of investment, collateral, track record, etc.) How much exposure can you tolerate in regard to these risks?

Government Regulation and Policy

What local government regulations might have an impact on the project? (waste management, zoning, taxes, etc.)

What state government regulations might have an impact on the project? (environmental, bonding, licensing, taxes, etc.)

What federal regulations/policy might have and impact on the project? (Federal marketing orders, milk pricing, international trade, etc.)

What risks are associated with local, state and federal policy affecting the project? (timing of regulatory approval, changes in policy, etc.)

How will these risks be managed? How much exposure can you tolerate in regard to these risks?

Producer Cooperation

Have existing cooperatives been contacted to determine the level of interest to avoid "reinventing the wheel"?

Have effective producer leaders surfaced who are strongly committed to exploring the feasibility of all aspects of the project and then to forming a new cooperative?

Who would the prospective members be? (location, size, commitment, etc.)

What would attract potential members to terminate their current marketing arrangements and join a new venture? (Price, new product, risk, etc.)

What level of investment would members be required to make to finance the new business? (Typically 40-50% of capital required)

What level of financial and market security risks would potential members be willing to assume by joining the new venture? (Return on investment, milk prices, payment security, etc.)

Are the prospective members patient enough to allow for a 3-5 year start-up period before they see profitability in the new business?

What risks are associated with forming a new cooperative business? (qualified board of directors, management, member commitment, member investment, etc.)

How will these risks be managed? How much exposure can you tolerate in regard to these risks?

Summary

This brief overview of some of the key questions related to starting up a dairy processing business covers a range of subjects including: consumer demand, marketing, processing, assets required, inventory and distribution, milk supply, milk procurement and assembly, leadership, management, finance, government regulation/policy, and producer cooperation. A proposed project may not involve all of these aspects or may indeed include considerations not covered here. It is hoped that this summary will prove useful in analyzing the potential for a start-up dairy business. It is not meant to "overwhelm" the reader with too many questions. The intent is to assist the reader in asking the "right" questions to enhance the probability of success. Starting any new business is a risky undertaking. Advisors cannot answer these questions on behalf of the key stakeholders of a proposed start-up. Being the primary risk-takers, and hopefully beneficiaries of a successful business, the stakeholders will have to answer these questions to their own level of satisfaction before they start the business.