



HOW TO DEVELOP A BUSINESS PLAN FOR A GRASS-FED BEEF OPERATION

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Cattle producers in California are increasingly considering whether or not to enter new market niches as a way of improving the long-term economic viability of their operations. One niche receiving much attention is the market for grass-fed beef. Factual data are needed to enable ranchers, lenders, investors, and managers in the beef distribution system to reach intelligent decisions concerning the operation and funding of a new enterprise such as grass-fed beef. These data are usually presented as one-year, three-year, or five-year business plans. This publication summarizes the process of preparing a business plan for a grass-fed beef operation. By using this material as a guide, it is expected that readers will be better able to tailor their ideas into plans that lenders will fund.

The necessary elements of an effective business plan include: the charter, management, the product, the market plan, department plans, financial plans, and a strategy for presenting this information in a written and/or verbal format. A good plan takes time to develop. Nevertheless, the time invested in developing a business plan will be worthwhile because (1) it makes the managers involved more aware of the strengths and weaknesses of the proposal, and (2) it significantly raises the chances that lenders/investors will fund the proposal.

DEFINING THE BUSINESS CHARTER

A charter is simply well-thought-out and clearly defined statements as to who you are, what you expect to accomplish, how it is to be done, and by whom. The statements are based on the five Ws: who, what, why, where, and when. Suggestions for information to include follow in the form of questions to answer.

- Who? Who are you (or your firm)?
- What? What is your purpose for being?
- What are your products or services?
- What markets are you going to penetrate?
- What market share do you expect to capture?
- What profit margins do you expect to achieve?
- Why? Why are you going to be in this business?
- Where? Where are you going to sell your product or service (locally, regionally, etc.)?
- When? When are you going to start operating?
- When do you expect to achieve your goals?

Exhibit 1 presents a sample charter for a new grass-fed beef operation being planned by an established cattle rancher. All five Ws are included although some are buried in implicit statements. Notice that the statements are simple and as specific as possible. The charter lists the firm's goals so anyone can understand what you hope to do.

Exhibit 1. An Annotated Charter

- (Who) The Grass-fed Beef Company
- (What/Where) The Grass-fed Beef Company will engage in wholesale sales in the counties surrounding Chico
- (Who) John and Jane Doe will be partners and sole owners of The Grass-fed Beef Company
- (What/Why) The Natural Beef Company will specialize in grass-fed beef packaged in boxes containing a wide assortment of cuts, as required by market demand
- (What/When) Achieve a 30 percent share of the wholesale grass-fed beef market in Butte County within four years and 50 percent during the fifth year. Expand sales into Shasta, Sutter and Yuba counties by the third year.
- Achieve a 20 percent margin on sales during the first quarter of the first year of operation.
- Earn pretax profits of 18 percent on sales beginning the fourth quarter of year two and continuing through the fifth year at this level.
- Provide a positive cash flow beginning the first quarter of year three.
- Produce a net return on investment of 50 percent by the end of year five.
- Expand the wholesale product line as market demand and profits permit.

MANAGEMENT STRUCTURE

A business plan should specify who would be in charge. It must indicate who will have responsibility for the following necessary functions in any ranch/agribusiness: production/ranching operations, marketing/sales, and finance/administration. Also, a flow chart or diagram showing the lines of responsibility may be used to illustrate the chain of command. If one person will have responsibility for more than one management area, as is typical in agriculture, estimates of what percentage of time will be spent in each area are useful to both lenders and the managers themselves. After these estimates are made, it may become clear that insufficient time is available for a person to adequately fulfill some responsibilities, thus risking failure. Also, lenders want to know whether someone in a position understands its scope, so short, written job descriptions may be included in this section of the business plan.

Management is the most significant profit-determining factor. The firm must have competent management to follow through on the functions of planning, organizing, directing, staffing, and controlling in order to ensure a profitable undertaking. This means that lenders will study the management of the proposed operation before making final decisions. Sometimes a decision-maker will be in the uncomfortable position of knowing that the proposed business could succeed, but only if there is a change in the planned management structure that would exclude, for example, the potential owners of the new company. In other words, wanting to be a rancher does not guarantee becoming a successful rancher.

THE PRODUCT

A business plan should include a product description written so that others can understand it. A key concern for a rancher considering whether to market grass-fed beef is the question of what form the product will take. The markets for live grass-fed cattle and processed beef are quite different and make quite different demands upon a rancher wanting to enter those niches. Obviously, the biggest difference is that cattle have not been processed into beef yet. A rancher wanting to market beef has to perform (or arrange for someone else to perform) many more of the processing tasks needed to get live cattle into the form of processed beef. For example, selling boxed beef requires that a box must be designed, produced and labeled before some combination of cuts of meat are processed and packaged in the box which, then, must be stored in some manner so it doesn't perish. A rancher lacking the time, skills or money required to perform any of the tasks will not succeed in marketing a processed product.

If the business plan is aimed at an outside audience, like potential lenders and/or investors, only a general understanding of the product is necessary; most people are familiar with agricultural products. However, non-ranchers may not understand the production process and may be concerned about whether the operation will be able to produce the target level of output. Therefore, brief descriptions of the production processes and output supply may be included in the business plan.

Production Process

This section of a business plan analyzes the production process of the proposed operation. It analyzes the specific facility needs and labor requirements.

1. Facility determination.

This phase of the analysis involves determining the specific facility needs of the entire operation. This is especially important for operations that will involve processing cattle into some form of beef. Each step in any processing to be done must be specified and all facility needs must be identified. For example, as soon as cattle are slaughtered, storage facilities and sanitary processing locations must be provided.

2. Labor needs.

Following the determination of facility needs, the decision-maker can estimate labor needs. The firm will be able to calculate this from equipment and service needs. The firm can then compare its needs to the available labor force in the area of the proposed operation.

The other issue concerning labor needs involves the availability of management and technically trained persons. Some types of agribusinesses do not require many people with special training or skills, but many businesses require employees with unique talents. This is an extremely important factor that generally will dictate the success or failure of the undertaking.

Output Supply.

This part of the analysis concentrates on determining the expected output for the proposed enterprise. There are usually four factors that need to be analyzed when determining product supply:

1. Minimum economic size of any processing facility/operation.

This factor is a consideration only if cattle are going to be processed in some way. Determining the minimum economic size of any processing facility to be utilized will, in turn, set the amount of raw product required to reach this scale of operation. A firm might, for example, determine that 20,000 pounds of raw beef per day would be needed to keep a minimum-size beef processing plant operating.

The minimum economic size of a facility can be determined by actual cost analysis of existing plants or by synthesizing a model facility from specifications obtained from equipment companies. Information related to necessary size requirements can be obtained by simply observing those companies already in the market. Three case studies of northern California grass-fed beef producers have been prepared to provide insights into the experiences of such firms. The relative level of success achieved by existing firms will give an indication of the likelihood of the success of a new firm operating with equal facilities. If the firm is entering a new market where there are no firms to observe, the decision-maker can still determine the necessary size of buildings and other facilities by working from the inside of the proposed facility. The first step would be to design the production techniques according to the technology to be adopted. The techniques will indicate how much space will be needed in the facility. The companies that sell processing equipment are often able to assist in laying out the production areas, because they are in the business of setting up their equipment so as to achieve the most efficient results. From the specifications of equipment to go inside a building, it quickly becomes clear how much space that building must provide. Therefore, the size and shape of a beef processing facility, or other agribusiness operation, can be determined by planning from the inside out.

2. Operational requirements.

Following the determination of the minimum size of facility that can operate economically, the decision-maker must next establish how much raw product will be required to supply that facility. For example, the firm would need to produce and/or procure about 18 to 20 head of grass-fed cattle each day for the processing plant mentioned earlier if it is to operate year-round.

3. Availability of requirements.

After the decision-maker calculates the amount of raw product required, he/she must determine whether or not this quantity is available in the required qualities and at a cost the firm can afford. An important factor in determining the cost of the inputs is the cost of transportation from the ranch to the proposed facility. Firms dealing with perishable products, such as beef, must also determine the maximum distance from the facility within which the firm must draw its raw product. This distance is dependent on the rate at which product quality deteriorates during the transportation process. Although live cattle shrink during transportation, this is much less of a problem than the potential for spoilage of processed beef, thus processing facilities are usually located much closer to customers than to the ranch.

4. Seasonal supply of cattle.

It is not enough to know that there are adequate cattle supplies in the area to satisfy the needs of a proposed plant. The firm must know whether it can be assured of securing the necessary supplies during all seasons of the year. Operations which process beef only part of the year are at a disadvantage in trying to keep production costs competitive.

THE MARKET PLAN

In most business plans, documenting the market for a product or service is difficult, but necessary to gain outside funding. This is the area in which a rancher will have the least amount of "black and white" data. Market analysis, however difficult to conduct, must be done. The availability of a market is critical to the success of any business venture. If a market does not exist for a product, there is no economic rationale for producing the product, and therefore the project can be terminated.

To adequately analyze the market potential for a grass-fed beef product, it is necessary to determine the current and potential consumption of the product, the types of markets to be used, the types of distribution systems to be used, how the market is entered, the types of buyers that must be satisfied, the types of selling arrangements to be used, and the prices to be charged (or received) for the product. In the following sections each of these factors is discussed.

1. Consumption.

It is necessary to determine the current level of consumption of the grass-fed beef product being considered, the trends in this consumption, and the current consumption and trends in consumption of competing meat products. It is also necessary to determine in what form, qualities, volumes, etc., the product is being consumed currently; who is currently providing for consumption demands; how competitors will react on the entry of a new firm into the market; at what capacity current competitors are operating; and whether the new firm can compete with existing firms.

Current consumption of grass-fed beef is low due to limited supplies available in most regions. This complicates the analysis for a rancher thinking of entering the market. Some sort of market research should be done to identify how much people would buy at particular price levels. This type of research is difficult because people cannot accurately estimate how much they would consume of a product when they have never tasted the product before.

Grass-fed beef is a very different product, in the eyes of a retail consumer, when it is boxed in large quantities for preparation and cooking at home versus served one steak at a time in a restaurant. Many people are unwilling to spend hundreds of dollars at one time for a large container of boxed beef, while they may be willing to buy smaller packages. Thus, a rancher needs to know what most consumers in his/her geographical area prefer.

2. Markets.

It is necessary to know what kinds of markets exist; where these markets are, local or distant; and what it will cost to serve these markets. Retail and wholesale markets for beef are very different. A rancher must be clear about which market type he/she is trying to serve.

3. Distribution system.

Next it is necessary to determine what type of distribution system will be needed. A firm must determine whether it will have its own sales force or use brokers; whether it will market under its own brand or a wholesale buyer's brand; whether it will transport the product to the market, and if so, what method it will use; and whether it should buy or lease equipment and what the cost will be. Making contact with potential buyers can be expensive, but it must be done. If customers will not come to you (because they don't know you or you are located too far away), you must go to them to make sales transactions. A rancher unfamiliar with the sales methods used in a retail or wholesale beef market may be wise to hire someone to perform this task.

Brand names help identify products that are no longer in a raw commodity form. However, customers must be made aware of, and favorably inclined toward, a brand before it can help with sales. This information and education process will require some form of advertising or promotion, which is costly and can be wasted if not done correctly.

Once a product is sold, it must be delivered to the buyer. Getting the grass-fed beef from where it is produced to where it will

be consumed is a very costly component in the marketing process. Transportation and storage costs grow over time and distance traveled.

4. Market entry.

The next step for ranchers involved with a processed product like grass-fed beef is to determine how the product will be introduced in the market -- through lower prices, through advertising and promotion, or through some other method? Another concern is the length of time it will take to build up the market to desired sales volume and what the costs will be.

Advertising does not have its full effect immediately. Often potential customers have to be contacted several times before your message "sinks in" and they act on it. Also, poor advertising can have a negative effect on sales. Thus, advertising efforts must be maintained over a period of time to have much of an effect and the information being communicated to potential customers must be useful if sales are to be generated. This is a significant cost at the beginning of a product's life. Over time, it is hoped that more people will try the product and some will become repeat customers, but no amount of advertising can guarantee this will happen.

5. Buyers.

The next task is to identify the potential buyers of the product. Specific questions that must be answered include: What types of buyers will there be? What quantities will they require? What product specifications will the buyers require? How reliable are the buyers? Have buyers indicated an interest in the product of the rancher? What kind of commitment will buyers make to get the product? Wholesale cattle buyers may be willing to take live animals, but retail beef buyers want a processed product. Dealing with the two types of buyers is very different.

6. Selling arrangement.

The kind of selling arrangement that will be encountered must be determined. These arrangements will include many specifics: the kind of pricing arrangements to be made; the kind of delivery schedules that will be required; the types of payment schedules that will be encountered; the kind of services the rancher will have to provide with his/her product, and the costs involved; whether or not the rancher will have sales offices and, if so, the location of those offices; the number of salespeople required; the types of compensation plans the rancher will have for his/her salespeople; and the total cost of the entire sales effort.

7. Prices.

Critical to the entire analysis is the question: What price can the rancher charge for his/her product? This question can be partially answered by analysis of past prices and price trends. On the basis of this analysis, future expected prices are projected according to expected future consumption demands as affected by expected future economic conditions. This is a relatively difficult task, obviously, especially if the projections must go very far into the future. When making these projections, the decision-maker should consider the expectations of buyers and other suppliers of the product.

DEPARTMENT PLANS

The objective of a department plan is to determine the department's needs and the operating costs required to complete its responsibilities in a given time period, whether it is one, three or five years. A department is a unit that performs some type of tasks, like marketing, finance, production, accounting, etc. Even though a small ranch or agribusiness may employ only one person, it is useful to specify plans for each "department" to identify what regular functions and special projects need to be undertaken.

A department plan should begin with a charter to define its purpose and responsibility within the company structure. Charters are generally assigned by the chief executive (or ranch owner). They should specify a department's goals and responsibilities so that they do not overlap those of other departments (this is important if more than one person is involved). If overlap occurs, it can be a source of friction and inefficiency.

Department plans should include projects that are to be accomplished within the time frame established by the plan, perhaps in the form of a simple listing of all projects, each with a descriptive paragraph or two. After all projects are accounted for, time schedules can be estimated. A chart listing the projects and their time schedule is a useful presentation tool. Personnel requirements follow logically from the project listing and time schedule. Job descriptions and pay level information can be

included in the department plan to indicate what types of skills are needed and when. Finally, department budgets of capital expenditures and daily operating costs can be included. The totals establish department needs and are then used in preparing financial plans outlined in income and cash flow statements.

FINANCIAL PLANS

Financial reports are really the key to any business plan. They indicate whether it is worthwhile to proceed, to stop and reevaluate the situation, or to cease operations all together. The financial plans for a proposed operation are presented in a series of reports including an income statement, a cash flow statement, a depreciation schedule, provision for income tax, and a balance sheet. These reports provide information on four critical issues, as noted below.

1. Investment capital needs.

Once specific facility needs have been determined, the decision-maker can determine what those facilities will cost, which in turn will indicate what the initial investment needs of the firm will be. This part of the financial plan is relatively easy to prepare once it is decided exactly what types of facilities the rancher wants. The costs are simply estimates from the equipment companies, construction companies, utility companies, and so forth.

2. Cost of operation.

This phase of the financial plan analyzes the information gathered thus far. The analysis includes applying appropriate wage rates; management costs; raw material input costs; various operational costs, such as utility rate structures; and fixed costs of repairs and maintenance, depreciation, interest, taxes, and insurance. This process should involve the development of cost budgets for the various phases of the operation. The result will provide a per unit cost of operation.

3. Profitability.

Profitability of the operation can be projected using the estimation of expected prices and costs. Price projections reported in the market plan, discussed earlier, and the per unit costs are combined to find estimated profit per unit. A projected income statement must be prepared to determine the profitability of the entire operation. In addition, preparation of a "break-even" chart is often recommended. This chart will show at what level of sales, given the ranch's costs and returns information, the rancher will be able to break even, or cover all costs of operation. The importance of a break-even chart is in knowing the minimum level of production that must be marketed to achieve the break-even point. For example, if the rancher knows that it can contract for that level of production and sales, it knows that it can at least break even on the proposed operation. This reduced level of risk may be enough to convince the rancher to go ahead with the new grass-fed beef enterprise even though it does not know the long-range profit potential.

4. Working capital needs.

Completion of the projected income statement has been the end of a business plan for many agribusiness firms. However, the most important item has yet to be included in the financial plan -- the cash flow summary. Provision for adequate working capital is perhaps the critical item for the successful operation of a business. It is necessary to prepare a cash flow summary to determine what the cash needs will be for the operation and what sources of cash are available to meet those needs.

To be more specific, the rancher will need to know how much capital will be required for day-to-day operation of the operation and when this capital will be required. Daily cash needs include expenditures on wages, inventories, utilities, raw product, and more. Sources of funds include sales receipts, borrowing, owners' equity, etc. The cash flow summary is also required to help determine the size of loans, the length of loans, probable payback periods, and the amount of interest and principle that can be paid back periodically. It is especially important for ranches to develop a cash flow statement because they are in a market in which business is not done on a cash-and-carry basis. In many agricultural markets it is common practice to allow a 30-, 60-, or 90-day payment period for customers. This means that there is a big difference in the income statement and the cash flow statement in that the cash lags behind sales by the amount of time in the credit period. This drains cash from ranchers issuing the credit.

To summarize the financial plan section of a business plan, data must be presented to tell the rancher how much all required facilities will cost; what the firm's operational items, such as labor, utilities, and raw inputs, will cost; how much profit the operation will make; and how much working capital will be needed to safely operate the business.

PACKAGING THE INFORMATION

Each of the elements for a successful business plan has been outlined in the sections above. In a successful plan, the individual elements must be organized in a logical sequence that will make sense to your audience. Enough information must be included to convey your intended message, but not so much as to overwhelm and confuse the reader. It is primarily facts that are of interest. Potential investors are interested in an honest assessment of how much will be returned on their investment and when.

To secure your audience's attention, keep your plan short and informative. Divide your plan into four or five sections. Exhibit 2 presents the table of contents for one sample business plan. Other ways of organizing the information may better suit a particular situation. The bottom line is that preparing a business plan is a useful means of communicating to both internal and external audiences what a proposal is all about. There is much wisdom in the old cliché: "managers do not plan to fail, they fail to plan."

Exhibit 2. A Sample Business Plan Table of Contents

Section 1

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- Competitive summary

Section 2

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- Personal profiles
- Financial statement
- Income statement
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- Provision for income tax

Section 3

- Department plans
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- Finance/Administration
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- Section 4
- Market studies
- Resumes of key personnel
- Product specifications

What Do the Case Studies Tell Us?

The three case studies of grass-fed beef operations attempted in Northern California make it clear how difficult it is to succeed in a new market niche for cattle. Two points are especially important when assessing the prospects for the future.

First, a grass-fed beef rancher must have a large-volume operation to keep costs competitive with alternative products. Grass-fed cattle compete with other cattle in both wholesale and retail markets. Thus, costs of grass-fed beef must be fairly close to costs for those competing cattle to attract buyer attention. Just like with any cattle product, scale economies enable grass-fed beef ranchers with high volume to keep production costs at a minimum.

Next, the relatively recent introduction of "grass-fed beef" products mean that overall consumer demand for such products are small currently. Few people have heard of, or tasted, grass-fed beef in the United States. Thus, participants in this market

niche will face a significant information and education challenge as they try to convince people to consume the product.

These two factors are in conflict, making the prospects for profitable grass-fed beef operations look unlikely at present. As long as there is limited consumer demand for grass-fed beef, it will be difficult for individual ranchers to expand their sales volume enough to capture the economies of large-scale production needed to keep costs below market prices.

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