
AGRICULTURAL ALTERNATIVES

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Starting or Diversifying an Agricultural Business

Due to a diversity of production conditions and marketing opportunities, Pennsylvania readily lends itself to small-scale production. Small-scale farming can be a very satisfying lifestyle, but to be financially successful you also need to view your operation as a business. New farmers considering adopting an enterprise outlined in the *Agricultural Alternatives* series need to view these enterprises as new businesses. An existing farming operation considering diversification must carefully evaluate how adopting a new enterprise will impact existing land, labor, capital, and management resources.

The Steps Involved

The first step in starting a new business or adopting a new enterprise is to choose opportunities that you are passionate about. Choosing an enterprise that you do not enjoy will only lead to lack of interest or failure in the future. During this process, you should include your immediate family in the discussion. Family unity will lead to acceptance of time taken away from family activities during the start-up phase. Many enterprises in the *Agricultural Alternatives* series include budget lines indicating a value for family labor. Family acceptance is necessary for your farm business to succeed.

When considering a new enterprise, researching of all aspects of the proposed enterprise is critical. This includes legal issues relating to starting the type of business on your farm (zoning regulations), obtaining the necessary funding for your business, realizing the time requirements of the practice, and researching available markets for the product you will produce. Good sources of information include your



local public library, the Internet, and people currently involved in the type of business you are considering. The research should include the history of the practice, the present conditions, and the future prospects.

Develop a Business Plan

The second step to take before undertaking any new business or diversifying an existing business is to develop a business plan. A business plan can be thought of as a roadmap of the future of your business and requires you to think through the process of where you expect your business to go in the future. This thinking process should include who your customers are and in what kind of marketplace you will

This publication was developed by the Small-scale and Part-time Farming Project at Penn State with support from the U.S. Department of Agriculture–Extension Service.

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operate. A business plan requires you to estimate costs and potential profits, consider the cash flow of your business, and determine how your business will adapt to a changing business climate. Many lenders now require a written business plan before considering new funding. The business plan will also help determine the viability of the practice prior to adoption or initial cash outlays.

Assemble Your Business Management Team

You should develop a business team prior to adopting a new enterprise. This team usually consists of a lawyer, an accountant, an insurance broker, possibly a mentor, and you and your family. Choosing the team can be time consuming, but time spent developing the team will reap many benefits during the life of the business. Choosing a lawyer and accountant familiar with the type of farming operation being considered is vital to the success of the team. When choosing your team, look for members who will provide initial consultations for free or at a reduced rate. These consultations may take the form of an interview conducted by the potential owner of the business.

The lawyer should advise the team concerning business structure, requirements for filing for a fictitious name for the business (if this is desired), and any other legal issues deemed relevant. If you are operating the business under your own name, you do not need to file for a fictitious name (for example, John Doe Farm). However, if John Doe decides to operate the farm under the name “Green Acres Farm,” he would need to file for a fictitious name for the enterprise. If you purchase land, you will need to involve a lawyer. Compatibility between the team members is critical because all members of the management team will need to work together for the success of the business. The accountant should advise the team concerning tax matters, employee payroll, record-keeping practices, and other financial aspects of the business.

You should also consider involving an insurance broker because they represent a variety of companies. The broker can consider which policies provide the best coverage for the money. One broker may not handle coverage for all operations. For example, because some brokers do not offer crop insurance policies, a separate sales person may be required if that type of coverage is required. Your business management team should consider a complete risk management strategy. More information on insurance can be found in *Agricultural Alternatives: Agricultural Business Insurance*.

A mentor usually has experience in the same or similar business to the one you are considering. Your mentor may also be someone currently in the same business. A mentor can provide valuable insight to a beginning operation. Mentors can advise you concerning suppliers, markets, and production practices unique to the area in which your business will operate.

Conduct a SWOT Analysis

Once you’ve decided to go into business and established your management team, the next task is to conduct a SWOT analysis for your business, yourself, and your family. SWOT stands for **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats. You should conduct the SWOT analysis with as many people present as possible and with the understanding that the process is meant to be constructive. The SWOT analysis can be an enlightening experience and is crucial to the beginning of any new venture.

- **Strengths** are mostly internal factors. For example, what strengths does each member bring to the team? These are beneficial to the success of the operation.
- **Weaknesses** are also mostly internal. For example, what are the overall weaknesses of the team? What aspects of the operation cannot be covered by the members of the team?
- **Opportunities** are both internal and external. For example, what are the opportunities available to the business? Unique production marketing or opportunities may be available because of a team member or the location of the business or practice.
- **Threats** are also both internal and external. For example, is a portion of the business high risk or is extreme competition a possibility? Have you chosen an enterprise that is particularly susceptible to production and marketing risks?

You may use a table similar to the example below to help you organize the information for your SWOT analysis:

	Strengths	Weaknesses	Opportunities	Threats
Internal				
External				

Plan Your Risk Management Strategy

The SWOT analysis will help the team identify risks that the business may encounter. Every business plan should include risk management strategies. Changes in production practices can reduce risk (e.g., using irrigation to control frost and to reduce the effects of drought). Insurance and the legal protections of certain business structures are other effective risk management tools. You need to evaluate these strategies in regard to effectiveness, expense, and difficulty of implementation.

Choose a Business Organizational Structure

The type of business structure you choose will have many implications on the future of your business. Some common business structures that may be used in agriculture include sole proprietorships, partnerships, C-corporations, S-corporations, and limited liability companies (LLCs). According to the USDA's National Agricultural Statistics Service, 86 percent of farms in the United States are structured as sole proprietorships and 7 percent structured as partnerships. Of the 3 percent structured as corporations, 80 percent of these farms are organized as family-owned corporations. Each structure has advantages and disadvantages. In some cases, the choice you make at the business start-up will be the choice for the life of the business.

- **Sole proprietorships** are the easiest type of business to begin and end. No legal filings are required unless it operates under a fictitious name. Advantages include less administration, lower fees, and sole control of the business by the owner. Some disadvantages include self-employment taxes and personal liability.
- **Partnerships** begin when two or more people agree to enter into a business. There may be “silent” partners, and some partners may have less invested than others. Although partnerships do not need formal documents for implementation, all parties should write and sign a partnership agreement. The advantages of partnerships include no double taxation of profits or capital gains, distribution of responsibilities, and pooling of risk. The disadvantages include unlimited liability, taxation of earnings even if they are not distributed, and control of the business shared among the partners.
- **C-corporations** are traditionally used for larger businesses. Many agricultural operations are structured under these guidelines. The corporation is a separate legal entity that incurs all liability and continues until dissolved. The advantages of C-corporations include potentially lower taxes on earnings, the ability to set their own accounting

year, and simplified division of income between family members. Two major disadvantages of the C-corporation include double taxation (taxes are paid by the corporation on earnings and by stockholders on distributions) and a requirement for formal stockholder meetings that must include minutes.

- **S-corporations** are similar to C-corporations in that they have many of the same tax characteristics. The advantages of the S-corporation include passing losses to the stockholders, and any stockholder that receives profits from the company must also receive a reasonable salary. Some of the disadvantages include a requirement for special elections and potentially higher tax rates.
- **Limited Liability Companies (LLCs)** are one of the newest business structures available today. An LLC may have only one member and can elect to be taxed at the partnership or corporate level. Advantages of an LLC include limited owner liability to the amount of the investment, ease of establishment, and no double taxation. Some disadvantages of LLCs are varying set-up requirements by states (some states do not allow LLCs) and differing state tax treatment from federal tax treatment.

The structure for the business is best decided by the owner with advice from the business team. Some of the structures discussed require a lawyer to implement—obtaining a lawyer's advice before choosing a business structure is best. The business structure will also play a part in the risk management strategy.

Marketing and Advertising

Marketing and advertising are not identical terms in the business world. Marketing involves selling goods or services, and advertising is promoting the goods or services. Marketing may be selling a product at auction or at a roadside market or stand. Advertising is telling the public what goods or services are being offered and where. Every enterprise publication in the *Agricultural Alternatives* series stresses marketing considerations, and several address general marketing topics for fruits and vegetables, livestock, and cooperatives.

Financial Management

Your business plan will include financial projections. Many of the publications in the *Agriculture Alternatives* series include sample budgets, which can be helpful in determining the start-up costs for these small businesses or enterprises. A yearly budget and cash flow projections are also important when considering a new venture. The research you conduct will aid in establishing the cash flow projections and budgeting process. The financial projections will help with the borrowing process for the new venture.

Obtaining funding for your new enterprise can take on several forms. There may be combinations of sources including friends, family, banks, cooperatives, and government programs. Regardless of the source of funding for your business, a business plan is critical to obtaining the necessary capital for your business and keeping your business on track. For more information on financing and business planning, please see *Agricultural Alternatives: Financing Small-Scale and Part-Time Farms* and *Agricultural Alternatives: Developing a Business Plan*.

Human Resource Issues

If your new business requires you to hire labor, you will also need to address human resource (HR) issues. When labor other than family is needed, the business is required to keep additional records and follow federal, state, and local guidelines. In most states the employer is required to withhold federal (income taxes, Social Security, and Medicare), state, and, in some cases, local taxes. These taxes must be paid to the government on a regular basis. In the case of Social Security taxes, the portion withheld from the employee must be matched by the employer, adding to the overhead of the business. Your accountant will inform you how and when to file these taxes.

You also should consider employee benefits. Many employers now offer benefits such as health insurance and paid vacations. Agricultural businesses need to be competitive with other industries. Because of the seasonality of most agricultural businesses, you may consider hiring part-time employees and, therefore, offering benefits may not be necessary. In either case, your business will be competing with other businesses or industries for quality employees. The seasonality of agricultural businesses requires specialized training for your employees. Because the business does not involve the same tasks every day, employees usually take approximately one year or production season to become comfortable with all tasks they must complete. An employee training process should be a part of the business and may require training new employees every year. Retaining quality employees may be a priority for the business because of the high costs involved in training programs. If the business requires the use of pesticides, the business and its employees must follow the U.S. Environmental Protection Agency's Worker Protection Standards. You can obtain these regulations from your regional Pennsylvania Department of Agriculture office. Other issues you may need to address include:

- Laws covering discrimination
- Migrant labor laws, if migrant labor is used
- If migrant labor is used, housing regulations for the employees

- Equal pay laws
- Americans with disabilities laws

You should consult your lawyer and accountant to make sure that your business is following all employee laws. More information covering legal requirements for agricultural employers can be found in the *Pennsylvania Tree Fruit Production Guide* available through your local extension office or online at tfpg.cas.psu.edu.

Value-Added or Food-Related Businesses

These forms of businesses require more in-depth research than commodity-producing agricultural businesses. Township or county officials may view a farm-based, value-added enterprise as a manufacturing business, which is subject to a different set of zoning regulations. Consult your local municipal officials concerning specific zoning restrictions in effect in your area. In many cases you may be required to apply for a zoning variance. Your research on value-added opportunities should include pricing, packaging, and marketing the finished product. You should also contact the Pennsylvania Department of Agriculture (PDA) concerning regulations related to your proposed business. Because most value-added businesses in agriculture are food related, you will need to follow another set of regulations.

For a food-related businesses or enterprise, you must contact the PDA before any construction begins to be certain that you are following all regulations. Extensive regulations regarding the preparation of any food products may require certain types of equipment and equipment made from specific materials (for example, stainless steel). You must follow these regulations because initial and subsequent inspections will be required. If the business fails an inspection, the operation will not be allowed to continue until the regulations are met.

If the business involves slaughtering animals, you must meet requirements before the slaughter begins. If the product will cross any state borders, the facility must be inspected by the USDA. If the product will not cross state borders, the PDA is the regulatory agency. You should contact the PDA regardless of your initial plans for marketing. They can inform you of which agency is responsible for your operation. Packaging requirements must also be met regardless of which regulatory agency is responsible for monitoring your operation.

Starting the Business

Once you have developed a business plan, assessed your strengths and weaknesses, considered the risks facing your business, selected a form of organization, and obtained financing, you are ready to start your new business or adopt a new enterprise. Once the business is in operation, keep all necessary records for future analysis and evaluation. Continuous evaluation and adaptation are necessary for all businesses. Businesses that do not continuously evaluate what has been done and research new possibilities will struggle and possibly fail. The members of the business team may change over time, but the team will continue to guide the future of the business. Many businesses use a team approach to management and organization because it guarantees diverse points of view and a broad knowledge and experience base for the business.

For More Information

Becker, John C. (1997). *Organization of the Farm or Agribusiness Enterprise*. University Park, Pa.: Penn State Cooperative Extension.

Harper, Stephen C. (1991). *The McGraw-Hill Guide to Starting Your Own Business: A Step-by-Step Blueprint for the First-Time Entrepreneur*. New York: McGraw-Hill Inc.

Martin, Charles L. (1992). *Starting Your New Business: A Guide for Entrepreneurs*. Revised ed. Menlo Park, Calif.: Crisp Publications, Inc.

Pinson, L., and J. Jinnett. (2000). *Steps to Small Business Start-Up: Everything You Need to Know to Turn Your Idea into a Successful Business*. 4th ed. Chicago, Ill.: Dearborn.

Regional Small Business Development Centers—contact your local extension office or go to www.sba.gov/sbdc/.

Starting a Business in Pennsylvania, Pennsylvania Department of Revenue—go to www.revenue.state.pa.us.

Wold, C., H. Summer, M. Schlake, J. Gottwals, K. Hayes, B. Madison, and W. Fraas. (2000). *Tilling the Soil of Opportunity: NxLevel™ Guide for Agricultural Entrepreneurs*. Denver, Colo.: NxLevel Education Foundation.

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Additional financial support for this publication was provided by the Risk Management Agency of the United States Department of Agriculture and the Pennsylvania Department of Agriculture.



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AGRICULTURE

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Penn State College of Agricultural Sciences research, extension, and resident education programs are funded in part by Pennsylvania counties, the Commonwealth of Pennsylvania, and the U.S. Department of Agriculture.

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Produced by Information and Communication Technologies in the College of Agricultural Sciences

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