

BUILDING THE SUCCESS OF FOOD HUBS THROUGH THE COOPERATIVE EXPERIENCE

MODULE 2. CREATING THE FOOD HUB BUSINESS

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MODULE 2. CREATING THE FOOD HUB BUSINESS

(Estimated time for completion 3 to 6 months)

Actions: Review feasibility analysis for the food hub. Hold meetings of steering committee to finalize the scope and nature of the business. If a cooperative or corporation, host information meetings for potential members or shareholders. For corporations, cooperatives, and non-profit business structures identify persons to serve as the ‘founding board’ to adopt articles of incorporation and bylaws. Identify and secure the location for the business. Develop capitalization plan.

Outcomes:

- Steering committee reviews and accepts or rejects feasibility analysis
- If accepted, tasks will be identified to organize business
- Timeline to complete tasks developed
- Legal identity established, board of directors seated
- Business plan and marketing plans developed
- Promotional materials developed, distributed to farmers and buyers
- Convene charter member/shareholder meeting
- Conduct equity drive
- Fundraising continues (\$10,000 to \$30,000)



Who is involved:

- Steering committee
- Farmers and buyers
- Stockholders or members
- Attorney, Advisors, consultants
- Community members

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PART 1. THE LEADERSHIP TEAM

Activities of the food hub project steering committee described in *Module 1. Identifying the Opportunity* will overlap and transfer to activities conducted by the food hub's Module 2. Part 1. The Leadership Team. Food hubs can be organized as investor-owned firms or as a cooperative corporation or non-profit organization. Investor-owned firms may seek to organize as a corporation or limited liability company (LLC) to protect personal assets from the food hub enterprise. Food hubs formed as a cooperative, corporation or non-profit enterprise require a board of directors. In a cooperative, the board of directors represent the interests of the members and make policy decisions in the best interests of the organization. Some of the food hub project steering committee members may continue to support the project and serve as members of the food hub's founding board of directors. Others may choose to relinquish their responsibilities. The following actions regarding leadership and organization are dependent on the type of business structure of the food hub.

Critical to the success of a new food hub moving from concept to reality is the need for one or more project champions. Boards of directors and food hub organizers will be project champions. They should have understanding of the farm and food sector with command of the information in the feasibility analysis and understanding of the goals and anticipated operations of the food hub.

CHARACTERISTICS OF A PROJECT CHAMPION

1. Credibility
 - a. Respected for their judgement, common sense perspective
 - b. Ability to complete tasks
 - c. Ability to have a long-term perspective
2. Financial stability
 - a. Viewed as a successful business person in their own right
 - b. Have sufficient people to manage their personal business so they are available to spearhead the development of the cooperative
3. Basic knowledge of the food industry
 - a. Familiarity with the industry from production to consumption
 - b. Understanding of product storage requirements
 - c. Understanding of marketing trends
 - d. Understanding of finance
 - e. Ability to learn about the industry or seek out experts
4. A developer
 - a. Neither thin-skinned or quick tempered, able to take misplaced criticism and occasional insults, patient
 - b. Efforts and actions do not normally receive financial compensation
 - c. Sense of humor and sense of the ridiculousness

Adapted from: Patri, Bill. 1998. *Creating Co-op Fever: A Rural Developer's Guide to Creating Cooperatives*. United States Department of Agriculture, Rural Business-Cooperative Service (RBS). Washington, D.C. RBS Service Report 54, July.

SECURING A BOARD OF DIRECTORS

The board of directors plays an important part in guiding the organization. They need to be respected members of the community. They should be successful business persons with knowledge of the food system. They need to have understanding and/or experience of the farm and food sector. Early on they will assist with member recruitment.

An effective board member:

- Approaches responsibilities in the spirit of a director on behalf of the members
- Maintains loyalty to the organization
- Welcomes information and best available advice, but reserves the right to arrive at decisions based on own judgement.
- Honors commitments.
- Supports board decisions (internally and externally) even when he or she may disagree with the majority opinion. Promotes unity within the organization.
- Offers opinions honestly and in a constructive way and respects the opinions of others.
- Understands legal and fiduciary responsibilities and avoids potential conflicts of interest.
- Gives respect and consideration to other board members and president or chairperson.
- Focuses on issues, not personalities and offers constructive feedback.
- Asks informed questions.
- Clearly understands her/his responsibilities.
- Is willing to actively serve on at least one committee.
- Comes to meetings on time, well prepared and actively participates.

MANAGEMENT AND STAFFING

Proper staffing of the food hub is critical to its early and future success. Adequate capital must be available to compensate the staff until sufficient volume of product is sold to build acceptable cash flow for the business to pay expenses in a timely manner.

Anecdotal stories exist of:

- A food hub in its early stages that secured grant dollars and hired a general manager. Board members did not provide appropriate oversight and management performance was insufficient to contribute to the success of the cooperative.
- A food hub in its early stages where growers pooled their money to pay staff to aggregate, market and distribute product. Employees were self-directed. There was not sufficient oversight by the growers resulting in loss of produce quality and loss of sales revenue.
- A food hub in the early stages of development that hired one person to aggregate product, sell the product, deliver the product (utilizing his personal vehicle with reimbursement for mileage provided), manage accounts payable and receivable, record keeping, and expand the business. This dedicated employee became overwhelmed and 'burned out.'

A cooperative-structured food hub board of directors directs the search and hires the general manager. A dedicated general manager with understanding of the ‘farm to fork’ continuum and existing connections with retail, wholesale, and institutional buyers will enhance the likelihood of the food hub’s success. Any additional employees are hired by the general manager.

Some food hubs rely on volunteers. Non-profit organizations can utilize volunteers in some circumstances. They need to make sure they are in compliance with labor regulations. It can be challenging to rely on volunteers for an extended period of time. Volunteers may have scheduling conflicts that prevent them from reliably helping at the food hub. There is a need for constant training. Food hubs that are organized as ‘for-profit’ businesses cannot utilize volunteers. Staff need to be paid for their labor.

PART 2. BUILDING THE BUSINESS

ORGANIZATIONAL DOCUMENTS

The steering committee will determine the best business structure for the food hub. Each business structure can have some limitations. The decision will be based on ownership of the business, distribution of earnings (non-profits do not distribute earnings), and the system of governance (See Module 1). Official organization of the enterprise builds trust and confidence with potential members, farmers, buyers, and those who will serve in a leadership capacity. When a business becomes incorporated, the personal liability of each member or shareholder for losses suffered by the enterprise is limited to the member or shareholder’s equity in the organization.

The steering committee should seek out assistance with an attorney and an accountant as the enterprise becomes more formalized. Legal counsel can provide guidance on the state statutes to be addressed with forming the enterprise and the development of the organizational documents (articles of incorporation, bylaws, contractual agreements, etc.). An accountant can assist the steering committee to build knowledge of the tax implications and Internal Revenue Service regulations impacting the owners of the food hub.

There is no Federal incorporation statute with which to comply to organize the business. Cooperatives, corporations, LLCs and non-profits incorporate under the appropriate State law. In most cases the enterprise will incorporate within the state in which it is headquartered. When more flexibility is desired than the state’s laws provide, the enterprise may consider incorporating in another state.

The articles of incorporation and bylaws of the proposed enterprise will be submitted and reviewed by the Department of State. The corporation derives its legal authority from the State. Once the review is complete the enterprise will be ‘chartered’ by the state. At that time the corporation is a “person” in the eyes of the law. It can do the same things that a person would do such as sign contracts, borrow money, own property, sue and be sued. Like a ‘person’ it must obey the law.

Cooperatives are unique in that they are owned by members – the persons who own a minimum of one share of stock, have voting rights, and utilize the services that that business will provide. They have equity in the business and have the privilege to share in the profits of the business in proportion to use. If the food hub is organized as a cooperative, the steering committee and founding board members will define who is eligible to be a member of the cooperative. *(See Page 12, Part 5. Useful Resources, Bylaw Considerations, #1. Defining Membership)*

ARTICLES OF INCORPORATION

The Articles of Incorporation is a legal document and binding to the directors, officers, and managers of the enterprise. Conduct beyond what is authorized in the articles can pose liability to the enterprise and to its leaders. The Articles of Incorporation tend to have the same components regardless of the business structure of the food hub enterprise. They include:

- Name of the enterprise
- Principal place of business
- The purpose for which it is formed
- Powers of the corporation
- Limitations of the corporation
- Period of duration
- Directors (Founding Board members names and signatures)
- Capital structure (stock or non-stock)
- Amendment process of the articles
- Notarized signatures of Founding Board members

In many cases it is possible to include information in the articles beyond what the statute requires and it is possible to amend the articles. It is recommended that excess information should not be included in the articles as amendments will need to be submitted and reviewed by the Department of State in which the business is incorporated. Other information can be included in other documents (bylaws or membership agreements) which can then be amended by the members, shareholders or board of directors.

BYLAWS

The bylaws describe how the entity will conduct business or govern itself. They must be consistent with the statute under which the business is chartered and consistent with the articles of incorporation. Failure of the leadership to follow the bylaws can lead to legal liability. Bylaws address issues not spelled out in the articles or in the statute but needed to make the entity an effective, well designed organization. While any activity of importance can be contained in the bylaws, **the document should contain broad issues of long-term significance**. Directors are responsible for making sure the enterprise adheres to the articles of incorporation and to the bylaws. The bylaws should include language on how they can be amended and may contain penalties for violation of the document. The bylaws are a living document. As the environment in which the enterprise changes, it is appropriate to periodically update the document. Depending on the statute, the bylaws should be adopted by the founding board or at the first meeting of charter members or shareholders. (*See Page 12, Part 4. Useful Resources, Bylaw Considerations*).

Components of the bylaws document may include:

- Membership requirements (if a cooperative)
- Meetings of members
- Directors and officers
- Duties of directors
- Duties of officers and manager
- Executive committee or other standing committees
- Membership/equity/stock certificates
- Operation of membership/stockholders capital investment
- Dissolution and property interests
- Unclaimed money
- Fiscal year
- Miscellaneous provisions
- Amendment process
- Date of adoption

DEVELOPING THE BUSINESS PLAN

The feasibility analysis investigates the need and opportunity for the business. The feasibility analysis answers the questions, “Will this succeed? Is it worth the time, effort and resources to organize?”

A business plan addresses the questions, “How will this work? How do we grow the business? How do we make it sustainable into the future?” **A business plan is developed after the feasibility plan concludes that the concept has merit.** The feasibility plan includes calculations and estimates. A business plan focuses on marketing and operation processes needed to grow the business. In the early life of the food hub enterprise the plan answers the questions, how will the business be launched, what will it cost, what are the sources of funds to capitalize the business? A solid business plan is important to attract commercial credit. *(See Page 14, Part 5 Useful Resources – Business Plan Components)*

Components of the business plan include:

- Vision and mission statements
- Marketing strategies to attract farmers and buyers
- Analysis of competition and pricing
- Identify regulations requiring compliance
- Identify internal processes and protocols
- Define physical and spatial needs
- Identify human resource needs
- Define finance strategies and risks
- Evaluate long-term outlook and contingency plans

DEVELOPING SHARED VISION, MISSION, VALUES AND STRATEGY

Numerous business management books suggest that mission and vision statements are important when a business begins and when it considers a major transformation. Development of mission and vision statements provides the leadership team the opportunity to articulate the goals of the organization and determine the appropriate business structure. These statements are useful to brand the business, differentiate the business from its competitors, develop strategies, develop business culture, and hire employees.

Vision statements describe the food hub when it achieves future success. Vision statements reflect the values and goals of the owners of the business and the reason for the food hub’s existence. Vision statements describe the stakeholders of the food hub and products and services it will provide. A vision statement is a commitment to the future. Shared values and goals of the food hub’s owners reduce conflict, provide direction for the business and a framework to make decisions when resources are limited.

Mission statements describe the present state of the business, its essential elements – what is the food hub, what does the food hub do, why does the food hub exist or what is its purpose. Mission statements can improve strategic alignment. Mission statements articulate the “how does it get done,” “who will do it,” “when will it get done,” and where will be done.” People will be attracted to work for a business whose values are similar to their own. Employees of the business can be evaluated through performance goals that help the business accomplish its mission. Mission statements can be guides when making decisions and provide a clear sense of what matters most.

When developing vision and mission statements, consider the following.

- List the assumptions that you hold.
- Identify the challenges for moving forward.
- List core values/principles that guide the food hub.
- What is the vision you hold for the food hub?
- What do you want the food hub to accomplish? What would success look like in the long term future?
- What is the near future purpose of the food hub?
- If a cooperative, who are the members of the cooperative?
- What needs of the co-op members that the cooperative is designed to meet?
- Who will serve as the founding or 'start-up' board of directors to oversee the development activities?

There is usually a gap between the present, i.e. the mission of the food hub and the future, i.e. the success of the food hub. The gap between present activity and future success is addressed through identifying and implementing strategies developed in a business plan.

CAPITALIZATION PLAN

Capitalization is the amount and source of money to start and operate the business. The founding board will determine whether the capital structure will be stock or nonstock. If stock (risk capital), then the board will determine the amount of member investment (if a cooperative) or shareholder equity (if a corporation) and the amount and source of borrowed money (debt capital). An initial infusion of capital will be required to pay the bills as expenses will be incurred before revenues are generated. A 'prospectus' document (whether a cooperative or corporation) can be a useful tool to define the risks and the potential rewards to cooperative members or shareholders who would become owners of the business.

The feasibility analysis identifies the capital requirements, the level of financing needed and the potential sources of the capital. The highest risk is in the early stages of the business and profitability can be non-existent to limited for the first 3 years in the start-up phase. It is important to manage the expectations of cooperative members or shareholders and they will need to be 'patient' until patronage refund (if a cooperative) or dividends (if a corporation) are paid on their investment. The best source of financing for a food hub is from its owners, cooperative members or shareholders. Commercial lending institutions expect that the owners of the business will have an equity stake in the business or 'skin in the game' before they are willing to commit to financing the organization. The business plan must be realistic to attract funding.

Some food hubs have utilized grant funds sourced from the government or charitable foundations as a means to support the organization, especially during the start-up phase. Utilizing grant funds is appropriate. It is important for the food hub organizers to make sure that the conditions (administration, time line, objectives, and goals) of the grant are in alignment with the goals and time line of the food hub. Grant funds can limit and will stipulate what the funds are to be used for. Some grant sources provide for reimbursement for expenses after they're incurred. Thus, there can be a time lag between when the expenses are incurred and when payment is made.

PART 3. FARMER AND BUYER COMMITMENT

FOR ALL FOOD HUBS: PRE-SEASON COMMITMENT OR GROWING PLANS

Balancing the supply of product with the demand for product is one of the biggest challenges of food hubs, especially when handling vegetables. Some producers prefer that food hubs provide the flexibility to sell surplus or under-grades (seconds). Established food hubs rely on pre-season commitment or growing plans. The food hub and the farmer work together to design a plan to define the amount and type of product to be delivered to the food hub at a designated time. This is not a contract. It is a 'good faith' effort on the part of the producer to deliver the product. The food hub can then plan to market the product to the buyer in advance of delivery. Shortfalls can occur and food hubs need to have sources for supplemental supply. If there is an industry-wide shortage then the food hub should contact the buyers that the product they expected cannot be delivered. This communication will preserve the relationship between the food hub and the buyer.

FOR COOPERATIVE-STRUCTURED FOOD HUBS – SECURING MEMBER COMMITMENT

A new cooperative must have a sufficient number of members to start the business and justify its existence. More members may be needed in the future to strengthen the organization. People join cooperatives for their economic benefits, i.e., the services that they receive. Depending on how membership is constructed, farmers can buy the right to deliver product to the cooperative. **Prospective members will want to understand how their participation will benefit them.** If the benefits are not obvious, few prospects will join and if they do, they will likely NOT regularly utilize the services of the organization.

It is both logical and expected that potential members the new food hub would be skeptical about investing in the emerging enterprise. Most of the concerns are related to the personal risks to their business once they commit to the food hub. The project champions need to be confident, honest, and prepared to answer the questions related to the benefits of joining, risks, governance, and operations of the food hub. Addressing the concerns of potential members builds credibility of the organization.

New members may be asked to join the cooperative by purchasing stock or paying a membership fee and by signing a membership application. The prospective member should receive a receipt for the funds collected and the cooperative should follow up with membership or stock certificates and other relevant membership materials. Precise accounting of money is a critical and sensitive issue. The organization should retain an independent accounting firm and controls put in place to assist with recording funds prior to the sale of stock or the collection of significant amounts of money.

Membership Agreements (if a cooperative)

- What will members receive?
- What will members agree to give?
- How will money change hands?
- How will quality be evaluated?
- How will the membership agreement be enforced?
- How will the agreement be terminated or renewed?

FOR COOPERATIVE-STRUCTURED FOOD HUB – PRE-MEMBERSHIP AGREEMENT

Once the feasibility analysis is complete and when consensus indicates that the enterprise should move forward, it is appropriate to solicit members/shareholders for the new food hub. If the food hub is a cooperative-structured business, a pre-membership agreement includes:

1. Statement of purposes for which the food hub cooperative is to be formed.
2. Description of the steering organization committee/founding directors and its powers.
3. Statement of what the new cooperative's bylaws will contain when formed.
4. Notice that the steering committee/founding directors may call a meeting of prospective members.
5. Duties of steering committee/founding directors to keep records and make accounting to the business when formed.
6. Subscription agreement for membership or shareholder certificate of stock.
7. Promise to sign marketing agreement and/or agreement to create a pre-season growing/commitment plan if not a cooperative.

Adapted from Rapp, Galen and Gerald Ely. 1996. How to Start a Cooperative. USDA Rural Development. Washington, D.C. Cooperative Information Report 7. November.

CHARTER MEMBER MEETING

According to most statutes (check with an attorney for clarification) when a cooperative is organized the articles of incorporation and bylaws must be adopted by a majority of the members or stockholders. For the convenience of establishing the business, only the persons named in the articles (known as the charter members) must vote and adopt the bylaws. These persons are considered members or stockholders as soon as the articles of incorporation are filed. It is appropriate and best practice that all persons who signed pre-membership agreements be invited to a meeting to approve of the bylaws.

CHARTER MEMBER MEETING AGENDA

1. Temporary presiding officer conducts first meeting and reports articles of incorporation have been filed.
2. Draft of proposed bylaws presented, discussed, and adopted as presented or amended.
3. Accept the membership of those persons not named in the articles of incorporation
4. Select first board of directors – suggested election process
 - a. Create a nominating committee to develop a panel of candidates (select only members), nominating committee should consider those persons who have demonstrated leadership, sound business practices, good communication skills, ability to reason and make appropriate decisions in a timely manner
 - b. Nominate two candidates for each position
 - c. If necessary and for continuity, stagger terms of office for the first board, i.e. some elected for 3-year terms, others for 2-year terms, others for 1-year term
 - d. Vote by secret ballot

PITFALLS TO AVOID

- **Leadership team is unstable during transition from concept phase to business launch**
- **Unrealistic expectations by shareholder (if a corporation) or member (if a cooperative) roles and responsibilities**
- **Inability to discipline persons not meeting responsibilities**
- **Lack of sufficient promised or committed business volume**
- **Inadequate business planning**
- **Lag in attracting sufficient equity or operating capital**
- **Ineffective pricing policies**
- **Poorly designed governance structure**



PART 4. USEFUL RESOURCES

BYLAW CONSIDERATIONS

(Answer these questions before consulting with an attorney to help design the legal documents. Some questions are more relevant to cooperative-structured businesses than other.)

1. **DEFINING MEMBERSHIP (if a cooperative-structured food hub):**
 - a. Who is eligible for membership?
 - b. What equity will members contribute?
 - c. Will members each have one vote? Or will there be weighted voting?
 - d. Are all members treated the same? Or are their classes of members?
 - e. How can a member terminate his/her membership?
 - f. On what grounds can a co-op terminate a member's membership?
2. **MEMBERSHIP OR SHAREHOLDER MEETINGS**
 - a. How often will members meet? Who can call a special meeting? What notice is required? What quorum is required?
 - b. What issues will members decide?
 - c. How can members vote? By proxy, by mail, electronically?
 - d. How will the by-laws be amended?
3. **DIRECTORS**
 - a. Who is eligible to serve on the board?
 - b. What are the duties of a board member?
 - c. How many seats should there be on the board?
 - d. Will there be board members from outside of the organization?
 - e. How long is each term of the director following election?
 - f. How many terms can a director serve in succession?
 - g. How are board members elected? Removed?
 - h. Are they paid? Are expenses reimbursed?
 - i. How will vacancies be filled?
 - j. How often does a board meet? What quorum is required? What meeting notice is required?

BYLAW CONSIDERATIONS cont.

4. OFFICERS
 - a. What are the titles of the offices?
 - b. What is the term of office?
 - c. What are the duties of each office?
 - d. How are the officers chosen?
5. COMMITTEES
 - a. Will there be standing committees of the board? (Examples: executive, audit, finance, governance, nominating)
 - b. If yes, what are they and what are their functions?
6. CAPITAL STRUCTURE
 - a. What is the capital structure of the organization? (Will the company issue shares of stock, membership or common stock, preferred stock, how many shares and at what value?)
 - b. What are the rights and responsibilities of each stockholder?
 - c. Will shares earn dividends?
 - d. What will the redemption procedure be?

BUSINESS PLAN COMPONENTS

1. Vision and values statements
 - a. Mission statement
 - b. Goals statement
2. Market strategy
 - a. To attract members/shareholders/producers
 - b. To attract buyers
 - c. Customer segmentation and what each segment values or requires
 - d. Competition – who are they, how does the food hub position itself in the marketplace
 - e. Distribution – market area, market channels served, pack and packaging standards, delivery and scheduling
 - f. Pricing – how is product priced
 - g. Promotion – image of the food hub, image of the services and products provided by the food hub, promotional messages and frequency and mechanism of distribution, costs
 - h. Inventory and storage management – maintenance of product quality, cold chain
3. Operations strategy
 - a. Product aggregation process, identified quality standards
 - b. External regulations – government
 - c. Internal regulations – based on policies protocols developed by enterprise board of directors and management
4. Resource needs
 - a. Physical or spatial needs of product handled for present business, expectations for future business
 - b. Identification of resource gaps and strategies to mitigate them – land, buildings, machinery or equipment

BUSINESS PLAN COMPONENTS cont.

5. Human resources
 - a. Management – tasks to be completed, workload
 - b. Staff – skill requirements
 - c. Gaps – if seasonal, how to attract and train employees, if volunteers how to insure a positive volunteer experience
 - d. Compensation – wages, benefits, labor law compliance
 - e. Communication between management and staff
6. Finance strategy
 - a. Equity requirements for cooperative members, stock options for shareholders
 - b. Risk assessment – *See Considering Cooperation – A Guide for New Cooperative Development*
 - c. Potential lenders
 - d. Debt service requirements
 - e. Auditing and controlling mechanisms
7. Evaluate strategic alternatives
 - a. Long-term outlook
 - i. Profitability – strategy to increase net income
 - ii. Liquidity – strategy to increase cash flow and pay down debt
 - iii. Solvency – strategy to grow net worth
 - iv. Risk – impact of strategic alternative to business threats
 - b. Contingency plans

PART 5. SUPPLEMENTAL INFORMATION

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This completes Module 2. Creating the Food Hub Business.

Please see Module 1. Identifying the Opportunity.

Components of Module 1 include forming a steering project steering committee, framing a feasibility analysis, and considerations for business structure.

Please see Module 3. Launching the Food Hub Business

Components include identification of operating systems, staffing and services, and the business lifecycle.