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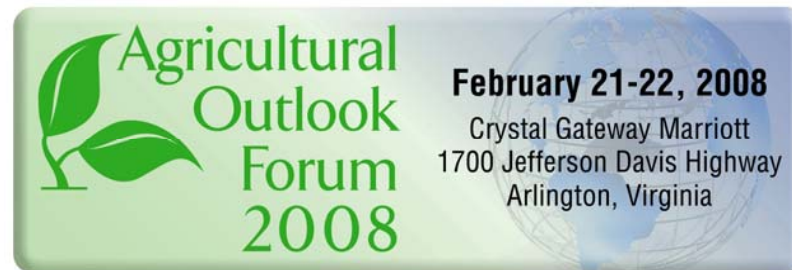
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# INNOVATIVE BUSINESS MODELS FOR RURAL AMERICA

*Presented to:*



*Presented by:*

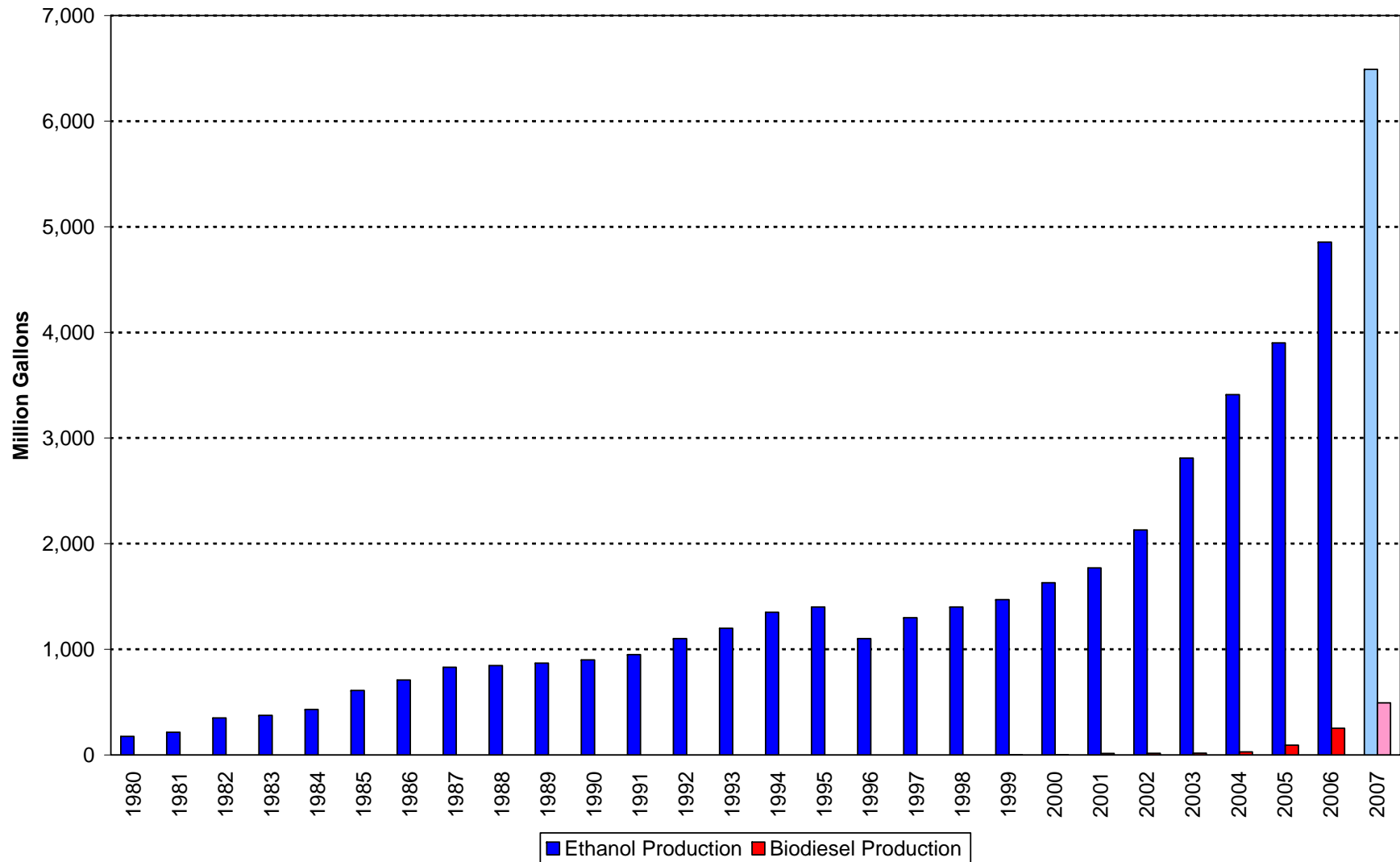
**Scott Richman, Senior Vice President**



# The Premise

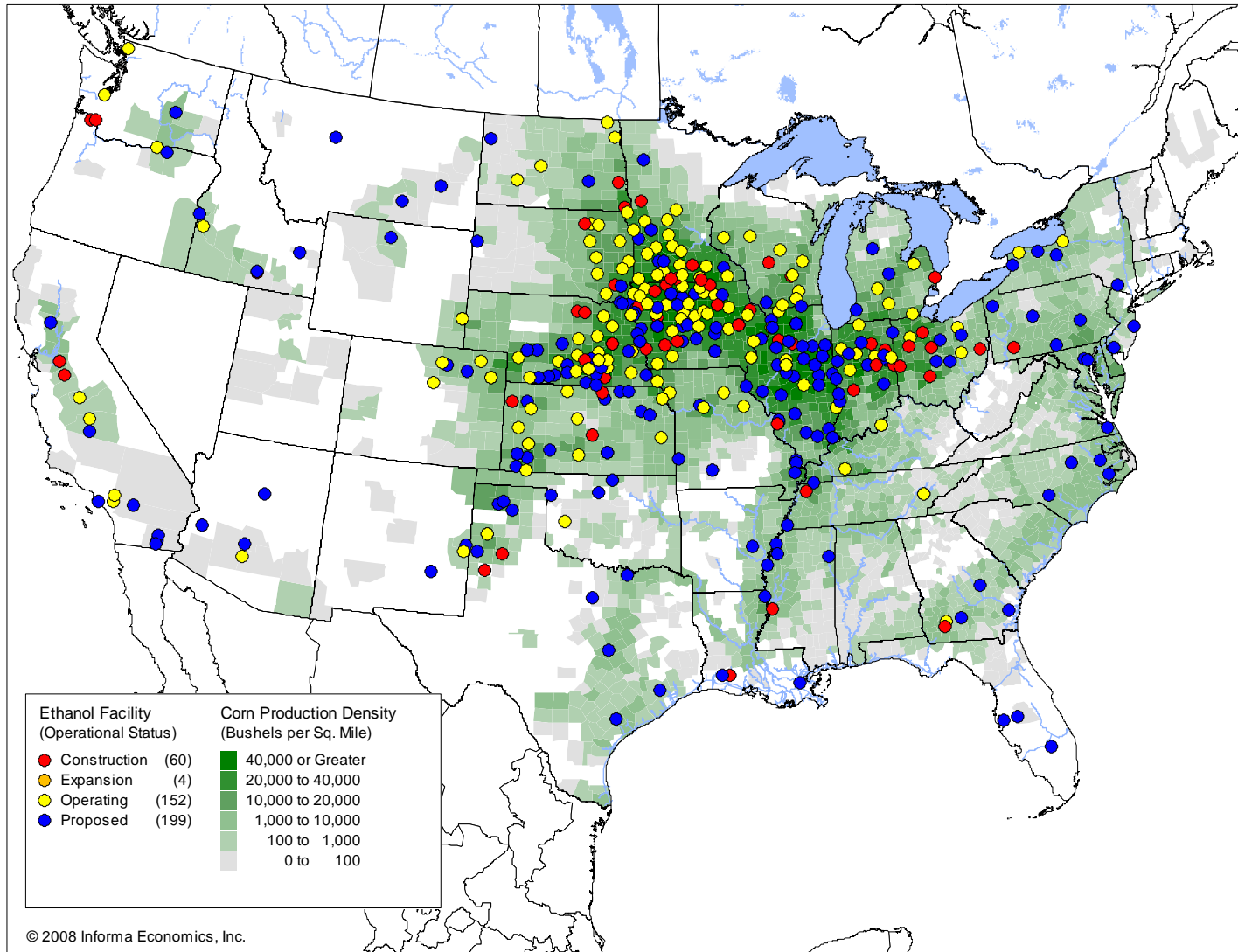
- Growth of renewable fuels industry has been the most substantial change in agriculture/rural economy in at least a generation
  - Extensive participation by farmers and other rural investors
    - 37% of ethanol industry capacity in late 2006
    - Participated less in recent building boom
- Key Questions
  - What business models are in use in the renewable fuels industry?
  - What are their advantages and disadvantages?
  - What are the implications for other value-added agriculture industries, as well as other rural industries, especially emerging ones?

# Growth of the U.S. Ethanol and Biodiesel Industries



Sources: USDA & DOE (History); Informa Economics (2007 Estimate)

# Geography of the U.S. Ethanol Industry



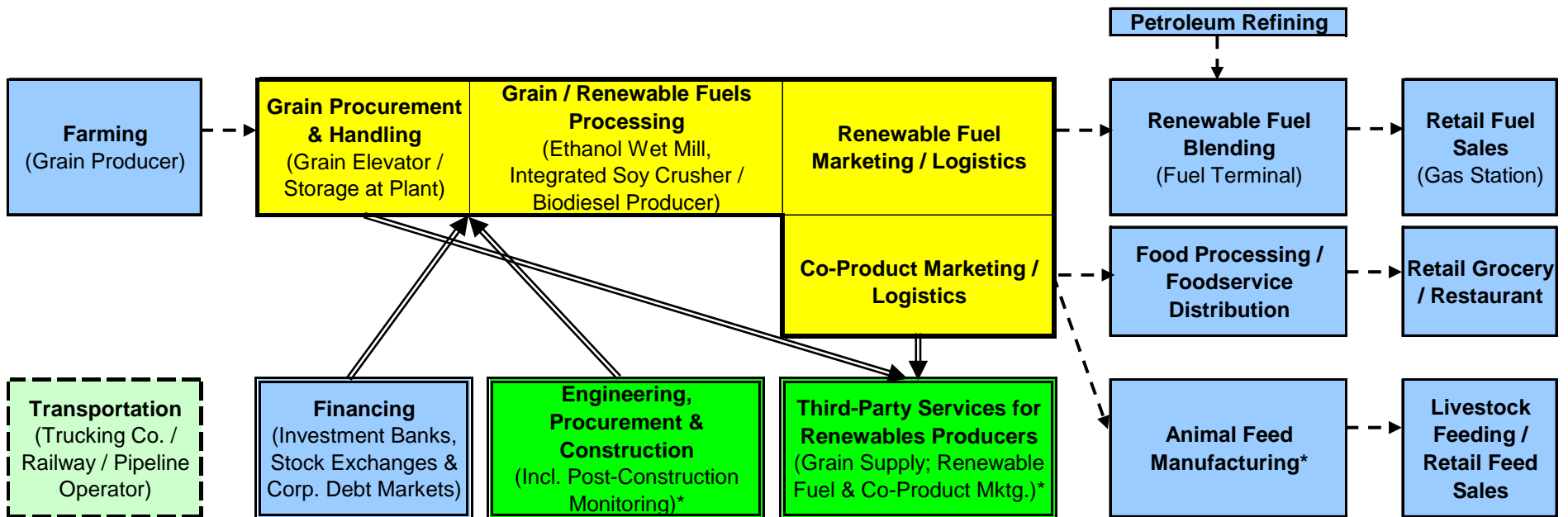
Sources: Renewable Fuels Association & Informa Economics (Current & Construction);  
Informa Economics (Proposed)

# Four Main Business Models

- “Corporate” Business Model. Producer is a corporation or a subsidiary. Internal staff manages plant, feedstock procurement, renewable fuels marketing and co-product marketing.
- “Farmer-Owned” Business Model. Farmers have majority ownership in the facility and have feedstock delivery obligations (mainly corn for ethanol). Often, third-party service providers market the output.
- “Engineer/Builder-Owned” Business Model. Design/build firms own facilities or retain a significant ownership interest, allowing a degree of control over management. Ownership in multiple facilities gives scale to have internal staff procure feedstock and market output.
- “Franchise” Business Model. Organization is not vertically integrated; depends on service providers to link to other levels of the supply chain, including feedstock procurement and product marketing.

# Corporate Business Model

(Wet-Mill Ethanol Producers, Biodiesel Producers with Integrated Crushing)



Key:

- Renewable Fuel Producer
- Transportation/Physical Commodity Flow
- Third Party
- Services Provided

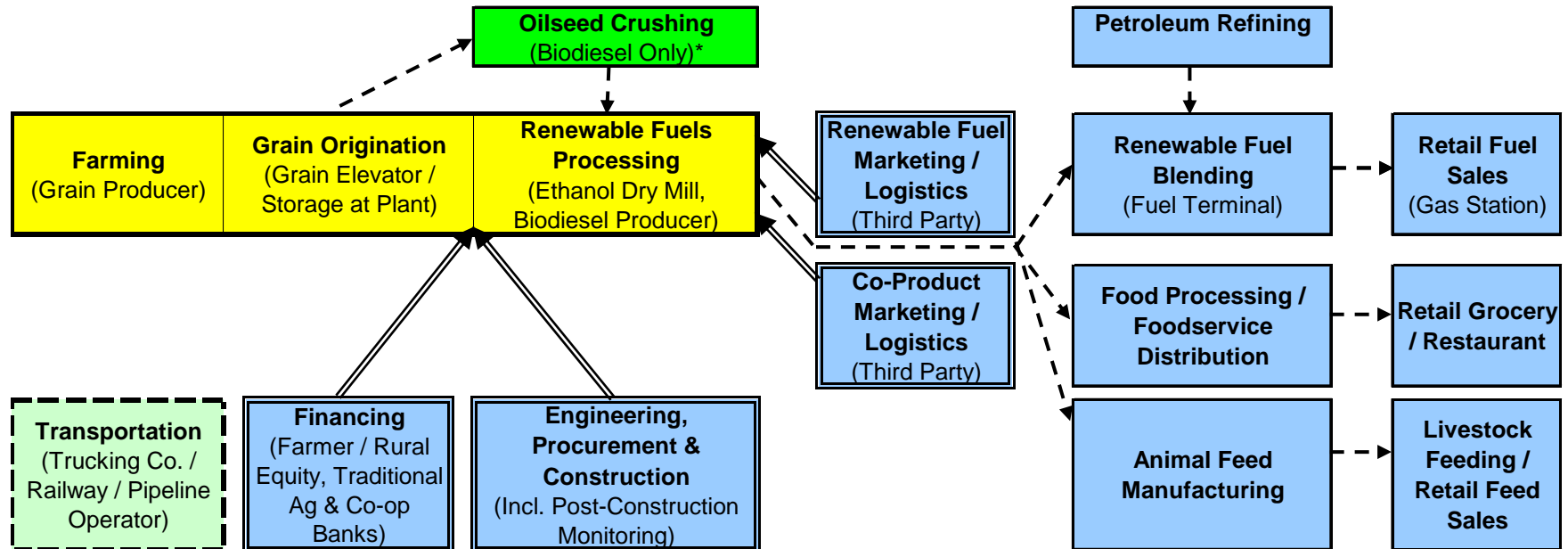
Notes:

\* Indicates internal function at limited number of renewable fuel producers.

Glycerin not depicted since raw glycerin is a small part of the revenue stream for biodiesel producers.

# Farmer-Owned Business Model

(Mainly Dry-Mill Ethanol Producers, Some Biodiesel Producers)



Key:

- Renewable Fuel Producer
- Transportation/Physical Commodity Flow
- Third Party
- Services Provided

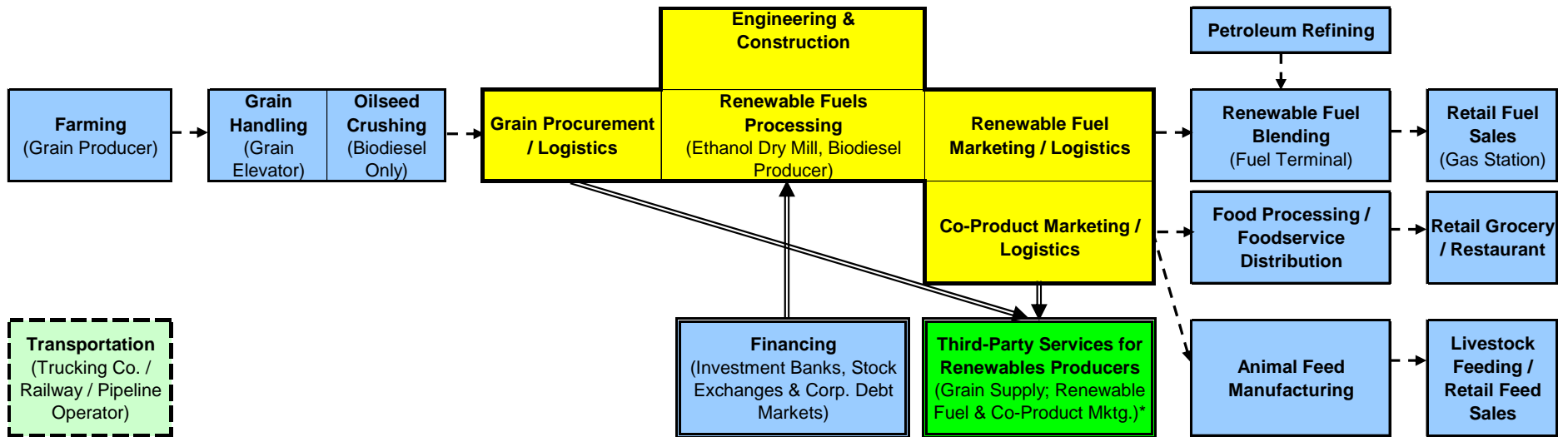
Notes:

\* Indicates internal function at limited number of renewable fuel producers.  
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# Engineer/Builder-Owned Business Model

(Mainly Dry-Mill Ethanol Producers, Biodiesel Consortium)



Key:

 Renewable Fuel Producer

 Transportation/Physical Commodity Flow

 Third Party

 Services Provided

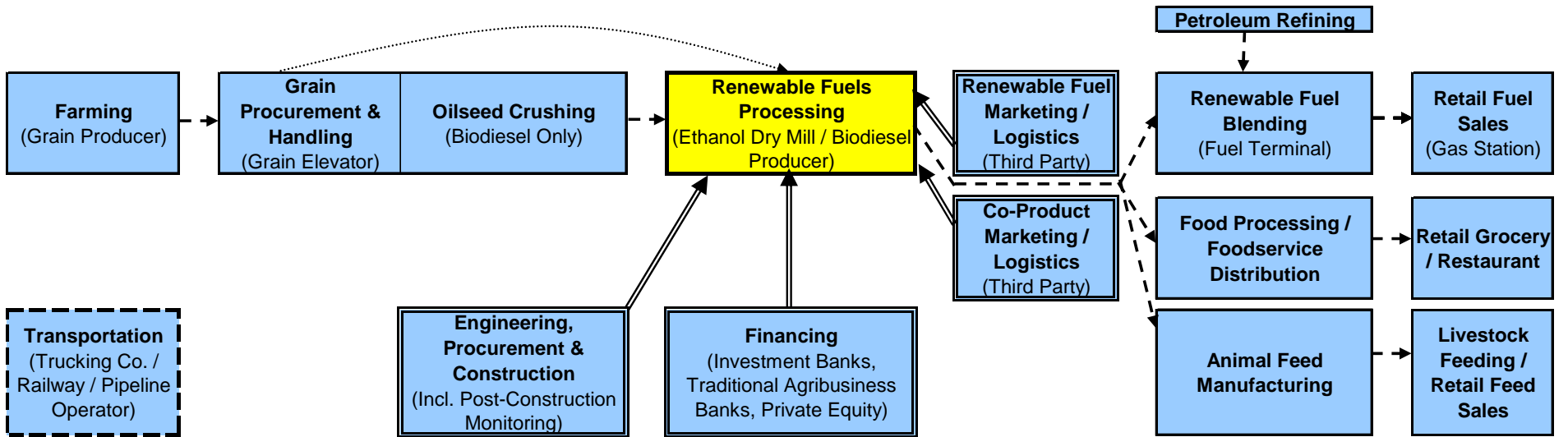
Notes:

\* Indicates internal function at limited number of renewable fuel producers.

Glycerin not depicted since raw glycerin is a small part of the revenue stream for biodiesel producers.

# Franchise Business Model

(Dry-Mill Ethanol Producers and Biodiesel Producers, Especially Those Owned by Financial Investors)



Key:

- Renewable Fuel Producer
- Transportation/Physical Commodity Flow
- Third Party
- Services Provided

Notes:

Glycerin not depicted since raw glycerin is a small part of the revenue stream for biodiesel producers.

# Six Categories of Legal Structures

- Sole proprietorship (rare among renewable fuel producers, except perhaps small biodiesel companies)
- Partnership
  - General partnership
  - Limited partnership (LP)
- Corporation
  - Non-profit
  - For profit
    - C corporation
    - S corporation
- Traditional cooperative
  - Marketing
  - Supply
  - Service
  - Education
- New generation cooperative
- Limited liability company (LLC)

# Advantages/Disadvantages

Structure	Main Advantages	Main Disadvantages
Cooperative	<ul style="list-style-type: none"> <li>•Link to grain supplies</li> <li>•Earnings taxed once</li> </ul>	<ul style="list-style-type: none"> <li>•Might limit equity from non-farmers</li> <li>•Farmers have limited liquid assets; can require large number of members</li> <li>•Share illiquidity (closed co-op)</li> </ul>
Limited Liability Company	<ul style="list-style-type: none"> <li>•Flexible business structure</li> <li>•Equity from range of investors</li> <li>•Earnings taxed once</li> <li>•Limited legal liability</li> </ul>	<ul style="list-style-type: none"> <li>•Lacks link to grain supply, but can overcome by having co-op be investor</li> <li>•Costly compliance with reporting standards if &gt;500 investors</li> </ul>
Limited Partnership	<ul style="list-style-type: none"> <li>•Equity from range of investors</li> <li>•Management via general partner can be streamlined</li> <li>•Earnings taxed once</li> <li>•Limited legal liability</li> </ul>	<ul style="list-style-type: none"> <li>•Lacks link to grain supply, but can overcome by having co-op be investor</li> <li>•Might be limited to accredited investors</li> </ul>
C Corporation	<ul style="list-style-type: none"> <li>•Main advantage: equity can be traded on public exchange</li> <li>•Tend to be large organizations with favorable access to capital</li> <li>•Can use equity for acquisitions</li> </ul>	<ul style="list-style-type: none"> <li>•Main disadvantage: earnings are taxed twice</li> <li>•Public reporting and compliance are costly</li> </ul>

# Which Business Model Is Right for a New Entrant to the Industry?

Right Model =  $f$  (Ownership, Size, Financing, Market Position)

- Examples

- Ownership/legal structure

- Co-op advisable only if significant proportion of equity is from farmers; otherwise a third-party feedstock supply agreement might be advisable
- C corporation advisable only when the company has critical mass and reason to go public now or in the future

- Size

- In most cases, it would not be cost-efficient or effective for a new company with a single 50-million-gallon-per-year plant to market its own ethanol

- Financing

- Lenders & debt holders tend to prefer that new companies use third-party suppliers & marketers that have substantial market presence & balance sheets

- Market position

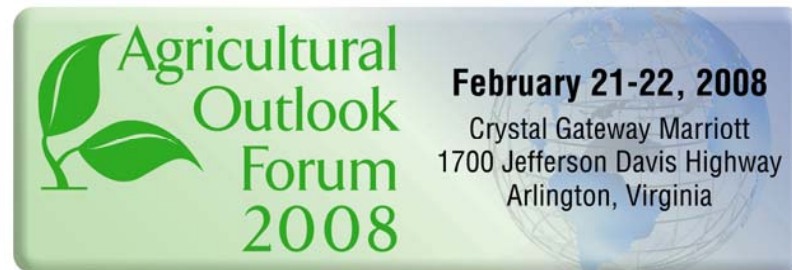
- New facility in the Corn Belt has higher probability of being able to hire an experienced grain buyer locally

# Implications for Emerging Rural Industries

- For some industries, “virtual integration” is appropriate and is an alternative to vertical integration
- Legal structures have the same advantages and disadvantages in other industries as in biofuels
- Farmers and other rural investors have assets (*especially these days!*) and can contribute vital business inputs, but raising equity from them can take time and can involve a number of participants
  - Challenge: land accounts for large majority of an average farmer’s net worth
- There are still opportunities to succeed by having ingenuity in developing new business models and adapting them over time!

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