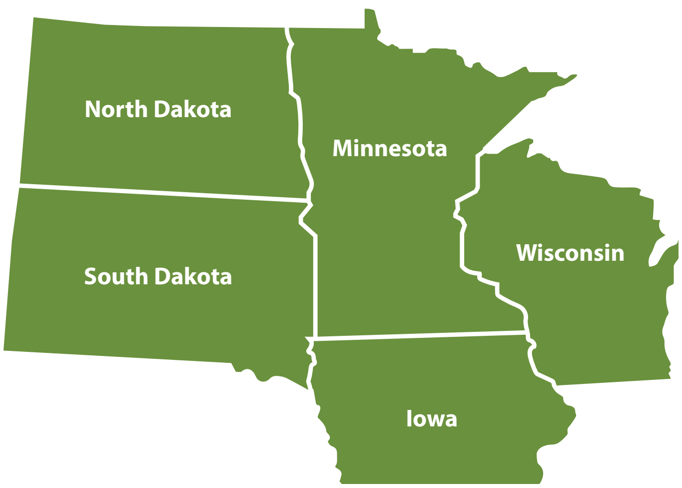
Financial Barriers Brief

This brief summarizes financing-related challenges facing the local and regional meat processing industry, as identified in Finance Working Group (FWG) meetings.

Background

In September 2021, the Agricultural Utilization Research Institute (AURI) and the United States Department of Agriculture, Agricultural Marketing Service (USDA-AMS) signed a multi-year cooperative agreement focused primarily on the Upper Midwest's small meat and poultry processors. The project explored opportunities to strengthen industry resiliency and create solutions to position the processors for success.

As part of this project, AURI convened a Finance Working Group in the spring of 2022 comprised of lenders and small business and economic development professionals working in the meat and poultry sector. The working group's goal was to identify challenges around the establishment or expansion of the meat processing business. This group's members represented the Upper Midwest region, including Iowa, Minnesota, North Dakota, South Dakota, and Wisconsin.



After completing its work, the FWG provided AURI with several recommendations for developing technical assistance materials for small meat and poultry processors.

Key Findings

Business Viability and Market Challenges

Understanding Financing Requirements and Processes

FWG discussions and interviews revealed several key opportunities and constraints facing the industry. The FWG discussed processors' ability to qualify for loans and expressed concern that they have inadequate assets to use as collateral.

Processors need to meet underwriting threshold loan requirements that are typically conservative in nature to minimize the risk of loss and to maintain a strong banking system. Lenders will not typically debt finance more than 50% of the project. That said, loan amounts to debt finance physical assets can reach up to 65% of the project/asset value, but the financed segment can vary significantly depending on the collateral. During the FWG discussions, the range most often stated as acceptable for local and regional meat processing debt financing was 45 to 50%. The remaining percentage of costs usually require cash in the form of non-debt equity contributions to the project. A lower percentage of debt financing typically indicates a lower risk profile. Lenders also find it easier to make informed decisions about funding existing businesses when they can use past financial information as a part of the review process. Finally, leasing assets can be a solution to replace typical bank loans, but the borrowers' financial knowledge is a critical component of a lease approval.

Benchmarking Challenges

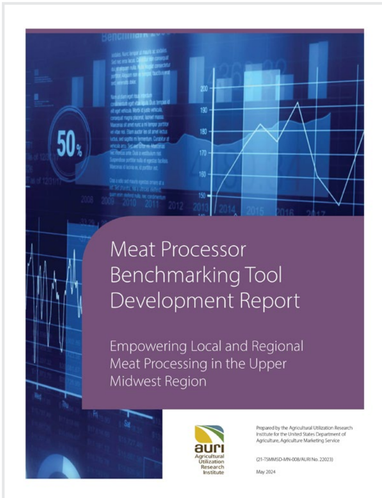
Solid market information can serve as a key risk-reduction data point for businesses by showcasing trends and emerging local or regional market opportunities. Market information is also important for lenders as they determine the risks of lending to businesses.

FWG representatives said it would be helpful to have access to industry financial and operational information to inform decisions during planning or expansion discussions with processors. The group discussed the value of creating a benchmarking tool for financial institutions and meat processing businesses that would include information on key metrics, risk areas, and return on investment (ROI). The tool will enable processors to better understand how they perform in relation to their peers and highlight potential areas for improvement and increased profitability. They noted that other agricultural sectors (e.g., crop production, ethanol) utilize industry benchmarking tools that include key variables, metrics, risk areas, and ROI expectations to assess the organization's financial performance. They suggested that a similar approach may be beneficial in the very small and small meat processing sector. The FWG noted that processors opting to use a benchmarking tool will have the ability to:

- Compare and measure key business metrics to other meat and poultry processors
- Determine areas that are working well for one's business and opportunities for improvement
- Identify strategic planning opportunities
- Aggregate information to highlight opportunities for industry-wide continuous improvement

AURI facilitated conversations with developers of an ethanol industry benchmarking tool to generate a comparable tool for the meat and poultry industry. Interviews were conducted with processors to better understand the financial performance metrics that should be included in the tool and guide its development. A very small and small meat processing sector benchmarking tool is now ready to launch.

Example data included in benchmarking tool:
The general data collected is shown below. (The actual collection matrix contains more detailed breakouts of several categories, resulting in approximately 84 data points. Most facilities will not need to enter information in every field.)



Production: Hanging weight in pounds/Finished pounds processed for each primary livestock type

Revenues: Finished pounds sold wholesale and retail for each primary livestock type. Total revenue in dollars collected for each primary livestock type, wholesale, and retail. Processing fees, grant/incentive income, and other non-facility revenue earned by the business.

Costs: All ingredients; supplies for packaging, cleaning, and office management; employee wages and benefits; professional/consulting fees; utilities, insurance, repair and maintenance expenses; and taxes. Other fixed costs include lease and storage expenses, transportation and freight, changes in inventory, and miscellaneous fees.

Balance Sheet: Assets by category/Liabilities and equity by category

Administrative Burden Challenges

Identifying Funding Sources

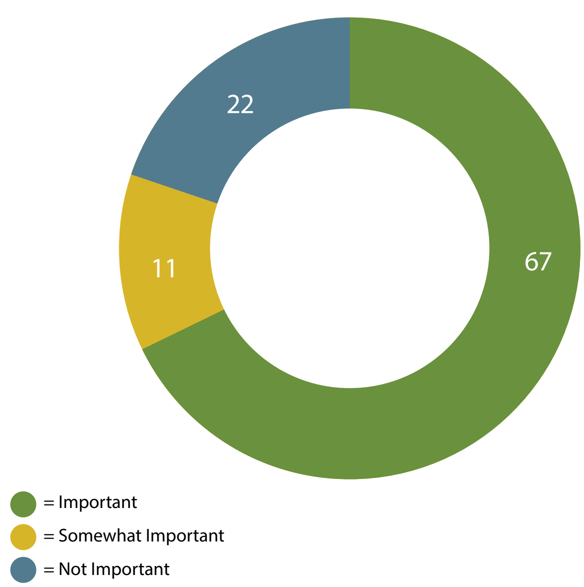
Applying for financing requires administrative staff that have both the time and specific skills to navigate lenders' application systems. Many small facilities do not have this type of support within their business. This may place small processors at a disadvantage and make them less competitive compared to large processors when attempting to secure public and private funding for expansion, etc. This issue amplifies well-known market competition factors that favor larger processors.

FWG group members emphasized that prior to starting a loan application, processors need to be aware of other available funding sources (e.g., gap financing and grants). Lenders indicated that they were often aware of funding options available for processors but lacked important details or an easy-to-reference resource. Processors also noted their general knowledge of funding options but not the details. There can be confusion about where to find specific grants, when the grants are available, and the requirements to apply. To offer a solution, AURI worked with USDA-Agriculture Marketing Staff (AMS) staff to create a document that indexes state and federal grants and loans available to meat and poultry processors in the United States. The funding opportunities resource includes a direct link to each grant or loan, eligibility requirements, minimum and maximum funding amounts available, and if a cost share or match is required.

Feasibility Study Frustrations

A feasibility study is a report that includes an opinion or finding conducted by a qualified consultant(s) evaluating a project's or operation's expectation for success based on economic, market, technical, financial, and management factors. Some financial institutions, as well as local, state, and federal grants, require feasibility studies, which can increase the administrative burden of procuring funding for small meat processing projects.

FWG percentage response to "how important are feasibility studies when assessing a loan application?"



Processors expressed frustration that the same complex feasibility study is often required regardless of the size of the project or type of funding (grants vs. loans). The FWG noted that utilizing a "one-size-fits-all" feasibility template is not suitable for many processors. While some funders, including the USDA, offer a guide describing what should be included in the study, the template can still be onerous to complete. Ultimately, it is unclear how much depth processors who hire a third party to complete the feasibility study are required to provide. To better understand the issues, FWG members were asked two questions about the importance, pitfalls, and limitations of feasibility studies as they relate to processors:

1. How important are feasibility studies when assessing a loan application?
More than 65% of FWG respondents stated that it is very important to have a feasibility study completed, especially if it's a new brick-and-mortar establishment (Chart 1). The remaining respondents said it is somewhat important or not important at all. Answers varied based on respondents' level of engagement with processors in loan or grant applications. For instance, one FWG member noted that feasibility studies are important because they help assess the viability of a business.

2. What are the pitfalls or limitations of a feasibility study?
More than half of the FWG indicated that cost, inaccuracy, and difficulty finding qualified parties to carry out the study are all pitfalls and limitations to feasibility studies. One FWG member shared an example where the feasibility study provided unrealistic projections despite the processor spending a substantial figure hiring a contractor to conduct the study.

Given their responses, the FWG recommended that the USDA review feasibility study requirements for local and regional meat processors applying for federal grants. Specifically, the USDA should explore a tiered approach that adjusts feasibility study requirements based on potential award amounts.

Broad Definition of Small Plants

The USDA defines a "very small" plant as 10 or fewer employees, with less than $2.5 million in sales. A "small" plant, on the other hand, is defined as having 11-499 employees. FWG participants expressed frustration with the plant size definitions and suggested another level may be needed between small and very small. Additionally, in conversations with industry stakeholders during a needs assessment, some too were surprised by the parameters for very small and small plants and believed the employee range is too wide for small plants. From the information collected, there is an opportunity to continue the conversation and explore potential benefits or concerns around creating another classification for plant size from the standpoint of regulatory compliance, demand, and funding opportunities. By expanding the definition, processors may benefit from increased chances at eligibility for grants or loans based on size.

Acknowledgments

The Agricultural Research Institute (AURI) and The United States Department of Agriculture, Agricultural Marketing Services (USDA-AMS) would like to extend gratitude to all meat and poultry processors in the five-state region, finance working group members, regional advisory task force members, and other industry stakeholders that contributed to the efforts of the Empowering Local and Regional Meat Processors in the Upper Midwest Project. This report was created in fulfillment of a cooperative research agreement between the United States Department of Agriculture Agricultural Marketing Service (USDA AMS) Local and Regional Foods Division (LRFD) and the Agricultural Utilization Research Institute (AURI). Its contents are solely the responsibility of the authors and do not necessarily represent the official views of the USDA. USDA is an equal opportunity provider, employer, and lender.