A Touchstone Energy® Cooperative

Starting Smart

A GUIDE TO CONVERGENT BUSINESS PLANNING

A Letter to Our Members

In the last few years, CFC has seen co-ops from across the country consider moving into convergent businesses—new product or service offerings that fit snugly with the co-op's core business of providing electricity while adding value for the co-op consumer. Their reasons range from strengthening member loyalty in an age of deregulation to improving the quality of life in their communities to developing a new source of revenue for the organization.

This increasing interest in broadening co-op services is a healthy and promising response to the dramatic changes we see in our industry. But it is also a development that carries varying degrees of business risk, and that, in turn, requires shrewd management and close cooperation between co-op boards of directors and their top managers—as well as their lenders.

I know that, for many of our members, starting a non-electric business is not a new experience. And, just as many of your have learned good lessons from such ventures, so have we. I think the lessons we, as cooperatives, have learned can be condensed to four points:

1. Why are we doing this? If it's to provide a needed service to your members, particularly in a way that builds on your co-op's skills and enjoys broad membership support, then, in our experience, such an effort is more likely to succeed. If it's solely to make a quick profit in a business outside of your co-op's core area of focus and in a manner that doesn't meet a clear need of your members, then the effort will be more likely to fail.

2. How does this venture fit with our core electric business? Does this opportunity complement your core business and enhance the perception of your cooperative? Also, do you have the management depth and expertise to handle launching a new company without hurting the "core" electric business?

3. Are we financially ready for this? You're not ready until you have a complete business plan that includes constant analysis of actual vs. forecasted results as well as an exit strategy to cover a range of contingencies.

4. Are the size and scope of this project realistic? It's one thing to get into a project that involves an investment of 1 to 2 percent of your co-op's total utility plant; it is an entirely different matter to put large amounts of money at risk in a venture that, if unsuccessful, could threaten or severely stress the co-op.

No single manual or guide can anticipate and answer all the questions co-op managers and directors will have as they embark on a convergent business initiative. However, "Starting Smart" provides a good place to begin the process.

Based on lessons learned from CFC's experiences, and produced with input from NRECA staff and co-op managers, this guide will help co-ops organize their approach to evaluating and launching a convergent venture.

Launching a convergent business initiative is a complex undertaking, and only a co-op's managers and board members have the knowledge of their system and their community that's needed to make this major strategic decision.

We offer this manual with the hope that it will assist you to evaluate both prospective convergent businesses and those in which you are already engaged.

Sincerely,

Sheldon C. Petersen
CFC Governor and CEO

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AN OVERVIEW

CHAPTER

1

An Overview

PLANNING SMART—RIGHT FROM THE START

Like many electric co-ops around the country, yours may be considering a move into a new business—propane, maybe, or Internet or water and sewer service. These and others may be appropriate additional businesses for a co-op to consider; they may support community economic development, strengthen consumer loyalty, and create additional revenue for your electric cooperative. Perhaps, even, your co-op is already in one of these businesses and considering another.

A convergent business builds on the existing skills of your co-op while fulfilling its commitment to meet your members' defined needs.

New ventures such as these are often referred to as "convergent businesses." What is a convergent business? It's a business that fits nicely with your co-op's core electric business and that, when added to your electric service, adds more value to consumers than if each service were offered by different companies. A convergent business also builds on the existing skills of your co-op while fulfilling its commitment to meet its members' defined needs.

Those convergent businesses that have the best chance to thrive must support the cooperative's fundamental mission, contribute to the co-op's success, and enhance the member's experience.

The path to a thriving convergent business may seem like a complicated one, but it all boils down to some familiar fundamentals: in branching out from your traditional, core service of providing reliable and reasonably priced electricity, you must ensure that your co-op maintains its financial and operational stability. The due diligence measures outlined in this guide will help identify the steps you and your board can take to manage most risks associated with convergence initiatives.

The history of the co-op program demonstrates our individual and collective abilities to meet and overcome awesome business challenges—challenges that our competitors were unwilling to confront. That history also teaches that, by working together, we can launch valuable new ventures successfully.

The convergent business trend within the co-op program poses challenges similar to those that attended the birth of the electric co-op program. As you ponder and prepare for a convergent business, you'll have to weigh a host of unfamiliar factors—just as your predecessors did when starting your electric co-op. Even if you're sure that the move your co-op is considering is sound and profitable, your partners and lenders will require assurances before signing on with you—again, a requirement little different from those the old Rural Electrification Administration imposed on co-ops at the dawn of the program.

This manual is designed to help you navigate the convergent business maze. It takes you through numerous planning steps involved in putting together a sound business plan and reaching a prudent business decision. It discusses some of the factors that affect how you integrate the new business with your existing one, and it helps identify benchmarks for assessing the venture's performance. It also points out some of the pitfalls you may encounter along the way.

Before going on, you should review Exhibit 1A (page 9) that provides a more detailed description of the basic elements of a convergent business plan. The exhibit covers steps in the business-planning process, details the kinds of issues to be addressed at each step, and refers you to the chapter in this manual that discusses those issues.

A QUICK LOOK AT WHAT'S AHEAD

Here's what you'll find in the coming chapters:

Chapter 2: Making the Decision—This chapter presents a look at how to get started in planning your convergent business campaign, with board-level decision-making flow charts. Chapter 2 also introduces the "stage-gate" method of organizing board reviews and discussion of the convergent business decision.

Chapter 3: The Director's Role—The co-op director's threefold duties of loyalty, obedience, and due care and diligence take on special importance when the co-op is considering a convergent business venture. This chapter reviews those duties and how they shape board actions in this demanding period, and suggests some of the questions board members and their co-op's management team should answer together before approving a convergence initiative. It underscores the fact that directors and their co-op's senior management must work as a team, focusing their combined business skills and knowledge of their community to reach seasoned, solid judgments about the venture's prospects for success.

Chapter 4: The Cooperative's Strategic Vision—An overarching vision of where the co-op is and where it needs to be is an essential business tool, even for businesses not planning to undertake a convergent initiative. Chapter 4 lays out the basic ingredients of a practical strategic vision and presents a method of developing one that unites the board, management, and staff behind the plan.

Chapter 5: Assessing Community Needs—Gauging the market potential for your new product or service offering is, obviously, a critical component of launching a successful convergent venture. Chapter 5 suggests ways to organize and accomplish the task of determining whether your community will turn to your co-op for the product or service you propose to offer.

Chapter 6: Regulatory and Political Considerations—Because co-ops are overseen by boards of member-elected directors who represent the interests of their customers, regulatory commissions in many states take a largely hands-off approach. That attitude, however, may not apply to a co-op's convergent business. Chapter 6 reviews some of the areas that may come under regulatory scrutiny in a co-op convergence campaign.

Chapter 7: Corporate Structures—A range of corporate structures is available for co-ops ready to move into a convergent venture. From subsidiaries operated on co-op principles to sole proprietorships, from S Corporations to Limited Liability Companies, each offers a different set of advantages. Chapter 7 provides an overview of the options.

Chapter 8: Alliance Alternatives—You may not have to go it alone to obtain the advantages of a convergent business. Other electric co-ops, telephone or agricultural cooperatives, and existing private companies may welcome your participation in bringing a valuable new product or service to your community. But there are important considerations to be weighed before taking on an ally, and Chapter 8 takes a look at them.

Chapter 9: The Acquisition Decision: Startup vs. Purchase—Starting your own company as a vehicle for your convergent business gives you greater control over the operation. Buying an existing operation is likely to bring a stronger revenue stream more quickly. Which way to go? Chapter 9 offers some guidelines for making the decision.

Chapter 10: The Corporate Culture—"The way things get done" is likely to be different for your convergent business venture than it has been in the electric utility environment, and management must set the new tone for the integrated organization. Chapter 10 raises some of the cultural questions ahead, and offers some tips to answer them.

Chapter 11: Information Technology Infrastructure—The technology infrastructure that keeps a business running is a critical factor in its ongoing success, and yet it can often be overlooked in the heat of making a deal. Chapter 11 raises some points to consider in the course of acquiring a new convergent company and outlines a strategy for integrating the new business's information technology infrastructure with yours.

Chapter 12: Financial Planning and Systems—The mix of debt and equity you use in financing your convergent business venture will have a significant impact on the venture's future. A "correct" blend of debt and equity can never be pinpointed, but Chapter 12 provides a range of issues to consider and gives you a backdrop for making this critical determination.

Chapter 13: Financial Modeling—A detailed model of your business's likely prospects, under both the "most likely" and "worst case" scenarios, allows you to take a hard look at the numbers before launching the new venture, and to establish essential benchmarks for its subsequent performance.

Chapter 14: The Exit Plan—It goes against the grain to ponder problems in the enthusiasm of launching a new business, but it's a necessary part of a sound business planning process. Chapter 14 discusses performance benchmarks and other elements of an exit strategy—an essential ingredient of any smart convergent business plan.

Chapter 15: Business Plan Execution—After you've done the marketing surveys, negotiated financing and partnerships, and devised an exit strategy, you have to prepare for a sound follow-through. Chapter 15 identifies some potential pitfalls to watch out for in the early going and outlines some elements of an assessment program.

A FEW ADDITIONAL FEATURES

Wherever possible, each chapter includes a list of additional references—books, organizations, and Web sites—that provide further information or help in accomplishing the step outlined in that chapter.

In addition, each chapter is accompanied by a brief case study chronicling the fictional Two-County Electric Cooperative's campaign to enter a convergent business. These case studies take the information out of the abstract by illustrating how the processes outlined in the chapter itself might unfold at a typical co-op.

EXHIBIT 1A

OUTLINE FOR A BUSINESS PLAN

TOPICS	CONTENT/ISSUES	RELATED CHAPTERS
PLAN OVERVIEW		
Description of the proposed business	Summary description of the Smart Convergence Venture (SCV), including why it is needed and how it will promote the cooperative's success.	
Projected financial results	Summary of alternative scenario results.	
Implementation schedule	Tasks, assignments and deadlines for organizing the SCV and moving it toward break-even cash flow. This could be in the form of a Gantt Chart.	
STRATEGIC FIT		
Summary of the co-op's strategic plan	Concise (one page) statement of the cooperative's vision, mission, and strategic goals.	4
The new venture's support of the cooperative's strategy	How will the SCV promote accomplishment of the cooperative's customer, financial and service goals? What is the strategic goal and mission of the SCV?	2, 4
The SCV's SWOTs.	Assess the strengths, weaknesses, opportunities, and threats relative to the SCV's strategic goals. How can the SCV use its strengths and opportunities to overcome internal weaknesses and external threats?	2
REGULATION		
Compliance with state enabling act for electric cooperatives	How can the SCV be structured to comply with the law and maximize benefits to cooperative members? Alliances, limited partnerships, and legislative action should be weighed.	6
Industry organizations	Are present participants in the SCV's industry likely to object to the cooperative's entry? Can those businesses seek regulations that will hamper or prevent competition from a cooperative-owned SCV?	6
Tax considerations	Are income, property and other tax implications well understood and included in the evaluation of prospects for the SCV investment?	6, 7
Licenses, permits and other regulations	Ascertain that license and permit requirements are known and can be met and that obligations regarding environmental protection, worker safety, and similar regulations are understood.	6

TOPICS	CONTENT/ISSUES	RELATED CHAPTERS
OWNERSHIP STRUCTURE		
Choice of alliance, startup or purchase	Consider requirements for equity investment, business expertise, culture fit, cooperative brand development, regulatory compliance, as well as purchase and alliance option practicality, to select the best alternative.	8, 9
Choice of cooperative, LLC or other structure	Consider benefits of cooperative membership, partnership with established businesses, tax consequences, financing impacts, and other factors.	7
KEY SUPPORT RELATIONSHIPS		
Service and product vendors	Are established relationships already in place with vendors who will supply important inputs to the SCV? Consider the relative benefits of sole-sourcing vs. frequent competitive bidding.	11
Insurance coverages	Are the coverage costs for liability, property, and other insurance needs included in the evaluation of the SCV's investment prospects? Should coverage be combined with that of the cooperative?	11
Professionals	Demonstrate that the needs and costs for consultants, public accountants, attorneys, and other professionals are understood and included. Can outside professionals perform work more efficiently than SCV/cooperative staff?	11
Purchasing procedures and controls	Document established vendor relationships and internal processes for making purchases. Processes should include quality controls and accounting procedures. Who will be responsible for these functions?	11
INFORMATION SYSTEMS		
Financial planning	Software or other documented procedures should be described and evaluated in sufficient detail to assure adequate consideration of marketing, organizational, and financing scenarios. Can forecasts be created quickly?	13
Accounting	Can Generally Accepted Accounting Principles financial statements be produced within 15 days of month-end that show inter-company transactions? Can financial statements between the cooperative and the SCV be reconciled? Who will be responsible for financial statement preparation and analyses?	13

TOPICS	CONTENT/ISSUES	RELATED CHAPTERS
INFORMATION SYSTEMS CONTINUED		
Budgeting	Variances between GAAP financial statements and budgets must be promptly explained and, if necessary, corrected. Who will be responsible for these functions?	13
Computer systems	Are the SCV's computer resources sufficient for its management, accounting, inventory control, etc.? Is the system compatible with the cooperative's? What will be the costs of adapting these two systems if necessary? Have those costs been included in scenarios?	13
Internet	Are procedures established to let the SCV make best use of the World Wide Web and e-mail? What are they?	13
MARKETING		
Competitive features of SCV's product or service	What unique customer benefits will the SCV's product or service offer? Why will customers buy from the SCV? How will the SCV maintain its advantages?	5
Target customers	What customer groups will patronize the SCV? How big is the market in terms of customer numbers and potential sales volume?	5
Competitors	Who are the SCV's likely competitors and how will the SCV become the preferred provider?	5
Pricing	How will the SCV set its prices to ensure both competitive pricing and full cost recovery? Can the SCV's product be sold on the basis of quality of service rather than lowest price?	5
Advertising	How will the brands of the SCV and the cooperative complement each other? How will the SCV's value proposition be communicated to customers?	5
Sales forecasts	Are "worst case" and "most likely" scenario forecasts based on supportable estimates of the likely number of customers and average purchases?	5

TOPICS	CONTENT/ISSUES	RELATED CHAPTERS
ORGANIZATION		
Target culture	Does the cooperative's culture fit the strategy of the SCV? If not, how will the organizations adapt? Should the SCV culture be based externally (customer) or internally (innovation)?	10
Constructive cooperative-SCV organizational relationship	How will the SCV's desirable culture be cultivated and, where appropriate, spread within the cooperative?	10
Functional workload and staffing	Has the SCV performed an analysis of what specific tasks must be performed, how many full-time equivalent employees will be required when and with what skills? Is the cooperative's staff prepared to recruit and hire professionals from another industry?	10
Staffing and compensation plan	Can the SCV hire the right kind of staff at compensation/benefit levels that allow it to remain competitive?	10
FINANCING		
Funding requirements forecasts	Are "worst case" estimates of funding for plant and equipment, as well as startup operating losses, based on credible details of construction costs, staffing, and other utility expenses.	13
Equity investment in SCV	How much equity investment will the SCV require for launch? What about after establishment (as indicated by industry statistics)? Can equity be provided by partners rather than by the cooperative?	13
Debt sources and terms	From what sources will the SCV be able to borrow and on what terms? Is leasing a cost-effective alternative for financing some assets?	13
Model scenarios	Is the SCV's financing plan based on credible alternative projections both within and beyond the control of the SCV and the cooperative?	13
MANAGEMENT CONTROLS		
Performance monitoring and correction	Who will have what responsibilities for continuously monitoring the SCV's performance and assuring that corrective action is taken, if necessary? How will the board ensure that management controls are established and executed?	14
Exit triggers	At what point(s) would the SCV be discontinued or sold by the cooperative?	14

CHAPTER

2

MAKING THE DECISION

This chapter presents a look at how to get started in planning your convergent business campaign, with board-level decision-making flow charts. Chapter 2 also introduces the "stage-gate" method of organizing board reviews and discussion of the convergent business decision.

Making the Decision

A FOCUSED, DISCIPLINED START

Before you consider the prospect of broadening your business, you and your board must have a clear idea of where you're going and how your plans fit into your existing business structure.

A focused and disciplined program of analysis is essential for any co-op considering a departure from its core business.

This chapter outlines the "stage-gate" method of focusing your approach to any new business proposal. By taking an organization through an orderly series of assessment and analysis stages, with each stage followed by a gate of board decision that opens on the next stage, the stage-gate structure helps to focus and direct your system's business discussions and subsequent actions.

The advantages of this approach are many:

- Assurance that the members, board, and staff agree on direction.
- Early identification of critical success factors, or benchmarks, that the new enterprise will have to meet.
- Prioritization of factors that require follow-up research.
- Development of a comprehensive outline that includes all the components needed to complete a business plan.
- Institution of budgetary and scheduling controls to ensure that all the required development work is accomplished cost-effectively.
- Advancement of the development plan if continued investment in the new business appears prudent.

Depending on the size and complexity of the project and the skills and available time of your staff, consultants or other outside professional help may be necessary to assist in the business planning process, market analysis, and review of the various types of business structures.

STAGE-GATE METHODOLOGY

Exhibit 2A, "Stage-Gate Critical Success Factor Assessment," illustrates the stage-gate method in outline form (the chapters in this guide follow the stages and components as defined in Exhibit 2A).

Stage I, "Initial Assessment," starts with threshold questions of co-op strategy and business viability, taking the process to its first gate: a board "go" or "no-go" decision.

These questions can help your staff and board determine if diversification is a good step for your co-op, as well as explore the potential for success and chart the course for the new business. Management should consider additional success factors as the situation warrants.

Stage I is the first convergent business planning step. The least expensive and time-consuming step, its purpose is to decide if a diversification effort is a good fit with the co-op's strategic plan. Management should consider what is already known regarding each critical success factor, including those unique to the cooperative's specific situation. One result of this stage is a prioritized list of issues to be resolved early before additional development costs are incurred. It also sets the timeline for Stage 2. Its most important contribution to the process, however, is to get board and management to Gate I, the fundamental decision of whether to proceed with business plan development.

If the decision is a "go" at Gate I, management should consider whether to obtain specialized help to further develop the business plan. Also at this point, business plan development work should be scheduled and costs budgeted.

Stage II, "Investigation," moves the process into a second set of business-specific critical success factors. Its purposes are to objectively re-examine the project, revise critical success factors and the planning budget if necessary, and identify alternatives for establishing and operating the business. This stage brings management and the board to Gate II, a "go" or "no-go" vote on directing the co-op to pursue the plan and the authorization of additional development expenditures.

Stage II is likely to take anywhere from several months to more than a year and involve more costs than Stage I.

Stage III, "Finalize Business Plan," brings the process to its final gate—the decision to launch the convergence initiative. It includes the revision and expansion of prior steps as directed by the board and the additional elements of "Management & Control" and "Business Plan Integration." If, at Gate III, the cooperative board and management conclude that all significant factors critical to success will be met, then the convergent business may be launched.

Exhibit 2B, "Process Flow: Business Plan Development and Implementation," illustrates the same process in the form of a flow chart.

Regular board updates should be included throughout the stage-gate process—not postponed until the next "gate" step. Such intermediate reports at each board meeting will help ensure that the initiative enjoys continued support and guidance at the highest policy level.

SUMMARY

A focused, disciplined program of analysis is essential for any co-op considering a convergent business initiative. The "stage-gate" model of assessment, investigation, and finalization—with its built-in gates of board-level decision points—provides this structure. An important feature of this model is that it allows management and the board to weigh—and, if necessary, discontinue—the plan at three critical points.

ADDITIONAL RESOURCES

1. Stage-gate: Product Development Institute Inc. www.prod-dev.com/stagegate.shtml
2. Cooperative Research Network manual: "Developing Superior Products and Services"

EXHIBIT 2A

STAGE-GATE CRITICAL SUCCESS FACTOR ASSESSMENT

STAGE I. Initial Assessment / Concept / Preliminary Feasibility: Does my Co-op want to diversify?

1. The Board's Responsibility
   - Consistency with EC's role in the community.
   - Complementary to the electric utility business.
   - Risk equity investment is justified and manageable relative to the co-op's size.
   - EC management can execute the plan and operate the business.
   - Benefits and risks identified.
   - Board has received agreement from members to spend capital.

2. The Cooperative's Strategic Vision

   Does the convergent business fit?
   - Clear EC vision and strategic plan.
   - Consistency with responsibilities to stakeholders.
   - Consistency with electric utility business strategies.

3. Assessing Community Needs

   Preliminary market research.
   - Market demand is sufficient.
   - EC's capabilities will be superior to main competitors.
   - Convergent business will complement EC brand.

4. State Enabling Act and Regulations

   Research legal authority to offer diversified products and services.
   - Convergent business is permitted under law and regulation.
   - Will trade associations or others object to EC entry?
   - EC entry will not jeopardize EC tax status or other benefits.

GATE I. Board of directors reviews findings and makes "go" or "no-go" decision

STAGE II. Investigate / General Feasibility: Exploring alternatives for a specific line of business

5. Corporate Structure Alternatives

   Tax and governance issues.
   - Cooperative membership value is maximized.
   - Appearance and fact of cross-subsidies can be eliminated.
   - Income and other tax impacts are acceptable.

6. Alliance Alternatives

   Does partnering make sense?
   - Alliance likely to be more beneficial than EC ownership.
   - Ally reliability and reputation can be verified in advance.
   - Mutually beneficial risk and profit-sharing can be arranged.

7. Acquisitions vs. Startup Decisions

   Analyze whether to buy a business or start from scratch.
   - Total costs of acquisition and startup options can be compared.
   - Satisfactory financing is available for either option.
   - Risk equity requirements of alternatives are acceptable.

8. Organizational Culture and Structure
   Understanding new markets and evaluation of existing co-op environment.
   - Convergent business culture will benefit EC culture.
   - Convergent business will create career opportunities.
   - EC organization will not hazard convergent business success.

9. Suppliers and Outside Service Requirements
   Principles of modern purchasing.
   - Critical resources, insurance, etc. will be available at affordable prices.
   - The EC affiliation allows for advantageous purchasing.
   - Inventory costs and supply access will facilitate superior service.

10. Information System Technology
    Research needs and latest technologies.
    - Hard/software requirements are understood and achievable.
    - Technical skills are available.
    - Billing service and other system compatibility with EC.

11. Financial Planning
    Introduction to CFC's General Business Model (GBM).
    - Equity and debt requirements are understood and achievable.
    - Potential financial impacts on EC are understood and acceptable to members, board, and staff.
    - Expected return on investment justifies risks and costs to EC.

GATE II. Board of Directors reviews findings and makes "go" or "no-go" decision

STAGE III. Finalize Business Plan: Update, revise, and expand analysis of all previous components of the convergent business plan as directed by the board. In addition:

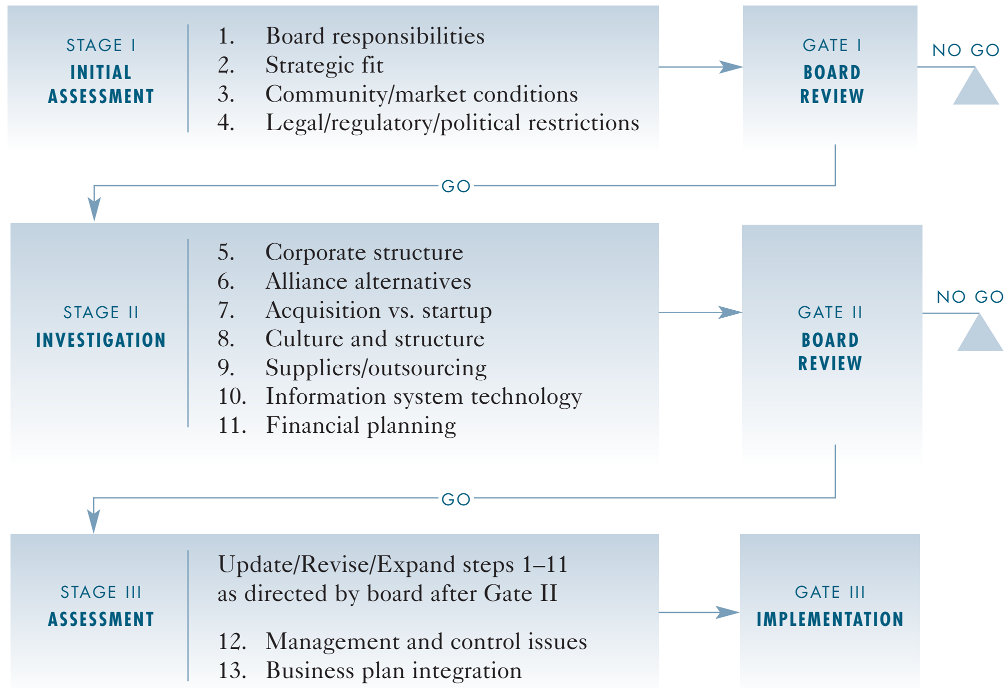
12. Management and Control
    Operational leadership is identified.
    - Sales, Return on Investment, etc. requirements are understood and will be managed.
    - Costs will be controlled and managed to stay within range of business plan.
    - Termination/exit plan will be triggered when indicated by business plan.

13. Business Plan Integration
    Ready to implement business plan.
    - Marketing, delivery, service, and support are in place.
    - Integrated forecast, budget, and accounting systems are functional.
    - Worst case, most likely, and other relevant scenarios are understood.
    - Worst case projections are acceptable and can be financed.

GATE III. The board reviews Stage III deliverables, makes decisions regarding alternatives, and decides whether to proceed with the launch of the convergence initiative. Members are still supporting expenditures of capital and ready to risk equity.

EXHIBIT 2B

PROCESS FLOW: BUSINESS PLAN DEVELOPMENT AND IMPLEMENTATION



CASE STUDY

GETTING STARTED

Two-County Electric Cooperative finds itself in a position many co-ops are facing today. It has provided excellent electric service to its members for more than 60 years. Rates are slightly higher than those of the neighboring investor-owned utility, but consumers are satisfied because of the co-op's superior service and contributions to the local community.

Unfortunately, the community is not growing. The co-op serves about 17,000 meters, a number that has remained steady for several years. The system adds about 150 new consumers each year, but this gain is offset by the loss of other consumers due to attrition and business closures. There is little opportunity for the co-op to grow its core electric business.

In other times, this steady state might not have been a problem, but the co-op faces new challenges today. Over the past several years, the state legislature has considered various plans for introducing retail competition in the electric industry. The co-op's statewide association says a study commission may recommend major changes to the state's regulatory structure during the next session.

Two-County's board of directors and management realize they need to be proactive in developing a strategy to maintain the co-op's financial strength in a restructured environment if such comes to pass. They also are aware that many co-ops are offering new products and services to strengthen and maintain their ties to members. The leadership wonders if such activities would be a good idea for Two-County. But, more importantly, they see real needs for products and services not being adequately offered in their area. They wonder if they could make a valuable contribution to the economic and social well-being of their community by offering them.

At the next board meeting, the manager recommends the board establish a task force to evaluate whether the co-op should offer new products or services. He suggests the task force limit its considerations to convergent businesses. The board looks puzzled.

"What's a convergent business?" one member asks.

"A convergent business is one that fits well with our co-op's core electric business," the manager says. "When we add its services to our electric service, we can offer more value to the consumers than if the services were offered by different companies." He also suggests the co-op leadership use a stage-gate process to evaluate options.

"The stage-gate process was originally developed to help companies with product development," he says. "I believe it will work well for us as we consider offering new products and services."

He explains how the process will help them focus on the critical elements of success for any new venture. It also will help them identify less-attractive projects at an early date, so they can be abandoned with the least possible cost.

"There are three stages," he says. "In each stage, the staff will analyze specific data and issues involving various aspects of the co-op and the proposed business. At the end of each stage, there is a gate. That's a decision point where the board will decide whether to continue to explore the idea." He points out that the gates also provide an opportunity for quality control, so everyone can be sure the task force is doing its job effectively.

In Stage I, he explains, they will decide whether a convergent business fits with the co-op's strategic plan. They also will identify a list of issues to be resolved early on. The board will make its first "go" or "no-go" decision at Gate I.

"If the decision is no," the manager explains, "the costs we incur will mostly be limited to staff time. If the decision is yes, it's on to Stage II."

In Stage II, the task force will conduct a thorough investigation of the options for a specific convergent business. It will look at alternative corporate structures, debate acquisition versus startup, explore organizational and cultural issues, identify potential suppliers, establish IT requirements, and begin the financial planning process. The board will have to be patient. This stage of the process could take months. Eventually, it will bring them to Gate II, for a second "go" or "no-go" decision.

A go decision authorizes the task force to complete Stage III by updating and finalizing the convergent business plan. In addition to the issues addressed in Stages I and II, the task force will consider management and control as well as how to implement the business plan.

As the board approaches Gate III, it will have a full picture of all the issues associated with the convergent business and a complete business plan for entering the business. If the decision is go, the co-op will be well-positioned to succeed. If the decision is to abandon the project, the co-op will suffer a loss, but not nearly the loss—in terms of both dollars and credibility with members—that it would suffer as a result of a business failure.

The board engages in a lively discussion of the manager's recommendations. There are concerns about the cost of stage-gate analysis. "We know what the needs in the community are," one says. "Wouldn't it be wiser to spend that money on the new business?" There are a few nods around the table.

"We think we know what the needs are," says another. "I'm not sure we know if we have the expertise to meet them, or if our members would support us in a business other than electricity. If we're going to do this, we need a good plan."

In the end, the board accepts the manager's recommendations and appoints the manager and key staff to the convergent business task force. The task force is specifically charged with leading the co-op through the stage-gate process to evaluate convergent business opportunities. The board also authorizes the task force to ask the co-op's legal counsel and accountant to assist as needed.

CHAPTER

3

THE DIRECTOR'S ROLE

The co-op director's threefold duties of loyalty, obedience, and due care and diligence take on special importance when the co-op is considering a convergent business venture. This chapter reviews those duties and how they shape board actions in this demanding period, and suggests some of the questions board members and their co-op's management team should answer together before approving a convergence initiative. It underscores the fact that directors and their co-op's senior management must work as a team, focusing their combined business skills and knowledge of their community to reach seasoned, solid judgments about the venture's prospects for success.

The Director's Role

FULFILLING THE BOARD MEMBER'S DUTIES

The three overarching duties of every electric co-op director—those of loyalty, obedience, and due care and diligence—take on special importance when your co-op launches a move into a convergent business. Directors must work closely with their system's management to ensure that their actions maintain the co-op's strength and stability.

This chapter examines how those duties govern directors' actions in the course of co-op planning and implementation of a convergent business strategy. All three basic duties will be covered in the discussion, but the greatest emphasis will be placed on the director's duty to exercise due care and diligence, since that is the area that will call for the most time and attention from your directors.

THE DUTY OF LOYALTY

Directors are expected to act in ways that are loyal to the organization—and, in the case of co-ops, to its members. In practical terms, this means the director will avoid conflicts of interest, honor confidentiality, and work at all times in the best interests of the organization and its membership.

Obviously, board members with a conflict of interest in any action relating to the new venture must excuse themselves from discussion and voting on the action. This does not mean, however, that a board cannot act on matters where one member has a conflict. It simply means that the member having the conflict must refrain from participation in the decision process.

Equally important is the concept of confidentiality. Most businesses will require the co-op to sign a confidentiality agreement before entering sales negotiations. That agreement usually prohibits the buyer from sharing any information about the potential sale to third parties other than limited disclosure as necessary to attorneys, consultants, and lenders.

Finally, the most important aspect of the duty of loyalty is to avoid acting in any manner that will be detrimental to the cooperative. This can include taking undue business risks in diversification that put the cooperative in jeopardy if the new businesses fail. Avoiding such risks will be covered in more detail in the discussion of due care and diligence.

THE DUTY OF OBEDIENCE

No less than the organization and management, a co-op's directors are bound by the many federal, state, and local laws and regulations—not to mention the co-op's own by-laws and policies—that govern electric cooperatives.

Because of the number and complexity of all these governing codes, boards should not be shy about getting legal advice—especially when it comes to diversification. Acquiring a business or starting a new one is a very complicated legal matter, and your board should consult its attorney early and often during the process. In fact, the attorney should be an integral part of co-op's convergent business planning team. The attorney need not be part of every discussion and need not sign off on every decision, but he or she should review and comment on every major decision. This is a cost-effective policy, too; a legal fee paid in advance is almost always less than the fees and expenses you're likely to face in getting out of a sticky situation that probably could have been avoided.

THE DUTY OF DUE CARE AND DILIGENCE

Essentially, exercising due care and diligence in making business decisions for the co-op means that a director should make those decisions only after becoming fully informed on the subject—and this is especially true when entering into any new venture that could place co-op resources at risk.

This does not mean that a director must become an expert on the business the organization is considering, but it does require board members to do a thorough review of all the business factors before reaching any decision on the proposed diversification. Again, this will require the closest collaboration between directors and co-op management.

One way for directors to satisfy their due care and diligence duty is by working with their management team to answer a series of questions aimed at uncovering their organization's readiness to undertake a convergent business initiative. Here are some of those questions:

1. Is the decision to launch a convergent business a part of an overall strategic plan for the cooperative?

Diversification should be part of a carefully developed, comprehensive strategic plan. Since a co-op's resources are limited, those resources must be used to gain the most benefit to the cooperative and its membership. Many diversification opportunities come along, but not all are a good fit with the co-op's strategic plan. Due care and diligence means a director should make certain that the diversification effort is in line with the co-op's pre-established strategic goals.

2. How will the project benefit the membership?

Any proposed diversification venture should offer clearly defined and understood benefits to the members. Directors should make sure the members need or want the service or product. Due care and diligence means a director should make sure that those wants and needs have been determined—and that the new business will actually satisfy them.

3. Will the new venture be a drain on the co-op's human resources?

From deregulation and competition to power supply decisions, co-op employees already face a host of daily challenges just operating the core business. How will adding a new business to their plate affect their ability to make sure the lights stay on? Care must be taken to ensure that management is not spread too thin in the diversification effort and that the core business is not neglected. Due care and diligence means a director should make certain that new initiatives are will not hurt the co-op's electric side.

4. Will the new business place an undue financial strain on the co-op?

Their powerful financial resources are a major strength of almost all cooperatives. Through conservative business practices, most co-ops have developed strong equity positions, and almost all exceed the financial requirements of outside lending and regulatory agencies. Because of this strength, most co-ops are likely to be in a good position to fund or finance diversification ventures. But none of this diminishes the director's duty to determine the financial impact diversification will have. Even successful ventures can have a significant negative impact on the co-op's financial resources because of new financing needs. Due care and diligence means a director makes sure the co-op will be able to handle the financial requirements of the convergence effort without jeopardizing the co-op's financial standing.

5. How will the convergent venture be financed?

It is vitally important that financing options be in place prior to making firm commitments on any plan. The co-op should get a letter of commitment from a lender prior to making any business decision that will require outside financing. Due care and diligence means a director will make certain financing is in place prior to making commitments that will require financing.

6. What constitutes success in the venture?

Clear goals should be established for your co-op's diversification initiative. Goals set in advance provide a yardstick against which to measure the venture's actual performance. Due care and diligence means a director will make certain such goals are established for the business. These goals and objectives need to be evaluated on a routine basis.

7. What are the consequences if the venture fails?

Directors must consider what will happen to the co-op if its new business doesn't live up to expectations. This is perhaps the most important question to answer before a diversification decision is made. Due care and diligence means the director should ascertain the impact of failure on the core business before approving any diversification effort.

8. Has an exit strategy—and the benchmarks that trigger it—been established?

An exit strategy should be developed well in advance to determine what happens if the business fails to meet expectations or reaches a level of development where the co-op wants to leave the business. Due care and diligence means the director should know the exit strategy for the business prior to approving any diversification.

ADDITIONAL RESOURCES

1. Encyclopedia of Corporate Governance www.encycogov.com
2. NRECA courses for directors www.nreca.org/product/catalogs.pdf
3. Cooperative Research Network manual: "Developing Superior Products and Services"

CASE STUDY

WHAT DIRECTORS DO

Early in Stage I, Two-County's convergent business task force asks the co-op's attorney to meet with the board of directors to discuss the directors' responsibilities in making decisions at the gates. "The board has a very important role to play in protecting the membership's investment in the co-op by ensuring the co-op takes the proper steps in developing and implementing plans for a convergent business," the attorney tells them.

She begins by reminding the directors they have three primary duties to fulfill: loyalty to the cooperative, obedience to the laws and regulations governing the cooperative, and due care and diligence in making decisions for the cooperative.

She explains that being loyal to the co-op means a director should avoid conflicts of interest. This raises an immediate question from a director who owns stock in a company that produces one of the products the co-op may consider marketing.

The attorney suggests he not participate in that decision gate in order to avoid any appearance of conflict of interest. The director readily agrees to withdraw from decisions involving that product.

The attorney also says loyalty means directors should honor confidentiality and never take actions that might harm the organization.

The attorney herself has an important role to play in helping the board fulfill its duty of obedience. She promises to advise them how the alternatives they are considering might be affected by the various state, federal, and local laws and regulations governing the co-op's actions. She also will ensure whatever strategy they ultimately devise will be in compliance.

At that point, the co-op's general manager asks to address the issue of due diligence. "I expect you to ask hard questions about what the convergent business task force is doing and to ask a lot of questions about our recommendations." He promises to do everything he can to be sure the board members understand all the issues before making any decisions. "You are our quality control system. It is your job to be sure we don't overlook something and our reasoning is sound."

By the meeting's end, both the directors and the business team are comfortable with their roles and confident they are prepared to move forward together in planning the co-op's future.

CHAPTER

4

THE COOPERATIVE'S STRATEGIC VISION

An overarching vision of where the co-op is and where it needs to be is an essential business tool, even for businesses not planning to undertake a convergent initiative. Chapter 4 lays out the basic ingredients of a practical strategic vision and presents a method of developing one that unites the board, management, and staff behind the plan.

The Cooperative's Strategic Vision

ACHIEVING A STRATEGIC FIT

The success of any new convergent business depends to a large extent on whether it fits with your cooperative's integrated package of products and services. It's essential, therefore, that you have a framework for narrowing your choices in the range of new business opportunities you may be considering.

A strategic vision statement—a broad explanation of how your co-op will maintain and enhance its value to its members—provides that framework. This chapter will help you assess whether your current vision statement accomplishes this basic goal and decide what's needed if it doesn't.

A PRACTICAL VISION STATEMENT

A workable strategic vision statement must meet three basic requirements:

1. It must recognize your co-op's community service role and other core values.
2. It must set specific goals for member service, organizational development, financial performance, and innovation.
3. It must project a clear and specific image of success for both members and employees.

Some co-ops address these requirements in a "mission statement" or a "statement of strategic direction." Whatever it's called, the point is that the statement equips the co-op's board, management, and employees with a guide to achieving their goal of continued outstanding service.

DEVELOPING AND USING A STRATEGIC VISION

Exhibit 4A, "Process Flow: Strategic Vision," outlines one way to put together a strategic vision statement for your co-op.

The process begins by establishing a clear understanding of your system's current and future obligations to a wide assortment of community groups. It starts, of course, with your members—but it also includes employees, government agencies, local employers, businesses and industries, and other institutions, all of which depend on your co-op. The key question at this beginning stage is: How well is your cooperative meeting its stakeholders' needs now, and how well will it do so in the future?

Next, board and management should explore generally held assumptions about the co-op. For instance, will its not-for-profit status ensure member loyalty in a restructured market—or in a new line of business where competition is the norm?

Finally, board members and management must settle on a set of fundamental co-op values. One way to arrive at these values is to ask, "What would be important to us even if we were not in the electric utility business?"

With this foundation of understanding—a recognition of stakeholder needs, a realistic assessment of strengths and weaknesses, and a recognition of the co-op's fundamental institutional values—you can state the co-op's strategic vision.

Programs your co-op has already adopted should then be reviewed to determine whether they fulfill the larger strategic vision (see Exhibit 4A, Step 6, page 30). In some cases, you may find that one goal conflicts with another. For example, programs to reduce electric distribution costs support a goal of being the low-cost electricity provider—but they may work against an equally important goal of providing the highest quality energy service. Such conflicts must be resolved before the process can proceed. In addition, programs to improve productivity, service, and competitiveness must be evaluated and, if needed, revised.

Your are now ready to determine whether a new business prospect fits with your co-op's strategic vision. By providing a structure for comparing the potential offering against the needs of stakeholders as well as your co-op's existing programs and business offerings, this approach helps ensure that your candidate for a convergent business will contribute directly to your co-op's long-term strategic success.

SUMMARY

Before your co-op enters a new business, you have to make sure the new offering will fit with the co-op's strategic vision of its future. By following the approach outlined in this chapter, you'll have a framework for developing a clear vision statement and thus be able to compare a potential convergent business against your overall goals. Chapter 5, "Assessing Community Needs," and Chapter 10, "Organizational Culture and Structure," discuss the next logical steps in the business planning process.

ADDITIONAL RESOURCES

1. Strategic planning: Management Assistance Program for Nonprofits www.mapnp.org/library
2. State Electric Restructuring Legislation Snapshot www.nreca.org/leg_reg/
3. Steiner, George A. (1997) "Strategic Planning, What Every Manager Must Know." New York, NY. Simon & Schuster, Inc.
4. National Consulting Group www.nreca.org/products/ncg.html

EXHIBIT 4A

PROCESS FLOW: STRATEGIC VISION

STEP	PROCESS	FLOW
1	Identify the electric cooperative's stakeholders. To what groups does the co-op have legitimate obligations? Customers, employees, members...?	STAKEHOLDER
2	What will the future (maybe five years out) most likely hold in store for stakeholders and the co-op? Specify regulatory, demographic, and other trends.	FUTURE
3	Challenge myths about the co-op, its people, its standing in the community, etc. Identify sacred cows and other potential misconceptions.	MYTHS
4	Identify the co-op's core values. What philosophical positions would the co-op's board hold even if it were in an entirely different business?	VALUES
5	State the co-op's vision in terms of community service roles and other values, including customer service and organizational goals, as well as others.	VISION
6	Summarize the co-op's existing productivity improvement, member service, and financial strategies, among others.	STRATEGIES
7	Compare existing strategies to the vision articulated at Step 5. Do existing strategies support the co-op's vision?	? NO YES
8	Describe the convergent business venture in terms of its value propositions, probable cost, and organizational impacts.	BUSINESS
9	Compare convergent business venture to vision, as indicated by stakeholder needs and related strategies. Are they consistent?	? NO
10	If no, abandon further business plan development.	YES
11	If yes, proceed with plan development research.	CONTINUE

THE VISION THING

CASE STUDY

Two-County Electric Cooperative's decision to explore convergent business opportunities raises a lot of questions: What businesses should we explore? How do we go about it? What role does the board play? The biggest question of all is this: How does the co-op provide value to its members? Before the board and staff can make any decisions about a convergent business, they have to be very clear about their vision for the existing electric business.

"It's obvious," says one board member. "We provide reliable electric service at a reasonable cost. That's what we've done for 60 years, and it's what we should be doing today." The other board members agree that is true.

"However, times are changing," says another. "Shouldn't the co-op change with them? Maybe there are other things we should be doing as well."

The co-op manager suggests the board and senior staff schedule a day together to discuss this issue and see if they can agree on a strategic vision statement—something that clearly defines the co-op's reason for existence. He asks the participants to prepare for the meeting by thinking about the following questions:

- Who are our stakeholders? What obligations does the co-op have to these stakeholders?
- What climate will we be operating in during the next few years? Is our service area changing? How will regulatory changes affect us?
- How do our members see us? Are we holding on to any myths about our relationship with our members and the community?
- What are our co-op's core values?

The questions lead to a lively discussion. As the participants talk about the first question, the manager lists the stakeholders and the co-op's obligations to them on the whiteboard. His list reads:

Members	Reliable electric service at a reasonable price Good stewardship of co-op resources Community support and service
Employees	Competitive pay and benefits Safe working conditions Opportunity to make a difference in the community
Government agencies	Compliance with rules and regulations
Community	Responsible actions Support for economic and social well-being

The task force invites the statewide association's legislative director to speak to the group about the outlook for changes in the state's regulatory structure. "The state legislature may consider retail competition in its next session," he says. "A lot of questions have been raised about that recently, and we don't know what will happen." However, he points out, with events in California and other places, consumers are paying much more attention to energy services. "It is always part of a co-op's mission to respond to member needs and concerns."

CASE STUDY

The manager points out how the co-op's operating climate is changing in other ways. "Agriculture is still an important part of our economic base, but, with technology, we are seeing more home-based businesses and telecommuters," he says.

The board has a lot of trouble with the question of how members see the co-op. "We're still the people that brought electricity to the homes in this area," one says.

"Tell that to my grandson," says another. "He can't believe there was really a time when people didn't have electricity. All he cares about is his computer and his games."

The group acknowledges that the reasons people were loyal to the co-op in the beginning may not ensure loyalty today. While it might make sense to the board and management to offer a new service, it better make sense to the members, too.

The final question is the easiest to answer. The manager returns to the board to list responses:

Honesty Integrity Reliability Safety Sound business practices

"I know we have been talking a lot today about change," a member says. "It seems to me one thing hasn't changed. The co-op's basic purpose since its inception has been to improve the quality of life in the Two-County community. As long as there are new needs we can meet, it is important for us to consider doing so."

At the end of the day, the board and staff are satisfied with their vision for Two-County Electric Cooperative:

"Two-County Electric Cooperative exists to improve the quality of life in our community. We will do that by providing electricity and other services for which the co-op is uniquely qualified. We will conduct our activities with a high degree of integrity and with respect for the needs of our members, our employees, and our community."

CHAPTER

5

ASSESSING COMMUNITY NEEDS

Gauging the market potential for your new product or service offering is, obviously, a critical component of launching a successful convergent venture. Chapter 5 suggests ways to organize and accomplish the task of determining whether your community will turn to your co-op for the product or service you propose to offer.

Assessing Community Needs

ASKING THE RIGHT QUESTIONS

Your convergent business initiative will stand or fall on two fundamental factors—customer interest in your offering and your ability to satisfy the market. Before introducing a new product or service to the marketplace, management must ask—and answer—two basic but essential questions:

1. Are there people out there who are willing to pay for the product the co-op plans to provide?
2. Can the co-op deliver the product the customer wants?

THE STEPS IN THE PROCESS

By going through a few key steps, you and your staff can determine whether the business is right for your market—and whether your organization is right for the business. Your new venture will have a much greater chance of succeeding if you take the following actions:

1. Define the questions you need to answer to reduce the uncertainties associated with the business.
2. Gather information from secondary and primary sources.
3. Answer the questions you started with.

Exhibit 5A, "Process Flow: Market Assessment" (page 37), offers a more detailed checklist of the steps in the research process.

STEP 1: DEFINE THE QUESTIONS

Long before you put a product on the market you need to ask and answer a number of questions. Some of these concern the market, others focus on your co-op and its ability to take on this new task. The right questions will help you assess the market in your community—and your ability to fulfill that market.

Here are some of the market questions you should consider researching (others may occur to you depending on your specific situation):

- What is your mission in offering this new product?
- What are your sales or profit goals?
- What is your target market? Is it stable, decreasing, or expanding?
- Do political, religious, or other socioeconomic factors make a difference in the sale of the product?
- Who are your competitors? How long have they been in the market? What do their customers think about them? Are they part of a national franchise?
- What distribution channels exist? Will you have to create new ones?

- Will sales of the product or service be seasonal or geographic? Will there be any other constraints on sales?
- How much will the product or service cost? Is it an ongoing market requiring special scheduling or a one-time sale?
- What customer service support is expected or required?
- What value can you provide that others cannot?

And here are some of the questions you need to weigh to assess your co-op's ability to meet the market's requirements:

- Does your co-op have an attitude of success?
- Is "selling" a familiar concept?
- Do you have a marketing department? Does it have the skills needed to promote the product?
- What's been your experience with ventures like this in the past, if any?
- Do you have staff on hand to manage this new venture?
- Do the board and management have a defined expectation of success?
- Do you have the resources available to implement the plan?
- To what degree is the co-op committed to the success of the project?
- Do you currently measure and reward success? If so, can this current process work with the new venture or are there compensation conflicts?

Answers to these questions will help you determine whether or not you have the right team to offer the right product to the right market.

STEP 2: GATHER INFORMATION

Much of the demographic information you need to get started is already available from a variety of secondary sources.

Secondary research can provide valuable information, but your market will most likely be just different enough to require primary research for the much more specific information you need. Professional market research groups rely on quantitative data from surveys and supplement those findings with qualitative research through focus groups to obtain balanced and product-specific consumer information.

STEP 3: ANSWER THE QUESTIONS YOU STARTED WITH

Finally, use the demographic, competitive, and sales data you've uncovered to answer the questions you developed at the beginning of the exercise. By now, you should have answers to most, if not all, of them. And you and your board should be ready to add this knowledge to the first "go" or "no-go" decision.

ADDITIONAL RESOURCES

1. Market research and strategy: "The 1-Day Marketing Plan," by R.G. Hiebing and S.W. Cooper (1992), NTC Business Books, Lincolnwood, Ill.
2. Hawkins, Del I.; Best, Roger J.; and Coney, Kenneth A. (2001) "Consumer Behavior, Building Marketing Strategy." New York, NY. Irwin/Mcgraw-Hill.
3. American Marketing Association Resources www.ama.org/resource
4. Cooperative Research Network manual: "Developing Superior Products and Services"

EXHIBIT 5A

PROCESS FLOW: MARKET ASSESSMENT

STEP	PROCESS	FLOW
1	Determine what questions need to be answered to make the "go or no go" decision.	QUESTIONS
2	Determine what information is needed to answer these questions.	INFORMATION
3	Determine the best sources of that information.	SOURCES
4	Conduct research through secondary sources.	RESEARCH
5	Compare findings to decision questions. Do results match?	? NO / YES
6	Identify target market.	ID MARKET
7	Develop quantitative survey instrument.	DEVELOP SURVEY
8	Conduct quantitative survey.	CONDUCT SURVEY
9	Compare findings to decision questions. Do results match?	? NO / YES
10	Identify target focus group.	ID FOCUS GROUP
11	Develop qualitative survey instrument.	DEVELOP SURVEY
12	Conduct qualitative survey.	CONDUCT SURVEY
13	Compare findings to decision questions. Do results match?	? NO
14	Review importance of decision questions and/or repeat research.	REVIEW

CASE STUDY

WHAT DO MEMBERS WANT (AND NEED)?

One of the first things the convergent business task force does is explore different business ideas. A staff member consults Power On-Line to compile a list of businesses other co-ops their size have entered and hands it out at the next meeting. The task force is surprised at how many co-ops are already involved in new products and services—and at the range of their offerings.

"I see there's a real trend toward offering Internet services," Two-County's manager says. "That might be good for our community. None of the AOLs of the world seem interested in our area. It is very expensive to connect, and we frequently have trouble getting online at home, and the speed and quality of the connection is poor."

Another task force member says better Internet service would be good for the schools. "If we can get all of our classrooms wired, our kids can get a better education," she says.

The staff member points out that many co-ops are offering stand-by generation. "That's an intriguing idea," he says. "Agricultural applications represent a significant portion of our load. Even short disruptions can cause problems with more sensitive applications."

"I'm in the poultry business myself," says one board member. "Our houses start to overheat quickly without ventilation. I can lose chickens as the result of even a short outage." Task force members identified several other businesses and even residential customers that also might be interested in stand-by generation.

Both businesses sound like good opportunities, but which one best fits Two-County's needs and abilities? "It's time to do a little research," Two-County's manager says. "What do we need to know to answer that question?" The task force makes a list:

- What are our goals in offering the product?
- Is there a need for the product?
- What is our target market? Who would use the product?
- Who are the competitors?
- How will we market the product?
- What customer support will we provide?
- What value can we provide?
- Do our members want us to provide the product?
- Will they pay for the service? How much?

The task force finds that much of the information is already available. It just takes time to compile it. They also conduct a survey of the co-op's members. This gives them a good picture, but they want to take one more step. They invite several groups of members representing different customer classes to participate in focus groups. They learn that members are very interested in stand-by generation but want to be sure it is safe. Some cannot afford to buy it outright but might be interested in leasing equipment. Others ask if they can use it to reduce their bills, not just for emergencies.

CASE STUDY

The task force is also hearing a lot about fuel cells and other types of distributed generation. Getting organized to provide stand-by generation would put them in a good position to offer other technologies as they become available.

What they discover about Internet service is not as straightforward. It is true none of the major national companies are marketing in the Two-County area, but there are several local companies that likely to oppose the co-op if it tries to compete with them. They also learn that Riverside Municipal Utilities recently started a new service they plan to offer in the Two-County area.

Also, the member survey shows that members trust the co-op to provide stand-by generation: they view it as another type of electric service, something the co-op is really good at providing. They have questions, however, about whether the co-op can provide Internet services effectively.

"I'm not so sure Internet is a good idea for us, anyway," the manager says. "We don't know anything about it. Maybe it makes more sense for other co-ops, but not us."

The task force prepares a recommendation for the board's Gate I deliberations. They recommend that the co-op continue with a Stage II evaluation of stand-by generation and leave Internet service to those better positioned to provide it.

CHAPTER

6

REGULATORY AND POLITICAL CONSIDERATIONS

Because co-ops are overseen by boards of member-elected directors who represent the interests of their customers, regulatory commissions in many states take a hands-off approach. That attitude, however, may not apply to a co-op's convergent business. Chapter 6 reviews some of the areas that may come under regulatory scrutiny in a co-op convergence campaign.

Regulatory and Political Considerations

CHECKING WITH YOUR STATEWIDE MANAGER

It is prudent to visit with your statewide manager to ensure that he or she knows about the business you are considering. Statewide managers are well-informed about the legislative, regulatory, and public perception of the co-ops in your state, and they have deep and broad relationships with key officials. They also are in a position to offer useful insight concerning these matters.

The bottom line is that a co-op's actions do not occur in a vaccuum. They can have political, business and regulatory impacts that go far beyond your service area. A good discussion with your statewide manager is one essential step in completing your due diligence—a step that is no less important than the financial, marketing or other aspects of a systematic analysis of the new business opportunity.

CHECKING THE REGS

Your cooperative's ability to enter into new convergent businesses may require the approval of state regulators. Obtaining such approval can be a complicated process, and you should check with your co-op's legal counsel early on in the planning process to anticipate how regulatory requirements might affect your efforts.

This chapter explores some of the ways regulatory bodies become involved in co-op convergence issues. The discussion will identify areas of state regulation that could affect a co-op's diversification decision and provide guidance on how regulation of co-op debt may shape that decision. Also keep in mind that provisions for your existing RUS debt may regulate your ability to enter a new business.

TYPES OF STATE REGULATION

Regulators may have jurisdiction over a number of co-op actions, including any of the following:

- Rates.
- Terms and conditions of service.
- Safety.
- Facility siting.
- Service territory.
- Financing.

In most cases, state regulation does not specifically address convergent activities, although regulators may keep close watch on the sharing of mailing lists, marketing materials, employees, and facilities. Regulatory jurisdiction over other areas of your co-op's operations, however, can obviously have an effect on such plans.

OBTAINING REGULATORY APPROVAL FOR CONVERGENT ACTIVITIES

One of the critical first steps you should take before considering a new enterprise is to determine whether you'll need the regulators' approval. If so, you should promptly factor the time and expense of the approval process into your budget planning.

Exhibit 6A, "State Regulation Survey," summarizes regulated co-op activities on a state-by-state basis as of November 2000. This survey provides a starting point for determining if approval is necessary for you to enter a new business.

A review of the survey with your system's legal counsel will be the first step toward determining whether you must get regulatory approval, the requirements of the approval process, and the time required to obtain it.

UTILITY CODES OF CONDUCT

Some states also have established Codes of Conduct—by statute, regulation, or both—governing the activities of utilities that branch into new lines of business. Designed to preserve and enhance competition among energy suppliers, these codes may cover everything from the use of customer information to staff, vehicles, and facilities. Again, your attorney should be asked to research this issue to see if your state has a utility code of conduct and whether its provisions apply to co-ops.

ADDITIONAL RESOURCES

1. NRECA's "Legal Reporting Service" www.nreca.org/publications/lrs.html
2. National Association of Regulatory Utility Commissioners Web site, with links to individual state commission sites www.naruc.org/stateweb.html
3. Electric Co-op Bar Association www.co-opbar.com

EXHIBIT 6A

STATE REGULATIONS SURVEY

	RATE REGULATED	IF YES	TERMS & CONDITIONS OF SERVICE	SAFETY	FACILITY SITING	TERRITORIAL ISSUES	FINANCING	OTHER	DID RESTRUCTURING CHANGE STATUS?
Alabama	N		N	N	N	N			
Alaska	O	F	Y	Y		Y			
Arizona	Y	F/S	Y	Y	Y	Y	Y	Y	Y
Arkansas	Y	F/S	Y	Y	Y	Y			Y
California	N		Y	Y	N	Y			Y
Colorado	O		N	N	Y/N	Y		Y	
Delaware	Y	F	Y	Y	Y	Y			N
Florida	N		N	Y	Y	Y			
Georgia	P		P	N	N	Y	Y		
Idaho	N		N	N	N	N			
Illinois	N		N	N	Y	Y			P
Indiana	O		O	O	N	Y			
Iowa	O		Y	Y	Y	Y			
Kansas	O	S	Y	Y	Y	Y			
Kentucky	Y	S	Y	Y	Y	Y			
Louisiana	Y	F	Y	N	N	Y			
Maine	Y	F	Y	Y		Y		Y	Y
Maryland	Y	F	Y	Y	Y	Y			Y
Michigan	Y	S	Y	Y	Y	Y			N
Minnesota	O		N	N	Y	Y		Y	
Mississippi	N		Y	Y	Y	Y			
Missouri	N		N	Y	N	Y			
Montana	N		N	N	N	Y			Y
Nebraska	N		N	N	Y	Y	N		
Nevada	N		N	N	N	Y		Y	N
New Hampshire	P		N	N	Y	Y	N		N
New Jersey	N		N	N	Y	Y			P
New Mexico	Y	S	Y	N	Y	Y	Y	Y	N
New York	Y	F	Y	Y	N	N			N
North Carolina	N		Y	N	N	Y			
North Dakota	N		N	N	Y	Y			
Ohio	N		N	N	Y	Y		Y	N
Oklahoma	O	S	Y	N	N	Y			P
Oregon	N		N	Y	Y	Y			N
Pennsylvania	N		N	N	N	Y			N
South Carolina	N		N	N	N	Y			
South Dakota	N		N	Y	Y	Y		Y	
Tennessee	N		N	N	N	N			
Texas	N		N	N	Y	Y			Y
Utah	N		Y		Y	Y			
Vermont	Y	F	Y	Y	Y	Y	Y		N
Virginia	P	S				Y			N
Washington	N		N	N	N	Y			
West Virginia	Y	S	Y	Y	Y	Y			
Wisconsin	N		N		P	Y		Y	
Wyoming	Y	F	Y	Y	Y	Y	Y	Y	

LEGEND: "Y"=Yes, "N"=No, "O"=Optional, "P"=Partial, "F"=Full, "S"=Streamlined
"Optional" means co-op has the right under state law to opt into or out of state regulation.
"Partial" means the state has some oversight authority over co-op rates, but not the specific ability to set rates.

CASE STUDY

THE REGULATORS ARE COMING

While the convergent business task force is exploring which business to enter, Two-County's attorney is addressing the legal issues. First, she conducts a careful review to be sure the state's enabling laws, and the co-ops' articles of incorporation and bylaws, allow it to enter a new business. Fortunately, she uncovers no problems.

The task force and attorney request a meeting with the manager of their statewide association to get his insight into regulatory issues. The state public service commission does not regulate the co-op's rates or financing, but it does have jurisdiction over terms and conditions of service and safety.

"If you go with stand-by generation, safety is likely to be a big concern," the statewide manager tells them. "There have been several accidents in the last few years, and local governments are enforcing building and electrical codes very strictly."

He suggests they meet early on with the commission staff and local building inspectors to keep them informed about what the co-op wants to do and to be sure they understand what regulations will apply to the installation and servicing of the units. At a minimum, there are requirements that installations be performed by licensed electrical contractors and meet national electrical codes. He suggests they contact Federated Rural Electric Insurance Exchange to get more information about safety issues and how to protect themselves against those types of risk.

"You also need to think about interconnection issues," the statewide manager says. If the units will only operate during an outage, a "break before make" transfer switch will probably be sufficient. If the units will operate in parallel with the co-op's electrical system, they will need an interconnection agreement with customers, even though the co-op is selling and servicing the unit.

"Depending on what size generator you offer and why type of fuel it runs on, you may also have to meet environmental requirements," he tells them.

The attorney then consults NRECA's Legal Reporting Service. She finds extensive resources covering regulatory law, safety, restructuring activities, tax and accounting issues, and environmental concerns. The information on distributed generation is particularly useful.

A review of the co-op's RUS loan contract does not turn up any impediments as long as the investment in the convergent business does not adversely affect the co-op's financial coverage ratios and complies with the 15-percent investment guidelines. Nevertheless, Two-County's manager arranges for the task force meet with their regional director's staff to keep RUS informed about their plans.

By the time the task force is ready to present the results of its market research, the legal team has compiled a complete list of legal and regulatory issues and strategies for meeting these requirements.

CASE STUDY

At Gate I, the board votes to proceed with a Stage II evaluation of stand-by generation services. The board also authorizes management to engage additional consultants to assist them. While the executive team has very strong capabilities, the board believes it is important to supplement their group with people experienced in the business issues associated with the new venture. The convergent business team task force engages Diversified Business Consultants, a company that has experience in startup business and cooperatives, to assist them in their continuing activities. The directors are looking forward to seeing the results of the Stage II analysis.

CHAPTER 7

CORPORATE STRUCTURES

A range of corporate structures is available for co-ops ready to move into a convergent venture. From subsidiaries operated on co-op principles to sole proprietorships, from S Corporations to Limited Liability Companies, each offers a different set of advantages. Chapter 7 provides an overview of the options.

Corporate Structures

A WEALTH OF ORGANIZATIONAL OPTIONS

From subsidiaries operated on co-op principles to general partnerships to limited liability companies, your co-op has a wide range of corporate structures to choose from when setting up a new business. Each form of organization has its own set of benefits, but, naturally, each also comes with some downsides. You may, for example, arrange to have greater control over the new operation—but that control may come at the expense of a higher tax liability.

This chapter reviews some of the organizational options you have when starting a new business, outlines some of the things you should consider in choosing one of those options, and takes a look at how a non-cooperative form of business works within your co-op's existing corporate culture.

One additional note: Since the choice of corporate structure can have such wide-ranging impacts—on your co-op's tax-exempt status, for example, or its ability to meet your lender's financial requirements—you should have your system's accountant or auditing firm as well as its lawyer on hand when considering this question. Sound accounting and legal advice will help you make the right decisions about organizing your convergent business initiative.

TYPES OF CORPORATE STRUCTURES

The choice of corporate organization for your new business venture depends on your system's operational status, financial and tax considerations, legal situation, and financing arrangements, among other factors. The most commonly used structures are:

- Cooperatives. Already familiar to the co-op, this business form also can offer competitive marketing advantages and tax exemptions to convergent businesses.
- General partnerships. Although management control is clear—it rests with a majority of partners—members of these ventures also have full liability for the venture's debts.
- Limited partnerships. Control is extremely limited in this kind of partnership, but liability is also limited.
- Sole proprietorships. Exclusive ownership of the venture provides the co-op with full management control—along with liability for all debts and the need to provide full security for any financing.
- C corporations. Corporation investors elect directors, who in turn hire managers. Liability is limited to the amount of investment, and investors pay taxes only on their dividends.
- S corporations. Restrictions on the number of owners makes raising capital more complicated for S corporations, but tax and debt liabilities are low.
- Limited liability companies. LLCs are becoming the most popular form for co-ops undertaking convergent business ventures, largely because of restrictions on partners' liabilities for the new venture's debt. Control is somewhat limited, however, as partners elect a managing member.
- T cooperatives. Taxable corporations operating on a cooperative basis, this business form offers significant marketing and tax advantages.

Exhibit 7A, "Forms of Business Entities," summarizes the main features of each of these types of organizations in a table format for comparison.

Most states govern the formation of these businesses through state laws, uniform acts, accounting rules, and other regulations. As a result, you and your co-op's lawyer should consider the impacts of your state's laws and regulations as well as these organizational characteristics before deciding on a corporate structure for your new business.

CHOOSING A CORPORATE STRUCTURE

One of the most important factors to consider when choosing a corporate structure is the liability your co-op and its members will face for losses incurred by the convergent business. Some structures offer more protection from liability than others, but that protection may be offset by still other considerations, such as limits on the types of activities in which the new entity can become involved.

You should also weigh the level of control you'll have over the new entity, and the ease with which that control may be exercised.

Financial considerations also play a significant role in determining your choice of corporate structure. The decision could affect your co-op's tax-exempt status as well as its covenants and obligations under various financing documents—such as financial ratios or limits on investments or non-member income. This is an area where careful consultation with your accountant is crucial.

Legal issues may also arise in connection with your choice of corporate structure, so you should consult with your co-op attorney before settling on a structure for your new business.

THE NON-COOPERATIVE BUSINESS IN A CO-OP SETTING

Many cooperatives choose to diversify their offerings by partnering with a for-profit business, often in the form of a limited liability company. Usually, this means the co-op shares ownership in, control of, and distributions from the convergent business venture engaged in by the LLC.

As a partner in such a venture, you would be able hold and operate your share of the LLC's business on a co-op basis, regardless of how the other participant is structured. Conducting a convergent business in this manner, however, can be complex, and you'll want to get expert legal, financial, and organizational advice before setting up an LLC.

ADDITIONAL RESOURCES

1. "Which Legal Form Is Best for You?" www.businessweek.findlaw.com/book/
2. University of Wisconsin Center for Cooperatives www.wisc.edu/awcc
3. Cooperative Research Network manual: "Developing Superior Products and Services"

EXHIBIT 7A

FORMS OF BUSINESS ENTITIES

	COOPERATIVE	GENERAL PARTNERSHIP	LIMITED PARTNERSHIP
Number and types of owners	Need at least two members	Need at least two owners	Need at least two owners with at least one general partner
Management control	Members elect board of directors which appoints management. One member, one vote	Management by majority rule	No management participation. Except in rare circumstances (i.e. selling all assets/merger)
Owners/liability	Liability limited to amount of investment	Unlimited liability for each partner for all partnership debts	Liability limited to investments (if possible)
Transferability of ownership	Membership interest is usually retired, not transferred	Restrictions imposed by partnership agreement—right of first refusal usually in effect	Restrictions imposed by partnership agreement —right of first refusal usually in effect
Continuation of life	Usually have perpetual life so long as serving common mission	May be dissolved by death or withdrawal of general partner	May be dissolved by death or withdrawal of last general partner; Limited Partner death or withdrawal has no impact
Tax implications	Taxable or tax-exempt [CFC borrowers generally 501(c)12 tax exempt]. If tax-exempt, 85% of income must be related business	Each partner pays taxes on own share of income (flow-through tax)	Each partner pays taxes on own share of income (flow-through tax)
Ease of raising capital	Outside equity raising is generally not feasible	Usually must rely on partner equity contributions	Usually must rely on partner equity contributions
Unique lender implications	Lenders don't have any practical recourse to members or credit support	Must know each general partner's participation since they can all bind partnership. Strong tax pressure to free partnership dividends	Lenders should look to limited partners for credit support. Strong tax pressure to free partnership dividends

SOLE PROPRIETORSHIP	C CORPORATION	S CORPORATION	LIMITED LIABILITY COMPANY	T COOPERATIVE
One—Individual	No restrictions on number of owners and types of stock	One to 75 owners; must be individuals & US citizens; only one class of stock; can't own subsidiaries	Many states require at least two members	Need at least two members
Owner has total control	Shareholders elect board of directors which appoints management	Shareholders elect board of directors which appoints management	Usually, members elect managing members or board of directors	Members elect board of directors which appoints CEO; CEO runs business
Unlimited personal liability for owner	Liability limited to amount of investment	Liability limited to amount of investment	Liability limited to amount of investment	Liability limited to amount of investment
No restrictions	Usually no restrictions	Restrictions by shareholders' agreement, if any	Usually, need (near) unanimous consent of other members. Difference between economic & equity interests	Membership interest is usually retired, not transferred
Until death of proprietor or otherwise dissolved	Perpetual	Perpetual unless fail to meet S-Corp requirements	Usually have finite life (often 30 to 50 years)	Usually have perpetual life so long as serving common mission
Owner pays taxes at individual rate on business net income	Taxes paid at corporate rate; owners pay taxes on dividends; corporate losses may be carried forward	Each shareholder pays taxes on own share of income (flow-through tax)	Usually, each LLC member pays taxes on own share of income (flow-through tax)	For-profit entity; however, distributions are deducted before calculation of net income
Lender will look to owner's personal assets; outside equity raising isn't possible	Substantial flexibility—public & private debt; equity; commercial paper	Equity raising is complicated by limitations on types/numbers of shareholders	Equity raising often limited by lack of free transferability of interests	Substantial flexibility—public & private debt; and usually (depending on state law) preferred stock
Limited diversity of collateral & sources of repayment	Recovery limited to corporate assets	Lenders must actively monitor ownership for tax compliance. Strong tax pressure to free partnership dividends	Lenders should be aware of limited life. Should get economic & equity interest. Strong tax pressure to free LLC dividends	Lenders must look at current and projected income. Shorter-term loans may apply

CASE STUDY

CHOOSING THE RIGHT CORPORATE STRUCTURE

The convergent business task force initially assumes the convergent business will function as a division of the existing cooperative. “That may not be the best way to operate the new business,” the co-op’s attorney tells them. She suggests they evaluate alternative corporate structures as a part of Stage II and make a recommendation for the board’s consideration at Gate II.

Organizing the new business as a separate division has appeal because it allows the board to exercise extensive control. It also allows the co-op’s members to benefit directly from cost sharing and other efficiencies. But the attorney points out there are also advantages to a separate corporation. She suggests the team compare alternate corporate structures in light of the co-op’s convergence goals:

- Strengthening consumer loyalty to Two-County.
- Contributing to the economic and social well-being of the community.
- Limiting financial risk and tax-exposure.
- Maintaining a comfortable level of control.

“You may also want to partner with another organization to share the costs and risks of the new venture along with the benefits,” she says.

The other cooperatives in the state face the same competitive issues as Two-County. It makes sense to the task force to explore the partnership potential with its neighbors. While a partnership makes the planning process more complex, it also makes more resources available, a factor that could help the new business succeed. The task force consults the Power On-Line database and finds three other co-ops in the state that are interested in stand-by generation. Two-County offers to share the results of its Stage I analysis with any interested co-op.

It turns out that Twin Rivers Electric Cooperative has been quietly doing some analysis of its own. The two co-ops discover they have similar visions and similar goals for a convergent business. They agree to join forces—a move that further expands the corporate structure options. Representatives from Twin Rivers’ board and staff join the task force and go to work.

The co-ops’ attorneys and accountants meet with the task force to help them analyze the implications of alternative corporate structures. They make a list:

CORPORATE STRUCTURE	PLUSES	MINUSES
Cooperative	Marketing advantage	Tax implications; hard to raise equity
General partnership	Clear management control	Full liability for debt
Limited partnership	Limited liability	Limited control
Sole proprietorship	Full management control	Full liability for debt; full security for financing

CASE STUDY

CORPORATE STRUCTURE	PLUSES	MINUSES
C corporation	Limited liability; investors taxed only on dividends	Less control
S corporation	Low tax, debt liabilities	Raising capital complicated
Limited liability company	Restricted liability	Limited control
T cooperative	Marketing advantages; tax deduction for patronage distribution	Hard to raise common equity

"I see that there can be advantages to a different type of corporate structure," Twin Rivers' board president says, "but it is very important to us that we support and adhere to cooperative principles. I'm not sure we would be comfortable with some of these options." Two-County's president agrees.

"Our research shows that a cooperative structure would be a real asset in marketing," Two-County's manager adds. "The good-will consumers already have toward Two-County and Twin Rivers can help us build loyalty to a new co-op."

The task force attorney suggests organizing the new corporation as a taxable cooperative under Subchapter T of the Internal Revenue Code. "This offers several key advantages," she says. "Taxable cooperatives can deal with non-members on a for-profit basis. That gives the convergent business more flexibility and greater ability to market products and services to non-members."

Some task force members express concerns about the potential tax liabilities of a taxable cooperative, but the co-ops' accountants assure them the business can be operated in a way that limits taxes. There is also some concern about the ability of the boards to exercise control over the new cooperative. That problem can be solved through a management agreement between the partners and the new system, United Services Cooperative, the attorney assures them.

The task force ends the session confident that a taxable cooperative will satisfy their key goals. They also are confident it will help them demonstrate financial strength and viability to their lenders. They look forward to discussing their recommendations at Gate II.

CHAPTER 8

ALLIANCE ALTERNATIVES

You may not have to go it alone to obtain the advantages of a convergent business. Other electric co-ops, telephone or agricultural cooperatives, and existing private companies may welcome your participation in bringing a valuable new product or service to your community. But there are important considerations to be weighed before taking on an ally, and Chapter 8 takes a look at them.

Alliance Alternatives

FINDING A PARTNER

It's not always necessary to go it alone when your co-op enters a new business. In fact, it may make more sense to form an alliance or partnership with an organization already operating in the business you're considering. An alliance with an existing company can reduce the time, cost, and additional staff needed to get into the new business. This chapter is devoted to factors to consider when screening potential partners to ensure that the partnership succeeds.

Alliances and partnerships generally fall into one of two categories: affinity relationships and third-party vendor, servicer, or outsourcing partner. In an affinity relationship, the co-op lends its brand and customer goodwill to the marketing of the partner's product or service in exchange for a portion of the sales revenue. Under third-party arrangements, the co-op basically retails the partner's product or service to its members.

A related but slightly different type of partnership is the joint venture, in which a co-op works with an existing company or organization—often another cooperative, like an agricultural service or telephone co-op—to offer a product or service. The two organizations split both the costs and the revenues of the venture. Both benefit by sharing in the risks—and the rewards—of the new business initiative.

PROS AND CONS

Like any other business strategy, alliances have their pluses—and their minuses. Partnering with an existing business offers a range of strong advantages:

- It's a good way to utilize expertise that you don't currently possess.
- It can be a quick and inexpensive way to enter a new business line or offer a new product.
- It complements your co-op's strengths with those of the partner.
- It offers an alternative to increasing staff size.

At the same time, you should consider the potential drawbacks of partnering with another organization:

- You don't run the show by yourself.
- Your partner's limitations become yours.
- Just like you have other business interests, your partner may have other business interests that at times take precedence.
- If your partner makes a mistake, the customer will see the mistake as yours.
- The values and culture of a partner may be very different and inconsistent with the cooperative principles.

THE FIRST FILTER

Once you've selected a business to enter and have found a potential partner to smooth your entry into it, you should consider the fundamental question of corporate compatibility. Size and market position won't mean a thing if your two organizations can't get along. Do both share the same level of commitment to the project? Are communications between organizations easy, responsive, and substantive? Do your two organizations have complementary cultures? If you can't honestly answer yes to these threshold questions, you should consider another partner for a successful alliance.

AN ALLIANCE CHECKLIST

Entering a business alliance merits careful consideration. Your co-op's reputation and relationship with its members will be on the line in every transaction between your partner and your customers. This list of questions and points to consider will help organize your alliance strategy:

1. Remember your original objectives for getting into this new line of business. Can you meet those objectives through a partnership?
2. Is another organization already in your target business? If so, can you succeed as a competitor, or would your chances be better if you partner with that organization?
3. Do you have the in-house expertise to operate this business, or would an alliance with an existing company in the same business make better use of both your staffs?
4. Give due consideration to the strengths your co-op brings to the proposal. You have an existing base of customers with whom you have a close relationship and regular contact through newsletters, bill inserts, and annual meetings. You also have strong name recognition and brand identity. These are powerful assets.
5. Do your due diligence. You should meet with the principal officers and managers of your potential partner, obtain financial reviews, and talk to current customers. You should also pay a visit to the company, looking particularly at departments that will be handling your business. And, if possible, you should sit in on some of its customer calls.
6. Consider how what you've learned about the potential partner will reflect on your co-op. Co-ops maintain very high service levels, and your potential ally may not live up to your standards. Find out what the company's service standards are—and whether it actually achieves them.
7. Walk through the potential partner's procedures for handling customer complaints. Customers will generally understand that everyone makes mistakes, but they want to know that their complaints will be handled quickly and correctly. Remember, when your partner makes a mistake, your customers will blame you.
8. Strengthen your own position. Potential partners will be more interested if you can offer them more sales, so consider working with other co-ops that may be interested in getting into the same business. You'll have a stronger bargaining position if you bring a bigger potential market to the table.

9. If you're still satisfied at this stage that you've got a sound business prospect, develop a Request for Proposals. This RFP should identify the business you're considering and the direction you want to take with a partner, specify your expectations of that partner, and declare how you want to structure the deal.
10. Maintain your own freedom of movement. Make sure any agreements allow you to retain ownership of your brand when it's used in the alliance. That way, if problems develop later, you can enter the business on your own or find a new partner when the contract expires.
11. Establish reporting procedures. State what information you will want and how often you'll want it, remembering to specify reports to verify any revenues you may be due. Prepare sample reports to reduce the possibility of questions arising later.
12. Weigh the "what ifs." Walk through some likely—and even not so likely—business scenarios with your potential ally's management and your co-op's legal counsel. And make sure you're comfortable with what the arrangement requires of you.
13. Make clear how payments will be handled. Will you be paying the partner as a third-party vendor, or will the partner pay you under an affinity relationship?
14. Put everything down in black and white. Get written agreements stating what you expect from the partner, and have your legal counsel review the documents.

THE PROCESS

Exhibit 8A, "Process Flow: Alliance Alternatives," offers a step-by-step outline of the process of considering and choosing a partner for your new business.

The heart of the process is the Request for Proposals, issued once you've determined that potential partners could help you enter your new business. Responses to the RFP are likely to trigger a new round of analysis and additional clarification.

After analyzing the responses, determine which organizations are still potential partners and conduct a due diligence review of them. This should include both a financial review of the potential partner and a site visit to the organization's operations. And good potential partners will likely want to perform their own due diligence on your organization.

After conducting your due diligence you will either find that there is not a partner you feel comfortable with or you will select a partner and begin contract negotiations.

ADDITIONAL RESOURCES

Alliance resources examples by line of business include:
1. Energy diversification—Energy Co-Opportunity www.e-coop.org

EXHIBIT 8A

PROCESS FLOW: RESEARCHING AN ALTERNATIVE

STEP	PROCESS	FLOW
1	Identify potential partners who are already successfully in the business.	ID PARTNERS
2	Prepare a Request for Proposals.	PREPARE RFP
3	Send the RFP to some or all potential partners identified in Step 1.	DISTRIBUTE RFP
4	Review their responses. Have more than one person do the reviews to obtain different points of view.	REVIEW
5	Request clarification or additional information as needed.	CLARIFICATION
6	Do the potential revenues, costs, and savings revealed in the proposals demonstrate that an alliance remains the right way to enter the new business? If not, look for other avenues.	? NO: SEEK OTHER AVENUES; YES
7	If the RFP responses show a likelihood of success, compare the proposals and choose those that have the greatest potential.	COMPARE
8	Conduct due diligence on the entities you feel are potential partners, including site visits.	DUE DILIGENCE
9	Do you feel comfortable with any of the potential partners? If not, widen the search or find another way to enter the business.	? NO: WIDEN SEARCH; YES
10	Select partner and begin contract negotiations.	NEGOTIATIONS

CASE STUDY

LOOKING FOR ALLIES IN ALL THE RIGHT PLACES

Two-County and Twin Rivers find they are very comfortable with each other as partners. They share a common corporate culture and commitment to the project. Communications are flowing smoothly, and the staffs of the two co-ops are working effectively together. They have confidence a joint venture will work well for them.

However, neither organization manufactures stand-by generation. While the co-op staffs have substantial power distribution knowledge and ability, their experience stops at the meter. They are not licensed electricians, who will be needed to perform the installations. The task force wonders if alliances with organizations that have these skills would make sense. “It would make it easier for us to get into business,” one task force member says. “On the other hand, we don’t know if somebody else would have our same commitment to member service.”

Their adviser from Diversified Business Consultants suggests they look at two possibilities: an alliance with a manufacturer of stand-by generating equipment and an alliance with an electrical contractor. “Some co-ops have developed affinity relationships with suppliers,” she says. “They allow another company to use the co-op name to market products and services. In return, they share in the sales revenue.”

“I certainly wouldn’t be comfortable with that,” Two-County’s manager says. “It sounds like we wouldn’t have any control. If they don’t do a good job, our members will blame us. Besides, we aren’t getting in this just to earn revenues.”

Their adviser agrees it could be a problem. “You might be more comfortable with a third-party arrangement that allows you to market the vendor’s products yourself,” she says.

The task force agrees this is a better approach for Two-County and Twin Rivers and issues a request for proposals (RFP) for vendors of stand-by generating equipment interested in working with the new co-op. They receive more than half a dozen responses. After a thorough review of the replies, the task force narrows the choice down to three companies. The task force compiles a list of key questions to guide the due diligence process of evaluating these companies as potential partners:

- Is the company in sound financial condition?
- Are we comfortable with its management and staff? Is its corporate culture compatible with ours?
- What are its service standards? Does it achieve them?
- How do they handle customer complaints?

The task force pays a visit to each vendor’s office and meets with the people who would handle the co-op’s business.

They are surprised to find that one vendor requests a meeting with them. “I understand your need to evaluate my company as a potential partner,” the vendor’s CEO says, “so I’m sure you will understand that we would like to evaluate you.”

After all this work, the task force concludes that Agri-Generating Inc. provides the best fit. They begin the task of establishing in complete written detail how the two companies can work effectively as partners. They also turn their attention to the potential for an alliance with an electrical contractor to perform installation and maintenance.

THE ACQUISITION DECISION: STARTUP VS. PURCHASE

CHAPTER

9

Starting your own company as a vehicle for your convergent business gives you greater control over the operation. Buying an existing operation is likely to bring a stronger revenue stream more quickly. Which way to go? Chapter 9 offers some guidelines for making the decision.

The Acquisition Decision: Startup vs. Purchase

STARTING FRESH—OR STARTING FAST

Some convergent business opportunities may require your co-op to launch the new enterprise from scratch, because no such organization exists locally and a suitable ally or partner cannot be found. Other situations may allow you to accelerate your co-op's entry into the new field by buying an existing business.

This chapter offers some help in considering this basic question. It outlines a framework for evaluating the relative pros and cons of a startup vs. a purchase and offers some resources for setting a price—from the purchaser's perspective—on an established business.

PROS AND CONS, IN GENERAL

Exhibit 9A, "Startup vs. Purchase: A Comparison," summarizes the typical reasons for and against developing a new business in-house or buying one from its present owners. These and a range of situation-specific pros and cons should be weighed carefully in making the startup vs. purchase decision.

The advantages of a startup often include greater flexibility, such as more control over the business development process—especially over costs. An in-house launch also makes it easier for you to tie the new operation's brand name recognition to that of your co-op and to cultivate the co-op's community service focus among the new business's employees.

The purchase option, however, offers advantages of its own. By buying an existing company, for instance, you can obtain instant expertise in the new business—including accounting and other management systems. In addition, an existing company has a track record of sales volume, cash flow, and vendor relationships that can help clarify its value. And purchased organizations may yield valuable sales and operating skills from the for-profit business world.

Both options, of course, have their disadvantages as well—and it's important to map out strategies for minimizing them.

The startup's need to recruit staff or develop in-house skills, for instance, can be met by hiring from similar local companies or by training new employees. Thorough research and planning can reduce the uncertainties of sales, cash flow, and key business relationships. Tailoring your training and compensation programs to the needs of your startup can go a long way to developing the right corporate culture in the new business (see Chapter 10).

Likewise, one of the leading risks associated with purchasing a business—committing a major investment at the time of purchase, before you know whether you've paid too much—can be controlled by meticulous research and planning. Careful management of the two organizations' brand identities can reduce or eliminate customer confusion arising from the differing names of the co-op and the business it buys. And another potential downside of purchasing an existing business—resistance of its current employees to your co-op's community service mission—can be minimized by incorporating co-op values into the purchased company's performance evaluation and compensation programs.

FINDING THE RIGHT PRICE

When a business is sold, both the buyer and the seller usually seek formal valuations. Your co-op may be able to perform such a valuation, but the process is more likely to require skills available only from an external source such as your system's public accounting firm.

The highest price you should pay is the lowest of three different ways of setting it:

1. The amount repayable from a 10-year financial forecast. This approach looks at ROR, ROE, TIRN and MDSC.
2. What this business is worth today based on professional appraisals.
3. The FuBTDA value of comparable businesses.

Valuation methods are usually classified into three groups:

1. Discounted cash flow: "Worst case" and "most likely case" cash flow forecasts are used to determine how much the business will be able to repay from operations. The forecasts should reflect conservative estimates of sales volume in competitive markets, debt service requirements, and the costs of reorganizing the business under co-op ownership.
2. Comparable transactions: Business brokers specializing in the purchased company's industry can provide statistics such as ratio of sales price to customer, unit sold, or operating cash flow based on recent similar deals. In addition, a payment can be included for owners' good will.
3. Net asset valuation: This method estimates the replacement cost, less depreciation, of the assets of the business being valued. These assets include "brand equity"—the value assigned to positive customer recognition of the company's name. Estimates of brand equity are often indirect, relying on discounted cash flow and comparable transaction data.

Goodwill may also become a bargaining chip in your negotiations with a seller. The company's existing relationships with customers and vendors, its name recognition, intellectual property, future business potential, and other aspects of goodwill are legitimate—but intangible—assets that you should approach with great caution.

ESTIMATING STARTUP REQUIREMENTS

Estimating the costs of a business startup should be included when doing any financial forecasting (see Chapter 13). Those costs come in three groups:

- One-time research, licensing, training, consulting, and other "soft" expenses.
- Equipment, real estate, and other long-lived assets.
- Operating expenses during the pre-breakeven period.

Other chapters in this manual cover aspects of these costs.

ADDITIONAL RESOURCES

Business valuation Web sites:

1. USBX Listing Exchange www.usbx.com/articles/val methodology.asp
2. DePaul University www.depaul.edu/~dshannon/Bvsites.htm

Startup business Web sites:

1. The Wall Street Journal Center for Entrepreneurs www.startupjournal.com
2. How To Start Up Any Business www.howtoadvice.com/BusinessStartup
3. Northeast Texas Community College www.bizcoach.org/start.htm
4. Palo Alto Software www.bplans.com

STARTUP VS. PURCHASE: A COMPARISON

EXHIBIT 9A

STARTUPS	PURCHASES
PROS	
Stage-gate options, investment risk control.	Access to business expertise.
Facilitated brand consistency.	Predictable sales, cash flow, etc.
Easier to align staff with co-op mission.	Acquire new culture.
CONS	
Need to recruit business expertise. (Through job content analysis and qualifications testing.)	Limited stage-gate optionality; up-front investment risk. (Mitigated by due diligence.)
Uncertainties in sales volume, cash flow, etc. (Mitigated by thorough planning.)	Customer brand confusion as acquired name differs from co-op. (Requires execution of brand merger plan.)
More difficult to cultivate appropriate corporate culture. (Consciously develop the right culture.)	Negotiation against superior knowledge of business. (Negotiate relative to startup or other alternatives.)
Management systems developed without certainty of critical success factors. (Mitigated by thorough planning.)	For-profit resistance to community service mission. (Can be mitigated by incorporating community service into performance evaluation and pay.)

CASE STUDY

TO BUY OR NOT TO BUY

Early on, the convergent business task force recognizes that the new business will need licensed electricians to install and maintain the stand-by generators. United Services Cooperative can hire staff directly, but the task force is also considering a partnership with an existing company. While they are debating the pros and cons of each approach, the task force leader gets an interesting call.

"I hear you folks may be getting into stand-by generation," the caller says. "I'm the owner of M&P Electric. After 35 years in the business, I'm ready to retire. Would you be interested in buying my company?"

The idea intrigues the task force. "I've known M&P for a long time," Twin Rivers' president says. "They run a good shop. And they have experience in stand-by generation." On the other hand, M&P offers services in addition to those needed for stand-by generation. Could United Services Cooperative fully utilize the expertise being offered?

"Did he say how much he wants for the business?" another task force member asks. "How do we know what it's worth?"

The task force realizes that evaluating this new opportunity is a formidable task, but a successful purchase could be the most advantageous way to gain instant expertise.

Their Diversified Business adviser suggests they ask the co-ops' accounting firms to help evaluate M&P's worth. "There are three basic ways to value the business: discounted cash flow, comparable transactions, and net asset evaluation," she says. The discounted cash flow method estimates how much the business will be able to repay for operations. The comparable transactions method looks at the parameters of similar deals. Net asset evaluation estimates the replacement cost of the assets of the business being valued.

"You should take a look at all three," the adviser suggests, "but you also need to have an idea of the highest price you are willing to pay." First of all, she says, never pay more than the least amount the seller is willing to sell for. She advises them to consider the amount of the investment that can be recovered from cash flow and the amount the co-op is willing to lose.

Then the task force can compare the cost of an acquisition against the cost of a startup and the cost of partnering with an electrical contractor.

When all the numbers are in, the task force sees that creating a business unit to perform the needed electrical services is more costly than either of the other options. While a partnership might be slightly less expensive in the short term, the task force finds benefits of having the expertise in-house to be very attractive. "Having an experienced staff positions us to take advantage of future opportunities without having to renegotiate our arrangement or look for a new partner," one member says.

The task force opens negotiations for the purchase of M&P Electric.

CHAPTER

10

THE CORPORATE CULTURE

"The way things get done" is likely to be different for your convergent business venture than it has been in the electric utility environment, and management must set the new tone for the integrated organization. Chapter 10 raises some of the cultural questions ahead, and offers some tips to answer them.

The Corporate Culture

CULTURING A CONVERGENT SUCCESS

Building on decades of successful operation, co-ops have developed their own unique corporate culture—a culture that has proven itself time and again in a variety of demanding environments.

But its focus on providing an essential service to customers in a monopoly situation offers little experience in the competitive arena—and that's a defining feature of the marketplace you're likely to face when your system moves into a convergent business. As a result, the business culture of your new operation will have to be different, too.

This chapter explores the importance of nurturing a corporate culture in your new business that fits the demands of that business—from developing a strong sales and marketing orientation to confronting aggressive competition for customers. It also offers some guidelines and tools designed to help co-op managers determine and meet the cultural needs of the new business.

CONSIDERING CULTURE

Corporate culture can be summed up in one simple statement: It's "how things get done" in an organization. The importance of that orientation, that corporate culture, can be demonstrated by considering the differences between the way a stable, well run electric cooperative functions and how things get done in another line of business.

An established electric co-op typically has clear missions and goals, and precise processes backed up by policy and procedure. Co-op employees consistently work to complete tasks in an integrated and coordinated manner. All of this reflects the technical nature and usually secure business position of a co-op utility.

Contrast this with operations in a more competitive business environment. Organizations in such industries must have a strong external, sales-oriented focus with heavy marketing support. Flexibility and adaptability become more important than stable, orderly processes, because the entry of new competitors or sudden changes in pricing are likely to require sudden shifts in direction in order to stay viable.

The point is that different elements and attributes—a different corporate culture—may well be required in your convergent business for the new business to succeed. The traditional co-op corporate culture will not necessarily support the business model or strategy of your new venture.

Like nature, organizations abhor a vacuum. In the absence of the right culture, something will move in to fill the void—and that something is likely to be the prevailing co-op corporate culture. Management's task is to make sure the culture that develops within the new operation fits its requirements for success.

MAKING THE MATCH

Before you plot a strategy for nurturing the right corporate culture, you must answer two basic questions:

1. Should the new venture's focus be primarily market- and customer-based—an external orientation—or should it emphasize systems and infrastructure—a more internal focus—to achieve the necessary results?
2. Does accomplishment of these goals require a flexible organization, strong on adaptation and employee empowerment, or a more stable one?

After you've matched your cultural requirements to the strategy and goals of your convergent business, the attributes must be seen as "how things get done" in the new operation.

And top management must lead by example in setting the tone. If your new venture has a strong external focus, emphasizing flexibility and customer service, everyone must be seen as ready to set aside other tasks to meet a customer's needs whenever they arise.

STRUCTURE THAT FITS STRATEGY

Business school textbooks teach that structure follows strategy. That's especially good advice when you're developing the organizational structure of your new convergent business, for reasons pertaining to both corporate culture and profitability.

From a profitability standpoint, you'll want to keep your new organization as lean as possible, simply to keep costs down and the product or service competitive. That goal, fortunately, meshes with efforts to develop a competitive, flexible corporate culture.

Here are a few guidelines that can help you meet both objectives:

- When staffing the venture, make sure the job functions support the business goals of the new business. Keep the organization lean, outsourcing tasks where possible to avoid saddling it with high overhead that will eat into its competitiveness. Also, keep its structure flat, so decision-making responsibilities rest with those closest to the customer.
- Develop wage and benefit packages independently from those of your core business—again to keep costs and overhead down. Consider incentive compensation plans, too, with part of some employees' pay pegged to performance on sales or service targets. In some cases, you can improve the new operation's prospects by even allowing key staff to take a minority ownership position, giving them a stronger stake in the venture's success.
- Implementation of separate compensation packages must be managed very carefully to prevent staff divisions between the two organizations—divisions that can crimp some of the business synergies you might have expected from the convergence initiative.

- Hire the right people, with the right skills, for key posts in your new operation. If you're acquiring an existing company, consider retaining key staff—but get agreements with them not to compete within your new market for a set period if they should choose to leave.

ADDITIONAL RESOURCES

1. Denison model Web site at www.denisonculture.com
2. The Human Resources Community at www.cooperative.com
3. Aligning Organizational Strategy and Structure through the Balanced Scorecard Collaborative at www.bscol.com and at www.balancedscorecard.com
4. "The Discipline of Market Leaders," by M. Treacy and F. Wiersema (1995), Addison-Wesley Publishing Co., Reading, Mass.

CASE STUDY

GROWING THE CORPORATE CULTURE

The convergent business task force has developed what it believes will be a workable framework for United Services Cooperative. The business will be organized as a Subchapter T taxable cooperative whose members include Two-County Electric Cooperative and Twin Rivers Electric Cooperative. Two-County and Twin Rivers will provide executive staff to operate United Services Cooperative under a management agreement. United Services Cooperative will enter into a third-party agreement with Agri-Generating, Inc., to market its line of stand-by generators. The acquisition of M&P Electric will provide the remaining staff and resources to perform the core activities of the new business.

The task force understands the new business will be substantially different from the one they are skilled in operating. They schedule a session with their adviser from Diversified Business Consultants to further discuss the implications. She suggests they focus on corporate culture and asks some key questions about each business. A task force member records their conclusions:

ISSUE	CO-OP	CONVERGENT BUSINESS
Key activity	Deliver electricity	Market and install stand-by generators
Source of customers	Serves customers in its territory	Finds customers through marketing activities
Business environment	No competition at present	Competitors

"It's important to develop the right corporate culture to get the results you want from the new business," she says. "We start with two basic questions: Should United Services Cooperative focus on internal systems and infrastructure or external factors such as markets and customers? Is a stable, consistent, organized approach more important to success, or is flexibility, adaptability, and employee empowerment more important?"

From the previous discussion, the task force believes the new business should be externally focused and flexibility will be important to its success. "That's almost exactly the opposite of what we want in the many of the co-op staff," a senior staff member says. "I don't want my linemen to be flexible and innovative when it comes to matters of safety. I want them to follow procedures exactly. That's extremely important if we are going to have safe and reliable operations."

Others agree they will have to accept a new way of doing things for the new business. "As a co-op, customer service has always been important to us," one says, "but I can see that it may be even more important for United Services Cooperative. And, we are going to have to learn how to compete. We'll need different skills on the staff if we are going to do this."

The adviser helps them identify some ways to create the culture they want in the new organization:

- Keep the organization lean.
- Outsource some functions.

CASE STUDY

- Establish job positions that support goals.
- Empower employees to make decisions.
- Hire the right people.

"We're also going to have to think about our compensation," Two-County's manager says. "If we want to get the right people, we'll have to provide benefits that encourage them to perform."

The task force agrees that establishing a new corporate culture for United Services Cooperative will be a challenging task, but they have also come to recognize that this will be important for the success of this new business.

CHAPTER

11

INFORMATION TECHNOLOGY INFRASTRUCTURE

The technology infrastructure that keeps a business running is a critical factor in its ongoing success, and yet it can often be overlooked in the heat of making a deal. Chapter 11 raises some points to consider in the course of acquiring a new convergent company and outlines a strategy for integrating the new business's information technology infrastructure with yours.

Information Technology Infrastructure

A CRITICAL—BUT EASILY OVERLOOKED—CONSIDERATION

In all the excitement over added revenues, new market opportunities, and operational benefits, one critical aspect of acquiring another business can often be overlooked. But the challenges of integrating the two organizations' information technology infrastructure—their computers, software, e-mail, and Internet systems—can be substantial, and you need to have a strategy in place ahead of time to confront them.

Over time, a business collects a set of hardware, software, and services to support its daily operations. The choices it has made in developing that infrastructure may have been shaped more by cost considerations, availability of technology, staff capabilities, or similar factors than by planned, integrated applications. As a result, even companies very similar in size or mission can have very dissimilar information technology support systems.

And when two businesses with diverse technology bases unite their operations, the challenges quickly multiply. This chapter details some of those challenges and outlines the elements of a strategy designed to ease them.

STRATEGY

As the acquiring organization, your co-op needs a specific strategy in place for combining information technology and communications systems. This strategy should address hardware, software, and human resource elements, with an eye toward four basic goals:

1. Minimizing service disruptions to existing customers.
2. Holding the line on spending.
3. Retaining essential information technology employees.
4. Exploiting new business opportunities presented by the technology.

In addition, you should set your information technology goals to support long-term plans for the acquisition. For example, if the idea is to build the acquired business for resale in a year's time, the strategy for information technology should mirror this by compartmentalizing and isolating systems as much as possible. If the plan is to fully integrate the acquisition into your co-op, the technology strategy might call for converting its data and business processes into yours.

Decisions about the fate of each system are often made at the departmental level. It is not unusual, for instance, to convert accounting data and processes into those used by the acquiring company and leave other applications as you find them.

The important thing is to have an information technology strategy—and plans in place to carry it out. Exhibit 11A, "Setting Up an Information Technology (IT) Shop," is a checklist you can use to help develop that strategy.

GETTING STARTED

Your first step in combining technology infrastructures is to find out just what the company you're acquiring has and what it does. You can then match this inventory to the needs of the business—and to your co-op's existing technology resources.

The questions you need to ask then become clear: What are the acquired company's essential business processes? What software does it have in place to support or accomplish them? What hardware does it have to run those programs? What operating systems and database engines support the applications?

Next, you should examine the company's desktop strategy. And don't overlook e-mail, which has become as essential as the telephone in modern business communications. E-mail servers can't be replaced as easily as telephone systems, but you'll still have to consider it. Is it important to merge the systems? Do you want all your employees to have the same domain name at the end of their e-mail addresses, or will separate domains for each entity work? These aren't minor considerations, because merging e-mail systems can be a hefty project in itself.

HARDWARE AND SOFTWARE ISSUES

The closer your co-op and the acquired company are in size and business mission, the more likely it is that you'll have two of everything when it comes to technology infrastructure—and the challenge will be to whittle that inventory down to one. If the acquisition is expected to be permanent, you should undertake a "best of breed" exercise to find the best programs in your new, expanded inventory for handling essential processes.

HUMAN RESOURCE ISSUES

High employee turnover—planned or not—is a strong possibility during acquisitions, but it can have particularly troublesome effects on technology systems. A fact of life in the computer field is that in many business settings, a handful of employees become so familiar with the unrecorded changes and improvements in their organization's systems that the sudden or unexpected loss of those employees can have a significant impact on operations.

Your best hedge against this is aggressive cross training, but you may not have time to establish such training programs. In the meantime, identify which employees have the knowledge you rely on and take steps to keep them on the staff. If they can't be retained or must be terminated, consider a severance package that includes provisions for part-time or contract support for a specified period.

ON THE NET

Today's Web-connected world poses a new set of questions for organizations acquiring others. Does the business you're taking over an Internet Web site? Do you want to merge that site into yours?

ADDITIONAL RESOURCES

1. Gartner Research www.gartner.com
2. CPA Online www.findaccountingsoftware.com
3. What's Involved in Planning a Computer System? www.nonprofits.org/npofaq/17/53

SETTING UP AN INFORMATION TECHNOLOGY (IT) SHOP

EXHIBIT 11A

Background Questions

- Is the company you're acquiring a startup or an existing business?
- Is the company expecting rapid growth?
- Can it afford a heavy capital investment?
- How quickly does the IT shop need to be operating?
- Is there a need to keep staffing low?
- Do you expect to absorb the company into your existing operation or sell it to a third party within three to five years?
- Does the company have unique IT requirements that do not fit standard business models?
- Would external access to company information cause serious problems?

First Decision: In-house or Outsource?

- In-house IT shops require major capital investments, staffing, and time to set up.
- Outsourced IT can be obtained fast with little capital investment, but ongoing expenses will be high.
- Outsourced IT is pay-as-you-go. You won't have stranded investments in outdated or unneeded equipment if conditions change dramatically. On the other hand, an in-house IT shop usually results in an operation that is more responsive to the company's needs.

Next Steps: Customize or Standardize?

- Customized applications are expensive and may not justify their costs in terms of value to the company.
- Standardized applications cost less, but they may not be responsive enough to help you capitalize on new business opportunities.

In all cases...

- Hire a person to produce an integrated IT system. This road map will help in future decisions.
- Avoid going overboard. Don't buy elaborate systems until you're sure you will use all the features. In addition to carrying additional costs, these systems may simply be too much to handle while you and your staff are trying to grow the company.

CASE STUDY

JOINING THE INFORMATION AGE

"Maybe I'm just asking this because it's part of my job responsibilities now," says one of the staff members on the convergent business task force, "but shouldn't we be talking about computers?"

"I thought we gave up on the Internet idea," somebody else says.

"Not for Internet services, for United Services Co-op's operations," he responds. "They're going to need computers and software and e-mail and Internet access and somebody to manage all that. How are we going to do this? We need to be thinking about a strategy now."

"Can't we just add them on to Two-County or Twin Rivers' system?" another asks.

"Maybe," he responds, "but we're talking a different business here, and I suspect the needs are going to be different. And we don't even know yet what we're getting in our acquisition of M&P."

The staff member who raised the issue offers to analyze what information technology the new business will need, inventory what they're getting from M&P, and outline some potential strategies for using technology to develop and support business opportunities.

United Services Cooperative doesn't have any really unique business requirements, but it does need hardware and software for the basics, including customer care, procurement and inventory management, e-mail and basic office functions, and a Web presence.

The results of his inventory of M&P's resources is not surprising, but disappointing nevertheless. "Let's just say they're not on the cutting edge of information technology," he reports. "And there's only one guy in the whole operation who knows how to make their system work. We better keep him." Fortunately, he is knowledgeable and eager for the opportunity to upgrade systems.

"If it were just M&P, we could limp along for a while," the task force member says, "but United Services is going to have needs substantially beyond their capabilities. We can integrate some of the functions, such as e-mail and a Web presence, with the co-op system but we are going to need new hardware and software for other functions."

The task force member suggests they initially look at ways to outsource these IT functions while they get experience in operating the new business. While this approach has a higher ongoing expense, they can avoid making major capital investment for things they may not ultimately need until they have a better understanding of just what those needs are.

"There's one thing I want to be sure of," Two-County's manager says. "I'm happy to let United Services Cooperative use anything we have if it contributes to their success, but I don't want there to be any disruption to our electric customers in any way."

The task force agrees to devote the resources necessary to ensure United Services Cooperative has the hardware, software, and applications in place to enjoy a seamless startup.

FINANCIAL PLANNING AND SYSTEMS

The mix of debt and equity you use in financing your convergent business venture will have a significant impact on the venture's future. A "correct" blend of debt and equity can never be pinpointed, but Chapter 12 provides a range of issues to consider and gives you a backdrop for making this critical determination.

CHAPTER 12

Financial Planning and Systems

ROLE OF THE CFC RVP

Early and frequent communication with CFC is key to ensuring a successful project. One of the first steps in communicating your plan for a convergent business is to discuss the proposed project with your CFC regional vice president. With extensive rural utility finance and management experience, the RVPs are an invaluable resource throughout the financial planning process.

The RVPs are familiar with CFC's lending products and services, as well as knowledgeable about the due diligence requirements that must be satisfied in order to make financing available for the project. They also can help you use financial forecasting software to assess the overall feasibility of the project and how it will impact the core business.

Good communication with your RVP and your Herndon-based associate vice president will ensure your lender is on board throughout the project planning process. From the earliest "project concept" discussions, to the final "go" decision, the RVPs are available to meet with co-op management, directors, or key staff to assist in calculating funding requirements, evaluating financial modeling data, and finding the right mix of debt and equity to launch your new venture.

HITTING THE FINANCIAL TARGET

In addition to supplying a product or service your market will buy, the success of your co-op's convergent business depends to a large extent on its ability to meet its financial targets.

Meeting those targets, in turn, requires that you have the right amount and kind of financing available at the right times, and that you use the right financial information systems to assure prompt and proper repayment of the financing.

This chapter will help you hit those targets by providing guidelines on some critical considerations in the financial planning stage of your campaign:

- Estimating cash funding needs for operations and asset acquisitions.
- Researching financing alternatives, including leasing and partner equity.
- Evaluating modeling, accounting, budgeting, and other information systems to support management of financial risks.
- Fashioning the best plan to meet funding needs from a range of alternatives.

ESTIMATING FUNDING NEEDS

Other chapters of this manual refer to funding needs which should be considered in developing the financing plan. Resolution of the alliance/startup/purchase question (Chapters 8 and 9) will lead to estimates of equipment and facilities costs. Consideration of marketing (Chapter 5) and staffing (Chapter 10) will yield additional cost estimates.

These and other funding needs should be plugged into a comprehensive model, such as the one described in Chapter 13, capable of running multiple scenarios.

You'll also need expertise in the new venture's industry to predict its organizational and resource needs and related operating and capital costs.

FINDING FINANCING

The best financing package for your convergent business initiative is likely to come from a combination of equity, debt, and other sources. Exhibit 12A, "Financing Needs and Alternatives," shows some potential funding options for different costs likely to be incurred by the new enterprise.

Startup costs are usually best financed with an equity investment to avoid piling debt and interest obligations on your fledgling business. Deferral of employee compensation and other professional costs, when possible, can help accomplish the same result. Vendors of vehicles and other equipment sometimes provide specialized financing for their products, which can also free up more of the business's equity and debt for other purposes. Real estate and long-lived plant facilities may be advantageously financed with secured debt. The point is that achieving the lowest financing costs and most flexibility will require diligent research.

In any case, you should begin discussions and negotiations with potential sources of bank lines of credit, equity, debt, and other financing as soon as your convergent business plan is in substantially final form.

ADEQUACY OF RISK EQUITY INVESTMENT

An insufficient startup equity investment may become a problem if your convergent business takes longer than you expected to break even or if it suffers a large unexpected loss such as uncollectible bills or adverse litigation. That equity depletion, in turn, can crimp the business's access to credit and probably lease financing.

Your best protection from this situation is to anticipate and plan for your new business's equity investments, perhaps to be met by partners or allies. Three rules of thumb will help you arrive at the strongest equity investment decision:

- Sufficient startup equity should be available to cover losses until the business is projected to break even, even under its "worst case" planning scenario.
- Debt-to-equity ratios after the business reaches its breakeven point should not exceed levels acceptable to prospective lenders.
- The new venture's equity should be sufficient to maintain its liquidity during business downturns caused by abnormal weather or other adverse conditions.

The cooperative's management and board need to seriously consider the possibility that their new venture may, despite meticulous research and planning, fail. The consequences of that outcome would be not only financial losses but also damage to the cooperative's credibility with its member-owners. Therefore, the cooperative should not place more financial or community confidence equity at risk than it can afford to lose.

FINANCIAL INFORMATION SYSTEMS

Prudent management requires financial information systems that can handle forecast modeling, billing, inventory control, budgeting, cash management, accounting, and other needs. Here are some minimum requirements for such systems:

- Financial statement models should be detailed enough to reflect all aspects of the business's operations—including taxes, sales estimates, staffing, and financing costs—and allow for frequent updates of forecasts.
- Billing and inventory control systems should be reliable and able to be integrated with your co-op's systems.
- Accounting systems should support preparation of financial statements (in audit format) within 10 business days of the end of the month—and they should clearly report transactions between the new business and your co-op.
- Budgeted financial statements should highlight significant accrual- and cash-basis variances from actual results and facilitate analysis of deviations from plan.

FINANCIAL PLAN DEVELOPMENT

Exhibit 12B, "Process Flow: Financial Planning" outlines an approach to identifying your convergent business's financing needs, meeting them most efficiently, and controlling the business's financial performance. That process begins with tapping industry expertise and assuring that your business plan is consistently thorough and reliable.

Next, financing needs for various startup and capital costs must be carefully estimated and alternative funding sources found for each (see Exhibit 12A). These two sets of inputs—financing requirements and alternatives for meeting them—should be plugged into a computer model to project the convergent business's likely performance under a variety of scenarios, especially "worst case" and "most likely." If the results of the "worst case" scenario present unacceptable risks to the financial well-being of the co-op or its member-owners' confidence, the project probably should be abandoned.

Input assumptions and resulting financial projections should be checked by industry experts and others involved in the convergent business planning effort. If you and your board decide to proceed with the convergence venture, it's time to begin discussing financing sources as well as developing financial information systems.

ADDITIONAL RESOURCES

Financial planning Web sites:

1. Financial Executives International www.fei.org
2. The United States Federation of Small Businesses, Inc. www.usfsb.com
3. IdeaCafe's Financing Your Biz www.ideacafe.com/getmoney/

Financial management information systems Web sites:

1. Association of Financial Professionals www.afponline.org/
2. Accounting System Selector by excelco www.excelco.com/index.html

EXHIBIT 12A

FINANCING NEEDS AND ALTERNATIVES

NEEDS	ALTERNATIVES		
COSTS TO BE FINANCED	DESCRIPTION	ADVANTAGES	DISADVANTAGES
Startup period operating losses	Debt	If available, quick cash	Compounding interest costs
	Cooperative equity	No compounding interest	Risk to cooperative
	Partner/ally equity	No compounding interest; reduced cooperative risk	Reduced cooperative control
Vehicles and other equipment	Leasing	Reduced cooperative cash requirement	Frequently high effective financing costs
	Vendor debt	If available, frequently lower financing costs	Payment obligations may not be as flexible as leasing
	Equity or senior debt	Typically lower financing costs than vendor debt	Consumes long-term financing for short-lived assets
Facilities and real estate	Seller debt	Reduced cooperative upfront cash requirement	Frequently seller requires rapid principal amortization
	Leasing	Frequently longer payment period than seller debt	Reduced cooperative control
	Equity or senior debt	Control over long-lived assets	May be most difficult financing to obtain

EXHIBIT 12B

PROCESS FLOW: FINANCIAL PLANNING

STEP	PROCESS	FLOW
1	Access consultants or others with expertise in the Smart Convergence Venture's (SCV) new industry for review of the strategic fit, financial, and other business plan components.	EXPERT REVIEW
2	Determine the types and ranges of estimates of operating and capital costs likely to require financing as indicated in the marketing, organization development, alliance/startup/purchase, purchasing, information systems, and other planning components.	FINANCING NEEDS
3	Research financing alternatives for each of the SCV costs likely to require funding, including equity, leasing, debt, and vendor financing; determine the costs, pros/cons, terms, and availability of each.	FINANCING OPTIONS
4	Use cost estimates and feasible financing alternatives to create SCV financial statement projections assuming "worst case," "most likely" and other plausible scenarios. (See Chapter 15 for more information on forecasting.)	MODEL SCENARIOS
5	Thoroughly check input assumptions and output financial statements with industry experts and others contributing to plan development; reconsider the financial feasibility of the SCV. Are changes needed?	? NO YES
6	Using financing requirements indicated under "worst case" assumptions, negotiate agreements with sources of equity, debt, and other funding.	FINANCING ARRANGED
7	In consultation with the cooperative's public accountants and in-house staff, design and install adequate accounting, budgeting, cash management, inventory control, billing, and other financial/operating systems sufficient to manage the SCV's performance and demonstrate compliance with financing agreements.	SYSTEMS
8	Review financial plan and systems with senior management and/or the board of directors if appropriate, and assure viability of management controls and exit strategies. (See Chapter 14 for more on these ideas.)	CONTINUE

CASE STUDY

FOLLOWING THE MONEY

By this point, the convergent business task force members are confident they have most of the elements in place for a successful entry into the stand-by generation business. "Not so fast," their accountant says. "How are you going to pay for all this?"

The task force members look at each other. "I thought we'd get a loan to cover the startup costs," one says. "It's a good business opportunity. We ought to have a positive cash flow almost from the start."

"Our accountant brings up a good point," Twin River's manager says. "We can't do this on a gut call. We need a detailed plan that tells us how much money we're going to need and where we're going to get it from."

Two-County's manager agrees. "And I'm not so sure a loan is the best way to go. I don't want to start out saddled with a lot of debt," he says. "We need to look at equity investments and see if we can lease some of the equipment we need."

One of the directors questions whether the co-op should invest its equity in the new business. "Isn't that a risk for the co-op?" he asks.

"All businesses need equity," the accountant tells him. "Yes, there is risk to the co-op, but if you're not willing to accept the risk, maybe you shouldn't start the business." He points out that lenders and, most likely, lease partners will demand a certain level of equity as a condition of financing. "The trick is to figure out the right balance for United Services Cooperative." He promises to help the team analyze the optimum financial structure and reminds them they will need to plan for worst-case outcomes as well as best and most likely scenarios.

The accountant also encourages them to think about the financial management tools they will need to manage the business, including:

- Detailed financial statement models reflecting all aspects of the business's operations.
- Reliable billing and inventory control systems.
- Accounting systems that allow quick preparation of financial statements and highlight variances between budgeted and actual results.

"I want to be sure we get a detailed report on transactions between the co-ops and United Services Cooperative," Two-County's manager says. "We need to know where we stand at all times."

The task force agrees it is a good thing they have spent so much time on marketing and organizational structure issues. The information they have acquired will make it much easier to develop a sound financial plan.

CHAPTER

13

FINANCIAL MODELING

A detailed model of your business's likely prospects, under both the "most likely" and "worst case" scenarios, allows you to take a hard look at the numbers before launching the new venture, and to establish essential benchmarks for its subsequent performance.

Financial Modeling

A DISCIPLINED LOOK AHEAD

It's nice to offer your members and your community valuable additional services, and it's a benefit to your co-op if you develop stronger consumer loyalty in the process. But the factor that ultimately determines whether your convergent business venture is a success is its financial performance—its ability to make a return on your co-op's equity investment and service its debt with timely principal and interest repayments, all while maintaining a competitive price.

A co-op's board and management must have confidence that their convergent business venture will accomplish this fundamental goal before they launch the new initiative. One way to achieve that confidence—or to find out if it is misplaced—is by modeling the performance of your new business. This chapter will help you develop an accurate model of your new business's prospects by covering key elements of such a model:

- Frames of reference for estimating "most likely" and "worst case" scenarios.
- Information—such as tax considerations—that may need special planning attention.
- The ability to do follow-up monitoring of the business's performance and to detect exit triggers before it's too late.

"MOST LIKELY" AND "WORST CASE" SCENARIOS

The new business's base case should be calculated using your best estimates—based on meticulous research—of the operation's sales volume and pricing, personnel costs, financing availability, equipment, productivity, and other information. These estimates should be neither optimistic nor pessimistic; rather, they should be realistic assessments that reflect consensus expectations, developed after thorough study of the industry and your market setting. If the resulting "most likely" scenario seems too good to be true, it probably is. You should review and adjust the data you entered into the model.

A credible "worst case" scenario is essential to the stage-gate business planning process outlined in Chapter 2. If the "worst case" results show significant losses or other major problems, you should strongly consider abandoning the project.

This scenario will also indicate the minimum equity financing you are likely to need for the new business. Assumptions about financing, however, should begin with the "most likely" scenario, adjusted for potentially unfavorable conditions.

Typically, business forecasters select a minimum probability—say, one in four, or 25 percent—for the "worst case" scenario to occur. For example, if the "most likely" annual unit sales volume of a given product (at its "most likely" price) is estimated to be X, then its "worst case" estimated sales volume would be Y, indicating a consensus estimate of 25 percent that the sales level could fall to Y.

MODELING INFORMATION THAT REQUIRES SPECIAL ATTENTION

Naturally, getting the most reliable projections from your modeling requires good information. Staffing, pricing and costing, and the many other model inputs all require careful estimation. Some data assumptions, however, may require special attention, since they will affect the business's profitability. Among them:

- Income taxes, which may vary by state, special treatments of some income and expense items, tax status of the new venture's owner(s) and other situation-specific factors.
- Potentially changing capital structures involving shifting combinations of equity, debt, leasing, and other financing methods.
- Book and tax depreciable bases of plant and equipment, which usually are determined only by careful accounting analyses.
- Projected transactions between the co-op and its new business, which must be identifiable to assure accurate accounting for debt and equity investments as well as revenue and expense billings.

All data entered into any scenario should be carefully checked for accuracy and consistency, and the results also should be scrutinized for anomalies and unexpected results.

FINANCIAL MODELING PROCESS

Exhibit 13A, "Process Flow: Financial Modeling," suggests an approach to bringing all the pieces of your business planning together in a package that will help you assess the venture's probability of financial success.

Early in the process of developing your business plan, everyone involved in the effort should agree on common definitions of what constitutes the "most likely" and "worst case" scenarios. As those two scenarios are developed, all the data used to produce them—and their final product, the projected financial statements—should be rigorously examined to assure consistency and plausibility.

The "worst case" projections serve two important functions. First, projected losses indicate how much equity investment the venture will need to withstand even the toughest times. Second, it may reveal likely losses that the co-op cannot afford, allowing you to scrap the plan altogether before you've invested too much money and time in the effort.

ADDITIONAL RESOURCES

1. Bplans.com www.planwizard.com
2. Business Planning Solutions Directory www.knowledgestorm.com
3. Berry, Tim (2000). "Hurdle: The Book on Business Planning." Eugene OR, Palo Alto Software, Inc.

EXHIBIT 13A

PROCESS FLOW: FINANCIAL MODELING

STEP	PROCESS	FLOW
1	Discuss concepts of "most likely" and "worst case" with business planning participants to assure consistent estimation of input data.	ASSUMPTION FRAMEWORKS
2	As preliminary financial model input data are developed during the stage-gate process and completion of convergent business planning components, commence input and review process.	INITIATE INPUTS
3	Assemble "most likely" scenario input assumption data (e.g. startup or acquisition costs, staffing, detailed product or service sales expectations, debt/equity/other financing components) and assure consistency; prepare "most likely" financial statement projections.	"MOST LIKELY"
4	Review "most likely" input assumptions and financial statement projections with business planning participants and revise as needed.	? YES
5	In consultation with business planning participants, develop "worst case" scenario input assumptions and prepare related financial statement projections; review and revise as needed.	"WORST CASE"
6	Develop other scenario input assumptions if needed to model alternative financing or ownership structures, staffing arrangements, product mixes, and other plausible plan variations.	OTHER SCENARIOS
7	Reconsider the relative pros and cons of proceeding with entrance into the new business venture; extend research in marketing, financing or other areas if needed to assure sound decision-making.	GO? NO YES
8	If the new venture is launched, establish a schedule for updating scenario projections to provide bases for corrective action.	UPDATE SCHEDULE

CASE STUDY

PICTURE THIS

The convergent business task force is very excited about the financial modeling phase of the stage-gate process. The model will give them a full picture of the expected performance of United Services Cooperative. If the projections are as positive as they expect them to be, the task force will be confident in recommending a "go" decision at Gate II.

The task force helps the Diversified Business adviser develop a base-case scenario from the most likely estimates for sales volume and pricing, staffing costs, inventory, financing, and other expenses. The estimates reflect information the task force gathered in analyzing market conditions, regulatory climate, and corporate structure issues. Their goal is to be as realistic as possible.

"Being realistic is important," the adviser tells them, "but being pessimistic is also necessary. We need to take a look at the worst-case scenario. What if sales don't achieve the targets we set in the early years? What if our expenses are much higher or our sales lower than we anticipate?"

"Then I guess our goose is cooked," cracks one task force member.

"Not necessarily," says the adviser. "If we can anticipate it, we can prepare for it. If we can't prepare for it, maybe we shouldn't get into the business to begin with."

The task force pays particular attention to assumptions that will affect United Services' profitability, including tax treatments; the balance between debt, equity, and other financing methods; depreciation methods; and transactions between the co-ops and United Services Cooperative. They insist the modelers check thoroughly for accuracy and consistency, and they review the projected financial statements carefully to be sure they understand and are comfortable with the results. They ask the modelers to develop several alternative scenarios in addition to the most likely and worst-case scenarios to test variables such as cost of debt.

The forecast results reassure the task force. While the most-likely case results are more attractive, they believe they can deal with the results of the worst-case scenario. They are ready to present their Stage II recommendation to the Two-County and Twin Rivers boards to proceed to Stage III, where they will finalize the business plan, establish management and control procedures, and get ready to implement the business plan.

The months of detailed planning and analysis pay off. The boards are confident in the decision to go forward.

CHAPTER

14

THE EXIT PLAN

It goes against the grain to ponder problems in the enthusiasm of launching a new business, but it's a necessary part of a sound business planning process. Chapter 14 discusses performance benchmarks and other elements of an exit strategy—an essential ingredient of any smart convergent business plan.

The Exit Plan

PROTECTING THE CORE BUSINESS

Protecting your co-op from unacceptable financial losses or complications that can hamper core utility operations must be an overarching objective of your business planning process. This chapter outlines some of the factors you and your board should consider when formulating an exit strategy.

Refusal to accept failure is an important part of the American tradition—and the co-op character. The importance of our systems to our communities, in fact, stems from the co-op commitment to provide a needed service where other utility companies, fearful of failure, would not.

But that attitude may need to be re-examined when the co-op enters a non-core business. Before you launch any new convergent venture, it's necessary to have a plan in place for evaluating its progress and performance—a plan that includes clear and fully accepted trigger points at which board and managers agree to consider exiting the business. This exit plan should also cover the steps your co-op will take in discontinuing the venture to avoid alienating your members and your community.

While the most common reason to implement an exit plan is to stem financial loss, a thriving venture might also threaten the core business and require the cooperative to depart the convergent activity through a sale of the new company.

A successful enterprise could grow in such scope and size that the co-op's focus on the electric utility may be in jeopardy. In this case, exiting the venture through a sale of the convergent business rather than extending the resources necessary to keep up with the escalating venture may be the wisest choice.

THE EXIT PLAN

No matter how carefully a co-op prepares, monitors, and follows through, directors and management may conclude that the new venture is not working out. It may no longer be a good strategic fit with the core business, for instance, or it may be having negative effects on the core business.

One way to manage this eventuality is to set benchmarks or trigger points—performance levels that must be achieved by a specific time. Trigger points can guide board and management on critical questions, including whether the co-op should exit the new business.

This decision is obviously a difficult one, but it's one that may have to be made. Patience is essential, however, because a good opportunity may take longer—and cost more—to develop than your original plans foresaw.

An exit plan is a vital part of the overall business plan, but it should be implemented only after a reasonable time has passed and board and management conclude, upon serious consideration, that additional time and investment are unlikely to improve the situation.

An effective exit strategy should have the following features:

- It must be formulated prior to the new business's launch.
- It must take into account the performance of the business over time as well as the effects of exiting the business. Board and management must look at how exiting the venture will affect the co-op's core business, customers, and the community as a whole.
- It should be executed in a phased and orderly manner. A poorly executed exit can erode the venture's resale value, hurt employee morale, damage the co-op's core business (both financially and in member goodwill), and limit your co-op's ability to undertake new business initiatives in the future.

ADDITIONAL RESOURCES

1. Seven strategies for exiting your business www.bankrate.com/brm/new/biz
2. Business Exit Strategy: Asset Liquidation www.sbaonline.sba.gov/wa/seattle/selegal.html
3. Business Plan Newsletter: Exit Strategies www.bizplanit.com/vplan/exit/newsletter.html

CASE STUDY

WHEN IT'S TIME TO LEAVE THE PARTY

The convergent business task force is enthusiastic and optimistic in its preparations to launch United Services Cooperative. They are confident in the results of their research, their forecasts, and their strategies.

"I don't want to sound like I'm preaching divorce before the wedding day," says one of the directors, "but what happens if this just doesn't work out? Sometimes businesses fail, despite planning, hard work, and great ideas. My brother-in-law started a business and almost worked himself to death, but through no fault of his own, he just couldn't make a go of it. Maybe we should be thinking about some kind of prenuptial agreement, so to speak."

The Diversified Business adviser agrees. "We need an exit strategy," she says. "It is important to be committed to making the business succeed, but it is only prudent to plan for failure as well." She suggests they establish trigger points that would cause them to consider abandoning the business and develop a plan to follow if, despite their best efforts, that comes to pass.

The task force members take some time to reflect on this idea. "Isn't that like saying we don't have any confidence in what we're doing?" asks one.

"That's right," says another. "We wouldn't go into this if we thought we were going to fail."

Two-County's manager points out that United Services Cooperative is different in several respects from the co-op. The co-op provides a service everybody needs, and, at least for the moment, there are no competitors. United Services Cooperative will provide a useful service, but not everyone will need or want it, and there will be competition. "We think we can give folks a better price and better service, but there are no guarantees here," he says. "We owe it to our members to consider all the possibilities—not just the outcomes we want."

The task force members agree it would be difficult to admit defeat after all their hard work, but it would be worse to continue on a course that would bring harm to the co-op. They recognize it is prudent to discuss these matters now, before the business is launched, when they can consider the issues calmly, rather than to be forced to react to events later in an emotional climate. Above all, they want to set clearly defined standards for performance, determine exactly how far the business will be allowed to deviate before they implement the exit strategy, and have an exit plan that can be executed in an orderly manner without damage to the co-op.

CHAPTER

15

BUSINESS PLAN EXECUTION

After you've done the marketing surveys, negotiated financing and partnerships, and devised an exit strategy, you have to prepare for a sound follow-through. Chapter 15 identifies some potential pitfalls to watch out for in the early going and outlines some elements of an assessment program.

Business Plan Execution

SOLID FOLLOW-THROUGH FOR A GOOD PROJECT

The first three years of a new business's existence are the most critical in its development, for that's when it faces its toughest challenges. This chapter will outline a program of periodic review designed to make sure your new business stays on a successful track.

AVOIDING THE OBVIOUS

Some of the most common causes of difficulties for a convergent business surface frequently:

- Lack of expertise.
- Over-optimistic assessments of the market for a new product or service.
- Funding problems, from causes as varied as underestimating the capital needs of the venture to financial backers pulling out of the deal.
- Inability to hedge against risks.
- Unrealistic cost expectations for the new offering.
- Paying too much to acquire an existing business.
- Poor planning.
- Lack of an exit strategy. Without a preplanned way to exit a new business, it becomes harder to pull out if it's not performing up to your expectations.

Knowing these common reasons for the failure of co-op convergent businesses, it makes sense for you to design an evaluation and review program with an eye to avoiding them. Taking stock of how well the new activity is meeting its original goals is essential, so disciplined follow-up and measurement steps must be built into your diversification planning.

Here are some of the questions you need to ask in the course of your evaluation process, perhaps monthly:

- How is the new business measuring up against your original expectations? Were those expectations reasonable?
- Is the business achieving its performance benchmarks?
- What effect is the new operation having on your core business?
- Do you need to make any mid-course corrections or take remedial actions to avoid problems?
- Would it be best to exit the business?

Exhibit 15A, “Process Flow: Implementing the Convergent Venture,” shows a flow chart that tracks the management and control of diversification activities. Carrying out that management and control requires that you develop ways to measure success and a review program that incorporates those measurements. You will also need to define the roles of board and management in overseeing and monitoring the new business. Finally, you must outline the appropriate course of action to take if the new activity fails to meet reasonable expectations.

MONITORING AND REPORTING PERFORMANCE

The new business’s progress must be monitored both financially and operationally. Financial indicators will give you an idea of how profitable or costly the new venture is, while operational measurements will help you pinpoint areas that need improvement.

Financial indexes typically include the balance sheet, income statements, operating cash flows, and key ratios derived from those tools. Operating indicators track the business’s development in physical terms, such as number of customers added, units sold, number of service calls, and the like. They will help you paint a clearer and more accurate picture of the business’s progress by eliminating distortions—such as changes in costs or pricing—that may crop up in the financial measurements. They also report on items that are key to the success of a business but that may not be captured in financial reports.

The indicators will be useful and effective only to the extent that they meet some basic requirements:

- They must be quantitative, objective, and measurable.
- They must be reported periodically, by the month or quarter, as well as year-to-date.
- They should be compared to previous reporting periods and annual figures.
- They should be in a manageable format.
- They must reflect true measures of the success or failure of the business.
- They should be broad enough to measure many different facets of the businesses.
- They should be measured, reported, and evaluated in a consistent manner.
- They should be specified ahead of time and should not be ad hoc or arbitrary.
- Report content and frequency must be tailored to the need and role of the parties receiving the reports. Board members and management should receive information that is useful in determining overall direction and progress, while operating personnel may need more detailed and more frequent reporting.

You should consider developing specific forms and formats, to be used on a consistent and regular basis (such as monthly or quarterly), to help measure and report performance.

Exhibit 15B, "Key Indicators for Monitoring Performance," outlines some of the key indicators for typical convergent business activities that can help you measure your new venture's performance.

THE BOARD'S ROLE

The co-op board must take an active and informed role in monitoring the new venture's performance, and this may require some specialization at the board level. One way to accomplish this is with a board subcommittee, supported with assistance from appropriate staff. This panel may also need orientation and training sessions, and it should be prepared to make periodic reports to the full board.

Board members and the co-op's management team have a wide range of formal and informal ways to ensure adequate monitoring and control of the new business:

- Periodic and regular financial and operating reports.
- Business plans with specific milestones and performance benchmarks.
- Reports of actual vs. projected results, both financial and operational.
- Detailed capital and operating budgets for the diversification activities.
- Reviews by task forces or focus groups.
- Evaluations by consultants or other outside contractors.
- Formal surveys and informal feedback from customers and other stakeholders.
- Performance reviews pegged to benchmarks and other trigger points.
- Periodic scans of the business environment to check on other companies' experiences.

Monitoring and oversight should reflect the original reasoning behind the co-op's diversification efforts. If the idea was to save costs for the core business, for example, reports and board actions should focus on the new venture's achievements in that area.

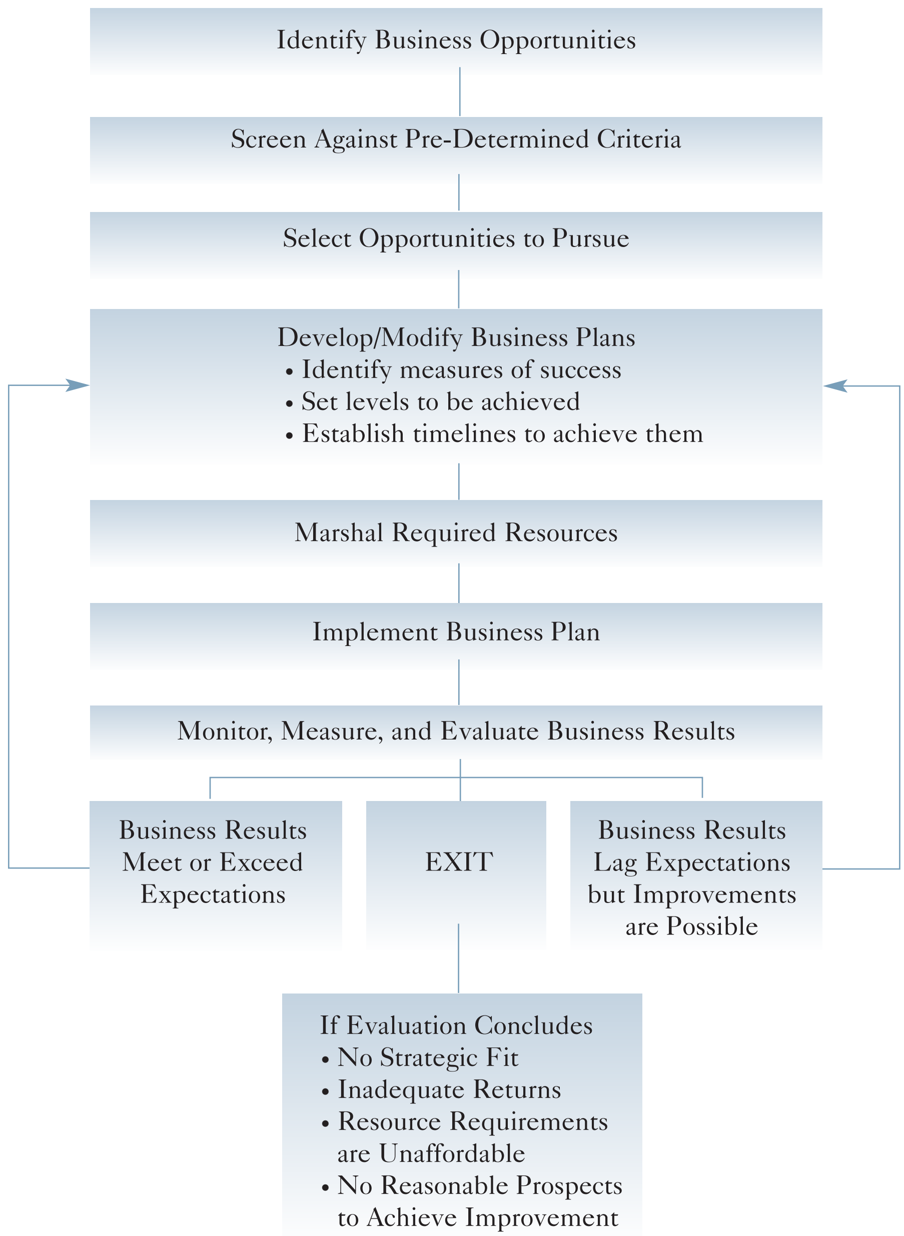
In addition, the board must not overlook the impact the new business is having on the co-op's core operations. Financial and operational reports and outcomes should be developed for the combined operation as well as for the new venture by itself.

The reports' frequency and level of detail depend on how much your co-op has committed to the new venture. That, in turn, can be gauged by dollars invested relative to the core business. The question of reporting detail and frequency also turns on judgments about how critical the new venture is to the success of the core electric operation and how far removed it is from the core business. The bigger the break from core utility operations, the more attention the new business is likely to need.

In any case, the scope and frequency of reporting on the new operation should be decided very early in the process of approving the diversification initiative.

EXHIBIT 15A

PROCESS FLOW: IMPLEMENTING THE CONVERGENT VENTURE



KEY INDICATORS FOR MONITORING PERFORMANCE

EXHIBIT 15B

INDICATORS/REPORTS	APPROPRIATE FOR:
Income statements, balance sheets, cash flow statements, capital and operating budgets, long-term financial forecasts, business plans, and periodic assessments	All ventures
Number of customers served or signed up	Propane, home security, ISP, DBS, CATV, paging, cellular, warranty plans, high-speed Internet
Revenues per customer	All customer-intensive convergent activities
Sign-up costs per customer	All activities where customer signup is expensive and critical
Units sold	All convergent activities
Number of “help line” calls received	ISPs, home security
Number of outages/hours of operation	On-site back-up generation, ISP

CASE STUDY

SHOW TIME

The convergent business task force is very close to making its Stage III recommendations to the Two-County and Twin Rivers boards, but the talk about exit strategy prompts them to give their business plan one more review.

"Are we overlooking anything?" one member asks.

The Diversified Business adviser suggests they review some of the factors that have caused other businesses to fail and see how their plans measure up. "In our experience, these are the most common causes of problems," she says, making a list:

- Poor planning
- Lack of expertise
- Inadequate funding
- Lack of exit strategy
- Over-optimistic market assessment
- Unrealistic cost estimates
- Paying too much for acquisition
- Poor risk management

After some thought, the Two-County manager says, "I believe we've done a good job in these areas. We've partnered with a company that has expertise in stand-by generation, and our acquisition of M&P Electric gives us what they lack. Our best analysis indicates we're paying a fair price. We have the funding in place. Heaven knows we've spent a lot of time and effort on planning. I think we're ready to go."

The other task force members concur. "There comes a time when you've done everything you can do," says one.

The Diversified Business adviser tells them the first three years are the most critical for any new business. Monitoring United Services Co-op's performance carefully during that time period is crucial. "You will need to be looking at two things," she says, "financial performance and operational performance."

The task force develops specific forms and formats for the criteria they will monitor on a monthly basis, taking care to be sure their standards are quantitative, objective, and measurable. They will compare the criteria to previous reporting periods as they gain experience and also to the projections in their financial forecast.

"It will be important for our boards to be informed on a regular basis, but reviewing all this information is going to be a lot of work," Twin Rivers' manager says. "I'd like to suggest we set up a sub-committee with representatives both of our boards to monitor United Services Cooperative, with the help of staff, of course."

The Two-County manager concurs. "I want to be very sure that I, my staff, my board, and my members are satisfied with the direction we are taking with United Services Cooperative," he says. "A board committee can help us do that."

The convergent business task force schedules a day-long retreat with the senior staff and boards of Two-County and Twin Rivers to review what they've learned in the stage-gate process, to present their business plan, and to make their final recommendation at Gate III: proceed with implementing the business plan for the formation of United Services Cooperative. The participants in the retreat are impressed with the depth of the task force's effort and the results.

The boards, confident the months devoted to planning will pay off, authorize the task force to go forward with United Services Cooperative. They are proud of the effort and keenly aware their work has just begun.

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