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discussed in more details elsewhere, the Service agrees that the term "trade or business" has the same meaning as when used in Section 162 of the Internal Revenue Code. Of the many cases which have addressed the issue of "trade or business" in the context of Section 162, in Notice 2006-108 the IRS singled out one of those cases, Groetzinger v. Commissioner in support of the Service position that merely signing up for CRP constitutes a trade or business. The Supreme Court in Groetzinger stated that the ". . .. resolution of this issue [meaning of 'trade or business'] requires an examination of the facts of each case." The Groetzinger case involved a gambler who devoted 60 to 80 hours per week to pari-mutuel wagering on dog races with a view to earning a living from such activity. The taxpayer went to the track six days per week for 48 weeks in the year in question. The betting activity was more than a full-time job.

It is an unbelievable reach to assert that a case involving a taxpayer putting in up to twice the number of hours in a normal work week could stand as authority for a situation where merely signing up for a conservation program constitutes a trade or business.

In conclusion

The CRS report totally ignored the core issue involved in the debate over whether all CRP payments or only those from an activity constituting a "trade or business" should be subject to self-employment tax. That core issue is where the line for what amounts to a trade or business should be drawn. There is no discernible support in tax law for the notion that the line should be drawn to include all profit making ventures as has been suggested by the Internal Revenue Service. That is what the Congress needs to understand in considering H.R. 2419.

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Value-added business success factors -- the role of management and operations

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(fifth in a series of six)

There has been a surge of interest in farmer-owned business ventures that seek to capture additional value from commodities past the farm gate. Some of these ventures have been very successful, some marginally successful, and some have failed. Supported by funding from the Ag Marketing Resource Center at Iowa State University, we conducted in-depth interviews with farmer-owned businesses to determine the key factors that influenced the relative success or failure of these ventures. A better understanding of why some ventures succeeded while others failed provides valuable insight for the success of future farmer-owned businesses. This article focuses on the role of management and operations for business success.

Research method

To identify factors having the greatest impact on the success or failure of farmer-owned business ventures, a cross-section of seven farmer-owned commodity processing businesses formed since 1990 in North Dakota, South Dakota, and Minnesota were selected. Extensive interviews were conducted with individuals who played, or continue to play, an important role in the formation and operation of the business. This included leaders in the formation of the business, key members of the management team, selected board members, lenders, local leaders and others.

Research results

Competent professional management is essential to a business venture's success. The right Chief Executive Officer (CEO) and management team can mean the difference between success and failure. Management needs to be involved very early in the business project. One successful venture we interviewed hired its CEO prior to the equity drive. The CEO was then able to lead the equity drive and provide input on plant design and oversee construction. The plant was up and running on schedule.

While this example is more often the exception than the rule (the CEO often comes on board after a successful equity drive), all of the businesses we interviewed agreed the sooner the CEO is hired, the better the start-up process unfolds. Although board members are usually successful producers and community leaders, there is no substitute for good professional management.

It was also particularly helpful when the CEO had been involved in similar start-up operations.

Management recruitment -- The board should plan for a significant investment in the recruitment and retention of a CEO. Recruitment strategies varied among the business's we interviewed, with several using executive placement (a.k.a. headhunter) firms. One CEO responded to an ad in a trade magazine. Another CEO of a successful venture was re-

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cruited because he was personally acquainted with one of the founding directors. While there appears to be no patented formula for successful recruitment, the board should make an appropriate investment in time, money, and networking to find, recruit, and hire an industry savvy CEO.

The CEO is the only member of the management team that the board hires. So, once the CEO is hired, the board should leave the remaining hiring decisions to the CEO. The CEO is responsible for building the management team.

As was articulated in a previous article, the board of directors and the CEO must have a shared vision of the organization including its future growth and operations. This shared vision will enable the CEO to manage and build an appropriate management team and will help alleviate micro-managing by the board, which can be very detrimental to board/CEO relations. One CEO we interviewed reported that the board of directors must be committed to reinvestment and growth in order to attract top quality management.

CEO compensation -- Providing adequate compensation and incentives is absolutely necessary for attracting top management professionals. While often challenging for a fledgling organization, an appropriate compensation package will insure that the CEO has as much incentive for business success as the board and the owners. Two successful organizations we interviewed reported offering performance-based incentives described as 'phantom stock' to top management.

Industry knowledge -- The entire management team needs to develop and maintain market and industry savvy and awareness. Market and industry awareness is often a prime selection criterion for key positions. For the venture to succeed, it must remain competitive in its industry in terms of operating efficiency and cost of operations. It is the management team's responsibility to be aware of industry standards and recommend investments and upgrades over time to insure that the venture remains competitive.

Operating margins and investor returns must also be competitive with industry standards and the management and the board must be aware of the margins and returns of other industry participants. This too will likely require ongoing reinvestment of some of the earnings to expand or upgrade facilities. In the absence of such industry awareness, the board and farmer-members may develop unrealistic expectations regarding the returns from their venture. Many farmer-owned processing activities are fundamentally commodity businesses characterized by thin margins.

Employee training -- Finally, the new organization should plan and prepare for significant investments in employee training. This is particularly relevant if the facility is located in a rural area where manufacturing and processing industries are rare. New employees will likely need substantial training in areas such as safety, sanitation, and quality control.

Another measure to enhance competitiveness is to maintain a lean management team.

(next article – the role of local infrastructure and support)

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Internet Updates

The following updates have been added to www.extension.iastate.edu/agdm.

Managerial Costs – C5-209

Opportunity Costs – C5-210

Current Profitability

The following profitability tools have been updated on www.extension.iastate.edu/agdm to reflect current price data.

Corn Profitability – A1-85

Soybean Profitability – A1-86

Ethanol Profitability – D1-10