

The Potential for Creating an Agri-business Financial Rating Agency/System for Kansas

July 2009

This paper is written to address the following Feedgrains and Oilseeds Recommendation.

“To review and research the availability of, or the potential for creating a ‘rating agency/system’ designed for rating the financial integrity of agricultural product buyers including such entities as brokers, buyers, elevators, processors, livestock feeders and ethanol plants. This research should also include an assessment of the potential for Kansas Farm Bureau providing this service.”

Further clarification was provided by the committee. “Given the current volatility in agricultural markets, the potential for Kansas grain and livestock buyers to become financially unstable is high. It is imperative that the interests of Kansas farmers and ranchers be adequately protected; a rating agency/system would allow producers to check the financial viability of prospective buyers prior to selling to or contracting with them (Paul Myers moved, seconded by Dale Peterson).”

Wikipedia tells us that there are two types of credit measuring entities, credit rating agencies and credit bureaus. A **credit rating agency** is a company that assigns credit ratings for issuers of certain types of debt obligations (such as companies, state and local governments, non-profit organizations, or national governments) as well as the debt instruments themselves. Examples of credit rating agencies in the U.S. include, A. M. Best, Moody’s, Standard & Poor’s and Fitch. Often, the debt obligations (securities and bonds) are traded on a secondary market, and the ratings make it easier for investors to more quickly assess risk, thus increasing market efficiency. A credit rating for an issuer takes into consideration the issuer’s credit worthiness, or its ability to pay back a loan. Proprietary analysis and financial ratios are used to assess credit worthiness but rating agencies caution that their advice constitutes only a “point in time” analysis, and are opinions regarding the likelihood that a given debt security will fail to be serviced over a given period of time.

The value of financial credit ratings has been widely questioned, especially after the 2008 financial crisis when the Securities and Exchange Commission submitted a report to Congress detailing plans to launch an investigation into the anti-competitive practices of credit rating agencies. For example, Moody’s, S&P and Fitch, which together control an estimated 90 percent of the market, are considered by the Securities and Exchange Commission to be Nationally Recognized Statistical Rating Organizations (NRSRO’s). This designation makes ratings from them a near requirement for security and bond issuers, and allows those three firms to actually charge the issuers for their rating services. Other rating firms that are not considered NRSRO’s must rely on fees paid by users of their rating services, which is a much more challenging business model. The issue is that a significant waiting period (some would argue for no apparent reason) is required to become a NRSRO, serving as a barrier to market entry.

Other issues related to credit rating agencies include: conflicts of interest, for example, being too familiar and close to company management, thus opening themselves to undue influence or being misled; and that credit rating agencies do not downgrade companies promptly enough. For example, Enron’s rating remained at investment grade four days before the company went bankrupt, despite the fact that credit rating agencies had been aware of the company’s problems for months.

A KFB Commodities Division review of the availability of an agriculturally based rating agency was unsuccessful, as the companies currently providing this service focus on larger companies (including those that are ag-based) that issue debt obligations such as securities and bonds. They do not focus on rating the financial integrity of smaller companies such as a country elevator, local ethanol plant, or feed yard.

A **credit bureau** is a company that collects information from an array of sources (including creditors, lenders, utilities, debt collection agencies and the courts), making the information available on request to

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their paying customers for the purposes of credit assessments or scoring. While credit bureaus do not report the “financial integrity” of individuals, they do help lenders and business assess an individual’s credit worthiness by providing information on borrowing and bill paying habits, even attaching a credit score, which can be used to compare one consumer relative to another. Examples include Equifax, Experian and Transunion.

A KFB Commodities Division review of the availability of an agriculturally based credit bureau was unsuccessful, as the companies currently providing this type of service focus on individual consumers. The credit bureau approach of reporting on historical borrowing and bill paying habits does appear though, to most accurately meet the committee’s goals; assuming that past performance is the best predictor of future financial integrity.

Further research for this committee recommendation found two entities that are available to protect farmer and rancher interests, the Kansas Grain Warehouse Inspection Program and the Kansas Attorney General’s Office, and one entity, the Better Business Bureau, which reports on a business’s marketplace practices but does not report either individual or business credit information.

The **Kansas Grain Warehouse Inspection Program** was established in 1907, when Kansas enacted its first warehousing laws. Protecting producers and their stored grain is the primary function of this program. The Grain Warehouse Inspection program requires that any entity that stores grain for the public be licensed and agree to abide by the laws and regulations of Kansas. A copy of the year-end financial statement must be filed; a proof of in-bound and out-bound scale tickets must be submitted and approved; stock insurance is required; and depending on the capacity, appropriate fees and either a bond or irrevocable letter of credit must be in place.

While the Kansas Grain Warehouse Inspection Program does work to protect producers and their stored grain, it does not provide farmers with the ability to check the financial integrity of prospective buyers or apply to entities that don’t provide public warehousing such as brokers, feed yards, processors or ethanol plants.

The **Kansas Attorney General’s Office**, through its multiple divisions and sub agencies, assists Kansans (including farmers and ranchers) who bring up legal complaints or questions. They can provide valuable assistance in cases of fraud or other illegal business activities but do not provide a way to assess a business’s financial integrity prior to selling or contracting, nor can they protect the interests of a farmer if an agri-business legally enters into bankruptcy.

A Review of the Better Business Bureau

The Better Business Bureau (BBB) reports on a business’s marketplace practices. It does not report either individual or business credit information. Their Reliability Reports contain information about the nature of the business, its principal officers, a three-year summary of any complaints processed, and any government action involving the business. See a sample for a Kansas ethanol plant’s Reliability Report in Appendix A.

The Better Business Bureau assigns a “grade,” which represents BBB’s degree of confidence that the business is operating in a trustworthy manner and will make a good faith effort to resolve any customer concerns. Details as to any issues identified by BBB are contained in the business’s BBB Reliability Report. BBB’s rating of a business reflects BBB’s opinion about the business based on information in their files and BBB experience. The rating is not a guarantee of a business’s reliability or performance,

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and BBB cautions users to consider a business's rating in addition to all other available information about the business. Ratings are only available on businesses that are in the BBB database and that occurs:

- a) By becoming an accredited member of their regional Better Business Bureau;
- b) If a complaint was lodged and the BBB contacted the business regarding the nature of the complaint and began the process of collecting information; or
- c) If a consumer (farmer or rancher) formally requests a Reliability Report, in which case the BBB will send a form to the business requesting information, along with conducting their normal data collection.

The Better Business Bureau assigns ratings by evaluating businesses in the following categories:

- BBB experience with the industry in which the business operates
- The business's length of time in operation
- Whether BBB has information that the business does not have required competency license
- Any known government actions against the business that are related to marketplace activities
- Any advertising issues found by BBB
- The number of complaints received by BBB from the business's customers
- The number of complaints received by BBB from the business's customers that are of a serious nature
- Whether the business has responded to complaints received by BBB
- Whether complaints have been resolved in a timely manner or the business has demonstrated it made a good faith effort to resolve them
- The business's overall complaint history with BBB
- Whether the business has failed to resolve the underlying cause(s) of a pattern of complaints
- Whether the business has honored any commitments to BBB to arbitrate or mediate disputes and comply with arbitrator decisions and mediated settlements
- Whether BBB has sufficient background information and clear understanding of the business
- Whether the business is a BBB Accredited Business
- Whether BBB Accreditation was revoked because the business failed to comply with agreed BBB standards

Ratings are determined by a proprietary formula that represents BBB's opinion as to (1) the importance of each category, and (2) the appropriate score given to the business for each category. BBB assigns grades from A to F with pluses and minuses. A+ is the highest grade and F is the lowest. A business may receive an "NR" (No Rating) instead of a rating under circumstances that include: the BBB file is being reviewed or updated; BBB does not have sufficient information about the business; or recent activity requires further review by BBB.

Better Business Bureau accreditation means the business meets BBB accreditation standards which include the Better Business Bureau Code of Business Practices and a commitment to make a good faith effort to resolve any consumer complaints. BBB accredited businesses pay a fee for accreditation review/monitoring and for support of BBB services to the public. BBB accreditation does not mean that the business's products or services have been evaluated or endorsed by BBB, or that BBB has made a determination as to the business's financial integrity.

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Kansas is currently served by two Better Business Bureau Offices:

BBB of Northeast Kansas

WWW: <http://topeka.bbb.org>

Email: tjyoungbbb@kansas.net

Phone: (785)232-0454

Fax: (785)232-9677

501 Southeast Jefferson, Suite 24

Topeka KS 66607-1190

BBB of Southeast, Central & Western Kansas

WWW: <http://wichita.bbb.org>

Email: info@wichita.bbb.org

Phone: (316)263-3146

Fax: (316)263-3063

345 N. Riverview Street, Suite 720

Wichita KS 67203

The Better Business Bureau: A Possible Solution?

While the credit bureau approach, based on collecting and reporting information regarding borrowing and bill paying habits appears to most accurately meet the committee's goals, the Better Business Bureau, while not a true credit bureau, does appear to be the best choice of the currently available business rating systems reviewed.

Similarities between the Better Business Bureau and a typical credit bureau include the fact that they provide business ratings which clearly indicate their opinion about the individual business and can be used to compare businesses. In addition, their ratings in part reflect information collected from court and government actions taken against the business and the length of time the business has been in operation.

A positive regarding the Better Business Bureau rating system approach is that they report on a business's marketplace practices, namely whether any complaints have been processed. This is a benefit because it creates a venue for customers (farmers and ranchers) to provide timely feedback regarding the business's buying and selling actions.

Another benefit to the BBB approach is their accreditation process, allowing businesses to voluntarily join and demonstrate their commitment to making a good faith effort to resolve disputes and complaints. Membership is relatively affordable, varying with the number of employees. A side benefit of BBB membership includes the opportunity for agri-businesses to participate in a group health and dental package.

A further benefit to the BBB approach is that Reliability Reports are available to consumers (farmers and ranchers) free of charge, with the costs of administering the BBB coming from member businesses. In contrast, conventional credit bureaus are funded through fees they charge clients for the reports they provide.

A challenge with the Better Business Bureau rating system approach is the fact that they do not utilize the network of financial data sources that conventional credit bureaus do, and as a result their reports don't include the payment history information that a conventional credit bureau provides, or the financial analysis that a credit rating agency provides. While this lack of financial detail is a challenge, the BBB approach, which provides farmers and ranchers the opportunity to report disputes and complaints, does provide a "history of marketplace practices" that at least in part, reflects a business's financial integrity.

Likely the biggest challenge with the Better Business Bureau rating system approach is that few agri-businesses currently participate with the BBB. A KFB Commodities Division review could only find ten agri-businesses accredited through the BBB of Southeast, Central and Western Kansas (the Wichita-based office serving 80 Kansas counties), including one feed yard, one livestock auction and two ethanol

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plants. Using the BBB website and their “Check out a Business or Charity” link, we ran the eleven currently operating Kansas ethanol plants and reports were only available on two. We also tried to look up ten randomly selected, moderate sized feed yards (5,000 to 20,000 head capacity) and no reports were available. Subsequent phone interviews with the Wichita office revealed issues with their website’s “business look up” application and as result, the number of agri-businesses in their database was found to be larger than the website search revealed, yet the overall number of agri-businesses is still very low.

It should be noted that collecting financial information on the many moderate sized, regional and local agri-businesses in Kansas, and getting them to cooperate fully, will likely be a tremendous challenge regardless of the rating system utilized or developed.

Creating an Agri-Business Rating Agency

The idea of “creating a ‘rating agency/system’ designed for rating the financial integrity of agricultural product buyers,” has two primary challenges; the first is conceptual, how do you rate the financial integrity of agricultural product buyers? The second is financial, what will it cost and how do you pay for it? The goal of this section is to briefly outline the conceptual and financial challenges that creating an agri-business rating agency would entail. If a decision was made to proceed further with this idea, more research would be needed and a more robust business plan required before a go/no go decision could be considered.

Regarding the potential for Kansas Farm Bureau providing/creating this service is a decision left to the KFB Board of Directors. The current framework of Kansas Farm Bureau and Agricultural Solutions, LLC, likely provide the business flexibility for KFB to pursue this type of entity if it were deemed a service needed but not available through other sources. The question that would need to be answered is whether or not a profitable business plan could be developed and implemented.

Conceptually, three methods might be used to rate the financial integrity of agricultural product buyers.

- 1) The credit bureau concept based on collecting and reporting information regarding borrowing and bill paying habits; relying on the assumption that past payment performance is a valid predictor of future financial integrity. This approach would likely be the most difficult to implement because it would require the collection of borrowing and bill paying data not just from major retailers, banks, utilities and creditors as is currently done by conventional credit bureaus but additional data would need to be collected from the vast number of farmers and ranchers who also deal with these regional and local agri-businesses.
- 2) The credit rating agency concept whereby analysis and financial ratios are used to assess credit worthiness; relying on the assumption that a point in time analysis is a valid predictor of future financial integrity. This is a potentially workable concept. A team of lenders, academicians and financial consultants could create a financial analysis template utilizing standard year-end financial and/or tax return data that resulted in a score conceivably representing financial integrity. Credit rating agency staff could then work with agri-businesses to collect the appropriate data, manage the database and make credit ratings available. The challenges and pitfalls to this approach are:
 - a. It is still merely a point in time analysis and given the potential volatility and seasonality in agriculture, may not react quickly enough to adequately forewarn farmers that a particular firm is in financial difficulty.
 - b. Just as with any agricultural rating system, it would likely be extremely difficult to get broad-based participation, including getting agri-businesses involved and providing data, and getting farmers and ranchers to demand and pay for the information.

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- 3) The Better Business Bureau approach where you focus on the business's marketplace practices; summarizing the number of complaints processed and any government actions involving the business, along with documenting the business's commitment to sound business practices and good faith efforts to resolve consumer complaints. This too is a potentially workable concept with bureau staff collecting data from businesses and farmers and ranchers, compiling reports, and working with the appropriate parties to resolve disputes and complaints. But like the previous concept, the Better Business Bureau approach would likely have similar challenges in achieving an adequate level of broad-based participation from both the agri-business community and individual farmers and ranchers. It should be noted that if this was the concept selected to move forward with, working to expand the current BBB should be actively explored before the creation of a competing BBB is considered.

The financial challenges of creating a rating agency/system would largely be similar to those facing any startup company, obtaining adequate capital and a client base large enough to support the business. What follows is a brief cost analysis based on a few simple assumptions and our experience with the KFB budget process. We assume a start small, go slow approach, beginning with a two-person office and initially operating in a four or possibly nine county block before expanding.

A simple, annual budget might look like this:

Rent and Utilities	\$ 25,000
Office Administration	\$ 50,000
<u>Salaries and Benefits</u>	<u>\$125,000</u>
Est. Annual Budget	\$200,000

Assuming the above annual budget is reasonable, one can then examine the breakeven number of subscriptions, given various farmer and rancher annual subscription rates. Note that it is not reflected in this analysis but a significant amount of time would be needed to build the initial database, likely requiring the entity to operate for at least a year with little significant income.

<u>Annual Subscription Rate</u>	<u>Breakeven Farmers</u>
\$ 30	6,667
\$ 50	4,000
\$100	2,000
\$200	1,000
\$300	667
\$500	400

While the above analysis is relatively simplistic, it does illustrate the financial challenges one would face if creating an agri-business rating system. Raising the question of whether enough farmers in a given geographic area would perceive the value of the service and pay the necessary fees? For example, if a two-person office could cover half of Kansas, would 2,000 farmers be willing to pay \$100 per year for the service? Could you find 4,000 farmers that would pay \$50 per year? Would the benefits of the service and information be great enough for farmers to justify the annual cost?

If the answers to the above questions are yes, and the decision was made to move forward with creation of a rating service, more research would be needed and a more robust business plan and projection required before making a go/no go decision.

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Concluding Remarks and Issues for Thought

This paper is written to address the following Feedgrains and Oilseeds Recommendation.

“To review and research the availability of, or the potential for creating a ‘rating agency/system’ designed for rating the financial integrity of agricultural product buyers including such entities as brokers, buyers, elevators, processors, livestock feeders and ethanol plants. This research should also include an assessment of the potential for Kansas Farm Bureau providing this service.”

This paper is intended to provide background information about services or systems that would rate the financial integrity of buyers of agricultural products and to assist Kansas Farm Bureau members as they consider the pursuit or implementation of such a rating system. Various approaches to collecting data and reporting credit information are defined and discussed, and a potentially viable, affordable and available (yet currently underutilized by agriculture) option was identified, the Better Business Bureau. Lastly, three conceptual approaches to creating a rating system along with the financial challenges were briefly outlined.

Given this review document and the concerns raised regarding the value, timeliness and accuracy of rating agency scoring, a key question that must be answered is; should Kansas Farm Bureau proceed with this idea?

If so, should Kansas Farm Bureau promote the efforts of the currently available and affordable Better Business Bureau and its approach and rating system, rather than proceed to create an alternative financial rating system?

And finally, if the Better Business Bureau is not seen as an adequate solution, how much is a Kansas farmer willing to pay for access to an agri-business rating system, and how many farmers would participate?

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Appendix A – Sample Better Business Bureau Reliability Report

BBB® Serving Southeast, Central, and Western Kansas
345 N. Riverview St., Ste 720
Wichita, KS 67203
(316) 263-3146
www.wichita.bbb.org



BBB Reliability Report for

Western Plains Energy LLC

A BBB Accredited business since 09/15/2008.

BBB Rating A+

BBB issues Reliability Reports on all businesses, whether or not they are BBB accredited. If a business is a BBB Accredited Business, it is stated in this report.

BBB Accreditation

This company has been a [BBB Accredited business](#) since September 2008. This means it supports BBB's services to the public and meets our BBB Accreditation standards.

BBB Rating

Based on BBB files, this business has a BBB Rating of A+.

[Click here for an explanation of BBB Ratings](#)

Business Contact and Profile

Name: Western Plains Energy LLC
Phone: (785) 672-8810
Address: 3022 County Road 18
Oakley, KS 67748-6064

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Website: westernplainsenergy.biz

Original Business Start Date: August 2001

Principal: Mr. Steven McNinch, CEO

Customer Contact: Mr. Steven McNinch, CEO

Entity: Limited Liability Corporation

Incorporated: July 2001, KS

Employees: 36

TOB Classification: Gasoline Additives-Manufacturers & Distributors

BBB Accreditation: This organization is a BBB Accredited business.

Products and Services

This company offers production of ethanol.

Customer Complaint History

BBB processed a total of 0 complaints about this company in the last 36 months, our standard reporting period.

BBB Program Participation

This company has agreed to use special procedures including arbitration, if necessary, to resolve disputes through their participation in the following programs: BBB Identification, BBBOnLine.

Government Actions

BBB has no information regarding government actions at this time.

Advertising Review

BBB has no information regarding advertising review at this time.

BBB Copyright and Reporting Policy

As a matter of policy, BBB does not endorse any product, service or business.

BBB Reliability Reports are provided solely to assist you in exercising your own best judgment. Information in this BBB Reliability Report is believed reliable, but not guaranteed as to accuracy.

BBB Reliability Reports generally cover a three-year reporting period. BBB Reliability Reports are subject to change at any time.

If you choose to do business with this business, please let the business know that you contacted BBB for a BBB Reliability Report.

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Report as of June 19, 2009 15:51

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