

Consider a Co-Packer: A Risk Management Tool

Do you have a food product or an idea for a food product? Is capital for investment in a building and processing equipment a problem? Is your bank telling you the risk is too great to secure start-up financing? These are common issues that people have when considering starting a food processing business. There is an alternative that will allow you to process a product and introduce it into the market with minimal economic risk: find and hire a contract packer.

A contract packer (or co-packer) is a manufacturer that has excess processing capacity and is willing to process your product under a private label for a fee. Contract packers are used more often than most people realize. For example, a well-known manufacturer of a national brand of ketchup may bottle their brand plus they may bottle several grocery chain brands at their processing plant. Most grocery chains do not own processing facilities. Instead, they contract with existing processing plants to package products under their grocery name and package label. A contract packer that has already invested in facilities is able to use extra plant capacity, which allows you as their client to introduce a product to the market with minimal investment risk.

Starting a business is hard, but keeping a business operating and making a profit is harder. Just earning a profit does not guarantee the business will survive. A business must generate a positive cash flow to ensure the business will exist long enough to make a profit. Buying raw materials and meeting weekly payrolls are two expenses that have to be paid, many times, before processed goods are sold and revenues are received. Debt repayment for

buildings and equipment present another major drain on cash reserves of new business ventures.

These are just a few of the financial risks involved with any business venture. Working with a contract packer can help reduce some of these risks for a business. Using a contract packer will allow a business owner to purchase processed product at a predetermined quantity for a one-time, predetermined price. As the packaged product is sold, the business can purchase more product as needed from the contract packer. This arrangement can allow the business to enter a market or test a new product in a market without investing in building and equipment. A new business can reduce the financial risk involved in owning or financing infrastructure, such as building and equipment, until the product is proven in the market. Once your new product is proven successful in the market, you may either invest in a processing facility or continue to use a contract packer.

Product liability is another concern for processed food products. Insurance to cover the liability of consumers becoming ill by a contaminated product is a major source of concern for food processors. Businesses should have product liability insurance as a safety net if a lawsuit is filed against their product. However, because lawsuits will eventually return to the original point of manufacture, the use of a contract packer can reduce some of the legal risk involved in product liability. Reliable contract packers will provide product liability insurance on all their processed goods. The use of a contract packer will provide added legal protection between your firm and possible legal



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claims. The use of a contract packer does not eliminate the need for product liability insurance, but it will reduce the amount of product liability insurance your business will need to purchase.

How do you find a contract packer? Start by looking in trade magazines or by contacting trade associations in your state to identify manufacturers of products similar to what you would like to market. These facilities are set up to handle your packing needs in a cost-effective manner. Call these companies and ask if they contract pack a product or if they are interested in contract packing.

When you have identified a contract packer, ask the owner for some general information about the company and references from other firms that have used their facilities. Ask about minimum order quantities and other services they may offer such as labeling, bottling, distribution and product liability insurance. If possible, shop among several contract packaging companies. This will allow you to compare the services offered and to get competitive rates for processing your product. Deal only with reputable companies that have a history of good business practices and are willing to protect your proprietary product with confidentiality agreements.

You should understand that the contract packer will need to make a profit, but your costs should still be low enough for you to price your final product competitively in the market. It should always be a win-win situation for both parties involved. Many times a contract packer can process the product for a fee that is lower than a small start-up company's processing cost. Additional cost savings may result from economies of size realized by hiring the contract packer to assemble your final product.

Using a contract packer may be the right choice for you, but it should be a consideration for the start-up company with a few products or a company considering expansion into new food product lines. A contract packer enables a company with a great product idea and limited resources to apply more of its resources toward building brand awareness and marketing and place your firm on the road to profitability.

If you'd like to discuss this option further, or if you'd like some help in locating a contract packer, please contact Dr. Ken Hood, hood@agecon.msstate.edu or Dr. Kim Morgan, morgan@agecon.msstate.edu, Department of Agricultural Economics: P.O. Box 5187, Mississippi State, MS, 39762. (662) 325-2750

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By **Dr. Kenneth Hood**, Extension Professor, Agricultural Economics and **Dr. Kimberly Morgan**, Assistant Extension Professor, Agricultural Economics

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