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Implementing Strategy: *The Key Strategic Decisions for the Farm Business*

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Farming success in the past has depended primarily on the ability of farm business managers to develop efficient operations. Successful farm business managers have developed the skill to evaluate new technologies, assess trade-offs between the effectiveness of substitute inputs, and make production process adjustments in order to achieve high levels of output and control production costs. The continual introduction of new input products/technologies for use on farms has provided significant rewards for concentrating on production or "doing things right."

With the continued industrialization of farming, a clear strategy to guide the farm business becomes increasingly important. Such decisions as the product mix of the farm, food-chain linkages, and the financial structure of the business require strategic analysis. The relationship between farm input suppliers and purchasers of farm production continues to change as identity-preserved production increases. The use of contract production increases the importance of carefully selecting partners, because payment for products will depend on the financial health of the partner as well as the market price. In this environment, success in farming will continue to require that operations be efficient, but there will be a growing payoff to strategic decisions or "doing the right thing."

Key Strategy Decisions

The successful farm business must make strategic decisions in seven areas: business enterprise focus, growth/downsizing, marketing and channel linkages, financial structure and business model, organizational structure, social responsibility, and managerial style/lifestyle. This publication briefly describes and illustrates these seven areas of strategic decision making.

Business Enterprise Focus

The choice of a business enterprise requires two critical decisions. First is deciding on the product that will be produced (e.g., corn, soybeans, hogs, cattle, dairy, specialty crops, etc.) and whether that product will be a commodity product or a differentiated product.

Generally, farm business managers have a choice between two quite different strategic directions: 1) a commodity product strategy and 2) a differentiated product strategy. The commodity strategy is the most familiar, exemplified by the production of corn, wheat, soybeans, hogs, milk, and cattle. A differentiated product strategy is exemplified by the production of specialty crops such as vegetables for the fresh or the frozen market and, increasingly, by the production of crops such as food grade

white corn, high oil content soybeans, high protein content wheat, etc. Figure 1 describes and contrasts the characteristics of the market, the managerial skills required, and the strategic approach most likely to be successful in commodity compared to differentiated product production.

A second decision concerns production techniques and process technology. Will hogs be produced with in-line farrow/finish technology or two-site production separating the breeding/gestation/nursery from the finishing? Will reduced tillage techniques be used in crop production? What about precision farming and GPS technology? Will new measuring and monitoring technology that facilitates collecting information on geographically dispersed production sites (e.g., geographic information systems and precision farming)—thus substantially reducing both the costs and constraints of managing a large acreage—be adopted? And, with the rapid rate of technological advance in agriculture, a very difficult strategic decision is when to abandon aging technology in favor of newer, more productive technology.

Figure 1. Alternative Strategic Directions

Commodity Product Strategy	*Differentiated Product Strategy*
Production Emphasis—The focus is primarily on production activities rather than marketing or finance.	**End-User Focus**—The focus is on final consumer or food processors needs rather than commodities.
Manufacturing Mentality—The science and systematic processes of producing commodities are emphasized.	**Distribution/Marketing Mentality**—Marketing and distribution decisions and expectations of consumers are as (or more) important as production considerations.
Low-Cost Producer—Cost control is critical to being competitive in a commodity business.	**Value-Added Production**—The additional revenue to be gained by quality enhancement for further processing is emphasized.
Large-Scale Operation—Larger scale operations generally have cost advantages over smaller scale units.	**Smaller Scale Operation**—A focus on a segmented consumer market and niche markets allows and encourages small scale, and more nimble and flexible producers.
Outsource Resources—Land is rented; machinery is leased or custom hired.	**Insource (Own) Resources**—More land and other resources are owned because the scale of operation is not beyond the financial resource base of the smaller producer.
Open/Impersonal Markets—Markets are open to all who meet gross commodity product standards at publicly known prices.	**Negotiated Markets**—Responding to consumer needs and producing products with specific attributes requires more direct communication throughout the chain.
Downside Price Risk—Excess worldwide production can result in significant downward price movements with supplies slow to adjust.	**Relationship Risk**—Contracts can be terminated and alliances severed unexpectedly.
Independent Decision Making—The traditional independent farmer provides most of the managerial and other resources and makes most of the decisions.	**Interdependent Decision Making**—The negotiated linkages with suppliers and processors reduces independence and forces joint, interdependent decision-making.

Size/Growth

As strategic options are assessed, nine strategic size/growth alternatives are available to the firm. Six of these options deal with growth (increased income or volume, but not necessarily facility size). The other three explore non-growth options. There is a certain logic and/or sequencing of these alternatives, i.e., some should be implemented before others are considered. This sequencing is discussed shortly, but first the alternatives are identified and described.

1. Focus/Specialize—"Stick to your knitting" is a very applicable cliché in this context. The focus of much of a farm business manager's managerial time is committed to improving efficiency and reducing cost. Lower cost producers will tend to have the ability to stay competitive and maintain future operations. Concentrating on one activity (farrowing or finishing, or hogs rather than hogs and grain) can aid in cost reduction through a more intensely managed operation.
2. Intensify/Modernize—The ability to push more production through the same fixed asset base is the concept. A more intensely run operation spreads fixed costs over greater output, lowering the overall cost of production. Accomplishment of this strategy is possible through both a more intensely managed current operation and the adoption of more modern, more intense production technologies. Examples include harvesting more acres with the same size combine by increasing the work hours per day, or higher yields through better fertilizer management.
3. Expand—The most common strategic move for many farm business managers is expansion of facility size. Examples including buying or renting more land, building larger livestock facilities, or getting larger machinery. This over-used method has merit after all possible efficiencies have been exploited with current facilities.
4. Diversify—Diversification, the opposite of specialization, involves the addition of new enterprises to the firm, for example, adding a livestock enterprise to a grain operation. Generally, this option is considered a risk-reducing method. However, because the economic forces that affect one agricultural enterprise generally affect others, this option may not be as advantageous for risk reduction as farm business managers might think. Diversification may also cause management time to be spread too thinly across enterprises. Diversification may have more potential in the exploitation of synergy by capitalizing on such factors as underutilized skills and/or resources, selling multiple products in the same marketing channel, or more fully using knowledge and management skills. And, if the farm business manager is serious about diversification as a risk reduction strategy, then the alternatives considered should include investments that are not subject to the same fundamental economic forces that affect agriculture. Such alternatives might include stocks or mutual funds, bonds, non-agricultural businesses, or residential or commercial real estate. Farm business managers may need the help of outsiders in choosing among these investments, just as they use the best information and expertise to choose among various farm or agricultural investments.
5. Replicate—When growth of the firm is the desired course of action, one option to consider is replication of an existing operation on a different site rather than the expansion of the current unit. The concept is to determine, for example, the most efficient size dairy unit (say 3,000 cows), and then grow by building additional 3,000 cow units. This option allows for decentralized management in smaller units. It is the multi-plant expansion strategy of the industrial complex. This option becomes important in livestock production as issues of odor nuisance and waste handling become more critical.

6. Integrate—Moving forward, backward, or vertically into production/processing may provide real benefits to the system. An example is packing plants on the East Coast raising hogs for their plants. This activity helps the packers eliminate some variability in quality and supply. An example for moderate-size hog producers is becoming part of a cooperative gilt multiplier to supply replacement gilts.
7. Network—There are proven economies of size in production and marketing in crop and livestock enterprises. Expanding a single firm to the size where those size benefits are available is not always the most prudent option. Networking allows a group of smaller operators to look like a large operation to the marketplace. A common strategy used by farmers to acquire inputs is to network through a farm supply cooperative or through less formal arrangements, for example, four tomato growers who pool their Internet purchases of tomato chemicals so they can take delivery of a semi-load.
8. Delay/Wait and See—The decision-making team may survey current conditions and determine that they are not sure what direction to take. In the short-run, inaction may have merit. "Buying time" may provide for new opportunities to manifest themselves. But the key issue with this strategy is to develop a decision trigger that will result in action.
9. Downsize—There are many in farming who are surveying their situation and wondering if continuing to operate at the current size or a larger size is the most logical plan. One strategic size option is to reduce the size of the business. The decision to downsize the business is often linked with a strategy to exit from the business, but this need not be the case. Downsizing may help improve the focus of the business or the efficiency of the business.

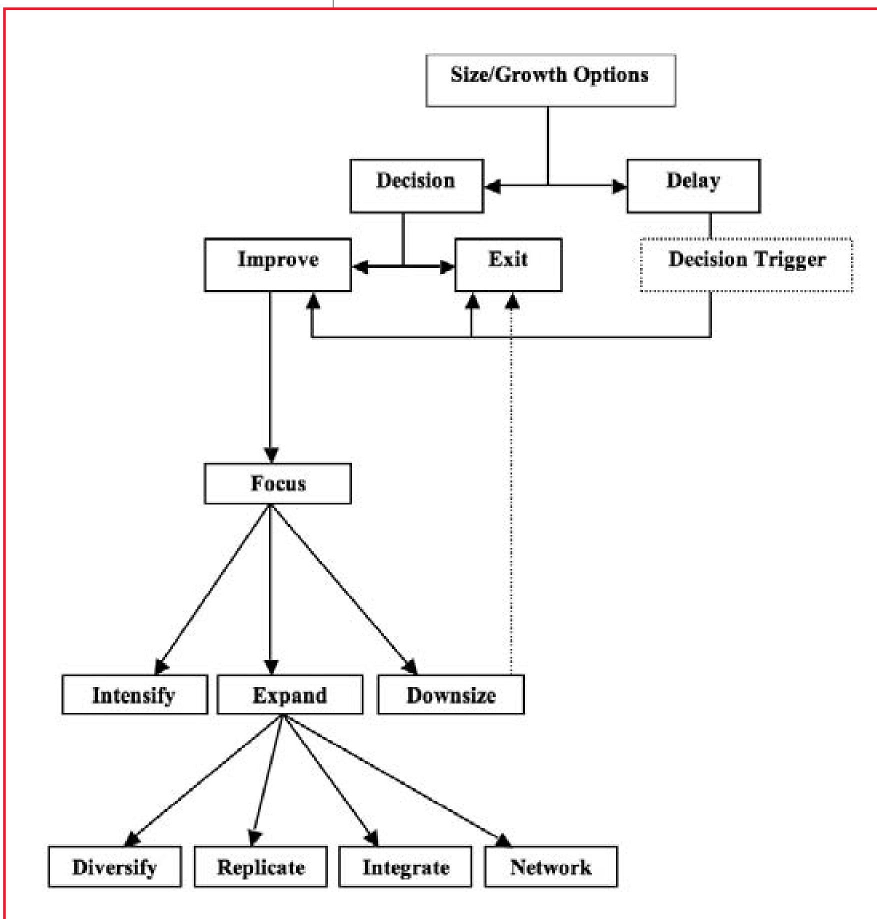

Figure 2. Strategic Planning Options Related to Growth and Downsizing

These strategic size/growth options are shown graphically in Figure 2. Starting at the top of the diagram, the initial decision is to either move toward making a decision or delaying. If farm business managers use the delay option, they need to establish a definite decision trigger that will cause them to move toward a decision. When a decision is triggered, managers are faced with selecting strategies that will lead to improvement or exiting from the business. If the decision is to improve, an initial step is to review the focus of the business. The focus of the business may lead to strategies to intensify, expand, or downsize the business. Expansion is most effective if it is used after all possible efficiencies have been exploited.

Once farm business managers have gained the maximum advantage in their existing operations, they should consider additional ways to improve or to expand their businesses. These include: diversify, replicate, integrate, or network. Growth decisions are difficult to make and require a significant commitment of both time and resources.

Marketing and Channel Linkages

The third area of strategic decision making concerns purchasing or sourcing inputs and selling or merchandising products. Acquiring inputs is in many cases one of the most important strategic decisions made by a firm. If the acquisition cost is too high, it is very difficult to restore profitability through improved efficiency in production or enhanced selling prices. If a farm business manager pays too much for feeder cattle using the open market purchasing strategy, it is hard to offset this high cost of the purchased cattle through improved feed efficiency or rate of gain in the feedlot or negotiating better selling prices for finished cattle.

And the various forms of sourcing and selling strategies today are different from those of the past. In addition to cash markets for inputs or products, futures and options markets might be available to source and sell inputs and products. Group purchasing of inputs through networks or other cooperative buying arrangements can not only generate cost savings from volume discounts, but can often result in higher quality or better services compared to individual purchases. And contract production and other forms of vertical and horizontal alliances and linkages may be part of the marketing and channel linkage strategy. Strategic decisions concerning acquiring labor, leasing or custom hiring machinery services, and renting land are also critical elements of this area of strategic decision making.

Financial Structure and Business Model

The fourth area of strategic decision making concerns the financial and business model structure of the business. Many farms tend to inherit their business structure from the past. For example, they are organized as a sole proprietorship, a partnership, or a corporation because that's the way it has always been done. Farm business managers finance their business with contributed capital and retained earnings combined with debt because that is the traditional financing structure for small businesses. But the strategic choices for financing and organizing the business are much broader and more complex than those traditionally used.

Farm business managers must make key strategic decisions with respect to not only the legal structure, but they also must make decisions regarding:

- Forms of equity capital, including the possibility of outside investor capital as well as different techniques to retain earnings to contribute to equity capital.
- The use of different types of debt arrangements and instruments, including fixed versus variable rate loans with different terms from different institutions with different amortization schedules.
- The business arrangement (e.g., contract production or joint ventures vs. independent production.)
- Leasing options (e.g., various capital leasing arrangements for equipment and alternative rental arrangements for farm land.)

The choice of the proper financial structure and business model for the farm business may have as much to do with its ability to withstand risk as the choice of business enterprise focus and marketing and channel linkages.

Organizational Structure

Strategy is implemented through organizational structure. As the business grows, the farm business manager needs to think about how the activities and tasks will be organized and who will be responsible and accountable for implementation—organizational structure.

The simplest structure and the usual starting point for small businesses is hierarchical, with all employees reporting to the owner-manager. Oversight of all employees and all activities becomes too large a task for the owner-manager in larger firms. Also, the simple manager-employee structure may be inefficient on farms where there is more than one owner-manager. In these situations, delegating or dividing responsibilities will facilitate increased management effectiveness by reducing duplication of effort and allowing managers to specialize.

Two common ways of dividing responsibilities for management tasks are along functional lines and along enterprise or product lines. For example, a functional structure might include both a production operations manager and a manager responsible for marketing, finance, and human resources. These managers might both report to the farm's general manager, who is responsible for strategy and public/external relations. An enterprise structure might include crop and livestock managers who both report to the farm's general manager.

On smaller farms that are organized along functional or enterprise/product lines, teamwork typically is required to get everything done. Thus the structural lines are necessarily blurred with respect to tasks, but not with respect to responsibility and accountability. For example, the marketing manager may run the corn planter in the spring, and the crop manager may turn out in the wee hours to help load hogs. In farm partnerships, or other multi-owner businesses, it is common for the owners to share some functional responsibilities, such as strategy and financial management, and to divide up other management responsibilities along either functional or enterprise lines. For example, one partner may manage the dairy enterprise, and the other manage crops and forages.

Regardless of the form of structure selected, the basic principles for structuring businesses should be followed. For example, the parity principle requires authority be delegated along with responsibility. Don't delegate responsibility for accomplishing tasks and withhold the authority to do it right. This and other principles of organizational structure are discussed in Purdue Extension Publication EC-729, "Principles for Structuring Small Businesses and Farms."

Social Responsibility

An increasingly important area of strategic decision making for farm business managers is perhaps captured best by the phrase "social responsibility." Regulators and a wary public are asking producers to be more environmentally responsible. They are asking questions about the possible pollution of surface and ground water and even of air. Concerns about the chemicals used in agricultural production and safety of the food supply are expressed more frequently today than in the past. The way that animals are housed and handled in the production and marketing process is subject to increased public scrutiny. The public, particularly neighbors, are concerned about the location of livestock facilities and the odors that might result. Some are asking questions about worker safety and whether farm employees have a safe working environment.

Like it or not, more and more farmers and farming practices are coming under public scrutiny, and the strategic response—whether it be in the form of trying to better

inform the public and neighbors, changing cultural practices and production techniques (e.g., more no-till, reduction of N and P use, nutrient management plans, containment facilities, knifing in manure, shelter belts, etc.), or choosing a different location for certain enterprises—is critical to the long-term success of the farm business. The strategic response must encompass more than a "public relations campaign" to convince skeptics that "we are right and they are wrong."

Managerial Style/Lifestyle

The final area of strategic decision making for any farm business manager relates to managerial style as well as lifestyle of the manager/operator of the business. Farm business managers must make key decisions concerning whether they will attempt to make all the decisions and do all the work, or delegate some of the decisions and/or work to others. Will service companies be used for certain tasks such as chemical application? Is the manager and organization committed to continuous improvement and learning new ideas, or do they want to stay with the "tried and true" and just do it better than anyone else? Does the farm business manager want to be primarily an operations manager or a general manager? How will the workforce be managed and motivated, with an employer-employee (boss-worker) approach or with a leader-team approach?

This area also includes strategic choices about the amount of time and labor contribution the farm business manager wants to make to the farming business compared to other business ventures, off-farm employment, or leisure and family activities. Farm business managers must make strategic choices concerning the level of risk that can be accepted and the financial and personal stress that can be managed or tolerated. And they must make important decisions about the level of consumption expenditures and living style that are desired and achievable from the farm.

A Final Comment

Strategic thinking is critical for the long-term success of a farm business, but it is frequently perceived to be a rather abstract concept and difficult to translate into specific decisions. Strategy can only be implemented by making concrete decisions about the future of the business—decisions concerning the business enterprise focus, size and growth, marketing and channel linkages, financial structure and business model, organizational structure, social responsibility and managerial style/lifestyle. These strategic choices must be guided by the vision that the owners have for the business and the economic forces that are shaping the industry.

This publication is part of a series on applying strategic thinking to your farm. Each publication has a unique focus, enabling you to select those topics of greatest interest to you, and contains reading materials and work exercises to help you—the farm business manager—develop, review, and, if necessary, modify your strategy for future business success.

Publications in the series are available at <www.agcom.purdue.edu/agcom/pubs/agecon.htm> and include:

EC-712	Measuring & Analyzing Farm Financial Performance
EC-716	Strategic Planning: Scanning the Horizon
EC-717	The Competitive Environment: New Realities
EC-719	Selecting and Managing Consultants
EC-720	Developing Vision and Mission Statements
EC-721	The Internal Analysis of Your Farm Business: What Is Your Farm's Competitive Advantage?

Other materials are available on-line at <www.agecon.purdue.edu/extension/sbpcp/>. This site contains information about strategy as well as financial management.

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