Strategic Business Management
Principles for the Agricultural
Production Sector in a Changing Global
Food System

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Strategic Business Management Principles for the Agricultural Production Sector in a Changing Global Food System

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Agricultural industries, producers, and producer organizations are often counseled to develop strategies or strategic alliances to address changing market and political environments. Over the next twenty years, production agriculture will experience fundamental changes, which, because of its rapidity and permanence, could surpass the tremendous changes that have occurred over the past fifty years. As the structure of agricultural production changes, so will the role and scope of agricultural producer organizations. Surviving organizations will be forced to fundamentally restructure their mission, goals, and purpose. Consequently, the application of strategic business management concepts will be increasingly more important for these groups over the next decade than at any previous time.

The purpose of strategic business management is to build a strategic (or competitive) advantage over rival firms (or organizations) which can lead to long-term above-average returns for a firm in an industry. In general, successful companies employ one of three strategies: (1) a low-cost strategy, (2) a differentiation strategy, or (3) a focus strategy. Each of these strategies provides direction for firm-level decision-making and implicitly develops entry barriers to protect the developed competitive position. In addition, it is essential for a firm to consider strategies to defend its competitive position, lest it be overtaken by other firms who adopt similar market strategies.

The best strategy is ultimately a function of consumer demand and the product/service attributes, core competencies, and managerial skills of each company. However, the worst strategy is being “stuck-in-the-middle,” that is, being unable to compete with others on the basis of cost, value, or market specificity. In any case, rivals may undercut prices, maintain market share, or become the supplier of choice whenever change occurs in an industry. In addition, strategies must be refined as market conditions change.

Over the next twenty years, farms and ranches will gravitate toward one of two production structures. The first type of production structure will be similar to many current farms and ranches in that undifferentiated commodity products will continue to be produced. Only low-cost producers will survive in this sector. A second category of producer will also evolve.
Farms in this category will produce differentiated, identity-preserved products that focus on certain product attributes and consumer demands. Strategic business management abilities will be especially critical for farms that gravitate toward identity-preserved production.

Agricultural producer organizations have historically performed the role of providing a unified voice in relation to commodity programs and other agricultural policies and as a conduit for information among producers. Trade liberalization, an increasingly global food system, the decoupling of commodity program benefits from production, and advances in biotechnology and information technology will alter the focus of agricultural producer organizations.

Surviving organizations will be those who change their primary objective from lobbying for traditional commodity programs to providing resources and services needed by producers to cope with change and to expand profit opportunities. Such organizations will continue to provide valuable lobbying efforts with respect to a new range of issues, such as intellectual patent rights, trade liberalization negotiations, contract law, and environmental awareness. In addition, new roles for agricultural producer organizations will also develop. These will include performing clearing-house functions for biotechnology information, facilitating strategic alliances and farmer-owned cooperative ventures, and developing new educational programs designed to improve members’ strategic and risk management capabilities with respect to specialty food and fiber production. Some producer organizations may provide risk transfer functions for members, serve as contracting agents to facilitate identity-preservation, and organize production contracts that ensure supply availability of specialty food and fiber products.

The combination of agricultural industrialization, trade liberalization, information technology, decoupled farm programs, environmental concerns, and consumer demands for food quality, safety, convenience, and nutrition will lead to unprecedented change in the agricultural production and the food and fiber processing and distribution sectors. Successful farm and ranch managers and commodity organizations are likely to be those who develop strategies which allow them to survive and prosper in this changing environment.
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Introduction
Agricultural industries, producers, and producer organizations are often counseled to develop strategies or strategic alliances to address changing market and political environments. Over the next twenty years, production agriculture will experience fundamental changes, which, because of their rapidity and permanence, could surpass the tremendous changes that have occurred over the past fifty years. The drivers of this change include advances in information technology, biotechnology, trade liberalization, decoupled agricultural programs, environmental concerns, and consumer demands for safe, nutritious, convenient products. Any one of these drivers could cause enormous change. However, their combination will cause dramatic and fundamentally long-lasting structural change.

As the structure of agricultural production changes, so will the role and scope of agricultural producer organizations. Surviving organizations will be forced to fundamentally restructure their mission, goals, and purpose. Consequently, the application of strategic business management concepts will be increasingly more important for these groups over the next decade than at any previous time. The reasons for expecting tremendous change and the use of strategic management principles by the agricultural production sector to adapt to change are addressed in this paper.

The Changing Structure of Agriculture
Agricultural industries are beginning to feel the effects of market globalization, agricultural industrialization, and trade liberalization. Advances in transportation and information technologies have allowed for the globalization of food and fiber processing and distribution. World population is projected to increase from current levels of 6 billion people to 6.5 billion people by the year 2006 (Figure 1). Much of this growth will occur in developing regions (Figure 2). Many food and fiber processing companies have found that growth in relatively mature, developed-economy markets is ultimately limited by a slowly expanding population. Asia and Europe are expected to garner the majority of income growth through 2006 (Figure 3). Technology has allowed firms to expand into those developing economies in which a larger proportion of increasing per capita disposable incomes is spent on improving diets. The evolution of agribusinesses into global entities is possible because of technological change and is being driven by increasing worldwide consumer demand for food and fiber.

Biotechnology now allows the production of crops that have specific attributes sought by consumers. Farmers in the United States, Canada, and...
Argentina are rapidly adopting genetically modified crops (Figures 4, 5, and 6). Eventually, crop and livestock products may be genetically engineered to provide animals and humans with needed vaccines and pharmaceuticals (Bonham 1999). Consequently, new market opportunities are emerging for food and fiber processors that require identity preservation of crop and livestock products with specific attributes. Such products usually must bypass traditional commodity markets to ensure identity specificity and supply. Contract production and both forward and backward vertical integration by investor-owned firms and producer-owned cooperatives are developing to meet this need.

Many societies have decided that the costs of maintaining tax-subsidized income and price supports for agricultural producers have exceeded the benefits. This shift has resulted from improved rural infrastructures,
information technology, and per capita farm incomes that now rival nonfarm incomes in many developed countries. Furthermore, social and demographic changes in many developed countries have altered political and economic desires. Many countries have embraced the concept of less support for production agriculture—a requirement for global trade liberalization. If trade were completely liberalized, countries would specialize in the production of those commodities for which they have a comparative advantage. A comparative advantage exists whenever the costs for one country of producing a commodity are relatively lower than the costs for another country. Note that costs in this context include opportunity costs (i.e., the value of the next best use of resources). No
This movement toward production specialization based on comparative advantage is certainly beneficial to consumers and to those producers in regions that have a comparative production advantage for specific goods. However, for producers lacking those comparative advantages, this movement is extremely painful and can result in the demise of certain agricultural sectors in a region. Strategic business management can be used by industries to develop strategic advantages and increase their ability to compete.

**Strategic Business Management Principles**

The production agriculture and food and fiber processing sectors operate in relatively competitive environments. A competitive business environment is one in which the prices of goods and services are driven toward the marginal costs of production by the entry and exit of firms. Entry occurs when firms in an industry are (or anticipate) receiving *above-average returns*, and exit occurs when firms are receiving *below-average returns* over the long term. That is, if a firm’s resources are earning *below-average returns*, those resources will be redirected to sectors in which returns are commensurate with opportunity costs.

Competition is not defined in terms of numbers of firms competing in an industry. Rather, it is entry (or threat of entry) and exit of firms that, given consumer demands, alter market supply and prices. Hence, supply, demand, and entry/exit are the mechanisms that drive market prices toward the marginal costs of producing a good or service. In such environments, the average firm will receive only a *normal* rate of return over the long term. A normal rate of return implies that resources used in the production of

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**Figure 5. Canada Adoption Rates of Genetically Modified Crops**

![Graph showing Canada Adoption Rates of Genetically Modified Crops]

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A normal rate of return implies that resources used in the production of
goods and services receive compensation equal to their opportunity costs (i.e., the value of their next best alternative) and that returns are sufficient to neither entice additional entry into the industry nor cause additional exit.

Although firms in competitive industries will, on average, receive only a normal rate of return on their investment, technological change, management abilities, location advantages, and many other factors will cause some firms to receive higher-than-average returns (and by extension, some firms to earn lower-than-average returns). The concept that even in a competitive environment, individual firms may have advantages over others is not new. For example, Alderson noted in 1957 that

Every business firm occupies a position which is in some respects unique. Its location, the product it sells, its operating method, or the customers it serves tend to set it off in some degree from every other firm. Each firm competes by making the most of its individuality and its special character. (p. 101)

Formal aspects of strategic business management were introduced in 1980 by Michael Porter in his seminal book *Competitive Strategy*. Porter devised a taxonomy for explaining the wide variety of behavior exhibited by business firms as they compete within an industry. Economists have long noted that a variety of positioning activity occurs in markets that are less than perfectly competitive. For example, Alderson notes that “competition is a war of movement in which each of the participants is searching for strategies which will improve his relative position” (p. 108). Strategic management concepts are widely used by business firms for market positioning and planning.

The purpose of strategic business management is to build a strategic (or competitive) advantage over rival firms, which can lead to long-term above-average returns for a firm in an industry. In addition, it is essential for a firm to consider strategies to defend its competitive position, lest it be
overtaken by other firms who adopt similar market strategies. Porter argues that successful companies employ one of three strategies: (1) a low-cost strategy, (2) a differentiation strategy, or (3) a focus strategy. Each of these strategies provides direction for firm-level decision-making and implicitly employs entry barriers to protect the developed competitive position.

A low-cost strategy occurs when a company in an industry makes decisions to gain a competitive advantage by producing output at the lowest cost per unit among rivals. Although all firms try to reduce production and marketing costs, adopting a low-cost strategy requires managerial decision-making that at all times seeks to control and reduce average costs of production throughout the value chain. This often requires a complete change in traditional ways of performing tasks and/or bypassing some of these tasks in an effort to reduce costs. For example, Iowa Beef Packers radically altered the technology and distribution system of the beef industry, which allowed them to become the low-cost producer of boxed beef.

Low-cost strategies can be employed through attaining scale economies, developing new technologies, outsourcing tasks, integrating market segments, or developing strategic alliances. A low-cost strategy provides a competitive advantage and above-average returns because of resulting larger-than-average margins or through increased bargaining power with purchasers. A low-cost strategy provides barriers to entry because firms employing such a strategy can price their products or services below those of competitors.

Although low-cost producers may initially generate a competitive advantage, several risks exist. For example, firms that pursue low-cost strategies must ensure that they are the lowest-cost producer in an industry. That is, little is gained by being the next lowest-cost producer. In addition, a low-cost strategy will not be successful if technological change alters industry cost structures or if rivals find it relatively easy or inexpensive to imitate the low-cost strategy. Finally, firms can be so focused on lowering costs that they overlook important changes in consumer desires for added quality or service, new developments in related products, and declining buyer sensitivity to price.

A differentiation strategy is one in which a producer incorporates features into goods or services that cause buyers to prefer that firm’s product/service over those of others. That is, differentiation seeks to increase the demand for a good or service and/or capture consumers who have relatively inelastic price elasticities of demand. Branded beef products that are geographically widely distributed (such as Certified Angus Beef) represent an example of a differentiation strategy. Because differentiation adds costs to products and services, it is essential that a differentiation strategy produce an output for which a premium can be charged in excess of added costs. In addition, successful differentiation strategies must create value for buyers that is not easily copied by rivals. Failure to do so results in a firm developing a market only to find that others can easily enter the market and gain an advantage without having to incur market development costs.

Successful companies employ one of three strategies:
(1) a low-cost strategy,
(2) a differentiation strategy, or
(3) a focus strategy.
Successful differentiation allows firms to command premium prices, increase unit sales, and/or build brand loyalty. Such a strategy can generate larger profit margins and provide bargaining power over purchasers and input suppliers.

Differentiation strategies are often attained by generating product attributes that are valued by purchasers for tangible or intangible reasons. Differentiation strategies fail when focus is erroneously placed on features that buyers do not perceive as providing added value, features for which price premiums in excess of perceived value are charged, or features that exceed buyers’ needs. In addition, such strategies sometimes fail because signals of value are inadequately communicated to buyers. Thus, differentiation strategies must not only provide appropriately priced features desired by consumers but also signal the value contained in added features.

A focus (or niche) strategy may contain elements of either a low-cost or a differentiation strategy, but it is tailored to a narrow market in which buyers have unique characteristics or requirements. Such markets might be defined geographically or by purchaser incomes, ages, demographics, or exacting specifications. For example, Laura’s Lean Beef Company produces lean beef products without using growth hormones. Although 1,600 stores now carry their “all-natural” products, their base marketing efforts center on direct communication with customers and specialty stores. Their focus strategy is centered on providing a differentiated product to a target market niche.

A focus strategy entails doing a better job of serving buyers in a target niche market than rivals. This can be accomplished either through providing products or services at lowest cost or by providing superior value for a narrowly defined market segment. Such strategies tend to work best in markets that are being “ignored” by other firms because of a lack of knowledge or because established firms find it too costly to tailor products for small-volume niche markets.

Knowledge of niche markets and ability to provide exacting products or services serve as barriers to entry. However, such strategies do entail risks. For example, larger competitors may find effective ways to match the value being offered by a firm using a focus strategy in serving a target market. Niche buyers’ tastes and preferences may eventually gravitate toward product attributes desired by a broader market. Finally, a niche market may become so appealing that it becomes crowded with aggressive rivals, causing profits to be split among many firms.

The best strategy is ultimately a function of consumer demand and the product/service attributes, core competencies, and managerial skills of each company. However, the worst strategy is being “stuck in the middle,” that is, being unable to compete with others on the basis of cost, value, or market specificity. In any case, rivals may undercut prices, maintain market share, or become the supplier of choice whenever change occurs in an industry. In addition, strategies must be refined as market conditions change.
Strategic Business Management and Farmers and Ranchers

Although farmers and ranchers have experienced slow and often painful changes caused by the changing structure of agriculture over the past seventy-five years, the pace of change may accelerate over the next twenty years. The trend toward decoupling commodity programs from agricultural production in developed economies means added flexibility in making crop and livestock enterprise decisions. However, with this added flexibility comes added risk. Producers are increasingly confronted with decisions regarding the production of new identity-preserved products and opportunities for investment and participation in value-added, vertically integrated food and fiber processing firms. As agricultural producers move closer to consumers in the food and fiber processing market, they must not only evaluate risk but also think and communicate with others using the language of their competitors—strategic business management.

Over the next twenty years, farms and ranches will gravitate toward one of two production structures. The first type of production structure will be similar to many current farms and ranches in that undifferentiated commodity products will continue to be produced. Only low-cost producers will survive in this sector. Technological change will continue to decrease real commodity prices. The adoption of biotechnology may accelerate that trend. The desire of producers to maintain living standards comparable to their nonfarm peers will force those remaining in this sector to operate farms and ranches that are, on average, substantially larger than is currently the case (Johnson, Zidack, and Angvick 1995). Because of their size and purchasing power, many of these low-cost producers will not be price-takers in input markets. Many input suppliers already focus their sales efforts on large farm/ranch firms with expansion potential (Akridge, Offutt, and Downey 1995). Such production units often require added value and additional service. In addition, larger farms/ranches will likely have interest in forward vertical integration activities. Consequently, strategic business management will be directly applicable to these producers.

A second category of producer will also evolve. Farms in this category will produce differentiated, identity-preserved products that focus on certain product attributes and consumer demands. The average size of these farms and ranches may not be as large as farms and ranches in the low-cost, undifferentiated production category. But the ability to negotiate contracts, manage risk, and use information technology will be essential for the production of differentiated products. Members of this group are likely to be involved in forward vertical integration through contractual arrangements that reduce risk or through investments in new generation cooperatives that produce value-added products. Strategic business management abilities will be essential for farms that gravitate toward identity-preserved production.

Strategic Business Management and Agricultural Producer Organizations

Agricultural producer organizations have historically performed the role of providing a unified voice in relation to commodity programs and other agricultural policies and as a conduit for information among producers. Trade liberalization, an increasingly global food system, the decoupling of
commodity program benefits from production, and advances in biotechnology and information technology will alter the focus of agricultural producer organizations.

Surviving organizations will be those who change their primary objective from lobbying for traditional commodity programs to providing resources and services needed by producers to cope with change and to expand profit opportunities. Such organizations will continue to provide valuable lobbying efforts with respect to a new range of issues such as intellectual patent rights, trade liberalization negotiations, contract law, and environmental awareness.

New roles for agricultural producer organizations will also develop. These will include performing clearinghouse functions for biotechnology information, facilitating strategic alliances and farmer-owned cooperative ventures, and developing new educational programs designed to improve members’ strategic and risk management capabilities with respect to specialty food and fiber production. Some producer organizations may provide risk transfer functions for members, serve as contracting agents to facilitate identity-preservation, and organize production contracts that ensure supply availability of specialty food and fiber products.

Agricultural producer organizations will be faced with increased demands for education regarding contract liability, negotiation strategy, dispute settlement, the dynamics of extended business relationships, and the trade-offs between price risk and business risk associated with selection of contracting firms. In addition, these organizations may research and publish information regarding the business worthiness of specific contracting firms and the historical and current contract terms for specific production agreements negotiated by producer/members with agribusinesses.

Developing and Implementing Strategic Plans
Developing a strategic plan is time consuming and hard work. It requires tremendous introspection and willingness to understand, accept, and adapt to change. In addition to brainstorming regarding future opportunities and obstacles, one must also be willing to realistically evaluate current and future weaknesses. Much of the effort involves envisioning the potential of a variety of (sometimes) abstract alternatives and then formulating a written plan that outlines the competitive environment. The external competitive environment is defined by the composition and relative bargaining power of rivals, input suppliers, customers, potential new entrants, and substitute products. The internal competitive environment consists of the strengths, weaknesses, opportunities, and threats facing a firm and its eventual strategic responses to each.

A complete strategic plan begins with a mission statement, which focuses the planning process. Next, a vision statement is developed, which identifies how goals will be accomplished. Finally, a written strategic plan must include specific tasks that will be followed to implement the plan and the steps that must be taken to protect a strategic position. Strategic plans are dynamic thought processes that must be revisited and altered in response to changing industry climates.
Historically, organizations such as business firms, government agencies, universities, and producer groups have engaged in strategic planning activities because of perceived benefits from such actions. Business firms tend to implement and frequently update strategic plans. However, most other organizations find it difficult or impossible to implement strategic plans. Difficulties arise because of the committee nature of management, heterogeneity of business cultures, diversity of personal incentives, and because change is costly and does not benefit everyone. In addition, commodity organizations seldom possess the property rights to assets or resources required for significant reallocation, nor do they tend to be sufficiently capitalized to initiate costly industry changes.

Because most farm and ranch firms have historically functioned as price-takers in commodity markets, strategic planning was not likely to yield tremendous benefits. Essentially, the only plan that could be implemented in such markets was to be a low-cost producer. The existence of commodity farm programs also obviated much of the need for strategic planning.

Given the dual owner/operator status of most farm and ranch managers and the complexities of family involvement, managers are often not willing to engage in the introspection process necessary for developing successful strategic plans. But anticipated changes in the structure of production agriculture are likely to make strategic planning an important aspect of future farming and ranching. Farmers and ranchers are more likely than commodity organizations to implement such plans because they have the capacity to reallocate resources. However, actions by individual farm and ranch managers will not be sufficient to generate the types of changes needed throughout the marketing channel to create competitive advantages for industries. Thus, commodity organizations may provide a leadership and partnering role with farm and ranch managers in developing strategic plans for agricultural production industries in response to global changes.

**Developing a Strategic Plan**

As is the case for developing any plan, strategic planning can only proceed after goals have been established. Thus, the first step in strategic planning is for an organization or firm to define quantifiable short- and long-term goals. For a producer organization, goals might be related to membership or budget levels or to participation at educational seminars or annual meetings. For farm/ranch firms, goals could be related to financial measures, size of operation, family member involvement, or inter-generational transfers. Goals must be well defined and measurable. The process of goal setting provides direction and focus for the planning process.

Once goals have been established, the remainder of the strategic planning process defines options that enable an organization or firm to reach its goals. These options are developed after considering the current and future external environment, including the relative market dominance of rival firms, input suppliers, output purchasers, potential entrants, and substitute products. Next, a thorough introspection of a firm’s internal environment is required, including a firm’s strengths, weaknesses, opportunities, and threats. Finally, a strategic plan is crafted that outlines a competitive strategy. The plan must describe specific tasks that must be implemented.
to reach short- and long-term goal, and delineate specific actions that produce entry barriers.

Conclusions
The combination of agricultural industrialization, trade liberalization, information technology, decoupled farm programs, environmental concerns, and consumer demands for food quality, safety, convenience, and nutrition will lead to unprecedented change in the agricultural production and the food and fiber processing and distribution sectors. Farm and ranch managers and commodity organizations are often counseled to develop strategies or strategic alliances to respond to change. Strategic management concepts, which have been commonly used by businesses outside the agricultural arena for the past fifteen years, will be essential tools for farmers, ranchers, and commodity organizations to generate competitive advantages in response to global change. The process of strategic planning begins with the establishment of quantifiable short- and long-term goals. The next step is to consider alternatives by evaluating the current and future external and internal competitive environments. A strategic plan is then developed based upon future expectations and an organization’s core competencies.
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