IMPLEMENTING STRATEGY: THE KEY STRATEGIC DECISIONS FOR THE FARM BUSINESS

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Abstract

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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 processes 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 rather than the market. 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, organizational structure, managerial style/lifestyle, and social responsibility. The types of decisions that farm business managers must make in each of these areas are summarized in Figure 1. This discussion will briefly describe and illustrate these seven areas of strategic decision making.

Business Enterprise Focus

The choice of a business enterprise focus requires two critical decisions. First is 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 (Figure 2). The commodity strategy is the most familiar, as 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

Figure 1. Key Strategic Decisions

I. Business Enterprise Focus
   A. Product
   B. Production/Process Technology
II. Size/Growth
   A. Focus/Specialize
   B. Intensify/Modernize
   C. Expand
   D. Diversify
   E. Replicate
   F. Integrate
   G. Network
   H. Delay/Wait and See
   I. Downsize
III. Marketing and Channel Linkages
   A. Sourcing and Purchasing Resources
   B. Merchandising and Selling Products/Services
IV. Financial Structure
   A. Business/Legal Choices
   B. Leasing Options
   C. Equity Sources
   D. Debt Decisions/Instruments
V. Organizational Structure
VI. Social Responsibility
VII. Managerial Style/Lifestyle
   A. Learning New Skills
   B. Time/Labor Contribution
   C. Risk/Stress Level and Attitudes
   D. Living Expenditures

fresh or the frozen market and, increasingly, in the production of crops such as food grade white corn, high oil content soybeans, high protein content wheat, etc.

A second decision concerns production techniques and process technology. Will hogs be produced in in-line farrow/finish technology or three-site production separating the breeding/gestation from the 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.

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.

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.

3. Expand – The most common strategic move for many farm business managers' is expansion of facility size. 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. 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, multiple products in the same marketing channel, or knowledge and management skills. And if the farm business manager

Figure 2. 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 process of producing food products rather than the art of raising commodities is 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 further processing and distribution 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, 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.	**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.

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 impact 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. This option allows for decentralized management in smaller units. It is the multi-plant 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 horizontally 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 production. 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.

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.

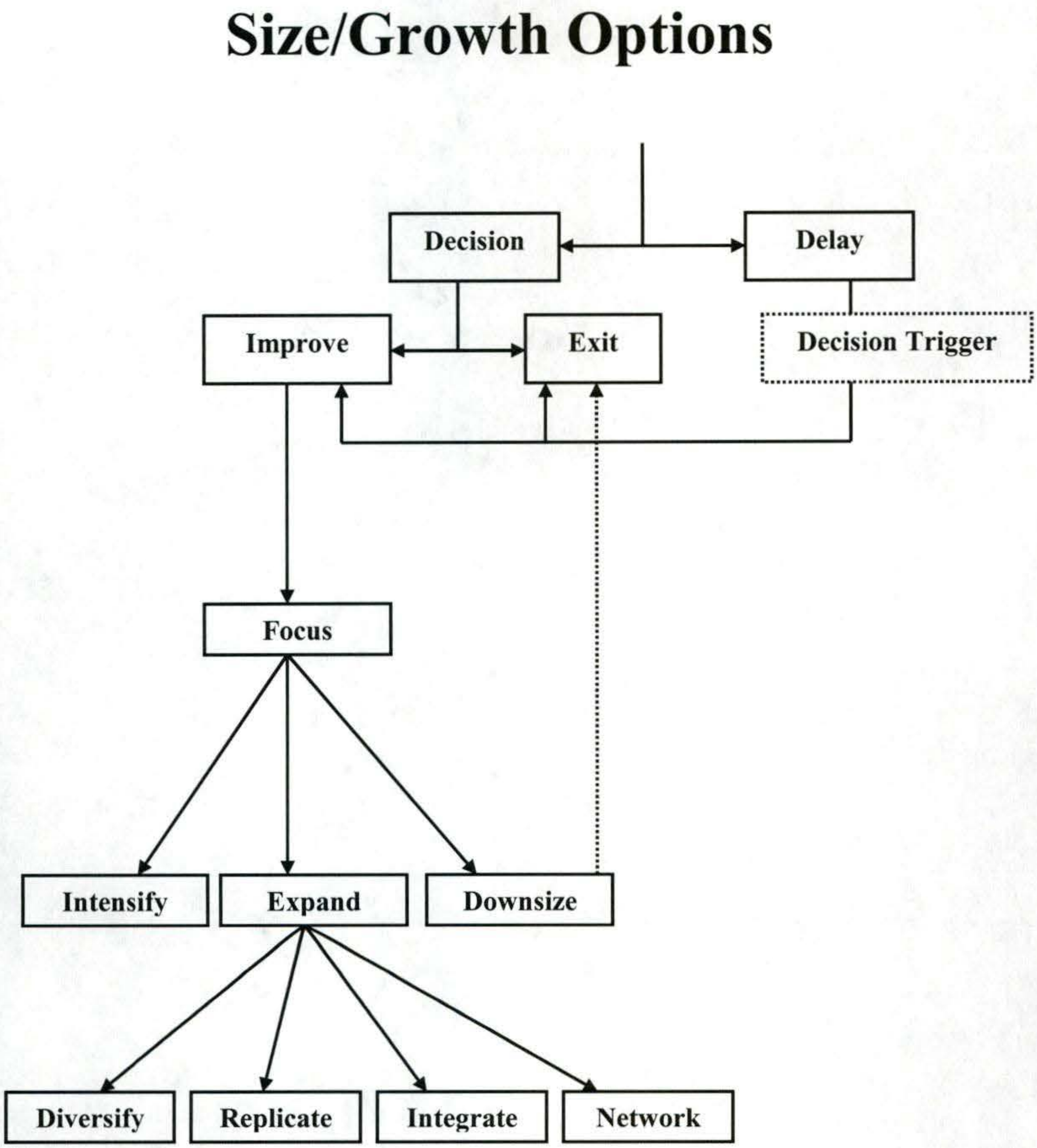
9. Downsize – There are many in farming who are surveying their situation and wondering if continuing to operate at the current size or a larger size is the most logical plan. One strategic size option is to reduce the size of the business. The decision to downsize the business is often linked with a 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.

These strategic size/growth options are shown graphically in Figure 3. 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. We will return to this critical decision later in the discussion to present useful analytical tools to evaluate alternative growth options.

Figure 3. Strategic Planning Options Related to Growth and Downsizing



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 than those of the past. In addition to cash markets for inputs or products, alternative 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

The fourth area of strategic decision making concerns the financial and organizational 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. It has been suggested that "there are 50 different ways to finance and organize a farm business, and borrowing money irrespective of the lender is only one of those ways".

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

- The business arrangement (e.g. contract production or joint ventures vs. independent production.)
- Leasing options (for example various capital leasing arrangements for equipment and alternative rental arrangements for farm land.)
- 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 choice of the proper financial and organizational structure 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 task will be organized – organizational structure. Oversight becomes too large a task for only one person in larger businesses, so the farm business manger needs to think about how the organization of the business should be changed. Delegating some responsibilities will free the farm business manager to do higher level management functions. Deciding how responsibilities and authority will be delegated determines whether decision-making power is centralized or decentralized.

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, 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 consultants be used for certain decisions or service companies used for certain tasks such as chemical application? Is the manager and organization committed to continuous improvement and learning new ideas, or does it 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.

Analysis of Growth Strategies

As noted earlier, growth decisions are critical to the long-term strategic direction of any business. Growing a business in essence requires answers to three fundamental questions:

1. Which business unit to grow?
2. What customers and products should be the focus of growth?
3. What must be given up to grow?

We will present analytical tools that can help answer each of these questions.

Question 1: Which business unit to grow?

The choice of business unit to grow is fundamentally a function of the opportunities or potential provided by the market and the capabilities and capacities possessed by the firm. These two determinants can be linked in matrix format as shown in Figure 4 where market potential is ranked from low to high on the vertical axis and firm capability is ranked from high to low on the horizontal axis. Using a variation of this matrix, the Boston Consulting Group (BCG) has identified four categories with respect to growth potential. The first category is "stars" which have high market potential and leverage high internal capability of the firm. Business units that are "stars" merit significant investment to support growth. A second category is "cash cows" that have low market potential, but in which the firm has high capability. These business units have been the base of growth of the business in the past, but the market has matured or become saturated and future potential is limited. They do generate significant amounts of cash which can be reinvested or redeployed in other business units, and it is typically best to use these funds to invest in business units that have more market potential.

The third category of business unit is the "?" which high market potential, but in which the firm has low capability. The fundamental question that must be answered for these business units is whether the market potential will continue to be sufficiently strong in the future that it is worthwhile to invest funds and other resources in developing the capabilities to convert these units into "stars". The final category are business units that are "dogs" – these units are characterized by low market potential and low firm capability, and the obvious approach to these business units is to exit and redeploy the resources to "?" or "stars".

Let's illustrate the use of this growth matrix framework to evaluate the question of which units to grow for a case study – MBC Farms. MBC Farms is a mixed enterprise farm located in Jasper County, Indiana. Like many farm operations, MBC Farms is trying to determine what strategic actions can be taken to remain competitive. The farm produces commodity corn and soybeans, contracted specialty corn, beef, and milk. Given its activities and its location, it has several growth alternatives. The dairy operation currently includes 250 cows, but there is an opportunity to sell more milk to a nearby processing plant at a price premium if the herd is expanded. The crop activities cover 3,000 acres with corn, soybeans, and forage. The opportunity also exists to sell additional identity-preserved corn under contract to the nearby plant of a major food processor, or premium quality hay at a premium price to horse owners and stables. The farm also includes a 25 head beef cow operation.

The problem with the current operation is that none of the business units are large enough to allow access to some markets. The small dairy and lack of storage with the crops limit the farm's ability to pursue business with the capabilities that have been developed, and thus receive higher prices. Size threatens the business longer term because it would appear that commodity products with no differentiation will provide less value. So, in order to stay in business, the farm must develop higher value products, or expand dramatically in low margin commodity markets.

Business unit analysis indicates that for MBC Farms the dairy operation has an above average rating on market potential and high rating on capability. Thus it is classified as a "star" – a business unit with a likelihood of becoming a more profitable enterprise and a strong candidate for growth. The commodity cropping operations have an above average capability rating, but have limited market potential, so are most likely a "cash cow".

Not all of the cropping operations could be intuitively considered cash cows. The higher value crops, the food-grade corn, and horse hay for instance, could be classified as a "question mark" – something for further exploration. But cash premiums for production tend to erode over time, and there is added management and work for these enterprises.

The small beef operation is characterized by low internal capability and limited market potential, thus it would be classified as a "dog".

Question 2: How do we grow?

The second question to answer is what customers and products to focus on in growing the business. We will use a second matrix to answer this question; on the horizontal axis we will plot products/services, and on the vertical axis we measure customers (Figure 5). Products/services are either ones currently produced by the firm (old), or ones the business has never produced before (new). Old products sold to old customers are known as a "market penetration" approach to growth. New products sold to old customers are known as "product development" strategies and focus on using the customer relationship to develop markets for new products. Old products sold to new customers are referred to as "market development" strategies. Finally, selling new products to new customers is a "differentiation" strategy.

In assessing MBC farms, the most likely areas for current products and product options would be the following:

- The diary operation expansion with the contract would be an old product to a new customer. MBC Farms, in choosing the dairy for its growth, would be pursuing market development growth.
- The food grade corn opportunity would be an expansion of an old product to an old customer (market penetration) since they already are producing food grain corn for this customer.
- Commodity crops and silage would also be market penetration growth given that they are produced for the dairy and sale to current buyers.
- Alfalfa hay for horse or stable customers would be a market development option because it focuses on current products for new customers.

Question 3: What might be given up?

Growing a business requires additional resources and a commitment to the growing business unit, or in many cases a reallocation of resources – particularly managerial time. How does one answer the question of what to give up? Note that our focus is on who performs an activity, not on whether the activity should be a part of the business. This is the classic outsourcing vs. do it yourself decision. The Outsourcing Matrix of Figure 6 suggests in a graphical form how activities required by the business should be accomplished, depending on competitive advantage value of the activity and ability of the firm to do the activity. The Outsourcing Matrix presented here is an adaptation of work by Insinga and Werle.[1]

There are two axes in the Outsourcing Matrix. On the vertical axis is the degree the activity will be, or is, a source of competitive advantage. There are three degrees: first, the activity provides no competitive advantage and is called a "Basic Activity"; second, it might provide an advantage and so is called an "Emerging Activity"; and third, it is a major source of advantage and so is called a "Key Activity" (rare skills/abilities that provide a distinct competitive advantage). On the horizontal axis is the ability of the firm to perform the activity well relative to competitors, either weak or strong.

To illustrate it could be argued that soil tillage is a basic activity that provides no competitive advantage – this activity is essential but is not sufficiently unique that it can't be done by an outside supplier. In contrast the timeliness and skill in harvesting and handling of specialty grains that must be identity preserved is a key activity that requires unique skills that are typically not available from an outside supplier.

As to MBC Farms some of the current activities are mapped on the Outsourcing Matrix. Basic Activities would include the raising of replacement heifers, which could be raised by a separate heifer replacement entity on contract. Additionally, application of fertilizer could be done on a custom basis. MBC has already identified crop marketing as an activity with some possible competitive advantage, but has recognized that others can do this better, so they collaborate with a marketing firm for those services.

A key activity at MBC Farms appears to be management of the dairy herd (nutrition, sanitation, cow comfort, etc.) to provide maximum milk production. Additionally, procuring and managing contracts for high-value crops appears also to be a source of competitive advantage. Both of these should continue to be done by people within the business, i.e., done in-house.

[1] RC Insinga and MJ Werle "Linking outsourcing to business strategy", *The Academy of Management Executive,* Volume 14, Issue 4: November 2000, pp. 58-70.

Figure 4. Business Unit Growth Matrix

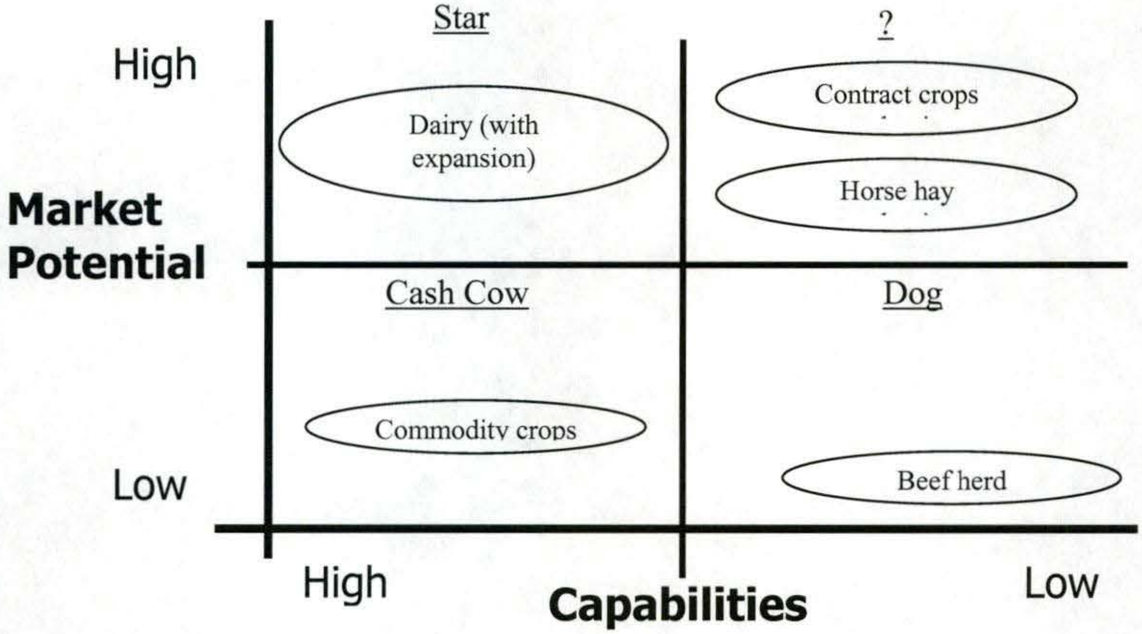


Figure 5. Growth Options Matrix

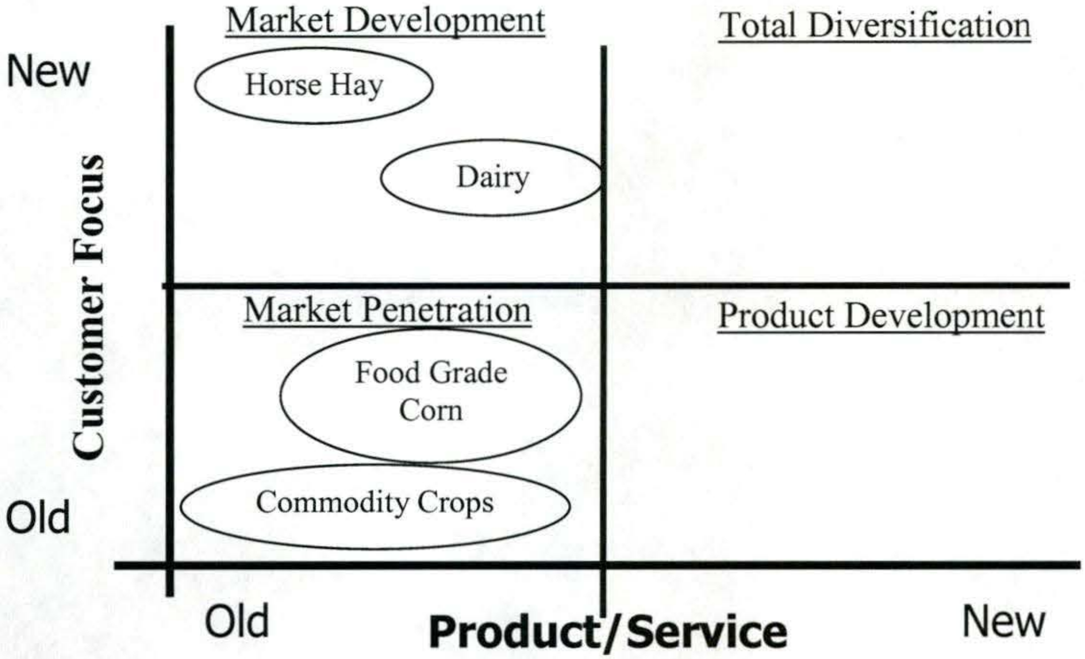
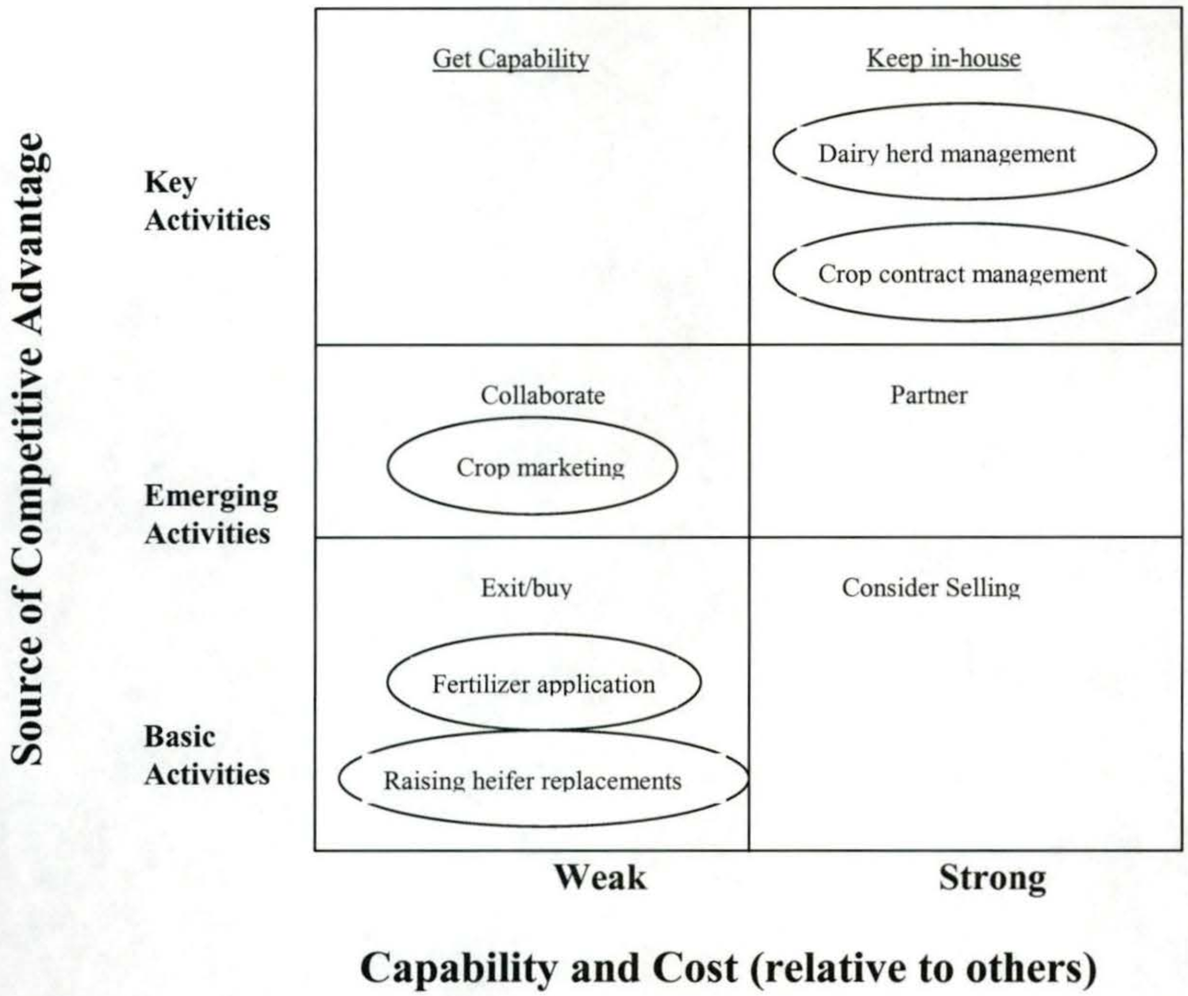


Figure 6. Outsourcing Matrix



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 marking concrete decisions about the future of the business – decisions concerning the business enterprise focus, size and growth, marketing and channel linkages, financial structure, organizational structure, social responsibility and managerial style/lifestyle. These strategic choices must be guided by the strategic positioning option chosen for the business – the choice between being either a low cost or a differentiated product/service provider.

Growing the business over time requires answers to critical questions before the resources are committed – these questions in essence attempt to assess the future market potential in terms of customers and products/services, the capabilities and capacities of the firm and the activities that should be pursued to obtain a sustainable competitive advantage. Growing the farm business with a focus on strategic positioning, market potential and competitive advantage will enhance the prospects of long-term success.