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Evaluating New Ventures and Enterprises

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Uncertainty is pervasive in today's business environment. For example, corn prices have followed a roller coaster this year. The nearby corn futures prices went from $3.90 in late January to $3.10 in early August, and then back to $3.80 in late September. Relatively low long-run price prospects have led many producers to seek out alternative enterprise opportunities. It is always important to remember that uncertainty creates opportunities. This leads us to the following question. What factors should be considered when evaluating a new venture or enterprise? This article briefly discusses some of the most pertinent factors that need to be considered when evaluating strategic options.

Converting a portion of a farm's acreage to organic crop production will be used as an example in the discussion below. Other examples of new ventures or enterprises are as follows: hemp production, canola production, production of non-GMO crops, and production of specialty crops such as white corn, waxy corn, sweet corn, tomatoes, and potatoes. Obviously, some of these ventures and enterprises would require a more detailed analysis than some of the other examples.

Reasons Why Businesses Fail

New ventures or enterprises often involve a major change or expansion in the operation. Because of this, before discussing relevant factors to consider, we will briefly review the failure rates of new small businesses and why businesses fail. Only 80 percent of small businesses survive the first year and only about 50 percent survive the five-year mark (U.S. Small Business Association, 2018). CB Insights (2019) indicate that there are numerous reasons why small businesses fail. Their top five reasons were as follows: lack of market need, not enough capital, not the right team, competition, and pricing. These reasons are implicitly included in the discussion below.

Strategic Options

Conventional planning typically assumes that managers can make projections using experience and predictions that remain relatively stable. This approach works well when dealing with projects with limited uncertainty. When dealing with new ventures and enterprises, assumptions made at the beginning of the project do not hold over time, resulting in needed adjustments to the original plan. Discovery-driven planning offers a way to approach a project involving uncertainty (McGrath, 2013). Discovery-driven planning frequently uses an "options" framework. For example, a farm considered transitioning to organic

crop production, may start by transitioning a relative a small proportion of their acreage. Depending on how this experiment works out, the farm may either decrease or increase acreage converted to organic production. More information pertaining to the evaluation of strategic options can be found in Langemeier and Boehlje (2017).

Impact on Current Operation

In addition to examining the impact of a new venture or enterprise on expected returns and risk, it is important to evaluate the strategic fit of the new activity. Does the new venture or enterprise leverage the resource base of the farm (e.g., knowledge of operators) and is it consistent with the strategic direction of the business? For example, if a farm is examining the conversion of a portion of their acres to organic crop production, does it have the knowledge base to successfully produce each of the organic crops? Organic crop production often involves more complex crop rotations, which may include small grain production and legumes. To control weeds, it is often necessary to extensively use rotary hoe and row cultivation operations, which requires the availability of additional labor during the growing season.

Two other aspects related to start-up challenges include managerial requirements, and ease of entry and exit. Langemeier and O'Donnell (2020) indicated that the differences in net returns for organic crop enterprises are much wider than those for conventional crop enterprises. It is likely that part of this difference is due to the experience needed to successfully production organic crops. It is also important to analyze the costs of entry and ease of exit when evaluating a new venture or enterprise. The flexibility of selling the new venture or dropping the enterprise if it does not perform as expected or ends up not fitting with the rest of the business needs to be considered. In particular, a farm needs to examine the challenges and costs encountered when exiting a venture or enterprise. As an example, if a farm starts producing organic crops and then decides to drop these enterprises, it incurs the costs associated with the transition years, in which the farm had to use organic practices and sell the crops at conventional prices, as well as additional machinery costs related to investments that were need to produce the organic crops.

Start-Up Challenges

Langemeier and Boehlje (2018) examined the start-up challenges associated with farm growth. This information is also relevant when evaluating a new venture or enterprise. Farms that add a new venture or enterprise often run into cash flow shortages and deplete working capital in the early phases of the project. Using pro-forma financial statements to gauge the size of these cash flow shortages is crucial. Operational inefficiencies may also occur when adding a new venture or enterprise. This is related to the learning curve, which is a curve depicting the relationship between per-unit cost and experience. A steep learning curve would implies that per-unit cost differences decline rapidly with experience while a flatter learning curve implies that per-unit cost declines slowly with experience. As noted above, there also may be management issues associated with the new venture or enterprise. A few questions may help convey possible management challenges. Has your management team allocated enough time for the new venture or enterprise? What is important to make the new venture or enterprise work? What are the constraints to making the new venture or enterprise work?

Going back to the example we have been using in this article, what are the start-up challenges associated with converting a portion of the farm's acreage to organic crop production? This may involve answering a series of questions such as the following. What will it cost of to purchase the machinery and equipment needed to successfully produce organic crops? Do we have sufficient labor and management time to make this conversion work? On a related note, have we assigned at least one management person to this new venture? How do the productions costs and yields of the proposed crops we are going to produce compare to those of crops we are currently producing? Do we have buyers lined up for the organic crops we are planning to produce? How will success be defined?

Concluding Thoughts

Several factors need to be considered when evaluating new ventures and enterprises. Planning is more intense when a farm is examining a venture or enterprise that they are not very familiar with. In addition to determining how a new venture or enterprise fits into the current operation, it is important to evaluate expected returns and risk, the cost and ease of entry and exit, and managerial requirements and

complexity. Finally, there may be start-up challenges such as cash flow shortages, operational inefficiencies, and managerial bottlenecks associated with a new venture or enterprise.

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