

## Doing the Right Thing

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The successful farm business requires key 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 paper briefly discusses and illustrates these seven areas of strategic decision making.

### Figure 1. Key Strategic Decisions

- I. Business Enterprise Focus
  - A. Product
  - B. Production/Process Technology
- II. Strategic Direction
  - 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

## Business Enterprise Focus

The choice of a business enterprise focus requires a number of strategic 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 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.

**Figure 2. Alternative Strategic Directions**

<b>Commodity Product Strategy</b>	<b>Differentiated Product Strategy</b>
<b>Production Emphasis</b> – The focus is primarily on production activities rather than marketing or finance.	<b>End-User Focus</b> – The focus is on final consumer or food processors needs rather than commodities.
<b>Manufacturing Mentality</b> – The science and systematic process of producing food products rather than the art of raising commodities is emphasized.	<b>Distribution/Marketing Mentality</b> – Marketing and distribution decisions and expectations of consumers are as (or more) important as production considerations.
<b>Low Cost Producer</b> – Cost control is critical to being competitive in a commodity business.	<b>Value-Added Production</b> – The additional revenue to be gained by further processing and distribution is emphasized.
<b>Large Scale Operation</b> – Larger scale operations generally have cost advantages over smaller scale units.	<b>Smaller Scale Operation</b> – A focus on a segmented consumer market and niche markets allows and encourages small scale, more nimble and flexible producers.

<b>Outsource Resources</b> – Land is rented; machinery is leased or custom hired.	<b>Insource (Own) Resources</b> – More land and other resources are owned because the scale of operation is not beyond the financial resource base of the smaller producer.
<b>Open/Impersonal Markets</b> – Markets are open to all who meet gross commodity product standards at publicly known prices.	<b>Negotiated Markets</b> – Responding to consumer needs and producing products with specific attributes requires more direct communication throughout the chain.
<b>Downside Price Risk</b> - Excess worldwide production can result in significant downward price movements.	<b>Relationship Risk</b> - Contracts can be terminated and alliances severed unexpectedly.
<b>Independent Decision-Making</b> - The traditional independent farmer provides most of the managerial and other resources and makes most of the decisions.	<b>Interdependent Decision Making</b> - The negotiated linkages with suppliers and processors reduces independence and forces joint, interdependent decision-making.

## Strategic Direction

As strategic options are assessed, nine strategic growth/downsizing 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

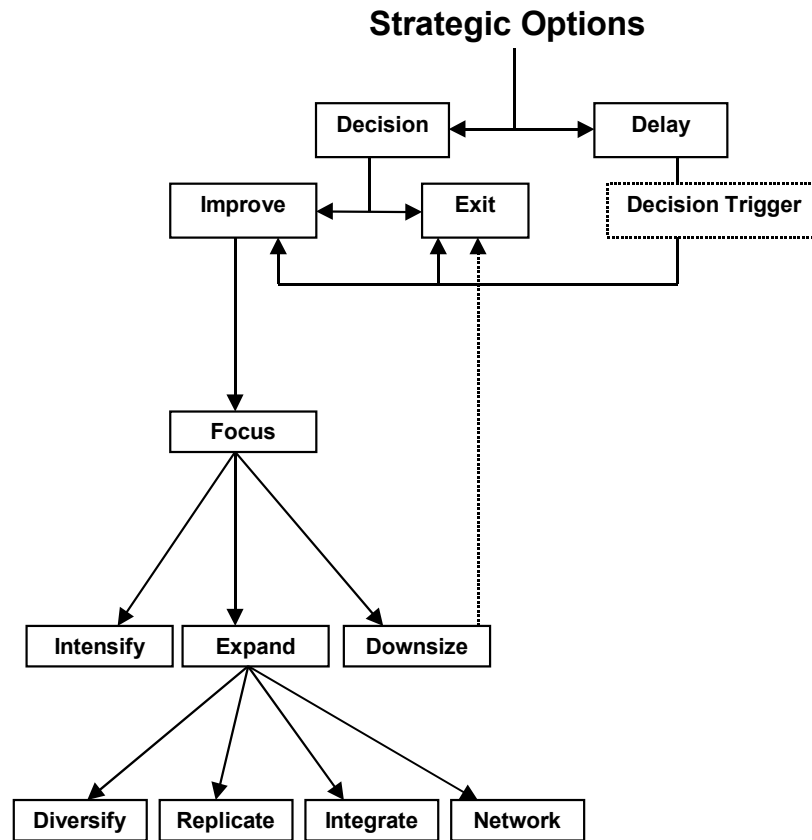
management skills. And if farm business manager is serious about diversification as a risk reduction strategy, then the alternatives considered should include investments that are not subject to the same fundamental economic forces that impact agriculture. Such alternatives might include stocks or mutual 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 growth/downsizing 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, farm business 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.

**Figure 3. Strategic Planning Options Related to Growth and Downsizing**



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.

### **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 is 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 farm business managers use for certain decisions or service companies that do 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 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.

## **Applying the Decisions**

Knowing what the choices are is one of the early steps in setting and implementing a strategy. To assist in the process, there are a number of aids farm business managers can use to help make the strategic choices that are needed. To illustrate this, the MBC Farms serves as a case study for examining strategic growth. The case seeks to answer three basic questions

about where the operation will go and how it will get there. Which unit to grow, how do we grow, and what must be given up?

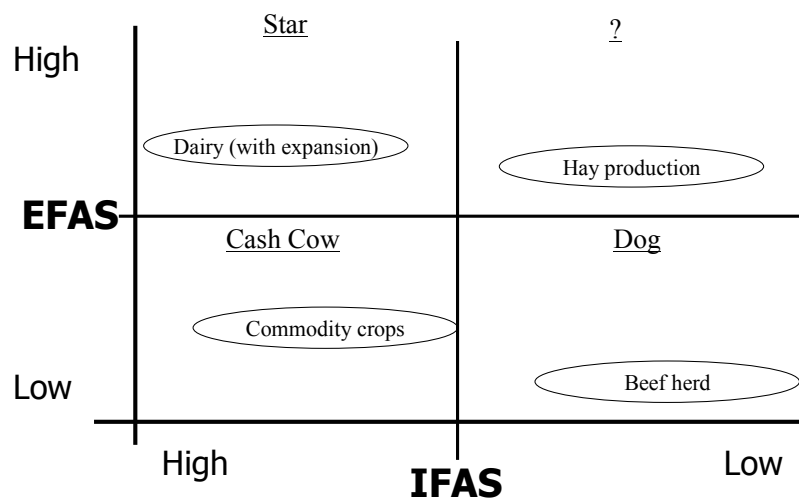
**Question 1: Which unit to grow?**

In approaching this problem, a Business Unit Growth matrix is useful (Figure 4). This takes the assessment of the grain and dairy division managers, primarily through the External Factor Analysis Summary (EFAS) and the Internal Factor Analysis Summary (IFAS) tables completed by the managers in the case study. The matrix helps integrate and evaluate environmental performance. To use it, farm business managers map a company’s strategic business units or products on a matrix according to how well the company does the task versus its relative importance to the market. Using the IFAS to measure the internal position provides a rating of that general position. A high number on the IFAS (above 3) means the business is performing strongly. The external rating is shown in the EFAS table. Again, a rating above 3 means the organization is positioned well to take advantage of opportunities or counter threats in the surrounding environment.

The dairy operation has a rating of 3.75 (of 5.0) on the external readiness – above average. Its internal position is slightly weaker at 3.20. Cropping operations have average internal competency but have slightly higher expectations for capturing value on the external side. The dairy has higher relative ratings to the crops, meaning that the crops units could be classified as potential cash cows and the dairy as a star – something with a high likelihood of becoming a valuable and profitable enterprise. Rather than develop the capabilities of crops, the money earned from it would be used to fund the star of the business, i.e., the dairy.

Not all of the cropping operations could be intuitively considered cash cows. Many students may think that the higher value crops, the food grade corn for instance, would be an enterprise with a bright outlook. Completing a net present value calculation on the proposed expansion of those operations may lead to a reconsideration of that potential. Cash premiums for production tend to erode over time, and there is added management and work.

**Figure 4. Business Unit Growth Matrix**



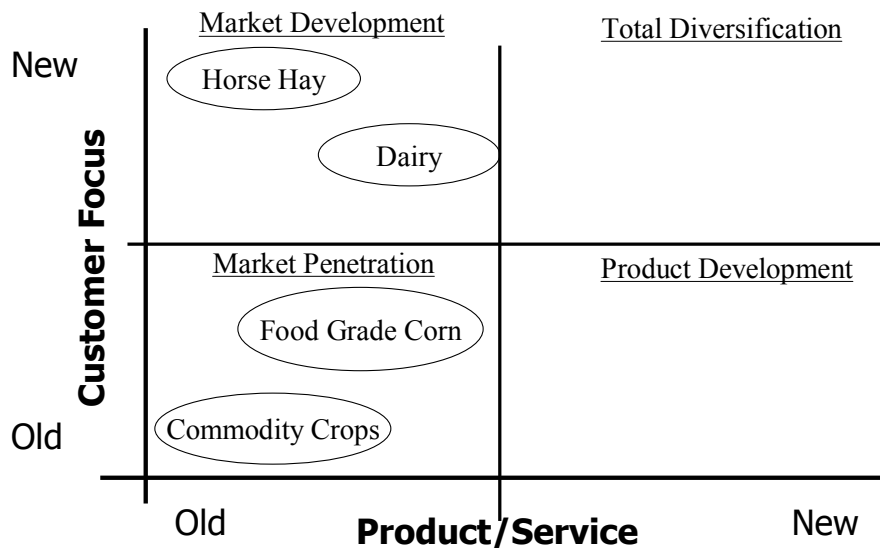
**Question 2: How do we grow?**

The next step is to assess how business development will occur. We do this by plotting the product to be sold versus the type of customer focus. We do this with the Growth Options Matrix (Figure 5). Products are either ones currently produced by the firm (old) or ones the business has never produced before (new). Customers are either current customers (old) or ones the business has not reached before (new). Old products sold to old customers are known as a “market penetration” approach to growth. New products to old customers are known as “product development” strategies and focus on using the customer relationship to develop markets for new products. Old products 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 dairy operation expansion with the context would be an old product to a new customer. MBC Farms, in choosing the dairy for its growth, would pursue strategies related to market development.
- The food grade corn opportunity would be an expansion of an old product to an old customer (market penetration).
- Commodity crops, silage, and alfalfa hay would be the same (market penetration) given that the latter two are still produced for the dairy

**Figure 5. Growth Options Matrix**



### **Question 3: What must be given up?**

The information in the MBC Farms case indicates that increased management responsibilities will negatively affect the family lives of the farm business managers. Craig in particular has voiced concern about the lack of time that he has for family activities. To examine the activities that are candidates for eliminating, or having someone else do, the Outsourcing Matrix can be used (Figure 6). The Outsourcing Matrix suggests, in a graphical form, how activities required by the business should be treated depending on value of the activity and ability of the firm to do the activity. The Outsourcing Matrix presented here is an adaptation of material developed by Richard Insinga and Michael Werle.<sup>1</sup>

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 required to be competitive and so is called a “Key Activity.” Basic activities are not sources of competitive advantage (standard and common activity commonly available); emerging activities might provide an advantage (may provide some value and are not commonly known); a key activity is clearly an advantage for the business (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.

As an example, it could be argued that driving a tractor is a basic activity that provides no competitive advantage. Tractor drivers do not possess any particularly unique skills that are not readily available. A farm business manager should consider hiring someone else to do it or contract with someone to do it so that it does not have to occupy the time the farm business manager might spend on higher value activities.

There are quite a number of activities that could be mapped on the Outsourcing Matrix. Basic Activities could include the raising of replacement heifers, which could be raised on contract off farm. Additionally, application of fertilizers could be done on a custom basis, thereby easing the work that Craig would have to do. MBC has already identified crop marketing as an activity with some possible competitive value but has recognized that others can do this better; therefore they collaborate with a marketing firm for those services.

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<sup>1</sup> 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 6. Outsourcing Matrix**

<b>Source of Competitive Advantage</b>	<b>Key Activities</b>	<u>Get Capability</u>	<u>Keep in-house</u> Dairy herd management Crop contract management
	<b>Emerging Activities</b>	<u>Collaborate</u> Crop marketing	<u>Partner</u>
	<b>Basic Activities</b>	<u>Exit / Buy</u> Fertilizer application Raising heifer replacements	<u>Consider Selling</u>
		<b>Weak</b>	<b>Strong</b>
		<b>Capability and Cost (relative to others)</b>	

**A Final Comment**

Strategic decision making for a successful farm business requires making critical choices in a number of areas: business enterprise focus, growth/contraction, marketing and channel linkages, financial structure, organizational structure, social responsibility, and managerial style/lifestyle. Making these choices requires difficult answers to basic questions such as which business unit to grow, how to grow and what to give up. Strategy is as much choosing what to not do as choosing what to do.