Ag Decision Maker

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Farm Business Strategies

Business strategies focus on the direction of the business in terms of expansion, maintenance, contraction, etc. Your business strategy should create and sustain a competitive advantage that enables you to consistently earn above-average returns.

Five types of strategies are discussed below. They are:

- Growth Strategies – expanding the size of the business
- Stability Strategies – maintaining the size of the business
- Restructuring Strategies – refocusing the business for improved performance
- Succession Strategies – transferring the business to the younger generation
- Exit Strategies – ending and leaving the farm business

Farm business strategies are part of the strategic planning process. An overview of Strategic Planning for the Farm Business and the factors that lead into selecting the strategy is available.

Growth Strategies

Growth strategies involve various ways of expanding the size of the farm business. Growth may take many forms and directions. Some of the common growth strategies are discussed below.

- **Capacity Expansion –** With this strategy, the current enterprises are expanded. It means more acres of crops or more head of livestock. In essence it is "more of the same." It is a horizontal form of expansion as opposed to a vertical expansion which moves up or down the supply chain. A capacity expansion strategy may be designed to take advantage of economies of size. Efficiency is also achieved because management is just focused on the existing enterprises.
- **Replicate –** This is a form of capacity expansion where the existing operation is replicated at a different location. This strategy is often used for livestock operation when further expansion at the current location is not feasible.
- **Intensify/Modernize –** This is another form of capacity expansion where the real assets of the business are not expanded. Rather, they are modernized so more production can be pushed through a fixed asset base. This can occur in both crop and livestock operation but is more common in livestock production.
- **Diversify –** This is another form of horizontal expansion. However, instead of expanding the existing enterprises, new enterprises are added. A diversification strategy may be designed to make use of economies of scope and other synergies between the enterprises to achieve low cost status. However, efficiency may be reduced because management is spread over more enterprises.
- **Specialize/Focus –** This strategy involves reducing the number of enterprises in the business. These few enterprises are expanded through horizontal strategy like capacity expansion or a vertical strategy like integration. One or just a couple of enterprises receive all of the management attention. This is the opposite of the diversification strategy.
- **Integrate –** Integration is a vertical strategy because it may move forward into the processing of products or commodities, or it may move backwards into the input/supply segment of the supply chain. This strategy often involves a group of farmers working together to move up or down the supply chain. It may also involve joint ventures with existing companies in the supply chain. Potential strategies may include the following.

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- Become indispensable in the chain
- Get to the ends of the chain
- Control the chain
- Reduce the number of links in the chain
- Become part of a chain that will produce the next product

- **Networking –** This involves working with others to gain advantages not available to individuals. Networking may leverage the activities and resources of your business operation. It may also increase the efficiency of the business operation. Networking can be used for either vertical or horizontal expansion. Networking can be accomplished through information arrangements, contracts or various types of joint ventures.

Stability Strategies

Stability strategies involve various ways of maintaining the size and organization of the business at its current level. Stability strategies sometimes occur after a long period of growth. Or they may occur from the beginning of the business. It often depends on the goals and ambitions of the owner/operator.

- **No Change –** The current operation meets the needs of the farm family.
- **Full Employment –** The operation is expanded until the family members are fully employed. At this point expansion stops and is maintained at this level as long as everyone is fully employed. Full-time hired labor to expand further is not considered as an option.
- **Adequate Income –** The operation is expanded until it generates adequate income levels for the owner/operator and farm family. However, if adequate income levels are not maintained over time, the business may be expanded until it does.
- **Profit –** After a period of expansion, the owner/operator may decide to sacrifice future growth by not reinvesting in the business but using all business returns for consumption.
- **Pause –** After a period of rapid expansion, the owner/operator may decide to pause for a period of time before continuing to expand.
- **Wait and See –** The owner/operator considers the current economic and business environment to be too uncertain for expansion at this time. So it is decided to wait until the future is more certain before expanding. However, if not managed correctly, the owner/operator may wait too long and miss the opportunity for expansion.

Restructuring Strategies

Restructuring strategies are used when the farm business is not performing as it should. Performance problems will range from inadequate income levels to the major threat of insolvency and bankruptcy. If the business cannot feasibly be restructured, it is liquidated.

- **Refocus –** This strategy is used to refocus the activities of the business. It usually involves changing the mix of enterprises including the primary enterprises on which the business is built. It is used for farm businesses that are solvent (adequate equity) but not profitable.
- **Retrenchment –** This strategy usually involves three sequential phases of contraction (liquidate part of business), consolidation (restructure business) and rebuilding. This strategy is used for farms that are neither profitable nor financially sound.
- **Liquidation –** If the business is neither profitable, nor financially sound and a retrenchment strategy is not deemed to be feasible, the decision is made to liquidate the business before the owner/operator loses all equity in the business.

Succession Strategies

These are strategies for transferring a farm business (not just the assets but the on-going business) from one generation to the next. The younger and older persons are often related but don't need to be. Succession strategies are often combined with estate planning by the parties.

- **Multi-person –** A younger person is brought into the business and the current operator and the young person farm together in the same business. At the retirement of the older person, the younger person takes over the operation of the entire business. So the life of the business continues beyond the retirement of the current operator. Arrangements for transferring ownership and management of the business from the older to the younger person are developed.

- **Spin-off –** A younger person initially returns to the farm business but after a year or so starts his/her own farm business. The younger and older parties may work together and share machinery, equipment, etc. However, each party operates his/her own business. At the retirement of the older party, the younger person merges the two businesses together and operates them as one business.

Exit Strategies

These are strategies for ending the farm business. This usually occurs at the retirement of the farm owner/operator but the strategy may start to be implemented several years before retirement.

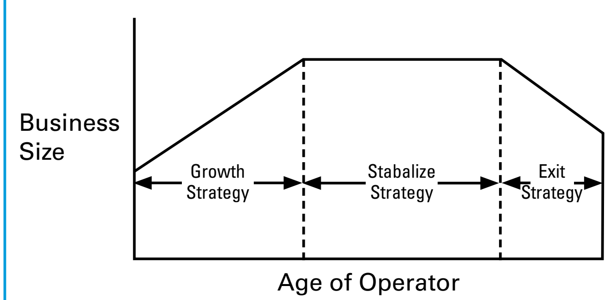
- **Holding Pattern and Exit –** The farming operation is not expanded or contracted for several years prior to retirement. The operation is maintained at its current level until retirement by the owner/operator. At retirement the assets are sold, often at a farm auction. The business ends abruptly.
- **Use-up Capital Assets and Exit –** No additional money is invested in the farm business (machinery, equipment, etc.). All profits are milked from the business with no reinvestment. At retirement, any remaining value of the assets is liquidated. The business ends abruptly.
- **Wind-down Business and Exit –** The size of the business is reduced by reducing the number and size of the enterprises. For example, livestock enterprises may be eliminated first, then rented land may be let go. Business activity is reduced gradually over time until it is ended at the owner/operators retirement.
- **Create Marketable Operation –** With this strategy, the business is sold as a business unit to another party. For this strategy to work, the business must be structured or organized so that the business unit is of greater value than the collective value of the individual assets.

Type of Strategy Based on Operator's Life Cycle

Business strategies are often closely tied to the life cycle of the farm operator. As the operator goes through the various phases of his/her life, the type of strategy often changes due to the operator's preference and planning horizon. Below are two typical series of operator life cycle strategies.

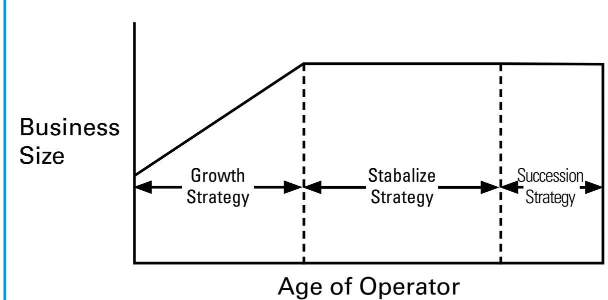
In Figure 1, the business ends when the operator retires.

Figure 1. Farm business ends



In Figure 2, the business is transitioned to another operator, often a son or daughter.

Figure 2. Farm business continues



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