



STRATEGIC ASSESSMENT OF A FARM'S RESOURCES AND BUSINESS ENVIRONMENT

Last month's newsletter briefly discussed the steps involved in formulating a strategic plan. Two of the steps involve assessing the farm's resources, and surveying the current and future business environment. These steps are the focus of this article. An article in next month's newsletter will discuss sustained competitive advantage.

Before assessing a farm's resources and business environment, it is common to first examine the external environment. Table 1 contains eight key questions for external analysis. As can be seen from table 1, examining the external environment involves thinking about potential changes in the macro-environment, dominant economic traits, competitive forces, changes in industry structure and business environment, strong and weak competitive positions, strategic moves, key success factors, and attractiveness and profitability of the industry. Articles, and for that matter books, could be written about each of these broad topics. The important thing to do is to think about changes that may occur in the near future that would impact your farm's ability to compete or changes that could lead to profitable endeavors. This information provides fodder for the opportunities and threats discussion below.

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A full internal analysis will include consideration of a farm's shared values and culture; ambitions, philosophies, and capabilities; and strengths, weaknesses, threats, and opportunities. It is helpful to ask questions related to these items. Table 2 contains five key questions for internal analysis. Each of these questions will be addressed below.

The first question relates to how well the current strategy is working. This question can be addressed by answering questions such as follows: do new employees understand and appreciate the farm's values and culture; are you taking advantage of each employee's capabilities; are you using inputs, including your own labor, efficiently; are you producing quality products; are you effectively using available technology; are you establishing good relations with suppliers and landlords; and are you meeting your long-term financial goals, which may be related to growth, profitability, or financial position? When evaluating how well the current strategy is working, it certainly helps to have several years of financial statements to examine. KFMA members should have this information readily available. If this information is currently not available, plans should be made to keep records that will allow your farm to produce a good set of financial statements (i.e., balance sheet, income statement, and cash flow statement).

The second question relates to your farm's strengths, weaknesses, threats, and opportunities. When evaluating strengths and

weaknesses it is common to evaluate human resource capabilities, with particular emphasis on what you do well and things that you either need to learn or hire someone with these skills to handle for you; physical resources (e.g., machinery and land); financial resources; innovation and technological capabilities; and if applicable, your customer mix, satisfaction, and loyalty. Many farms routinely examine technology, financial resources, and physical resources, but do not give a lot of thought to human resource capabilities. As a business expands, examining these capabilities becomes increasingly important. An analysis of opportunities and threats typically focuses on the operating environment (legal, political, social, available technology), power of suppliers and buyers, new competitors, size and scope of markets, new markets, and competitors. With regard to a firm's competitors, you typically want to know their strengths and weaknesses, strategies, and objectives. For example, will the eminent retirement of neighboring farmers open opportunities to rent and/or buy additional land? Will available technology free up labor so that you can farm additional land? As noted with the above two questions, many times the focus of examinations of opportunities and threats is related to farm growth.

The third step relates to the farm's cost competitiveness which involves a more detailed analysis of cost per unit of output, both at the whole-farm level and the enterprise level. Again, you can tackle this step by answering a series of questions. How do your expense ratios (total expense ratio, adjusted total expense ratio, and economic total expense ratio) compare to that of other farms? If your cost structure at the whole-farm level is high, is this high cost structure due to a particular enterprise? If you are not examining enterprise profitability annually, I strongly encourage that you consider doing so. Most farms are better at producing certain enterprises compared to others. The only way to really find out if this is the case is to examine the profitability of each enterprise. This process is particularly important on

crop/livestock farms where it is necessary to determine whether it is advantageous to grow or purchase feedstuffs, or more likely, some combination of the two.

The fourth question relates to how strong the farm's competitive position is. This is where your analysis of opportunities and threats come in. Industries and conditions change. Just because a farm has been profitable in the past, or even today, does not mean that you will be profitable five or ten years down the road. What do you need to do to tap your employees' capabilities? How important is future growth? Is the production of your primary commodities becoming more specialized? Are you in a position to take advantage of this change in how commodities are produced and marketed?

The fifth question relates to strategic issues that need to be addressed. These issues typically relate to weaknesses or threats. As farms continue to grow, professional development and utilizing consultants becomes increasingly important. It is very difficult to be an expert in everything, and even if someone was an expert, time constraints often do not permit managers from taking advantage of their expertise in multiple facets of the business. Another strategic issue may be related to land. How will your farm expand: rent land, purchase land, expand livestock enterprise, farm your ground more intensely (i.e., reduce fallow or increase use of double-cropping), or some combination of these options? If expansion appears to be a difficult option for your farm, how would a decision to not expand impact your competitiveness?

This article briefly discussed assessing a farm's resources and business environment. This typically involves internal analysis. Next month's newsletter will contain a related article pertaining to sustained competitive advantage.

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Table 1. Eight Key Questions for External Analysis.

1. What are the conditions and trends in the macro-environment?
 2. What are the industry's dominant economic traits?
 3. What is competition like, and how strong is each of the competitive forces?
 4. What is causing the industry's structure and business environment to change?
 5. What farms are in the strongest/weakest competitive positions?
 6. What strategic moves are others likely to make?
 7. What are the key factors for competitive success?
 8. Is the industry attractive and what are the prospects for above average profitability?
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Source: Adapted from Thompson, Strickland, and Gamble, *Crafting and Executing Strategy*, 2005.

Table 2. Five Key Questions for Internal Analysis.

1. How well is the present strategy working?
 2. What are the farm's strengths, weaknesses, threats, and opportunities?
 3. Are the farm's costs competitive with rivals?
 4. How strong is the farm's competitive position?
 5. What strategic issues need to be addressed?
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Source: Adapted from Thompson, Strickland, and Gamble, *Crafting and Executing Strategy*, 2005.

RECOMMENDATIONS FOR FURTHER READING

The purpose of this section of the newsletter is to briefly discuss articles and web sites that may be of interest to readers. In general, the articles discussed will not report on original research. Rather, the articles will contain citations to web sites and articles that discuss topics of general interest.

Jason Henderson discusses the recent agricultural boom in relation to the previous booms in the 1910s and 1970s in a recent Federal Reserve Bank of Kansas City article entitled "Is This Farm Boom Different?" In the 1910s, rising export demand during World War I and low interest rates caused farm incomes and

land values to escalate. In the early 1970s, U.S. exports increased sharply creating large increases in farm incomes and land values. Dampening demand caused farm incomes in the mid-1970s to drop, however, in the late 1970s, strong export demand and low interest rates resulted in another rise in farm incomes and land values. In both the boom of the 1910s and the boom of the 1970s, the higher incomes and land values were relatively short-lived. The author notes that the recent surge in farm incomes and land values has some similarities with these two earlier booms in that we have seen a surge in export demand and low interest rates. One big difference, however, is that

farmers have not used debt as extensively as they did in the earlier booms to finance investments in machinery and land. The author also notes that unlike towards the end of the previous booms demand remains strong, world supplies remain tight, and interest rates remain low. Of course, it is very difficult to predict the future. The author ends the article with the following question: will checking farm debt and capital spending be enough to keep any correction in agricultural profits from spiraling into a farm bust? More information can be obtained from the article which is posted to my contributor site on Ag Manager under “Recommendations for Further Reading”.

In a recent article in *Feedstuffs* (December 19, 2011 edition) entitled “Livestock Efficiency Gains a Must”, Tim Lundeen, noting a recent FAO study, indicates that by 2050 an expanded world population will be consuming two-thirds more animal protein than it does today. To meet the increased demand, increases in animal numbers *and* large improvements in the efficiency of livestock systems will be needed. At the same time, it will become increasingly important to confront water shortages, animal diseases, and pollution.

In two recent articles, Carl Zulauf and Evan Hertzog of the Ohio State University have analyzed U.S. crop yield trends and the changing variation in average U.S. yields. In the first article, to examine U.S. crop yield trends, the authors compare trends from 1940 to 1995 to trends from 1996 to 2011. These periods represent times before and after the emergence of biotechnology varieties. Trends

are estimated by examining crop yield per harvested acre. The estimated yield trends for corn were 1.86 bushels per harvested acre for the 1940 to 1995 period and 2.02 bushels per harvested acre for the later 1996 to 2011 period. For wheat, the estimated trends were 0.46 bushels per harvested acre and 0.34 bushels per harvested acre for the 1940 to 1995 and 1996 to 2011 periods, respectively. For 7 of the 14 crops analyzed in the study the estimated yield trend for the later period was higher than the estimated yield trend for the earlier period. These 7 crops included barley, corn, cotton, peanuts, rice, soybeans, and sugar beets. Notice that alfalfa, grain sorghum, and wheat are not in this list of 7 crops. In the second article, the authors examine the deviation in average U.S. yield from its trend-line yield. For 10 of the 14 crops studied the variation from trend-line yield was significantly lower during the recent 1996 to 2011 period than it was in the 1940 to 1995 period. Though lower in the recent period, the variation of yields for barley, soybeans, sugar beets, and wheat was not significantly lower in the recent period using statistical analysis. The authors note in their implications that the decline in yield variability appears to be characteristic of both non-biotech and biotech crops. Both of these enlightening articles can be found on my contributor site on Ag Manager under “Recommendations for Further Reading”.

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The Kansas Farm Management Association (KFMA) Newsletter is distributed monthly to provide farm management information to farm decision makers. Further farm management information can be found on the KFMA program website: www.agmanager.info/kfma; and, on the Extension Agricultural Economics website: www.agmanager.info. The Newsletter is edited by Michael Langemeier, Professor, Department of Agricultural Economics, Kansas State University.



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