FARMING IN THE 21ST CENTURY

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Preface

The U.S. agricultural industry is in the midst of major structural change — changes in product characteristics, in worldwide production and consumption, in technology, in size of operation, in geographic location. And the pace of change seems to be increasing. Production is changing from an industry dominated by family-based, small-scale, relatively independent firms to one of larger firms that are more tightly aligned across the production and distribution chain. And the input supply and product processing sectors are becoming more consolidated, more concentrated, more integrated.

Agriculture in the 21st century is likely to be characterized by: 1) adoption of manufacturing processes in production as well as processing, 2) a systems or food supply chain approach to production and distribution, 3) negotiated coordination replacing market coordination of the system, 4) a more important role for information, knowledge and other soft assets (in contrast to hard assets of machinery, equipment, facilities) in reducing cost and increasing responsiveness, and 5) increasing consolidation at all levels raising issues of market power and control.

These profound changes in the agricultural industry present new challenges and new opportunities that require new ideas and concepts to analyze and implement. They require new learning and thinking. Some of those new ideas and concepts are presented here, not as empirically verified truths, but as "thoughts" to stimulate different and better thinking. They have been developed based on observations, analysis and discussions with numerous managers and colleagues in agribusinesses in North America and Europe. This series focuses on Farming in the 21st Century; companion series are also available on Financing and Supplying Inputs to the 21st Century Producer (Staff Paper 99-11), and Value Chains in the Food Production and Distribution Industries (Staff Paper 99-10).

Our purpose in sharing these "thoughts" is to invite discussion, dialogue, disagreement — in general to encourage others to develop better "thoughts".

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Farm Expansions — The Critical Questions

Expansion of the farm business is one of the more strategic decisions that a producer makes. But many producers approach expansion decisions more from an opportunistic perspective than a strategic perspective. All too often an expansion decision is made when an opportunity arises — a parcel of land near-by becomes available to rent or buy, or a machinery dealer comes by with a special deal on a larger combine. Maybe the price is right or the purchase or rental arrangement is so good you can't pass it up, but does it really fit in your overall plan for where you want the farm business to be ten years down the road? What is your expansion strategy, and how can you sort out the good deals that fit that strategy from the equally good deals that don't?

Probably the first issue to consider in developing an expansion strategy is to understand what is meant by the word expansion. When most producers describe their expansion plans, they almost always involve the commitment of additional resources. And if expansion is defined in terms of the size of the resource base of the firm, that perspective makes sense.

But an alternative perspective on expansion is to view it as increased output rather than increased resource commitments. Fundamentally, increased output can be obtained in two different ways: 1) increasing the amount of resources used in the business and thus the total output, or 2) increasing the efficiency of resource use and obtaining more thruput — more output with the same commitment of investment or fixed resources. Undoubtably the thruput strategy will usually require the commitment of some additional resources such as managerial time, labor or operating funds to implement the strategy, but this approach typically is a lower cost, more efficient strategy for expansion than one that requires the commitment of additional capital and other fixed resources.

Assuming that expansion means increased output — however it is obtained — let's look at ten critical questions that will help you shape your expansion strategy. Our focus here is not to provide you the answers to these questions, but to pose them for you to consider in your development of an expansion strategy.

1. What am I really good at? What am I best at? What enterprise? What management function?

2. What will give me the best return on my resources?

3. Can I intensify present resource use? Push my buildings and machinery harder? Increase output without using more resources by increasing efficiency, tighter scheduling?

4. Do I have unused or underutilized resources? Excess labor? Excess managerial resources? Rough land that has timber potential? Land with development or recreational potential?

5. If I increase size, can I lower unit costs? Go from 8 row to 12 row equipment and farm more acres with the same labor? Reduce costs per unit of milk by adding 30 more cows?

6. What are the alternative ways to obtain resources? Rent land? Lease machinery? Custom farm acreage? Hire labor? Create a joint venture? Hire specialized services such as crop scouting or fertility maintenance?

7. Should I diversify? Will it reduce risk? Even if not, will it allow better resource use?

8. How much financing will be available and does this limit my options? Debt capital from lenders? Equity capital from family members or investors? Leased capital?

9. What are the risks of this expansion? Financial risk? The right technology? Errors in projections? Changes in regulations and government policy?

10. What are the start-up problems and costs? Construction delays? Time spent in locating land to buy or rent? Interest cost of buying machinery in anticipation of acquiring more land? Learning costs of a new venture or new enterprise?

Answering these questions will go a long way in helping you develop an expansion strategy and take advantage of those opportunities that fit with that strategy.