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Strategic planning for financial success

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Strategic planning for financial success

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Gene Nelson teaches ag and resource economics and is head of the Agricultural and Resource Economics Department at Oregon State University. He is the author of several publications on farm management and agricultural finance and co-author of *Farm Business Management: The Decision Making Process.*

He is a former farm management Extension specialist, has served on the editorial advisory board of *Agri Finance* magazine and received the USDA Superior Service Award for developing risk management teaching materials.

Nelson holds a Ph.D. in agricultural economics from Purdue University.

Purpose

The purpose of this module is to introduce you to the concepts and approaches of farm and ranch planning. It also includes an overview of other modules in the series.

We'll discuss why planning is important, a general framework for planning a farm business and how other modules that teach tools for long-range planning fit into this framework.

Videotape script

By Gene Nelson

Why plan? After all, fluctuating commodity prices, falling land values, droughts and changing farm programs make planning seem like a waste of time. It's hard to plan for the future when everything in agriculture is so volatile. But planning is even more important when conditions are changing.

Sometimes farming and ranching is like rolling dice. If I roll two dice, I have the possibility of rolling any number from two through 12. I can't *plan* to roll a seven, but by studying the dice and the probabilities of rolling different numbers, I can develop a plan. I know that the chance of rolling a seven is greater than the chance of rolling any other number. My plan, then, is to bet one dollar against six on rolling a seven. My plan might also include how many times to bet, what to do with my winnings and how to explain any losses to my wife.

This is one module of the *Business Management in Agriculture* series and is intended to be used with its corresponding videotape. The script may vary from the actual videotape text.

This is what planning is all about – studying your business and what is happening around you, coming up with a course of action consistent with your goals and making adjustments as you learn about the future.

Why is planning important now? Compared to the 1970s, the agricultural economy of the 1980s has been turned upside down. Sometimes it seems the only thing we can be certain about is uncertainty. Planning is needed to cope with this ever-changing world.

Beginning farmers as well as established operators are facing tough individual business decisions. The right answer for one producer will not be appropriate for another. Each farm operator has different goals, resources and perceived opportunities.

To compete effectively, you need to set your own goals and establish your own plans for achieving them. An old adage says, "If you don't know where you are going, any road will get you there."

You know that everything will probably not work out exactly as planned, but if you have done a thorough job of planning, there will be fewer surprises. In the process of developing your plan, you should identify sources of risk that will affect your business. Also, your plan should be flexible, indicating how you will adapt to new conditions.

WHY PLAN?

- Cope with uncertainty
- Farmers face tough business decisions
- Each farm is unique in goals, resources, opportunities

Why managers don't plan

Most farmers and ranchers agree that planning is important but when it comes to actually doing it, many are reluctant. Why? Maybe because planning forces you to face the fact that your resources are limited and that it will not be possible to accomplish all your goals. There are also some psychological problems that discourage planning.

1. Planning reminds you that the future is uncertain and risky. Often you prefer to ignore this risk.
2. Planning isn't easy. It involves careful thought and analysis to resolve difficult issues.
3. Planning may aggravate conflicts within your family about who should make decisions and which goals should have priority.
4. Planning makes you vulnerable. When you seek advice for developing a plan, you have to admit you don't have all the answers.

Sometimes planning isn't done because managers think they can't find the time. Planning is too important to leave undone. Successful managers *make time* for planning.

Approaches to planning

To develop a farm business plan for the next five years, you must consider the uncertainty in agriculture and the potential for change. Strategic planning from the world

STRATEGIC PLANNING EMPHASIZES:

1. Assessing external environment
2. Identifying opportunities for change
3. Provides framework for responding through:
   - setting goals
   - assessing strengths and weaknesses
   - identifying threats/ opportunities
   - setting priorities
   - allocating resources

of business is an approach that explicitly considers uncertainty and change.

Strategic planning emphasizes assessing your environment (what is happening around you) and identifying opportunities for adjusting or positioning your business. Strategic planning provides you with a framework for responding effectively to your changing environment.

To accomplish this, however, you must:

1. identify your goals,
2. conduct an appraisal of your business's strengths and weaknesses, and
3. identify threats and opportunities in your environment.

Then you are ready to:

4. establish priorities for action and
5. allocate your limited resources in a way that is consistent with established goals.

Many farmers have found that planning by crisis doesn't work. When the going gets rough, there is a tendency to shorten your outlook and plan day to day. But you cannot manage effectively by reacting to each new crisis. This approach of planning as you go assumes that you can not understand the complexities of our agricultural economy and anticipate the future.

Strategic planning, on the other hand, helps you assess long-range opportunities by anticipating change instead of reacting to it.

Never has strategic planning been more important in agriculture than today. Farmers and ranchers are realizing they must manage their own futures; they can't rely on government to do it for them. Markets, international competition and government policies are all important considerations. Planning a specific course is better than drifting in stormy waters.

What is strategic planning?

Strategic planning starts with fundamental questions. Are you in the right business? What are your goals? What does it cost you to produce corn? Are export markets for grain expanding or contracting? Will future interest rates be higher or lower? Will land values increase or decrease?

Strategic planning looks outward. Strategic planning also looks inward, considering available resources and evaluating your business's past performance. Its primary concern, though, is keeping the business in step with a changing environment. Success in agriculture depends on the opportunities and threats posed by off-farm trends.

Strategic planning anticipates the future. It considers the probabilities of future events but does not attempt to predict what will happen. Managers can make better decisions about what to do now by anticipating future possibilities rather than waiting to see what happens.

Strategic planning is long-range planning. Year-to-year planning is not adequate because farming and ranching are long-term ventures. Your plan should look ahead at least five years. But this does not mean you plan only every five years. You should revise your plan at least once a year.

Strategic planning is flexible. It allows for making adjustments in response to a changing environment by indicating what will be done depending on what happens.

Strategic planning is a family project. It is a vision shared by all who are involved in management of the business. Your lender, accountant and attorney can help, but the final decisions must be made by those who will implement them and live with them.

Strategic planning concentrates on making decisions that need to be made now. It is action-oriented. It asks: What shall we do now, and how will we adjust if a particular event occurs in the future? Decisions to allocate resources ask how we will use our money and resources now, considering future possibilities.

Strategic planning will not guarantee success, but all things considered, you can improve your chances of success by planning.

Planning steps

Strategic planning involves seven steps and related questions. They are:

1. identifying your goals (What do you want to accomplish?),
2. inventorying resources (What do you have to work with?),
3. analyzing business performance (What have you done in the past?),
4. assessing the environment (What might you do in the future?),
5. deciding on a plan (What will you do now?),
6. implementing the plan (How will you do it?), and
7. evaluating the plan (Is it working?).

These steps describe the planning process. Other videotape modules in the *Business Management In Agriculture* course will help you complete these steps. I'll discuss each of these steps and introduce the instructors you will see later.

1. **Identifying goals.** Identifying your goals is the first, most important step of the planning process. Your goals will guide the rest of the planning process. Paul Gessaman from the University of Nebraska describes how to identify goals.

STRATEGIC PLANNING

1. Identify goals
2. Inventory resources
3. Analyze performance
4. Assess environment
5. Decide on a plan
6. Implement the plan
7. Evaluate the plan

RESOURCES

Land
Labor
Capital
Management

Marketable products

"If you want to be an effective manager of your home and farm or ranch, you need to know where you are going, how you intend to get there and when you intend to arrive. These insights come directly from your goals, your statements of what you want to achieve.

"If you've never identified goals, or if you've identified goals but don't know how to attain them, you're not alone. Most people hope for a better future, but few identify goals that describe the future they want. Even fewer consistently manage for goal attainment.

"In this module, we'll deal with five topics that can help you be a better manager. They are: goals and their importance, the nature of goal-directed management, identifying goals, priority setting and developing a management plan." – *Paul Gessaman*

As Dr. Gessaman points out later, defining goals clearly enough to write them down provides motivation, makes priorities explicit and encourages family cooperation.

2. **Inventorying resources.** Once you have established your goals, the second step in the planning process is to inventory your resources. Land, capital, labor and management are resources that you must transform into marketable products. If you've kept adequate farm records, you'll find much of this information there. Dick Wittman, a rancher from Idaho, discusses how to select and implement a farm records system.

"A common misconception exists that we only keep records so we can report our taxes. But a successful farm business needs records for many other purposes. Some of the most common uses of good records are:

1. measuring operating and financial performance,
2. supporting loan applications,
3. arranging for insurance coverage,
4. estate planning and valuation,
5. analyzing investments in depreciable assets,
6. measuring the profitability of individual enterprises,
7. monitoring production inventories and
8. developing sound marketing plans.

"Without proper records, business decisions are made on the basis of gut feelings and emotions which can lead to foregoing more profitable opportunities. If operating losses start accumulating unnoticed, you may find yourself bankrupt, sold out and looking for new employment."
-- *Dick Wittman*

A balance sheet summarizes your capital resources (assets) and how they are financed (liabilities). Freddie Barnard from Purdue University will help you understand the usefulness of this financial statement.

"The primary use of a balance sheet is to measure the risk-bearing ability, or financial solvency, of your business. In other words, it shows the margin by which your debts would be covered if the business was ended and assets sold. A balance sheet also:

1. reports the amount and type of debt and equity capital (sometimes called the financial structure of the business) used to finance existing assets,
2. provides insight into a business's liquidity, or its ability to meet financial obligations in a timely manner,
3. is usually part of a loan application,
4. is useful in preparing income tax reports (assuming accrual accounting is used), and
5. can be used to document the financial position of a business to outside parties." -- *Freddie Barnard*

3. **Analyzing business performance.** The purpose of analyzing business performance, the third step in planning, is to identify the strengths and weaknesses of your business based on past performance.

Dr. Barnard also acquaints you with an income statement and how it can help evaluate the profitability of your farm business.

"In working with Midwestern farmers, I find that many of them are not fully aware of the benefits of developing financial statements. These statements can help you analyze the business performance of your farm. For example, an income statement answers questions such as: Did our operation end the year with a profit or a loss, and how much was that profit or loss? These important questions are especially crucial during times when resources are limited, and everyone seems to lay claim to fewer dollars.

"You'll find income statements useful in completing Federal Income Tax Schedule F. It can help you calculate a variety of financial ratios for analyzing business strengths and weaknesses, and it will help you work with lenders when you apply for a loan or refinance an existing one." -- *Freddie Barnard*

If your income statement shows that your goals are not being met, you need to ask why. Why has performance been poor? Can these weaknesses be corrected? This requires honest self-appraisal. Is it low yields? Poor

IF YOUR INCOME STATEMENT SHOWS THAT YOUR GOALS ARE NOT BEING MET, YOU NEED TO ASK WHY.

EXTERNAL FORCES:

- Economic trends
- Commodity markets
- Input costs
- Technology
- Regulations
- Government programs

production efficiency? Are costs too high? Is the farm too small to be efficient? Are marketing decisions resulting in low prices?

In his module, "Analyzing financial performance," Dr. Barnard discusses several financial indicators you can use to systematically analyze business performance to determine strengths and weaknesses.

"The four criteria most often used to analyze financial performance are liquidity, solvency, profitability and efficiency. The fourth criterion, financial efficiency, measures the relationship between financial inputs and outputs. Several ratios are used to measure financial efficiency. Let's take a look at some of them."
– Freddie Barnard

4. **Assessing the environment.** Once you have analyzed these ratios and understand your farm's strengths and weaknesses, the fourth step is to study your environment to identify what might be done. Take a close look at the forces affecting operation of your farm business. Those forces include economic trends, commodity market trends, input cost trends, technological developments, new regulations and farm program changes. Do any of these trends or forces pose threats? Do they represent opportunities?

The purpose of assessing your environment is not to predict trends, but to identify and better understand how they might affect the future of your business.

When you compared your past performance with your goals, you probably found some gaps. Do any trends, the changes occurring in your environment, represent opportunities that will allow you to close those gaps? If so, those opportunities deserve consideration as you put together your long-range plan.

5. **Deciding on a plan.** The fifth step, deciding on a plan, involves selecting a feasible and profitable plan that is consistent with your goals, abilities and resources. This is when you decide whether to expand your business, change production practices, add a new enterprise, discontinue a current enterprise, change your marketing program or refinance your assets. Dick Hawkins from the University of Minnesota and Bart Eleveld from Oregon State University will introduce you to some tools you can use to compare the profitability of your alternatives.

"The complete budget approach helps you analyze fairly major changes in your farm business. It is the most appropriate tool to use when an alternative course of action will change the size or organization of your business, and when these changes will have a long-term impact on the business in terms of enterprises, finances, etc. When properly done, a complete budget allows you to compare your present farming program with projections of all receipts, expenses and net earnings of each alternative you consider." -- *Dick Hawkins*

"In many cases, the changes you might want to make in your operation are small relative to the overall business. In other words, there are large parts of the farm or ranch that will *not* be affected by the change under consideration. Doesn't it make sense, then, to use a budgeting technique that considers only the costs and returns that will be affected by the proposed change? As useful as whole-farm budgeting is, we don't want to use it when a much simpler, quicker and equally appropriate analysis will do.

"That's what partial budgeting is all about. It's a way of analyzing business adjustments that involve only a small part of the farming operation." -- *Bart Eleveld*

Your alternative plans should also be compared in terms of their effects on liquidity or cash flow. Freddie Barnard introduces the tool for assessing liquidity in his module "Developing a cash flow statement."

"The key to financial success is maintaining a sound cash flow. Clearly, a business that can't meet its financial obligations in a timely manner is a business in trouble. Perhaps the single most important tool a manager has for identifying and controlling cash flow is the cash flow statement." -- *Freddie Barnard*

After comparing how alternatives would affect profitability and liquidity, many managers are still reluctant to make hard decisions. Some put off decisions because they hope to get more information. Others are cautious because all available choices involve some risk.

But timing is important. The earlier you recognize and act on an opportunity, the better your chance of success. Adopting a profitable change now, rather than a year from now, can make the difference between survival and failure.

The key components to the success of any plan are the decisions that must be made now to reach desired goals, taking advantage of opportunities and avoiding threats, within available or acquirable resources.

6. **Implementing the plan.** Once your plan has been developed, it must be implemented. Implementation includes motivating family members and employees, and acquiring necessary resources. Scheduling work includes specifying what tasks must be completed, when they must

IMPLEMENTATION INCLUDES:

1. Motivation
2. Resource acquisition
3. Scheduling
   - What tasks
   - When to complete
   - Who will do them
4. Follow up
5. Work with lender

EVALUATION TOOLS

Timetable -- monitor implementation
Records -- monitor financial progress
External trends -- monitor opportunities and threats

be completed and who will be responsible. And you need to follow up to be sure everything is carried out as planned.

Implementation may also involve convincing your lender of the soundness of your business plan.

Many people never get around to getting things done. The farmer who remarked, "I already know how to farm better than I do" is an example. To overcome a hesitancy to tackle a big job, it is often easier to divide it into smaller jobs, tackling one small piece at a time.

7. **Evaluating the plan.** The planning process isn't complete until results are evaluated. This step is often underestimated. By evaluating the results of past plans, you learn from experience and improve your planning skills. Evaluation distinguishes the farmer with 10 years of experience from the farmer with one year's experience repeated 10 times.

A timetable helps determine whether or not implementation is on schedule. And a good record keeping system enables you to monitor the financial progress of your plan and make necessary adjustments to ensure its success. You should also monitor trends that may affect your plan.

Summing up

Through strategic planning, you analyze your past performance, your current situation and trends that affect your operation. In the process of planning, you identify strengths and weaknesses as well as potential opportunities and threats. Your plan should exploit opportunities while avoiding threats.

Why plan? Because planning tells you whether or not your goals are realistic. Planning provides the discipline to think through future possibilities and initiate a course of action. Planning helps you deal with future uncertainties, reducing the possibility of surprises. Planning allows you to make better use of your resources, directing them toward achieving your high-priority goals.

Don't sit by and let events dictate the future of your farm or ranch business. Strategic planning can not guarantee success. However, strategic planning, using the tools presented by the national authorities in this video course, can give you more control over your future and can enhance your chances of success.

Strategic planning can't eliminate the risk in agriculture, but it can help you choose the best bets. Good luck.

Exercise 1

Video questions

Indicate whether each of the following statements is true (T) or false (F).

T F 1. Planning is more useful when uncertainty about future trends and events is less than normal.

T F 2. Short-range planning is more important than long-range planning.

T F 3. Because all farmers and ranchers face the same environmental trends, their plans are likely to be very similar.

T F 4. Planning is often put off because it requires you to face up to reality, resolve conflicts among family members and admit that you don't have all the answers.

T F 5. Strategic planning takes a long-range view in order to anticipate changes in agriculture, rather than reacting to them day by day.

T F 6. Planning will guarantee success.

T F 7. Identifying goals is an important part of the planning process that should be done after your plan is developed, so you will know which goals are feasible.

T F 8. Planning will reduce risk.

T F 9. Because everything is so unpredictable in agriculture, a long-range plan should look ahead no more than one year.

T F 10. Planning involves predicting future events that will affect your farm business.

T F 11. After you have developed your plan for the next five years, you should consider revising it before the end of the first year.

T F 12. It is not necessary to write out your goals as long as you have them in mind.

T F 13. Your most important resource is not your land, capital or labor, but your management ability.

T F 14. The first step in analyzing the strengths and weaknesses of your business is to compare your past performance with your goals.

T F 15. Opportunities and threats resulting from changes in your environment suggest what you can and should do to have a successful business in the future.

T F 16. As you develop your long-range plan, you should specify all the decisions to be made over the next five years.

T F 17. It is better to be cautious and not commit yourself to decisions until you have all the information you need.

T F 18. Once you have planned what you should do, implementation is automatic.

T F 19. Evaluating your plan by comparing what actually happened with what was planned is important so you can explain to your lender why the loan cannot be repaid on schedule.

T F 20. Doing a thorough job of planning should reduce the possibility that future events will catch you by surprise.

Answer key 1

Video questions

Indicate whether each of the following statements is true (T) or false (F).

T **F** 1. Planning is more useful when uncertainty about future trends and events is less than normal.

Comment: False. Planning is more important when conditions are dynamic. Strategic planning involves anticipating future possibilities while current decisions are being made and thinking through what business adjustments will be made depending on what happens in the future.

T **F** 2. Short-range planning is more important than long-range planning.

Comment: False. Both are important, but long-range planning is needed to determine the direction for short-range planning. It is important to consider long-range possibilities in the development of your short-range plans.

T **F** 3. Because all farmers and ranchers face the same environmental trends, their plans are likely to be very similar.

Comment: False. Plans for any two farm operations will not be the same because of differing goals, resources and perceived opportunities.

T F 4. Planning is often put off because it requires you to face up to reality, resolve conflicts among family members and admit that you don't have all the answers.

T F 5. Strategic planning takes a long-range view in order to anticipate changes in agriculture, rather than reacting to them day by day.

T **F** 6. Planning will guarantee success.

Comment: False. Planning cannot guarantee success, but it should improve your chances of achieving your goals by making you aware of resources you have available, strengths and weaknesses of your past performance, and opportunities and threats posed by your environment. Planning can also help keep you on track and help convince your lender that your business is a good credit risk.

T **F** 7. Identifying goals is an important part of the planning process that should be done after your plan is developed so you will know which goals are feasible.

Comment: False. Identifying goals is the first step in the planning process. Your goals determine the direction the planning process will take and are needed to carry out other steps in the process.

T **F** 8. Planning will reduce risk.

Comment: False. Planning will help you assess risk and develop approaches to cope with it.

T **F** 9. Because everything is so unpredictable in agriculture, a long-range plan should look ahead no more than one year.

Comment: False. Even though everything is changing in agriculture, agriculture involves long-term production processes, making it important that plans extend for more than one year. A planning period of at least five years is needed so that you can anticipate future conditions, whatever they may be.

T **F** 10. Planning involves predicting future events that will affect your farm business.

Comment: False. Planning does not predict the future. It recognizes, however, that there are probabilities associated with future events and bases a plan on these probabilities. The purpose of planning is to identify and better understand how future events and trends might affect your farm business.

T F 11. After you have developed your plan for the next five years, you should consider revising it before the end of the first year.

Comment: True. A strategic plan is a flexible plan that should be revised when new information indicates it should be. The plan should be reconsidered at least once a year.

T **F** 12. It is not necessary to write out your goals as long as you have them in mind.

Comment: False. It is important to have your goals in writing so that relationships (competitive/complementary) can be examined, priorities can be set, cooperation among family members can be encouraged and so there will be a written reminder to motivate your everyday decision-making.

T F 13. Your most important resource is not your land, capital or labor, but your management ability.

T F 14. The first step in analyzing the strengths and weaknesses of your business is to compare your past performance with your goals.

T F 15. Opportunities and threats resulting from changes in your environment suggest what you can and should do to have a successful business in the future.

T F 16. As you develop your long-range plan, you should specify all the decisions to be made over the next five years.

Comment: False. Your plan should include only those decisions that need to be made now. However, you should consider what effects your decisions will have on the business over the next five years.

T F 17. It is better to be cautious and not commit yourself to decisions until you have all the information you need.

Comment: False. You will never have all the information you need to make a decision. Although you should consider all information available and proceed cautiously, acting promptly is important in order to take advantage of opportunities and remain competitive.

T F 18. Once you have planned what you should do, implementation is automatic.

Comment: False. If it were automatic, the job of management would be much easier. Seeing that your plan is carried out involves important challenges of motivating other people, acquiring necessary resources, dividing jobs into smaller tasks, scheduling work and monitoring progress.

T F 19. Evaluating your plan by comparing what actually happened with what was planned is important so you can explain to the lender why the loan cannot be repaid on schedule.

Comment: False. The most important reason for evaluating your plan is to help managers improve planning skills.

T F 20. Doing a thorough job of planning should reduce the possibility that future events will catch you by surprise.

Comment: True. You may be disappointed, but you should not be surprised.

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