When to Upgrade Your Farm

When it comes to maintaining your farm's long-term success, there are few tasks more neglected than the process of expanding one's capital resources. This shouldn't come as a surprise. In an industry where profits are both historically razor thin, and where just about any improvement carries with it a new level of debt, it can seem overwhelming to just keep the operation running at its current levels. But, as with any business, the key to success is concentrating on the areas in which you excel and reshuffling your resources so as to best empower these strengths. In other words, that oft-repeated truism, "You've got to spend money to make money."

In short, the key to successfully growing an agricultural business is not altogether different than growing any other business. With this in mind, here is a series of questions designed to get you started planning for and implementing a successful expansion of your farm. Please note, however, that they should comprise but a starting point in your planning process and do not replace individualized advice of financial consultants, legal advisers and other trained professionals. Your individual success plan is as unique as the farm for which it is designed.

How do I know when it is time to build a new farm or expand my current operation?

First, take a long, hard look in the mirror.

The most important factor to consider when eying an expansion to your business may have nothing what-so-ever to do with heads of cattle, acres of land or even dollars and cents. Instead, ask yourself where you want to go under the best of possible circumstances. Don't forget to include your personal aspirations as well as those for your business. Equally important is the practical question of whether or not you can commit an extremely large chunk of your finite resources – primarily time and money – to the difficult endeavor before you. Questions to ask include:

How long do I intend to stay in farming?

If you are nearing the end of your career and have not begun enacting plans for a *successor or an exit strategy, then you may have more pressing matters at hand than capital expansion. Even if you were to proceed with an upgrade, a half-realized investment may not hold its value when subjected to an appraiser's critical eye.*

Is my personal life stable enough that I can commit to this endeavor?
If you aren't "settled down," then why would you want to further tie yourself to your land? Even if you have that proverbial wife and mortgage under control, are there kids on the scene who'll need college tuition?

To what extent does my personal happiness revolve around a steady, stable income level?
If the word "debt" makes you cringe, perhaps you should reconsider. Risk is a fact of life when making such an investment.

Now then, if you've made it through your personal trials of self-reflection and are still thinking about expanding your farm's capital resources, let's take a careful look at your financial picture and the list of questions that should accompany this evaluation:

How much debt do you have already?
If you're like many of today's farmers, you probably don't own out-right most of the equipment upon which your farm's success depends. Let's consider the underlying philosophy of debt in the first place, which is the concept that you can eke out more from that money's buying power than can the bank or lending party. But there's a cost for using their money. Too much in interest payments can erode your profit margin and doom even the most brilliant of business ventures from the start.

How much do you rely on others for the success of your business venture? Can you continue to rely on them?
If getting good help is difficult already, you need to consider the additional holes produced by an expanded operation.

Don't forget to look around.

Be sure to scrutinize the state of the industry as a whole and any particular niches that your business occupies. For instance, if you own a primarily dairy-based operation and have flourished under a rising demand for milk, should you really bet the farm that those elevated levels are here to stay? Don't forget to consider the possibility of interference outside the free-market system, such as legislative intervention.

What about the competition – are you selling your product on the same shelf as those from cheaper markets?

It's a fact of life that the U.S. agricultural industry is seeing increasing pressure from the developing world as farming equipment becomes more affordable and advances in transportation and logistics decrease transit time. For instance, only the experienced farmer would consider entering the soybean production market without taking a long, hard look at the surging giants Argentina and Brazil.

What aspect of my business should I choose to expand?

Before you even break out a calculator, you must first evaluate the different types of growth that are possible. You may find that only one or two types of growth are even possible given your current situation:

Expanding operations – The business theory behind this type of growth is perhaps the simplest to conceptualize and, in turn, to enact. If what you're doing now is turning a profit and can be expected to continue turning a profit, why not maximize this potential by replicating this operation either at your existing location or in a new setting. This is a form of growth known as horizontal growth because it enlarges but does not alter the goal of your business.

Advantages

- Maximizes the value of successful management practices already in place.
- Ideal when land and labor costs in your area are cheaper than your competition.

Drawbacks

- Can expose your business to the dangers of fluctuations in a single commodity's market.
- Does not create synergy by reducing overhead costs in the way vertical growth does.

Upgrading efficiency – This can be as straight forward as building a state-of-the-art milking parlor, thus allowing you to squeeze more productivity out of existing constraints. This growth, too, is an example of horizontal expansion because it does not change your business' focus.

Advantages

- Increases the competitiveness of your farm within a tight space constraint.
- Stresses technical advantages of a highly advanced country over the labor disadvantages.

Drawbacks

- May require a large investment for only moderate gains in productivity.
- Can require a higher rate of reinvestment in order to maintain operations.

Diversification – Invest in separate and unrelated agricultural endeavors.

Advantages

- Can empower your farm to weather the volatility of a single commodity's market.
- Brings new skills and abilities to light, which allows for a refocusing.

Drawbacks

- May require additional permits and other restrictions thereby increasing overhead.
- May spread managerial oversight too thin in the opposite effect of synergy.

Specialization – The opposite of diversification, this timeless strategy has been around since the beginning of civilization when division of labor first freed man from subsistence living.

Advantages

- Will create a leaner, more competitive version of your existing operation.
- Maximizes the overhead-to-profit ratios and allows for more purchasing leverage.

Drawbacks

- Can expose your business to the dangerous fluctuations in a single commodity's market.
- May expose the farm to risk of species-specific disease or unfavorable weather patterns.

Expanding up or down the supply chain – At last, there is vertical expansion. This business model relies on the comparative advantage a business enjoys when its owners get involved in their market beyond their phase of production. For example, the dairy farmer may opt against outsourcing the rearing of stock animals and instead set up a separate operation to raise the heifers, thus offering competitive advantages such as increased feed purchasing power.

Advantages

- Can help you corner the market and make your business more indispensable.
- Develop and/or strengthen a brand or marketability across a line of products.

Drawbacks

- As with diversification, dividing your attention can lead to inefficiency.
- Could place blinders in terms of realizing new markets for the various raw products.

Collaboration – Enter some sort of cooperative agreement – officially or on an as-needed basis – that combines your farm's unique assets with the advantages of another business. This type of growth could exist as either horizontal or vertical. For example, horizontal, collaborative growth exists when two or more farms specializing in livestock help fund a marketing campaign to bolster the reputation of a region's meat quality. Vertical, collaborative growth occurs when an apple orchard strikes an agreement with a juice manufacturer to invest in research and development to create better and fruit storage technology.

Advantages

- Shares common expenses such as product marketing, thereby reducing overhead.
- Can create greater leverage that is only possible from increased market presence.

Drawbacks

- Individual collaborators give up some degree of autonomy, which creates tough choices.
- Requires additional skill sets such as communication and interpersonal prowess.

Growing income potential without physical expansion the value-added way

One of the most frequently used phrases around the agriculture industry over the past few years has been "value added." This theory of growth emphasizes not mere expansion of activities, either horizontally or vertically across the supply chain, but rather a sophistication of the efforts already underway. It's a market niche that is proving to be particularly appealing to farmers in more developed countries as a means of differentiating a product from its cheaper alternatives.

In essence, by adding value to your end product's marketability, you can increase the profit levels of existing markets and open up entirely new markets in which there is limited or no competition. Just look at the blossoming market for organic-certified foods as an example.

While the conscious cultivation of end-product value requires a little bit of business finesse, it should be well within your reach. And the payoffs can be enormous. It has long been observed that the biggest danger in the agricultural marketplace is the sheer enormity of the competitive landscape. With soybeans being grown by the ton the world over, why would the consumer elect to buy your product? This is especially true in the face of competitors with cheaper input costs such as labor and lower or nonexistent tax rates. But, instead of merely running the same old lowest-price-wins race, consider cultivating aspects of your product that differentiate it from the competition.

Specialization by categorization – Whether the category is inherent or perceived, you can increase the market value of your product by refining it into a label or brand. This can be as simple as locating a new hybrid of tomato plants that offers fruits of a different appearance. Or, it can mean achieving an additional certification, such as "organic," "green" or adherence to a regulating third party, such as the International Organization of Standards (ISO).

Market bundling – Finding ways to tie products together in the consumer's mind can mean increasing your market share by piggy-backing on another established product. For example, a vineyard may pair up with a local cheese maker to sponsor regular wine and cheese tasting events. It is inevitable that some cheese lovers will find a new-found taste for wine and vice versa.

Hedging your markets – The most common example of this in recent times has got to be the example of American corn growers who have capitalized on the rising prices resulting from growth in the renewable energy sectors. Many long-sighted growers have used these windfalls to buy into the ethanol refining sector. That way, if corn prices spike, they are able to profit off of the increase with higher sales across the board. But if prices slump, then ethanol production will be cheaper thus allowing a clear offset to what traditionally could proved disastrous.

How do I budget for controlled growth? How do I fund it?

Now that you've considered both the reasons for seeking expansion and the different types of possible growth, it's time to crunch some numbers. As is the case any time you find your farm at a financial crossroads, you should prepare a full, detailed budget.

Of course, the type of budget that's right for you will vary with the type of farming and ownership model you pursue. Nonetheless, the process is similar whether you raise heifers or grow Christmas trees. It's important to always do an honest assessment using basic budgeting components including: a **balance sheet** of assets, liabilities and equities; a **cash flow budget** showing the anticipated expenditures and incomes based on past expenses; an **operating budget** that incorporates less concrete figures such as the cost of depreciation to equipment; and, finally, an **income statement** that draws on the first three to forecast a probable profit range.

The next part of the planning process involves identifying and obtaining the necessary funding to enact the growth plan. Perhaps the simplest way of obtaining funding is to pursue a loan from a known financial institution. Be sure to examine banks specializing in farm loans, although you may still prefer to deal with a local, general-purpose financial institution. There are also a large number of government-subsidized loans available. A good place to start is the United States Department of Agriculture's Farm Service Agency and the Small Business Administration.

So what's next?

Today's changing agricultural marketplace is about as unpredictable as any market. Nonetheless, it's an industry that will never become obsolete and will see demand rise as quickly as world population – especially as rising income levels in developing countries create new socio-economic classes of consumers with ever-expanding palettes.