

**BUSINESS
MANAGEMENT
IN AGRICULTURE**

A joint project of the Cooperative
Extension Service, Farm Credit and
Chicago Mercantile Exchange

Planning the farm business

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Planning

Planning the farm business



John Ikerd

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.

John Ikerd is a professor and head of Extension Agricultural Economics at the University of Georgia. He worked as an Extension economist in livestock marketing for seven years in North Carolina and eight years in Oklahoma before moving to Georgia in 1984. His entire professional career has been spent working with farmers on their management and marketing problems.

Ikerd was raised on a small dairy farm in southwest Missouri. Upon completion of a B.S. degree at the University of Missouri in 1961, he worked with Wilson Foods in merchandising and sales promotion. He returned to the University of Missouri in 1965 where he completed M.S. and Ph.D. degrees in agricultural economics.

Purpose

The purpose of this module is to help you:

1. feel comfortable with farming as a successful business as well as a good way of life;
2. realize the importance of marketing as an integral part of the management function;
3. understand the "discipline of the marketplace," or the economic realities of the farm economy;
4. understand risks and their relationship to profitability and feasibility of your farm business;
5. become familiar with objectives which integrate production, financial management and marketing strategies;
6. develop an objectives-based approach to management and marketing decision-making;
7. understand the basic functions of management and their relationship to marketing strategies; and
8. realize that you can make logical marketing decisions as a natural part of farm business management.

Videotape script

By John Ikerd

Moderator— I want to introduce to you Clay and Sandy Johnson, farmers . . . good farmers, in fact. They, like many good farmers, owe money on their land and equipment and borrow money for production expenses. Unlike some farmers, however, Clay and Sandy have been able to make ends meet even during hard times.

However, they are far from confident about their future in farming. The economic downturn in the 1980s made them realize that being good producers is not enough. They realize that if they had borrowed more heavily during the good times they, too, could be broke today.

Clay and Sandy know also that just being cautious is not enough. They want their income to keep up with the income of families who work in town, meaning their farm business has to grow. And they know you just can't grow very much nor very fast without taking a few chances. Still, they know if they take too many chances they could end up broke.

The Johnsons, in this story, are asking a very important question: How can farm families make an acceptable living, without endangering their financial survival, in the risky business of farming?

Farming: business or way of life?

Fred— Well, another good year! And, you're making your loan payments on time again.

Sandy— Doesn't everyone?

Fred— Don't I wish? Sure would make my job easier.

Clay— Well, we may have been making our payments okay but we're not very happy about how our farm has been going. It seems that we have to work harder and harder every year just to make ends meet.

Sandy— We keep hearing that things are getting better, but we just don't see it.

Clay— Even with higher prices and government payments we seem to be stuck in a hard-work and low-pay profession. The rewards are few and far between.

Fred— Well, I hesitate to bring this up, but looking over your financial statements for the past few years, I can see why you're concerned. Your income has been dropping nearly every year and your net worth has plunged because of falling land prices. You also sold off some assets to make loan payments.

Clay— We had to do that . . . we've sold some breeding stock and some equipment, and even 80 acres of land over the past few years.

Fred— I'm not suggesting that you should have kept those assets. Selling them may have been the best alternative you had at the time. But your cash flow is down because you're running a smaller business.

QUESTION

How do you make an acceptable living without endangering your financial survival in the risky business of farming?

Sandy— If we hadn't sold part of our business we couldn't have kept the rest.

Fred— Yes, but you can't expect a smaller business to earn more money, especially during hard times. If your business doesn't grow, your income won't grow either. That's the bottom line.

Clay— The bottom line? You talk about our farm as if it were just another business. Fred, farming is different.

Sandy— I agree. Farmers are at the mercy of the weather. Our crops can be destroyed by drought, floods, or hail if insects and diseases don't get them first.

Clay— And, we farmers can't set prices like other businesses can. We have to take whatever the market offers.

Sandy— We have to decide how much to produce without knowing what we will get for it. How can you run a business under those conditions?

Fred— Well I must admit . . .

Sandy— And, even if we could run the farm as a business, I'm not sure we would want to. Lots of things in life are more important to us than money. If that weren't the case, we wouldn't be in farming in the first place.

Clay— We don't want to raise our kids as if they lived in town and worked in a factory somewhere. We want them to be farm kids—growing up with the same quality of life and basic values we had as kids on the farm.

Sandy— A good way of life on the farm is a lot more important to me than having a profitable "business."

Fred— I understand what you're saying. Farming is a unique business, but it's still a business. It is a purposeful, economic activity. That makes farming a business, whether you like to call it that or not.

Clay— . . . Purposeful . . . economic . . . activity . . . ?

Fred— Sure, it's an economic activity. You have to use money, land, labor, and management, to produce products. Profit—money—is at least one measure of your success.

As far as being purposeful . . . you're farming for a reason . . . you called it "quality of life." It takes some minimum level of profit to keep a farm in operation. You can't get much "quality of life" on a farm that is going broke or is bankrupt.

Sandy— I didn't mean to imply that money isn't important. Sure, I want my kids to be able to do the things the kids in town do. I know those things take money. And, I'll have to admit over the past few years our way of life

hasn't been what it used to be. Maybe we do need to be more businesslike than we have been.

Clay— I don't know. I really don't think I can do much better. My crop yields are well above the county average nearly every year. We save as many pigs per litter as anyone and I'll match feed efficiency with anybody you lend to. We went through the financial planning courses you recommended last year . . .

Sandy— You've said yourself that we have as good a set of records and financial statements as any you've seen.

Clay— I don't know what else we can do.

Marketing—a function of farm business management

Fred— I agree that you are excellent producers, and you're improving as financial managers. But there is one part of your operation that we haven't talked about very much. That's marketing.

Sandy— Well . . .

Fred— Do you consider the markets when you make production decisions? Do you consider alternative ways of marketing and pricing? Do you have pricing objectives and strategies? Do you get as much out of everything you produce as you could?

Clay— I simply don't see how I can produce for the markets when I don't know what the prices are going to be at harvest time.

Sandy— We do look at marketing alternatives . . .

Clay— . . . but, I am not going to put my money in the pit with those speculators in Chicago by trading futures or options. I get as much as I can out of what I produce. I still don't see much use in developing pricing objectives when we can't set prices.

Sandy— Clay, we've talked about marketing before. Honestly, are we willing to deal with marketing the way we should?

Clay— What do you mean?

Sandy— Well, I was talking with Frieda Jones after church last week about the drop in soybean prices. She said she had priced most of their beans when the prices were up during the dry spell last spring.

Clay— So . . .

Sandy— So, if Frieda Jones isn't afraid of the Chicago speculators, why should we be? In fact, she says that farmers like us who don't price ahead are the real speculators.

Fred— Wait a minute. I don't want to cause a family argument. I don't mean to imply that marketing is simple. You can lose money dealing in futures and options, particularly if you don't know what you're doing. There's no crystal ball that predicts market prices. But we can make some reasonable estimates and use them to make logical marketing decisions.

Look, Sandy, Clay, . . . marketing must be considered as an integral part of the overall farming operation. If you look at the marketing, production, and financial aspects of your operation at the same time, you can develop strategies and make decisions for the total farm business. That's what I call a logical approach to marketing.

Clay— Well, it sounds like something we should look into. . . . I guess we never learn unless we're willing to try. How do you suggest we get started?

Fred— I suggest we get started by attending a marketing study group meeting at County Extension Center a week from Monday night. Our bank has been co-sponsoring marketing study group meetings for several months now.

Sandy— Clay, I think I'll go even if you can't. Producing for the markets and getting higher prices might be just what we need to add to our quality of life without taking anything away.

Fred— Clay, Sandy, I have another appointment in a few minutes. But you folks are going to do fine. I do hope I see you at that extension meeting. In the meantime, why not take this little quiz.

Clay— Quiz? Sounds like grade school.

Fred— Not really a quiz . . . more like an exercise to get at your farming philosophy . . . your thoughts concerning balancing farming as a business and as a way of life. Remember, you don't need to be all business. Farming as a way of life is important, too. But most important, you need to understand the tradeoffs between the two ways of thinking and decision-making.

Moderator— Let's stop the videotape at this point and independently complete Exercise 2 (pp. 21-22). Spouses and partners in farming operations may want to share and discuss their views later. We'll be back soon to continue our story.

(Pause)



Moderator— Clay and Sandy took their lender's advice. They have completed the self-analysis. They have talked about their farming philosophy. They have opened their minds to considering a different basic approach to farm decision-making.

Our continuing story finds Clay and Sandy Johnson at the marketing study group meeting suggested by their lender. The person leading the discussion is their county agent.

Discipline of the marketplace

Gary (county agent)— We're pleased that you folks could join our marketing group this evening. We're using a video/workbook by Dr. John Ikerd, a farm business management specialist from the university, as a basis for our discussion tonight. We'll have plenty of time for discussion as we go along. But let's get right into the program with the videotape.

Dr. Ikerd— Many farmers tell me that marketing is the area where they need the most help. They say they know how to produce, but they don't know how to market what they produce. Even some of our best producers will admit that they don't feel very confident about the marketing end of their business.

What do these farmers mean when they say they need help with marketing? A lot of them mean, quite simply, that they want to get a higher price. Others would settle for any profitable price.

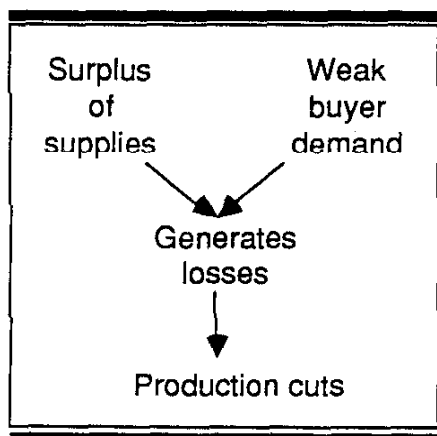
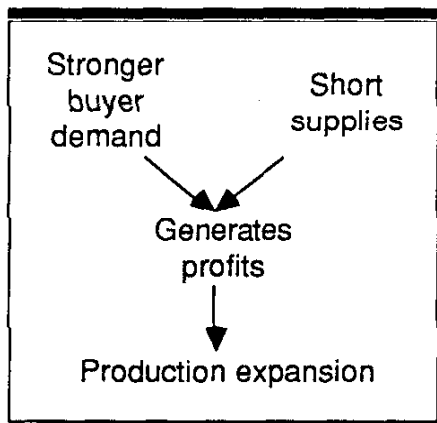
But a lot of them want to be able to produce whatever they want, sell it whenever they want to sell it, and get a profitable price for it. Folks, this view of marketing is simply unrealistic.

You cannot expect a profitable market to be created for whatever you choose to produce. To be a good marketer, you need to accept the "discipline of the marketplace." You need to learn to produce for the market.

You begin by realizing that a free market economy is one driven not by producers but by consumers. Ultimately, the market value of any good or service is determined by its value to consumers. The market doesn't care what it costs you to produce something.

The retailers who sell your grain or livestock products to consumers are not free to set prices as they choose. They can raise prices only if consumers are willing and able to buy more, at current prices, than you farmers have produced.

Ultimately, higher prices for scarce supplies at the consumer level will be passed back down to you, the producers. Higher prices mean higher (or increased)



profits. And, higher profits provide you the incentive and the means to expand production of those things the consumers value most. So profit-driven expansion is the market's response to stronger buyer demand or short supplies.

On the other hand, when consumers are unwilling to buy what is offered at the current price, the seller has to drop the price—resulting ultimately in losses to you, the farmer.

Lower prices are the market's signal to farmers that they have produced too much of something or that it's something consumers don't want. Losses reduce farmers' incentive to produce things that are in surplus and ultimately will force production cuts as farmers lose more and more money.

This is the discipline of the marketplace. Those who produce things that consumers are willing and able to buy are rewarded. Those who produce things that consumers don't want or can't buy are penalized. Farmers must produce for the markets. They cannot expect to find or create a profitable market for whatever they choose to produce.



Understanding business risks

Clay— I think I understand what he was saying about the discipline of the marketplace. We have to produce things that people are willing and able to buy at a profitable price. But I still don't see how farmers can do very much about marketing.

Sandy— How can we produce for the market? There is no way we can know at planting or breeding time whether prices will be profitable at harvest time, or when the hogs are ready to sell.

Gary— Of course, you can't know for sure what prices are going to be, anymore than you know how much you're going to produce. But nevertheless, you make logical production decisions—how much fertilizer to apply and what ration to feed—without knowing yields or gains. You can make logical marketing decisions in much the same way.

Clay— But I have a lot better estimates of my yield per acre or pigs per litter than I have of grain and hog prices.

Gary— That may be true right now. But you could get estimates of prices, 4 to 6 months into the future, that are about as accurate as your production estimates. I suspect that, like most farmers, you've simply invested a lot more time and effort in gathering production information than in gathering marketing information.

Sandy— And to be honest, we don't do such a good job of estimating production levels. Our estimates may average out pretty good over several years. But if we have dry weather, our crop yields can be half or even less of what we expect.

Clay— And I have to admit, our pigs per litter vary a lot from one farrowing to the next.

Gary— We need to recognize right up front that uncertainty and risks are an unavoidable part of farming, whether they are related to production or to marketing.

The next segment of our videotape deals with risks. Let's play that segment now. I think it will answer a lot of your questions.

Dr. Ikerd— If we are to have any chance of making profits in farming, we must manage risks because profits are "returns to risk." If there weren't any risks in farming, there simply wouldn't be any profits.

You can avoid most risk if you want to. You could rent out your land to someone else, put your money in an insured bank account, and get a job in town . . . and you would earn a return on your land, labor and capital without taking much risk.

But if you want the chance to earn more than you can in these risk-free alternatives, you have to risk earning less.

Risk can be defined as the chance or the probability of an unfavorable outcome. Getting less is an unfavorable outcome. So, by definition, risky decisions, even well-thought-out decisions, can have bad outcomes.

But risk management, not simply risk-taking, is the key to profitability. Managing risks means that you decide how much and what kind of risk you want to take and how much and what kind of risk you want to avoid.

There are two basic kinds of risks in farming: business risk and financial risk. Business risk includes both production risks and market risks. It can be defined as the chance or probability of an unfavorable net return or net income.

This unfavorable outcome can result from either poor yields and high production costs or unfavorable market prices.

You can manage production risks using such tools as irrigation and crop insurance in addition to good management practices. You can manage market risks using such tools as forward contracting and hedging with futures or options.

But to manage business risks, you must deal with both production risks and market risks together.

RISK MANAGEMENT MEANS—

- How much to accept?
- What kinds to take?
- How much, and what kinds to avoid?

Understanding financial risks

Financial risk is the other general kind of risk. Financial risks relate to financial feasibility in much the same way as business risk relates to profitability.

Financial risk depends entirely on how your farming operation is financed. A totally equity financed farming operation has the least financial risk. The greater the use of debt financing, the higher the level of financial risk.

Financial risk is the chance of an unfavorable financial outcome. In the short run, you may be concerned that you won't be able to meet your cash flow commitments. In the longer run, you are more concerned about the financial survival of your farm business.

For a given total dollar-and-cent loss, a farmer with greater debt repayment commitments is less likely to meet his monthly cash flow requirements. Farmers with greater total debt-to-asset ratios also run a higher risk of financial failure from a series of bad production or weak (or soft) market years.

To sum up: In the case of business risk, greater risk usually means greater potential for profits, but there is an offsetting risk of greater loss. In the case of financial risk, higher financial risk adds to the potential for growth in a farm business over time. But there is an offsetting threat to survival or risk of infeasibility.

A successful farm business must be both profitable and sustainable over time. Thus, farmers must consider both business and financial risks in developing integrated business management strategies.

Gary— Let's stop here and discuss what we've seen. Are there any questions?

Clay— Financial risks and business risks may be different but they are certainly related. Obviously, I'll be more likely to meet my cash flow commitments if I make profits than if I lose money.

Gary— Certainly the two are related. A profitable business operation is a lot more likely to be feasible than an unprofitable one. But, you can have a business that is profitable but not feasible. For example, you may be able to cover all production costs in any given year, but still fall short of the amount needed to pay off previous debt commitments.

Clay— Can you also have a business that is feasible but not profitable?

Gary— Only if you were able to cover your cash flow commitments or make debt payments using something other than profits.

PROFITABLE BUT NOT FEASIBLE

- Cover cost of production
- Fail to service previous debt

FEASIBLE BUT NOT PROFITABLE

- Cover cash flow commitments and debt with other than profits

Sandy— We've been paying off debts by selling land and breeding stock over the past few years because we weren't making any profits. I guess we're an example of an operation that has been feasible but not profitable.

Fred— You're right, Sandy. That's the reason we're here. We'd like to see you get your farming operation back to a point where it is profitable as well as feasible.

Clay— The things we've heard tonight make a lot of sense but I still don't see how we can put all of this risk stuff together in a simple way to make practical management decisions.



Management by objectives

Gary— Management by objectives (MBO) is a good common-sense approach to doing just that. MBO has been popular with corporate business managers for some time, and I think it will work just as well for farmers.

Clay— Last winter Sandy and I attended a Business Management for Agriculture workshop where they talked about "goal" directed management. What's the difference between goals and objectives?

Gary— I think of an objective as a specific result or outcome needed to achieve a more general goal. For example, your goal might be a net income of \$30,000. Some specific objectives needed to reach that goal might be 9 pigs per litter, \$50 average hog prices with 40-bu./acre yields and \$7.50 soybean prices. The point is that you have something specific to aim for. Whether you call them goals or objectives is up to you.

Clay— We never really followed up on that goals meeting. I guess what we need to do now is turn our goals and objectives into a workable farm plan.

Gary— It's too late for us to begin on management by objectives tonight, but I have a videotape and some other material on the subject. Why don't we get together about the same time next week and we'll see if managing farms by the MBO method makes any sense to you.

Clay— We'll be here if we can. This is a busy time of year for us.

Sandy— Yes, but we need to make sure we are busy doing the right things. I still feel that marketing is one thing we haven't done enough of. If an objectives approach to management will help us get more out of our markets, that's what I want to do.

Gary— In the meantime, why don't you go back and review the goals you established in that earlier meeting. You can check out the videotape and workbook materials here at the county office if you like. And I'll see you next week.

The first step to effective management by objectives is setting goals and objectives. Let's take a break and do Exercise 3 (pp. 23-26), which is an opportunity to practice setting short- and long-range farm and family goals.



(Pause)

Moderator— This time, as we return to the story of Clay and Sandy Johnson, we find them at the second marketing study group meeting. Dr. Ikerd's video on farm management by objectives is already playing. Let's tune in.

Farm business management by objectives

Dr. Ikerd— In this next section, we'll be looking at management by objectives. Management by objectives has been the cornerstone of corporate business management for decades. Peter Drucker, a noted business consultant and scholar, has said that for a large corporation to perform effectively, each job should focus on well-defined objectives for the whole organization.

Most farms have very simple organizational structures. So we might question whether management by objectives is relevant to farm management. Farm businesses are, however, typically made up of a variety of enterprises and activities, and farm managers perform a variety of management functions.

Management by objectives integrates production, marketing and financial management. It focuses all enterprises, activities and management functions on achieving well-defined overall objectives for the total farm business.

Peter Drucker relates a good story of three stonemasons who were asked what they were doing. The first replied, "I am making a living." The second one said, "I am doing the best job of stone-cutting in the entire country." The third one looked up with a visionary gleam in his eye and said, "I am building a cathedral."

How would you answer if you were asked what you were doing with your farming operation? Some might answer simply, "I am trying to make a living." Others might say, "I am trying to be the best farmer in the county." How many of you could tell me what you are building with your farming operation? How many of you

MANAGEMENT BY OBJECTIVES

Integrates decisions

- Production
- Marketing
- Financial

Focuses

- Enterprises
- Activities
- Management functions

Achieves

- Overall objectives

know what you want your "cathedral" to be five or ten years from now?

If you can't envision your cathedral, you have no way of knowing whether a given business management strategy is good or bad. Once you have well-defined objectives, you can begin to develop logical management strategies that will at least improve your odds for success. You can begin to manage your farm rather than let it manage you.

I like to classify management functions into three categories: planning, implementing and evaluating. A good way to remember these three management functions is that management is easy as "P.I.E."

First, you develop a "plan" for achieving your objectives, next you "implement" the plan, and then you "evaluate" the results to see whether or not the plan is working. If it is working, stick with it. If it is not, change it. You continue to plan, implement and evaluate over and over again as you move from where you are to where you want to be.



Producing for the market

Now, let me shift direction just a bit and talk specifically about marketing decisions. In the planning phase of marketing, you have to answer two basic questions. First, what are you going to produce? And second, when, where and how are you going to market or sell it?

In general, farmers must produce for the markets rather than expect to create markets for whatever they produce. Thus, a farmer's production decision becomes one of producing a commodity that has a "reasonable" chance of returning an "acceptable" profit.

But what level of profit is "acceptable"? You answer this important question in the process of setting your goals and objectives. A profit level consistent with achieving your long-term objectives is an "acceptable" profit.

Okay then, what "chance" of an "acceptable" profit is "reasonable"? Here again we go back to your objectives. How much "risk" can you afford to take in pursuing those objectives? A "reasonable" risk is the risk you consider to be "reasonable." This is something you'll have to decide for yourself.

Now, chances are you'll produce the same things this year as you produced last year and the year before. But you need to reevaluate some aspects of your enterprise mix on a continuing basis.

And regardless of whether you're considering one change or a whole new farm plan, marketing begins by producing something that has a "reasonable" chance of returning an "acceptable" profit.

FUNCTIONS OF MANAGEMENT

- Planning
- Implementation
- Evaluation

"Easy as P.I.E."

MARKETING DECISIONS

When?

Where?

How much to market?

- Which marketing functions to perform?
- Which to leave to middlemen?

Choosing a marketing method

In the process of deciding what to produce, you may also have to answer the questions concerning when, where and how you are going to market. Marketing methods can have a definite impact on both expected profits and the degree of risk you face in pursuing those profits.

A basic question you need to answer in choosing a marketing method is: Which marketing functions do you want to perform and which are you willing to leave to others?

In the case of direct marketing, the farmer performs all the marketing functions from production to the actual selling to consumers. Examples of direct marketing are the roadside stand and farmer's markets. These farmers assemble, sort, process, package, distribute, price and merchandise the things they produce.

But in most cases, farmers perform only some of the marketing functions and leave the rest to specialized marketing firms or the so-called middlemen.

Farmers often feel that they would be better off eliminating these middlemen. In some cases it may be true. But the marketing costs—including wages, transportation, packaging, utilities, depreciation, insurance and advertising—must be paid by someone. The question is whether you, the farmer, can do the marketing for less than the specialized marketing firms can.



Choosing a pricing strategy

Most farmers leave a lot of the marketing functions to the marketing firms. Their most important method decision is the method of pricing—your pricing method can affect when, where and how they are going to price the things you produce.

A pricing strategy is basically a “price-risk-management” strategy. Market prices for farm commodities are inherently uncertain. The methods you use to deal with this uncertainty are an important part of your overall marketing plan.

Forward pricing is one way to manage the inherent risks in market prices. A contract to deliver your product at a fixed rate at some future time can “eliminate” price uncertainty.

Hedging in the futures markets “reduces” rather than eliminates price uncertainty but is more flexible than fixed-price contracts. Commodity options is another method of “managing” price risks that offers protection against “downside” price risks while leaving much of the “upside” price potential intact.

Most forward pricing strategies have no effect on either production or financial risks. But less price risk may allow you to take on higher production or financial risks sometimes necessary to gain acceptable profits.

Production, market and financial risks must be considered together. As a result, decisions regarding what you are going to produce, how to market and how you are going to price and finance it must also be made together.

The pricing strategy

The most difficult part of marketing is knowing when to accept a price and when to wait for something better. A predetermined strategy will help, but the pricing decision is never easy because no one is ever quite sure of future market prices or whether they will go up or down in the next 24 hours.

A pricing strategy is a plan to help you decide when to price. The objective of a pricing strategy should be to get an acceptable price out of whatever you've decided to produce.

Farmers generally can't set prices but they may have a range of alternative prices to choose from. Commodity futures and options contracts, for example, typically offer a wide range of prices over the year as they are traded prior to contract delivery. Forward cash contracts typically are based on futures or options, so they offer a similar range of prices.

Making pricing decisions

Anyone would prefer selling at the highest possible price rather than merely settling for an acceptable price. Unfortunately, no one can consistently pick the top of a market . . . not you . . . not the market experts. Market outlook information and technical pricing strategies may help. But no marketing strategy will ensure the highest price.

You need to know what price levels are consistent with an "acceptable" profit for your overall farming operation. You may want to consider current outlook information and market trends in making your final pricing decision. But you shouldn't let an acceptable price slip away.

You may need to make some adjustments in your pricing objectives during the production process. The market situation and outlook may change. But these adjustments should be a part of your overall pricing strategy. Once you decide on an overall strategy, stick with it. You can always reevaluate and change your strategy before the next crop.



THE PRICING STRATEGY:

A plan for getting an "acceptable" price for whatever you have chosen to produce.

MARKETING RULE

Stick with your pricing strategy

EVALUATE DECISIONS

Determine whether you achieved your objective—not whether you got the highest possible price or profit.

Merchandising what you produce

The final step in marketing is merchandising. Merchandising is simply getting the most out of whatever you have produced. The value of any commodity may be determined as much by where it is and when it's there as by its physical characteristics.

The method of exchange can also make a difference in the value of your commodity. Farmers with very little bargaining power may be better off selling through auctions or through commission sales firms. Larger producers may get a better price by selling direct and negotiating for themselves.

Merchandising is a matter of getting your product to the buyer who is willing and able to pay the highest price at a given time. Farmers who deliver the right product to the right buyer at the right place at the right time are more likely to get the right price.

The bottom line—profit

The final piece of the management P.I.E. is evaluation. You should evaluate your marketing decisions from the standpoint of whether you achieved your objectives, not whether you got the highest possible price. If you realized the profit potential you thought was there when you decided to produce, your strategy has succeeded.

Marketing: a part of your overall management plan

Clay— Gary, I'm glad we came tonight. I'm beginning to see how we can do some things on the marketing side of our business.

Sandy— We think we know what we can reasonably expect our farm to do for us financially. What's our next step?

Gary— I would suggest that you begin to develop an overall management plan that includes a good marketing strategy. Remember the three functions of management: planning, implementation and evaluation—easy as P.I.E.

Sandy— I guess we're still at the planning stage, aren't we?

Gary— That's right. A good way for you to start developing your plan is to budget out each of your farm enterprises. Start by estimating the costs and returns you might reasonably expect to get next year. We have another tape in our Business Management in Agriculture series that deals with enterprise budgeting if you need some help.

You will then need to add the costs and returns from all your enterprises to see how they match with your overall farm income objective.

Sandy— What do we do if they don't match?

Gary— First, you need to recheck your figures to make sure you haven't been too optimistic or pessimistic in your cost and return estimates. If your estimates are okay, something else is wrong and you may need to consider some alternative enterprises or management strategies.

If you still fail to meet your objective, you may have to face the fact that your farm can't earn what you had hoped for. You may have to adjust your objectives.

Sandy— What do we do after we get our goals and expectations in line?

Gary— The key figures in your enterprise budgets become your management objectives. For example, if your hog budget shows 8 pigs sold per litter, a 3.4 feed efficiency, corn cost of \$2.25/bu. and a \$45/cwt. hog price, these values become your management objectives for the hog operation.

Clay— If I can keep these key factors on target, then the hog operation will contribute its part in my income goal. The \$45 hog price, in this case, becomes the target price for my marketing strategy.

Gary— That's right. Now you're talking like a farm business manager.

Clay— It's all beginning to make sense, Gary. You know, two weeks ago I didn't think there was much I could do about marketing. Now, I'm beginning to think it may be the most important thing I can do.

Gary— You still have a lot of details to work out, but I think you're on the right track now. The important thing is that you know you can manage your farm as a business. Remember, a business is an economic activity with a purpose.

Sandy— And making profits may be just one of several purposes.

Gary— That's right. But once you begin to think like business people—I should say "farm" business people—everything else, from setting objectives to marketing, will begin to fall into place.



FARM MANAGERS MUST ACCEPT DISCIPLINE OF THE MARKETPLACE

- Produce for markets
- Don't expect markets to be created

MARKETING STRATEGY

- What to produce
- Marketing methods to use
- Pricing strategies
- Getting the most out of what is produced

Summary

Moderator— Let me try to summarize what we have learned from the story of Clay and Sandy Johnson. First, we have learned that farms are businesses. And even though farming is different in many respects, farmers can benefit from the management philosophies and tools that have been tried and proven in the corporate business world.

Farmers must accept the discipline of the marketplace. They must produce for markets rather than expect to create markets for what they produce.

Uncertainties and risks are an inherent part of farming. Marketing is basically a matter of managing market risks. But we can't deal with market risks in isolation from production risks and financial risks. Marketing is just one part of overall farm business management.

Management by objectives is one approach to better farm business management. The basic idea of management by objectives is quite simple: You decide what you want to do with your farming operation, then make decisions that will allow you to do it.

Management by objectives is a lot like taking a trip. First, you decide where you can go that you would like to go and when you want to get there. That's your objective. Next, you decide how to get there and what route you are going to take. That's your management plan.

While you are on the trip, which is implementing your plan, you check for landmarks along the way. In other words, you make sure you are on schedule. That's controlling or evaluating the effectiveness of your overall plan.

A marketing strategy is just one part of an overall farm business management plan. A marketing strategy answers these questions: What am I going to produce? What marketing methods will I use? How and when will I price it? And how will I get the most out of it once it's produced?

A well-planned trip gives you a better chance of ending up where you want to be. A well-planned farming operation does the same.

Succeeding videos in this series will give you the tools you need to develop a management plan and marketing strategy for your farming operation. We hope we can help you build your "cathedral" by making your farming operation what you want it to be through more effective farm business management.

References

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- Ikerd, John E. 1986. *Managing Risks for Profits*, Bulletin 940, Cooperative Extension Service, University of Georgia, February.
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Exercise 1

Video questions

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

- T F 1. Farm families have to choose either to consider their farm as a business or to consider farming as a way of life.
- T F 2. The definition of a business as a “purposeful economic activity” is not appropriate for a farm unless the farm operator’s main objective is to make profits.
- T F 3. A farmer who does a good job of marketing will always be able to find a profitable market for his products.
- T F 4. A free market economy is a consumer-driven economy. The value of something is determined by consumers without regard to production costs.
- T F 5. Falling prices are the market’s way of telling farmers they are producing something consumers don’t want, or are producing too much of something.
- T F 6. Farmers can ignore the market’s price signals indefinitely if they choose to do so.
- T F 7. Marketing begins by producing something that has a reasonable chance of returning an acceptable profit from the marketplace.
- T F 8. Uncertainty and risks associated with unpredictable prices for agricultural commodities make marketing a nearly impossible task for farmers.
- T F 9. Risk may be defined as the certainty of an unfavorable outcome or result.
- T F 10. Two basic types of risk in farming are business risks and financial risks.
- T F 11. A business that is financially feasible will also be profitable.
- T F 12. A business that is profitable will also be financially feasible.
- T F 13. A business may be profitable but not financially feasible or feasible but not profitable.
- T F 14. Management by objectives is a complex approach to management that is useful primarily in large, complex business organizations.

- T F 15. The management by objectives approach to farm business is appropriate only for those who view farming primarily as a business rather than as a way of life.
- T F 16. Three basic functions of management are planning, implementation and evaluation.
- T F 17. Farmers are “price-takers” but they typically can sell all they produce at the going market price.
- T F 18. Most farmers have a wide range of prices to choose from if they choose to do so.
- T F 19. The choice of a marketing or pricing method should be considered at the same time as the decision to produce.
- T F 20. A farmer’s pricing decision must be made either at the time of the production decision or at the time of delivery.
- T F 21. A professional price forecaster should be able to tell you when a market price has reached its peak.
- T F 22. It doesn’t make sense to use the futures markets unless you expect to make money on your futures transactions, at least on the average over time.
- T F 23. A single pricing strategy may include several different courses of action, each of which should be followed under a given set of circumstances.
- T F 24. Merchandising means getting the right product to the right buyer, at the right place and the right time.
- T F 25. The planning process should begin by defining specific management objectives that are consistent with your goals or the goals of the farm family.

Exercise 2

Determining your farming philosophy index*

Check the space on each line that best represents your feelings relative to the two extreme values:

- 1 2 3 4 5
1. How would you describe yourself?
- As an individual
.....Competitive ___ ___ ___ ___ ___ Cooperative
- As a family member
.....Independent ___ ___ ___ ___ ___ Farmer by heritage
- As a farmer
.....Businessperson ___ ___ ___ ___ ___ Steward of land
- As a community member
.....On my own, detached ___ ___ ___ ___ ___ Close to friends and neighbors
-

2. What are your main concerns?
- As an individual
.....Personal success ___ ___ ___ ___ ___ Being a good farmer
- As a family member
.....Standard of living ___ ___ ___ ___ ___ Way of life
- As a farmer
.....Protecting investment ___ ___ ___ ___ ___ Keeping the land
- As a community member
.....Winning in competition ___ ___ ___ ___ ___ Being respected
-

* Adapted from: Coleman, Mick, "Counseling with Farm Families," Workshop Materials, Extension Human Development, University of Georgia, Athens, GA, 1988; and Davis-Brown, K, and S. Saulamon, "Farm Families in Crisis," *Family Relations*, 36 (4), 368-373.

1 2 3 4 5

3. What would you like to accomplish in the next 5 years?

- As an individual
Financial independence ___ ___ ___ ___ ___ Self-respect
- As a family member
Provide for family ___ ___ ___ ___ ___ Preserve family's way of life
- As a farmer
Expand farm business ___ ___ ___ ___ ___ Pay off farm debts
- As a community member
 ...Explore opportunities for investment ___ ___ ___ ___ ___ Make the farm more secure

4. What material and social resources would you consider to be of greater value in achieving your objectives?

- As an individual
Education and skills ___ ___ ___ ___ ___ Commitment to farming
- As a family member
Family off-farm income ___ ___ ___ ___ ___ Family commitment to farming
- As a farmer
Willingness to take risks ___ ___ ___ ___ ___ Willingness to defer family needs
- As a community member
Good credit rating ___ ___ ___ ___ ___ Strong moral support

Computing your farming philosophy index:

Assign values of 1 through 5 to your answers as indicated above each set of spaces. Assign a value of 3 if you don't know how to answer any given question.

Total your values for all 16 categories. This is your farming philosophy index value. Values may be interpreted as follows:

Index	Philosophy
60-80	Farming is a way of life.
30-60	Farming is a business and a way of life
16-30	Farming is a business.

There is no one right philosophy for farmers. However, you should recognize that if you farm strictly as a way of life, your farm is less likely to be a successful business, and if you farm strictly as a business you may give up many of the potential benefits of farming as a way of life. If your index is somewhere in the middle range, you may be able to achieve success in farming as a business as well as a way of life.

Husbands and wives may want to compute their indexes separately and compare results. Comparisons may identify points of potential family conflicts. Different results for husbands and wives can also identify potential benefits from letting one management partner handle those parts of the operation that require a business orientation, while the other handles more of the traditional farming tasks. Such comparisons may be useful also for fathers and sons or others who farm in partnership.

Exercise 3a

Identifying farm/ranch goals*

Each person should initially complete this exercise without discussing it. As you identify goals, try to capitalize on the interests, motivations and abilities of family members and/or business associates.

If possible, when you have identified goals, share what you have written with your family members and/or business associates. Then develop versions that represent the combined thinking of all persons involved in the farm or ranch operation. Remember to observe these three ground rules for discussion: Be open and honest with one another, resist the temptation to make value judgments about each other's statements, and refrain from reacting until the other persons have fully expressed their ideas.

Use a copy of this exercise to record goals that reflect the combined thinking of family members and business associates.

What comes first to your mind as an important long-term goal (important over the next 10 to 20 or more years) for your farming or ranching operation?

What are other important long-term goals for your farming or ranching operation? List at least two.

How important is attainment of these goals to the long-term well-being of the farm or ranch? In the blanks next to the left margin, assign numbers that reflect the importance or urgency of each. Number them "1," "2," and so forth.

* This material is adapted from the *Business Management in Agriculture* module "Identifying farm/ranch and family goals," by Dr. Paul Gessaman, University of Nebraska.

What comes first to your mind as an important short-term goal (important over the next one to a few years) for your farming or ranching operation?

What are other important short-term goals for your farming or ranching operation? List at least two.

In the blanks next to the left margin, assign numbers that reflect your view of the importance or urgency of each goal. Number them "1," "2," and so forth.

If possible, when you have identified and ranked these goals, share your results with family members and/or business associates. Use an extra copy of this exercise to record the results of your combined thinking. Remember to observe the discussion ground rules when you share and discuss your goal statements.

Exercise 3b

Identifying family goals*

Each person should initially complete this exercise without discussing it with other family members. As you identify goals, try to capitalize on the interests, motivations and abilities of family members.

If possible, when you have identified goals, share what you have written with your family. Then develop versions that represent the combined thinking of all family members. Remember to observe these three ground rules for discussion: Be open and honest with one another, resist the temptation to make value judgments about each other's statements, and refrain from reacting until the other persons have fully expressed their ideas.

Use a copy of this exercise to record goals that reflect the combined thinking of family members and business associates.

What comes first to your mind as an important long-term goal (important over the next 10 to 20 or more years) for your family or for family life?

What are other important long-term family life goals? List at least two.

How important is attainment of these goals to the long-term well-being of family members? In the blanks next to the left margin, assign numbers that reflect the importance or urgency of each. Number them "1," "2," and so forth.

* This material is adapted from the *Business Management in Agriculture* module "Identifying farm/ranch and family goals," by Dr. Paul Gessaman, University of Nebraska.

What comes first to your mind as an important short-term goal (important over the next one to a few years) for your family or for family life?

What are other important short-term family life goals? List at least two.

In the blanks next to the left margin, assign numbers that reflect your view of the importance or urgency of each goal. Number them "1," "2," and so forth.

If possible, when you have identified and ranked these goals, share your results with family members. Use an extra copy of this exercise to record the results of your combined thinking. Remember to observe the discussion ground rules when you share and discuss your goal statements.

Exercise 4

Financial-based management goals

Examine the balance sheet of Frank Farmer on the following pages and answer the following questions.

1. How much net income would Mr. Farmer need to earn for the coming year to realize a 10% return on his equity or market value of his net worth in the farming operation? (Assume that he includes interest on borrowed capital and compensation for land and family labor and management inputs in the cost figures used to calculate net income.)

\$ _____

2. Frank Farmer expects to plant 360 acres of corn and 240 acres of soybeans and has a 40 sow hog operation. Frank typically expects to earn 40% of his net income from his corn, 30% from soybeans and 30% from hogs. How much would he need to earn per acre of corn and soybeans and per sow in his breeding herd to achieve the income objective in question 1?

Corn \$ _____/acre

Soybeans \$ _____/acre

Hogs \$ _____/sow

3. For the coming year, Frank expects to produce 100 bu. of corn per acre and 30 bu. of soybeans per acre, and expects to market 550 head of hogs at an average weight of 220 lbs. How much will Frank have to earn per bushel of corn and soybeans and per hundredweight of market hogs to meet his income objective in question 1? (He applies sales of cull breeding stock against his expenses to come up with a net cost of production for market hogs in his hog operation.)

Corn \$ _____/bu.

Soybeans \$ _____/bu.

Hogs \$ _____/cwt.

4. What would you do if this were your farm and one or more of the objective returns per acre or per head seemed unreasonable or unlikely for the coming year?

Ending balance sheet*

Name: Frank Farmer

Date: December 31, 19X1

Assets			Liabilities and net worth		
	Cost	Market value		Cost	Market value
Current assets			Current liabilities		
Cash	\$ 9,660	\$ 9,660	Accounts payable	\$ 86,000	\$ 86,000
Livestock:			Portions of I-T and L-T		
Hogs	22,000	22,000	debt due in 12 months:		
Grain inventory:			Intermediate (I-T)	6,000	6,000
Corn	60,000	60,000	Long-term (L-T)	3,000	3,000
Soybeans	15,000	15,000	Accrued interest:		
Supplies	3,340	3,340	Accounts payable	5,860	5,860
			Intermediate (I-T)	1,440	1,440
			Long-term (L-T)	0	0
			Accrued taxes:		
			Real estate	500	500
			Income & Soc. Sec.	1,200	1,200
Other	0	0	Other	0	0
Total current assets	\$ 110,000	\$ 110,000	Total current liabilities	\$ 104,000	\$ 104,000

* From the *Business Management in Agriculture* module "Preparing a balance sheet," by Dr. Freddie Barnard, Purdue University.

Assets			Liabilities and net worth		
	Cost	Market value		Cost	Market value
Intermediate assets			Intermediate liabilities		
Machinery:			Machinery loan (Amount due beyond 12 months)		
Cost \$136,000	\$ 94,000	\$ 94,000		\$ 18,000	\$ 18,000
Acc. Dep. 45,000	91,000				
Breeding livestock	9,000	9,000			
Other	0	0	Other	0	0
Total intermediate assets	\$ 100,000	\$ 103,000	Total intermediate liabilities	\$ 18,000	\$ 18,000
Long-term assets			Long-term liabilities		
Land and buildings:			Real estate mortgage (Amount due beyond 12 months)		
Cost \$124,000	\$ 110,000	\$ 117,000		\$ 51,000	\$ 51,000
Acc. Dep. 14,000	110,000				
Other	0	0	Other	0	0
Total long-term assets	\$ 110,000	\$ 117,000	Total long-term liabilities	\$ 51,000	\$ 51,000
			Total liabilities	\$ 173,000	\$ 173,000
			Net worth	\$ 147,000	\$ 157,000
Total assets	\$ 320,000	\$ 330,000	Total liabilities and net worth	\$ 320,000	\$ 330,000

Exercise 5

Identifying management objectives

Assume that hogs and soybeans are your two main cash enterprises. Enterprise budget summaries for these enterprises are shown on the following pages. You also have 100 acres of corn devoted to raising feed for your hogs. Expected net returns over costs for the corn enterprise (based on the \$2.25 price in your hog budget) are shown in the summary table below.

In addition to farm income, you have a part-time job in town. Your off-farm job is expected to earn a net income of \$10,000 after considering costs of travel to and from work and other work-related costs. The part-time work also appears in the summary table below.

You have a total fixed cash flow commitment of \$70,000 to service previously incurred debts and to pay family living expenses.

Using the budget summaries for hogs and soybeans on the following pages, complete the summary table. Answer the following questions using returns over total costs.

1. What is your expected net cash flow for the year? _____
2. What are your expected net returns over enterprise cost for the year? _____
3. Assuming that you have included costs of land, labor, capital and management, do you expect your farm to be profitable this year? _____
4. Do you expect it to be financially feasible? _____
5. How would \$4.00/cwt. lower hog prices and \$1.00/bu. lower soybean prices affect your expected profitability and feasibility? _____

Net income summary

	Net cash flow	Net return
Off-farm work	\$10,000	\$10,000
Corn for hogs	xxxxxx	\$1,500
Hog enterprise	_____	_____
Soybean enterprise	_____	_____
Fixed cash commitment	_____	xxxxxx
Net family income	_____	_____

Enterprise budget summary: hog farrow to finish

Number of sows in herd	120
Number of sows farrowing	100
Pigs weaned per sow per year	16
Selling weight of market hogs (lbs.)	220
Culling-replacement pct	50
Cwts. of market hogs sold	3,118
Feed conversion (lb. feed/lb. mkt. hog)	3.75
Cost of feed (corn price/bu.)	\$2.25
Selling price of market hogs	\$45.00

	Cash costs	All costs
Total variable costs:	\$98,897	\$116,781
Total fixed costs:	<u>2,000</u>	<u>34,325</u>
Total costs:	\$100,897	\$151,106

Total returns:	
Market hogs:	\$150,290
Breeding stock:	<u>9,078</u>
Total returns:	\$159,368

	Net returns over cash costs	Net returns over all costs
Variable:	\$60,471	\$42,587
Total:	\$58,471	\$ 8,262

Enterprise budget summary: soybeans

Number of acres	100
Average yield (bu./acre)	40
Price (\$/bu.)	6.50

	Cash costs	All costs
Total variable costs:	\$16,910	\$20,760
Total fixed costs:	<u>1,000</u>	<u>4,971</u>
Total costs:	\$17,910	\$25,731

Total returns:	\$26,000
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	Net returns over cash costs	Net returns over all costs
Variable:	\$9,090	\$5,240
Total:	\$8,090	\$ 269

Answer key 1

Video questions

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

- T (F) 1. Farm families have to choose either to consider their farm as a business or to consider farming as a way of life.
Comment: False. Farming can be both a desirable way of life and a successful business.
- T (F) 2. The definition of a business as a “purposeful economic activity” is not appropriate for a farm unless the farm operator’s main objective is to make profits.
Comment: False. One of the primary purposes of farming may be to provide a quality way of life. Profit may be seen not as a primary objective, but as a secondary objective necessary to sustain the farming operation.
- T (F) 3. A farmer who does a good job of marketing will always be able to find a profitable market for his products.
Comment: False. Effective marketing cannot insure a profitable market for whatever a farmer chooses to produce. Marketing must begin by producing something that has a reasonable chance for an acceptable profit from the marketplace.
- (T) F 4. A free market economy is a consumer-driven economy. The value of something is determined by consumers without regard to production costs.
Comment: True. Prices in the long run cover costs of production only because producers who lose money cut production allowing prices to rise to levels consistent with production costs of remaining producers.
- (T) F 5. Falling prices are the market’s way of telling farmers they are producing something consumers don’t want, or are producing too much of something.
Comment: True. Prices fall only when there is a surplus at current price levels.
- T (F) 6. Farmers can ignore the market’s price signals indefinitely if they choose to do so.
Comment: False. Lower prices signal necessary production cuts. If farmers ignore these signals, persistently unprofitable price levels eventually will limit their ability to obtain financing for surplus commodities. Production cuts will follow.
- (T) F 7. Marketing begins by producing something that has a reasonable chance of returning an acceptable profit from the marketplace.
Comment: True. Production decisions should be market oriented.

- T (F) 8. Uncertainty and risks associated with unpredictable prices for agricultural commodities make marketing a nearly impossible task for farmers.
Comment: False. Uncertainty in agriculture production and markets may be greater in magnitude than for most other industries, but are otherwise no different in basic nature. Business managers have to base decisions on expectations and odds or probabilities of success in any business, including farming.
- T (F) 9. Risk may be defined as the certainty of an unfavorable outcome or result.
Comment: False. Risk is the “chance” or “probability” of an unfavorable outcome. The term “risk” is reserved to refer to those situations where outcomes are inherently uncertain.
- (T) F 10. Two basic types of risk in farming are business risks and financial risks.
Comment: True. Business risks include production risks and marketing risks.
- T (F) 11. A business that is financially feasible will also be profitable.
Comment: False. A business that is financially feasible has a better chance of being profitable as well. But it can be financially feasible to operate an unprofitable business.
- T (F) 12. A business that is profitable will also be financially feasible.
Comment: False. A business that is profitable is more likely to be financially feasible. But if profits are not sufficient to cover fixed debt service or other cash flow commitments, a profitable business may be infeasible.
- (T) F 13. A business may be profitable but not financially feasible or feasible but not profitable.
Comment: True. Follows from two false statements above.
- T (F) 14. Management by objectives is a complex approach to management that is useful primarily in large, complex business organizations.
Comment: False. Management by objectives is a simple approach to management decision making. It is suitable for small or large businesses.
- T (F) 15. The management by objectives approach to farm business is appropriate only for those who view farming primarily as a business rather than as a way of life.
Comment: False. The concept of management by objectives can be used to pursue qualitative objectives, such as way of life, as well as quantitative objectives, such as profits.
- (T) F 16. Three basic functions of management are planning, implementation and evaluation.
Comment: True. Functions of management may be categorized in many ways. The P.I.E. categories represent one possible set that is appropriate and possibly useful.

- (T)** F 17. Farmers are “price-takers” but they typically can sell all they produce at the going market price.
Comment: True. This is one advantage that farmers have over many other businesses.
- (T)** F 18. Most farmers have a wide range of prices to choose from if they choose to do so.
Comment: True. A wide range of prices is offered for many commodities over a period of a year or more prior to delivery through forward contracting, futures, options, etc. There are also alternatives with respect to place, form, and method of exchange as well as time.
- (T)** F 19. The choice of a marketing or pricing method should be considered at the same time as the decision to produce.
Comment: True. A production alternative using one marketing method may show a reasonable chance for an acceptable profit; whereas, another marketing alternative may not.
- T **(F)** 20. A farmer’s pricing decision must be made either at the time of the production decision or at the time of delivery.
Comment: False. The pricing decision for a commodity can be made at any time after the commitment to produce and before the actual exchange of physical ownership, and in some cases even after physical delivery.
- T **(F)** 21. A professional price forecaster should be able to tell you when a market price has reached its peak.
Comment: False. Nobody knows for sure when a market has reached its peak until after the fact. By then it is too late to do anything about it.
- T **(F)** 22. It doesn’t make sense to use the futures markets unless you expect to make money on your futures transactions, at least on the average over time.
Comment: False. The primary benefit of using futures may be to limit price risk. Reduced price risks may make feasible production that would not have been feasible without hedging in futures. Thus, total profits may be greater even with modest net losses in futures positions.
- (T)** F 23. A single pricing strategy may include several different courses of action, each of which will be followed under a given set of circumstances.
Comment: True. A strategy is simply a plan and may have any number of contingencies or alternatives to be followed under predefined conditions.
- (T)** F 24. Merchandising means getting the right product to the right buyer, at the right place and the right time.
Comment: True. As a result you get the right price.
- (T)** F 25. The planning process should begin by defining specific management objectives that are consistent with your goals or the goals of the farm family.
Comment: True. These objectives will drive the rest of the planning process.

Answer key 4

Financial based management goals

1. Check the net worth figure in the second column of the second page. Net worth at market value is \$157,000. Ten percent of 157,000 is \$15,700. The \$15,700 should be a net return to equity capital and risk after paying interest on borrowed money and setting aside compensation for operator and family labor and management.

2. Multiply \$15,700 by the appropriate percentage and divide by acres or sow numbers for each enterprise.

Corn:

40% of 15,700 = \$6,280

$$\frac{\$6,280}{360 \text{ acres}} = \$17.44/\text{acre}$$

Soybeans:

30% of 15,700 = \$4,710

$$\frac{\$4,710}{240 \text{ acres}} = \$19.62/\text{acre}$$

Hogs:

30% of 15,700 = \$4,710

$$\frac{\$4,710}{40 \text{ sows}} = \$117.75/\text{sow}$$

3. Divide the objective returns per acre or per sow by appropriate expected yield figure.

Calculate cwts. of hogs sold per sow:

a. $\frac{550 \text{ hogs}}{40 \text{ sows}} = 13.75 \text{ hogs sold per sow}$

b. $220 \text{ lbs} \times 13.75 \text{ hogs} = 30.25 \text{ cwts. sold per sow}$

Corn:

$$\frac{\$17.44}{100 \text{ bu.}} = \$0.17/\text{bu.}$$

Soybeans:

$$\frac{\$19.62}{30 \text{ bu.}} = \$0.65/\text{bu.}$$

Hogs:

$$\frac{\$117.75}{30.25 \text{ cwt.}} = \$3.89/\text{cwt.}$$

4. An objective for any given enterprise that is reasonable over time may not be reasonable for any given year. In this case, you should consider the possibility of allocating more or less of the total income objective to any given enterprise. Maybe it looks like a good year for corn but not for hogs. If so, corn can carry a larger percentage of the load this year. The total income objective may not be reasonable for this particular year. If so, you may have to adjust your income target for this year and expect to make up the shortfall in some future year.

If you are pessimistic about doing any better in future years, you may need to reassess your overall farming operation. Is there a better enterprise combination? Is your objective percentage return reasonable? Are you in fact willing to accept less than your opportunity return for land, labor and management to stay in farming? Regardless, a competitive return to your resources, including capital, is a good place to start in setting financial objectives for your farming operation.

Answer key 5

Identifying management objectives

Net income summary

	Net cash flow	Net return
Off-farm work	\$10,000	\$10,000
Corn for hogs	xxxxxx	\$1,500
Hog enterprise	58,471	8,262
Soybean enterprise	8,090	269
Fixed cash commitment	<u>(70,000)</u>	<u>xxxxxx</u>
Net family income	\$ 6,561	\$20,031

- What is your expected net cash flow for the year? \$6,561
- What are your expected net returns over enterprise cost for the year? \$20,031
- Assuming that you have included costs of land, labor, capital and management, do you expect your farm to be profitable this year? (Net return of \$20,031 over all cost.) Yes
- Do you expect it to be feasible? (A \$6,561 positive cash flow.) Yes
- How would \$4.00/cwt lower hog prices and \$1.00/bu. lower soybean prices affect your expected profitability and feasibility?
 - Shortfall for soybeans: 100 acres X 40 bu. = 4,000 bu.
4,000 X \$1.00 = \$4,000 less cash sales.
 - Shortfall for hogs: 3,118 cwts. sold X \$4.00 = \$12,472 less cash sales.
 - Total shortfall: 16,472 less cash and less income.
Result: Operation would still be profitable. 20,031 – 16,472 = \$3,559 net revenue
But it would not be feasible. 6,561 – 16,472 = (\$9,491) net cash flow
Feasibility would require additional cash inflow or reduced cash outflow for the coming year.
- Assuming that the estimated feasibility and profitability of your farm is consistent with your farm business objectives, identify a set of quantitative objectives for your hog and soybean enterprises in the spaces provided.

Management objectives

Hogs		Soybeans	
Key result areas	Objective	Key result areas	Objective
Sows farrowed	120	Yield/acre	40 bu.
Pigs weaned/sow	16	Costs/acre cash	\$119
Selling weight	220 lb	Total variable	\$158
Feed conversion	3.75		
Corn cost	\$2.75		
Hog price	\$45.00		