The Role of Business Planning

What is business planning? In a nutshell, business planning is all about finding, describing and refining the competitive advantage of a particular operation to assist in achieving its goals and objectives (production, financial, transitional, family, etc.). Jack Welch, former CEO of General Electric is often quoted as saying, “If you don’t have a competitive advantage, don’t compete.”

So, just what is a competitive advantage? In an industry where there are many participants, such as agricultural production, a competitive advantage is something that you, as a single producer, can do better than anyone else. It may be producing the best genetic cattle, the tastiest vegetables, or it may be producing these things cheaper than anyone else.

Business planning is about finding, describing and refining your competitive advantage and moving your business in a direction so that the goals and objectives of the business can be fulfilled. This material will help answer some of the key questions regarding the planning process.

Business planning is not a new concept. Planning relies on components that have been used by managers for many years. The plan should serve as a mechanism to connect the production, marketing and financial aspects of the operation, while at the same time considering retirement and business transition needs, etc. In a very general sense, the plan is a statement of how you intend to react to the constant changes in the business environment in which you operate, and how to achieve the goals and objectives that you have set. Most importantly, the process can help to identify the competitive advantage (or advantages) of your individual operation, and help you to devise specific strategies and tactics to capitalize on those advantages. Specifically, the planning process helps to:

1) Identify goals. (What do you want to accomplish?)
2) Identify inventory resources. (What do you have to work with?)
3) Assess the business and environment in which the operation exists. (What might you do in the future?)
4) Analyze business performance. (How have you done in the past?)
5) Decide on actions. (What will you do now?)
6) Implement strategies. (How will you do it?)
7) Evaluate the plan. (Is it working?)

Who should do the planning?

While the function of owners and/or managers is to plan, implement and evaluate, the planning process should involve everybody that is involved in the operation. In this way, individual goals are expressed and it can be determined if an individual goal helps to fulfill the overall goals of the operation.

Bevers, Stan, Blake Bennett, Rob Borchardt, and Brenda Duckworth. Department of Ag Economics, Texas Cooperative Extension, Texas A&M University. May 2003.

Historically, farm managers/owners have devoted most of their time to the labor tasks. Organizational and control activities have been performed on an as needed basis. Planning for the business has been relegated to bits and pieces, often done in response to a crisis when evaluating a change in the operation or for tax purposes.

Planning should provide a roadmap for management, making it the most important role. As a general rule, no matter how urgent the labor tasks become, planning and control activities are more important in the long term. In fact, adequate planning often allows the other functions, such as production, to flow more smoothly, reducing the total management time needed to "run the farm".

What types of planning are there?

The term "planning" can mean different things in different situations. From a management perspective, there are a number of different components that have to be planned. Operational plans typically outline how to achieve very specific and very short run (this year's) goals and objectives. Operational plans are very "tactical" in nature, meaning that they describe how specific goals will be achieved through day-to-day operations.

Financial plans assist in evaluating current financial position, and the potential for future financial performance. Marketing plans assist in evaluating where your business is positioned in the marketplace and with implementing risk management strategies. Financial and marketing plans can certainly have a tactical component; however, they tend to be "strategic" in nature. Strategic planning focuses on the long term (historically thought to mean plans greater than 1 year out).

What are the benefits of business planning?

Given that tough individual management decisions must be made on a daily basis, the planning process provides information and structure to assist in decision making. The process leads to a better understanding of all aspects of your own business, especially the financial needs and interactions. One product of the process is a set of benchmarks (production, financial, etc.) for future comparison and progress monitoring.

Planning provides a link between short and long term goals, helps to tie specific activities to goals, identifies resource constraints and commitments, and outlines expected returns and payoffs. Planning helps the testing of ideas on paper before implementation, and builds confidence to move forward and take advantage of opportunities. Managers can feel more in control when they are proactive, rather than reactive.

Most people's perception of their business is flawed in some important aspect. These flaws are always eventually discovered in the real world. In this respect, a well-thought-out business plan may improve the chances of success.

A formal written plan can facilitate much needed communication, and helps it keep the business focused, leading to a better understanding of the relationship between the business and the family. This helps to clarify the roles that family members, partners, and employees play in the operation.

Business roles that any particular individual might fill include production, marketing, financial and legal management, or labor. Similarly, family roles can include a combination of home maintenance, parenting, leisure, and social/community interaction and service.

For resource suppliers, formal business plans help to communicate your image, your past performance, and your projections for the future. Documentation serves as evidence of your ability to manage, plan, and communicate. Documentation also helps you measure and determine if you have achieved your goals. ***A goal that is not written down is simply a wish.*** In addition, documentation provides the manager with an "audit trail" that demonstrates how a conclusion was reached.

Finally, one of the primary benefits of the planning process may in fact be the acquisition of planning experience. The thoughts that are developed during the planning process can force owners and managers to think more precisely, leading to the ability to manage more effectively. In a sense, *the planning process is as important as the plan itself.*

What are some barriers to planning?

Given the widely recognized benefits of the business planning process, why are many farm managers reluctant to engage in the activity? The most common answer to this question is that they are always "too busy putting out fires". In other words, all available time is committed to the labor and control activities of the operation. Over time, managers likely will place an increased emphasis on planning functions, and will discover ways to re-allocate time, or delegate tasks to "free up" time for planning and strategic thinking.

The second most common response to the earlier question is that farm managers are unsure how to start the process, have never seen a formal business plan, and do not know how to develop one. In addition, there is often a fear of the unknown, as well as a reluctance to engage in planning activities that might shed light on some unpleasant realities.

Some managers cite the inaccuracy of long run financial projections as a reason to avoid at least the strategic component on the business planning activity. To be blunt, this is a rather poor "excuse" not to plan, not a legitimate barrier to the planning process.

What are the steps in business planning?

One important task is to constantly assess the current situation. The level of detail here will depend on the needs of the individual. However, if the manager can first adequately address seven issues, then assessing any subsequent situation and how it will affect the operation will be more easily addressed. A second important task is to determine and document where the business (and perhaps the family) needs to be in the future. This strategic component is one of the most important, but most difficult steps in the process for most farm managers because it often involves such abstract concepts as vision, mission statements, goals, and objectives. This step also involves some concrete "number crunching" to determine the size and scope of business activity needed to achieve financial and other objectives.

Seven general issues need to be addressed in the planning process. These issues were listed at the beginning of this paper, but are important enough to list again.

1) Identify goals. (What do you want to accomplish?)
2) Inventory resources. (What do you have to work with?)
3) Assess the business and the environment it exists in. (What might you do in the future?)
4) Analyze business performance. (How have you done in the past?)
5) Decide on actions. (What will you do now?)
6) Implement strategies. (How will you do it?)
7) Evaluate the plan. (Is it working?)

These issues are certainly not addressed in any sequential order, and the answers are inter-twined between issues. Starting and stopping points are not always clear, and the process is more like a continuous circle where there are always revisions being considered and made. Each one depends upon the others. However, for the purposes of this lesson, each issue will be briefly discussed.

1) <u>Identify goals</u>. Each operation should identify its goals. These include the overall goals of the operation, but should also take into account the personal goals of the individuals involved in the operation. A goal should be SMART. SMART is defined as specific, measurable, attainable, rewarding and timely. Specific means the goal should be definite as to what will be accomplished. Measurable means the goal should be able to be proven. The goal should be attainable and not so far out of reach that the individual gets frustrated trying to reach it. The goal should be rewarding in that reaching the goal helps to move the operation in its expected path. Finally, the goal should be timely, or the goal should have a time limit as to when it will be accomplished.

2) <u>Inventory resources</u>. All resources available to the operation should be determined. These include physical/natural, human/personnel, equipment, animal/crop, and financial resources. See the lesson Resource Inventory in this curriculum.

3) <u>Assess the business and the environment that it exists in</u>. This is most generally accomplished by utilizing the SWOT analysis. See the SWOT lesson in this curriculum.

4) Analyze business performance. The business should be evaluated to determine its production and financial strengths and weaknesses. Most commonly, farm managers evaluate the production side of an operation. However, the business should also be evaluated from the financial side. The manager should determine those commodities that are contributing to the financial strength of the business and those that are not.

5) Decide on actions. Once the first four questions have been adequately answered, the manager can decide upon a course of action. This may include changing commodities produced, adopting new technology, buying new resources, etc.

6) Implement strategies. While this question seems the same as question 5, there is a difference. Implementing strategies includes the process of communicating with the other members of the operation the desired actions and how they should respond to achieve those actions.

7) Evaluate the plan. Currently, every operation does some evaluation of their operation each year, whether they know it or not. Each year, the IRS wants to know the profitability of the operation. During this time, most managers do some evaluation. However, the IRS approach to evaluating an operation will never be adequate from a business management standpoint. Each manager should evaluate the operation to determine whether goals set for the year have been met, and if they haven't, should the goal remain for the next year or should the goal be adjusted.

Once the issues about where the business should go and resources currently available to work with have been addressed, the next step in the planning process is to identify, select and test alternatives. Again, the level of detail and the specific components included in this issue will vary greatly from business to business depending on the needs of the individual.

The feasibility of proposed alternatives (both financial and production) is explored, and risk management strategies may need to be considered in this step. See the Enterprise Budgets lesson of this curriculum.

The final ongoing task in the process is to implement the plan. This involves controlling and steering production activities in the direction outlined in the plan, monitoring progress toward goals and objectives, and documenting the process along the way.

The Role of Business Planning

Lesson Plan

I. Goals

A. The participant will understand the role of business planning for an agricultural operation.

B. The participant will be able to address the seven issues surrounding business planning.

II. Lesson Highlights

A. Business planning is about finding, describing and refining the competitive advantage of your operation.

B. Jack Welch, former CEO of General Electric quotes: "If you don't have a competitive advantage, don't compete."

C. The participant must address the seven issues in order to do a complete job of business planning.

1. Identify goals of the operation: Goals should be SMART (specific, measurable, attainable, rewarding and timely).
2. Inventory resources available and those needed that are not available (covered in a separate lesson).
3. Assess the business and the environment that it exists in. This assessment is commonly done using the SWOT analysis (covered in a separate lesson).
4. Analyze the business performance. The business should be analyzed from both the production and financial side (covered in a separate lesson).
5. Decide on actions for the operation. This could include changing commodities produced, buying new resources, paying debts, etc.
6. Implement strategies. The manager needs to communicate with others involved in the business as to their responsibilities in fulfilling the action plan described in issue five.

7. Evaluate the plan. Every manager should effectively evaluate their plan to determine whether goals were met. This evaluation should then proceed with the next years planning process.

D. Who should do the planning?

1. The planning process should involve everyone in the business.
2. Planning is a long-term process that smoothes the short-term reaction.

E. What types of planning are there?

1. Tactical plans: These are short-term plans. Examples include what to plan this year, whether to sell calves now or next month.
2. Strategic plans: These are long-term plans. These may include equipment purchases, land acquisition, etc.

F. What are the benefits of business planning?

1. The plan itself is not as important as the planning process.
2. Provides a link between short and long term goals.
3. Helps to tie specific activities to goals of the business.
4. Identifies resource constraints and commitments.
5. Allows a manager to be proactive instead of reactive.
6. Opens communication between all involved in the business.

G. What are the barriers to planning?

1. Allowing time for the planning process. The most common barrier is "I am too busy putting out fires to plan."
2. Why plan when the future is uncertain anyway.

III. Potential Speakers

A. Extension Agents
B. Financial Planners

IV. Review Questions

A. What basic reason is there for business planning?

Answer: Business planning is all about finding, describing and refining the competitive advantage of a particular operation to assist it in achieving its goals and objectives.

B. A detail list of resources available and unavailable is included in the business planning process. True or False

Answer: True

V. For More Information

Bangs, D.H. *The Business Planning Guide, 7th Ed.* Upstart Publishing Co., Chicago. 1995.

Doye, Damona. "Goal Setting for Farm and Ranch Families." Oklahoma Cooperative Extension Service Fact Sheet no. WF-244. Oklahoma State University.

McCorkle, Dean and Stan Bevers. "Business Plans for Agricultural Producers." *Risk Management Education Curriculum Guide*. RM 3-01. Texas Cooperative Extension. August 2001.

Wilson, Troy D. and David M. Kohl. "Business Planning – A Roadmap for Success." *Farm Business Management Update*. Virginia Cooperative Extension Service. August 1997.

The Role of Business Planning
Overheads

Introduction

√ Business planning is about finding, describing and refining the competitive advantage of your operation.

√ "If you don't have a competitive advantage, don't compete."

√ Seven issues to be addressed:

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3. Assess the business and the environment that it exists in. This assessment is commonly done using the SWOT analysis.
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Case Study Application

The case operation needs to plan for the future. Several areas need to be addressed and will be discussed. Planning will lay the groundwork for the family and the operation to move forward. The operation needs to evaluate their operation financially.

Strengths: The operation has a strong family base to draw upon. Mr. Doe is personable and does a good job of working with customers. The operation grows high quality vegetables that are demanded by his customers. The operation also produces calves from its cow herd.

Weaknesses: The operation is struggling financially although the cash position does not reflect it. Currently, the operation is progressing because of Mrs. Does off farm job. The farming operation is losing money. Vegetable production is adequate, however only the onions contributed to profitability during the year. The cattle operation needs to be evaluated from a production and financial standpoint. Productivity is low per breeding cow and costs are high relative to the low production. The Doe's need to determine where their improvement efforts will be put in the near future. While the cattle herd needs the most improving, efforts there will take longer to affect the financial situation. The vegetable mix to be grown in the coming year needs to be closely considered.

Opportunities: Many opportunities exist for the cattle operation. Shortening the calving season in order to sale more calves of uniform size will benefit the operation. In addition, grouping his calves with those of neighbors will increase the total head sold at any one time. The Doe's should evaluate the growing of organic vegetables. Customers' preferences are to this type of production. However, will yields be harmed by not using insecticides and herbicides?

Threats: The greatest short term threat to the operation is Mrs. Doe possibly losing her job. The operation would not survive without her off farm income. The operation needs to become profitable. The local farmers market may be cutting into Mr. Doe's customer base.

Resources: The Does have adequate resources to continue the operation. However, the Does need to start planning for equipment replacement. Some of the equipment is aged and will have to be replaced in the next five years.

Financial Situation: The current financial situation of the operation is good, but is moving dangerously in the wrong direction. Profitability is a major concern. Without the off farm income, the overall family situation would be worse. The operation will continue to lose equity if profitability isn't addressed.

Balance Sheets Evaluation: At first glance, the balance sheet shows an operation that has owner equity. There was a small increase in equity from the beginning balance sheet to the ending balance sheet. Current liabilities were met with family income and, as a whole, the cash position of the family increased slightly. This was due to the operation's loss of $15,310 being offset by Mrs. Doe's salary of $16,000.

Income Statement: The income statement is the most negative financial statement. The income statement reflects those costs and income generated from the farming operation as well as the personal withdraws. As a result of the farming and ranching activities, net farm income was a negative $15,310. While some years of loss are expected in production agriculture, no business can continue to operate at a loss for long. The Does must determine which commodities are contributing to the profit and which to the loss.

Cash Flow Statement: The cash flow statement reflects no months where the family or operation is in a cash deficit. This is due to Mrs. Doe's monthly salary from the school system.

Enterprise Analysis: The enterprise analysis takes the income statement and allocates the income and expenses by the commodities produced. The most profitable commodity grown by the operation was onion. Only two acres were grown, but this commodity contributed approximately $5,200 to the business. Four acres of sweet corn were grown resulting in a loss of $1,033 to the operation. Two acres of cantaloupes and tomatoes were grown resulting in losses of $1,800 and $4,000 respectively to the operation. The Does need to evaluate the role that both of these commodities pay in the entire operation. Considerations for poor production years and/or prices and demand from customers should be made. If the production year was bad, will it improve? If the prices received for these commodities were low, can something be done to increase the price? Do Mr. Doe's customers expect him to have tomatoes at his stand? This is sometimes called a "loss-leader". In the retail sector, a product may be sold for a loss in order to get a customer in the store in order to purchase other products.

The largest drain on the operation is the cattle herd. The cow herd lost approximately $14,000. The Does need to consider whether the cows are necessary and if so, how can the income and expenses associated with the herd be improved in order to make them profitable.

Summary: As mentioned earlier, planning lays the groundwork for an operation to move forward. This management must consider its commodity mix in order to affect the profitability of the operation.