The Farm Management Review

by
Gregg Hadley
Associate Professor of Agricultural Economics and Extension Farm Management Specialist
UW–River Falls, UW-Extension and the Center for Dairy Profitability
1-715-425-3188 gregg.hadley@uwrf.edu www.uwrf.edu/extension/GregH.php

Issue 1 **January 2010**

GREETINGS!

Welcome to the first issue of The Farm Management Review (FMR). The purpose of FMR is to inform managers and advisors about farm and agribusiness management concepts and research. Each issue of FMR will cover two management topics. These topics will be qualitative (for example, strategic planning or human resource management) and/or quantitative (for example – financial, operations, or risk management) in nature. More often than not, the examples and research covered in FMR will be dairy farm oriented, but the concepts and lessons conveyed will be applicable to any business.

The agricultural industry has been on a roller coaster ride the past few years. The dairy, beef and swine industries had to endure a horrific market year in 2009. With this in mind, this issue of FMR will deal with two "tried and true" management concepts (the SWOT Analysis and Cost of Production) that can help producers to plan for their future.

Please remember, any views expressed or implied in FMR are the views of Gregg Hadley and may not represent the views of UW-River Falls, UW-Extension or the Center for Dairy Profitability.

THE SWOT ANALYSIS

Adversity like the dairy and livestock industries faced last year, while trying, offers managers the opportunity to reassess their current condition and their future. The SWOT Analysis is an important part of the business planning process.

The Concept

"SWOT" stands for Strengths, Weaknesses, Opportunities and Threats. "Strengths" and "Weaknesses" refer to issues under the direct control of the farm or agribusiness. "Strength" is something the firm is good at, and a "Weakness" is something the firm is not good at. For example, the managers of a dairy farm may find that they have excellent feed bunk management (Strength) but poor somatic cell counts (Weakness).

"Opportunities" and "Threats" refer to issues that the firm has no direct control over. A new milk plant opening in the area would be an example of an "Opportunity" for a dairy farm. Another milk plant means more buyers

competing for the dairy farm's milk, which should give the dairy farm's managers the "opportunity" to exercise more negotiating power.

"Threats" are external influences that may adversely affect the firm. If a country that normally imports US dairy products is in a recession, it may not be able to buy as many US dairy products. This "threat" may hurt the farm if it results in a decreased milk price.

You do not need a sophisticated computer program to conduct a SWOT Analysis. You simply need good data (production, financial, animal health, crop production, human resource management, marketing, etc.) paper, and a pen or pencil. Because some managers may be overly generous or too critical in assessing their firm, it may be helpful for a manager to ask their fellow managers, employees, advisers, consultants, veterinarians and agribusiness representatives to assist them in conducting the SWOT Analysis.

To begin, write "Strengths" at the top of a page and list everything the firm seems to be good at. Next, write "Weaknesses" on the top of a page and list everything that the business is not good at.

After listing the firm's strengths and weaknesses, then do the same for the opportunities and threats. Do not be surprised if an issue is both an opportunity and strength. For example, urban encroachment may threaten a farm. This may make spreading manure more complex. On the other hand, urbanization may also increase land values, which increases the farm owner's equity on a market value balance sheet.

Once you have listed the strengths, weaknesses, opportunities and threats, it is time to do something with this information. Use the analysis to develop prioritized goals and a plan to achieve those goals. The plan should:

- build upon the firm's strengths,
- improve upon its weaknesses ,
- take advantage of the firm's opportunities,
- and minimize the threats facing the firm.

An Application

As an example, assume that a farm manager, Maria, has conducted a SWOT Analysis and found these results:

Strengths
- Very low cost of production
- Great herd health

Weaknesses
- Lower milk production
- Profits are positive but too low to support the family

Opportunities
- Milk price is expected to go up

Threats
- Urban encroachment

Looking at the SWOT Analysis results, it is apparent to Maria that the farm needs to be more profitable for her family. There is the opportunity that milk price may go up, but, then again, it may not. She would rather not merely

rely on that hope. Since the farm is profitable, she could consider expanding, but the urban encroachment might make expansion more difficult.

Maria then notices the low cost of production and good herd health strengths and the lower milk production weakness. She wonders if there is a way to increase revenues by increasing milk production without an offsetting increase in her cost of production or a dramatic increase in herd health problems. Maria decides to call her nutritionist, veterinarian, herdsperson and farm advisor to determine the feasibility of this idea, and, if feasible, to help her develop and implement a plan to increase milk production.

Take Home Message

When developing future business plans, a SWOT Analysis is a good tool to use to determine the current strengths and weaknesses of your farm and the external opportunities and threats that may affect the farm in the future.

RISK MANAGEMENT AND KNOWING YOUR COST OF PRODUCTION

Both input and output prices have been very volatile the past few years. Many expect this volatility to continue. The concern over increased price volatility has led many to refocus their attention on their risk management programs.

This renewed risk management concern is good, but many managers overlook a critical component needed to make good risk management decisions – knowing his or her firm's cost of production (COP). Simply put, how can you make a good price risk management decision if you do not know your actual COP?

The Concept

While some managers know their COP and put it to good use in making risk management decisions, far too many managers do not. They either look to lock in a price that "just feels right", make risk management decisions based upon the industry average COP, or they make risk management decisions using a "guesstimate" of their own COP. Of course, if the manager uses a COP value that is not reflective of his or her farm's COP, it could lead to poor decisions. No one wants to lock in an unprofitable price, but, if you do not know your COP, it is possible.

It is extremely important to realize that every firm's COP is different. Table 1 illustrates this. The table displays the *average* COP values for 542 AgFA dairy farms. AgFA is UW-Extension's and the Center for Dairy Profitability's farm financial database. The table also displays the average COP for the 271 *lower* COP AgFA farms (the lower 50% of the 542 farms) and the 271 *higher* cost dairy AgFA farms (the upper 50% of the 542 farms). The table shows that there is quite a difference in COP values among the average, lower and higher COP farms.

Table 1. 2008 Cost of Production of AgFA Dairy Farms Sorted by Size

Cost Measure	Average 2008 (542 Farms, 147 Cows, 20,465 lbs Of Milk Per Cow) $/cwt	Average Lower Cost (271 Farms, 212 Cows, 22,024 lbs Of Milk Per Cow) $/cwt	Average Higher Cost (271 Farms, >81 Cows, 18,906 lbs Of Milk Per Cow) $/cwt
Purchased Feed	$3.73	$4.01	$3.46
Hired Labor	$1.95	$2.15	$1.74
Other Operating Costs	$9.63	$7.71	$11.55
Interest	$1.01	$0.91	$1.10
Depreciation	$2.85	$2.09	$3.61
Total Costs	$19.16	$16.88	$21.45

An Application

Randy is the manager of a 150-cow WI dairy farm. The typical cow on Randy's farm produces about 20,000 pounds of milk per year.

Randy recently had the opportunity to lock in his milk price for the coming year at $18.50/cwt. Most market analysts said the price would go up. Some said it would go down.

Before making this risk management decision, Randy decided he should consider costs and did some checking around. He found that the average COP for a WI dairy farm was $19.16. Randy assumed that his farm was probably "pretty average" and that $19.16 was "probably about right." He decided not to lock his price in. "No sense locking in an unprofitable price, especially since the price is likely to go up" Randy thought to himself.

The milk price tumbled. It ended up averaging $13.50 for the year. Randy was wrong about his assumption about his COP. His actual COP was better than average, $16.50/cwt. Had Randy taken the time to calculate his own COP, he could have locked in a return of +$2.00/cwt (+$60,000 on a whole farm basis). Instead, he lost $3.00/cwt (-$90,000 on a whole farm basis).

Take Home Message

If you are serious about risk management, you need to know your farm's COP!

Want to Learn More?

If are interested in learning more about conducting a SWOT Analysis or your COP, I encourage you to contact your county UW-Extension office, the Center for Dairy Profitability (608-263-5665) or feel free to contact me by using the contact information on page 1.

NEXT TIME…

In the next issue of FMR, we will be discussing two more management issues:

- Understanding Your Management Type
- How To Calculate Your Firm's Cost Of Production