MARKETING

Dollars & Sense

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Develop a competitive strategy for your business

There are several powerful forces that drive management for all businesses. It seems that the business of beef cattle production is beginning to understand that those forces apply to us, too. In his book Competitive Strategy, *Michael Porter has outlined the nature of competition for the business community. I will take three of his truths and apply them to the business of cattle production and marketing.*

TRUTH 1 ***Competition in an industry continually works to drive down the rate of return on invested capital toward the competitive floor rate of return.***

Retail stores make a profit based on shelf space. They allocate shelf space based on the likelihood of a product to sell quickly. They are sure to set prices so that they make a profit on each item sold. Therefore, the more times in a month that they can sell from the same shelf space, the more money they can make to pay overhead expenses.

In the commodity beef system, in which retailers must move product off their shelves as quickly as possible, we find retail-to-wholesale margins are driven down as retailers attempt to maximize returns by influencing the price they pay for the product from the packers and feeders. The low margins are also passed back through our commodity system since each step back toward the cow-calf producer has less price-setting power. Cow-calf producers are the final price takers.

Producers, wishing to make a profit, must find a way to lower costs. Using more technology and advanced production systems, which offer the opportunity to lower per unit costs if volume is sufficient, often does that. Those technologies often require a great deal of volume in order to reduce average unit costs.

As producers buy expensive technology, two things happen. First, they must get bigger to handle the volume needed to take advantage of the unit-cost-reducing technology. Second, the proportion of the overall cost of production between fixed costs (buildings, equipment, technology) and variable costs (feed, health costs) grows quickly to a larger proportion of fixed costs. That fact reduces the producers' flexibility to respond to market forces as they continue the push to cover those high fixed costs.

The system of competition then drives the margin down on each unit sold. As the margin declines on assets that are expensive, the rate of return on those assets also declines. This, of course, is not to say that small farms cannot stay in business in this system. They just need to discover how to do so with margins that are equal to other high-volume operations.

This truth begins to change as the nature of competition changes. In the changing beef system, branded products offer a different economy than the commodity system and offer smaller operations, through relationship marketing, another chance for business success.

TRUTH 2 ***The essence of formulating competitive strategy is relating a company to its environment.***

Developing your farm business policy or strategy requires an assessment of what it is that you do better than others in creating value for the products you sell. Value rewards in the commodity system typically have come from only pounds of meat sold. The profits you have been able to extract in the price-taking system have come only from your management ability to lower costs.

That does not give an incentive for producers to raise quality. However, in the value-added system, value can be created through consistency, quality characteristics and time of sales. This truth says, given the beef system environment, we must decide on an individual farm basis to which attempt at value creation we want to devote our efforts, assets and risk.

TRUTH 3 ***The company's strengths and weaknesses are its profile of assets and skills relative to competitors, including financial resources, technological posture and brand identification.***

There is no shortage of information encouraging you to identify your strengths and weaknesses as a beef producer. The caution that Porter makes is that the strengths and weaknesses that you identify need to have economic significance, or they aren't of much use in designing your strategy.

For example, the marketplace does not directly reward strengths like "hard working" and "good cattleman" primarily because these characteristics are not quantifiable. However, if your strength is that you have been able to identify a cattle management system that has a high reproduction rate, low cost of gain or high feed efficiency, then you can determine directly the value of your strengths.

Think like a CEO

These truths are important to help you identify a strategy for your business that is in line with the same methods that are used by your corporate-CEO counterparts. Porter's analysis is just as true for agriculture. The competitive nature of production agriculture will require you to understand these truths to find and to maintain a competitive strategy for your business.

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