Dollars & Sense

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Three ways to make money

In his book, Competitive Advantage, *which has been the cornerstone of strategic planning in the business world for years, Michael Porter says that every firm competing in an industry has a competitive strategy, whether explicit or implicit. This strategy may have been developed explicitly through a planning process or it may have evolved implicitly. In other words, it was planned or "it just sort of happened." Our purpose here is to help with the former.*

Executive's challenge

Porter and I suggest that the "it just sort of happened" method may be one that rarely produces the best strategy for your operation. Labor, rather than management, often has the first claim on a manager's time. Under this scenario, when attention is needed for emergencies or daily chore routines, labor has first claim on all people involved in the operation, leaving management and planning time as a residual. This further complicates the executive's role in business planning, leaving the strategy sessions for late nights when fatigue has set in.

So why the reference to executives rather than the traditional use of the term "farm manager?" We limit ourselves when using old terms by using old strategies that go with those terms. If we think about all of the information — risk, production, finances and people — involved in a successful farm or ranch operation, it is easier to draw the parallel to a business executive's challenge.

Strategic planning offers solutions to the following question:

How do you get where you want to go with the resources you have or can get?

Strategic planning

Strategic planning is the continuous process of systematically evaluating the nature of your business, defining its long-term objectives, identifying quantifiable goals, developing strategies to reach these objectives and goals, and allocating resources to carry out these strategies.

The strategic planning process has three parts:

- ► Identifying where you are.
- ► Establishing where you want to be.
- ► And determining how you can get there.

(1) Where are you? Here, you must examine the history of your operation by taking a critical look at the events that have shaped your business and determine why you do the things the way you do them.

(2) Where do you want to be? This is a time for envisioning, being creative and looking beyond present issues. Then you make your vision concrete by setting measurable goals.

(3) How can you get there? Develop action plans to accomplish your goals. Some strategies will be continuations of the tried and true — some will be brand new. All are tightly connected to your goals. Develop action plans to execute your strategies. Planning is not about what you will do in the future; it is about what you will do now to make the future.

At the heart of a strategic plan is a set of business goals. The focus of that step is understanding and planning for profits. Understanding how profits are made (or not made) on your operation is the only way to develop a meaningful plan that will strategically position your business to increase those profits.

Now to the point: There are three ways to increase profits in your business:

(1) Increase your margin per animal;
(2) Decrease overhead costs; or
(3) Increase volume.

These are the only ways to increase profit in any farm or ranch business. The key to finding the money in your planning process is finding out where your operation falls in these three areas and narrowing down the potential actions that can be taken to increase the contribution to profit from each.

Increasing your profits

Overhead costs are defined as costs that would not change if you were to add or subtract from your current production level. Sometimes we refer to these as fixed costs.

Gross margin can be determined for each enterprise or profit center in your business or for your business as a whole. Plan to start by looking at the gross margin for your entire business. Gross margin is a measure of the economic efficiency of your livestock operation. It is calculated by subtracting the direct costs of production from gross income. Gross profit is the sum of all profit centers' gross margins added together.

Volume is a measurement of the size of the farm business; the greater the volume, the larger the business unit. If the gross margin is positive, then increasing the volume will increase profits — provided the increased size does not also increase overhead costs.

Sometimes managers fall into the trap of thinking that increasing volume (i.e., getting bigger) will solve the profit problems. However, as strange as it may sound, "I am losing money on every animal I sell so I need to sell more," is something I have heard many times. In other words, "what I am losing in margin I will make up for in volume."

Profit or loss is determined by subtracting overhead costs from gross profit. One key factor in understanding decision-making regarding these three ways to increase profits lies in the interaction between them. As mentioned earlier, increasing volume while also increasing overhead costs does not mean more profit. And reducing your unit cost of production may not increase profits if you also have to reduce the volume of animals.

Managing your business with a CEO philosophy is not an abstract concept that looks good on paper and is impractical in practice. The strategic management of your operation with all decisions and investments, capital and human, made with the prior knowledge of the likely impact of that investment on your business strategic plan, is the difference between the steps on the ladder of success and the steps in front of the courthouse.

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