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## Benchmark Your Performance

Danny Klinefelter

Most producers don't know how they stack up against their competition in terms of key performance metrics. The majority of people I talk to at extension meetings think they're about average or a little above, and that's not possible.

It's not enough to know how you're doing compared to the average. How do you stack up against the top 25 percent or the top 10 percent. Numerous university studies have found $100 or more differences in average net income per acre between the top third and the bottom third of farmers in the same region, producing the same crops even after adjusting for differences resulting from owning versus renting land. A study by Terry Kastens at Kansas State several years ago found about half the difference was due to revenue (price and production) and about half due to costs. One of Dave Kohl's recent articles indicated that a summary of FINBIN data from the University of Minnesota showed that the top 20 percent of producers earned an average rate of return on assets above 15 percent while the average ROA for the bottom 20 percent was negative.

My point is that it's hard to get better if you don't know what your strengths and weaknesses are. This covers all areas of management - finance, operations, marketing and human resources.

Producers participating in state farm business farm management associations and those working with some of the more progressive farm accounting firms have a better idea of how they're performing, but mostly at the production and whole farm financial level. Very few have drilled down to the specific enterprise level that would let them really understand the detail needed to fully analyze their performance. Whole farm data can mask offsetting strengths and weaknesses.

The Farm Financial Standards Council developed recommendations for standardized financially reporting guidelines and common definitions for key financial ratios almost twenty years ago, but as of yet have not developed a national database similar to the RMAs annual financial summary for non-farm businesses. Some ag lenders have developed their own databases, but only a few make the information available to the public. The Standardized Performance Analysis (SPA) developed by the National Cattlemen's Beef Association gets close; but, the number of ranches in the database is still fairly limited. By the end of August, the Association of Agricultural Production Executives website will contain links to many of the publicly available

databases. You can go to
http://associationofagriculturalproductionexecutives.org to see what is available. Let me know if you are aware of any links we haven't included.

One of the biggest issues is to make sure the data is actually comparable, i.e., that you're comparing apples to apples. For example, is the balance sheet information for the farm only or does it include farm and non-farm assets and liabilities. Are assets valued on a cost or market basis, and are deferred taxes included? Is the income statement data farm only or farm and non-farm, is it on a cash or accrual adjusted basis, etc?

Some of the best examples I have seen come from peer groups who have developed common reporting standards and include very detailed metrics deemed important by the members.

One of the advantages that peer groups have is their ability and willingness to discuss and learn from their differences. If a member is at the bottom of the group, they can explore why the differences exist and possible ways to improve. One dairy group member told me that it drives a continuous improvement mentality. He says that the members are so competitive and interested in self improvement, that even if they don't see exactly why they are in the bottom of the group on a particular metric, they find ways to get better simply because they know what they need to focus on. His group looks at 30 different metrics for the breeding, calving and heifer raising enterprises, and another 30 for the milking enterprise. If these were just whole farm financial metrics, the number would be excessive. However, they also include production and health measures, functional level efficiency indicators, and specific expenses category measures.

Another thing to keep in mind is who you're comparing yourself to. What are the differences in geographic location, size, production systems and marketing/purchasing arrangements? Some of the peer groups formed by TEPAP graduates are comparing themselves to producers in the top 1-2 percent of the industry, so being at the bottom of the group may still mean they are among the best.

Remember, the function of a competitive market is to drive the economic return to the average producer to breakeven through supply and demand responses. At that point the top producers are still profitable and growing, the average producers are just hanging in there, and those on the bottom end are losing money and being forced out of the industry. Your job is to stay out of the back of the pack.

## Peer Advisory Groups: Providing an Outside Perspective

Danny Klinefelter

In the book *The Breakthrough Company*, Douglas Adams is quoted: "Human beings, who are almost unique in having the ability to learn from the experience of others, are also remarkable for their disinclination to do so."

The best managers I know recognize that however well their business is doing, someone, somewhere has a better idea or way of doing things. One of my favorite quotes is by Jack Welch, the former chairman and CEO of General Electric, who said "The only truly sustainable competitive advantage is the ability to learn and adapt faster than your competition."

I believe peer advisory groups can be a cost effective way to help farm CEOs address the need for continual exposure to different perspectives and new ideas, as well as providing a way to continue the never ending process of finding ways to become better managers. Even though this makes sense in concept, groups are successful only if they are made up of the right people. The chemistry and trust between the members is critical. However, bringing together experienced people who have or are facing similar challenges can be extremely helpful.

It should be noted that peer groups aren't just for CEOs. Groups of successors, CEOs, marketing managers, operations managers, human resource managers, etc., have also been formed.

Peer groups are typically made up of 5-10 producers. Members are usually not neighbors, direct competitors or anyone who might have a conflict of interest. It also helps to bring together people with different strengths. Openness and candor are critical to getting the most benefit. Members of groups I work with often tell me they hear things they don't like to hear, but need to hear. That is where much of the value occurs. If everyone is to get maximum benefit, they need to be honest and open to constructive criticism. Some groups use a professional facilitator, others rotate the discussion leadership among the members. Meetings are usually monthly or quarterly. These groups essentially allow their members to have a true outside board of directors or advisors made up of people who have skin in the game. Although there is a significant time commitment and travel costs, there are no out of pocket director's fees like there are for an advisory board or outside directors on a corporate board.

One group I know, whose members have asked to remain anonymous, meets for a day and a half every 3 months. The meetings rotate and are held near the base of operations for one of the members. At some of their meetings, part of the first day is spent visiting the operation and/or looking in depth at some area of the business selected by the host. The next morning, the member is put on the "hot seat" and the group makes comments and suggestions, and responds to questions regarding the issues they raise.

It is not a comment that is very politically correct, but flying with the eagles and not scratching with the turkeys is a very real issue in any business. CEOs and other managers need to make sure they are seeking out and interacting with the successful people in their industry and not hanging out with the losers. This is essential for stimulation, motivation, and personal growth. Successful people challenge you and force you to think, they cause you to consider alternatives and they inspire you. Losers tend to be victims. Everything that goes wrong is someone else's fault. They jealous of success, they are tradition bound, they can't see alternatives, and they drag you down to their level.

The following are just some of the advantages a peer group can offer:

1. In closely-held businesses, the CEO and other members of the management team also frequently view issues from the same vantage point. This tends to create blind spots and limit objectivity. Peer groups provide a way to overcome that problem.

2. CEOs and successors need a "sounding board" for their ideas. Have they missed anything, are there alternatives they haven't considered and what are some of the implementation issues that may not have occurred to them? Peer group discussions can provide feedback on plans and ideas, explore what if questions, allow members to draw on the experience of others, and help provide greater insight and objectivity.

3. The ability to draw on different individual's strengths can benefit everyone involved. Within a group some people will have greater skills and interest in market analysis, some in personnel management, some in management information systems, others will be computer/technology buffs, and some will be strong in particular operational/production areas. Peer groups can be an effective way to overcome weaknesses and complement strengths. Too many managers attempt to reinvent the wheel when someone else already has a solution.

4. Business success takes vision and insight. Peer groups can help turn the focus away from the day to day issues and look at the bigger picture that can improve your odds of success.

5. Support can often be as valuable as the ideas gained. This may involve the encouragement needed to try a new idea or see something through to completion. It can also help in breaking out of an old mindset or offering the support needed during periods of stress or financial hardship. Everyone needs someone they can count on when faced with a challenge.

6. Managing a small, growing business. Friends and family may not understand the issues that are being faced. However, every CEO or successor in a peer group has the same sense of isolation and can offer support and understanding in a way that no one else can.

7. Peer groups can also provide access to the collective membership's network of contacts, sources of information, resources, and expertise related to specific problems or opportunities. This expanded network can also help in identifying new markets, supply sources, potential employees, and business opportunities. Some of these groups have even served as the genesis for various business alliances.

8. Coordination of field trials and the development of databases and benchmarks on marketing, production, compensation programs and comparative financial information can multiply the availability and usefulness of information, while reducing acquisition time and costs.

9. Peer groups also provide an opportunity for needs-based training. Assume that several producers decide they need training in some area of personnel management, succession planning, process improvement techniques, financial analysis, options strategies, etc. The type of program and level of expertise they need might involve anywhere from 1-3 days, and the quality of the presenter might require charges of $3000 - $5,000 a day, plus expenses. Assuming that this type of program isn't available through their state's extension service, the cost for one producer could be prohibitive; but, shared by 5 - 10 producers, it could be very reasonable. In addition, the questions and perspectives of multiple participants will likely open up some possibilities and issues that might not otherwise be considered.

10. Frequently, successors in closely-held businesses either won't or can't always effectively challenge the ideas of the CEO because doing so can lead to conflicts which have spillover effects on business and/or personal relationships. In these instances, peer groups made up of other successor candidates can give them somewhere to get feedback on their point of view and to get help with ideas on how they might better approach the issue.

11. One of the biggest challenge many business owners face is that there is no one to answer to. There is no boss or supervisor looking over their shoulder making sure that they have completed all of their tasks. There is also no one pushing them to set higher goals and take action to attain those goals. A peer advisory group can provide the accountability needed for improving your business's performance.

12. It is incredibly easy for a business owner to stay within their comfort zone. A peer group allows the emerging and seasoned business owner to stretch beyond their current situation and set higher goals and reach them faster than they would on their own.

These groups need ground rules, and they need to have planned agendas to keep discussions on target and for everyone's benefit. The members need to be able to give and take. People who can't accept criticism or who can't admit they are wrong are not good candidates. The same is true for people who only take, but don't contribute.

Like marriages, partnerships and business mergers, a match that looks great on the surface doesn't always work. The right chemistry, a common vision and values are critical. You won't really know until you start working together. As with anything, there is always a learning curve. Sometimes you have to recognize that you have the right idea but the wrong people and start over or change the make-up of the group. One recommendation I often give when groups are starting out is to have the members go through a session on personality styles using either Myers-Briggs or the DISC. It can help gain a better understanding of and appreciation for individual differences, and create more effective group interaction. Some have even developed vision or purpose statements to make sure everyone has a clear understanding of what the group is intended to accomplish.

Because membership is by invitation, groups need to start out with a basis for removing members when there isn't the right fit or chemistry. Getting everyone's agreement up front is critical for amicable separations. There also needs to be a confidentiality agreement, so that all members, even those who leave the group are professional enough to respect the rights of the other members.

I am a firm believer in the peer advisory group concept. Although I work in extension, I don't think continuing education programs or experience can provide everything producers need to achieve or remain on top. Peer groups afford a very personalized and ongoing management development opportunity. There are two times, however, when I feel they can make a critical difference. The first is in good times when it is too easy to become complacent. The second is bad times when the margin for error is small and it can become easy to be paralyzed by fear.

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## Autopsies and Management Improvement

Danny Klinefelter

In a past life, I started using autopsies in loan officer training and development. We applied the methodology to evaluating sales calls, nonperforming loans and workout situations. Since then I've started using the same approach in management development.

Management autopsies involve dissecting and evaluating the results of key decisions, whether things went well or poorly. The process requires digging deep enough to determine why things turned out as they did. What was overlooked, what assumptions were wrong, what should have been done differently, were there mid-course adjustments that could and should have been made, and if external factors or conditions were a factor, are there any leading indicators or more detailed/timely information that needs to be considered in making future decisions? Most important, what was learned? The objective is to improve the odds of repeating successes and cutting down on repeating mistakes.

Autopsies are a key component of continuous management improvement, whether it's the CEO, managers or front line employees. The continuous improvement concept is built upon the "5 Whys" principle. This principle says that on average you have to ask "why" five times to get to the real heart of an issue. The reason is that the first responses tend to be the obvious, the simplest, assigning blame, or accepting that the results were a function of outside forces over which the business manager/employee had no control. The best managers have learned that every complex problem has at least one answer that is simple, obvious and wrong. But, they have also learned that almost every problem contains the seeds of its solution.

For example, typical answers to the question of why net income dropped are: 1) commodity prices fell or were too low, and/or 2) input prices rose or were too high. That may be what happened; but, the questions should be directed at whether anything could have been done to change the outcome or mitigate the impact. Commodity prices may have been lower, or input prices higher; but, was there an opportunity or are/were there tools available that would have produced a better outcome? Of you sold near the top of the market or bought when input prices were lower, did you use an approach that is replicable or were you just lucky? Success isn't absolute, it's relative. Profits may be lower during cyclical downturns, but are you doing better than your competition?

Jack Welsh, the former CEO and Chairman of General Electric, has two quotes that have stuck in my head.  The first is “The only truly sustainable competitive advantage is the ability to learn and adapt faster than your competition.”  The second is “Someone somewhere has a better way of doing things and everyone in the organization needs to be compelled to find it, adapt it and continuously improve on it.”

One of my biggest frustrations isn’t that I or anyone else makes mistakes.  We all make them and they are necessary in order to grow and improve.  The problem is when we don’t learn from them.  As a manager, lender, consultant and board member, I’ve seen it again and again.  We need to frequently remind ourselves that one definition of insanity is doing the same thing over and over, and expecting different results.

# Budget Monitoring and Analysis

Danny Klinefelter

Typical producers treat planning and analysis as a beginning and end of the year exercise. Even then, most of them see it as a chore rather than on opportunity.

The most successful managers spend a great deal of time on monitoring and analyzing performance. By staying on top of things, they are much more likely to spot problems and opportunities before it's too late.

Business problems are like a cancer, they eat away at profits, liquidity and owner equity. But, spotted and addressed early enough, they are often treatable. Similarly with opportunities. Most of the best opportunities are only there for a short period of time and if they're not capitalized on, they're gone. For example, how long did the opportunity to sell corn for over $6 in 2008 exist?

It's been my observation that the main difference between the top 10 percent and the rest of the top 25 is almost entirely one of timing, whether it's when to get in, when to expand, when to cut back or when to get out.

The simplest and one of the most useful monitoring tools is the annual projected cash flow budget prepared on a monthly basis. The process involves comparing actual and year to date cash flows with projections. The focus is on the significant variances or differences. Many producers I work with use a 5 percent or greater deviation as a rule of thumb for flagging areas that need attention. The question is why the difference occurred, was it timing, a quantity difference or a price difference? Any number in a budget ought to be tied back to the basis or assumptions on which it was developed.

Unfavorable variances can point to problems that need to be addressed immediately. In other cases the cause may be something that can't be corrected, but it may mean that plans for the remainder of the year need to be revised. Planned investments or purchases may need to be deferred or you may need to talk to your lender about any changes in borrowing or repayment plans.

Monitoring also involves tracking leading indicators outside the business. Forward pricing opportunities for commodities relative to the marketing plan is one example. Tracking changes in the interest rate yield curve, energy prices, commodity stocks reports and carryover: use ratios and exchange rates are some commonly used indicators.

This external focus is too often overlooked. Comparing actual to budget is important, but it is only an historical perspective, i.e., looking at what has already happened. Regular budget analysis should also examine the assumptions built into projections and consider whether the bases for projections have changed and whether plans need to be revised. Adjustments to capitalize on opportunities, avoid problems or mitigate risks are what separate the winners from the also rans. It's much like a top coach or general who develops a detailed game or battle plan. Those who have been the most successful are those who are able to make mid-course adjustments in light of new information or because they recognized things weren't going as originally planned. Remember, the definition of strategic management is the ability to anticipate, adapt to, drive and capitalize on change.

The discussions that go into developing a budget or business plan also present an opportunity for learning and better communication both for the management team and for the development of potential successors. The ongoing review and adjustment process is equally as important. I've mentioned this before; but, one study of farm borrowers over a period of several years found that, on average, they overestimated cash receipts by 15 percent and underestimated cash expenditures by 17 percent. If the errors were purely a function of market and production variability, revenues should have been underestimated as often as they were overestimated, and the same should have been true for expenditures. The identification of where errors occur most frequently can direct greater attention to the need for better information or leading indicators, where risk mitigation efforts need to be focused, and where biases tend to occur in assumptions. It's a critical part of continuous improvement and learning from mistakes.

As a final comment, one of the most frequently overlooked uses of the process described is for family living budgets.

## Contingency Planning

Danny Klinefelter

The typical producer treats planning as a beginning and end-of-the-year exercise, and tend to limit themselves to most likely outcomes. Even then most of them see it as more of a chore than an opportunity.

The real difference between the best and the rest of the herd doesn't lie just in planning, but in contingency planning. Top managers spend more time thinking about "what if" scenarios and developing contingency plans. While they don't dwell on the negative, they do consider what could go wrong and what their options are if it does. It's the same process that successful coaches and generals go through in developing game and battle plans.

John Baker, director of the Beginning Farmer Center and the Iowa Crisis Hotline, offers this advice: "Don't be afraid to ask dumb questions; they're more easily handled than dumb mistakes."

Contingency planing involves analyzing different scenarios and developing specific plans for dealing with critical issues before they become problems. Tackled ahead of time, issues such as death, divorce, disability or a decision by one of the owners to leave the family business can be handled more objectively while there is time to consider alternatives and implement possible solutions. Succession planning, successor development, buy-sell agreements, and various types of insurance are some obvious examples of ways to deal with the issues just mentioned.

In addition to the areas just mentioned, contingency plans should be developed to address such questions as:

- What if we had a major disease outbreak?
- What if we lost a major contract or our biggest land lease?
- What if a key employee suddenly quit?
- What if our lender discontinued financing us?
- What if input prices doubled or commodity prices fell by 50 percent (sound familiar)?
- What if a supplier or buyer defaulted on a contract?
- What if we sold the farm/ranch?

The list can go on indefinitely, but the things that could happen and that would have a significant impact on the business need to be addressed ahead of time and strategies developed on how to deal with the situation. Lenders refer to this practice as shock testing. It's at the root of risk management. Being proactive isn't just about anticipating problems, it's also about removing obstacles, improving processes and capitalizing on opportunities. Also, in times of economic adversity, the best strategy isn't always profit maximization, sometimes it's loss minimization.

Contingency planning also applies to major investments, expansions, new ventures or new enterprises. Every plan should have a back plan, and every entry strategy should have an exit strategy, before the final decision is made. The point is you need to spend your time before you spend your money.

This seems so obvious, but most people don't do it. They're always fighting fires. Those who wait until a problem hits tend to react emotionally and make knee jerk decisions, because they don't have the time or the information to develop and evaluate alternatives, or implement anything that might have been able to mitigate the risk.

# Being Prepared to Borrow

by

*Danny Klinefelter*

The size and capital intensity of today's commercial farms and ranches make it virtually impossible to operate the business or to grow without using credit. But the current level of financial stress and the increasing emphasis on risk management is going to make the credit acquisition process more rigorous for agricultural producers.

This will mean a more performance based approach to borrowing. To help you be better prepared, the following twelve questions lay out a framework for developing the documentation needed in a loan package or business plan. The first six should really be no brainers; but, I never cease to be amazed by how superficially they are often addressed. Even if your lender doesn't specifically ask them, they are questions a business oriented producer ought to be addressing from a risk management standpoint.

1. **How much money are you going to need?** Not just initially, but over the period of and for the purpose of the loan request. Lenders don't want to loan all they feel comfortable with and then suddenly find they need to loan significantly more in order to see the situation through to completion. Estimates of repayment ability need to be realistic and conservative, and cost estimates need to address typical contingencies.

2. **What is the money going to be used for?** Be specific. It's not enough to say "operating expenses." In the past, too many operating loans have been used to subsidize lifestyles, refinance and/or pay carryover debt, and finance capital purchases. Plans need to be supported not just by budgets, but by documentation showing that they reflect past experience. Too many projections appear to be based on realistic estimates, but further review often shows they represent performance levels that are out of line with what the business has actually been able to achieve in the past. If you're projecting improved performance, you need to be able to demonstrate both how and why.

3. **How will the loan affect your financial position?** It is obviously important to know what your net worth, financial structure, historical cash flows, profitability and risk exposure are at the time of the loan request, but what will things look like after the loan is made? Will your risk profile in terms of working capital, leverage and debt repayment capacity change materially?

4. **How will the loan be secured?** You need to recognize that collateral is adequate only if, under the worst conditions, enough could be collected to generate sufficient cash to repay the loan and cover all the costs involved. Except for control purposes, the primary purpose of collateral is to provide insurance in the event of default; therefore, the important lending consideration is not what it is worth at the time of the loan request, but what is its expected value at the due date of the note or at the date of the next scheduled payment. The lender needs to account for the period of time involved, potential changes in collateral value and condition, legal and selling costs, and the fact that a distress sale will bring less than an arms length transaction under normal market conditions. The changing nature of security has become one of the most significant factors affecting agricultural lending. More loans are now dependent on soft in addition to hard assets, i.e. key personnel, contracts and leases. There are also more joint ownership arrangements and market risks related to specific attribute raw materials rather than straight commodities. All of these make it more difficult for the lender to assess a net realizable value. For example, what's an empty hog building or dairy facility really worth in today's environment?

5. **How will the loan be repaid?** Will it be from operating profits, from non-farm income, from the sale of the asset being financed, from refinancing or from the liquidation of other assets? How predictable and dependable is the source of repayment?

6. **When will the money be needed and when will it be repaid?** This two-part question should be answered by the projected cash flow budget. Answering this question makes sure both you and the lender know how the business operates. Almost as many credit problems have resulted from a lack of understanding and communication, as have resulted from unrealistic expectations. Marketing plans and trigger points, contract terms and conditions, and various pooling arrangements are often not adequately communicated or documented.

7. **Are your projections reasonable and supported by documented historical information?** Too many producers still do not have the production, marketing and financial records to demonstrate their track record and support their numbers. Many loans have not been made that probably could have been repaid simply because of a borrower's inability or unwillingness to provide the lender with complete and well documented historical information on his financial position and performance. It is extremely important that borrowers be objective in

their cash flow projections, not just for the lender but also for their own management purposes. One study of farm borrowers over a period of several years found that, on average, they overestimated cash receipts by 15 percent and underestimated cash expenditures by 17 percent. If these errors were purely a function of market and production variability, revenues should have been underestimated as often as they were overestimated, and the same should have been true for expenditures. Unfortunately, there has been a tendency toward too much wishful thinking and a lack of adequate planning in the development of cash flow projections.

8. **How will alternative possible outcomes affect your repayment ability?** Due to the numerous factors affecting production agriculture, cash flow projections frequently vary from the actual outcome. The importance of making sound projections and analyzing "what if" scenarios is even more important considering the increased volatility that producers have to deal with. Even under marketing and production contracts with established price bases, quality discounts and premiums can still result in a great deal of uncertainty. But, the most frequent error is one that occurs when borrowers and lenders actually believe they are addressing the issue. And that is when they evaluate the impact of standard scenarios such as a 10 or 25 percent decrease in revenues. For some businesses this practice overstates the risk involved, while for others it may seriously understate the potential risks. Done correctly, the alternatives considered should reflect the business's actual historical performance variability as well as the range of current forecasts. While nearly all farmers and ranchers are on a cash basis for income tax purposes, most lenders will adjust this information for changes in inventories, accounts receivable, accounts payable and accrued expenses to get an estimate of income on an accrual basis. Many lenders are requiring borrowers to provide annual accrual basis income statements, and more will be. This is because while cash basis income accounting is valuable for income tax management, it is often a very inaccurate measure of business performance. Cash basis income can lag accrual income as much as 2 years in detecting upturns or downturns in profitability.

9. **How will you repay the loan if the first repayment plan fails?** No commercial lender wants to enter into a situation in which foreclosure is the only alternative if things do not go as planned. Contingency planning is critical. Recognize what could go wrong and what you plan to do if it does. Every plan should have a backup plan and every entry strategy should have an exit strategy. This latter point is particularly true where

niche markets or new ventures/enterprises are involved.

10. **How much can you afford to lose and still maintain a viable operation?** There are several factors to consider here. The first is to recognize that a viable net worth is not anything above zero. Most commercial lenders require some minimum equity position, e.g. 40 percent, below which they will not continue financing without an external guarantee. With this in mind, the answer to the question must be based on the effect of various combinations of both potential operating losses and declines in asset values. Lenders call this shock testing.

11. **What risk management measures have been or are to be implemented?** This can cover anything from formal risk management tools to management strategies. The major issue here is to make absolutely sure that both the borrower and the lender understand how these measures work. For example, incorrect use of commodity futures and options can increase rather than reduce risk. It is also critical that the lender is supportive and committed. A lender's unwillingness to finance margin calls can destroy a successful hedge.

12. **What have been the trends in the business's key financial position and performance indicators?** The first issue is do you know? The second is if the trends are adverse, what are the specific short-and long-term plans for turning things around? If they are to keep doing what you've been doing and hope things get better, you're setting yourself up for a rejection. Timely action, willingness to change, and the ability to manage problems are hard to measure, but as risk increases they become critical in the credit decision process.

In conclusion, there are four important points for agricultural borrowers to keep in mind. First, a lender's request for more accurate and complete information shouldn't be viewed as questioning your character; it's just good business. Second, any time new ownership/management of a lending institution occurs, tougher credit standards will almost always follow. Such changes usually do not indicate that the new management is too demanding, but that the former management was too lax, which frequently explains why there is new ownership/management. Third, many of the stricter credit standards being adopted can be directly attributed to legislation which provides for additional borrowers' rights, increased food safety and environmental risks, and/or increased risks of lender liability lawsuits. Because litigation usually arises from situations in which borrowers are highly leveraged or in financial trouble, it has become more difficult for higher risk borrowers to qualify for credit. Just as malpractice lawsuits have changed the practice and raised the cost of medicine, the threat of legal action has changed the lending environment. Finally, borrowers need to have the information required to negotiate terms or to find another lender if they have to. Becoming complacent just because your lender has never required all that has been mentioned above, could prove to be a poor risk management strategy if the management, ownership or underwriting standards of your lending institution suddenly changed.

# Staying in Front of the Pack

Danny Klinefelter

I recently attended Purdue's Midwest Food and Agribusiness Executive Seminar. It was a great experience. At the end of the program, Mike Boehlje and Allan Gray led a wrap up where the participants talked about their main take aways. The following points came up several times: sustainability requires a continuous learning and improvement culture; effective strategy and decision making require the consideration of multiple perspectives; and it is critical that management is open to and actively seeks input not just from outside, but also from inside the business.

The last point is one I want to focus on in this article. Too many people see these issues as applying just to big businesses; but, I think they're just as applicable to a farm with two employees.

Many family owned and managed operations are good examples. Only about a third have developed a strategic plan. There are two reasons why most haven't and both result from CEOs who have become too isolated. The first is that the strategic planning process requires sharing information, and the second is that it requires the CEO to respond to the ideas of others and to defend their own ideas. The result is that many threats and opportunities aren't identified, and the strengths and weaknesses of the business aren't often objectively or accurately assessed.

A couple of years ago, Jeff Magee and I wrote and article for the TEPAP participants about improving organization effectiveness and competitiveness. It was about leadership. Given what I heard at Purdue, I think the ideas we talked about worth sharing.

As a business grows and becomes more complex, a primary competitive differentiator will be the commitment, involvement, and contributions from employees throughout the organization. Companies that use the old command-and-control management model—in which the "big" ideas have to originate at the top and decision making is highly centralized—are increasingly likely to stagnate and lose their competitive advantage. These businesses usually lack the entrepreneurial culture of ownership and continuous improvement that will be required to reach or remain at the front of the pack.

One key to a business's success is its ability to cultivate "thought leaders," people who question the way things are done, propose new initiatives, make wise decisions for the company and help it grow. This ability separates an organization invested in personnel asset development from one that is simply invested in personnel management. Only within an atmosphere that invites participation and success will people and organizations live up to their potential.

It is also vital to build the confidence level of each employee to foster courage and self-motivated initiative. Without confidence and good attitudes, employees will rarely perform at the desired levels. Employees also must clearly understand the objectives and value of the goal process if the business's long-term objectives are to be met in an ever-changing environment.

Don't get me wrong. To be successful, a business needs to have strong, visionary leadership and effective policies, procedures, performance metrics, and monitoring. The challenge is to find ways to create a culture that unleashes the organization's potential. The point is that dictatorships or bureaucracies tend to kill initiative and innovation because the potential thought leaders quickly learn that the penalty for questioning the status quo or making a mistake far outweighs any potential gain from trying something new or different. Such organizations tend to develop excessively rule-bound, conformist cultures that are hamstrung by the status quo and permeated by mediocrity.

Great organizations not only believe in the necessity of making mistakes, but they also see mistakes as virtually synonymous with growth and progress. Their belief is that if people haven't failed, they haven't tried hard enough. The objective is to learn from their mistakes and avoid making the same one twice.

These organizations spend as much time analyzing what they need to stop doing or do differently as they do evaluating new opportunities. Alternative approaches and new ideas are not only allowed, they are encouraged and even rewarded through incentives whenever they produce positive results.

To stay ahead in this rapidly changing world, the internal rate of change inside the business needs to exceed the rate of change in its external environment. If it doesn't, the business will be falling behind even though it may be moving ahead.

There are reasons that businesses such as General Electric became institutional names for decades, and why others never attain that status. One of these reasons is their emphasis on personnel asset development. They cultivate thought leaders among their employees and ascending managerial-leadership ranks.

Creating "Wise Organizational Decision Making" individuals, environments, and groups requires:

- An environment that champions such behavior
- Managers at all levels who encourage and reward the constructive challenge of issues, logic, and decisions
- Individuals who want to learn and mentally grow every day
- Individuals who can fulfill expectations and accept accountability
- An environment that inspires a self-starter attitude and encourages learning , even in the face of mistakes
- And most important, an organization that does not stifle thought leaders through micro- or “only my way” management

An organization’s failure begins with individuals, teams, departments, and managers who smother independent thought. This practice can lead to significant loss: loss in business growth, loss in customer retention and loss in securing new customers. Ultimately, it will make it difficult for the organization to attract, uncover, or retain potential thought leaders, and encourage those with better opportunities to leave.

Many of the hard--charging owners and executives see these issues as important, but too soft and lacking in a specific process oriented solution. My observation is that it is precisely because it is so difficult and so few do it well, that it makes so much difference in terms of an organization’s performance (effectiveness) and competitiveness.

Ultimately, it is people rather than things that take an organization from good to great. Two pioneering management studies, both published as best selling books, *Good to Great* and *First Break All the Rules: What the World’s Greatest Managers Do Differently*, reached the same conclusion. Organizations become great by getting the right people, in the right places, doing the right things, and then managing them in a way that allows them to perform up to the best of their abilities. Jim Collins, author of *Good to Great*, wrote, “Good is the enemy of great. And that is one of the key reasons why we have so little that actually becomes great. We don’t have great schools, principally because we have good schools. We don’t have great government, principally because we have good government. Few obtain great lives, in part because it is just so easy to settle for a good life. The vast majority of companies never become great, precisely because the vast majority become quite good - and that is their main problem.”

Effective leadership can’t be captured in or implemented by a formula. There are best attributes, but there isn’t one best practice. It is for that reason that many great technicians, theorists, doers, politicians, and hard-asset managers are seldom great leaders. The required talent set is different. To quote Albert Einstein: “Not everything that counts can be counted and not everything that can be counted counts."

Obviously, many small organizations have been extremely successful even though their leaders treat the employees as basically "hired hands." There have also been legendary "dictatorial" superstars who have led large organizations to the top of their field. The point is that as organizations grow, become more complex, and have to adapt to change more rapidly on multiple fronts, this style of management is less likely to be successful or sustainable. These organizations are far more likely to fail or experience an unnecessary and potentially catastrophic adjustment whenever a leadership transition occurs. Too often the remaining management team will consist of technical staff and loyal soldiers who have become dependent on and accustomed to being directed rather than leading. They will not have been selected, trained, or equipped to assume the reins. The culture of the overall organization will also not be conducive to adapting rapidly.

Strategic management is all about anticipating, adapting to, driving and capitalizing on change. To quote Bill Gates, "What was isn't any more and what is won't be for long." Add this to increasing levels of uncertainty, and an organization's ability to learn, anticipate, adapt, and innovate will have as much to do with its long-term success and viability as the operational and tactical skills that have traditionally separated the also-rans from the winners.

I'm not advocating turning the ship over to the troops. But, I do believe that a leadership model that embraces continuous change, and the constructive expression of employees' ideas and initiative will be more effective and competitive than one that operates as if the source of all best ideas emanate from the top.

# The 5 Percent Difference

Danny Klinefelter

I worked in the Farm Credit System from 1982- 1987. As bad as times were for agriculture, one of the things that struck me was that a lot of farmers remained profitable. Their market value net worth may have declined with land values falling by half, but their earned net worth kept increasing.

After I came back to Texas A&M, I conducted a study of the factors contributing to the changes in earned net worth between the top 25 percent and the bottom 25 percent of producers in a major ag lender's portfolio over the six years between 1982 and 1987. The portfolio was separated into six farm types: corn-soybeans, wheat, cotton, farrow to finish hogs, dairy and cow-calf in order to compare like type firms. I looked at production per unit, net price received per unit, cost per unit, asset turnover and leverage. It was interesting that leverage appeared to be as much a result of, as it was a cause of problems. If the rate of return on equity (ROE) was higher than the rate of return on assets (ROA) greater leverage, it required better risk management, but it also resulted in greater profitability. If ROE was less than ROA, being highly leveraged took the business down faster. Essentially, leverage was the straw that broke the back of farms who were unprofitable, had poorly structured debt or lacked sufficient liquidity.

The results that surprised me most were the differences in production, prices received and cost of production. The top 25 percent were only about 5 percent above average, while the bottom 25 percent were about 5 percent below average. Obviously, the really low performers weren't included in the study because they didn't remain in the database throughout the period.

Later studies by the University of Illinois, Kansas State University and the University of Minnesota using their farm business records found similar results. Although they didn't break out the factors the same way, all three found about $100 per acre differences in net farm income between the top and bottom groups. One of Kansas State's studies by Terry Kastens found 53 percent of the difference was revenue (price and yield) and 47 percent resulted from lower costs. Last year, Dave Kohl was quoted in Crop News Weekly on net income information from Minnesota's FINBIN financial database, "The biggest surprise is the widening gap in net farm income from the top 20 percent to the low 20 percent of producers in the database. In 2008, the average net farm income was $426,476 for the top 20 percent compared to -$33,206 for the low 20 percent. When analyzing the data since 2003, the financial extremes have become greater each year."

The important point is that the top producers tend to sustain their advantage over time and the gains compound themselves in the form of accumulated equity. Remember the multimillionaire, future hall of fame baseball player with the .300 lifetime batting average only gets 1 more hit every 20 times at bat than the .250 hitter who just manages to hang on. The incremental differences may seem small, but they do it over and over again.

Consider the following example. Assume an average corn yield of 200 bushels per acre, an average price of $4.00 per bushel and per acre cost of $650.00, which would generate a net income of $150.00 pr acre. What would be the impact per acre net income beating the averages by 5 percent?

| Factor(s) | Per Acre Net Income |
|---|---:|
| Yield only | $190.00 |
| Price only | $190.00 |
| Cost only | $182.50 |
| Yield and Price | $232.00 |
| Yield and Cost | $222.50 |
| Price and Cost | $222.50 |
| Yield, Price and Cost | $264.50 |

Conversely, the per acre net acre impact of being 5 below average would be:

| Factor(s) | Per Acre Net Income |
|---|---:|
| Yield only | $110.00 |
| Price only | $110.00 |
| Cost only | $117.50 |
| Yield and Price | $72.00 |
| Yield and Cost | $77.50 |
| Price and Cost | $77.50 |
| Yield, Price and Cost | $39.50 |

Some may question the ability to generate higher yields and at the same time have lower costs. However, it occurs frequently. Producers renting the same quality ground in the same area often pay significantly different rent. Sometimes it's because of their relationship with the landlord, sometimes because of being better negotiators and sometimes because of their reputations for being better stewards or managers. Some achieve lower rents by providing additional services. Still others achieve lower costs through economies of scale, by sharing resources with other farmers or simply by making more efficient use of their resources. I see farmers all the time with the same equipment and labor force on 1500 acres that another producer uses to farm 2500 acres. Several TEPAP participants share equipment and even labor with producers in other parts of the country. Some joint purchase to achieve better input prices. The possibilities and the examples are endless; but, there are always ways to do better and it comes down to management and being willing to change.

# ALTERNATIVE FARM BUSINESS ARRANGEMENTS

**By: Danny Klinefelter**

Two of the most efficient businesses I have encountered are companies most people have never heard of: United Food Service Purchasing Co-op (UFPC) and Restaurant Services Incorporated (RSI). Both are closed cooperatives.

USFC is owned by the YUM Brand companies: KFC, Pizza Hut, Taco Bell, Long John Silver's and A&W, and RSI is owned by the Burger King franchisees. Both serve as the supply chain manager and exclusive purchasing agent for their members. This includes risk management. Last year UFPC did over $5 billion in business with less than 200 employees; RSI topped $3 billion with less than 100 employees.

If national brands and Fortune 500 companies believe they achieve greater efficiency, reduced costs, and better risk management by working together, why should farmers with $1 million, $10 million, or even $100 million in revenue think they are better off and can do a better job by going it alone? It's been my observation that fierce independence can often be as much the cause of problems as it is a source of opportunity. Remember the old saying, "Pride cometh before the fall."

I'm not talking about business mergers or open membership cooperatives. It's not that anything is wrong with either of those approaches; but, that's not the focus of this article. My point is that farmers and ranchers can maintain the separate ownership and operating management of their businesses and still achieve economies of scale, critical mass, lower costs, and more quality and depth in specific technical/management skills by joining forces in separate jointly owned entities. To date, most have been structured as LLCs, Sub-S corporations or closed cooperatives. The scale of these entities can and does vary, depending on the purpose and objectives of the parties involved.

The following are some examples I've seen in agriculture over the past 10 years.

In one case, three farms share the services of a Chief Financial Officer (CFO), who is also a Certified Public Accountant (CPA) with experience as a corporate controller, and a data entry secretary/bookkeeper to be able to do true cost accounting and still keep their costs to a level each can afford.

The CFO has children and wants to work part-time on a flexible schedule. She is paid for 30 hours a week. Because she is in a rural area, she has fewer career options at which to employ her skills than in an urban market. She is paid $75,000, the secretary $35,000 and the overhead runs $40,000, for a total of $150,000 divided equally among the three operations. These two people also make sure bills are paid, manage vendor accounts, monitor budget versus actual performance variances, perform financial and feasibility analyses, and generate a variety of management reports.

Another group of three farmers in different regions of the country jointly own planters and combines and share labor to lower per acre costs and keep high-dollar resources working 6 months a year rather than 2.

A third group of five vegetable producers formed a marketing company that generates marketing and production contracts for the export market. Contracts are first offered to the member/owners; but, the company also contracts with non-member growers for any additional volume or if the owners decided to pass on an opportunity.

In another case, three blueberry grower associations, in Michigan, Georgia and Chile, joined together to form a federated marketing cooperative. This organization provides the growers with a competitive advantage in negotiating with retail grocers because it can provide fresh blueberries nine months a year.

My final example involves a farmer in a midwest rural community who organized a land investment company using local business people. The farmer is one of the ten investors. The investors each made an initial investment and agreed to a fixed annual contribution for the next nine years. The equity funds were leveraged with borrowed money to purchase local farmland. The farmer cash rents the land from the company. At the end of ten years, the property is to be sold or the group can elect to extend the arrangement.

Other groups made up from 3 to 30 producers have formed entities that handle a number of functions:

- Personnel recruiting, training, and record keeping, including H2A
- Risk management
- Input purchasing and contracting – some of these contractual arrangements are very innovative
- Product and services advertising, marketing, selling, and contracting
- Veterinary services
- Nutritionist services
- Agronomic services
- Bulk feed, fuel, fertilizer, and grain storage

- Processing plants, e.g., the Southwest Cheese joint venture
- Feed mills, e.g., feedlots, dairies and unit trains
- Repair shops
- Trucking
- A leasing company
- Biodiesel processing to produce their own fuel
- Self insurance pools, e.g., Texas Ag Coop Trust
- Genetic services, e.g., sires and donors for artificial insemination and embryo transfers
- Exporting and importing of breeding stock, fruits and vegetables and specialty grains.

The above list obviously isn't exhaustive; but, I hope it makes the point.

Not everything these separate entities do necessarily involves the full-time employment of the people and resources needed to perform the services. Some of these entities in turn outsource contract for specialized services they aren't big enough to justify the cost of internalizing or that they need on only an occasional basis.

Joint efforts also often extend to services that offer benefits only if there are multiple participants and perspectives. Some obvious examples are research test plots and financial and operating performance benchmarking.

Another is needs-based training. Assume that several producers decide they need training in some area of personnel management, succession planning, process improvement techniques, options strategies, or other topics. The type of program they need might involve anywhere from 1-3 days, and the quality of the presenter might require charges of $3000-$10,000 a day, plus expenses. Assuming that this type of program isn't available through their state's extension service, the cost for one producer could be prohibitive; but, shared by 5-20 producers, it could be very reasonable. In addition, the questions and perspectives of multiple participants will likely open up possibilities and issues that wouldn't otherwise be discussed.

Those who want to see their farms continue as full-time businesses beyond the current generation must continue to explore new ways of doing business. The possibilities are limited only by imagination. Unfortunately, many people tend to be bound by tradition and their own experience. It has been my observation that the top 1 percent of farm and ranch managers are 10 years ahead of the typical producers. The top 10 percent are out in front by at least 5 years. Just being better than average is living on the edge.

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Klinefelter, Danny. "Working Alone Together," Corn & Soybean Digest, Penton Media. Overland Park, KS, Vol. 68, No. 3, pp. 15-16, March, 2008.

# Successor Development and Management Transition on Family Farms and Ranches

Danny Klinefelter

"Successful management transitions don't just happen…they are planned." (Dr. David Kohl)

This publication assumes that several other key parts of the management transition puzzle have been or are being addressed. Successor development and management transition are parts of a larger whole. Neglecting any one of them can undermine everything you are trying to accomplish. These assumptions are listed below:

- The successor has been selected.
- They want the job and their family supports the decision.
- The successor is capable of growing into the position.
- The business can afford them.
- The current management/ownership (Hereafter referred to as the current CEO), has their estate and retirement plans in place, they have been communicated to the family, and are in the process of being funded.

There are a multitude of potential economic and relationship issues that can derail the best laid transition plans; but, having a well thought out plan, with action steps and a timeline significantly improves the odds of success.

The most successful cases I have observed and worked with over the past 30 years have started early and deliberately. The less they have left to chance, the better it has worked.

A timetable is a key component of a successful management transition. It not only helps keep the successor from becoming frustrated, it also helps prevent the current CEO from procrastinating. In addition to the successor's development plan, the timetable needs to address the delegation of responsibility and transfer of authority. The process isn't just one of transitioning in the successor, but also one of transitioning out the current CEO.

The management transition process isn't just about the successor assuming the duties of the current CEO, but also the process of other family members and key employees adjusting to a new leader. It has to be a major part of the role of the current CEO to support that transition. It also provides support for the successor making changes without them being perceived as an indictment of the past or criticism of the predecessor.

Mark Voeller, a nationally recognized family business consultant and author of the book *Exit Right*, says that sixty percent of failed management transitions are due to unresolved family conflicts and communication issues, and twenty-five percent are due to poorly prepared successors. The focus of this article will be on those two aspects of the transition process.

Successful management transition involves three critical and at times simultaneous processes: successor development, the transfer of management responsibility and authority, and the exit of the current CEO.

Ten lessons I have learned from the businesses that have been successful in completing these processes are that they have done the following:

- An assessment of the needs of the business, not just for now but for the future. This includes a determination of the management skills and attributes that will be needed.
- An objective assessment of the strengths and weaknesses of the current CEO. This includes an assessment of the CEOs ability to teach and mentor the successor in the areas of need identified in the business assessment.
- An objective assessment of the strengths and weaknesses of the successor.
- Open, honest and mature two-way communication.
- The creation of a management development plan that addresses the successors strengths and weaknesses, experience, responsibility, training, and honest/objective evaluation and feedback.
- Planned experience, exposure and networking opportunities for the successor, not just outside the business, but also outside the industry.
- Developed a common vision for the business.
- An ongoing delegation of responsibility and authority, with a specific timeline.
- Involved the successor in the development of the business plan and in the strategic decision making process.
- Implemented a plan for what the current CEO is going to do next.

## Communication and Working Together

Based on Voeller's work as well as my own observations, I want to begin with a discussion about successors and current CEOs working together.

Good communication and interpersonal relationships are imperative to overall business performance and sustainability. Most managers understand the need to improve various facets of their business management practices. However, these two areas tend to be neglected or minimized in terms of their importance. Peter Drucker, often called the father of modern management, also said that 60 percent of all management problems are the result of poor communication. While poor business decisions can cause the ultimate failure of a business, I have witnessed too many farm and ranch businesses torn apart and ultimately fail because of communication and relationship problems. Unless there is a major blow up, most outside observers never realize the underlying cause of the problems that manifest themselves in poor business performance. This section discusses what I see as the five most common communication and relationship problems.

The first problem is the dictatorship or as Don Jonovic, president of Family Business Management Services, describes it, the “der Fuehrer or el Jefe” management model. Everyone knows the management style I’m describing, “This is mine and if you want to work here or inherit your share when I’m gone, just do what I tell you. If I want your opinion, I’ll ask for it .” If someone does own it all, that’s obviously their prerogative; but, it is a management style that is best suited to a business in its last generation, because it is an extremely dysfunctional system for developing a capable successor.

Unfortunately, a more open participatory management style goes against the basic nature of those who like the idea of being “boss” and being able to tell other people what to do. Being in charge and having the final say is one thing; but, some people seem to have a need to force their will on others just to prove they can and to make sure that no one forgets it. You don’t lead by hitting people over the head - that’s assault, not leadership.

On a personal note, when I was growing up, our dad used to kid my brothers and me anytime we would say “I think”. His response would be, “How do you know what you think, I haven’t told you yet.” Fortunately for us, he didn’t mean it. While we all knew the final decision was his, he was always encouraging us to “use our heads” and to come up with new ideas. When we did, he would talk them over with us to get us to explain our reasoning, to think about what the consequences might be, and to see if we had considered any alternatives. Unfortunately, I see situations all the time where the sentiment originally expressed is intended.

The second problem is of the biggest roadblocks to progress in any organization and that is secrecy. Don Jonovic says that most family businesses are not just closely held, they are hermetically sealed. He talks about making a presentation in which he discussed how information is passed from one generation to the next. After the presentation, a woman came up to him and said that he had missed the method that her husband used with their son. When he inquired what it was, she said “read my mind.” Since then he has included it in every management succession seminar he has given.

Far too many CEOs share information only on a need to know basis. Successors need to be able to share in the accumulated wisdom and experience of their elders. They shouldn't have to learn by osmosis or only through their own experience. Key employees and family members also want and need to know the answers to the following questions:

- What are they expected to do?
- Why are they doing it?
- How are they doing?
- How can they improve?
- Where is the business headed?
- How does it plan to get there?
- What is my role?
- What's in it for me?

The third behavior I see all too often is people who cannot admit they are wrong. It is just as often true of the successor as it is of the CEO. These individuals frequently resort to turning a difference of opinion into an argument. The result is that this tends to escalate the disagreement to the point where it becomes an emotional exchange rather than pursuing a rational discussion. This behavior generally produces one of three outcomes: 1) if the person being challenged has position power, they crush the challenge to their authority, 2) both parties revert to childish behavior which accomplishes nothing but embarrassment and/or resentment, or 3) knowing the behavior that differences of opinion create, others simply give up challenging the person's ideas or assertions and much needed constructive discussion of issues, logic and decisions never occurs.

The fourth problem is unresolved conflict. This may be between people working in the business or between family members in the business and those who have an ownership interest but don't work in the business. These problems are like an insidious cancer that eats away from inside the business. If they are not addressed and resolved, they not only have an adverse affect on business performance, they can also be the landmine that prevents the successful transition of the business to the next generation.

It is important to recognize that disagreement is normal and inevitable. In fact, if the business is going to change and grow, it is essential. Henry Ford was once quoted as saying, "If two people in a business agree on everything, then one of them is unnecessary." The corollary to that statement is that if they disagree all the time, then both of them are useless. The problem occurs when a disagreement grows into conflict. All other issues may become secondary and the conflict could become the business's Achilles' Heel. Unfortunately, conflicts are often never properly addressed. Under a strong authoritarian leader, problems often don't fully manifest themselves until the current CEO dies or turns over the reins.

The fifth problem relates to learning how to fight fair. In order to learn how to do this, people need to focus on developing both emotional maturity and interpersonal skills. At a minimum, there are five basic ground rules: avoid personal attacks, don't drag others into taking sides in the argument, don't use subversion, focus on the issue at hand (i.e., don't dredge up old issues), and keep heated discussions in private. Bullying or childish behavior may win battles, but the result may be that family relationships and/or businesses end up losing the war.

When it comes to working together, those who do it best tend to follow two basic rules: the Golden Rule, "treat others as you would like to be treated," and the Platinum Rule, "treat others as they would like to be treated." The Platinum Rule basically recognizes that everyone is different and reflects two of the habits Stephen Covey describes in his book *7 Habits of Highly Effective People*, "Seek first to understand, then to be understood" and "Think win-win."

I think the first is self-explanatory. It can help though if the parties involved have some understanding of personality style and generational differences. Many state extension programs offer workshops on these topics. The win-win idea, however, is often misunderstood. It isn't based on compromise, but on fostering an attitude that is committed to finding solutions that will truly benefit both sides of a dispute. Solutions do not of course exist in themselves; they must be created.

## Developing Strategic Management Skills

In addition to learning how to manage the day to day operations of the business, successful transitions require passing on the "strategic smarts" and "strategic thinking skills" to the successor.

To be successful as a CEO the successor also has to learn to become a leader, not just a manager. Leadership revolves around vision, ideas and direction, and has more to do with inspiring people than with day-to-day implementation. Top managers recognize that their ability to attract and motivate people will in large measure determine how successful they are. A leader is great, not because of his power, but because of his ability to empower others. When it comes to managing people, the top managers see themselves more as the head coach than the boss. J. Paul Getty once said "It doesn't make much difference how smart, how much knowledge or how much experience an executive possesses; if he is unable to achieve results through people, he is worthless as an executive."

Leaders must be able to judge the strengths and weaknesses of the business, to assess the opportunities and threats in their environments, and most importantly, to identify which issues are most important and deserve their closest attention.

It's important to recognize that in order to stay ahead, the internal rate of change in the business needs to exceed the rate of change in the business's external environment. It doesn't, the business will be falling behind even though it may be moving forward.

Two comments I frequently hear are that most farmers and ranchers run their businesses more as producers than as business managers, and they are resistant to change. From my experience, most of the producers I work with don't see either statement being directly applicable to them. Most believe they are managing their farm or ranch as a business. The question should really be: Are they using the best business management practices and do they possess the necessary management skills and attributes to compete with the best in the business? Almost every commercial producer also believes he has made significant changes in his business. The real issue is: Are they moving forward as fast as their leading edge competitors - the top 10%?

As an analogy, consider two people driving in the same direction on an interstate highway. Both are clearly changing, i.e., moving forward. However, one is traveling 55 mph and the other 70 mph. If they both drive 8 hours a day, 5 days a week, at the end of one year the one going 70 mph will be 31,200 miles ahead of the other. But what if the 70 mph driver decided to ramp things up to do business 24/7/365? If the 55 mph driver stayed on his current pace he would now be falling behind by 498,800 miles per year. Assuming the highway circumnavigated the earth, the slower driver would be getting lapped about 20 times a year.

Is this example extreme? Yes. Is it unrealistic? No. Large commercial dairies typically milk around the clock, 365 days a year. In another instance, one row crop operator I know now farms in 12 states so he can diversify production and market risks in addition to utilizing his labor, management and equipment nine-ten months a year rather than the normal single-site planting and harvesting periods.

Strategic management is largely a matter of anticipating the future, recognizing emerging problems before they occur, and taking corrective action while the window of opportunity for effective response is still open. In fact, the definition of strategic management is the ability to anticipate, adapt to, drive and capitalize on change.

Top managers are opportunistic, because they recognize that timing is everything. Timing doesn't relate just to knowing when to get in, it also deals with knowing when to pull back, when to expand and when to get out. One of the key points in the book *Good to Great* is that the best companies spend as much time analyzing what to stop doing as they do analyzing new opportunities. Unfortunately, the average manager tends to jump on the bandwagon after the early adopter profits have already been made and then frequently doesn't get out until he's forced to. As the old saying goes, most people change when they feel the heat, rather than because they see the light.

The top managers also spend more time thinking about "what if" scenarios and developing contingency plans. They don't dwell on the negative, but they consider what could go wrong and what they'll do if it does. It is no different than what successful coaches and generals do when they develop game or battle plans. The average manager may plan, but they tend to limit themselves to most likely outcomes and don't spend enough time on contingency planning. Typical producers also tend to treat planning and analysis as a beginning and end of the year exercise. Even then most of them see this as more of a chore than an opportunity.

John Baker, Director of the Beginning Farmer Center and the Iowa Crisis Hotline, offers the following piece of very sage advice, "Don't be afraid to ask dumb questions, they're more easily handled than dumb mistakes."

The most successful managers spend a great deal of time on monitoring and analyzing performance. By doing so, they are much more likely to spot problems and opportunities before its too late. They are also more likely to be treating the cause and not just the symptom of a problem. They also always use two analytical skills in solving problems. The first perspective - they look at multiple frames of reference. And second, they always look for the heart of the issue. The reason they don't jump to conclusions is they have learned that every complex problem has at least one solution which is simple, obvious and wrong.

Successors need both experience and training to develop the visioning and evaluative skills to strategically redirect the businesses. They also need to develop the ability to conceive alternative ways of doing business and to choose those which make the business more effective.

Unfortunately, only one-third of family businesses have a strategic plan for their business. There are three reasons why most do not have one. These are that the strategic planning process a) requires sharing information, b) requires the CEO to respond to the ideas of others and to defend their own ideas, and c) requires a commitment to the plan versus the typical entrepreneurial manager's style of keeping his or her option open and to themselves.

In contrast, many successful family businesses actually have three plans, not just one. These include a long term strategic plan for the business, a detailed business plan, and short term contingency plans for dealing with the unexpected. While most farmers and ranchers are good at tactics and operations, the top farm and ranch executives recognize that to be successful, they first have to determine what they want to accomplish and then let that determine how they get there. It boils down to recognizing the difference between doing things right and doing the right things. A lot of failures have been businesses who were doing something very well, but that were no longer relevant or what the market wanted.

We need to recognize that 80 percent of our results are produced by 20 percent of what we do. The management philosophy of doing first things first is based on the Pareto Principle, more commonly known as the 80:20 rule. One of the things that sets top managers apart is that they set priorities and follow through on them. The most successful are the ones who have figured out which the 20 percent are and then put most of their time and resources into accomplishing them. The other 80 percent get eliminated or turned over to someone else. The major reason most major goals are not achieved is because people spend most of their time doing second things first.

Success emanates from first doing the right things and then doing them well. Hockey great Wayne Gretsky was quoted as saying, "What separates me from the average player isn't that I'm stronger or faster, but that they go where the puck is while I try to go where it's going to be."

It is important to recognize that it is the planning process, not the plan document that matters most. The strategic planning process involves both internal and external environmental scanning. This is often described as a S.W.O.T. analysis, i.e., identifying **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats. The process can be both threatening and frustrating to action oriented managers who often view the necessary brainstorming as mostly a waste of time. However, it is only through this process that a clear vision of where the business needs to go, what it will take to get there, what could go wrong, and both implementation and exit strategies can be fully fleshed out. Dwight Eisenhower once said, "In times of crisis I have found that plans are often useless, but that planning is absolutely essential."

It is equally important to recognize that two-thirds of the businesses that do engage in formal strategic planning never implement the plans that are developed. The problem lies in the fact that the management system (or lack there of) and management's operating style often do not support implementation, and the planning process serves mainly as a thought provoking exercise.

The development of short term contingency plans involves analyzing different scenarios and developing specific plans for dealing with critical issues before they become problems. Addressing issues such as a death, divorce, disability, or a decision by one of the owners to sell his or her interest, and doing it at a time when things are going well also helps make the discussions less threatening and emotional. In addition to these areas, crisis plans can be developed to address such issues as:

- What if we sold the farm/ranch?
- What if we had a major disease outbeak?
- What if a key non-family manager suddenly quit?
- What if output prices suddenly fell by 50 percent or input prices doubled (sound familiar?)
- What if we lost a major contract or our biggest land lease?
- What if our lender discontinued financing us?

In each case, the objective is to discuss the issues and develop action or contingency plans. The major issues also need to be readdressed on a regular basis.

Over the long term, the success of a family business requires not only a shared vision but also a strong set of common values. As families expand and grow older, goals and values inevitably become more diverse. This is particularly true when the family members involved in the business include cousins or in-laws who grew up under different family influences and not just siblings who grew up in the same family.

Remember that the CEO is the business's key to link to its external environment. Successful businesses actively promote mentoring and networking opportunities for the successor as a way to prepare them for leadership. In order for a business to continue to be successful, each generation needs to bring in new strategic ideas that build on the business's core competencies.

## The Educational Process

One of the key components of educating the successor and increasing their understanding of the business and how it works is the development of a business plan. It's not just a tool for guiding the business; but the process, discussions and information involved in preparing the plan are a critical element in the development of the successor. The reason is every facet of the business has to be explored. A well prepared business plan serves several purposes and accomplishes several things:

- It improves internal and external communication.

- It evaluates the feasibility of plans and their sensitivity to different assumptions.
- It can help to discover and anticipate problems and limitations, as well as helping to discover and evaluate opportunities.
- It can help in acquiring funding.
- It forces management to take an integrated approach to addressing production, operational, financial, marketing and human resource issues.
- It requires an assessment of capabilities and a clarification of vision, goals and direction.
- It makes projections more realistic.
- It increases the involvement of and interaction between the current CEO and the successor, as well as the rest of the management team.
- It builds the commitment to something specific.

The most successful businesses also recognize that the business plan isn't a once and done document. It has to be continuously monitored against actual results and regularly updated to reflect changing conditions and circumstances.

If successors are going to develop and improve their decision making skills, then they need to learn from their mistakes. An important part of that process involves performing autopsies on the results of key decisions, whether things went well or poorly. This requires digging deep enough to determine why things turned out as they did. What was overlooked, what assumptions were wrong, what should have been done differently, were there mid-course adjustments that could and should have been made, and if external factors or conditions were the cause, are there any leading indicators or more detailed information that needs to be considered in making future decisions? Most important, what did they learn?

Another increasingly critical part of a successor's education is the development of negotiation skills. The ability to negotiate touches almost every facet of a business, from dealing with input suppliers, lenders, landlords, customers, labor and even family members. The success of negotiations affects prices paid and received, the acquisition of resources, relationships, and terms of arrangements. More now than ever and likely even more so in the future, top managers have to be skillful negotiators. It is critical to a successor's development that they be included in these negotiations even if at first it is only as an observer.

Those who are most successful recognize the importance of understanding different negotiating styles and strategies, doing their homework, maintaining self-control, and having a walk away point. One approach won't work in all negotiations. They also recognize that strategies need to be situational and dependant upon circumstances, timing, personalities, relative bargaining power and whether its intended to be a one-time deal or long-term relationship.

Seminars, symposiums and other formal continuing education programs are another component in successor development. This includes both skills training and increased knowledge in areas identified in the transition plan and the performance appraisal process; but, it also needs to includes exposure to different perspectives, new ideas and alternative approaches. While it is important to participate in educational programs specifically targeted to farm/ranch operations, the most successful operations I know also make it a point to get outside their commodity, their geographic area and even agriculture as part of their continuing education. One of the things I tell everyone that asks me about The Executive Program for Agricultural Producers is that as much of what they learn will come from the other participants as it does from the faculty. In part this occurs because the participants are very business oriented commercial producers and agribusiness executives who represent the spectrum of agricultural enterprises and geographic regions throughout North America, in addition to a few international participants every year.

One of my biggest frustrations in teaching business concepts are people who have to have things put in terms of their enterprise, geographic area or industry before they can see how it applies to their situation. Someday they will either be out of business or working for someone else, because they are always going to be two steps behind the leaders.

### Providing An Outside Perspective

CEOs and successors in commercial farms and ranches are facing an increasing need for specialized knowledge to address internal management issues. At the same time, pressure is mounting to stay in touch with the business's external environment.

Successors also need to see how the rest of the world operates. Many of the most successful management transitions I have seen were those where the successor had worked elsewhere before coming into the business. Some family businesses actually require the successor to have from 3-5 experience elsewhere and to have earned at least one real promotion before they come back to the business. This experience lets them gain a broader perspective and allows them to see different management styles. It also gives them an opportunity to prove themselves in an environment where they aren't the "crown prince," "hired hand" or "the kid."

Another option that I have seen work is an internship, where the successor works for another successful operation for a period of time. These businesses may even not be in the same commodity or state. Internships allow the successor to build self-confidence and to be held accountable to someone other than a family member. It also allows the successor the opportunity to compare the internship operation with the home operation in terms of how people are managed and decisions are made.

If the business is large enough or includes more than one enterprise or lines of business, allowing the successor to assume responsibility for one part or location has also been an excellent training ground. Likewise, responsibility for or experience in the different management functions can help deepen the understanding and broaden the perspective of the successor. Obviously, in smaller operations one person may wear all the management hats and the opportunity may not exist. But even then, it is critical for the successor to gain actual experience working with finance, marketing, operations, production and personnel management. It is more difficult to manage things you have never gotten dirty doing or had the responsibility for.

The best managers I know recognize the importance of networking and the need for continual exposure to different perspectives and new ideas. They realize that however well their business is doing, there will always be a better idea or way of doing things. One of my favorite quotes is by Jack Welch, the former chairman and CEO of General Electric, who said "The only truly sustainable competitive advantage is the ability to learn and adapt faster than your competition." It is important to recognize that what he is referring to is continuous learning and improvement. Most sustained success comes from doing 20 things 5 percent better than from doing 1 thing 100 percent better. Remember, the future hall of fame baseball player with a .300 lifetime batting average only gets 1 more hit every 20 times at bat than the player who hits .250 and just manages to hang on.

I believe peer advisory groups can be a cost effective way to help both current farm CEOs and management successors address this issue, as well as providing a way to continue the never ending process of finding ways to become better managers. Even though the concept makes sense, groups are successful only if they are made up of the right people. The chemistry and trust between the members is critical. However, bringing together experienced people who have or are facing similar challenges can be extremely helpful. Peer groups are typically made up of 5-10 producers. Members are usually not neighbors or direct competitors. It also helps to bring together people with different strengths. Openness and candor are critical to getting the most benefit. Members of groups I work with often tell me they hear things they don't like to hear, but need to hear. That is where much of the value occurs.

If everyone is to get maximum benefit, they need to be honest, even what may seem brutal at times. Some groups use a professional facilitator, others rotate the discussion leadership among the members. Meeting are usually monthly or quarterly. These groups essentially allow their members to have a true outside board of directors or advisors made up of people who have skin in the game.

It is not a comment that is very politically correct, but flying with the eagles and not scratching with the turkeys is a very real issue in any business. CEOs and successors need to make sure they are seeking out and interacting with the successful people in their industry and not hanging out with the losers. This is essential for stimulation, motivation, and personal growth. Successful people challenge you and force you to think, they cause you to consider alternatives and they inspire you. Losers tend to be victims. Everything that goes wrong is someone else's fault. They jealous of success, they are tradition bound, they can't see alternatives, and they drag you down to their level.

The following are just some of the advantages a peer group can offer:

- In closely-held businesses, the CEO and other members of the management team also frequently view issues from the same vantage point. This tends to create blind spots and limit objectivity. Peer groups provide a way to overcome that problem.

- CEOs and successors need a "sounding board" for their ideas. Have they missed anything, are there alternatives they haven't considered and what are some of the implementation issues that may not have occurred to them? Peer group discussions can provide feedback on plans and ideas, explore what if questions, allow members to draw on the experience of others, and help provide greater insight and objectivity.

- A peer advisory group acts as an informal board of directors and provides members an opportunity for bouncing ideas off of their peers. Each group member brings their wealth of personal and business experiences to the table and provides an atmosphere of synergistic creativity.

- The ability to draw on different individual's strengths can benefit everyone involved. Within a group some people will have greater skills and interest in market analysis, some in personnel management, some in management information systems, others will be computer/technology buffs, and some will be strong in particular operational/production areas. Peer groups can offset weaknesses, complement strengths, and reduce the need to try to be good at all things as a manager.

- Business success takes vision and insight. Peer groups can help turn the focus away from the day to day issues and look at the bigger picture that can improve your odds of success.

- The psychological support can often be as valuable as the ideas gained. This may involve the encouragement needed to try a new idea or see something through to completion. It can also help in breaking out of an old mindset or offering the support needed during periods of stress or financial hardship.

- It can be very lonely being the manager of a small, growing business. Friends and family may not understand the issues that are being faced. However, every CEO or successor in a peer group has the same sense of isolation and can offer support and understanding in a way that no one else can.

- Peer groups can also provide access to the collective membership's sources of information, resources, and expertise related to specific problems or opportunities. This same expanded circle of contacts can also helping identifying new markets, supply sources, potential employees, and business opportunities.

- Coordination of field trials and the development of databases and benchmarks on marketing, production and comparative financial information can multiply the availability and usefulness of information, while reducing acquisition time and costs.

- Peer groups also provide an opportunity for needs-based training. Assume that several producers decide they need training in some area of personnel management, succession planning, process improvement techniques, financial analysis, options strategies, etc. The type of program and level of expertise they need might involve anywhere from 1-3 days, and the quality of the presenter might require charges of $3000 - $5,000 a day, plus expenses. Assuming that this type of program isn't available through their state's extension service, the cost for one producer could be prohibitive; but, shared by 5 - 10 producers, it could be very reasonable. In addition, the questions and perspectives of multiple participants will likely open up some possibilities and issues that wouldn't otherwise be discussed.

- A peer group offers a safe confidential environment where business owners can tell the truth about what is going on in their personal and business lives and get real answers to the challenges they face on an ongoing and daily basis.

- Frequently, successors in closely-held businesses either won't or can't always effectively challenge the ideas of the CEO because doing so can lead to conflicts which have spillover effects on business and/or personal relationships. In these instances, they need somewhere to get feedback on their point of view and to get help with ideas on how they might better approach the issue.

- One of the biggest challenge many business owners face is that there is no one to answer to. There is no boss or supervisor looking over their shoulder making sure that they have completed all of their tasks. There is also no one pushing them to set higher goals and take action to attain those goals. A peer advisory group can provide the accountability needed to assure follow through on commitments.

- It is incredibly easy for a business owner to stay within their comfort zone. There are two situations where peer groups can make a critical difference. The first is good times, when it is too easy to become complacent. The second is bad times, when the margin for error and window of opportunity are very small. A peer group allows the emerging and seasoned business owner to stretch beyond their current situation and set higher goals and reach them faster than they would on their own.

These groups need ground rules, and they need to have planned agendas to keep discussions on target and for everyone's benefit. Like partnerships or marriages, the members need to be able to give and take. People who can't accept concept constructive criticism or who can't admit they are wrong are not good candidates. Neither are those who are just there to take away and not give back, or those who try to dominate the discussion.

Because membership is by invitation, groups need to start out with a basis for removing members when there isn't the right fit or chemistry. Getting everyone's agreement up front is critical for amicable separations. There also needs to be a confidentiality agreement, so that all members, even those who leave the group are professional enough to respect the rights of the other members.

## Developing a Common Vision

The development of a common vision for the business includes addressing and working through the personal and family issues that are and will be involved. In part, this is because people, even from the same family, often have different goals, priorities and vested interests. We can talk about and strive for separating business and family issues and decisions; but, the reality is they are intimately connected. This is even more true when some of the owners are actively working in the business and some are essentially outside investors. Everyone may agree on the costs and benefits of a decision, but still disagree on what to do because of the sharing of risks and rewards. Those working in the business tend to be more focused on reinvesting in the business and future growth, while those outside the business see it more as an asset on their balance sheet which isn't generating much of a return. Even within the business, the current CEO and the successor may also differ because of the stage in their life cycle. The current CEO often has more equity at risk and is concerned about long term security, particularly if his retirement is going to be funded out of the business.

One exercise that I encourage both the CEO and the successor to do is for each to independently write out their thoughts in response to the questions in the following seven areas, and then share and discuss their ideas:

Core Values

-What is important to me?
-What is acceptable?
-What is not acceptable?

Vision

-What does my future for the business look like?
-What do I want from the business?
-What do I hope will happen?
-What am I afraid might happen?

Mission

-What is the purpose of the business?
-Why am I here?

Goals

-What do I want the business to accomplish?

-What do I want to do or achieve personally?
-What sacrifices am I willing to make in order to make it happen?

Objectives
-How will I measure both the business's and my own performance and progress?

Strategies
-What is my plan or approach for accomplishing the goals I have set out?

Tactics
-How do I propose to implement these strategies?

Some of those reading this will see it as too academic or touchy-feely. I can only tell you that the leaders of some of the most successful family businesses in the country have gone through the exercise and learned a great deal from it.

## Performance Evaluation

Constructive performance evaluations are essential for successor development. Unfortunately, traditional performance appraisals tend to be just the CEO telling the successor what he thinks the successor did well or needs to improve on. This approach is often ineffective if the CEO avoids issues that may be taken as criticism, if it results in a confrontation or the successor becoming defensive, or if it leaves the successor feeling they have no input. Stated another way, performance appraisals can take on a parent:child tenor rather than being a business opportunity the helps the successor grow.

An alternative approach is known as the negotiated performance appraisal. This approach is not about pay, it is a coaching tool, it is about performance improvement, promotes two-way communication, provides feedback to both the CEO and the successor, puts on burden of analysis on both parties, and clarifies what needs to be done.

Feedback is a critical and necessary part of successor development. The successor, as do all employees, needs to know how well they are performing, needs positive feedback and validation on a regular basis, and needs input on how to improve.

The negotiated performance appraisal approach begins with both the CEO and the successor preparing separate lists prior to the actual performance review. The CEO's list addresses where the successor is performing well, where they have shown improvement and areas where the CEO would like to see improvement. The successor's list addresses areas where they believe they have performed well, areas where they think they have improved, areas where they think the CEO would like to see improvement, and what they would like to see the CEO do to help them be more effective. These lists are then exchanged prior to the review discussion.

The focus of the review session is then on recognizing the successor's strong points, reaching agreement on areas where improvement is needed, laying out the specific steps that are needed for improvement to occur, setting realistic goals, and solving the problems that are identified.

This approach addresses two basic problems that are often stumbling blocks to effective appraisals. The first is that if the person being reviewed knows of their weaknesses, they prefer to point it out themselves. The second is that it helps the CEO identify ways they can be more effective in helping the successor develop their fullest potential.

## Concluding Comments

It does happen that the successor: 1) isn't capable of handling the position - they either don't have the ability or the right talent set, 2) the CEO position just isn't a good fit - they may be very talented in and passionate about production, marketing, finance, etc., but not be a good CEO, and 3) some very capable successors actually don't want to be there or don't want the responsibilities that go with the CEO position. The reality is that some successors come back to the business out of a sense of guilt or loyalty or to avoid being disinherited. Others come back because it was the path of least resistance or they couldn't get another job that offered the same opportunity or lifestyle somewhere else.

Ultimately, it is people rather than things that take a business from good to great. Two pioneering management studies, both published as best selling books, *Good to Great* and *First Break All the Rules: What the World' Greatest Managers Do Differently*, reached the same conclusion. Businesses became great by getting the right people, in the right jobs, doing the right things and getting the wrong people out of the business.

In some cases the problem of choosing the right successor occurs because it is impossible for some parents to be objective when assessing the skills, abilities and competencies of a child. Although less frequently than in the past, primagenture may have been the problem. That occurs when the eldest son automatically becomes the chosen one, when a daughter, a younger son or an in-law might be more capable.

Relationship and communication issues aren't limited to those between the current CEO and the successor. Spouses, other children in the business, key employees, children not working in the business but with an ownership interest, grandparents, and in-laws can all represent relationship landmines that can unravel the best of plans.

It also is not always possible to follow the transition timeline, i.e., the successor assuming full control when the current CEO retires. Everyone and everything may be on the right path, they just may not be there yet. The death or disability of the current CEO can and often does happen too soon. Even then, the more forethought, contingency planning and successor development that have occurred can reduce the adverse affects on the business.

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# Ten Best Management Practices

Danny Klinefelter

This isn't a top 10 list; but, they are things that any producer can do but that 95 percent of producers don't. If you're looking for an edge or ways to get better, these would be a good place to start.

1. Coordinate revenue and cost management. Too many producers treat input and commodity pricing as separate issues. Every lending institution has an asset:liability committee (ALCO). When they price loans and set loan terms they consider their cost of funds, and their ability to match fund the loan for the period the loan rate is set or their ability to sell the loan so that someone else bears the risk of the cost of funds changing. Similarly, farmers who locked in $900 a ton nitrogen may not have been unprofitable if corn was forward priced at $6 a bushel. Anyone can get lucky occasionally, but trying to outguess the market is a fool's game. Focus on managing margins. Locking in commodity prices based on what you think costs will be or locking in costs based on what you think commodity prices will be isn't managing margins, it's speculating. The best grain marketer I know uses a pricing system where he never hits the market high, but he always covers his costs. He has been farming over 30 years and says there is enough volatility in the market that there has never been a year where there hasn't been at least one opportunity to cover all of his costs with 80 percent of his 5 year rolling average yield.

2. What if scenarios and sensitivity analysis. This is simply contingency planning. Think about what could go wrong and what you'll do if it does. Any good coach or general prepares a game plan or battle plan that considers alternative strategies to deal with different situations. The average manager may plan, but they tend to limit themselves to most likely outcomes and don't spend enough time on contingency planning. Family business consultants often talk about the need to plan for the 4 Ds - death, divorce, disability and departure, and doing it at a time when things are going well so that the discussions are less threatening and emotional. In addition to these areas, crisis plans can be developed to address such questions as:
   * What if we sold the farm/ranch?
   * What if we had a major disease outbreak?
   * What if a key non-family manager suddenly quit?
   * What if we lost a major contract or our biggest land lease?
   * What if our lender discontinued financing us?
   * What if our major supplier or buyer went bankrupt?

3. Monitoring and analysis. The most successful managers spend a great deal of time on monitoring and analyzing performance. They are much more likely to spot problems and opportunities before its too late. Business problems are like a cancer, they eat away at profits, cash flow and owner equity; but, spotted and treated early enough, they are often treatable. Good decision makers always use two analytical skills in solving problems. The first is perspective - they look at things from multiple frames of reference. And second, they always look for the heart, i.e. the cause, of the issue. The reason they don't jump to conclusions is they have learned that every complex problem has at least one solution which is simple, obvious and wrong.

4. The 80:20 rule. This is simple recognizing that 80 percent of what we accomplish is produced by 20 percent of what we do. The management principle is one of doing first things first. Most people never accomplish their goals because they spend too much time doing second things first, i.e., what they know how to do, what they like to do, what is easiest to do and what is urgent. The most successful managers have figured out what the 20 percent are, established priorities and then put most of their time and resources into doing those things first. As much as possible, the other 80 percent get delegated to someone else or outsourced.

5. Autopsies. This involves evaluating the results of key decisions after the fact, whether things went well or poorly. What was overlooked, what assumptions were wrong, what should have been done differently, were there mid-course adjustments that could and should have been made, and if external factors or conditions played a part, are there any leading indicators or more detailed information that needs to be considered in future decisions. Most important, what did you learn? The objective is to cut down on repeating the same mistakes.

6. The 5 percent rule. Numerous studies have found that most sustained success comes from doing 20 things 5 percent better than from doing 1 thing 100 percent better. It is also true that the top quarter of producers in terms of profitability tend to be only about 5 percent better than the average, whether in terms of costs, production or marketing. But, they do it over and over again. Remember, the multimillionaire, future hall of fame baseball player with a .300 lifetime batting average only gets 1 more hit every 20 times at bat than the player who hits .250 and just manages to hang on.

7. Benchmark your performance. Most producers have no real clue how well they stack up against their competition. The majority think they're

average or a little above. That's not possible. It's also not enough to know how you're doing compared to the average. How do you stack up against the top 25 or the top 10 percent. Numerous university studies have found $100 or more differences in net income per acre between the top 25 percent and the bottom 25 percent of farmers in the same region, producing the same crops even after adjusting for differences resulting from owning versus renting. A Kansas State study found about half the difference was due to revenue and about half due to costs. This information is available from various state farm business farm management associations, agriculturally oriented accounting firms and some agricultural lenders. Peer groups are another possible option. The best case scenario is to be able to compare information at the enterprise level. It's harder to come by, but worth the effort. Whole farm data can mask offsetting strengths and weaknesses.

8. Analyzing what to stop doing. The most successful companies and managers spend as much time analyzing and determining what they need to stop doing as they do evaluating new opportunities. This could be getting rid of assets, enterprises or people. It could also be land leases or contractual arrangements. In other cases it may involve eliminating unnecessary operating practices or procedures.

9. Use accrual adjusted income not cash basis to evaluate profitability. Cash basis income is great for simplicity and tax management; but it is a poor way to measure the true profitability of the business. Cash basis income often lags accrual by 2-3 years in terms of recognizing either downturns and upturns in profitability. That's often too late to respond. Measuring accrual adjusted profitability doesn't require an accrual accounting system, it simply requires having balance sheets prepared as of the beginning and end of the period for which cash basis income is measured. The balance sheets need to include inventories, accounts receivable, prepaid expenses, accounts payable and accrued expenses. From there the adjustment process is a matter of arithmetic. Almost all state extension services and the recommendation of the Farm Financial Standards Council can provide information that describes the process.

10. The E-Myth principle. Every business has four constituencies: employees, buyers, input suppliers and funding sources. The objective is to do some grassroots research and find out the top 3 or 4 things are that most frustrates each of these groups in dealing with businesses like yours. If you can eliminate or reduce several of those frustrations, you can become the supplier, customer, tenant, employer or borrower of choice.

# Twenty-Five Attributes of the 21$^{st}$ Century Farm Executive

Danny Klinefelter

The Executive Program for Agricultural Producers (TEPAP)* has given me the opportunity to get to know some of the best farmers and ranchers in North America. But, even among this group, there are some that stand out. It's clear that being a top producer, focusing on controlling costs, keeping good records and having a sound marketing program are all essential to being a good manager; but, these characteristics alone aren't sufficient to describe those who are setting the standard for those who want to remain competitive and successful in the future. Based on my observations along with input from the TEPAP participants and faculty, this article discusses twenty five attributes which set the top managers apart.

1. Jim Moseley, who has been both a successful farmer and Assistant Secretary of Agriculture, says, "You have to look at the environment you're working in and make sure you're fitting in. You can't force the environment to come to you - you have to go to it."

   The top managers anticipate and adapt to the changing needs of their markets. They see themselves as sellers and their buyers as customers. As obvious as that seems, most farmers see themselves as the customer, even of the businesses they sell to.

   I've noticed two distinct characteristics of the best managers when it comes to positioning their business: first, they are more focused on producing value than quantity and second, they are always looking at emerging trends and developments at least 2 steps up the value chain. The grain elevator may buy their crop, but it's the processor, the retailer and ultimately the end consumer who determine where things are heading.

   Remember, the future will always belong to those who see the possibilities before they become obvious.

2. I serve as executive secretary for the Association of Agricultural Production Executives (AAPEX). At our annual meeting we often invite one speaker who represents a position that is diametrically opposed to that of most of our members. Our objective isn't to change their mind

or for them to change ours, but rather to seek to understand.  Two years ago, for instance, we had the former head of International Greenpeace on the program.  This is one example of a characteristic of top managers, and that is that they are more open to exploring new ideas and different points of view.

We all like to think we're open minded, but in reality we're conditioned and limited by our beliefs and biases.  The top managers, however, tend to consider a wider array of alternative perspectives before they form an opinion or make a decision.  For example, many conservatives listen to radio personality Rush Limbaugh.  Liberals on the other hand are more likely to read newspaper columnist Molly Ivins.  In the process, they reinforce their biases and beliefs.  The top mangers on the other hand are more likely to listen to both, even if they personally agree with one more than the other.  The reason is that they recognize that half the population sees things from the other point of view and they need to understand that perspective, because it's reflected in their markets as well as the political and social environment they operate in.

We all see things through a filter. Make sure yours isn't creating too many blind spots.

3. It's critical to success to have access to new information, different points of view, and insights from outside the business.  I think that's one of the primary benefits participants get out of attending The Executive Program for Agricultural Producers (TEPAP).  I tell anyone who inquires about the program that regardless of how good the faculty is, at least half of the benefit they receive will come from what they learn from the other participants.

The top managers realize the importance of networking and developing alliances across the value chain.  Many of these are information networks not just business arrangements.  They range from formal organizations such as AAPEX, to password protected internet discussion groups, to peer advisory groups.  The objectives vary from environmental scanning, a critical element in strategic thinking, to information seeking, to opportunity identification, to serving as a way to obtain critical feedback.

We need to recognize that learning is much more than the absorption of knowledge.  It's seeing the world simultaneously as it is and as it can be, understanding what you see and then acting on your understanding.

Unless you have an appetite to absorb new and potentially unsettling things, you won't learn many of the things you'll need to know in order to be successful.

4. Wayne Gretsky was once asked by a reporter what he thought accounted for his success. He recognized that he wasn't bigger, stronger or faster than most of the people he played against. Gretsky believes that what made the biggest difference was that most players were always going where the puck was, while he always tried to go where it was going to be. This is a classic example of strategic thinking.

   Top managers are strategic thinkers. They realize that in order to be successful, they first have to decide what they want to accomplish and then let that determine how they go about doing it. Strategic management is all about anticipating, driving and capitalizing on change.

   Most farmers are good at tactics and operations. If they weren't, they wouldn't still be in business. While these tasks need to be done, there is a distinct difference between operational and strategic thinking. Think of the example of building something. The operational manager says these are resources, skills and tools I possess, now what can I build with them? The strategic manager on the other hand says, what is it I want to build, then he decides what resources, skills and tools he needs in order to build it?

   It's an old cliche, but it's all about the difference between doing the right things versus doing things right. A lot of failures have been businesses who were doing something very well, but that were no longer relevant or what the market wanted.

   In order to be successful, you first have to be doing the right things.

5. One of the worst mistakes a manager can make is to put together a team of clones of himself. It's like putting together a football team. Every coach would like to have several 6'6" 300 pounders who run 4.7 40-yard dashes and bench press 500 pounds, but he wouldn't want 11 of them on the field at the same time. A major factor in putting together a winning team is the ability to put together the right combination of talent.

   That's why top managers have to have the ability to objectively assess strengths and weaknesses in people, including themselves. Then they build on their strengths and compensate for their weaknesses. This may mean hiring someone with the abilities they don't possess, forming an alliance with someone who is strong in the areas they aren't, or outsourcing. The book <u>First Break All The Rules: What the World's Greatest Managers Do Differently</u> identifies two very profound conclusions about the best managers. The first is they have the ability to identify a person's talents and then find the right job fit. The second is that almost all their focus is on building on a person's strengths, not on fixing their weaknesses.

Remember, picking the right people is half the job. The other half is figuring out how to make diverse people and elements work together. Only then can the whole be greater than the sum of its parts.

6. There is an old saying "if it isn't broke…don't fix it." However, Tom Peters in his book <u>Thriving on Chaos</u> argues, "If it isn't broke…you probably haven't looked hard enough!"

The top managers operate in a continuous improvement mode. They're never satisfied because they know there is, or soon will be, a way to do better.

Rather than looking for a way to do one thing 100 percent better, they focus on doing 100 things 1 percent better, day in and day out.

Exceptional managers not only believe in the necessity of making mistakes, they see them as virtually synonymous with growth and progress. If someone hasn't failed, they haven't tried very hard. The objective is just to never pay twice for the same mistake.

It's important to recognize in this rapidly changing world, that in order to stay ahead, the internal rate of change in the business needs to exceed the rate of change in the business's external environment. If it doesn't, the business is falling behind even though it may be moving forward.

One of my favorite quotes and one that the best managers I know live by, is a quote from Jack Welsh, the former chairman and chief executive of General Electric, who said " The only truly sustainable competitive advantage is that ability to learn and adapt faster than your competition."

Remember, if it isn't broke…maybe it's because you haven't looked hard enough!

7. The issues surrounding identity preservation and food safety are putting increasing pressure on all of agriculture to move in the direction of coordinated production systems. While many farmers are resisting because of the loss of independence, the most successful farmers I know are looking for the opportunities and are proactive in developing relationships. They're concerned that in the near future a lot of farmers are going to find themselves on the outside looking in, with access to markets and proprietary technology cut off when processors and retailers reach the point where they're working with only qualified suppliers. A major bioterrorism or food safety event could accelerate this trend.

   The managers who are best able to adapt to these changes are those who see things from a systems perspective and look at their farming operation as a biologically based manufacturing plant. This perspective makes it easier for them to see how things fit together both within the business and across the value chain. They recognize that most of the inefficiencies and risks occur at the interfaces between the stages. It also means that many of the economic opportunities and advantages lie in reconfiguring and coordinating the steps in the process. This includes such things as improving alignment, combining steps, standardizing operating procedures, shortening transmission time through better and more open communication, and adopting anytime intervention technologies. Poultry and swine integrators are prime examples. Dairy and vegetables aren't far behind.

   Unfortunately, too many people tend to change only when they feel the heat, rather than because they see the light.

8. One of the most successful seed corn producers in the U.S. also farms in South America. But, what most people don't know is that he consulted with growers in South America for two years and brought the agronomists who now oversee his operation in South America up to work in his U. S. operation to learn how he runs his business before he ever planted an acre. In other words, he did his homework before he took the plunge.

   Top managers are always attempting to push the envelop back by trying something new or different, but at the same time they are calculated risk takers and excellent risk managers.

I know many farmers who look at those who are more successful and think they've just been lucky or haven't faced as many setbacks. The reality is that those who are most successful have generally made more mistakes than the average farmer, because they've made more decisions and tried more things that someone else hasn't done before. They've just been quicker to recognize and fix their mistakes or cut their losses, and then capitalized on their successes.

The best managers do their homework, consider their options, complete with the possible pitfalls and traps, and develop a strategy before any major undertaking.

9. A friend of mine in Illinois says that one of the things he has learned about producing specialty grains under contract is that the moment he gets one contract, he needs to be looking for the next one, because within three years enough other producers will come in to drive the premium down to the point where the crop becomes just another commodity.

   Top managers are opportunistic, because they recognize that in business and in life, timing is everything. Timing doesn't relate just to knowing when to get in, it also deals with knowing when to get out. In fact. One of the key points in the book *Good to Great* is that the best companies spend as much time analyzing what to stop doing as they do analyzing new opportunities. This is going to become even more important as the rate of change becomes exponential rather than linear. Management experts call those moments at which sharp growth or sharp declines occur, tipping points.

   The money made and lost on exotic animal species such as ostrich and emus have been good examples.

   Unfortunately, the average farmer tends to jump on the bandwagon after the early adopter profits have already been made and then frequently doesn't get out until he's forced to.

   Remember, even if you're on the right tract, you'll still get run over if you sit there too long and even the right decision is the wrong one if it's made too late.

10. In the family business management program I co-direct at Texas A&M, we talk about "fire drills" around the 4 D's - death, divorce, disability and departure. The focus is on scenario analysis, where everyone sits down and agrees on the best course of action at a time when there isn't

a crisis.  This same approach can be extended to developing strategies for dealing with such things as the loss of a major contract or tract of land, a change in farm policy or being denied credit by your primary lender.

The top managers spend more time thinking about "what if" scenarios and developing contingency plans.  They don't dwell on the negative, but they consider what could go wrong and what they'll do if it does.  It is no different than what successful coaches and generals do when they develop game or battle plans.  The average farmer may plan, but they tend to limit themselves to most likely outcomes and don't spend enough time on contingency planning.

Whether it's cards, chess or business, every entry strategy should have an exit strategy.

11. The best managers I know seek out people they respect and can be open with.  Many are members of a peer advisory group or have an outside advisory board, or both.

    The top managers are more likely to seek input and expertise from outside the business.  They recognize the limitations of being at the top of their industry.  For example, if you're the best producer of a particular commodity, how much are you going to learn from other producers of the same commodity.  They may learn a lot from you, but what you're able to learn from them may be limited.

    Southwest Airlines is a good analogy.  Southwest isn't the largest airline, but financially it is probably the most successful.  One of its advantages over its competitors is that it has the fastest turnaround time in the industry.  In part this is because they fly only one type of plane, in part it is a function of their boarding system.  So where is one of the places they turned to look for ways to get better?  Certainly not the other airlines.  Obviously, it wasn't just a matter of speed, passenger safety and aircraft maintenance also had to be considered.  The answer is an Indianapolis 500 pit crew boss.  He's responsible for changing tires, refueling, servicing the engine and taking care of his driver while getting the car back on the track in a matter of seconds.  I don't know what Southwest learned, but they surely weren't limited in their thinking.

    Remember, thinking outside the box frequently requires getting outside the box and that may mean your commodity, your geographic area or even agriculture for that matter.

12. One measure of success is not whether you have tough problems to deal with, everyone has problems, but whether your problems are the same as last year. Colin Powell, quoted in *The Black Collegian* says, "There are no secrets to success. It is the result of preparation, hard work and learning from failure."

    The top managers see change and challenges as opportunities, and don't tend to view themselves as victims. They don't enjoy adversity, but they recognize that setbacks are a part of life. They learn from setbacks, make adjustments and move on. They don't get bogged down in self pity, complaining or blaming someone else for their problems. For one thing they realize that problems and change create opportunities for those who figure out how to solve them first and are prepared to act.

    I tell my students and the farmers I work with that the true measure of the individual lies in how they react and respond to adversity. While we are frequently not responsible for what happens to us, we are totally responsible for how we react and respond.

    Remember, Walmart's Sam Walton was originally a small-town main street merchant of the type he is criticized for displacing. The difference is that he was an excellent leader who was able to solve problems and willing to change rather than go out of business.

13. Leadership revolves around vision, ideas and direction, and has more to do with inspiring people than with day-to-day implementation. Top managers recognize that their ability to attract and motivate people will in large measure determine how successful they are. A leader is great, not because of his power, but because of his ability to empower others.

    When it comes to managing people, the top managers see themselves more as the head coach than the boss.

    The best leaders recognize that all people have some things in common: they like to feel special, so they acknowledge them; they want a better tomorrow, so they show them hope; they desire direction, so they navigate for them; they are selfish, so they speak to their needs first; they get low emotionally, so they encourage them; they want success, so they help them win.

    J. Paul Getty once said "It doesn't make much difference how smart, how much knowledge or how much experience an executive possesses; if he is unable to achieve results through people, he is worthless as an executive."

14. The Standardized Performance Analysis summary of 400 cow-calf operations over the period 1991-2001 found that the annual net income per cow averaged a positive $144.65 for the top 25 percent and a negative $233.24 for the bottom 25 percent. In analyzing the data, one of the things that stands out is that it wasn't just one thing that accounted for the difference, it was a combination of factors.

    The top managers approach to business is more balanced between the business's key performance areas. This includes production, marketing, finance and personnel management. While they may not be at the top in every area, they are consistently above average. If not, they either hire someone who is, outsource, or form an alliance to compensate for their weakness.

    During the farm financial crisis I worked for the Farm Credit System. One of the things that struck me was that even during that period some farmers were very profitable. So when I returned to the university, I was curious what the difference was between those who had done well and those who struggled. Using 1982-1987 data and information from several lending institutions, what I found was the top 25 percent of producers averaged about 5 percent better than the overall group in terms of yields, cost per unit of production, returns per dollar invested in machinery and equipment, and average "net" price received for the commodities they produced. The bottom 25 percent, on the other hand, were about 5 percent worse than the overall group on these same performance measures. While the differences were marginal in each performance area, net income after taxes averaged a positive $50,000 per year for the top group and a negative $25,000 per year for the bottom group. That means that over the six year period, the net earnings of the top 25 percent totaled $300,000 while the net losses of the bottom 25 percent totaled $150,000, a difference of nearly a half million dollars.

    Remember, the future hall of fame baseball player with a .300 lifetime batting average gets only 1 more hit in every 20 times at bat than the player who hits .250 and just manages to hang on.

15. Typical producers tend to treat planning and analysis as a beginning and end of the year exercise. Even then most of them see this as more of a chore than an opportunity.

    The top managers spend a great deal of time on monitoring and analyzing performance. By doing so, they are much more likely to spot problems and opportunities before its too late. They are also more likely to be treating the cause and not just the symptom of a problem.

One of the things that better managers consistently do in their analysis is look at multiple frames of reference. This approach not only reveals more, it also provides a much more accurate picture.

The top managers are always digging into things. For many, analysis is almost an obsession. Not only are they trying to spot problems, they're also looking for opportunities and ways to improve performance. Another distinguishing characteristic is that when there is a problem their first impulse is ask why, not who. This approach is more likely to reduce treating the same problem over and over. It also increases the likelihood of repeating successes. By not always trying to attach blame, they also tend to engage everyone in the organization in an ongoing analysis process. They're also more likely to hear what they need to hear, not just what employees think they want to hear. This sort of company wide attitude is at the root of continuous improvement management.

As a general rule, the most successful person is the one who has the best information.

16. Sports abound with examples of the stars who excelled under pressure when the emotion of the moment tended to work against their lesser opponents. Michael Jordan in basketball, Tiger Woods in golf and Joe Montana in football all used pressure situations to improve their focus and perform at an even higher level under pressure. The best managers are the same way.

Top managers decisions are based more on reason and judgement, and less on emotion. That doesn't mean they aren't emotional, but that they have the ability to set aside their emotions when they are making decisions or dealing with people.

They also know that there is a difference between emotions and intuition. Emotions are a psychological reaction, intuition relates to insight and a gut feeling born of experience. The best managers learn to trust their intuition, but at the same time never believe it is enough.

They recognize and understand emotions, both their own and others. Numerous studies have shown that emotional intelligence is more important than intellectual intelligence in determining success.

Remember, in terms of competence, there are three types of people: those who can see what needs to happen, those who can make it happen, and those who can make things happen when it really counts.

17. Each year there are more that 2300 birds that collide with Jet engines. Pilots call these "bird strikes" and they represent a significant problem. In the past, Scott Air Force Base has been closed to incoming aircraft due to high populations of migratory birds landing on and around the runways. They experimented for years with high tech alarms and "bird bangers"; but, their efforts were in vain. Finally someone came up the idea to employ natures predator... the peregrine falcon. Armed with this new weapon, within as little as six seconds of releasing the falcon the runways were clear of the pesky black birds and starlings. This is an example of outside the box thinking.

    Top managers are more creative in their approach to business and seeking out ways to force themselves to think outside the box. They continually challenge existing paradigms, particularly when it comes to business arrangements. Anytime they hear someone say that's the way we've always done it, they know they have a competitive advantage. As Satchel Paige once said, "It's not what you don't know that bothers me, it's what you do know that just ain't so."

    One of my biggest frustrations in explaining business concepts are people who have to have things put in terms of their enterprise, geographic area or industry before they can see how it applies to their situation. Someday they'll either be out of business or working for someone else, because they're always going to be two steps behind the leader.

    The best managers are those that have the ability to adapt and apply the elements on one situation to another. The following are just a few examples. Some farmers now farm 24 hours a day by employing multiple shifts in order to more fully use facilities and equipment. Others have entered into shared equipment ownership with producers in different production regions to more fully utilize labor and equipment. Still others carry it a step further by diversifying their production and price risk over multiple geographic regions and market windows. The use of innovative financing arrangements and marketing strategies drawn from other business sectors is even more pervasive.

    The most successful farm executives I've met don't necessarily invent ideas, but they are able to put them in context and add perspective.

18. Peter Drucker, who is often called the father of modern management, says that 60 percent of all management problems are the result of poor communication. That's the reason top managers work so hard at communicating more effectively.

One of the biggest roadblocks to progress in any organization, large or small, is secrecy. Don Jonovic, president of Family Business Management Services, says that most family businesses aren't just closely held, they are hermetically sealed. He talks about making a presentation in which he discussed how information is passed from one generation to the next. After the presentation, a woman came up to him and said that he had missed the method that her husband used with their son. When he inquired what it was, she said "read my mind." Since then he has included it in every management succession seminar he has given.

Far too many owners and senior managers share information only on a need to know basis. Successors need to be able to share in the accumulated wisdom and experience of their elders. They shouldn't have to learn by osmosis or only through their own experience. Employees and family members want and need to know the answers to the following questions:

- What are they expected to do?
- Why are they doing it?
- How are they doing?
- How can they improve?

Top managers have also learned that employee buy-in and commitment requires a clear understanding, a shared vision and a sense of ownership. In addition to the answers to the four previous questions, there are four more that they make sure that everyone in the business knows.

- Where is the business headed?
- How does it plan to get there?
- What is my role?
- What's in it for me?

In regard to the latter question, it often isn't just money. It can be a chance to learn, to be recognized, to gain greater responsibility, to achieve more job security, or to be part of a winning team.

If employees and family members knew the answers to the eight questions discussed a lot of management and performance problems would either go away or be significantly reduced.

If a leader can't get a message across clearly and motivate others to act on it, then having a message doesn't matter.

19. Did you know that: 20 percent of our time produces 80 percent of our results, 20 percent of a business's customers produce 80 percent of the profits, 20 percent of employees take up 80 percent of a manager's time and when it comes to charitable donations, 20 percent of the people will give 80 percent of the money.

    The management philosophy of doing first things first is based on the Pareto Principle, more commonly known as the 80:20 rule.

    One of the things that top managers do which sets them apart is that they set priorities and follow through on them. The most successful are the ones who have figured out which those 20 percent are and then put most of their time and resources into accomplishing them. The other 80 percent get eliminated or turned over to someone else.

    The major reason most major goals are not achieved is because people spend most of their time doing second things first.

20. In his book, <u>Leadership Is An Art</u>, Max Dupree states that succession is one of the key responsibilities of leadership. Yet it is the one that the fewest leaders seem to learn.

    The top managers focus on the business's future. There have been too many businesses that flourished under one manager and then floundered or failed under the next because no one was properly prepared or the wrong person was selected to take over.

    Nearly all the farms I know are still closely-held family businesses and there are several things that I've noticed about those that have been successful over several generations.

    The first is that they don't take the desires of the next generation for granted. Too many business failures and personal tragedies have occurred because the next generation came into the business or dutifully assumed management responsibility simply to avoid disappointing their parents, to avoid conflict or to avoid being disinherited.

    These businesses have established a clear basis for successor selection. This includes the type and style of management needed, the necessary skills and attributes, and how the successor is expected to fit in and work as a part of the management team.

Finally, two closely related issues that need to be addressed are first, a plan for what the retiring manager will do next and second, identifying opportunities and addressing the issues that will be involved for candidates not selected as the successor. Without something meaningful and worthwhile to go to, many incumbent managers either can't or won't leave their position. It is also important that the business doesn't lose the talents and experience of unsuccessful successor candidates, that relationship problems do not result and that those who stay don't lose their motivation.

21. If you look at the lives of effective leaders, you'll find that they often don't fit the stereotypical mold. For example, more than 50 percent of the CEOs of Fortune 500 companies had C averages in college. Nearly 75 percent of all US presidents were in the bottom half of their class. And more than half of all millionaire entrepreneurs never finished college. So what makes it possible for people who might seem ordinary to achieve great things? The answer is passion, and nothing can take its place. It creates a positive attitude and it motivates them even in trying times.

Among the distinguishing characteristics of top managers is their passion and their attitude. They love what they do and they love doing it. Passion is probably the first step to significant achievement. It increases willpower, it changes the person and it makes the impossible possible.
There are too many setbacks and the road to success is too long to maintain the drive and the attitude needed to win without passion. But we need to realize that passion isn't just being enthusiastic or being a cheerleader. It's at the core of the person, it's the inner fire that drives them when there is no apparent reason to keep going. It's also the attribute that inspires others to follow.

The average person expects someone else to motivate him. He perceives his circumstances are responsible for the way he thinks. The truth is that attitude is a choice.

A leader with great passion and a few skills will almost always outperform a leader with great skills and no passion.

22. Albert Einstein, one of the most brilliant problem solving minds in history, once said “We can’t solve problems by using the same kind of thinking we used when we created them.”

One of the things that sets top managers apart is that they are excellent problem solvers. Those who are best at it demonstrate five qualities:

- They anticipate problems
- They accept the truth
  - Two of the major stumbling blocks for most managers are denial and blame.
- They see the big picture
  - They don’t allow themselves to get so bogged down in details that they lose sight of what’s important.
- They handle one thing at a time
- They don’t give up on a major goal when they’re down

They also have the ability to learn from their past experiences and mistakes, so that they don’t keep repeating them. And they have the ability to not only recognize existing contexts, but they are capable of visualizing future contexts.

Remember top managers always use two analytical skills in solving problems. The first is perspective - they look at multiple frames of reference. And second, they always look for the heart of the issue. The reason they don’t jump to conclusions is they have learned that every complex problem has at least one solution which is simple, obvious and wrong.

23. Over time, I have seen almost as many family businesses fail because of internal conflicts as have failed because of adverse economic conditions.

The top managers have learned how to resolve conflicts constructively.

It is important to recognize that even in healthy and successful businesses, disagreement is normal and inevitable. In fact, if the business is going to change and grow, it is essential. Henry Ford was once quoted as saying “If two people in business agree on everything, then one of them is superfluous.” The problems occur when a disagreement grows into conflict. Then all other issues may become secondary and it could become the business’s Achilles’s Heel. Unfortunately, conflicts are often suppressed or ignored without being properly addressed. Then they become a cancer that continues to grow. Under a strong authoritarian leader, problems may not erupt until the leader dies or turns over the reins. By then, the differences are often unreconcilable except through the legal system, in which case the only winners are the attorneys.

An important corollary to the issue of addressing conflict is learning to fight fair. This requires focusing on the development of both emotional maturity and interpersonal skills. At a minimum, there are five basic ground rules; avoid personal attacks, don't drag others into taking sides in the argument, don't use subversion, focus on the issue(s), and keep heated discussions in private.

Bullying or childish behavior may win battles, but the result may be that family relationships and/or the business end up losing the war.

24. The ability to negotiate touches almost every facet of a business, from dealing with input suppliers, buyers customers, labor and even family members. The success of negotiations affects prices paid and received, the acquisition of resources, relationships, and terms of arrangements.

More now than ever and likely even more so in the future, top managers have to be skillful negotiators.

Historically, the best negotiators were considered to be those who got the best end of the deal. Unfortunately, the party to the negotiation who got the short end of the stick often felt cheated or resentful.

Today, many negotiations involve arrangements and relationships that will be ongoing. In order to be successful, the results of the negotiation have to be seen as fair by everyone involved. Thus, the term win: win solutions.

Those who are most successful recognize the importance of understanding different negotiating styles and strategies, doing their homework, maintaining self-control, and having a walk away point. One approach won't work in all negotiations. They also recognize that strategies need to be situational depending upon circumstances, timing, personalities, relative bargaining power and whether its intended to be a one-time deal or long-term relationship.

25. While some might question whether it relates directly to business management, one of the things I've observed about those farmers that I judge as most successful is that they have learned how to balance their lives.

They love what they do, so it isn't a matter of having to get away from the business to have fun. The issue of balance relates to business versus family and developing outside interests.

I'm not just talking about annual vacation time. Although the business can and will be all consuming at times, healthy family relationships are essential if the business is to remain healthy over the long term. Time away and directed to other interests also allows people to be re-energized and re-focused when they return to work. Periodic extended absences by the business owner and members of the management team also allow potential successors to grow by assuming more responsibility. While business is a serious endeavor, businesses tend to do best and achieve the most when people enjoy what they're doing and are able to have fun in the process. Happy people are more productive, have higher energy levels and are more creative.

Remember, success is getting what you want; happiness is wanting what you get.

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# Evaluating Producers' Value Added Business Plans

by Danny Klinefelter

Low margins and volatile returns are causing an increasing number of agricultural producers to explore ways to gain more control over the market for their products. Many of the value added activities being considered involve alliances along the value chain and pooling or more formal cooperative arrangements between a group of producers. Unfortunately, for every one of these efforts that succeed, another fails. This article looks at just a few of the questions that need to be considered in analyzing producers' value added business proposals.

1. First and foremost, do they have a business plan that articulates their strategy and demonstrates the idea has been well researched? In addition to the typical components, does the plan realistically address the major "what ifs" and contingencies, including an exit strategy. A well defined vision is important; but, there is sometimes a fine line between a vision and a hallucination.

2. What are the business's goals and objectives? What are the sales goals? What is the breakeven level of sales? What are the objectives and expectations in terms of market share to be gained? What are the financial objectives? Is the business expected to achieve a specific rate of return on investment by the end of a certain year.

3. What are the overall market trends and forces driving expectations. In other words, what is the social, political and economic environment they will be operating in and how will it affect the proposed venture? Great ideas can fail simply because they are implemented at the wrong time or in the wrong place. In analyzing trends and drivers it is important to recognize that the rate of change can be exponential rather than linear.

4. Are they going to be in the commodity or differentiated product business? If it is a commodity business, the only source of competitive advantage is to lower costs or be able to gain some market advantage, through price discounts on inputs, price

premiums on output, or access to markets or contractual arrangements not available to others.

5. How is the market for their product(s) segmented? Has a profile been developed that identifies the primary and secondary customer groups for their product(s)? Who are their competitors? What business and marketing strategies do they employ?

6. If they are going to be competing in a product market, what is their value proposition and competitive advantage? As Jack Welsh is often quoted as saying, "If you don't have a competitive advantage, don't compete." They need to demonstrate how they are going to differentiate themselves and capture the value they create. What is their uniqueness? How can existing resources be used more synergistically? Is what they plan to do replicable? How likely and quickly might their advantage be replaced by new developments? This is basically a question of how competitive and sustainable is the proposition?

7. If their value added proposition is simply taking on another step in the value chain, do they possess or have they lined up the management capability (and backup) and experience needed to successfully operate the venture. Simply assuming an additional position in the value chain does not guarantee the same return or performance of the existing middlemen. There are skills, knowledge, relationships, and reputation (brand name or individual) that can determine the difference between success or failure.

8. Is there already excess capacity in the segment of the industry they are pursuing? If there is, they are inviting retaliation from the existing players. Who are the competitors, how strong are they and how are they likely to respond? A price war might totally change the venture's prospects for success.

9. If an investment in equipment and facilities will be required, how flexible are those assets? Do the assets have an alternative use and a viable market if the venture is unsuccessful? Will they be owned or leased? If leased, what are the terms ?

10. Can they provide the continuity and assurance of quantity, quality, and timing that potential buyers need? This may be seasonal if they have the ability to fill an off-peak niche.

11. If they are going to build a processing or handling facility, will it be of sufficient size and operated at a capacity utilization rate that achieves or exceeds competitors' economies of scale?
12. Is the venture's success dependent upon a single or a few buyers or suppliers of specific inputs? How viable are these critical partners and can they be trusted? Have they been involved in similar ventures with other producers and what is their track record? Will the arrangement involve a contract and, if so, what are the risks in the contract terms? How would a merger or sale of their principle customer/supplier affect the venture?

13. Does the business and it's products have a registered/protected name? Do any food products have a Universal Product Code (UPC) and will product labels require nutritional analysis and labeling?

14. If the venture will involve food processing are there plans for implementing a HACCP program and trace back system to address food safety issues and liabilities?

15. If the venture involves exporting have they addressed the issue of ISO 9000 and/or ISO 14000 certification?

16. If they will be acquiring an existing business, what direct or contingent liabilities will be assumed? Would they be better off buying the firm's assets rather than the business?

17. If a cooperative arrangement or alliance is involved and the venture requires a certain volume to be viable, what are the penalties if one or more of the participants decides to leave?

18. If the venture involves a legal structure with multiple investors is there a formal stockholder agreement or buy-sell? At a minimum it should address voting rights, the basis for valuation and transfer restrictions. Is there a repurchase provision or funding mechanism to protect the business while also providing investors some liquidity?

19. What are the risks and requirements associated with government programs and regulations? This includes everything from licensing, permitting, and compliance issues to the impact of subsidies and protection from competition in the form of tariffs or

quotas. What are the risks and likelihood of changes in programs or regulations?

20. Are there state or local economic development incentives in the form of abatements, financing, exemptions, etc., that they could be taking advantage of? What are the penalties if the terms of these incentive programs are not met?

The importance of conducting a comprehensive analysis is compounded by the fact that in addition to financing the project, many lenders will also be financing the member producers equity investment. It is possible, therefore, that directly and indirectly they could end up financing 100 percent of the venture.

# Where is Farming Headed?

By Danny Klinefelter[1]

Over the next 20 years, the Food and Drug Administration, the Environmental Protection Agency and the Homeland Security Agency will have more impact on how we farm than will the USDA. Food safety, environmental concerns and the protection of genetic patents, along with their attendant legal liability, are going to drive companies into integrated systems with the capability to monitor and track the production, processing and distribution system from the initial inputs to the end user. While the speed of this transition has slowed recently, a major food safety event or act of bioterrorism could accelerate it almost overnight. You can add to these issues the economic pressures to reduce acquisition costs, improve scheduling and asset utilization, provide greater quality assurance and reduce response time to changes in consumer demand. The result will be increased by vertical coordination of the supply chain through outright ownership, tight structured alliances and/or contractual arrangements.

But we already know all of that, the question is what will it mean for producers? Less independence for one thing. It will also mean increased documentation of nearly every step in the production process, which will be facilitated by new developments in monitoring, measurement, information and intervention technology. It will also produce a greater economic payoff to precision farming and remote sensing of technology. Flexibility and the ability to learn and adjust will be at a premium. In fact, one of the greatest potential sources of competitive advantage will be whether management can learn and adapt faster than its competition. As in virtually all segments of industry, the rate of change is becoming exponential rather than linear. Another critical factor in a business's long term success will be the ability to develop business enterprise entry and exit strategies which focus on getting in before the takeoff point and out before the value decay function heads south.

Other than for the true niche market entrepreneur, the future for many commercial farmers may lie in becoming a qualified supplier in one of the evolving value chains. While many will resist entering into these relationships because of the loss of freedom or because they believe the premiums offered are inadequate to offset the additional requirements, they may do so at their own peril. Over time, many of these qualified supplier relationships will evolve into exclusive rights of access to input and output markets, new technology, superior information and lower costs for related inputs and services. Like a marriage, the biggest risk for producers will be finding a partner they can work with and who will be around for the long haul. Exclusive franchise, dealership and distributorship relationships in other industries already possess these characteristics and there are a number of similar relationships that already exist in production agriculture.

For example, fifteen years ago, one of the best known firms in the food industry was contracting with 800 growers. Since then the number had dropped to 60 growers producing on slightly more acres than the original 800. The remaining 60 are those who were willing and able to expand, who produced the best and most consistent quality in a timely manner, who were willing to adjust to make the relationship work and who could do all this while continuing to become more cost efficient. They are also producers who were willing and able to expand into new geographic areas, because most are now multi-state growers.

But there is obviously a limit to how few producers a company can and will want to work with, unless it wants to move into direct ownership. Although some farmers and farm organizations are certain that is where things are heading, for many companies it won't be, at least not within the foreseeable future. For one thing, many companies do not believe they can do as good a job as their best growers. They also do not see production agriculture as the highest and best use of their capital. McDonalds, Anheuser Busch, and Ford have not found it to be in their best interest to own their own retail outlets. Yet, their franchises, distributorship, and dealerships have been widely coveted and very rewarding for many of their owners.

Once these value chain companies consolidate their supplier base to some critical mass, they will offer additional services both as a means of reducing their own costs by lowering their growers' costs and as a way to tie their growers closer to them. Self insurance pools and lower cost group insurance programs are one example. Another will be financing. This is one area where these companies would have a tremendous advantage over traditional lenders. They would have no marketing costs, they would not need additional physical facilities or personnel, they will have more information and better performance monitoring capabilities, their average loan size would be significantly larger, their borrower pool would be a select group of top managers and last but not least, they would control the source of repayment. In addition, many of these firms already have direct access to the nation's money markets.

It's not that our current open market system doesn't work. It's just that in many cases it works too slowly and too sporadically; plus, managing the liability issues in our litigious and media driven society is starting to overwhelm many other economic considerations. Consumers are also becoming more demanding in terms of both product and consistency and specific attributes tailored to their individual needs.

Two additional forces could also make it less advantageous to be a traditional commodity producer growing for the open market. The first is that in order to assure adequate supplies, the coordinated systems will plan to produce more than their anticipated needs. During periods of above normal production or below anticipated demand, the excess supplies will be even larger. If this surplus is dumped on the open market it will serve to destabilize the market and increase price volatility. While I am hopeful it will not happen, a backlash against GMO's in the U.S. similar to what has occurred in Europe would push the focus of new product development and production offshore into Asia, Africa and South America where population growth and the demand for food will be open to the adoption of new technology. U.S. producers who oppose GMO's primarily for the purpose of preserving their current way of life are likely unwittingly simply accelerating the speed of their own demise.

This article is not intended to suggest that these changes are good or bad, or that there won't still be a significant part of agriculture producing open market commodities; but, rather to reflect on some things that producers need to be thinking about as they develop their longer term business strategy.

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# Working Together

Danny Klinefelter*

Good communication and interpersonal relationships are imperative to overall business performance and sustainability.  Most managers understand the need to improve various facets of their business management practices. However, these two areas tend to be neglected or minimized in terms of their importance. Peter Drucker, often called the father of modern management, once said that 60 percent of all management problems are the result of poor communication. While poor business decisions can cause ultimate failure of a business, I have witnessed many closely held businesses torn apart and ultimately fail because of communication and relationship problems. Unless there is a major blow up, most outside observers never realize the underlying cause of the problems that manifest themselves in poor business performance. This article discusses what I see as the five most common communication and relationship problems.

The first problem is the dictatorship or as Don Jonovic, president of Family Business Management Services, describes it, the "der Fuehrer or el Jefe" management model. Everyone knows the management style I'm describing, "This is mine and if you want to work here or inherit your share when I'm gone, just do what I tell you. If I want your opinion, I'll ask for it ." If someone does own it all, that's obviously their prerogative; but, it is a management style that is best suited to a business in its last generation, because it is an extremely dysfunctional system for developing capable successors.

Unfortunately, a more open participatory management style goes against the basic nature of those who like the idea of being "boss" and being able to tell other people what to do. Being in charge and having the final say is one thing; but, some people seem to have a need to force their will on others just to prove they can and to make sure that no one forgets it.

On a personal note, when I was growing up, my dad used to kid my brothers and I anytime we would say "I think". His response would be, "How do you know what you think, I haven't told you yet." Fortunately for us, he wasn't serious. While we all knew the final decision was his, he was always encouraging us to "use our heads" and to come up with new ideas. When we did, he would talk them over with us to get us to explain our reasoning, to think about what the consequences might be, and to see if we had considered any alternatives. Unfortunately, I see situations all the time where the sentiment originally expressed is intended.

The second problem is of the biggest roadblocks to progress in any organization and that is secrecy. Don Jonovic says that most family businesses aren't just closely held, they are hermetically sealed. He talks about making a presentation in which he discussed how information is passed from one generation to the next. After the presentation, a woman came up to him and said that he had missed the method that her husband used with their son. When he inquired what it was, she said "read my mind." Since then he has included it in every management succession seminar he has given.

Far too many owners and senior managers share information only on a need to know basis. Successors need to be able to share in the accumulated wisdom and experience of their elders. They shouldn't have to learn by osmosis or only through their own experience. Key employees and family members want and need to know the answers to the following questions:

- What are they expected to do?
- Why are they doing it?
- How are they doing?
- How can they improve?
- Where is the business headed?
- How does it plan to get there?
- What is my role?
- What's in it for me?

The third behavior I see all too often is people who can't admit they are wrong. It is just as often true of the junior members of the management team as it is of those in senior positions. These individuals frequently resort to turning a difference of opinion into an argument. The result is that this tends to escalate the disagreement to the point where it becomes an emotional exchange rather than pursuing a rational discussion. This behavior generally produces one of three outcomes: 1) if the person being challenged has position power, he/she crushes the challenge to their authority, 2) both parties revert to childish behavior which accomplishes nothing but embarrassment and/or resentment, or 3) knowing the behavior that differences of opinion create, others simply give up challenging the person's ideas or assertions and much needed constructive discussion of issues, logic and decisions never occurs.

The fourth problem is unresolved conflict. This may be between people working in the business or between family members in the business and those who have an ownership interest but don't work in the business. These problems are like an insidious cancer that eats away from inside the business. If they are not addressed and resolved, they not only have an adverse affect on business performance, they can also be the landmine that prevents a successful transition of the business to the next generation. Fortunately, most states have some type of mediation program if people will take advantage of their services.

It is important to recognize that disagreement is normal and inevitable. In fact, if the business is going to change and grow, it is essential. Henry Ford was once quoted as saying, "If two people in a business agree on everything, then one of them is superfluous." The problem occurs when a disagreement grows into conflict. All other issues may become secondary and the conflict could become the business's Achilles' Heel. Unfortunately, conflicts are often never properly addressed. Under a strong authoritarian leader, problems often don't erupt until the leader dies or turns over the reins. But, by then the differences between the heirs are often irreconcilable except through the legal system, in which case the only winners are attorneys.

The fifth problem relates to learning how to fight fair. In order to learn how to do this, people need to focus on developing both emotional maturity and interpersonal skills. At a minimum, there are five basic ground rules: avoid personal attacks, don't drag others into taking sides in the argument, don't use subversion, focus on the issue at hand (i.e., don't dredge up old issues), and keep heated discussions in private. Bullying or childish behavior may win battles, but the result may be that family relationships and/or businesses end up losing the war.

When it comes to working with people, those who do it best tend to follow two basic rules: the Golden Rule, "treat others like you would like to be treated," and the Platinum Rule, "treat others as they would like to be treated." The Platinum Rule basically recognizes that everyone is different and reflects two of the habits Stephen Covey describes in his book *7 Habits of Highly Effective People*, "Seek first to understand, then to be understood" and "Think win-win."

I think the first is self-explanatory. It can help though if the parties involved have some understanding of personality style and generational differences. Many state extension program offer workshops on these topics. The win-win idea, however, is often misunderstood. It isn't based on compromise, but on fostering an attitude that is committed to finding solutions that will truly benefit both sides of a dispute. Solutions do not of course exist in themselves; they must be created.

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# Paying Family Members

Danny Klinefelter

A major source of friction in the family farm businesses I deal with focuses on compensation. There are a number of complex and often conflicting issues involved ranging from tax considerations to parental concerns. The issue is further compounded when there are both family and non-family members in management, and/or when some family members work in the business and some are employed outside of the business.

Craig Aronoff and John Ward, two nationally recognized experts on family owned business management, offer the following simple but very important advice to family business owners when establishing compensation policies, "Pay family members what the job is worth. If you want to otherwise enhance their standard of living or reduce your estate taxes, do it through gifting - preferably through private gifts outside the business."

Their point is that pay involves not only money, it also conveys a message. In order to keep the message clear, Aronoff and Ward suggest thinking of family remuneration in four parts:

1. A salary or wage for the job based on its market value.
2. Performance bonuses for meeting certain predetermined objectives.
3. Profit distribution (dividend or bonus) based on company profitability to reward ownership.
4. Parental gifts for estate planning and expressions of love for family members.

Parents invite trouble whenever their motives are unclear. Some parents underpay children in order to convey a parental lesson or to control their lifestyle. Others overpay them in order to buy their dependency or to provide for their grandchildren. By not recognizing or admitting their intent, parents can create an ambiguous pay rationale. Furthermore, as compensation levels become less justifiable and more arbitrary, pressures increase to keep information secret from other family members and employees. The results will almost always be detrimental to the business in the long run because values and trust are comprised.

There are two fundamental principles to keep in mind when considering compensation for family members.

1. Separate our reasoning and actions into three categories: What is appropriate as an employee, as an owner, as a family member.
2. Make sure communications and expectations are unequivocally clear?

# Causes of Farm & Ranch Failure

Danny Klinefelter

There were more farm failures during the 1980s than at any time since the 1930s. Financial stress was widespread, geographically, and affected all types of farms. Unlike previous agricultural recessions, however, the nation's general economy was relatively strong during the same period.

There were a number of studies examining the characteristics of farmers who have failed or experienced financial trouble. The following overview deals with those characteristics observed most frequently. The list is not presented in any order of importance or order of association with failures. Failures usually display elements of several, and in some cases, many of the characteristics discussed.

**Death or Disability of the Owner**

Many farm businesses are managed as one-man shows. Little financial information and almost none of the business decision-making functions are shared with others in the business or the family. There is seldom a plan for management succession or for developing backup management. Thus, when something happens to the only decision maker, many firms either fail or experience a traumatic adjustment process.

**Natural Disasters**

We generally think of weather when we talk about natural disasters. However, they also include such things as disease outbreaks (i.e., the 1971 corn leaf blight), severe insect infestations and environmental problems such as water pollution.

Because they can't change the weather, many farmers have largely ignored it in their planning and management. Top operators, on the other hand, recognize that successful business management is, to a large extent, successful risk management. Not being able to control a source of business risk does not mean that the business can't be managed to compensate for it and, in some cases, to capitalize on the risks involved.

For example, multi-peril crop insurance has been underutilized by many farmers experiencing financial stress, particularly given the level of federal subsidy involved. Frequently, farmers have been underinsured because they view insurance as an investment rather than a risk management tool.

Another characteristic associated with weather problems is increased market variability. Because markets tend to overreact on both the up and the down side, there has been a tremendous payoff to farmers who have taken advantage of the pricing opportunities presented. Yet only a few top farmers understand or have learned to effectively use the many pricing tools currently available, such as the futures and options markets.

Better managers employ production practices that reduce yield risks, maintain and use rainfall and temperature records, study commodity stock levels and carryover/use ratios for both the commodities they produce and their substitutes, consider preplanting subsoil moisture levels in selecting varieties and seeding rates, and analyze both projected cash flow margins and their historical variability. A high percentage of those who have failed due to weather related problems have done none of the above.

**Marital Problems**

The most obvious of these problems is divorce, which takes its toll on the business in many ways. The stress on the parties involved invariably leads to a reduction in the time and energy going into managing the business. The legal costs involved and the potential division of assets also can create financial stress. Even when a divorce does not result in the sale of assets or additional borrowing to meet the demands of the settlement, management quality often suffers. This can occur for a number of reasons, such as the loss of a key member of the management team, the involvement of more parties in the management process (sometimes without adequate knowledge or ability), outside interference by persons offering advice to the estranged spouse, and in some cases, the problems created by dealing through attorneys.

Even when divorce does not result, marital problems usually reduce the quality of management, if for no other reason than the emotional stress they cause.

**Speculation**

There is an old saying among commodity traders that “the markets have room for bulls and bears, but not for hogs.” The same is true for most markets. Too many people have gone into business or expanded without adequate planning, without adequately analyzing the added costs associated with the added returns, or without analyzing potential risks. Moreover, much of the planning that has been done has been based on inadequate research and information and on unrealistic expectations. Land buyers, in particular, have often relied on expected inflation, low real interest creates and expected capital gains to justify investments not supported by the investment’s repayment ability. This philosophy may have worked reasonably well for commercial real estate speculators who were willing to sell and take a profit when the market offered one, or who were willing to get out and cut their losses when things began to sour. Unfortunately, too many farmers become “married” to their land. Land ownership need to be more of a business proposition and less of a romance.

Another problem has involved looking for a pot of gold in alternative enterprises. For example, a major problem in fish farming has been the lack of adequate market research and the assumption that the market is virtually unlimited. Many agricultural commodities have a very inelastic demand and the response of market prices to rapid increases in production often have been dramatic. Demand is said to be inelastic when commodity prices decrease proportionately more than aggregate production increases, which results in a decrease in total revenue. “New” industries are particularly vulnerable. The problems are compounded by the fact that many of these enterprises require new skills and often more intensive management than traditional crop and livestock enterprises. The potential returns may be high, but so are the risks.

**Inadequate Information**

Most decisions are no better than the information they are based on. Unfortunately, too many farm businesses have poor recordkeeping and inadequate management information systems. The result has been that much of the planning and analysis that has been done can be described by the computer slogan “garbage in – garbage out.” The ability to use financial information to control costs, to spot and correct problems and to recognize profit opportunities has been a major factor in separating successful from unsuccessful farm operators.

One study of 300 Production Credit Association borrowers over a 4-year period found that, on average, they overestimated cash receipts by 15 percent and underestimated cash expenditures by 17 percent. The uncertainty in agriculture obviously caused some of this error. However, if the errors were purely a function of market and production variability, both revenues and expenditures should have been underestimated as often as they were overestimated. Too often plans are not based on accurate, well documented information, and instead involve too much wishful thinking.

This doesn’t mean that every farm needs to be on a computerized, double-entry accounting system. But for commercial farm business, management should have regular summaries of financial position and performance down to the individual enterprise level.

**Insufficient Monitoring**

Farmers need to realize that financial management is not just an exercise to be carried out at the beginning and end of the year. Rather, it involves keeping on top of what is going on in the business by comparing plans to actual performance and taking action when it is needed. From the financial standpoint, this includes comparing actual versus projected cash flows on a regular basis. Too many businesses have failed or developed serious problems simply because it was too late before the farmers or their lenders recognized that something was wrong.

Good financial management is more of a prevention than a cure. Regular monitoring and control can help prevent many mistakes; keep the mistakes that are made from becoming as big, help identify strengths, weaknesses and opportunities; and focus attention on the causes and not just the symptoms of problems. It doesn't guarantee success, but it does improve the odds.

**Overdependence Upon Collateral**

Both borrowers and lenders have been guilty of this. To quote agricultural consultant Roy Ferguson, "it's not borrowing money that gets people in trouble, its borrowing for things that can't pay for themselves."

The problem is that most borrowers and lenders have only gone half way in their analysis of repayment ability. They have limited themselves to analyzing annual cash flow projections and historical cash basis income. While cash flow is an important element of repayment ability, plans which are limited only to annual cash flow projections can be very misleading. An operation can be going broke and still generating a positive cash flow for several years by reamortizing debts, selling off assets (including inventories), increasing accounts payable and not replacing capital assets as they wear out (i.e., living off of depreciation). Moreover, because cash flow projections are based on expected values, the actual outcome can vary significantly. Too little effort has gone into evaluating the impact of alternative possible outcomes. Even when some attempt has been made to do so, it has usually involved evaluating a standard decrease in expected revenues, i.e., a 10 percent reduction. This is a first step, but it isn't specific to the performance history or risk inherent in an individual industry or business. In their planning and analysis process, farmers or lenders need to attempt to determine exactly how much of a decrease in revenues and/or increase in expenses the farm can actually withstand relative to both its net worth and its total cash flow commitments.

The neglected half of repayment capacity has been the evaluation of historical and projected profitability on an accrual basis. Numerous studies have demonstrated that cash basis income accounting can lead to lags of as much as 2 years in recognizing developing profitability problems. The reverse is also true, in that cash basis accounting delays recognition of profits during growth periods when the problem may be liquidity rather than profitability.

In any case, without sufficient inheritances, nonfarm income and/or asset appreciation to offset losses, in the long run a farm has to be profitable to survive.

We need to remember that equity isn't the only thing that can be too highly leveraged. During the 1970s, the debt/asset ratio for agriculture remained relatively constant because debt and asset values were increasing at approximately the same rate. Yet the debt/income ratio was clearly indicating that a major connection was going to occur. From 1970 to 1980 the debt/income ratio for agriculture increased from 3:1 to 8:1.

**Improper Loan Structuring**

Debt servicing problems often occur if the loan repayment period is not matched to repayment ability. This occurs most frequently when operating funds are used for capital purchases. But it has also been a problem when too much debt has been taken on for expansion or capital investment in response to favorable price levels. Both producers and lenders have too often ignored the fact that agriculture is a cyclical industry. Many failures have resulted building up term debt in the good times, without thought to the repayment capacity margin that will be needed to get through the less favorable times that will likely occur sometime during the repayment period. These unfavorable periods may be caused by natural disasters, lower commodity prices, reduced government program payments and higher input costs, including interest rates. Debt structure should be based on conservative repayment estimates. Prepayment, if results are better than projected, is much easier than attempting to refinance under unfavorable circumstances.

**Lack of an Effective Marketing Program**

Too many farmers have taken excessive price risks without trying to reduce uncertainty by using options, hedging, forward contracting, etc. Many failures have been based on "homerun fever" and the emotional reactions to what is going on in the market. A related problem has been that many producers don't even know their total cost of production or what their breakeven price is.

Rick Brock, who heads a marketing consulting firm for grain producers frequently makes the point that he knows farmers who spend $150,000 and 6 months producing a crop, then spend $1.50 on a farm magazine and an hour in the coffee shop talking to their neighbors to decide when to market it.

The problem is even more apparent for specialty enterprises. For example, one of the main reasons for failure among fish farmers has been the lack of attention to marketing. Unlike the markets for more traditional agricultural commodities such as cattle, corn or wheat, many of the markets for fish are not well developed, are very seasonal and/or are highly differentiated based on consumer preferences. Many producers have not adequately considered the availability, market power, financial stability or the specific requirements of potential buyers or processors. Unfortunately for them, specialty products usually require more emphasis on selling skills and greater use of contractual arrangements than do the more homogeneous agricultural commodities.

Producers also need to remember that the product pricing decision is not the only marketing decision. Purchasing inputs represents the other half of the equation. Buying right is the first half of any effective marketing program. If someone pays to much up front, they frequently can't get the margin they need when it comes time to sell.

Some producers have failed because they didn't consider the impact of substitutes for their products, or the effect that increased supplies would have on price. Economists refer to these as price elasticities. Many producers have made major capital investments requiring long-term financing based on the assumption that current price levels would continue, only to find that prices fell sharply as other producers came in or expanded in response to the same price incentive.

**Tunnel Vision Toward Production Technology**

Many of the producers who have failed or are in trouble have been considered by the farming community to be top farmers. This is largely because the general definition of a top farmer is tied almost entirely to his production ability, but attaining the highest yields does not necessarily result in the highest profits. Many top producers have neglected or not understood the financial and marketing aspects of management. More emphasis needs to be placed on marginal cost and return relationships in determining input levels. It is not that production is unimportant, but that economic analysis and management balance are too often lacking.

**Poor Production Management**

Although most sound production practices are well known, some producers fail to apply them. Some are not using the latest knowledge or technology, are sloppy in their production practices or are not timely in the things they do. While trying every new idea or tool that comes along can be disastrous, being too slow to adopt available technology also has been the undoing of many operations. “A day late and a dollar short” is not a bad management axiom.

### Poor Money and Time Management

Analysis of a large number of failures has shown that many farmers were spending too much time and/or money on non-productive and non-profitable assets and activities. In large measure, these problems resulted from a lack of planning and failure to establish goals and priorities. The old 80/20 rule is applicable to a wide range of situations. It refers to the fact that without well defined objectives and self-discipline, most farmers and ranchers will spend 80 percent of their management time on activities that produce and 20 percent of their profit and only 20 percent on those things that account for 80 percent of their profit. This rule also applies to the lack of balance often seen among the key areas of business management such as production, financial management, marketing and human resources.

Good managers recognize that things never go exactly as planned. Therefore, for every plan they have a backup plan in much the same manner that a successful coach develops a game plan using several different strategies. This contingency planning allows time to evaluate alternatives before events occur, and shortens the time it takes to respond to changing conditions. One of the most obvious differences between successful and unsuccessful managers is that those who are successful tend to be proactive and always thinking ahead, while the unsuccessful always seem to be reacting to the latest crisis.

### Failure to Control Living Expenses

This problem often arises when business and family goals and priorities are not established, or when there are conflicts between them. Rather than striving to maintain an absolute standard of living, the family needs to be willing and able to adjust its standard of living to business income. During periods of higher income, the family may be tempted to make major purchases such as a new home, more expensive cars and recreational vehicles. Then, if income decreases, these assets may have to be sold, often at a loss. Lowering one’s standard of living can involve a loss of social status and personal dignity. Many business failures have involved farmers who were either unable or unwilling to live within their means when income fell, and many profitable businesses have failed because the owner(s) took more out than the business earned.

### Emphasis on Tax Minimization

Financial problems can result when unnecessary capital investments or capital replacements are made to minimize income taxes without an adequate analysis of the impact on the farm's repayment capacity or profitability. The objective should be to maximize after tax profits over time, not simply to minimize income taxes in the short run. Most tax accountants have not considered, nor have they been paid to consider, the overall business management implications of tax minimization strategies. It isn't that tax management is unimportant, but that it should not be an overriding factor in the firm's overall financial management.

**Attempting to Support Too Many People from the Operation**

Many failures have resulted from a parent's desire to bring children into the business or to help them get started. In the cases studied, problems occurred because of the amount of debt taken on to expand the business, the increased risk resulting from higher financial leverage, and/or because family living withdrawals exceeded the net income of business. As problems began to develop, many parents had too much pride or sense of obligation to make the needed changes until it was too late. In many cases, children should have begun participating in the operation on a part-time basis while continuing full-time, off-farm employment until the business could realistically support them.

**Managing the Family in Business**

When several members of the family are directly involved in the business, management problems often occur. The most serious problems usually result from the lack of a clear division of responsibilities, the inability to separate personal feelings from business decisions, and unclear or conflicting goals and priorities among the individuals involved. The problems frequently involve not only the family members employed in the business, but also their spouses and other employees who are not part of the family.

When several family members are involved in management of the business, it may be difficult to objectively and fairly reward performance, especially if there is favoritism or if responsibilities are assigned on the basis of age or sex rather than ability. Also, there may be differences in philosophy and operating style. Parents often create problems when they are unwilling to delegate any decision making responsibility or at the other extreme, when they totally abdicate their authority in order to avoid hurting feelings. The goal of the family business should be to develop a team approach which recognizes and capitalizes on the different interests, skills and abilities of the family members involved.

## Lack of Management Ability

This may be the most difficult factor for an individual to recognize or to objectively assess, but it is critical. Many farmers have failed not from a lack of intelligence or hard work, but as in any other business, simply because they did not have the training, aptitude or ability to be effective managers in an increasingly complex and high risk environment. Problems also have developed when the business, or a new enterprise, was started on too large a scale allowed to grow too rapidly without allowing adequate time for management ability to grow with the business. Many farmers who have failed were excellent operational managers; but most have not been good businessmen, particularly in terms of executive management skills. Many of them have been unable to see the total picture of the farm business and have focused more on the symptoms than or causes of problems. Still others have been able to see only the big picture without paying enough attention to the necessary details. These individuals often made snap decisions, relying heavily on their intuition. When they failed they tended to blame everyone and everything but themselves. More than 60 percent of all new nonfarm businesses fail within the first 5 years, largely because of poor management. Is there any reason why commercial agriculture should be expected to be any different?

## Inadequate Attention to Personnel Management

One of the weaknesses of many farmers has been in the area of personnel management. Hiring practices often have been penny wise and pound foolish. Using the lowest cost inputs, including labor, is often a mistake. Cost needs to be measured against quality and productivity. As non-farm businesses have learned, the strength of a business is in its people. Hiring quality employees and rewarding them appropriately not only reduces employee turnover but also allows the business to acquire people with better skills and greater capacity for learning and assuming additional responsibilities. With dependable, quality employees, management has more time to concentrate on those activities with the highest payoff. Good employees not only get more done but also are more likely to get the job done right.

## Concluding Comments

There are farmers and ranchers who are very successful because they are doing exceptionally well in one area of business (i.e., marketing or production), or because of a favorable investment such as buying land just before a land market boom. But this kind of success often has more to do with favorable circumstances than with management skill.

If inheritances, non-farm income and windfall gains are excluded, the farmers and ranchers who have succeeded over time have done so largely because they are good managers. The characteristic that most differentiates the successful from the unsuccessful is management balance, both among the key areas of business performance and between short run and long run considerations. From a profitability standpoint, the most successful often have not been the best in any one area, but they have been consistently better than average in each year.

The importance of management balance was emphasized in a 1980-87 study of factors contributing to farm profitability. In this study, the differences between the top 25 percent and the bottom 25 percent of a group of producers were analyzed. It was found that the top group averaged only about 5 percent better than the overall group in terms of yields on comparable quality land, costs per unit of production returns per dollar invested in machinery and equipment, and average “net” price received for the commodities produced. The bottom group, on the other hand, was about 5 percent worse than the overall group on these same performance measures. Strangely enough, the debt/asset ratio for the two groups was about the same. While the differences were marginal in each performance area, net income averaged a positive $50,000 per year for the top group and a negative $25,000 for the bottom group.

In addition to a more balanced approach to management, the successful group was found to be much more heavily involved in planning and monitoring business performance. This included generating better information at both the whole farm and the enterprise level. Former Secretary of State James Baker has a plaque on his wall which succinctly summarizes this aspect of successful management: “Proper Preparation Prevents Poor Performance.”

Finally, the desire for independence has been one of the primary motivations of many people who go into farming .Yet it has also been the Achilles heel of many farmers because they have attempted to do everything on their own resources. The owners of many small operations can capture the economies of size and specialization available to larger producers by pooling resources (through consolidation, joint ownership or cooperative arrangements) and/or by employing outside expertise.

# Political Rhetoric, Emotional Arguments and Reality… Is There Any Connection?

By Danny Klinefelter

I got into the office this morning, turned on my computer and the first message I read was about limiting government payments to "millionaire" farmers and "corporate" agriculture.

What is a millionaire farmer anyway? Is it based on net worth? The farmer who spent 30 years paying off 160 acres in central Illinois or Iowa is probably a millionaire.

Is it $1 million gross sales? In a normal period, the typical farmer would have a net before tax income of around 10 percent on sales. He probably worked over 40 hours a week and took all the risks associated with running a business, so I'm not sure I would consider him to be part of the undeserving rich.

If it's net income per person and we use the magic $250,000 before tax net income that is the general criteria being used to separate the rich from the middle class in income tax politics, then that would translate to roughly $2.5 million gross sales per person/family unit, which is not the same as per operation.

What about corporate farms? I assume the rhetoric is about outside investors or publicly traded companies; but, the reality is that 98 percent of farm corporations are closely held family businesses that have elected a corporate legal structure for business or estate planning reasons. What is there that is inherently evil about a corporation?

When is comes to saving the family farm, who is being targeted? I understand that a 1600 acre corn and soybean operation run by a husband and wife with one hired man or a teenager who is still at home fits the definition. But what about a 5000 acre farm operated by a father and his two grown sons, which supports 3 families? Is it a family farm or one of the bad guys?

I also hear a lot of talk about the virtues of a competitive market. Yet, the same people often promote policies that prevent markets from working. A truly competitive market is very efficient, but also very impersonal and can be very cruel. The function of a competitive market is to drive the economic return to the average producer to breakeven through supply and demand responses in both input and output markets. In equilibrium the top end - not necessarily the biggest - are profitable and growing, the average are hanging in there, and the bottom end are losing money and are forced to exit the industry. Being on the bottom isn't always a matter of being a poor operator, it can often be a matter of timing. Those who haven't built enough equity, are too highly leveraged or lack sufficient liquidity can be victims of getting caught in a cyclical downturn, particularly one as severe as we may soon be experiencing.

One thing to remember for those who favor the "letting the chips fall where they may", i.e. the competitive market philosophy, is that each time the bottom layer gets weeded out, the level up becomes the next vulnerable group. What this means is that survival depends on continuous improvement at the pace needed to remain in the front half of the pack.

Just a few random thoughts. I would welcome some well thought out comments.

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# Understanding the National Political Process

by Danny Klinefelter

Almost daily, I hear or read of someone complaining about national politics and wondering why politicians just don't seem to listen. From what I've observed, politicians do pay attention; but, primarily to those who count. Please note that I didn't say to those who are more important or more in need.

I'm going to use two situations to illustrate my point. The first is the presidential election campaign and the second is congressional representatives' voting patterns.

Even in the most contested presidential elections, only about 55 percent of the eligible voters will go to the polls. Pollsters and political strategists have become sophisticated enough to know the voting population's demographic and geographic characteristics. Using this knowledge allows them to pretty accurately identify the 65 percent of eligible voters from which the 55 percent will come. They also know that about 40 percent of that 65 percent (26 percent of the total) will vote Democratic even if the candidate's qualifications or ethics are suspect. Likewise, another 40 percent (26 percent of the total) will vote Republican, regardless of who the person is. What that translates to is that 20 percent of the 65 percent (13 percent of the total eligible voters) actually decide the election's outcome. Political strategists also ensure there will be a lot of rhetoric and chest beating to appeal to the party loyalists; while they can be secure in the knowledge of regardless what is said or done, well over a third of the eligible voters will remain disengaged. Therefore, the focus is on the undecided 13 percent. In the end, the eventual winner doesn't need to get all 13 percent, just more than half. The math isn't quite as straightforward as I'm laying out; but, it's not far off. The point is that from an election standpoint, the dollars, the effort and the message will be disproportionately focused on the 13 percent of voters who "count." Furthermore, if you consider that many states are almost certain to be red or blue, in reality the resources will be even more focused on the undecided voters in the "battleground" states.

Congressional representative's vote from a different standpoint. Congressional issues are more localized and more partisan. Over a 2-year term, a representative will vote on roughly 1000 pieces of legislation.

However, only about 30 of these bills will play heavily in her/his local re-election. While the representative may not know the exact 30, he can be pretty sure of the 40 from which the 30 will come. For these pieces of legislation, his re-election hinges not just on how he votes, but whether he gets them passed. As a result, how he votes on the other 960 issues is going to be heavily influenced by two factors. The first factor which will weigh on his decision is the ability to trade his support (vote) in order to get support for his own important issues, i.e., I'll vote for yours if you'll vote for mine. The second factor is supporting the party line. Why? Partly for philosophical reasons; but, probably more importantly because supporting party leadership affects committee assignments, support for his legislative agenda, and party funding support in his re-election campaign. Conscience, integrity, and personal beliefs about what would be best for the country are important; but, politics comes first 95 percent of the time.

The fact that politicians focus on "those who count," may frustrate the general public. However, politicians are going to continue to do what they get rewarded for. For their behavior to change, all eligible voters would have to vote; voters would need to use their heads and study both sides of the issues rather than relying on their emotions, political pundits, media bias and following the party line; and, addressing causes of problems rather than treating symptoms would have to become more important. The latter point is particularly problematic because the payoff to treating causes often takes years and elections occur more frequently. Therefore, those who would affect change often wouldn't be able to show any immediate results and the credit would go to someone years later who is in office when the results come to fruition.

I'm not holding my breath. If anything, the increasing emphasis on political correctness, partisanship, sound bites, spin and what have you done for me attitude appear likely to increase the level of voter apathy. From an economic and social management perspective, my biggest concern is that the political process tends to be very short sighted.

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# Victimism Can Be a Crippling Disease

Danny Klinefelter

Our market-oriented economy is based on competition. We tend to admire winners and aspire to succeed. Over the years, I have known successful part-time producers with full-time off-farm jobs, mid-sized producers who have succeeded by superior management skills, and successful large scale producers who are outstanding entrepreneurs and executives by any industry standards.

Unfortunately, the success of some has resulted from monopolistic competition and unethical or illegal practices. Where these situations exist, it is our duty to stand up, speak out and take action. But our response needs to be based on facts and not on conjecture or emotions.

There is another problem in agriculture, however, that I think is equally insidious. It's like a cancer that attacks and eats away at the healthy part of the industry. The trouble is there doesn't seem to be any politically correct way to address it. And that is the "I am a victim mentality" characterizing a minority but still a significant number of agricultural producers. These are the people who like to blame their problems or lack of success on anything or anyone but themselves. They frequently can't see their own faults, and even when they do, they usually aren't doing anything significantly to change the way they manage their business.

This group somehow seems to feel that the most effective way to deal with the winners is to bad mouth them to try to bring them down to their level rather than doing what they can to raise their own level of performance. Unfortunately, there isn't a vaccine to treat envy or resentment.

The problem is compounded over time because those suffering from Victimism tend to invest too little into trying to change the things they can. They may work harder and worry more; but, they generally keep using the same approaches to management and business models that they always have. Too much of what could be productive time and energy are dissipated in periods of depression or wasted on the senseless venting of their frustrations. In today's world, the key to success generally lies not in working harder but in working smarter.

It is also true that everyone isn't blessed with the same management skills and abilities. It's not so much a matter of superior intelligence. Rather the differences frequently lie in creativity, sense of timing, risk management psychology, and the ability to see the big picture and how things fit together.

We all have a tendency to want to blame our circumstances on forces beyond our control. But, again and again studies have shown that over the same time period, in the same area and producing the same commodities some producers are making money while others are losing it. Just as examples, the New Mexico, Oklahoma, Texas Standardized Performance Analysis results for commercial cow-calf producers over the period 2003-2007 found that the top 25 percent of producers were generating $177.93 net income per cow, while the bottom 25 percent were losing $188.21 per cow. A 5-year study of Illinois Farm Business Farm Management Association in the 1990s found that the most profitable one-third of central Illinois crop farmers netted on average $97 more per acre than the least profitable one-third, even though the farms compared had similar soil types and were raising the same crops. A similar study in Kansas about 10 years later found almost exactly the same thing. Year to year, the uncontrollables can play havoc; but, over time the winners are those who do a better job of managing the business.

I have known literally hundreds of top managers who have turned down the opportunity to share valuable knowledge, insights and management practices in the farm press, not to protect a competitive advantage; but, because they feared the petty reaction of some people in their local community who would see the story as a form of self aggrandizement. The result is that a lot of valuable information is never shared.

Many of the victim mentality producers loudly profess a belief in free enterprise and self reliance; but, they often espouse beliefs and solutions that are really more socialist in nature. They're a lot like the pro basketball player who says I play the same game and work just as hard; therefore, I should be paid the same as Michael Jordan.

Fortunately – the future of agriculture lies with those producers who overcome bad weather, bad prices and bad luck largely by being better managers.

## Don't Tell Me Anything I Don't Want to Hear

Danny Klinefelter

After reading the comments and reactions on Ag Talk, I reread the "Family....By Invitation" article that appeared in the April issue of Top Producer. I didn't see anything in it that took sides or appeared to be advocating the Family Farms business model. It simply provided information on a topic that has been a major point of discussion and rumors across much of the midwest.

One of the defining characteristics of the best managers I know is that they are open to exploring new ideas and different points of view. We are all conditioned by our beliefs, experiences, and biases, i.e., we see things through a filter. The management challenge is to make sure that your filter isn't creating too many blind spots.

Try to keep two things in mind. First, strategic management is about anticipating, adapting to, driving and capitalizing on change. It's hard to compete with or adapt to something if you don't know or understand what you're dealing with. Second, the function of a competitive market is to drive the economic return of the average producer to breakeven through supply and demand responses in both input and output markets. In equilibrium, the top end are profitable and growing, the average are hanging in there, and the bottom end are losing money and being forced to exit the industry. Being on the bottom isn't always a matter of being a poor operator or not working hard; it can often simply be a matter of timing. Those who haven't built enough equity, are too highly leveraged or lack sufficient liquidity can be victims of getting caught in a cyclical downturn. Business success and survival depend on continuous improvement at the pace necessary to stay in the front half of the pack.

If I've learned nothing else in my career, it's that you don't have to agree with or like someone to learn something from them. I've also found that I've learned far more from my mistakes than I have from my successes. The same is true for innovative or different business models. Even the biggest failures were often doing some things right. But, you first need to get past the emotion and the generalizations to determine what can be learned and built on.

Remember, every complex problem has at least one solution that is simple, obvious and wrong.

It's also important to recognize that different people have different goals and priorities. That doesn't necessarily make one right and one wrong. Most successful managers are competitive and driven. Many live to work. For me, it's one thing if the differences are one of ethics or integrity, it's another if it is just that the measures or standards of success are different.

One thing that directly or indirectly factors into all these issues is the certainty and increasing rate of change. A lot of people not only don't like it, they resent it. Great managers follow the advice expressed by Jack Welsh, former chairman and CEO of General Electric, when he said, "The only truly sustainable competitive advantage is the ability to learn and adapt faster than your competition." These managers have learned that change and their ability to capitalize on it creates their greatest opportunities. Unfortunately, too many people tend to change when they feel the heat rather than because they see the light.

# Notes and Quotes: Some Thoughts and Observations on Succeeding in Today's Agriculture

by Danny Klinefelter

Most of my career, in industry and academia, has been spent studying the differences between successful, average and unsuccessful farm and ranch managers. Over the years I have known successful part-time producers with full-time off-farm jobs, mid-sized producers who succeeded by superior management skills, and successful large scale producers who were outstanding entrepreneurs and executives by any industry standards.

While numerous books have been written about the subject and there are an endless number of cliches' which attempt to capture the essence of successful management in a few words, it's pretty clear that there isn't one all encompassing set of attributes or criteria. At the same time, I have always found it interesting and enlightening to study quotes that capture at least some of the key elements. Those listed below include some of my own observations as well as some of my favorite quotes from Peta Alexander, Jim Collins, Peter Drucker, Wayne Gretsky, Tom Peters, Mark Twain, and Jack Welch. They obviously reflect my personal biases; but, I hope you will find them insightful as well as thought provoking.

1. The future will always belong to those who see the possibilities before they become obvious.

2. Wayne Gretsky was once asked by a reporter what he thought accounted for his success.
He recognized that he wasn't bigger, stronger or faster than most of the people he played against. Gretsky believed that what made the biggest difference was that most players were always going where the puck was, while he always tried to go where it was going to be.

3. It's all about the difference between doing the right things versus doing things right. A lot of failures have been businesses or organizations who were doing something very well, but that were no longer relevant or what the market rewarded.

4. There is an old saying "if it isn't broke…don't fix it." However, Tom Peters in his book <u>Thriving on Chaos</u> argues, "If it isn't broke…you probably haven't looked hard enough!"

5. In business, the only truly sustainable competitive advantage is the ability to learn and adapt faster than your competition.

6. Too many people tend to change only when they feel the heat, rather than because they see the light.

7. The best companies spend as much time analyzing what to stop doing as they do analyzing new opportunities.

8. The main difference between the top 10% and rest of the top 25% is their timing.

9. To remain successful, a business needs to be a learning organization. That means everyone in the business needs to recognize that someone, somewhere, has a better idea or way of doing things and they need to be compelled to find it, learn it, adapt it and continually improve it.

10. When the rate of change inside a business becomes slower than the rate of change outside, the end is in sight. The only question is when.

11. Two comments I frequently hear are that most farmers and ranchers run their businesses more as producers than as business managers, and they are resistant to change. From my experience, most farmers don't see either statement being directly applicable to them personally. Most believe they are managing their farm as a business. The question should really be: Are they using the best business management practices and do they possess the necessary management skills and attributes to compete with the best in the business? Almost every farmer also believes he has made significant changes in his business. The real issue is: Are they moving forward as fast as their leading edge competitors - the top 10%?

As an analogy, consider two people driving the same direction on an interstate highway. Both are clearly changing - i.e., moving forward. However, one is traveling 55 mph and the other 70 mph. If they both drive 8 hours a day, 5 days a week, at the end of one year the one going 70 mph will be 31,200 miles ahead of the other. But what if the 70 mph driver decided to ramp things up to do business 24/7/365? If the 55 mph driver stayed on his current pace he would now be falling behind by 498,800 miles per year. Assuming the highway circumnavigated the earth, the slower driver would be getting lapped about 20 times a year.

Is this example extreme? Yes. Is it unrealistic? No. Large commercial dairies typically milk around the clock, 365 days a year. In another instance, one row crop operator I know now farms in 15 states so he can diversify production and market risks in addition to utilizing his labor, management and equipment nine-ten months a year rather than the normal single-site planting and harvesting periods.

12. Remember, the future hall of fame baseball player with a .300 lifetime batting average gets only 1 more hit in every 20 times at bat than the player who hits .250 and just manages to hang on.

13. It's not what you don't know that bothers me, it's what you do know that just ain't so.

14. One of my biggest frustrations in explaining business concepts are people who have to have things put in terms of their enterprise, geographic area or industry before they can see how it applies to their situation. Someday they'll either be out of business or working for someone else, because they're always going to be two steps behind the leader.

15. It is not a comment that is very politically correct, but flying with the eagles and not scratching with the turkeys is a very real issue in any business. Make sure you are seeking out and interacting with successful people in your industry and not

hanging out with the losers - this is essential for stimulation, motivation, and personal growth. Successful people challenge you and force you to think, they cause you to consider alternatives and they inspire you. Losers tend to be victims. Everything that goes wrong is someone else's fault. They're jealous of success, they're tradition bound, they can't see alternatives, and they drag you down to their level.

16. Remember, Darwin didn't actually say it was the survival of the fittest, what he said was that it's not the fastest, strongest or smartest who survives, it's those that are able to adapt to change.

17.In times of change, the learners inherit the earth, while the learned find themselves to be beautifully equipped to deal with a world that no longer exists.

18.A man should never be ashamed to admit he was wrong, which is but saying that he is wiser today than he was yesterday.

19.Knowing is not enough; we must apply. Willing is not enough; we must do.

20.The secret of getting ahead is getting started. The secret of getting started is breaking your complex overwhelming task into small manageable tasks, and then starting on the first one.

21.Vision without action is a daydream. Action without vision is a nightmare.

22.We can't solve problems by using the same kind of thinking we used when we created them.

23.If you're not failing every now and again, it's a sign you're not doing anything very innovative.

24.You don't lead by hitting people over the head – that's assault, not leadership.

25.If two people in the same organization agree all the time, then one of them is unnecessary. If they disagree all the time, then both of them are useless.

26.Those who say it can't be done are usually interrupted by someone doing it.

27.Do not confuse motion (or effort) and progress. A rocking horse keeps moving, but it doesn't make any progress.

28.Don't worry about people stealing your ideas. If your ideas are any good, you'll have to cram them down people's throats.

29.If everything is under control, you are going too slow.

30.Surrounding yourself with dwarfs does not make you a giant.

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# Why Producers Should at Least Be Thinking About Becoming a Qualified Supplier

by Danny Klinefelter

For the past thirty years we have heard that U.S. and Canadian agriculture are moving toward a bi-modal structure comprised of a relatively few large scale commercial producers and a large number of smaller, often part-time farms. In many ways I've always felt this was a gross oversimplification; but, there is a rapidly growing trend toward two types of producers in another context. I believe we are moving toward an industry structure made up of open market commodity producers and qualified suppliers for coordinated supply chains. Obviously the speed and extent of this transition will differ dramatically by commodity and by geographic region; but, the impact will be pervasive. Almost all broiler and seed production, and the majority of vegetable and pork production already reflect this model.

I don't expect my opinion to be overly popular; but, I do think it's prudent for producers to consider. Like everyone else, I have heard the evils of captive supplies; but, in many respects it's a concept that makes sense. The last part of this article will address some of the reasons why I feel that way.

Why do I think producers should at least be evaluating their supply chain options and working to identify and develop relationships? Remember the old axiom "a day late and a dollar short"? At some point, becoming part of a coordinated system may not be an option and it could be too late for a producer to get into the most attractive relationships. Historically, the typical pattern has been for a processor or retailer to start with a large number of initial suppliers and then over time cull down to a much smaller number of the best performers. For example, twenty years ago one major U.S. food processor was contracting with about 800 growers. Today they have 60 producing more than the original group. The others are either no longer producing the crop or are producing for someone else. What this indicates is that if a producer does decide to pursue the qualified supplier strategy, he needs to be committed to doing what will be required to remain in the top end of the group. Otherwise, he may make a substantial investment and still end up on the outside looking in. It also means that the qualified supplier strategy won't be the best choice for all producers, even some of those who have the opportunity to participate in what would initially appear to be very favorable relationships. In any case, it will be extremely important for producers to consider how to structure their business in order to manage the risk involved in these arrangements.

Producers will need to do their homework in order to make sure they are properly positioned if they ever do decide the qualified supplier route is the way to go. Most of the documentation and requirements aren't something that can be accomplished overnight. It's also important to recognize that the speed of the transition to coordinated supply chains and traceability will be heavily event driven, e.g., by value trait developments, disease outbreaks, bioterrorism, food safety issues, GMO contamination, etc.

The findings of Canada's Best Management Practices of Leading Farmers Project indicated that this trend isn't isolated to the U.S. The study found that 13 percent of Canadian farmers currently have some type of formal arrangement with a processor or retailer. However, 66 percent of the top 10 percent do.

The implications of a coordinated system becoming closed to all but selected qualified suppliers would be significant to independent producers in a number of ways. Not only would that particular output market be closed, but so could access to specific inputs and technology, e.g. genetics, services, designer chemicals matched to specific genetic attributes. Non-participants could also be cut off from access to specific information such as performance benchmarks and market signals versus what would likely be increased open market volatility as captive systems either dump surpluses or go into the market sporadically to cover shortages. One critical input market that will also be impacted both in terms of access and pricing is the capital market, i.e. if a producer doesn't have a locked in market or price, he may not be able to get funding or at least not at a competitive rate. This issue will likely be exacerbated by lender responses to increased risks, by favorable captive financing opportunities and by the introduction of new risk management tools such as group based self-insurance programs. The development of alternative forms of business relationship models such as rights of first refusal, geographic exclusivity and franchising arrangements would only serve to widen the gap.

There are several things producers and policymakers need to recognize that are driving this trend. First and foremost is that all farmers are not alike. They differ in terms of management ability, the ability to work with them, their willingness to change and adapt, their ability and willingness to document and verify what they are doing, and the quality of what they produce. Beyond these factors, there are several other major drivers that also need to be recognized. One is the ability of the processor or retailer to limit and mitigate the economic impacts of the legal liabilities and media driven public perceptions associated with issues such as food safety, bioterrorism, BSE, GMOs, environmental contaminants, etc. In some cases, it's not that a closed system is more efficient than an open market system; but, that the firm can't afford the risks associated with the contingent legal liability or the loss of public confidence that would occur if they weren't able to demonstrate the ability to isolate and contain the source/cause of problems as they arise.

The ongoing drive to reduce costs and drive out inefficiencies through such process improvement methods as lean manufacturing, 6 Sigma, TQM, balanced scorecarding or continuous improvement management systems are also behind many of the structural changes. Other factors include the need to reduce variability, increase predictability and shorten the response time to changes in conditions or markets. Quality assurance programs also demand more consistency and process compliance, including documentation and verification. Anyone who has been through a HACCP or ISO certification and subsequent compliance audit has a good feel for what's involved. The need for better supply alignment to improve timing in terms of when, where and how much, such as just in time inventory systems and optimal plant operating efficiency and capacity utilization are also driving the movement to more coordinated linkages. Protection of GMO patents is also a growing factor. The mapping of the human genome and the related developments that will occur in attribute specific pharmaceuticals and nutraceuticals will only accelerate the trend. Finally, developments in technology are going to continue to make traceability and anytime intervention both more feasible and economical. Remote sensing, embedded chips, GPS verification and tracking, containerization and bar coding are just a few of the more important current examples.

Change and the rate of change are both exciting and frightening; but, they are also sure to continue and accelerate.

# Farm Mergers and Acquisitions as a Business Strategy

by Danny Klinefelter

Ed McMillan, an agribusiness consultant and mergers and acquisitions specialist, told the Association of Agricultural Production Executives members that due to increasing global competition, shrinking margins and emerging technologies, if commercial farmers and ranchers want to remain competitive, growth will be a necessity…not a luxury. In terms of management strategy he encouraged them to consider three options:

- **Lead**…proactively develop a future direction that's right for your business, e.g. increase productivity and output; increase value added of current products; expand the size of the current operation; or leverage skills and assets into a new operation.

- **Follow**…find someone who knows where to head and get on board, i.e. merge or align with another business.

- **Get Out of the Way**…find a buyer and decide where else to best invest your skills and capital.

While his comments won't resonate well with many producers, they were directed to a group of producers who are looking at the long term and who want to remain players as full-time operators.

My objective in this article is to address some of the issues that need to be considered by producers who might be considering about a merger, either as the acquirer or the acquiree, as a business growth or sustainability strategy. Although the idea of a merger of equals tends to be the most appealing option, I have yet to see one that worked out that way.

If any merger is to be successful, the first question is would the new entity be greater than the sum of its original parts in terms of competitiveness and performance? This may result from economies of scale, management specialization, complementarity of talents or resources, or access to new input and output markets. One caveat, just getting bigger does not necessarily produce economies of scale. Scale economies usually result from shifting to a new cost or revenue curve, or from moving to a lower point on the industry's long run cost curve.

Two comments I frequently hear are that too many farmers and ranchers run their businesses more as producers than as business managers, and that they are resistant to change. From my experience, most farmers don't see either statement being directly applicable to them personally. First, most believe they are managing their farm as a business. The question should really be if they are using the best business management practices and do they possess the necessary management skills and attributes to compete with the best in the business. In a February, 2003 *Corn and Soybean Digest* article "Is 1000 Acres Part-Time Work," I referenced several studies documenting the significant differences in financial performance between the average and the top managers. Second, almost every farmer believes he has been making significant changes in his business. The real issue again is, are they moving forward as fast as their leading edge competitors, i.e. the top 10 percent. Let me use an analogy to make my point. Consider two people driving the same direction on an Interstate Highway. Both are clearly changing and both may even be headed in the same direction. However, one is traveling 55 mph and the other 70 mph. That means one is getting further ahead of the other by 15 miles every hour. Based on five 8-hour days a week, at the end of one year he will be 31,200 miles ahead (145,600 - 114,400). That's a pretty big advantage. But what if the 70 mph operator decided to ramp things up do business 24/7, through round the clock multiple 8-hour shifts, think of modern manufacturing plants or large dairy operations. If the 55 mph driver stayed on his current pace he would now be falling behind by 498,800 miles per year (613,200 - 114,400). Assuming a highway that circumvented the globe, he would be getting lapped about 20 times year. Is the example extreme? - yes. Is it unrealistic? - no. One row-crop operator I know now farms in 15 states so he can diversify production and market risks, in addition to utilizing his labor, management and equipment 9 months a year rather than the normal single site planting and harvesting periods. A Florida specialty crop operator I recently met harvests 364 days a year, they don't work on Christmas Day, and plants a new crop every 3 days.

The second question may actually be harder to answer and that is an honest and objective assessment of you and your business, as well as your prospective business partner. Essentially, it involves doing a comprehensive S.W.O.T. Analysis of each firm's strengths, weaknesses, opportunities and threats - both internal and external. This means not just considering the historical and current situation, but also what risks and changes are on the horizon for the industry. This then needs to be followed up with a similar evaluation of what the answers would be for the merged entity. Synergy, compatibility, complementarity and new opportunities are all key things to look for. Some poorly conceived mergers could actually compound both firm's problems.

It is critical to know what you need out of a merger, what you would gain and what you would be willing to give up. Part of the rationale behind any successful merger needs to be the ability to compensate for weaknesses and to capitalize on strengths. Some of the possible reasons not previously mentioned might include management succession, the ability to grow without taking on additional debt, the elimination of duplication, the ability to adapt new technology and the ability to more fully utilize existing resources.

Over the past few years, the farm press has profiled several farmers who have merged operating entities in order to capture greater economies of scale and as a way to achieve greater management specialization by pulling together a management team with complementary skills, i.e. where one business's strengths offset another's weaknesses and vice versa.

While mergers can offer a great deal of economic potential they also present their own set of risks. This is particularly true on the relationship side of the business. A merger is a business marriage and just like any other marriage, things don't always work out even when the business rationale appears to make sense. Most of the failures that occur are because they involve people with different backgrounds, personalities, egos, values, personal and business goals, and management/work styles. These are all things that need to be recognized, discussed and never underestimated in terms of their impact on the venture's potential. Due diligence shouldn't be limited to just doing the homework on the financial and legal matters.

One of my favorite quotes is from Pita Alexander, New Zealand's best known and most respected farm business consultant, who says:

> "Never forget that with partners or a joint venture of any kind, it is invariably harder to get out of a business arrangement than it was to first get into it. Don't get personally and financially involved with any business unless the benefits are real, sustainable, bankable and enjoyable. Think about what your exit strategy would be before you enter the business. You will often find that the exit strategy is much more important than the entry strategy and seldom is enough thought given to it."

Over the past three years I have received calls from several farmers who have been approached by another farmer offering them the opportunity to acquire their farm business, i.e. to acquire their business as an ongoing entity in exchange for continued employment and a minority ownership interest in the combined entity. In all but one case, the firms seeking to be acquired were viable and by most measures successful operations. What all of the firms seeking to be acquired said, however, is that as they looked down the road they could see changes occurring in agriculture that they didn't feel they had the ability or expertise to handle. All were top producers and operations managers with strong technical skills. Where they felt lacking was in areas such as executive and strategic management skills, strength of an overall professional management team, access to capital, management information systems, people management skills and/or having access to a strong supply chain relationship.

Obviously, the merger or acquisition approach isn't and won't be a viable option for many farmers. In some cases they wouldn't bring anything to the table that another business wanted or needed other than their assets. Likewise many farmers who are used to running their own business would never be happy working for someone else. This is particularly true if the other business's management and operating style are significantly different than their own. And more often than not this will be the case, because the reason the business they would benefit most from merging with has been successful is because it is managed differently.

Mergers or acquisitions take a lot of time, effort and commitment if they are going to be done right and for the right reasons. A high level of trust and communication is essential, both parties need to be willing to lay all of their cards on the table and there has to be something in the arrangement for all parties involved. Peter Drucker, often called the father of modern management, has said that 60 percent of all management problems are the result of poor communication.

Whatever the nature of the arrangement, there is one thing that I believe is absolutely essential for any multiple owner business, and that is a written buy-sell agreement signed by all the parties involved, including their spouses. There are three basic types of buy-sell agreements: cross-purchase agreements which are entered into between the individual owners, entity agreements which are between the business entity and the individual owners, and a combination of the two. The purpose of the buy-sell is to reach agreement on how potential events should be handled in a manner that is viewed as fair to all parties involved at a time when everyone is getting along and thinking objectively rather than emotionally. While there are an unlimited number of issues that can be addressed, at a minimum I believe the following are essential:

- The basis for establishing value and any discounts that may apply in specific situations
- Rights of first refusal
- Installment purchase terms

- Permitted transfers
- Voting rights
- Put and call provisions which specify the conditions under which an owner must sell or the company/other owners must buy
- Antidilution provisions
- Take along rights
- Management and board compensation restrictions
- An arbitration or mediation provision

If you do decide to pursue a merger, I can't stress strongly enough the need to use advisors who know their stuff and have experience working with successful mergers. Tax accountants and attorneys are important, but they often lack expertise to address many of the key management questions. A good mergers and acquisitions specialist to help facilitate the deal and equally important, the implementation, can pay huge dividends and eliminate a lot of the problems that frequently develop.

The structure of agriculture is going to continue to change and many aren't going to like what occurs. But, I sincerely believe there are several ways to survive and succeed; however, almost all are going to involve a greater level of interdependence.

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