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What Business Model Should I Use to Grow?

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There are numerous motivations for farms to expand their businesses. Even in today's environment of tight margins, many farms are exploring expansion options. When exploring these options, it is important to address key questions pertaining to the farm's strategy. A previous article (*farmdoc daily*, August 5, 2016), discussed ten questions that should be addressed when examining challenges and opportunities associated with farm growth. This article focuses on the seventh question: what business model should I use to grow?

Organizing and implementing growth strategies in production agriculture has expanded well beyond the traditional organic growth strategy where assets are added to the current business. The following eight business models are discussed in this article: organic or internal growth, mergers and acquisitions, franchises, strategic alliances, service provider, asset or service outsourcing, agricultural entrepreneur, and investor. The discussion below closely follows Boehlje (2013).

Organic or Internal Growth

This is the typical approach to expansion where assets are acquired and added to the current business. Examples including renting or purchasing additional land, adding additional livestock facilities, and leasing and purchasing machinery and equipment. If the expansion is sufficiently large or geographically separated from the current farming operation, it may be operated as an independent entity from a production perspective using the common "replicate" strategy of the industrial sector where an optimal plant size is determined and expansion occurs by a building a new plant. This strategy has been used extensively in the livestock industry where a laying hen, swine, or dairy farm replicates another production site rather than building onto the current site. Some crop farms are exploring the use of the replication strategy.

Mergers and Acquisitions

The merger and acquisition strategy is commonly used in the business world and becoming more common in production agriculture. This approach involves the acquisition of a business rather than the individual or selected assets of that business. This strategy has advantages to both the buyer and seller of the assets. From the buyer's perspective, the purchase may include assignable leases. This allows the buyer to control resources with significantly less capital. From the seller's perspective, in the absence of the merger and acquisition strategy, it may be difficult for a retiring farmer to find a ready buyer for buildings, grains bins, and machinery and equipment. With this strategy, it may also be possible for the retiring farmer to work part-time for the farm purchasing their assets. A challenge with this strategy is that some of the resources, including personnel, may be redundant given the resource base of the purchasing farm.

Franchises

With the franchise model, the franchisor offers the franchisee a set of services and protocols including market access, standard operating procedures (SOP's), input discounts, qualified supplier status, and managerial oversight. The franchisee is in essence acquiring the rights to operate in a particular geographical area using the services and protocols of the franchisor. Because of the size and scale of franchisor's business, the franchisor is expected to be able to obtain input cost reductions or better prices from suppliers and buyers, and is also expected to accelerate the learning process of franchisees through benchmarking of best management practices of the most successful franchisees.

Strategic Alliances

Strategic alliances are a common business model used to combine the resources of two or more businesses to obtain size economies, increase market access, and facilitate business succession or intergenerational transfers. Strategic alliances may involve parts of the business (e.g., machinery sharing; joint marketing of products) or the entire business. The challenge of these business arrangements is the joint decision making that is typically involved and the difficulty that sometimes occurs with respect to exiting the alliance. As with other business arrangements, it is best to agree during the formation process on the termination arrangements.

Service Provider

The service provider model is commonly used in both grain and livestock production in the form of custom crop operations, contract growing of livestock, and contract spreading of manure. The basic concept is that resources are provided or activities performed by one party for another for a fee. The service provider is an independent contractor rather than an employee.

Asset or Service Outsourcing

Complementing the service provider model, is the asset or outsourcing model. Leasing and rental arrangements are used extensively in production agriculture to obtain machinery and equipment, grain storage space, and land. This business model often reduces the capital outlay needed to obtain control of resources, and also increases the flexibility to expand or downsize the business more rapidly in response to changes in the business climate. Other asset or service outsourcing examples used in production agriculture include acquiring marketing, accounting, or veterinarian expertise.

Agricultural Entrepreneur

This model may involve investigating the business opportunities in supply industries such as machinery and equipment, seed, or crop protection as well as providing trucking or logistics services. Other examples include grain origination and storage, product processing, land clearing, construction, and tiling.

Investor

The investor business model is characterized by the how and why an agricultural entrepreneur acquires or invests in a business. In this instance, the acquisition is motivated primarily by financial objectives with the expectation that the business will require little managerial input or oversight. This is sometimes characterized as the Warren Buffett approach to business investments – buy businesses (not assets) that have good management in place, are in strong competitive positions, and currently undervalued in the market.

Concluding Thoughts

Boehlje (2013) suggests using three categories to classify the above business models. The first category is represented by the organic or internal growth model. The second category, referred to as the corporate parenting or learning approach, is comprised of mergers and acquisitions, franchises, strategic alliances, and service provider. The third category, referred to as the deal making or portfolio approach, is comprised of asset or service outsourcing, agricultural entrepreneur, and investor.

The key point that we want to make in this article is that the business model a farm uses when expanding the operation is not just limited to the traditional organic or internal growth model. Today's environment provides opportunities to experiment with other business models. Of course, the business model chosen should be closely aligned with the farm's vision and strategic direction. Future articles will explore how expansion impacts the farm's current operation, start-up challenges, and a farm's sustainable growth rate.

References

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