



Measuring Business Excellence

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Outline

- Business Excellence
- Gross Farm Objective Income
- Financial Measures
- Growth Measures
- Competitive Advantage
- Unique Resources



Business Excellence

- Overall Farm Objectives
 - To push profits to the level consistent with the capital, resources, and abilities of the farm operator
 - To relate choices in the farm business with choices in the farm household in a manner consistent with the needs and wishes of the family



Business Excellence

- “Farm management is concerned with the best program for the individual farm. It recognizes that no two units are exactly alike in respect to soil and other basic resources, the farmer’s capital and debt position and finally his managerial ability,” Heady and Jensen, 1954.



Business Excellence

- “Farm management cannot be considered in terms of sweeping recommendations for all farms. There is one best plan for each farm. We can set down basic principles for all farms. But when it comes down to deciding what crops and livestock will be produced, how they will be produced, and the farming practices that are best, each farm must be considered on its own merits,” Heady and Jensen, 1954.



Business Excellence

- Total Quality Management
 - Management philosophy that fosters an organizational culture committed to customer satisfaction through continuous improvement.



Business Excellence

- Total Quality Management
 - Five Principles:
 - Leadership
 - Customer Satisfaction
 - Continuous Improvement
 - Management by Facts
 - People-Based Management



Business Excellence

- Measurement
 - Gross Farm Objective Income
 - Financial Measures
 - Expense Ratios
 - Profit Margins
 - Growth Measures
 - Acres
 - Income
 - Assets



Business Excellence

- Data Used in Measurement
 - Kansas Farm Management Association (KFMA) farms with continuous data from 1983 to 2002
 - Number of farms = 360
 - Profit quartiles sorted on economic total expense ratio
 - Growth quartiles sorted on total acres



Gross Farm Objective Income

- $GFOI = \text{Net Cash Flow} / (1 - \text{Exp. Ratio})$
- Net cash flow includes:
 - Family living expenses
 - Principal payments
 - Taxes
 - Off-farm income



Gross Farm Objective Income

- Example:

- Net Cash Flow = \$50,000

- Exp. Ratio = 0.80

- $GFOI = \$50,000 / (1 - 0.80) = \$250,000$



Financial Measures

- Expense Ratios
 - Financial Total Expense Ratio
 - Economic Total Expense Ratio
- Profit Margins
 - Operating Profit Margin Ratio
 - Economic Profit Ratio



Total Expense

- Financial Total Expense
 - Cash operating expense
 - Depreciation
- Economic Total Expense
 - Cash operating expense
 - Depreciation
 - Opportunity charge on unpaid family labor
 - Opportunity charge on equity



Expense Ratios

- Financial Total Expense Ratio
 - $(\text{Financial Total Expense}) / (\text{Value of Farm Production})$
- Economic Total Expense Ratio
 - $(\text{Economic Total Expense}) / (\text{Value of Farm Production})$



Profit

- Net Farm Income
 - Net Farm Income = Value of Farm Production – Financial Total Expense
- Economic Profit
 - Economic Profit = Value of Farm Production – Economic Total Expense



Profit Margins

- Operating Profit Margin Ratio
 - $(\text{Net Farm Income} + \text{Interest} - \text{Unpaid Family Labor}) / (\text{Value of Farm Production})$
- Economic Profit Ratio
 - $(\text{Economic Profit}) / (\text{Value of Farm Production})$



KFMA Profit Measures

- Financial Total Expense Ratio
 - Average 0.7828
 - Top Quartile 0.7067
- Economic Total Expense Ratio
 - Average 1.1603
 - Top Quartile 0.9509



KFMA Profit Measures

- Operating Profit Margin Ratio
 - Average 0.0807
 - Top Quartile 0.2272
- Real Value of Farm Production
 - Average 216,275
 - Top Quartile 338,103



Growth Measures

- Acres
 - Total Acres
 - Total Crop Acres
- Income
 - Value of Farm Production
- Assets
 - Total Assets



KFMA Growth Rates

- Average

- Total Acres 0.91%
- Total Crop Acres 0.01%
- Value of Farm Production 1.19%
- Total Assets 2.14%



KFMA Growth Rates and Financial Measures

- Growth Rate in Total Acres
 - Average 0.91%
 - High Growth Quartile 4.38%
- Operating Profit Margin Ratio
 - Average 0.0807
 - High Growth Quartile 0.1245



Competitive Advantage

- Position and Dynamics

- Position

- Overall cost leadership
 - Differentiation

- Dynamics

- Refers to how a firm accumulates resources and capabilities, as well as to how it adjusts over time to changing circumstances.

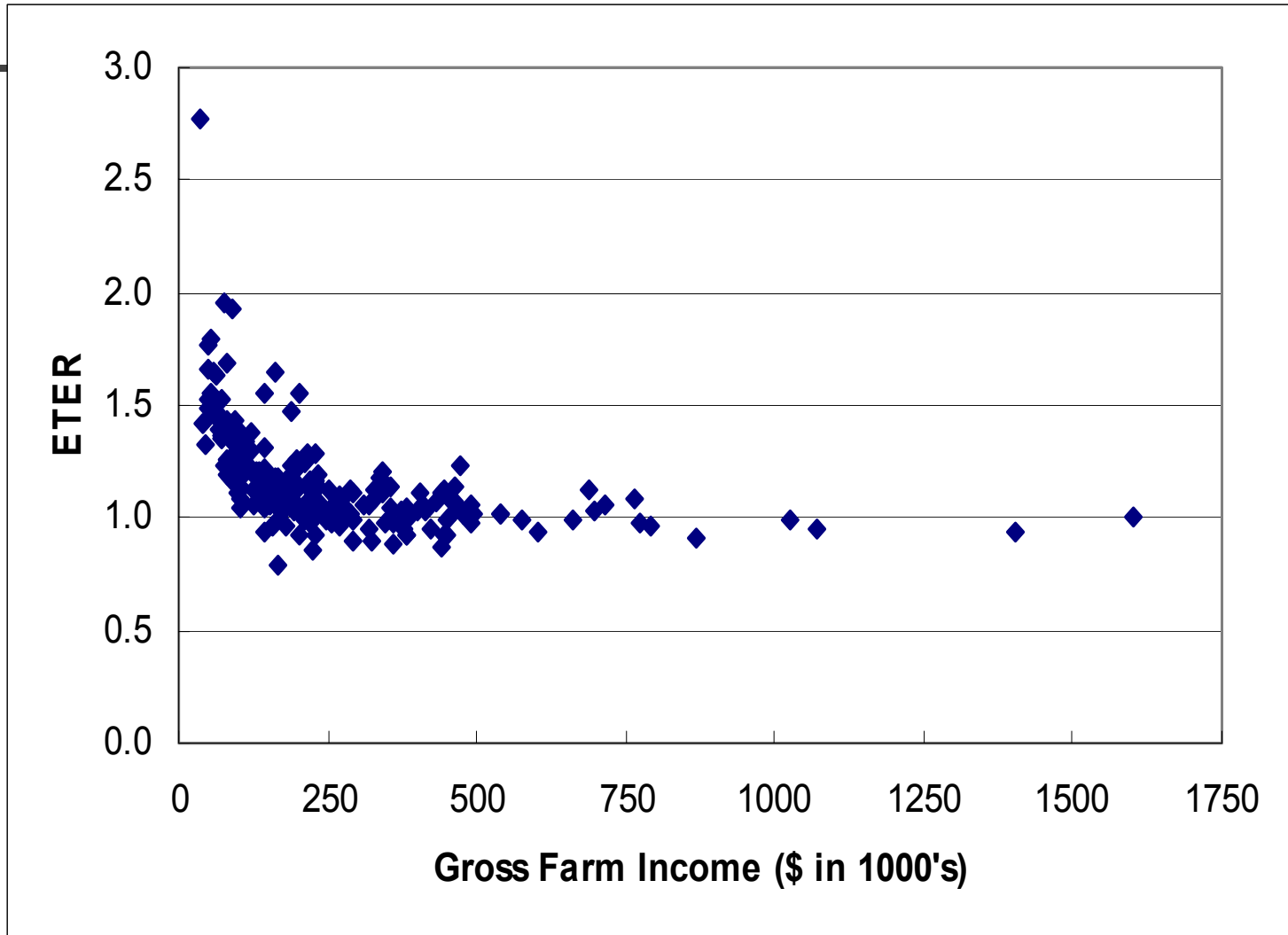


Competitive Advantage

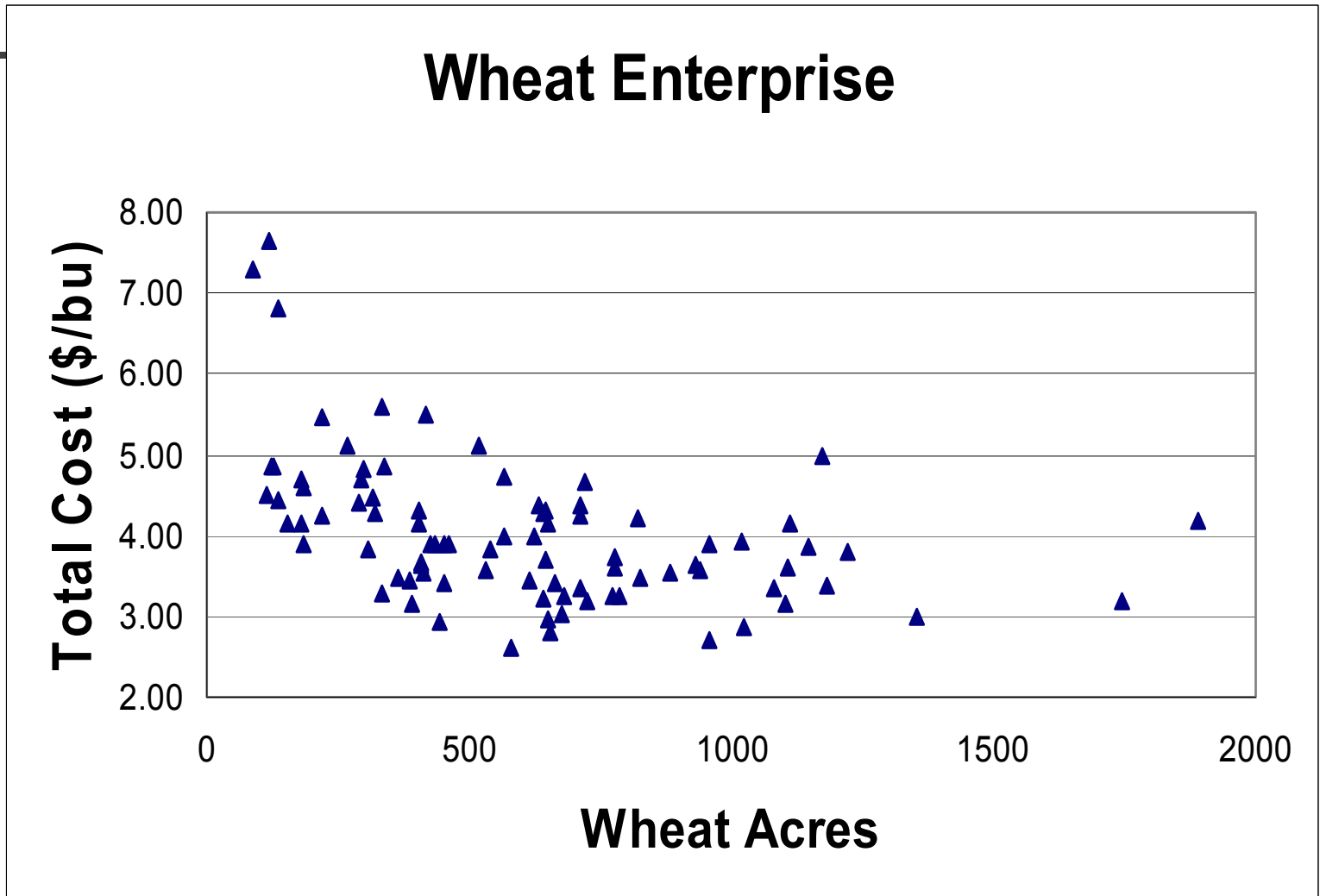
Relative Price Per-Unit

		Lower	Average	Higher
Relative Cost Per-Unit	Lower	1 Indeterminate Position	2 Competitive Advantage	3 Competitive Advantage
	Average	4 Competitive Disadvantage	5 Parity Position	6 Competitive Advantage
	Higher	7 Competitive Disadvantage	8 Competitive Disadvantage	9 Indeterminate Position

Competitive Advantage



Competitive Advantage





Identification of Unique Resources

- Framework for Analysis
- Internal Strengths
- Internal Weaknesses
- External Opportunity
- External Threat
- Short-Term Goals
- Long-Term Objectives



Framework for Analysis

- The Question of Value
 - Do our resources and capabilities enable us to respond to environmental threats and opportunities?
- The Question of Rareness
 - How many competing farms already possess similar resources and capabilities?



Framework for Analysis

- The Question of Imitation
 - Do farms without a particular resource or capability face a cost disadvantage in obtaining it compared to farms that already possess it?
- The Question of Organization
 - Is the farm organized to exploit the full competitive potential of its resource and capabilities?



Internal Strengths

- Identify two internal strengths (what the business does well). How important are these strengths to the overall competitive advantage of the business, and what (if anything) is the business doing to maintain this advantage?



Internal Weaknesses

- Identify two internal weaknesses (what the business does not do well). How important are these weaknesses to the overall competitive advantage of the business, and what (if anything) is the business doing to improve on these weaknesses?



External Opportunity

- Identify one external opportunity that the business might consider taking advantage of. How important is this opportunity to the future of your business, and what (if anything) is the business doing to take advantage of this opportunity?



External Threat

- Identify one external threat that the business might face in the future. How important is this threat to the future of your business, and what (if anything) is the business doing to respond to this threat?



Short-Term Goals

- Draft two short-term (within a year or two) goals of the business.



Long-Term Goals

- Draft two long-term (within ten years) objectives of the business.



Possible Misconceptions

- More profitable farms are bigger, so bigger must be better.
- Borrowing money makes me more profitable.
- My market value net worth increased last year, that means I'm profitable.
- We've always done it that way, we must continue to do it that way.



Possible Misconceptions

- Since I work hard, I should make a good living.
- They do it and make money, I can do it and make money.
- Those who get the best price, make the most money.



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 - MF-905: An Integrated Financial Management Package
 - MF-1101: Whole-Farm, Profit Objective Pricing
 - Thinking About Farming in the Nearby Future, Especially Related to Size and Growth