Building a Business Plan for Your Farm: Important First Steps

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1. Introduction

This paper provides some detail to assist managers and other stakeholders in taking what many consider to be the first steps of putting together a formal business plan. Referring to my example business plan outline (available on the web at www.agmanager.info), this paper basically covers the "description" section and sets the stage for the remainder of the process. Remember, the business plan is intended to be a written summary of what the organization hopes to accomplish, and how it intends to accomplish those dreams. Given that, one of the first considerations in beginning to formalize a business plan is the principle audience for the plan.

Different "stakeholders" may have an interest in the business plan of a particular organization for very different reasons. Certainly, for the management team itself the most comprehensive version fo the plan provides a blueprint or roadmap to help in accomplishing the goals and objectives of the organization. Debt providers (bankers) are interested in a demonstration of the ability of the business to pay principle and interest, and a demonstration of the organization's strategy for dealing with financial risk. Equity providers (investors) look for the plan to demonstrate an ability to generate acceptable profit levels (return on their investment) over time. Finally, there may be incentives available, or regulations in place associated with the development of "nutrient management" plans, "water quality protection plans", or a wide variety of very specific documentation of production practices. Government and other regulatory agencies may be interested in those aspects of the overall plan. The interests of all potential stakeholders may be addressed in a very comprehensive master business plan. It may, however, be appropriate to develop audience specific versions of the overall business plan to better meet the needs of particular stakeholders. Keep the primary audience in mind as the overall plan, or variants of the plan are developed.

Begin with the description section of the plan, which is exactly that, a description of the current business and an overview of future plans. Most formal plans begin with a title page to grab attention. The title page typically includes the business name, the name and address of key owners and/or managers, and the date of the latest revision of the plan. A table of contents typically follows the title page, though obviously the table of contents cannot be drafted until the plan is written. Numerous outlines and example formal plans are available to provide guidance in outlining a plan for your farm or business.

Very early in any written plan, provide an overview, or a definition of your business. It can be short, and simple, but should read well and be well organized. Identify primary products, production practices marketing methods, and other highlights of the business. It may be appropriate to provide a brief history of your business. Remember, the process is all about your competitive advantage. Therefore, in this definition or overview section you should be able to succinctly describe your competitive advantage, while at the same time highlighting potential problems (this is likely done after completion of the other tasks in the planning exercise). Keeping the intended audience in mind, demonstrate an effective management team, and discuss other resources in a very general way. Questions to answer that may help in describing your business include: Who are the customers, how many are there, how do we reach them, and why are we in business? Do we produce for a commodity or specialty market? What is the status of "our" business (i.e. startup, expansion, takeover, etc.)? In addition to these issues, non-production agriculture businesses often consider such questions as: What type of business are we in (merchandising, manufacturing, processing, production, service, etc.)? What phase of the business cycle are we in (embryo, growth, mature, declining, starting new, etc.)? When will our business start, and operate (hours, seasonal or cyclical, etc.). Most importantly, all businesses need to answer the following question. "Is there anything about this particular business that gives me an advantage or dis-advantage?"

2. The Planning Process

As businesses, including farms, become larger, more complex, and involve more stakeholders the traditional command and control management style needs to be replaced by a participatory management style that includes all involved in the business. For the farm management team, this means that skills in planning, communication, negotiation and relationship management are important. Under the traditional command and control management style, planning for the operation and the future of the business is typically done in a very informal manner. The flow of the thought process for the management team (often one individual) often begins with a consideration of the resource base. Activities and enterprises are then selected that "fit" with the resource base. Perhaps some attempt is made to formalize goals and objectives, but in many cases these remain in the minds of the individual managers or owners.

Traditional thought process flow

Resource Base $\longrightarrow$ Activities and Enterprises $\longrightarrow$ Objectives (Maybe) $\longrightarrow$ Goals (Maybe)

A more encompassing management style blends long-term dreams with short-run realities in a well thought out plan. The flow of the thought process for a "planned" management style is dramatically different. The significance of this difference cannot be over-emphasized, as it dramatically opens up the scope of possibilities available to the organization. The management team (and other stakeholders) begin with an over-riding vision of where they want the business or entity to go. The vision is focused down to a more concrete mission, which is made workable through well thought out long-term objectives and short-term goals. A strategy is formulated, selecting enterprises and activities that lead to accomplishment and fulfillment of goals and objectives. Specific tasks and tactics are spelled out, and a resource base is assembled (beginning of course with the existing resource base) to implement the plan.

Planned thought process flow

Vision → Mission → Objectives → Goals → Strategy (Enterprises Activities) → Tactics (Tasks) → Resource Base

The planning thought process flows naturally, and is systematic. Each stage of the process narrows the focus. It is an on-going circle, a never ending cycle of planning thought. At times management and stakeholder efforts devoted to long-term planning may focus on the Vision, Mission, Objectives, and goals components. At other times short- term planning sessions (weekly work detail meetings, for example) might be devoted to short-term goals, and activities and tasks that will lead to accomplishment of those goals. This systematic approach to planning and managing will not allow the entity to stray off in a direction that violates the fundamental principles spelled out in the vision and mission statements. The first several components of the planning process are examined in more detail in the following sections.

Vision and Mission Statements

Vision is a long term concept, focusing on where the business hopes to be in the future. The vision provides guidance for the organization over the long term. Characteristics such as business size and scope, composition and quality of products or services, target markets, and work force composition may be reflected in the vision statement. Vision statements often directly reflect deeply held core values such as honesty, integrity, passion for rural lifestyle, concern for the environment, etc.

The more specific mission statement then needs to embody the broader vision. A well written mission statement outlines the basic purpose of the business and summarizes what is done, who it is done for, and how the organization conducts itself. To use the analogy of a physical structure, the mission statement provides a foundation for the rest of the plan. Just as physical structures can collapse in the absence of an adequate foundation, many businesses have failed due to lack of a shared purpose or understanding regarding direction. Therefore, in formulating a mission statement it is important to focus attention on the guiding values, principles, and primary roles of the organization so that you provide direction for the business. These can include economic, environmental, family, and community components as well as others. The mission statement should encompass the primary roles of the organization, and provide guidance for balancing those roles. The mission statement is then used as a reference when making decisions. All stakeholders need to be involved in formulating the mission statement. When individuals are not involved, they are less likely to be committed to the overall mission.

As an illustration of the flow from an over-riding "vision" to a more focused "mission", a ranch could have a vision of producing the highest quality beef products possible. More concrete attributes like genetic characteristics, environmental responsibilities, commitment to the community, employee friendly workplace, etc, then need to be incorporated into the mission statement.

The process of developing vision and mission statements is as important as the product. Getting input from every stakeholder, drafting statements, getting feedback, revising, and re-writing gets the communication flowing regarding things that really matter. However, due to the abstract nature of the activity, developing vision and mission statements can be one of the more difficult tasks for the farm business management team. Because of this difficulty, and the belief by some production oriented managers that it is not a critical component (remember the traditional thought process flow), many business plans are not well grounded on a solid foundation. Those who do expend the time and effort to base their planning activities on an over-riding vision and a more specific mission for their organization will find that they provide a solid foundation for the business and provide guidance for day-to-day activities.

Developing Vision and Mission Statements

Individuals and organizations approach the visioning process differently. There are, however, a few suggestions that may make the process easier. For example, it is very difficult for people to objectively think about long term success in times of extreme hardship. Therefore, it is certainly appropriate to focus planning efforts on short-term goals, and associated activities when the organization is faced with extreme stress. Relegate long-term planning activities (visioning) to non-crisis time periods. Throughout the visioning process, keep some core values in mind. Think about what you admire or respect in other people or businesses. If you respect someone who is hardworking and honest, then you likely value hard work and honesty. Stephen Covey[1] suggests that the vision - mission statements of the organization should address all four basic human needs and capacities (to live, to love, to learn, and to leave a legacy). Pondering the following questions may help in formulating a clear and brief mission statement that is specific to your farm business. What business are we in, and why? Why am I doing what I am doing? What do I want to accomplish with my business and in life? What need are we filling? (Not "what product are we producing?") Are we considering new activities (what needs will we fill)? We are pursuing these activities because .... What are we good at (strengths of our business)? Who are our customers, and what are their needs? What qualities of products will we produce? What role do family members, partners, and employees play (roles, responsibilities)? What do

[1]For an excellent discussion of the visioning process, and to see examples of vision - mission statements, I suggest reading the works of Stephen Covey, including the following: Covey, S.R. The Seven Habits of Highly Effective People. Simon and Schuster, New York, NY. 1989.

we expect the business to contribute to the various stakeholders? What do we want our farm (or business) to be in ten years? We will be recognized by our ability to .... What makes our business unique? There are many ways to begin drafting a vision and mission statement. Thinking about (and filling in) the following matrix of business and personal attributes may help to concisely verbalize "why our business exists", and "what do we what the business to look like".

Visioning Matrix

	Now (Mission Statement)	Future (Vision Statement)
What Business are we in, What Products / Services do we provide		
Primary Production Practices (Standard or Unique)		
Size and Scope (enterprise mix) of the business		
Marketing Practices (Traditional or Unique		
Management / Organizational structure		
Social - Environmental concerns / responsibilities		
Labor force structure and philosophy		

Managers who successfully communicate to others what they want to accomplish generally are more efficient in accomplishing those dreams because everyone is headed in the same direction. Many traditional management teams find that summarizing their values and attitudes is the most difficult phase of developing a business plan. However, those common values and attitudes are the foundation of the business and will be ultimate indicators of success. Remember, all stakeholders (employees, business partners, etc) must be oriented to the mission if the business is to efficiently move forward. With that said, one danger of written vision and mission statements (and the most common criticism) is that they can quicky become too abstract and all encompassing. This pitfall can be avoided if the plan oriented management team remembers that trying to do too many things can impede the success of the business. Keep the most important purpose and intent of the visioning activity in mind; to inspire and direct you and others in the business, not to impress outsiders. Keep both the vision statement and the mission statement brief (a rule of thumb for the mission statement is 100 words or less) in order to avoid the temptation of allowing the statements to become too broad.

Realize that developing vision and mission statements that are appropriate for your farm or business will require a significant amount of time and effort. Spread that effort over numerous family and stakeholder discussions. With that said, lets begin with the following generic templates to illustrate and begin the thought process. If it helps you get started on the visioning process, look back at the points you included in the visioning matrix to help you individualize the following generic statements.

Vision Statement

In ten years our business will be providing ______..... We will be recognized for our ability to _____ .... We are pursuing these activities because_____ ....

Mission Statement

The mission of _______________ is to operate a ______________ ..... This endeavor will provide:
(desired financial results)
(desired product results)
(desired living-family environment)
(desired family - business transition results)
· (recognition within industry, community, etc.)

Your business may, or may not, currently have vision and mission statements. If it does, you should check for currentness, and support. If not, your business will be better off if management provides the leadership and commitment necessary to develop them.

<u>Objectives and Goals</u>

All farmers have in mind certain things that they want to accomplish in their business, and in other roles in life. The planning thought process simply helps define and formalize those "dreams" into short-term goals and longer-term objectives that support the over-riding vision and mission of the organization. For lack of a better terminology, we will refer to the process as "goal setting". In general, objectives and goals describe conditions that you hope to achieve and reflect hopes and dreams for your business or personal life. Continuing the flow from formulating vision and mission statements, the goal setting process is often challenging for agricultural business managers because many people have not tried to formalize their abstract ambitions. However, clearly defined written goals are not an option for a serious, comprehensive business plan. Remember, planning is by definition a goal oriented activity. Going back to the physical structure analogy, if the mission statement provides a foundation for the plan, well written objectives and goals provide a solid framework for achieving the mission of the organization.

Under traditional management organizational systems, setting personal and business goals and objectives is often like making New Year's resolutions. They can be fairly easy to make, but are often difficult to stay on track to attainment. This is, in my opinion, because they are often not a direct carryover from the "visioning" process talked bout earlier. In other words, they are often not tied to a solid foundation. Without having written goals to direct your efforts, arriving at your destination in life and in business will be heavily influenced by forces beyond your control. This is why it is so critical that your goals and objectives flow seamlessly from the over-riding vision and mission of the organization. Build on what you think is important from your mission statement. Make the mission statement operational by translating it into more specific objectives and goals. Objectives give direction, goals provide the specifics and set the timetable.

Like all planning activities, the goal setting process takes time, a precious commodity for everyone. However, clearly defined goals are a critical element in developing a well designed business strategy. Here are some specific reasons why written goals are important, and why they work to direct the organization in the desired direction. First, documentation that indicates where the business is headed allow others including lenders, investors purchasers of outputs, input suppliers, regulators, and other family members to decided whether, and how they want to be a part of the future of the business. Second, by setting goals, we initiate behavior to begin to achieve the goal. Achieving goals then serves as a rallying point for the family or management team, providing much needed continuous motivation. Finally, without goals there is no way to measure the results of management decisions, or make adjustments to management decisions. Well documented objectives and goals provide this reference. To summarize, well expressed goals provide management direction and consistency, and add precision to the decision making process so that resources can be allocated more effectively. In addition, goals facilitate sharing with others and demonstrate to all stakeholders that the farmer has given serious thought to the current situation, and to the future.

Goal setting requires creative thinking, as goals are personal and unique to the specific situation because they reflect values and beliefs (from the vision and mission). Goals need be specific enough to provide the guidelines for decision making, while at the same time being flexible to allow for changes an interests and priorities which constantly change. The formal objective and goal setting process must involve discussion and compromise among family and business partners (communication is critical throughout the planning process). Goal setting is really about asking yourself (individually or as an organization) a series of questions, and honestly appraising the answers. Think about these broad, over-riding questions: What do I really want out of life? What do other stakeholders or other business partner(s) want out of life? Jot down a few initial thoughts that come to mind as you ponder those questions.

Think about your farm or your business, and as the following questions: What are we trying to achieve? What can we do that is most productive and worthwhile? As you again document some of the thoughts that come to mind it may be time to as the reality check question: When can we realistically achieve these things? As you think about the things you would like to accomplish, also consider the people, and the potential conflicts involved by considering the following questions: How can we capitalize on the interests and abilities of the people involved?

How do we resolve conflicts? You may, or may not have satisfactory answers to these questions at this time, however you should begin to realize the importance, and the power, of considering these issues. An additional broad issue is on the minds of many late career farm owners and managers: Who will take over when I retire? Again, jot down some possibilities as we begin our goal setting activity. Remember, it is the process of contemplating these and other tough questions that ultimately helps business managers and family members to begin to formulate objectives (longer-term general direction), and goals (short-term measurable actions).[2]

Paul Gessaman, a long time business planning specialist from the University of Nebraska, suggests that a family farming operation, for example, might begin the objective and goal setting process by having each individual involved work through a "self assessment". Each person involved begins by pondering such "big" questions as; is farming/ranching our best occupation? Then the focus turns to more specific questions such as; what aspects of farming/ranching do I enjoy or want to do? The following groups of statements are adapted from the original work of Paul Gessaman (the original work includes much longer and more comprehensive lists of "self assessment" statements). The idea is that each stakeholder would begin the goal setting activity by rating each statement on a scale including strongly agree (SA), agree (A), undecided (U), disagree (D), and strongly disagree (SD). Many individual farm and business planning teams have found this exercise extremely helpful in initiating the goal setting process.

Statements Regarding Farming in General	SA	A	U	D	SD
Farming/Ranching is the best occupation for me					
I enjoy the variety					
I look forward to work every day					
I can accept a lower income to be farming / ranching					

Statements Regarding Farming/Family Interaction	SA	A	U	D	SD
It is important that the family work together					
Farm work comes before family activities					
I can delay farm work for family activities					

[2] I have adopted the convention of referring to longer-term (usually more than one year) aspirations and associated written statements as objectives, and referring to shorter-term specific action statements as goals. Other authors use different terminology (long-term goals and short-term goals) for example. Please do not allow yourself to get bogged down in the terminology if you are gathering information on "goal setting" from a number of sources

Statements Regarding Specific Tasks	SA	A	U	D	SD
I enjoy working with livestock					
I enjoy raising crops					
I enjoy machinery maintenance and repair					
I enjoy record keeping					
I enjoy marketing agricultural products					
I enjoy negotiating with suppliers, lenders, etc.					

Statements Regarding Management Tasks	SA	A	U	D	SD
I enjoy planning for the future					
I believe I get higher yields and production than others					
I work harder and/or manage better than others					
I enjoy working with employees					

Statements Regarding Alternative Careers	SA	A	U	D	SD
I could enjoy working in another occupation					
I could enjoy working for another farm / ranch					

Statements Regarding Stakeholder Communication	SA	A	U	D	SD
Our family makes important decisions together as a group					
We enjoy planning for the future together					
I am satisfied with the level of organizational communication					

Statements Regarding Community Involvement	SA	A	U	D	SD
I enjoy involvement in community activities					
I have too many claims on my time					

The planning team may want to modify these lists, add categories, or in other ways modify the exercise to better fit their individual situation. Information from each stakeholder's self assessment can then be summarized into some general statements regarding how you, and others in your organization, feel about farming and ranching in general, relationship between the farm and the family, specific skills and interests, competitive advantage, working off the home farm, management communication, etc. The exercise captures the motivation, interests, abilities, skills of each individual involved, and can yield benefits beyond the goal setting component of formulating a business plan. For example, the process may lead to discussions about finding innovative ways to accomplish certain aspects of the business that are not particularly liked by any of the current stakeholders, increasing job satisfaction of individuals within the organization.

In order to translate the self assessment activity (these general statements combined with additional information) into formal objectives and goals, it is important to understand the difference between the two. Under the terminology convention that I have adopted (certainly not universal), objectives are more general, and have a longer time horizon. They reflect what the organization hopes to accomplish over the long-run. They should flow directly from the mission statement, translating it into motion. Examples include:

Increase gross income per acre:
Reduce work load:
Devote more time to family activities:

Goals, on the other hand, should be specific time-bound statements that provide the benchmarks for measuring success. Goals translate objectives into statements that are specific. They work on the principles of focusing attention, mobilizing energy, increasing persistence, and developing work habits. Examples include:

Increase average wheat yield to 42 bushels per acre next year:
Contract with a custom operator to put up alfalfa crop beginning this year:
(*These first two example goals are actions directly related to the first two example objectives*)
Reduce pre-weaning calf death loss to 5% or less beginning with this year's crop:
Replace combine before next harvest:

The following widely used acronyms may help planners to distinguish between long-term objectives and short-term goals. Long-term objectives DRIVE (Directional, Reasonable, Inspiring, Visible, and Eventual). Short-term goals are SMART (Specific, Measurable, Attainable, Rewarding, Timed). Goals that are too general and vague provide little direction for the management team. Remember, specific strategies and tactics (production and marketing plans) need to flow easily from the objectives and goals.

To continue with the objective and goal setting process, some businesses may find it useful to have each stakeholder or business partner translate the information from the previous exercise into goal setting matrix like the following. Draft objectives and goals that are consistent with the statements resulting from the self assessment, and that flow from the vision and mission of the organization.

Category	Near Term (Goals)	Longer Term (Objectives)
The overall business production enterprises and activities		
Marketing and management		
Financial position size, structure		
Personal / family family - business interaction family communication community		

We are not done yet: In the next step of the goal setting process, the broad array of objectives and goals that various stakeholders bring to the "table" from the previous exercises need to be "thinned out" and prioritized. In other words, there is a need to make choices to reduce the demands on limited resources, and to reduce conflicts between business and family activities, as well as conflicts between the objectives and goals themselves. There is a need to examine whether short-term goals aid or impede long-term objectives, for example. Furthermore, some goals may naturally be substantially more important to stakeholders than others. Keep in mind that the entire planning thought process is continual and iterative. Numerous meetings and conversations involving all stakeholders will be needed to move the process forward.

The prioritization process does not rule out efforts to attain a variety of goals. It does, however, help assure that higher priority goals receive preference in the use of available resources. Prioritization can range from "strict" (highest priority goal is achieved before working on lower priority goals) to "limited priority groupings" (highest priority goals get more attention, but lower priority goals are not totally ignored.

The following exercise is suggested as one way to prioritize goals and resolve conflicts. Begin by developing a list of long-term objectives that are agreed upon by all stakeholders. Remember, an important consideration when developing the list of objectives is that they are consistent with, and flow naturally from the vision and mission of the organization. Always double check that there is not an in-consistency developing in the goal setting process. We begin with the objectives because typically the list of long- term objectives is shorter, and less controversial, than the list of short-term goals presented by various stakeholders.

With the list of agreed upon objectives in front of the planning team, separately create a master list combining each stakeholder's list of short-term goals. Include with this list an estimate of primary resource commitments necessary to achieve the goal. Tentatively sum up the resource commitments by primary resource category (money, labor hours, etc.). Then rank each goal on a scale of 1 to 10 with respect to how well it matches up with other goals and long-term objectives (1 being a poor fit or conflict, 10 being complementary and consistent with achieving other goals and/or long-term objectives). Formalizing this process should help stakeholders to arrive at an "overall ranking" of the list of goals. A worksheet similar to the following can be used to summarize this information.

Goal	Labor Commitment	Financial Commitment	Match with other Goals and Objectives	Overall Rank

Some may find it useful to categorize the master list of goals according to their "role" (father, farmer, student, homeowner, etc.). This may help to narrow down a long list of un-related goals into categories that will be more likely to directly compete with each other. This should make it easier for stakeholders to come together to agree on most important items. The overall ranking process again involves answering a series of questions. Which goals are most important for family well being? Which goals are most important for the business? Are short-term goals consistent with, or conflicting with long-term objectives? For the rest of the list (where there is not consensus), communication inherent in the planning thought process can help to resolve tradeoffs and rank goals and objectives terms of importance. This communication is vital in minimizing the conflicts tat may arise when establishing, prioritizing, and reconciling goals among individuals. This subjective, communication oriented process will help to bring family members or business partners closer and help to build an internal support system for the final business plan and it's implementation. In addition, don't hesitate to involve other interested parties (landlords, etc) in certain aspects of the process.

I have mentioned it several times, but it cannot be over-emphasized that the goal setting process is iterative. After contemplating and trying to prioritize short-term goals, the management team may find that there is a need to go back and re-visit long-term objectives, or even revise the mission and/or vision statements of the organization. The process continues (perhaps over several communication sessions with time for individual reflection in between) until the organization has arrived at a set of business and family objectives and goals flowing from a vision and mission that all stakeholders are satisfied with.

When the "stakeholder teams" become stuck in disagreement regarding particular objectives or goals, make sure that all parties at least see the issue the same way, and understand the nature of the disagreement. Also make sure that all stakeholders have had the opportunity to share their opinions. Go back to the family and business core values that are most important, and if necessary consider bringing in outside resources to explore additional options. Re-examine the estimates of resource commitments to the various competing alternatives. Perhaps most important, make sure that all stakeholders are satisfied that the decision making (goal setting) process is being handled fairly, even if they disagree with the majority on the overall ranking of a particular goal or objective. If an acceptable degree of agreement regarding a particular objective or goal cannot be reached, then it must be removed from the list, or lowered in terms of importance. Otherwise, stakeholder commitment to the overall plan will be jeopardized.

Hopefully, and for the purpose of proceeding with this paper we will assume, disagreements can be resolved and a list of objectives and goals that support the mission and vision of the organization can be developed. The agreed upon list of long-term objective and short-term goals can then be incorporated into the organizations business plan along with the vision and mission statements. Keep in mind, however, that the list is never final. As with other elements of the planning process, objectives, goals, and the prioritization objectives and goals change over time. Markets, family situations, resource availability, financial performance, interests, business opportunities, etc. will vary over time. When this happens, the mission is revisited, objectives, goals, and priorities are revised, and plans are updated. While time and effort is required, the updating process renews and improves your capability for effective management.

If the goal setting activity is successful, a list of activities, strategies, and tactics that support goals (this will be incorporated into the production plan, HR plan, transition plan, etc.) will flow naturally and with surprising ease. Details will follow in subsequent papers regarding business plan development.

As I final thought on the goal setting process, keep in mind the following potential common pitfalls that not only make the goal setting activity less productive, but can lead to frustration with the planning and visioning process as a whole. First, avoid making goals that are too lofty. Remember that goals need to be attainable within the economic and physical capabilities of the organization. Avoid too many short-term goals at once. Each individual goal may seem well within the reach of the organization, but the stakeholders involved can become overwhelmed and frustrated if the organization is attempting to accomplish too much in a short time period. While the ability to measure progress toward goal achievement is very important, too much emphasis on the quantitative aspects of performance measurement in the goal setting and implementation process can lead to frustration, especially if external factors lead to less than optimal performance of some aspect of the organization. Similarly, remember to consider risk when developing production and performance targets that are translated into goals. Finally, gather and discuss among stakeholders as much information as practical in the goal setting process. Taking the process too "lightly" and not taking time to gather and evaluate as much information as possible will most certainly lead to less than optimal planning results.

3. Organizational, Legal, and Financial Structure

Organizational (Management) Structure

The vision, mission, and core values form the foundation and set the stage for behavior within any business organization. The cultural framework within which stakeholders interact is important in determining the performance of the organization. Stakeholders (including employees) need to know what their role is, and what is expected. A well-defined organizational structure yields a framework for stakeholder interaction, and assures that everyone involved in the organization understands what is expected, and how decisions will be made. Whatever organizational structure is ultimately selected, it must facilitate the following important outcomes: First, each stakeholder must be aware of the vision, mission, objectives, and goals of the organization, and each stakeholder must be committed to achieving those objectives and goals. Often this involves each stakeholder playing an active role in developing those objectives and goals. Second, each stakeholder must understand the roles of other stakeholders. This is accomplished by providing an organizational climate that is conducive to open communication and problem solving. Finally, lines of responsibility, authority, and accountability need to be clearly established and understood by all stakeholders.

The most traditional, and still common, form of organizational structure is the hierarchical management structure, where decisions are made in a top-down command and control fashion. Power and authority are retained at the top, and most decisions are made or approved by the manager. This type of organizational structure is slow to respond to evolving opportunities in many cases, however it does provide order and security within the stakeholder team.

A second general form of organizational structure is the bureaucratic system, where responsibility is diffused among various levels of the workforce. Each individual in the management chain is constrained by rules and procedures that strictly dictate the decision making process. This type of organizational structure is obviously slow in responding to opportunities, and is often the least flexible.

A human, or "people oriented" organizational structure spreads out the decision making responsibility among the individual employees and managers, or teams of employees and managers. A "hybrid" organizational structure might capture some elements of the people oriented organizational structure while providing some top-down direction from management.

The organizational structure implemented in a small business will ultimately depend on the management or owner philosophy, the abilities of key personnel, and to some extent the sheer size of the operation. No one structure is "best" in all situations. Planners and managers need to weigh the advantages and dis-advantages of each organizational structure, and decide on an appropriate structure for their situation.

From a business plan development perspective the critical thing to keep in mind is the importance of identifying a capable management team and management structure that is consistent with the vision and mission of your organization. As stakeholders put together a vision statement and a mission statement, it is important to think about an organizational or management structure that will facilitate implementation of that vision.

Business Organization (Legal Form)

In this section of the plan the purpose is to describe the current ownership structure of the business, and perhaps explore alternatives. Individual managers should place as much emphasis on this portion of the plan as needed to provide direction in achieving long run business objectives. For example, if the legal form of the business structure has significant implications for family tax management, estate planning, business transition planning, or other important objectives then a significant amount of attention should be given to this section of the plan. In other instances the existing business structure may be adequate to achieve the objectives and goals of management, and a simple description of the existing structure (how owners are compensated for their investment) may be all that is needed.

In this paper I provide only a brief overview, and attempt to bring attention to the primary issues to consider. If you are considering a new venture, or substantial changes to the existing business legal structure, remember that legal requirements and documentation for various business entity possibilities vary from state to state. Work closely with legal counsel, an accountant, and other management professionals that are well versed in this area to decide which structure(s) may be most appropriate for your situation and to assist in developing those legal structure. Here, we are considering the issue of legal structure in the context of the overall business planning process. We are summarizing information and formalizing a thought process in order to find, describe, and refine our competitive advantage. For this purpose, what is needed is an overview of the various options that are available.

When the stakeholder team of a business, or potential business, is considering the choice of an organizational structure the primary issues are: 1) source of capital, 2) liability, 3) management flexibility and control, 4) continuity, 5) taxation, 6) legal filing requirements. The issue that is talked about as much as any other (and perhaps rightfully so) is the issue of liability. A primary objective of most equity investors is to limit their personal liability. This is particularly true of investors who do not wish to participate in management. The choice of organizational structure should not be taken lightly, as it can be very difficult and costly to change once a business is operating under a particular structure. The following is an overview of the principle types.

Sole proprietorship

The sole proprietorship is still the most common form of business organization for farms and ranches. The business is limited to the life of the owner, and the individual is responsible for all debts and obligations. Income is reported, and taxed at individual rate. Primary advantages of the sole proprietorship operating structure include ease of startup, as there are few formalities to go through to get the business going, and management control. Decision making is centralized with the owner - manager. An individual can conduct business in any state, with few reporting requirements. The corporate "double taxation" problem is avoided, with profits simply taxed at the owner's personal rate. Similarly, business losses can typically be used to offset other income for taxation purposes. On the other hand, there are certain IRS code benefits available to other organizational structures that cannot be captured under a sole proprietorship. Additional disadvantages in many situations include the fact that the sole proprietorship terminates with the death of the owner, and investment capital is limited to that available to the sole owner, making it difficult to obtain long term financing and limiting growth potential, particularly as the operator ages. This "life cycle" disadvantage results in the sole proprietorship being the least effective structure for maintaining the overall farming operation at peak efficiency. An additional important consideration is that the owners personal assets are subject to any business liabilities. Finally, the sole proprietorship organizational form can be a hindrance to estate planning, however, if the farm operation will cease at the owner's death, this may be the simplest structure to liquidate.

Partnership

In a general partnership all partners share equally in rights and responsibilities of business management. Partners are jointly responsible for debts and obligations of the business. Income distributions, responsibilities, etc are typically spelled out in a partnership agreement. General partnerships can be registered with secretary of state, but this is not required (in Kansas). Income is passed through for tax purposes, so profits are taxed at the rates of the individual partners. Partnerships must file for a Federal Employer's ID number whether they have employees or not. Again, consult legal and accounting expertise when considering forming a partnership. At a minimum, it is strongly recommended that you prepare a buy-sell agreement and a partnership agreement, to avoid major conflicts down the road if circumstances change.

The primary of advantage of a general partnership relative to some of the more complex organizational structures is the ease of organization, and the low initial cost of organization. The general partnership is a quasi-entity that can own assets, enter into contracts, etc. Resources are drawn from all partners, expanding the resource potential relative to a sole proprietorship. Partners can take business losses as personal tax deductions. The liability issue is a primary concern when considering a general partnership. Liability is shared between partners, however each partner is liable for all obligations against the partnership, and may be held liable for obligations against another partner. Control and decision making are shared, and legally each partner can act on behalf of the business. This aspect has some advantages, however it does underscore the importance of choosing partners with care as it is difficult to get rid of a "bad" partner. As with a sole proprietorship, there is not continuity of life beyond the partners, and depending on the details spelled out in the partnership agreement and associated buy-sell agreements the business may be forced into liquidation with the death of a partner. Due to these uncertainties, it may be difficult for the partnership to obtain large sums of capital. Finally, unlike some of the more complex organizational structures, there is no way to accumulate earnings within the partnership tax deferred. The pass-through taxation characteristic dictates that partners must pay tax on their share of the profits, even if retained.

A more formal class of partnerships (requiring formal partnership agreements and other documents meeting the requirements of the state where formed) include limited partnerships, and family limited partnerships. The most general form, the limited partnership, is a formal agreement between one or more general partners and one or more limited partners. Limited partners have no voice in management. Therefore, the general partner views the limited partners as a source of capital, while the limited partner is essentially trading a voice in management for limited liability. A primary advantage is the limited liability feature. Each limited partner is liable for debts only up to the amount of his or her investment in the company. Another advantage is the flexibility of this organizational structure. A person may be both a general partner and a limited partner. Limited partner interests can be sold at any time to raise capital, though once sold there are limits on the ability to trade those interests. The life of the company is not tied to any one partner's mortality. Profits are "passed through" to investors, so income is taxed at individual rates. Disadvantages include the complexity and cost of formation, and the advanced accounting and reporting requirements imposed by state regulations. The general partner may expose themselves to unlimited liability, while the limited partners have little voice in management. The limited partnership is often considered to be a good choice for property ownership, or for raising capital.

The family limited partnership is a special form of limited partnership provided for by statutes in most states. The principle objective of a family limited partnership is to carry on a closely held business where management and control are important. The advantages and disadvantages are similar to those of a limited partnership, however, there are restrictions regarding who can participate as partners.

Corporation

The corporation is the most complex business structure that would typically be considered by an agricultural business. The corporation is a separate legal entity comprised of shareholders, directors, and officers. It is considered to be a separate taxable entity, however, it may be taxed under sub-chapter C or sub-chapter S. The C corporation reports income and expenses on a corporate tax return, and is taxed at corporate rates. Profits are taxed before dividends are paid. Dividends are also taxed to shareholders, who report them as income resulting in the "double taxation" of profits. The S corporation is taxed in much the same way as a partnership. Profits are taxed at the shareholder's individual rate. Either type of corporation can enter into contracts, own property, etc.

A primary advantage of the corporate organizational form is that no shareholder, officer, or director can be held liable for debts of the corporation (unless a law was breached). Additionally, interests in the business can be readily sold by transfer or sale of shares of stock. This simplifies the problem obtaining capital and compensating resource owners, and facilitates estate planning. Depending upon whether the corporation is formed as a sub-chapter S, or a sub-chapter C, various levels of flexibility in tax planning are available. The entity can exist into perpetuity as long as regulations are met, and there are some advantages in the availability of pension plans, medical plans, other insurance plans, etc. relative to other forms of business organization.

A primary disadvantage of the corporate structure is the initial startup cost, and ongoing administrative requirements. Fairly extensive articles of incorporation are required, and documentation is required in each state of business. Extensive record-keeping and filing of reports is required on an on-going basis. Furthermore, management control is vested in the board of directors and officers, so minority shareholders may feel left out. Under the sub-chapter C structure there is the possibility of double taxation of profits, and it is more difficult to use business losses to offset profits from other endeavors. Finally, the corporate entity can be the most difficult and costly to dissolve, making business exit difficult if circumstances change.

Limited Liability Company (LLC)

A limited liability company is a business entity that combines the limited liability of a corporation, with the flexible management options of a general partnership. Kansas was the fourth state to authorize this form of business entity in 1990.

Advantages include the limited liability of the various parties involved, relatively flexible management options that the structure allows, and partnership tax status. Depending on the way the company is set up, it can be perpetual, or there may be a limit on the life of the company. This form of business structure is not provided for in every state. Limited liability companies are complicated (and expensive) to form, and are subject to complex accounting and reporting requirements. In addition, ownership interests are not as liquid as shares of stock in a corporation, and are much more difficult to transfer making it a less attractive choice if estate planning is an imminent concern. The following table summarizes the pro's and con's of the various legal organization choices.

Type	Liability	Continuity	Management control	Taxation	Capital acquisition
S P	Unlimited	None	Proprietor	Individual	Difficult
Gen Partnership	Unlimited	None	Partners	Individual	Limited
Limited Partnership	Limited	None	Partners	Individuals	Limited
C corp	None	Perpetual	Board	Double	Stock
S Corp	None	Perpetual	Board	Individual	Stock
LLC	None	Limited	Members	Individuals	Possible

With all the complex choices available, it is important to seriously consider the legal organization structure of the agricultural business. There are no “blanket recommendations” as no single structure can meet the needs of all agricultural businesses in all situations. Many businesses consider changing the organizational structure when making major changes to the business, when attempting to bring another generation into the farming business, or when going through the estate planning exercise. General questions that need to be considered include: how much money do we need to raise now, and what are the sources of funding available? What is the possibility that we will need to attract capital for growth? What skills are needed in the business, and are there others currently available that have those skills? How much am I willing to expose myself, and others, to the responsibility for debts and other obligations of the business? What structure will provide the appropriate level of flexibility regarding ownership and management control, taxation flexibility, and transition and estate planning?

Financial Structure

Inadequate financing, or inappropriate mix of financing and be a major contributor to business failure. The nature and timeliness of financing can impact success and survival probability. In the context of the business planning thought process, there is a strong relationship between the organizational type, and the range of available financing options.

Beginning with the basics, there are two major categories of financing available to businesses, debt and/or equity. Equity is a contribution of resources in exchange for an ownership stake. This can be cash or non-cash, tangible or intangible. The ownership stake allows the investor to share in the company’s profits. A simple example of equity capital contribution is the contribution of owned land to a sole proprietorship farming operation. The “business” simply uses the land that is owned by the manager, and profits accrue to the manager in return for his or her contribution of land to the business. Debt involves borrowing resources from creditors with the stipulation of repayment of principle and interest in the future. Again, the resource can be cash or non-cash, tangible or intangible. The reward to the provider of debt financing is the interest payment. Debt can be secured, or unsecured. Secured debt is backed by some underlying asset of the business, meaning that if the debt is not re-payed according to the agreed upon terms, the creditor may exercise the right to take title to the underlying business asset. Leasing can be viewed as a special case of debt financing, where the creditor (leasing company, landlord, etc.) agrees to provide the use of a resource or asset in return for an interest (lease) payment.

Sources of capital (either debt or equity) for traditional agricultural businesses have included the founders (entrepreneurs), friends and family, and financial institutions. The complexity, and scale of operation, of some modern agricultural businesses dictates that they look to sources of financing that have been used by other entrepreneurs and businesses for some time, including business contacts and associates, venture capitalists and business angels, and the general public.[3] If appropriate, don't ignore one final source. It is becoming more common to obtain outright grants and incentive payments for certain business activities associated with agriculture.

The organizational structure may to some extent dictate the financing options that are available. For example, venture capitalists and business angels, as well as the general public are more likely to provide financing in a corporate structure. Providers of long term financing may in general feel more comfortable with a corporate structure, simply because of the life cycle nature of other business organizational structures where the business tends to follow the life cycle of the management/ownership team. Many businesses, for example, follow the performance pattern of an early stage, a growth stage, a mature stage, and a declining stage where the owner is phasing into retirement. Long term investors like to see an organizational structure that facilitates continue growth, and provides a motivation for the business to remain on the "cutting edge".

Remember, when making major changes to an existing business, or when starting a new business venture, having the appropriate investors (financing) on board at the early stages can critical. Traditional funding sources should be considered and explored. If it is determined that non-traditional sources of financing may be required at the onset, or in the future, consider the legal form and organizational structure that will best facilitate attracting capital for your business. Then make a list of potential sources of financing, and assess the ability of each potential source to contribute various types of needed resources. At the same time, evaluate the potential cost (interest payments, lease payments, ownership and control interests in the company, etc.) of each potential source. Control may need to be sacrificed to obtain the necessary capital. On the other hand, the right investors may bring valuable connections and/or management skills to the business, in addition to tangible resources.

Most importantly, many agricultural businesses of today which are both large in size and complex in nature will need a comprehensive business plan in order to attract interest from either traditional and alternative financing sources.

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[3]For an excellent discussion of options available refer to the following paper available on the agmanager.info web site: Amanor-Boadu, V. "Options for Financing Agricultural Value-Adding Businesses" , Department of Agricultural Economics, Agricultural Marketing Resource Center, Kansas State University, 2003.