SECTION 1

INTRODUCTION

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INTRODUCTION

Farm and ranch managers face many challenges. There are many definitions of management, but in its broadest sense, management is the allocation of resources used in the production of some good which is sold to make a profit and meet the business goals of the firm. The WIRE (Western Integrated Ranch/Farm Education) program is based on the concept of integrated resource management. Integrated resource management requires an understanding of the relationships between all available resources, the activities performed and external influences in evaluating the impact of each decision. The objective is to maintain a profitable operation consistent with business and family goals through proper utilization of available resources. The WIRE focus is on the development of a logical systematic approach to managing all the resources to that end. The manager who continually monitors and strives to understand resource use, products sold and financial status while looking for ways to improve has a better chance of achieving business and family goals.

This view of management suggests the success or failure of a ranch/farm business is a direct reflection on management and not the weather, markets, etc. The challenge of management is selecting the right things to do which requires organization. The process of organizing a ranch/farm requires continuous and dynamic change regarding personnel and the allocation of resources. In organizing the available resources to produce a product, a manager is responsible for numerous functions. The basic functions of management are:

- Planning;
- Implementation;
- Control/Evaluation

Planning is the process of deciding "what things to do"; implementation is the process of "taking action"; control is the process of "measuring performance"; and based on performance there is the continuous process of "revising plans". These management functions are applied to financing, production and marketing areas of the business. Thus, management involves determining direction, making decisions, and taking action and evaluating results.

To make sound management decisions, it is vital to remember that allocating sufficient time to perform the functions of management must receive a high priority. While many ranchers\farmers do not enjoy the record keeping, analysis and mental thought needed for completing the management process, it is a vital part of being an effective manager. The intent of the WIRE program is to provide 1) an overview of the decision-making process; 2) a process and educational materials for conducting ranch\farm analyses; and 3) skills needed to make sound management decisions. To summarize, sound management decisions are rooted in allocating time to complete the functions of management. An overview of these functions and the management process is provided in the following text.

PLANNING

Every manager has a plan, for having no plan implies a completely random production and marketing system. While ranchers\farmers do not operate in a random manner, they generally have difficulty explaining their plan because it is not likely to be fully developed or written out. This section outlines the steps for developing a ranch\farm plan.

If asked, most ranchers\farmers would agree that planning is important. Why then are so many of them reluctant to actually develop a plan? The reason probably lies in the difficulties or problems that must be addressed in completing a plan. Some things that discourage planning are:

1. It involves detailed thought and analysis to address difficult issues;
2. It reminds them of the uncertainty associated with the future;
3. It forces them to seek advice and assistance; and face conflicts regarding goals and who makes decisions.

As a result, many rancher\farmers are reluctant to plan because it forces them to consider uncertainties and address conflicts. The reverse side is that these difficulties are the very reason they need to plan. Because of uncertainty, limited resources, and multiple goals; a business needs to identify what opportunities to pursue. Thus, while some managers indicate they do not have time to plan, planning is too important to leave undone. Successful managers allocate time to plan. An adage states “If you don't know where you are going, any road will get you there.”

Planning starts with some basic questions. Where is the business? Where do I want it to be in 5-10 years? How do I intend to get there? This means that planning looks inward, considers the resources available and evaluates the business's past performance. However, development of a business plan is largely a forward looking technique that forces the manager to consider the future. As a result, planning is an approach that explicitly considers uncertainty and change. One great value of effective planning is that it allows managers to identify critical assumptions and decisions. The contingency provisions of a plan regarding these critical assumptions are just as important as the specification of things that are known. Planning provides your business with a framework to adjust and respond effectively to an ever changing environment. The end product is a plan for future action complete with expected income, expenses, and goals to be obtained. It is similar to blueprints for a new building, proving the plan for a manager to follow to arrive at a desired goal. Just like building blueprints, different goals and available resources makes planning an individualized process.

The general planning process involves a series of suggested steps to evaluate and select management alternatives. The process is cyclic with continuous feedback and re-evaluation as conditions change. Management decisions are made based on repeated evaluation of plans compared to actual response in light of current and forecasted conditions. The suggested planning steps are summarized below.

1. Establish Strategic Goals. The logical starting point in the planning process is the identification and specification of goals. This is an extremely important step because goals guide the rest of the planning process. Goals should identify both family wants in life and where you want the business to be in 5 and 20 years. Goals should also be SMART: S-specific statement of what is to be accomplished; M-measurable; A-attainable; R-related to other ranch goals and constraints; and T-tractable. Goals should also be prioritized since they are to serve as guides in the planning and decision-making process. Since resources are limited, once a higher priority goal is achieved remaining resources can be allocated to lower priority goals.

2. Inventory of Resources. Once goals have been established, the next step is to inventory all available resources. The type, quantity and quality of resources available determine what enterprises can be considered in the planning process. A general listing of types of resources to include in your inventory are land, labor, working assets, capital, management and rules and regulations. To assist in the planning process detailed inventories of these resources will be needed to effectively balance the use of individual resources with their supply. For example, the inventory of land would include acres by broad class of use, soil type, capability class, capital improvements and potential problems. A resource balance sheet which identifies availability and demands for resources is needed throughout the planning process.

3. Explore Possible Enterprises. Identifying the strengths and weaknesses of a business is an important part of planning. Before laying out the future direction of your business, it is important to know how the business has performed in the past. Criteria commonly used to analyze financial performance are liquidity, solvency, profitability, and efficiency. Financial statements are essential in analyzing the performance of a business. For example, the income statement addresses the question regarding profitability of the business. If the income statement shows that profitability goals are not met, you as the manager should look for reasons why. This requires an honest self appraisal of the business; is the reason low yields? are costs too high? or is it low product prices due to marketing practices? Several measures to analyze

performance will be suggested and discussed, as well as several ratios to measure financial performance.

Another aspect that needs to be assessed when analyzing alternatives is the business' environment. This involves careful assessment of external forces that determine the environment your business will be operating in. These include such things as the general condition of the economy, and particularly input and commodity prices. Another important consideration is farm programs and state and federal rules and regulations. The purpose is to increase your knowledge of these forces to better understand what threats and or opportunities they pose for your business.

Armed with information on your business and the business environment you face the difficult task of deciding on a plan. The purpose here is to select enterprises that will allocate resources to allow you to best accomplish your strategic goals. In general, a manager will be making decisions regarding whether to add a new enterprise, change production practices on existing enterprises or expand the business.

There are several economic tools to use in comparing alternative enterprises. For example, whole ranch/farm budgets can be used to analyze major changes in your business. A properly prepared budget will allow you to compare receipts, expenses, and net earnings for each alternative enterprise being considered. If changes are to be made, these changes should only be made after critical analysis of five major factors affecting profitability: 1) increased size; 2) increased productivity 3) decrease overhead costs; 4) decreasing variable costs; and/or 5) improved marketing of products. Optimization procedures can be used to determine the best combination of enterprises for the available resources.

4. Enterprise Plans. Once potential enterprises are identified, the next step is to develop enterprise plans. To best describe an enterprise plan, begin with the product to be produced (weaned calves, satisfied hunter, etc.). With the final product in mind, work back through the production process to identify the production activities and resources needed. The production activities should outline specific resource needs, management requirements, expected production, expected income and expected expenses. By comparing potential enterprises with resource needs, management can direct changes in resource use to new enterprises and avoid conflicts and loss of flexibility.

A word of caution, think through each enterprise plan carefully. Neglecting one or a few activities in the production process may give a false picture of profitability. Also, when estimating resource use and level of production, be pessimistic! This means being conservative in assumptions of production, while at the same time being on the high side regarding input costs (labor, capital, etc.).

5. Flow of Resources. In addition to considering the costs and returns in evaluating enterprises, there is the concern of resource competition. Several enterprises may be competing for the same resource. In particular, adding an enterprise that competes with existing enterprises for a limited resource, such as forage, may well affect both the existing enterprises and the resource. Development of resource flow plans will help avoid these conflicts.

Resource flows begin with putting the production process for each enterprise onto a calendar. These are used to make resource flow plans, which show when activities in the production process are to take place, the amount of resource needed and where the resource is needed. The flow of resources is helpful in revealing resource limitations and times of abundance. Such information is necessary in obtaining a more realistic view of resource availability for the enterprises selected.

6. Implementing the Plan. This is the point where the manager puts a plan into action. Implementation of your plan involves acquiring the necessary resources, scheduling the tasks to be completed and overseeing all aspects of the plan. The specifics will be discussed in more detail in the section on implementation.

7. Control/Evaluation. Monitoring and control is the final step in the planning process. The importance of this step is often overlooked by managers and goes undone. However, plan evaluation is critical to determine performance and identify problems so adjustments can be made. Furthermore, a good record keeping system is essential if you are going to monitor, evaluate and make necessary adjustments to your plan.

While planning does not guarantee success, following the planning process outlined and using the tools obtained from the Wyoming Integrated Ranch/Farm Education (WIRE) program can improve your chances of success.

ORGANIZATIONAL STRUCTURE OF MANAGEMENT

The above discussion on the functions and process of management outlines a framework for managers to follow in selecting the “right things to do”. These functions can also be discussed as decisions and actions at three levels: 1) strategic; 2) tactical; and 3) operational. Planning and decision making are to be from the top down, strategic to tactical to operational, or general to specific. Implementation and control is from the bottom up or specific to general. Implementation and control involve the day to day operations which allow the tactical plans and strategic goals to be accomplished.

Strategic decisions are broad in nature because they deal with the overall question of "what do we really want to accomplish through the business?" While this may seem like a frivolous question, decisions regarding strategic goals need to be seriously and carefully considered. After all, strategic goals should be used to provide direction and focus to other management decisions and actions. In addition, results from these management decisions and actions are evaluated in terms of whether they helped achieve the strategic goals. Viewed in this light, strategic goals are extremely important, for they influence decisions at all levels of the operation and its long term direction.

Once strategic goals have been determined, managers need to decide how these goals are to be accomplished. This involves making tactical decisions about what alternatives (enterprises and/or marketing) will produce the desired results (strategic goals). Alternatives are then selected based on the resources of the ranch/farm and the projected performance of each alternative. Tactical goals are more specific than strategic goals in that they indicate what alternatives the ranch/farm will use in achieving its strategic goals.

With the alternatives selected, the operational decisions necessary to implement the alternatives must be made. Operational decisions determine the specifics of the what, when, where, who and how of specific tasks for each alternative selected. In short, operational decisions are the specific tasks needed to fulfill the tactical alternatives in achieving the strategic goals.

It is clear that operational decisions are essential to the success of a business. However, while not as obvious, the strategic and tactical goals are just as important and must be set first. The idea here is that it is most important for management to select "the right things to do". This requires giving serious time and attention to goals, planning, analysis and evaluation.

SUMMARY OF INTEGRATED RESOURCE MANAGEMENT

To make sound decisions about the right things to do, an overall picture of where you want to go is necessary. This overall picture is obtained by specified goals and established plans about how you will achieve those goals. The major difficulty is that ranchers/farmers usually do not recognize the importance of setting goals and their ability to organize and concentrate resources to obtain results.

The key to management deciding the right things to do lies in having a logical and organized approach. The functions and process of management outlined above provide such an approach. The process allows all pieces of information and actions taken to be directed toward achieving specified goals, as well as feedback for remedial action. This organization of an operation is one that requires continuous planning and constant changes to be made in the allocation of resources based on adequate records, analysis and evaluation. After all, it is this detailed planning and organization that brings a business face to face with the facts that are frequently ignored. Moreover, it is these facts that jar us into modifying our goals and/or activities. In the end, managers who continually plan and strive to understand and monitor available resources, products sold and financial status, while looking for ways to improve, have a better chance to succeed.

WHY MARKETING AND RISK MANAGEMENT?

The previous discussion dealt with the steps in the management process and the importance of making decisions in that process. Perhaps the hardest part of making decisions for the farm\ranch manager is planning in the face of uncertainty. Not all the information about input prices, product prices, yields and other factors is known with certainty. Managers often find their best decisions turn out to be less than perfect because of changes which take place between the time the decision is made and the time the outcome of that decision is finalized. Many agricultural decisions have outcomes that take place months or perhaps years after the initial decision is made. Thus, continually evaluating and monitoring those decision outcomes is very important. As unexpected outcomes occur the management plan is re-adjusted and different measures are implemented.

When an outcome is more favorable than expected, a manager may regret not having implemented the decision more aggressively or on a larger scale. However, in this type of occurrence, the financial health of the firm is enhanced. Unfortunately, if an unexpected outcome has a negative effect, such as low prices on income, the achievement of business goals and perhaps even the existence of the business can be threatened. Risk management is mostly concerned with reducing the possibility of unfavorable outcomes, or at least softening their effects, so the business can come closer to meeting its goals and or surviving. Remember, earlier in this chapter, it was said the success of the business was a function of the manager not of weather, markets, etc.

SOURCES OF RISK

The integrated resource management approach deals with the management of all the available resources. The common sources of risk managers face while managing all the available resources can be summarized into three areas. These areas are production risk, marketing or price risk and financial risk.

Production risks associated with agriculture are due to crop and livestock performance being dependent on biological processes rather than manufacturing processes. These biological processes can be affected by such things as weather, diseases, insects, weeds, feed conversion and soil fertility. These are factors which cannot be predicted accurately.

Unfortunately, agricultural producers cannot dictate what price they receive for their products. Given the market structure agricultural producers face, they are often "price takers" when selling their commodities. Too often marketing is an afterthought at the end of the production process. As such, producers are faced with accepting the price at harvest in a highly variable cash market. Thus, price variability in the market translates into price risks, which compound with production risks and increase the variability in returns.

Financial risk is incurred when money is borrowed to finance the operation of the business. This risk is caused by uncertainty about future interest rates, a lender's willingness to continue lending at the levels needed now and in the future, changes in market values of loan collateral, and the ability of the business to generate the cash flows necessary for debt payments.

Production, marketing or price risk and financial risk exist on most farms and ranches and are interrelated. The ability to repay debt depends on production levels and prices received for the production. Financing the production and storage of commodities depends on the ability to borrow the necessary capital. Therefore, all three types of risk need to be considered together, particularly when developing the whole Ranch/Farm business plan.

MARKETING AND RISK MANAGEMENT

Marketing decisions have become an increasingly important part of the overall job of managing your Ranch/Farm business. Successful managers have always had to make the right decisions regarding what and how to produce. Historically, what and how to produce has been the most critical area of Ranch/Farm management. While using up-to-date production technology and making sound production decisions are still necessary, that alone is no longer sufficient to assure success in farming and ranching. Now, effective management of capital and marketing have become key areas of successful Ranch/Farm business management.

WIRE: MARKETING AND RISK MANAGEMENT COURSE CONCEPTS

Other courses and training are available that deal in depth with production and financial management. This program will focus on the marketing area. The objective of this program is to familiarize producers with the concepts of marketing or price risk and alternatives available to help manage price risk. Specific objectives and topics to be covered in the rest of this program are: 1) To illustrate how product diversification can reduce variability of returns, 2) To discuss the advantages and disadvantages of marketing alternatives which are price at delivery and forward pricing in nature, and illustrate how these alternatives affect price risk. Specific alternatives to be discussed are a) cash markets, b) forward contracts, c) video auctions, d) hedging with futures, e) using put options, and f) retained ownership or feeding of livestock, 3) To discuss and illustrate agricultural options as a marketing alternative for managing price risk, and 4) to discuss the development of a marketing plan and how it relates to the integrated resource management approach.