Strategic Decisions and Business Plans for Pork Production Operations -Pork Industry Handbook
Michigan State University
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pork industry handbook

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Strategic Decisions and Business Plans for Pork Production Operations

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The Importance of Planning

Because of major changes in pork production, strategic planning and ability to implement the plan is critical to your future. Having a clear understanding of the strengths and weaknesses of your farm and the business environment allows you to match the strengths of your enterprise with available opportunities. The fast changing global food market, along with the shifting structure of U.S. agriculture makes it essential to examine these factors.

Strategic planning focuses largely on managing the interaction of your pork production business with competitors, neighbors, government agencies, suppliers, customers, various interest groups, and multiple other factors. The business plan is a succinct document that incorporates the components of strategy and mission into a detailed blueprint with regard to external environments, internal characteristics, and financing. One planning document could include overall strategic direction as well as the detailed business aspects. Some people prefer to have two documents, keeping the "big picture" separate from the detail of running the operation. The important thing is to know where you want to go and to have an idea of how to get there.

Making Strategic Decisions

The first step is to identify what business you are in. A successful business starts with a clear direction—what is to be achieved and how best to achieve it. While your own mission may be to survive, make a profit, be your own boss, or even be rich, you must determine the **ultimate purpose** and the **specific targets or objectives** of your business. Pork producers must recognize that they are in the food business rather than in the pig raising business. The differences may be subtle but critical to meeting consumer needs to ensure future sales.

Mission and Philosophy

Developing mission statements can get people excited about their work and instill a commitment from the people involved. General Eisenhower believed the statements themselves mean little but the activity building the statements means everything.

There is no set process for developing a mission statement. Mission statements may mention your commitment to social responsibility, quality, survival, growth, profitability, customers, markets, or how your operation differs from others in the same business. They may be brief and general, or very detailed. They typically contain a few of your main priorities. Most importantly, they state the organization's reason for being as clearly as possible. Operations with specialized teams in different functions may want to have each team develop their own with each linked to the overall enterprise mission.

Once you have defined your mission statement, the next step is to define the firm's basic philosophy. Would you prefer to build your business slowly from a solid base, or are you a risk taker? Will you concentrate on high quality, low costs, or both? How will you relate to neighbors, packers, suppliers, and competitors? What type of community involvement do you plan for your business?

When all the owners, family members, and employees know the operation's mission and philosophy, they can make daily decisions and conduct themselves in a consistent manner. Even small decisions on a pork production farm can impact quality and profitability, so the more people "clued in" to these important overall plans the better.

Your Enterprise Goals

Goals are defined as broad, ideal conditions that specify how the general policy directions of the mission will be carried out. They can be used as a tool to assess the success of the organization in fulfilling its mission. Having the goals written down can make it easy to check your progress periodically, and to re-focus efforts after serious distractions like a period of low hog prices. A possible goal could be "To become the most profitable mid-sized pork producer in my state within the constraints of my existing land base." Another goal may be "To increase the profitability of the operation by niche marketing high-quality products while keeping the physical size of the operation stable." Still another may be "To expand my operation to 500 sows, farrow-to-finish, while improving waste management and increasing profit."

The owner, family members, and perhaps a few key employees should agree on a long-term direction and develop major goals in line with this direction. Goals that become the shared purposes of the owners and employees are much easier to implement.

Objectives to Achieve Goals

Accomplishing a goal requires establishing and achieving specific objectives. An objective to the above-stated goal could require that the operation "build a new farrowing facility within one year to increase the number of pigs produced."

A subsidiary objective may be "To purchase genetically improved sows and have them bred in time to fill the new unit." Another objective could specify expanding staff to handle the expected increase in labor requirements.

Establish performance reports and measurements that indicate progress toward the objective. Do not rely on instinct or crude guesses to appraise performance—you must have records. Put your objectives in writing and express them in clear, concise, and unambiguous statements. Modify your statements to meet changing conditions and priorities.

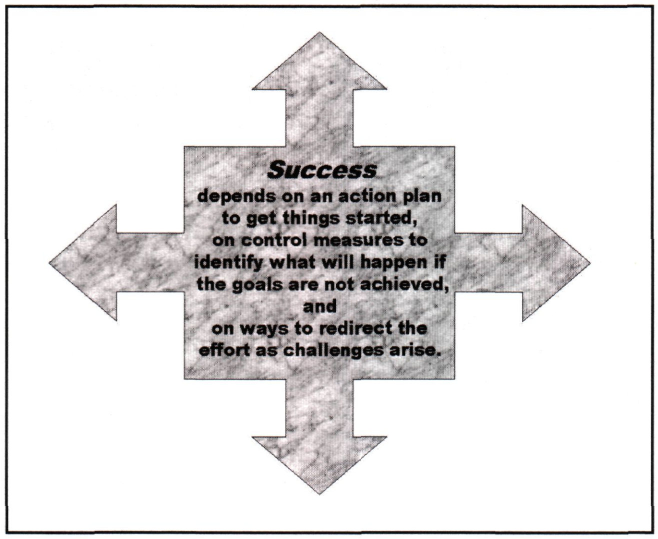
Economic Industry Analysis

Consider the competitiveness of the farm within the pork industry and the broader business environment. Shifting trends may change the ability of the enterprise to compete by lowering costs of competitors or lowering revenues. Examples of shifting trends may include competition from other food sources, shifts in population (e.g., the purchasing status of "baby boomers"), trends in the economy, legislation (e.g., safety or anti-pollution regulation), and location of packing plants. It will be important to distinguish short-term cycles such as low hog prices in 1994 and 1998 from long-term trends such as increased exports and steady domestic demand. Some of these can be dealt with by careful timing of expansions or restructuring, while others may require a major change in plans. It's much easier and less expensive to delay construction of a building *before* concrete is poured.

While certainty is not possible, forecasting can be used to anticipate economic or business changes including:

- Technological breakthroughs.
- New competitors.
- Changes in the cost and availability of feed.
- Changes in market access.
- Changes in government regulations.
- Changes in consumer taste.

An unanticipated technological breakthrough or a sudden change in costs and prices may force reallocation of resources. Goals may need to be delayed or dropped, and parts of the business may need to be drastically changed. Some needs of the business may not be met for a while, but flexibility can increase your chances of survival.



External Information Needs

An information system is the way producers gather, screen, analyze, and use all information that may affect their business. Trade shows, magazines, seminars, extension specialists, and veterinarians are all part of an information system. Use these resources to keep informed of new approaches to managing, improving, and possibly enlarging the swine enterprise. The internet can be a fast way to scan large amounts of information from many sources. However, just like any other information format, the validity of the information depends on the source.

Internal Business Analysis

Once the information about your external environment is accumulated, consider how to best fit the business into that mix. To do this, understand the strengths and weaknesses of the enterprise. Collect essential internal information from records as you conduct everyday business; this is the most important information of all. This information may include pigs/sow/year, return on assets, asset turnover rate, whole herd feed efficiency, carcass quality, and so on. Compare to benchmarks—industry standards for similar systems or performance of realistic model farms to get an indication of competitiveness.

The technology used to produce pork can often yield competitive advantages. You may see that a competitor has an apparently insurmountable cost advantage from adopting a new technology. Your operation may not be able to implement new technologies as quickly for various reasons. However, your family or employees may have skills in husbandry or that offset disadvantages in other areas. Once you know the areas in which an operation excels, assess weaknesses and develop a strategy to survive and thrive while implementing change. An effort to catch up technologically may take a while, but taking advantage of the skills of your employees in pig management may provide a better chance for survival.

Sometimes smaller or diversified farms have advantages over specialized pig farms in flexibility. Small businesses can often respond more quickly to cost swings or changes in the market, and can change genetics or production methods more quickly than larger firms do. However, they still can't afford to be too far behind in pig raising technology for the long term.

Operational Considerations

A series of considerations can help you understand some of the internal and external forces, including your attitudes that may affect the future. Additional questions based on your own specific circumstances may be even more important to consider. There are no right or wrong answers to these questions, and you should not be disheartened if your responses concern you. The exercise should help you understand the situation and your motivation, thereby helping you make the necessary preparations and changes to achieve the mission.

- Do you believe that past expansion in the hog industry prevents future profitability?
- Are you unwilling to invest new capital in the operation to modernize it?
- Can you make major renovations if needed to conform to manure management standards?
- Is the land under and around your operation too valuable to pass up an offer?
- Can neighboring land be purchased for expansion?
- Are your neighbors too close? Do they oppose your business?
- Are you willing to relocate the operation?
- Can you expand the operation without additional land?
- Would you consider specializing in a particular phase of production (such as farrowing or finishing SEW pigs) and joining a network?
- Are you going to retire within five to ten years?
- Will the operation remain intact after you retire?
- Is there anyone in the family excited about taking over the operation?
- Are you willing to buy a computer and keep detailed production and financial records?
- Can you transition from a manager/laborer to a manager of laborers? Do you want to?
- Do you believe hogs have to be above $45/cwt to be profitable?
- Has the equity in the operation grown over the past 5 years?
- Do you like to learn new things?
- Do you embrace, cope with, or resist change?
- Can you weather periods of low hog prices and low profitability?
- Would you rather be raising pigs than anything else?

Finalizing a Strategy

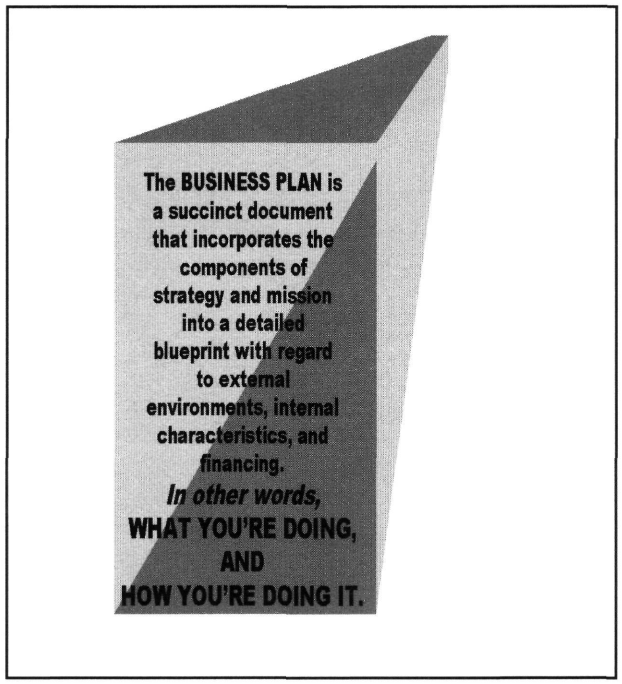
You may decide that you have the strengths to compete with other producers "head-to-head" on cost of production. Or, you may choose to target a market that will pay for a certain type and quality of pigs. You may see opportunities to network with a number of producers so each can specialize in one stage of production. Or, you may realize that you are constrained by a combination of circumstances. You may have restricted opportunities and only limited chances for success, but you should be able to make choices with information and good planning.

At this point in planning, you should have decided whether to own sows and produce feeder pigs, operate a complete farrow-to-finish operation, or purchase pigs farrowed by someone else. You should have decided whether to invest in modern confinement facilities, or to work with a low investment system. Low investment systems typically require more labor and feed to produce each pound of pork, while high investment facilities require a longer payback period, and thus a long-term commitment to pork production. Contracting as part of a larger system can provide access to capital, labor, technology, and animals, and is another consideration in the planning process.

Low investment facilities make it easier to get in and out of the business with fewer penalties. However, the portion of the pork industry utilizing pasture systems or other low investment strategies is shrinking each year.

The Business Plan

The business plan is a succinct document that incorporates the components of strategy and mission into a detailed blueprint from which to operate. It details the actions that will be taken in light of external influences, internal resources, and financing. The business plan should be rewritten when a new venture is developed or a new major initiative is launched, or when all of the



original goals are achieved. The plan serves several important purposes:

- It helps determine the viability of the venture in a designated market.
- It provides guidance for planning activities.
- It provides parameters for assessing progress.
- It helps to obtain financing.

Financial statements are a critically important part of your business plan. A business plan should reflect the current financial position of the business and the expected financial position related to possible future management decisions.

Financial Statements in the Business Plan

For producers already in business, this means including a current balance sheet, income statement, statement of cash flows, and selected financial ratios. For new businesses or businesses that require further investment, pro-forma (projected) financial information should be included. The owner needs to identify additional cash needs and justifications for the investment. Pro-forma statements should include a balance sheet, income statement, cash flow, selected financial ratios, and a break-even analysis. There are several computer software programs available that can assist with these calculations and track this data over time.

The purpose of the financial section is to assess the liquidity, solvency, profitability, repayment capacity, and efficiency of the business. A balance sheet lists the business assets, liabilities, and equity, providing a picture of the business at a particular point in time. For consistency of comparison, the balance sheet should be calculated for the same time period each year. The income statement is used to calculate the single most important measure of whether your business will continue to operate profitably in the future. A simple way to think of the income statement is as a record of the revenues and expenses incurred by the business during the year. The statement of cash flows identifies how cash was or will be generated and how it was or will be used.

Liquidity identifies the ability of the business to pay obligations without disrupting normal operations. The balance sheet is used to calculate working capital (current assets – current liabilities) and the current ratio (current assets/current liabilities). The cash flow coverage ratio can be calculated ([net income + depreciation + interest]/[current portion of term debt + interest + allowance]) using the statement of cash flows for more in-depth analysis of liquidity.

Risk

Solvency is used as a measure of risk. It determines the effect of selling off all assets and paying off all of the liabilities—or to put it another way, it's what you owe versus the value of what you have. A widely used measure is the debt to asset ratio, which measures the total liabilities in proportion to the assets. A higher ratio indicates the business is exposed to more risk. Another measure of solvency is equity to asset ratio, which measures the portion of the business that is owned compared to the total asset value, including financed assets. Creditors and lenders prefer this number to be as high as possible, as it reduces the amount of risk they face. These measures are calculated using information from the balance sheet.

Other sources of risk include operating a business in an old way when new competitive pressures have arisen, producing products that fewer people want, and mismanagement in ways that are not readily noticeable. These may be hard to measure, but should be considered in the planning process before they impact the financial measures.

Returns (Profit)

Profitability is an area of concern to producers and lenders alike. Net farm income is listed on the income statement. Net farm income is an absolute number, and can be affected by the business structure. Are all the costs accounted for? Is there a fair return for your own management and labor? Are different operations such as crops and hogs tracked separately so one doesn't cover for sub par performance in the other?

Balance sheets and income statements are used to calculate return on assets, a second common measure of profitability. Return on assets ([net income + interest]/average total assets) indicates how much income the assets are generating. Most hog farms will average 6 to 10%; ROA above10% is good.

Balance sheets and income statements are also used to calculate return on equity (net income/average total equity). Return on equity indicates how well the owner's investment is producing income. In general, return on equity should be higher than return on assets, meaning the business is earning more from using the assets than is paid to the bank/lender to borrow money—otherwise the operation is losing equity and is a bad investment. Most hog farms will average 8 to 15%; ROE above 15% is good.

Debt

Repayment capacity is the ability to repay debt from farm income. It also evaluates the business' ability to accept additional debt after all other commitments are made. Term debt and capital lease coverage ratio is calculated from the income statement and identifies the ability of the operator to cover all term debt and capital leases. A higher ratio indicates more flexibility for the operator during lean years. A second repayment measure is the capital replacement and term debt repayment margin, which evaluates the ability of the operator to generate the necessary funds to cover all existing term debt and replace the capital assets such as buildings and equipment as they wear out over time.

Financial Performance

Financial efficiency or ratio analysis is a measure of how well the business performs. There are many ratios that could be used, some specific to an industry. Only the general ratios are discussed here. A commonly used ratio is the asset turnover ratio, which measures how efficiently assets are being used to generate revenue. A higher ratio indicates the assets are being used more efficiently. An acceptable asset turnover ratio would be above 0.60 and a good ratio would be above 0.90. If a farm achieves gross revenues of $90 per year for every $100 of total assets, their ratios is 0.90.

Operating ratios include operating expense ratio, depreciation expense ratio, interest expense ratio, and net farm income from operations ratio. The first three ratios added together represent the total direct expenses per dollar of gross farm revenue. All four ratios added together represent the allocation of gross revenue in percentage terms.

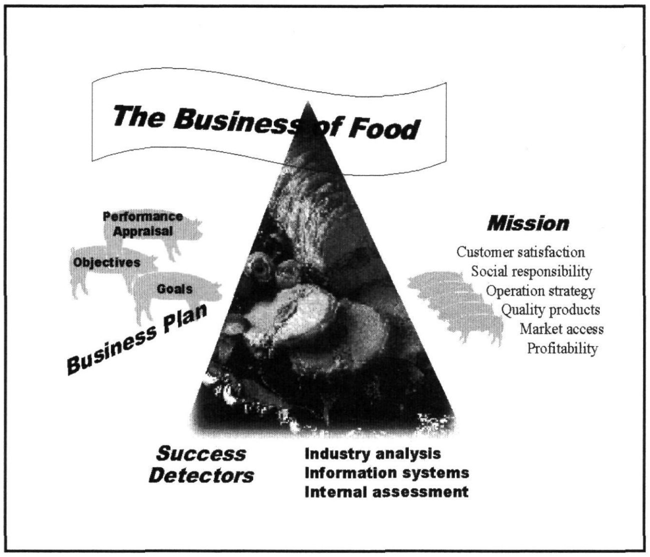
No one measure or ratio can be used in isolation of other measures since there are many factors involved. For more information about how to calculate these measures, consult the new NPPC Production and Financial Standards.

Your Management Team

A description of the structure and management of the business follows the purpose of the business and the financial information. This section covers the principle members of the management team and their responsibilities. It often includes each employee's title, salary, responsibilities, and short resume. This will describe how key people will help the business to attain the goals.

Personal and Personnel Considerations

The main people in the operation should be considered when planning the direction of an operation. While this is a major personnel management consideration, it also figures into overall



business planing. Care should be taken that people don't get "trapped" into doing what they really don't want to do when an operation is changed or expanded.

It's important for each person to determine which parts of their job they may like or dislike. Changes may need to be made for competitive or profitability reasons, and there may be another job or a different business structure that will suit the people involved better. Each person critical to the operation should consider appropriate questions to get an idea of personal preferences. Following are some questions that may be useful.

- Do you like to be near and work with pigs?
- Do you prefer to work in breeding, farrowing, nursery, or with finishing pigs?
- Do you like to work with people?
- Do you prefer to be in charge?
- Do you take direction well?
- Do you have supervisory skills?
- Do you have coordinating skills?
- Do you like running a business?
- Do you enjoy deal making?
- Do you like to work in an office?
- Can you work with numbers?
- Can you operate a computer?
- Do you keep good records?
- Do you like grain farming?

Some operations may be more efficient by raising crops and specializing in one phase of production, such as finishing or farrowing. Some people may find superior job satisfaction and salary by applying their skills and resources to something totally different. If their desires and skills don't fit the goals of the operation, it's best to know this in advance. Recognizing where people fit best within an operation will allow employees to perform at a high level and improve moral.

Limitations

Planning is an excellent tool for the business owner to increase the chances of a successful, long-term operation, but it does not guarantee success. There are limitations to planning. Owners and managers don't control all factors affecting their business. Factors under outside control include markets, weather, government policies, and so on. A plan available for decision making frequently results in better decisions and minimizes negative effects on the business when coping with unexpected challenges.

The most difficult limitations of planning are the assumptions the plan is based on. Assumptions concerning market conditions, regulatory changes, and competitive pressures may not be accurate during periods of plan implementation. Make the assumptions based on current available information.

Resistance from employees not committed to the direction of the business can also limit the success of the plan. Setting direction before employees are hired can provide a basis for choosing the best employees. If the planning process is begun after employees are on board, they should be involved. This will help the employees understand where they fit into the business, how they can help reach the goals, and ultimately how to improve chances of success.

Summary

Success depends on an action plan to get things started, on control measures to identify what will happen if the goals are not achieved, and on ways to redirect the effort as challenges arise. A good plan can help a pork business cope with the ever-changing world only if it is well conceived and implemented, and remains dynamic. Additional help and resources can be obtained from your local Extension Service, accountants, lenders, and the NPPC Production and Financial Standards.

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