

Step 6-Identifying and Evaluating Alternatives

Q: What alternatives are feasible for the future?



Consider different possibilities for using your physical and human resources to meet your business and personal goals. Be creative, look at potential enterprises you may not have considered in the past, and outline several alternative farm operations. From this group of possible enterprises try to organize a farm business to meet your goals, as well as match available resources with your need to withdraw cash, and your ability and willingness to assume risk.

The purpose of this step in the planning process is to identify, describe, evaluate, select and plan the implementation of alternatives. The previous step helped you determine whether you need or want to change your current farm business. That decision was based on the assessment of whether your present farm business will meet your needs and fulfill your goals in the future. For farmers envisioning change, this step suggests a procedure for describing and evaluating alternatives.

After evaluating alternatives, you may realize that your current combination of enterprises on the farm is the best possible given the resources available to you. It is only by testing alternatives that one can determine whether the current farm can be improved. But for farmers who decide to implement an alternative, the next step in the planning process (Step 7) considers the intermediate actions you may need to take to establish your desired farm; that is, describe how the transition from the present farm to the desired farm will be accomplished.

Why Does the Farm Need to be Changed?

An initial activity for this step is to answer the question of why you want to change the farm; that is, what is unsuitable about the current farm, or in what manner may the current business not meet your objectives in the future. Such statements or explanations often help in deciding whether to implement an alternative. They can provide an indication of why you want to change the farm, which business goals or personal interests are not being satisfied, or the manner in which your goals are not being met.

Following are two example statements of why a current farm is not satisfactory for the future:

"My debt-to-asset ratio is nearly 0.5 and the equity in the farm is \$250,000. I want to decrease that risk (lower the debt) and increase the equity so I am better prepared for retirement. However, based on the analysis completed in the previous step, I would need above average yields at all times to make much progress toward reaching this goal over the next five years."

"The farm is now generating (and is projected to continue generating) \$26,000 of cash withdrawal each year, and my spouse and I are working off the farm to make up the difference. I would like to increase the amount of cash we can withdraw from the farm so we can give up one of the off-farm jobs."

Precise statements like these about the situation or problem that you want to address is a critical first step to making changes. You also

may want to describe why you want to make a change, such as generate more income so another family member can join the farm operation. With these statements, you are setting goals for the change; that is, establishing benchmarks against which to test whether progress is being made.

Identifying Alternatives

The next activity in this step will likely involve identifying alternatives, but how do business owners recognize opportunities? A process to identify alternatives is not easily taught, but perhaps the following suggestions will provide some ideas.

- Gather information about what others are doing (some of this may have already been accomplished as parts of Step 1 and Step 3);
- Review what you consider to be the business' strengths and shortcomings, and where you think the business is going (Step 3);
- Evaluate the current business from a different perspective;
- Gather ideas from others through conversation, listening, and reading;
- Study information about consumers' interests;
- Anticipate trends in consumption, production, and technology;
- Use your imaginations; and,
- Buy information or hire consultants.

Possible Alternatives

Another activity in completing this step of the planning process is identifying alternatives to

consider; these might include the following:

1. Modify the farm business by adopting an alternative:

- **Production technique** (such as altering tillage, fertility, and pest control practices);
- **Marketing strategy** (for example, enter into contracts to market directly to processors, or more fully utilize the futures market);
- **Scale of operation** (expand or contract the scale of the business or an enterprise);
- **Product or commodity** to produce, such as a specialty crop rather than a basic commodity;
- **Labor management strategy** (alternatives may include hiring, discharging, retraining or offering a new incentive package to employees; hiring a custom operator for selected tasks and redirecting present resources to other tasks; compare part-time to full-time employees);
- **Risk management strategy** (for example, consider diversification relationships, insurance coverage levels, and the level of debt);

- **Capital budgeting/asset strategy** (such as the impact of selling, buying, leasing, leasing out, or allowing a lease to expire; an example may be to purchase a larger combine, lease a combine or hire a custom harvester);
- **Financing strategy** (possible issues may include whether to reduce debt, finance with short-term or long-term debt, finance with variable or fixed interest rate, finance with a different lender or credit source); and,
- **Tax management strategy** (for example, should the business be reorganized to reduce self-employment and income taxes).

2. Add value to a commodity by completing some processing on the farm.

3. Invest in an off-farm agribusiness firm.

4. Stimulate innovation by designating different management personnel, reassigning management tasks, and involving other business and asset owners.

5. Start a new business such as providing a custom operation service to neighbors.

6. Change careers, for example, reduce the amount of time and other resources invested in the farm operation so more time can be spent at off-farm employment.

These examples illustrate only a few alternatives a farmer might consider. Most often, owners envision the future farm as a combination of existing, modified, and new activities. Likewise, identifying alternatives is an opportunity to consider non-farm options even though the primary activities at the present time are agriculture-oriented.

Describing the Alternative

After selecting which alternatives to thoroughly evaluate, you will want to accumulate additional information about the activity and describe how you would operate it. The description would likely specify the types and quantities of inputs you would expect to use, and the product you plan to produce. Essentially, you are developing the "recipe" for operating this al-



ternative enterprise, not much different than what you did in completing the inventory of your current farm in Step 1.

A critical difference between the two steps (Steps 1 and 6) is that this time you may need to do more research if your understanding of the alternative is insufficient to develop an enterprise budget. To help describe the alternative, you may need to repeat some of Step 3 by asking questions about the alternative being considered. The type of information you will likely document in your description of the new or modified enterprise are:

- Production practices, technology and costs;
- Marketing opportunities and strategies;
- Necessary management skills; and,
- Types, quantities, and times when resources are necessary to meet the needs of financing, labor, land, equipment, and buildings.

By developing these descriptions, you are outlining functional plans, should you decide to implement the alternative. These outlines will be finalized later in this step for alternatives you decide to implement.

By developing a record of the alternative's description, you should be better prepared to add or delete information during planning and implementation. For some alternatives, you may not have all the information necessary to decide whether to implement it, so a system to organize and collect information becomes important. As information is collected or conditions change, you are then ready to decide whether to adopt the alternative.

Specifying the Alternative's Goal

By specifying a goal for the alternative, you are establishing a criterion for deciding whether to implement it. Relevant issues to consider might include

- What is the problem that needs to be addressed?
- What do you hope to accomplish by implementing the alternative: reduce costs, increase overall revenue, etc?
- How and when do you want the problem resolved?
- How does the alternative impact your other goals?

To some extent, you may already have specified a goal as part of your description of the problem you want to address (an earlier activity in this step). Setting a goal for the alternative helps de-

fine the direction the farm is going and why you want to proceed in that direction. It also helps determine whether to implement the alternative and sets a benchmark against which progress can be compared as the alternative is being implemented (more on monitoring progress in Step 9). For most alternatives, you will specify criteria in terms of the alternative's impact on the farm's overall profit, cash flow, equity growth, other activities, and personal goals. This would include matching resource availability with needs.

Evaluating the Alternative

The procedures for evaluating the alternative, and testing it to determine if it accomplishes what you desire, is similar to the procedure used in Step 5. Both analyses are projections into the future, but this step involves changes to the business rather than just changes in prices and costs. The following procedure is suggested:

- Prepare enterprise budgets to reflect the alternatives being considered;
- Review the alternatives' impact on the whole-farm profit, cash flow, and equity accumulation;
- Assess the activities necessary to implement the alternative to determine how the alternative relates to your skills and interests;
- Determine if the outcome fulfills your goals;
- Consider the impact on your level of risk exposure (since the alternative is a new activity, it will pose different risk considerations that should not be overlooked—see Step 8);
- Consider whether the firm has the resources necessary to implement the alternative (such as, the availability of labor, capital, and management skills);
- Consider the legal ramifications of adopting the alternative (such as environmental rules, labor law, or required license); and,
- Consider whether the alternative addresses the problem that led to the search for the alternative.

Data necessary to test the alternative is similar to what was used in prior steps. Information about quantity and cost of inputs, quantity and price of output, and timing of activities will be needed. Compiling less tangible information, such as necessary labor skills and uncertainty relative to the alternative, will likely require added effort.

A question sometimes asked is, "How much detail is necessary to test an alternative?" Perhaps the best response is to gather information until you have confidence in your analysis and decision.

If the Criteria is Met

If the alternative meets the criteria and appears that it will improve the overall farm operation, you will want to prepare to implement it. The implementation could involve preparing a plan on how to make the transition (as described in the next step). It also may involve updating functional plans (production, marketing, financial). For some alternatives, updating the functional plans may only require slight modification of the business operations described in Step 1.

Also, as alternatives are developed, tested, and some appear feasible, you may want to revisit some of the previous steps. It already has been suggested that Step 3 may need to be updated in an effort to gather more information about an alternative. Another example of updating a step if an alternative is likely to be implemented would be to review long-term business goals (Step 4).

At this point, you have described your *desired farm business*. However, you may find that you cannot directly or seamlessly move from the current operation to the redesigned operation. Instead, a series of smaller changes may be the best way to accomplish the larger change. Each of these smaller steps needs to be feasible so that one does not "de-rail" the entire business. Step 7 is an opportunity to consider transitional changes to reach the desired business. It is a time to describe changes that need to be made, when, in what order, and what resources are necessary to accomplish the change. The step also offers a chance to test each of the steps to determine if they move the business in its desired direction, including the cost and returns of changing the business.

Conclusion

This step emphasizes identifying and testing alternatives. The methodology for completing the evaluation is similar to that of testing the current farm. The discussion of this step focuses on identifying alternatives and gathering the information about the alternative.

The product is a list of enterprises that you are willing to undertake and have (or will obtain) the skills necessary to perform. The enterprise should be consistent with your prioritized goals, whether the farm has the physical and human resources to implement the alternative, and whether there is a reasonable chance of success given risk and assumptions. Each enterprise needs to be thoroughly documented and have a budget prepared.