



Texas Agricultural Extension Service

CONSIDERATIONS IN ENTERPRISE DIVERSIFICATION

Lawrence A. Lippke
Economist-Management
Texas Agricultural Extension Service

In this time of tight economic margins in agriculture, producers are seeking alternatives which will allow them to continue farming and ranching. One method of improving profitability in agriculture which has received much publicity lately is diversification. Producers across the country are being encouraged to seek other enterprises, either to supplement existing ones or to replace them. While diversification does offer some benefit, the extent to which it will improve profits is highly dependent on individual attributes, goals, geographic region, technological feasibility and the number of producers implementing similar alternatives.

With this in mind, a checklist of considerations one can use to evaluate various alternative enterprises is in-

cluded below. Because of the wide range of alternative enterprises available, it would be almost impossible to develop an analytical tool which would be sufficiently generic to evaluate all enterprises and yet provide enough information for decision making. Furthermore, not all considerations are economic in nature. Many of them pertain to matters which cannot be quantified, such as personal goals, management expertise and commitment to accomplishing required tasks. Therefore, the points included on the checklist are intended only to assist a producer in organizing his analysis of various diversification alternatives. The producer will still need to develop budgets, partial budgets, cash flow projections, financial statements and several other documents in order to make a final decision.

1. Have you identified goals and objectives for both your business and your personal life?
 - a. What do you wish your business to look like five (ten) years from now and what are some intermediate steps or objectives required to get there?
 - b. Have you conducted a full inventory of your resources, both physical and human, which can contribute to accomplishing these goals and objectives?
 - c. Are you willing to make any required personal sacrifices to make this enterprise profitable (time with family or in social activities, changes in lifestyle, privacy, etc.)?
 - d. Does the enterprise require of you special personality traits or interests to make it profitable?
2. Is this enterprise technically feasible for your location given the following production factors?
 - a. Climate
 - b. Soils
 - c. Water
 - d. Insects
 - e. Diseases
 - f. Growing season
 - g. Adapted varieties
 - h. Historical production patterns in the area
3. Is there a market for the commodity?
 - a. Where is the market area?
 - b. What is the cost of transportation to deliver the commodity?
 - c. Does the commodity require any processing prior to arrival at the market and, if so, are the processing facilities readily available to handle the increased production?
 - d. Does the market demand specific grade/quality standards?
 - e. What price does the market offer and how volatile are those prices?
 - f. Is the market willing to forward contract and what are the specifications?
 - g. Must you provide an abundant and/or continuous supply of the commodity?
 - h. What are the possible marketing alternatives?
4. What share of the defined market do you plan to produce?
 - a. How large is the market in terms of quantity of commodity currently trading?
 - b. What will happen to commodity price if your production increases supplies by 10 percent? (25 percent, 50 percent)
 - c. Is your level of production sufficient to command contracts or to exercise market power?
5. Can the market be created or expanded to absorb an increased supply of the commodity?
 - a. What are the costs of advertising/promotion?

- b. What are the costs and special requirements of shipping?
 - c. Does the commodity require any processing and, if so, what are those costs?
 - d. Must you enter the retailing (broker) business to market the commodity and, if so, what are those costs and do you have the time and ability to do so.
6. Once you are in full production with this commodity, what are the expected costs and returns?
- a. What is the impact of varying commodity price levels?
 - b. What is the impact of varying yield/production levels?
 - c. What are the costs of production given varying climatological and pest problems?
 - d. What are the prorated establishment costs, if any?
7. For enterprises with an establishment period and a multiple year productive period:
- a. Is the enterprise profitable based on the costs of establishment, the expected costs and returns while in production, the life of the enterprise and opportunity interest rates (investment analysis)?
 - b. If the enterprise is profitable, can you afford the cash flow requirements of the pre-productive period until the cumulative cash flow becomes positive?
 - c. Are you able to acquire the necessary start-up capital for establishment of the enterprise? What about meeting the annual operating capital requirements?
8. What is the impact of the new enterprise on the profitability of existing enterprises?
- a. Is the proposed enterprise complementary or supplementary with existing enterprises, or does it compete with them?
 - b. Is any land diverted from existing enterprises and what are the existing returns to that land?
 - c. Do you have spare labor available for the proposed enterprise or must you take it away from existing enterprises or hire new labor?
 - (1) If taking labor away from existing enterprises, what is the impact on returns from those enterprises?
 - (2) If hiring new labor, can that labor also be used to increase profits from existing enterprises?
 - d. Will the new enterprise compete with existing enterprises for capital (money, machinery, etc.)? If so, what is the impact on those enterprises? Will any newly acquired capital for the proposed enterprise be used with existing enterprises and, if so, what impact does that have on the profitability of existing enterprises?
 - e. Do you have the management skills and time required?
 - (1) What is the cost of acquiring necessary management skills?
 - (2) What impact does your management ability have on projected yield/production levels?
 - (3) How much management time is taken away from existing enterprises and what is the associated

impact on net returns of those enterprises?

(4) What are your feelings regarding:

(a) The systematic approach toward evaluating diversification?

(b) The long-term commitment required by multi-year enterprises?

9. What is the impact of producing the new enterprise on the farm's risk?

a. What is the correlation of risks inherent in the new enterprise with the risks of existing enterprises?

b. What risk reducing measures are available for the proposed enterprise?

c. How will investment of additional resources and the diversion of existing resources from present uses affect the financial risk position of the farm?

10. What special requirements are associated with the proposed enterprise?

a. Are there any legal restrictions or requirements?

b. Will the proposed enterprise limit off-farm employment opportunities?

c. Does the enterprise require an abundant and/or continuous supply of special production inputs? What is the structure and market power of those input suppliers?

d. What data bases are available to answer some of the questions above and to keep you up to date on the latest developments in markets, production technology and management techniques?

e. Does the enterprise require any special record keeping to provide information for both management decisions and various government reports?

References

Rathwell, P. James. "Evaluation Procedures for Alternative Enterprises." Paper presented at Southern Regional Outlook Conference, Atlanta, GA, 1986.

Criner, George K., Duane A. Smith, Kathy J. Sage, and Ralph Reeb II. *A Standardized Methodology for Evaluating Commodity Potential*. Maine Agricultural Experiment Station, Misc. Pub. 688, April 1986.

Freese, Betsy. "How To Diversify Your Farm This Year." *Successful Farming*, Vol. 85, No. 4, pp. 11-18, February 1987.

Acknowledgements

Appreciation is expressed to Danny Klinefelter, Joe Pena and Ashley Lovell, Economists-Management, Texas Agricultural Extension Service, for their assistance in developing the checklist.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socioeconomic level, race, color, sex, religion, handicap or national origin.

Issued in furtherance of Cooperative Extension Work in Agriculture and Home Economics, Acts of Congress of May 8, 1914, as amended, and June 30, 1914, in cooperation with the United States Department of Agriculture. Zerle L. Carpenter, Director, Texas Agricultural Extension Service, The Texas A&M University System.

3M-11-87, New