

Structure and Strategy, How Do They Match in the Netherlands?

Hennie van der Veen and Karel van Bommel

Agricultural Economics Research Institute; The Hague



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Structure and Strategy, how do they match in the Netherlands?

Hennie van der Veen and Karel van Bommel¹

Farm organization, and the balance between the household and the farm have changed. This paper explores the relation between the organizational form and strategy of Dutch farmers and shows that strategy and structure are related. Legal persons and partnerships with multiple households can be especially found among the farmers focusing on economies of scale. One-man businesses and the one household partnerships more often show diversification strategies. One-man businesses are relatively more encountered amongst the life style farmers, whilst one household partnerships are stronger present amongst rural entrepreneurs.

Keywords: family farm, household, legal form, strategy, typology

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1 INTRODUCTION

Farm organization, and the balance between the household and the farm have changed in the last years. Originally the concept of the organization of the farm was predominantly characterized by the owning family providing all the inputs of labor and capital for the farm: land would be in full ownership and other capital and labor would be fully provided by the family. In this organizational form there was no use of contractors. Over time this paradigm has shifted, as 'family farms' started renting land, using bank loans and hiring personnel and contractors to make more efficient use of machinery. The treadmill of the cost squeeze and the fact that the current farms are smaller than what should be the optimal farm size, lead to changing farm strategies such as part-time farming, on-farm cheese making and other forms of food processing and retail. Although these strategies are not totally new, incentives for entrepreneurial activity is increasing as the EU-support for standardized bulk products and production processes is slowly disappearing in favor of rural development plans.

Due to these changes, farm size and the agricultural production no longer define the farm typology entirely. Aside from the established typology the USA (USDA 2000), Canada (Hopkins 2004) and the Netherlands (Silvis 2001, De Bont 2005) are now using a typology, which is also defined by farm strategy. This paper depicts the most commonly encountered strategy/structure matches of farms in The Netherlands and describes what policy makers can gain from these observations for the formulation and implementation of their policy strategies.

2 STRATEGIES

Through the past decades, farmers have developed various strategies to survive the treadmill of the cost squeeze. This paper focuses on the following strategies:

- Efficiency of scale: technological progress, be it in larger/more efficient machines or information technology, helps to increase labor productivity and further increases the dimension of what should be considered as the optimal size of the farm. Growth is usually a necessity to maintain economies of scale. Dairy farmers for example have to keep investing in milk quota, because productivity of cows grows with an average of 2% per year. To keep making optimal use of the housing system, farmers have to buy or lease milk quota regularly. Large-scale farmers make the highest net investments² (De Bont, 2005), the implicit effect of which is that large scale farms are expanding. As technological development progresses, the optimal size of farms grows, which in turn requires the need to expand. Large-scale farmers generally realize economies of scale. De Bont (2005) shows that the large farms have more European Size Units (ESU) per €1 million of book value when compared to other farms.
- Environmental entrepreneurs: diversification in agricultural niche markets with a focus on environmental aspects such as nature management and organic farming. For these farmers, the sustainable use of natural resources is more important than maximizing agricultural output.
- Rural entrepreneur: diversification in farm related niche markets. The farm activities of the rural entrepreneur are usually too small to provide a sufficient income. Instead of increasing the farm size, they engage in non-agricultural niches, which are related to the farm. Some start a shop on the yard to sell their own products, others go into recreational activities, like the setting up of camping sites, organizing excursions or starting a health-care center on the farm. Rural entrepreneurs usually have land-based farms, like dairy farms or arable farms. Some farmers also offer contracting services to make more optimal use of machinery.
- Life style farmers: farming provides them the opportunity to live in the countryside. The main source of income doesn't arise from the farm, but from other activities such as off-farm

occupation or investing capital in assets. For farms that are no longer able to compete with lower margins per unit of production and larger production units, joining the labor market by taking a part-time job can provide a decent alternative to forming a full income. Also some agricultural activities can simply be combined with other farming activities in a part-time approach (e.g. poultry fattening or cereal growing), as they are not necessarily a day filling or year-round activity. In the case of the farmers' spouse, it could be attractive not to join farm work at all, but to stay in her own profession, reaping the benefits from his/her investment (sunk cost) in human capital. Making off-farm investments with cash flows generated by the farm can also provide an attractive secondary source of income. This can also include putting unused buildings to use for non-agricultural purposes (e.g. renting them out to store caravans or to house a car repair shop).

- Stopper: should it become clear that the farm is most likely not to find successor, stopping the farming activity can be an attractive option. In the Netherlands it is no longer common practice that a son or a daughter takes over the farm. Only 39% of the farms with an entrepreneur over the age 50 years have a potential successor (Silvis 2001). The structure of these farms usually changes when the farming practice is approaching its end. Farmers also minimize their investment. Sometimes they partially sell off the farm, i.e. milk quota or land that is inconveniently located. These farmers generally keep up the practice on a small scale until the end, because they consider it as their way of life. Consequently, most farms of stoppers are characterized by more extensive types of farming, possibly renting out their old barns and greenhouses for storing caravans. It is highly unusual that they sell the complete farm at once. What's more is that the selling of the farm in pieces usually realizes a higher value in aggregation than through selling it as a whole in one instance.

In farm typologies used in Canada and the USA the stopper (retirement farms) and lifestyle farms are also recognized, but the farm typologies are identified solely by the amount of turnover. In this paper we take the typology a step further by also identifying the rural entrepreneur and the environmental farmer. We used the following indicators to characterize the strategy of the farms in the Dutch FADN³ 2003.

- Large-scale farmer: The farm is larger than 200 European Size Units (ESU).
- Environmental farmer: At least €10,000 of environmental subsidies received or organic farms.
- Rural entrepreneur: At least €50,000 of revenue from: recreation, electricity production, fabrication of dairy products (like cheese), domestic selling of products and the agricultural contracting business.
- Life style farmer: Smaller than 100 ESU and the income from labor, renting out of privately owned assets and revenue of liquidities (including savings and stock, calculated as 5% of the average value in the year 2003) of at least €25,000.
- Stopper: The most senior entrepreneur is over 55 years of age and the age difference between the senior and the youngest entrepreneur is no more than 20 years.

These strategies are not exclusively applicable to a single farm. A stopper can for instance also be characterized as an environmental farmer. Figure 1 shows the distribution of the strategies in the Netherlands under the indicators mentioned above. More than 16% of the farmers can be regarded as stoppers and about 14% of the farmers have large-scale farms and focus on economies of scale. Less common strategies are life style farmers, rural entrepreneurs and environmental farmers.

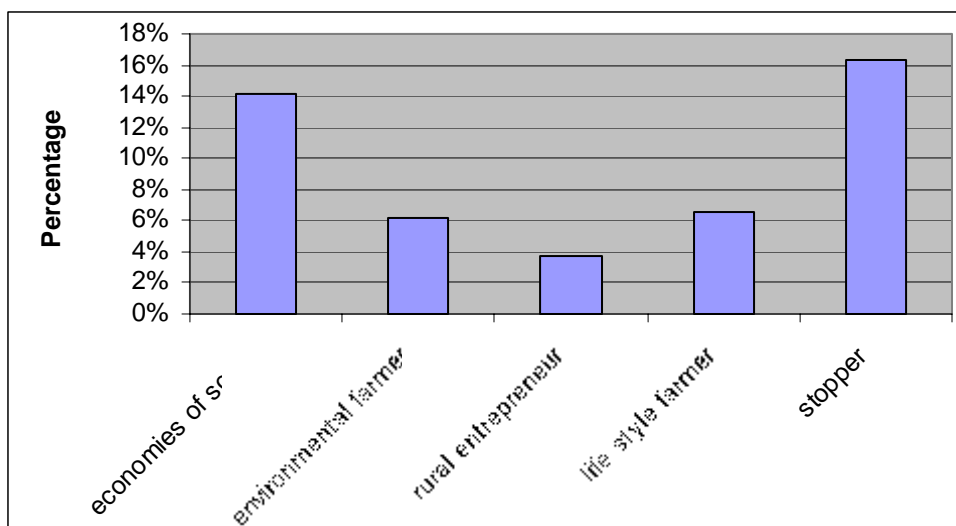


Figure 1 Distribution of Strategies in the Netherlands 2003
Source: Dutch FADN

3 ORGANISATIONAL FORM AND STRUCTURE

Many farming operations, at least in the Netherlands, are becoming more complicated. Some have moved into other enterprises than the traditional farming activities. In arable farming there are several farms that rent or rent out land on a seasonal basis, to be able to specialize and reach efficiencies of scale in one crop. Many farms now consist of two or three farm entrepreneurs. These are often father-son or spouse combinations, which could be due to fiscal or emancipation reasons. This construction can involve only one household, but sometimes two or even several households. The organizational forms and structures of farm encountered can be characterized by:

- **Size:** the size of an agricultural farm is expressed in European Size Units (ESU). The number of ESUs is calculated by using standards per hectare crop or an animal. These standards are based on the gross margins. Another indicator for size is acreage or turnover.
- **The legal structure:** A juridical title used to run a commercial operation. Sometimes a holding has more than one legal structure. For example in the Netherlands, a farm can have a legal father-son partnership on an operational basis, whilst a part of the land is owned by the father under his private ownership and rented out to the partnership. Likewise the son is also sometimes the full owner of recently bought milk quota. In fiscal terms there are three operations with their own fiscal income.
- **Household and family members:** there could be several individuals living together under one roof behind a single agricultural holding. They are either employed on the farm or could be owners. Besides employing direct family members, some (large) farms also work with personnel. Unraveling these family relationships is of great value. Most commonly the situation is encountered wherein the successors (the next generation in the family) can be employed on the farm or be partly owner, whilst either (still) living with his/her parents or having started a household of his own. Needless to say is that households can also have members that work on the farm, but are *not* owner. Including employment of members of the household in the family farm implies that the farm income has to support several workers. In situations where this is not possible you find that some households have members with an off-farm job, or another fixed income source like a pension, social security payments or revenues from capital investments. It could also be that he/she runs a self-employed business (through an independent legal structure) that is totally separated from the agricultural holding.
- **Modernity:** The age of the fixed assets expressed as the book value of the assets divided by

- the replacement value
- Solvency: The share of equity in the total assets.
- Age of oldest farmer. The most senior entrepreneur usually has a big influence on the chosen strategy of the farm. Quite often you see that the successor chooses a different strategy after the farm take-over.

The farms in our dataset are divided in four categories of organizational structures:

- One-man businesses
- Partnerships with one household (for example father and son before take-over)
- Partnerships with multiple households (for example two brothers)
- Private limited company

Figure 2 shows the occurrence of legal structures of farms in the Netherlands. As you can see, the most important legal structure is the partnership. In most cases, the partnership is between partners of the same household, either with spouses or with parents and children, who are still living at home. A farm has to be rather large to support more than one family. The partnerships with more than one household are usually partnerships between father and son (with his own household). Only rarely do two siblings run a farm together, only 2.6% of the farms has more than 1 potential successor (Statistics Netherlands). The private limited company is not commonly used in the Netherlands. A farm has to be (very) large should it be fiscally interesting to establish a private limited company.

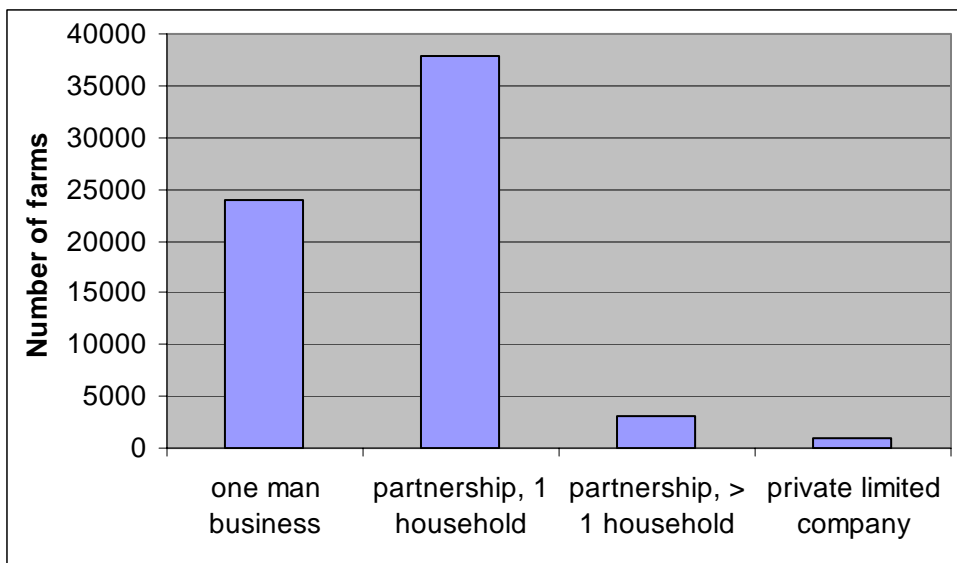


Figure 2 Distribution of Legal Structures in The Netherlands, 2003

Source: Dutch FADN

3 ORGANISATIONAL FORM AND STRATEGY

The organizational form and the choice of strategy are related to each other. Traditional organizational forms no longer suffice due to adoption of more complex strategies. On the other hand farm structures notably influence the choice for a certain strategy.

Figure 3 shows the distribution of strategies in relation to the mentioned legal organizational forms. The right-most column shows the distribution of organizational structures of all the types of farmers. Most obvious is that rural entrepreneurship is stronger represented in the partnership with one household than one finds on average. Not surprisingly, the one-man business is less commonly encountered in the strategy of economies of scale in the same comparison, while the private limited companies and larger partnerships are more commonly found. As stated before, large-scale farms generate enough income for multiple households.

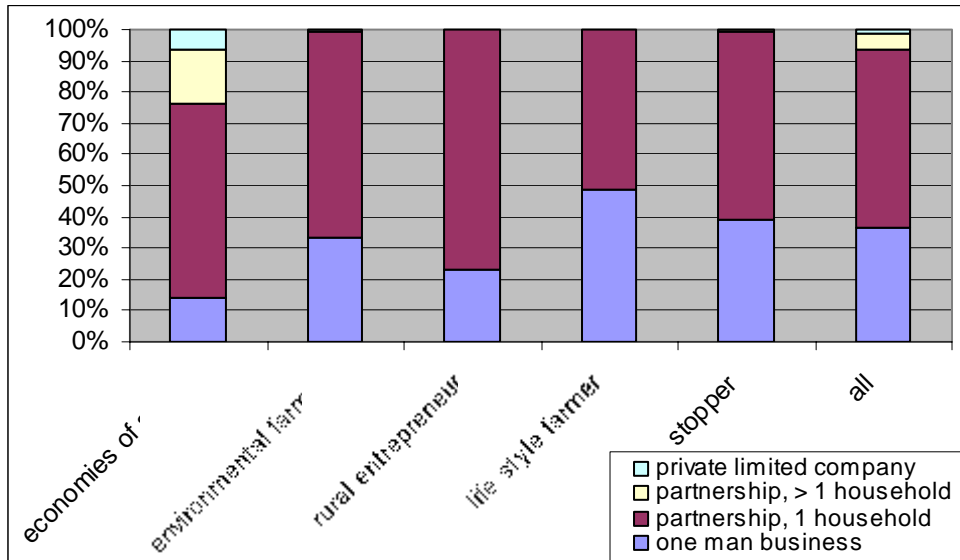


Figure 3 The Distribution of Legal Status and Strategies 2003
Source: Dutch FADN

Figure 4 shows the economic size (ESU) of the farms of the different strategies. The fact that life style farmers are smaller than average and farms focusing on economies of scale are larger than average, is partly due to the assumptions made for characterization of the farms in the database. However, it is interesting to observe that the rural entrepreneur, the environmental farmer and the stopper are about the same size, although smaller than average, at least in economic size.

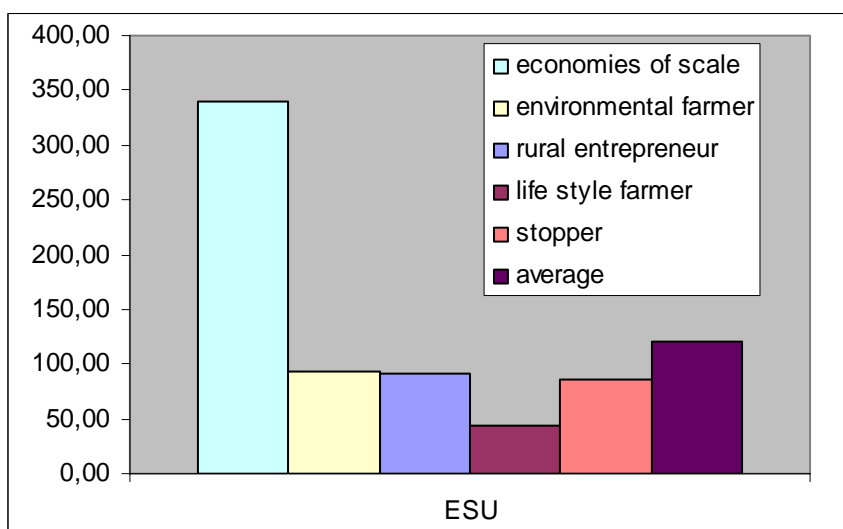


Figure 4 Economic Size of Farms in The Netherlands 2003
Source: Dutch FADN

Environmental farmers operate on about the same size of land as the farms focusing on economies of scale (Figure 5). There are many farms with horticulture under glass and intensive livestock production with limited acreage, amongst the large-scale farmers. Large-scale farms are in ownership of more than half of the land, whilst environmental farmers *rent* more than half. Environmental farmers are more extensive than farmers focusing on economies of scale. What's more is that they often rent land, with limited rights of use, from nature conservation organizations. It is remarkable that the stoppers are smaller than the average farm, expressed in economic size, while they have a larger than average acreage. This is due to the fact that stoppers usually opt for less intensive production systems, e.g. less intensive crops and beef cattle instead of dairy cows. Life style farmers have the smallest acreage and almost all their land is under full ownership. Life style farmers have the smallest acreage and almost all their land is under full ownership.

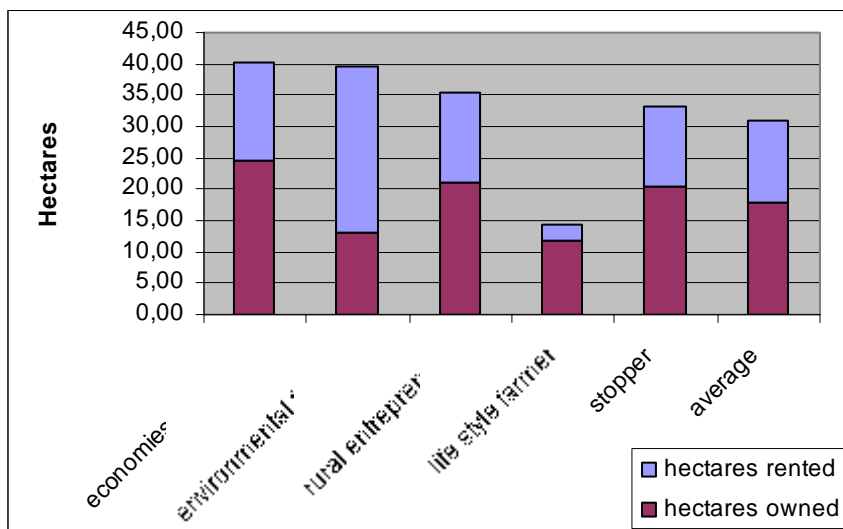


Figure 5 Acreage expressed in Hectares Rented and Owned 2003
Source: Dutch FADN

On average large scale farms have a work force of 6, while the overall average is only 2 (Figure 6). Most farmers only use about one labor unit of own labor. Mostly large-scale farms make use of lots of external labor, however the rural entrepreneur and environmental farmers also rely on external labor to a certain extent. Life style farmers, not surprisingly, make little use external labor.

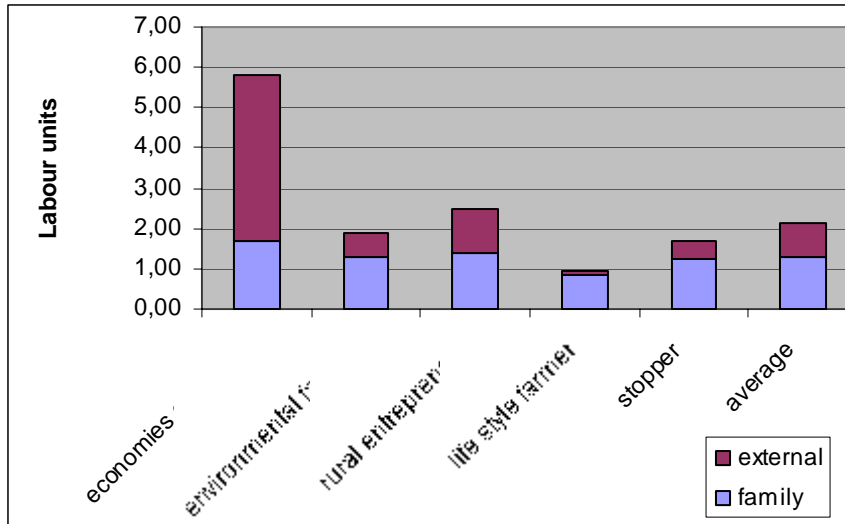


Figure 6 Family and External Labor Units
Source: Dutch FADN

Other farm characteristics mentioned are modernity, solvency and age of the most senior entrepreneur. Figure 7 depicts that (as we would expect) the modernity of stoppers is far below average. Rural entrepreneurs and large-scale farmers have the most modern farms. However the last group of farmers is more leveraged than the rural entrepreneurs, leading to lower solvency. On average environmental farmers are younger than the other groups of farmers. Part of the explanation for this phenomenon lays in the fact that many organic farms have been founded just after a successor has taken over the farm (van der Veen 2004). What's more is that currently half of the organic farms were founded after 1995.

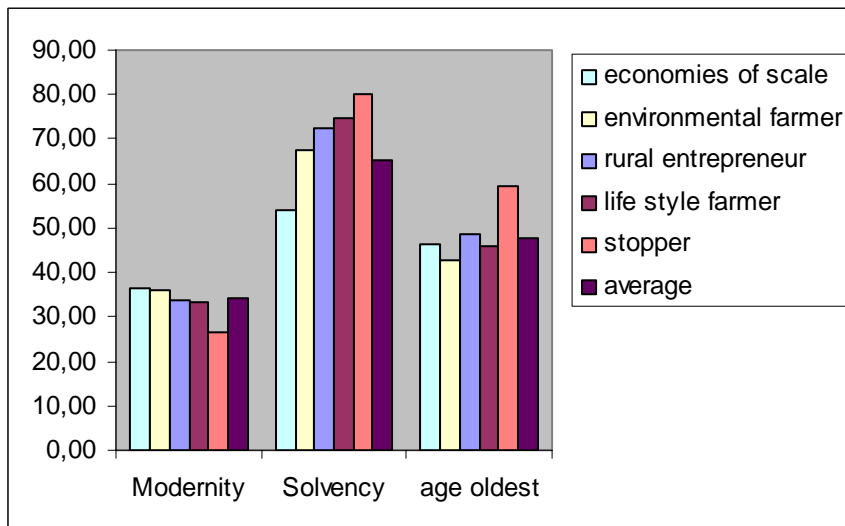


Figure 7 Characteristics of the Farms According to their Strategy
Source: Dutch FADN

4 POLICY AND STRATEGY

The EU agricultural policy has had a big influence on the farm strategies. The direct support on products secured the income of farmers, as it guaranteed a minimum price for products. On average, the farmers with product support did not grow as much as the farms without product

support made apparent for instance when one compares the intensive livestock sector (both no support) and horticulture under glass. Many farms that received product support now lack an optimal farm structure. With the decoupling of direct support subsidies and the rural development plans, EU governments are attempting to incite the environmental farmer and the rural entrepreneur, making farms become more integrated into the general society. Farmers now receive subsidies for nature conservation plans and setting up of new rural activities.

This policy change will make these two strategies more interesting to adopt. The number of farms with the strategy of environmental farmer or rural entrepreneur is expected to grow, but they will stay niche markets. The farms with economies of scale strategies have to compete more and more on the global market. According to Massink (2002) not all sectors will be able to compete on a global market, especially arable farmers and farmers with beef cattle will have to face fierce competition. Not all farms will be able to survive in this strategy, some will adopt other strategies, like engaging into niche markets, while others will sell the farm all together. For example dairy farms in the Netherlands, which are obligated to move due to town and country planning, buy up complete arable farms on a new location to start a bigger dairy farm. They can benefit from a better structure of the farm (size and location of parcels) and the newest technologies in the stable.

CONCLUSIONS

Given the continuous cost squeeze and the changing EU agricultural and rural policy, farmers are incited to change from traditional farming with a focus on low cost to other strategies. For farmers with a focus solely on farming, economies of scale is still the main strategy. However, strategies as rural entrepreneurship and environmental farming can also be encountered. For these farmers, their activities are still related to farming and are contributing to the countryside. Life style farmers, on the other hand, do not focus on farming anymore, but generate income from off-farm labor or capital.

This paper shows that strategy and structure are related. Legal persons and partnerships with multiple households can be especially found among the farmers focusing on economies of scale. One-man businesses and the one household partnerships more often show diversification strategies. One-man businesses are relatively more encountered amongst the life style farmers, whilst one household partnerships are stronger present amongst rural entrepreneurs and to a smaller extent amongst the environmental entrepreneurs.

The acreage of the environmental farmer is about the same size of the acreage of the farms focusing on economies of scale. The difference is that environmental farmers rent a larger share of their land. Life style farmers hardly rent land and mainly rely on own labor. The opposite applies to farmers focusing on economies of scale.

If we look at the other characteristics then it appears that especially younger farmers focus on environmental farming and that their farms have an above average modernity. Stoppers, not surprisingly, have the lowest modernity and the highest solvency.

Given the fact that most farms are still family farms and that the organizational structure in most cases is a given fact, it can be concluded that the choice of strategy is influenced by the organizational structure. This can provide policy makers with interesting insights. Increasing the number of environmental farmers for instance can be best stimulated by focusing on young farmers. On the other hand, life style farmers and stoppers restrict the renewing process in agriculture, as they hardly focus on continuity.

¹ Hennie.vanderveen@wur.nl and Karel.vanbommel@wur.nl; Agricultural Economics Research Institute (LEI), P.O. Box 29703, 2502 LS The Hague

² Net investment = investment minus disinvestment minus depreciation

³ The Dutch FADN contains a sample from the Farm Structure Survey. The survey field is defined as farms between 16 ESU and 1200 ESU. This can have an influence on the result, as the largest and the smallest farms are not represented. Probably many life style farmers can be found with the smallest farms, while we might miss some farmers that focus on large scale economies.

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