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From Entrepreneurship to Enterprise: Strategies to Help Small Farms Survive and Thrive

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It is an all too common story: an enthusiastic and energetic family harnesses a lifetime dream, secures funding and opens an agricultural business. Unforeseen market conditions or adverse weather challenge the family's assumptions. The capital reserve is depleted sooner than income is generated to replenish it, and shortly after that the creditors are threatening foreclosure, a credit rating is ruined and a family is looking for a new home and a new source of income. This issue of the *NC State Economist* discusses some of the pitfalls facing new farm enterprises and means of avoiding them.

Farm Entrants and Exits

According to reports published by analysts at USDA's Economic Research Service (ERS), small farms, like all small businesses, have a relatively high exit rate of between nine and 10 percent a year (Hoppe and Korb 2006; MacDonald, Korb, and Hoppe 2007). Two primary factors affect the failure rate of agricultural enterprises: the size of the farm and the age of the operator. Exit rates decline as the income of the farm increases, although the researchers still consider the six to seven percent overall exit rate for larger farms having sales of over $250,000 as high. The research also found that exit rates are lower for producers between 45 and 54 years of age, and for those who bring prior business experience to the farm operation.

Business failures are especially catastrophic for farmers, since their primary residence and land are generally tied up as a part of their capital investment. When failure occurs, it can be costly. Entrants to commercial farming commit substantial amounts of money and effort to the enterprise, and some of the costs of exiting might be avoided if the risks of entry and the causes of failure were better understood. Even land that has been inherited can potentially be at risk if a younger generation, with less management experience, takes over farming responsibilities and the parents relinquish involvement in day-to-day operations.

The "Valley of Death"

MacDonald, Korb and Hoppe presented their findings with the suggestion that their data would be useful for policy makers considering legislation, risk management and educational programs targeted to inexperienced farmers. These are essential components of efforts to reducing the farm failure rate.

Their analysis also demonstrates another area that should be addressed in working with new producers: how to move a young farm from entrepreneurial start-up to a stable, thriving enterprise.

While there is an overwhelming amount of literature focusing on the start-up phase of business development, there is little that addresses a second, and perhaps more essential aspect of the enterprise's life cycle. This phase – known as the "valley of death" – occurs when a business has successfully completed its introductory phase, typically about twelve to eighteen months after the business begins operation.

For agricultural enterprises the "valley" emerges at the point where the farm's activity is characterized by accelerated expenditures, increasing customer acquisition and expanded production. The USDA-ERS studies make the case that higher income farms managed by experienced owners have a lower probability of exiting. It therefore stands to reason that efforts should be made to address the factors that can aid in growing the farm operation and in providing farmers with needed business skills.

Three key areas can make the difference between jumping over the “valley of death,” or being swallowed up by it: management, marketing and finances. These are discussed below.

The Management Challenge

Every business requires periodic reassessment of its operating environment. This is no less true of agricultural enterprises than for nonfarm businesses. An agricultural producer who is experiencing steady growth and market development needs to look beyond functioning as a one-person enterprise, and should begin to think in terms of building an organization that can help the small farm develop into a successful agribusiness.

The best business schools in the world teach that a differentiation of labor within organizations is the key to their success. Generally speaking, most individuals are incapable of being successful in all three of the major areas of business activity: marketing, management and finance. Because of this, few growing small businesses can continue to thrive with only one person handling all aspects of the business.

Successful family farms traditionally have divided responsibilities between spouses or between parent and an adult child or between siblings. Where farm owners do not have a close family member to provide assistance, the development of relationships with others in the community who may serve as paid advisors (such as a bookkeeper or a business consultant) can assist the producer in maintaining objectivity in assessing farm operations and market conditions. One-person businesses tend to burn out because they cannot balance all of the responsibilities of their operations and perform equally well in all tasks. This is well-represented in the USDA-ERS studies referenced above.

Common Marketing Mistakes

Marketing is a second important element of bridging the "valley of death." Over time, a poorly executed marketing strategy impacts profitability. Two common marketing errors are (a) a failure to identify a distinctive competitive edge and build a strategy around it; and (b) a lack of understanding the product from the customer's perspective.

Consumers are inundated with products at virtually all price points and at every level of quality. Even specialty crops and heirloom varieties can be perceived as undifferentiated products in the consumer's mind, unless the producer develops what the advertising industry refers to as a "unique selling proposition" that captures the customer's attention.

Looking at one's marketing efforts with the eyes of a consumer is helpful. Sellers see their products typically in terms of features, such as the variety of vegetables being sold or the selling price. However, customers frequently buy goods based on perceived benefits, (i.e., health and nutritional value), or the intangible sense of well-being created by buying local produce from a known producer.

Successful agricultural business owners use their knowledge and expertise as a tool to cut through customers' information overload. Many value-added producers have been successful in using customer relationships, on-farm visits, and internet sites that facilitate direct-to-the-customer communication as ways of attracting and retaining customers.

Cross-marketing with complementary businesses is another option. It establishes a brand identity for the producer or community. For example, a Christmas tree farm in the NC mountains has partnered with a local bed-and-breakfast to provide an affordable weekend get-away package to attract people to the area. The four-county association of small growers known as Foothills Fresh, encompassing Lincoln, Gaston, Cleveland and Catawba counties, sponsors an annual farm tour that is similarly the result of cooperation among all member producers.

Poor Financial Information

Financial management is the third critical component of bridging the valley of death. Two key financial management problems common to small farms are a lack of adequate record-keeping and poor cash flow management.

Inexperienced farm owners often co-mingle their business funds with their household accounts. This means that they do not have a clear picture of their income and associated expenses, and, as a result, cannot get a good handle on how cash is flowing through their operations.

Producers who lack financial discipline often make emotional buying decisions regarding farm purchases, especially when the cash flow is strong in income-producing months. Without historical records and cash flow statements to keep things in perspective, producers may forget that money needs to be set aside to pay taxes, repay operating loans or build savings to cover fixed expenses incurred during the months when no income is generated.

One way to reduce the tendency for producers to mismanage cash is for one person to be responsible for financial records; another is to require two signatures on business checks. Additionally, a third-party financial advisor, such as a paid bookkeeper or accountant, can help producers develop useful financial statements that capture the farm's income and expense patterns. Good record-keeping and sound cash flow management can benefit farmers by potentially reducing the cost of capital and improving cash-on-hand during low income producing months.

Conclusion

Staying in business is the goal of most small farm enterprises. Small agribusinesses need to "think big" by establishing a division of labor, a clearly-defined marketing strategy and sound financial record-keeping. Continued profitabilitywill be the end result.

For More Information

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