

Module 2

Strategic Business Planning

Module Outline

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Learning Objectives

The learning objectives of this module are to:

- Learn about the components of the strategic business planning process.
- Know the purpose and procedures in the planning process.
- Be able to plan and execute action steps critical in the development and implementation of a business plan.
- Provide examples of the business planning process as it applies to a business operation.

Introduction

Now that we have been through the journey of economic changes and mega trends impacting the industry and your business, let's pull it all together with a strategic business plan.

Research has linked strategic business planning to as much as 30 percent higher business profits. While the research is limited to claim a cause-and-effect relationship between the two, it does provide clear evidence that business plans lead to increased profits and profitable producers utilize strategic business plans. A side benefit is a document that helps to facilitate focused communication with partners, stakeholders, suppliers, lenders and advisory teams. Now, let's roll through the components of a strategic business plan.

PODCAST #1: Is today's business environment too volatile to do strategic business planning?

You may recall that global economics, trade issues and trends may result in more volatility in extremes. Then, you may ask, "Is today's business environment too volatile to do strategic business planning?" To the contrary, in a volatile business and economic environment it is important for business persons to conduct planning to minimize emotions and make more objective decisions. Positioning the business to capture profits on the positive side of the cycle and develop plans to mitigate risk in adverse business conditions are key successful management strategies for today.

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What is Strategic Business Planning?

The saying, “If you don’t know where you’re going, any route will take you there,” reflects the importance of business planning. Strategic business planning involves analyzing the business and its environment to create a master plan for taking the business where management wants it to be. Developing a business plan is a process to help business owners grow their operations, increase profits, develop and market products, and/or plan for business transition. A good planning process allows business owners time to step back from the day-to-day operations and focus on the bigger picture. For example, thoughtful discussions with key players inside and outside of a business help ensure a common vision and understanding of where the business is headed, strategies for how to get there, and what objectives or metrics will be used to measure success. Business planning can circumvent short-term emotional decisions and focus decisions on well thought out objectives and goals.

Purpose of Strategic Business Plans

Business plans may be prepared for many different reasons, including new business start-ups, major changes in existing businesses, or to maintain the strategic direction of an ongoing business. A business plan can be used internally for management purposes, and externally to communicate a business’ vision and direction to attract investors, to obtain financing from creditors, or to recruit quality partners or employees. Business plans can provide an owner with a way to evaluate the feasibility of a proposed venture.

The process used in developing a business plan may reveal previously unconsidered opportunities or limitations. A plan should provide clear direction for the organization. Also, it can be customized depending on the target audience – investors, creditors, board of directors, family members, or others.

Business Planning for Agriculture

Recent research has shown that only one in seven agribusiness owners with \$250,000 or more in annual revenue have some form of a business plan. A written business plan can be invaluable for both large and small producers, especially those in a startup, expansion, or transition mode. Even small, stable businesses can benefit from a simple business plan that focuses on areas of strength and on improving limitations to help meet business objectives. While most farmers and ranchers have a clear plan in their mind for their operation, conditions are changing at an accelerated rate. The value of a written business plan is to provide a well thought out and agreed upon guide for decision making. Many agricultural producers are turning to value-added or niche crops, employing non-traditional practices, planning for transition, or implementing unproven technology. In these situations, a sound business plan is essential.

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PODCAST #2: How much time should it take to develop a business plan?

Yes, business plans can take from 50 to 100 hours to prepare, depending on the size of a business and depth of the plan. However, when you are investing significant amounts of time and money into your business venture, putting honest, objective, candid thoughts on paper can prevent financial headaches and heartaches. Like the old Fram oil filter commercial said, “You can pay now or pay later!” For example, a group of producers formed a cooperative to process and sell their produce directly to consumers. When quizzed about a written plan, the alpha leader indicated they didn’t have time and would develop it later. Eighteen months later this business filed for bankruptcy.

What is a Business Plan?

A business plan is a *written document* outlining the mission, vision, goals, objectives, strategies for execution, tactics and metrics for the key functional areas of a business. Also included are management, finance, production, marketing, and risk management plans. Simply put, a business plan is a road map for a business. The depth of detail that a business plan contains will vary depending on the scope of the business and the purpose for which the plan is being prepared. For example, a non-traditional business trying to obtain venture capital will have a much more detailed plan than a more conventional business trying to obtain a small loan. Also all business plans have common parts. These commonalities will be discussed later.

Who Should Prepare the Plan?

Although professional consultants can help in developing business plans, the business owner should take the lead role and ultimate responsibility for developing and implementing a business plan.

The most effective planning processes seek and incorporate input from many levels. In a family business, both spouses should have input as well as any other family members who have a stake in the business. In a large business, the president or manager should not have sole responsibility for creating the plan. The process should include the entire management team, including potential management successors. The planning process and the discussions involved can be an invaluable part of the successor’s development. An advisor or facilitator, and in some cases a mentor, can be valuable for both input and keeping the planning process on track. Many books, websites, and computer programs are also available as resources.

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SWOT Analysis

Before one embarks on strategic business planning, it is useful to conduct a SWOT analysis. SWOT stands for: Strengths, Weaknesses, Opportunities and Threats. The *Strengths and Weaknesses* components are designed to critically examine the business internally, while the *Opportunities and Threats* components assess the business' external environment.

First, when assessing the strengths and weaknesses of a business it is necessary to objectively examine a business' core competencies. That is, what sets the business apart from others? What are the unique capabilities that the business has and can retain? What are the quality and quantity of resources within the management's control? What are the abilities and skills of the owners, managers, and employees? Is the resource base large enough? How modern and efficient is the physical plant? Is there adequate access to markets and a quality labor force? What are the lifestyle conditions of the surrounding area for quality of life? The process of answering these questions forces the owner/manager and stakeholders to recognize that most every business is constrained by its internal environment. It is important for it to build upon the physical resources and human skills and abilities available. It also involves addressing how management plans to compensate for the weaknesses identified.

Second, every business face uncertainties, threats, and opportunities that are beyond its control. Many of these threats and opportunities were outlined in the megatrends section. In this part of the analysis, assessing the external environment requires an examination of vulnerability to economic and political change as well as to domestic and global market forces. Examples of external threats that can cut profits and/or make a business venture more difficult include changing regulations, environmental issues, and natural resource constraints. However, on the other side of the coin, new market opportunities can be created by demographic or competition changes, new technologies, changes in lifestyle, or consumer habits.

What are the Various Components of a Business Plan?

The following components are generally found in most business plans. The order and emphasis placed on each component will vary depending on the business and purpose of the plan.

Executive Summary

An executive summary is exactly what it says, a brief summary of a business plan which an executive might read to gain a quick understanding of a plan – between 1-2 pages in length. It is a concise overview of the key aspects of the plan including the company's current status, mission and objectives, products and services, marketing strategy, and summary of financial projections. It should highlight the key elements for success, such as break-even sales, price, or market share. The executive summary, which should be written *after the plan has been completed*, gives an interested party a quick overview of the plan. If the summary sparks interest, additional detail is available in the body of the plan. An executive summary should create enthusiasm about the business venture by

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making clear the intentions of the business and the opportunities. *See a sample executive summary for Milky Way Dairy, LLC in Appendix A.*

History and General Description

The history and general description of the business is a simple narrative of what the business is about, its structure and why this structure is important to current success. This section should include a list of farm partners and key employees by name and their background qualifications, reasons for starting the business or for any major changes that have occurred, and a general description of the industry and its economic status. For an existing business, a discussion of products and past success (or failure) should be included to provide a track record for the reader. *See a sample history of Milky Way Dairy, LLC in Appendix B.*

Vision and Core Values

Visioning in a business requires the owners and stakeholders to express what they stand for and believe in and may not necessarily be tangible. The vision will usually touch everyone in the business including employees, investors, lenders, customers and the community. The vision ties in with the core values, which provide an example of how people are expected to act regarding character. Some examples of core values would include: respect for individuals, customers and making the world a better place.

Mission Statement

A mission statement describes why the business exists (i.e., What is the business' mission?). It should be brief and general enough to be flexible, but rigid enough to give the business a strategic direction. A mission statement may encompass business, family, and/or personal goals.

Like the entire business plan, development of the mission statement should include input from all levels inside and outside the business, not just management. The mission statement should be visible; that is, every person involved in the business, not just the owner or manager, should know and easily grasp the concepts contained in it.

In summary, a mission statement should generally be 25 to 50 words, have input from employees and stakeholders; be made up of key words; be visible and posted; be futuristic; and be updated every 3 to 5 years.

Two Examples of Mission Statements

“McPherson Farms will provide high quality crops and livestock for our customers on a profitable basis that brings honor and respect to the business, employees, family and community.”

*“The mission of Wittman Farms is to produce high quality grain, livestock and timber commodities for U.S. and foreign customers in a manner that will assure:
-- a fair return on investment to our owners,
-- a safe and fulfilling environment to live and work in, and*

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-- a farm capable of producing sustained income for future generations.”

Goals and Objectives

Goals and objectives translate the mission into concrete terms. A useful exercise is to have owners, stakeholders, and influencers of business decisions identify their top three business, family and personal goals for the short run (less than one year) and long run (three to five years) in writing. This process allows stakeholders to build off of commonality, negotiate and work out differences. This is where a mentor or facilitator can be useful in discussions and keeping people on task. Clarity in goals is often the principle underlying profits and balance in business and lifestyle objectives.

Use the acronym SMART when establishing business and personal goals.

S- Specific

M- Measurable

A- Attainable

R- Rewarding

T- Timed

Established objectives with quantifiable metrics and measurements can provide focus for execution of tactics in day-to-day operations, for a more rewarding business.

Objectives should be quantitative, simply written, straightforward statements such as the following:

- Increase net profits by 10 percent per year over the next five years.
- Reduce fertilizer cost by 30 percent by utilizing manure and global positioning systems.
- Invest five percent of net income for retirement.

Your objectives should be *measurable* and selected in such a way that they contribute to the attainment of your goals which in turn allow you to accomplish your mission and live your core values and vision. Objectives are what you are expecting to occur.

A summary of Milky Way Dairy, LLC's goals is included in the executive summary in Appendix A.

Organization and Management

Business organization and management are essential parts of a plan. The business plan should explain how the business is legally organized; examples include sole proprietorship, partnership, corporation, or Limited Liability Company (LLC). For larger businesses, the duties and responsibilities of all involved should be outlined along with an organizational chart indicating where the decision-making power rests. Details on management compensation and allocation of profits and losses are essential, along with a backup management plan. If seeking outside financing, readers will want to know what experience each of the key personnel holds making him or her compatible with the venture. In a family business, each member's role and responsibilities in the operation

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should be clearly defined. If expertise is weak in a certain area (operations, finance, etc.) the plan should express concern about this issue and offer ways to compensate for the problem. If professionals such as attorneys, accountants, or crop or livestock consultants are to be used, this section should explain their roles.

The business plan may also include a section about business transition strategy, particularly when a business succession is planned. Plans regarding ownership, management and asset transition or transfer to the next owners should be discussed.

Key Planning Assumptions

Since it is impossible to have data to support every aspect of a business plan, much of business planning is based on logical assumptions rather than hard facts. Therefore, assumptions of how issues outside the owner's direct control might evolve during the planning period should be established. For example, a logical assumption relating to rapid increase or decrease in input prices due to economic conditions should be included.

It's critical to outline the *key planning assumptions* from the beginning. Trying to gain objectivity regarding the business venture is the purpose. This helps in avoiding bias because of the emotion involved in planning a business venture. Key planning assumptions may include: trends in supply and demand, the global economy, the marketplace, and/or consumer behavior patterns. They may also include changing government policy or the future of a particular technology. Be sure to document sources of key data and assumptions. Using reliable sources of information in the business plan will help avoid using assumptions of what the owner hopes will happen, versus what an informed, unbiased third party believes is likely to happen.

Marketing Strategy

The marketing strategy describes how sales or revenue objectives (i.e. \$1 million in projected sales revenue per year) will be accomplished in light of the conditions uncovered in the market analysis. A marketing strategy includes decisions regarding pricing, cost, and market analysis. Knowing break-even prices is critical to developing a sound marketing plan. Sound enterprise budgets can be a valuable tool in the decision whether to add or remove an enterprise. A good marketer may utilize a risk management marketing program with strategic set targets for profit based upon cost. A good marketing strategy may include selling product inventory above break-even on a timely basis, and meeting cash flow and debt payment commitment deadlines. If a product is branded or has proprietary value, the marketing strategy should discuss how the product will be protected to maintain its uniqueness.

A well developed and logical marketing strategy can avoid the mistake of holding inventory when the market suddenly drops below the break-even point. It's also important to have a backup marketing strategy in case the original plan fails. Within this marketing strategy is an analysis of the competitive environment.

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Financial Strategy and Plan

Business and personal financial statements are a very important component of a strategic business plan. Developing the balance sheet and income statement and then refining the numbers through an accrual analysis are imperative in telling the financial story of your business.

The cash flow projections with various price and cost sensitivities along with loan structure can be useful in bringing the business plan to life. These projections summarized in the business plan link the production and operational plan to financial outcomes which, in turn, are useful in determining financial needs. Understanding financial ratios is crucial to understanding the financial strengths and weaknesses of the business from a historical and futuristic point of view. Of course, the enterprise analysis can be very useful in examining which components of the business are making money with deployed resources.

Operations and Production

Perhaps the most overlooked aspect of a business plan is the operational plan. The operational plan includes issues related to location, facilities, equipment and material needs, supplier and distribution factors, human resources and personnel management, processes, inventory, and quality controls. This portion of the business plan should tie together the product, marketing and financial sections of the business plan into a unified approach toward actually running the business.

Also, in this section the capacity of facilities to meet expansion needs, the availability of competent employees, and how quality will be measured and maintained should be addressed. Systematic flow diagrams showing labor needs by season, timing and change in inventory throughout the year, and scheduling may be needed, particularly in more complex businesses.

Action Plans

Even the most well-developed objectives and strategies can become meaningless without appropriate action. One of the most effective ways to define tactical responsibilities and to hold individuals accountable is by developing specific action plans for each objective. Action plans should clearly define the action step, responsibility and time frames to effectively accomplish each objective. Also, managers should periodically review the status of action plans to assess how well the business plan is being implemented. An example of an action plan is to have 25 percent of the grain marketed in the month of May by the marketing manager.

Metrics for Evaluation

How will results of the business plan be measured? Implementing appropriate evaluations and controls lets business owners and others know that the plan is being executed successfully and that milestones are being met. These controls also ensure accountability and discipline in following the plan. Operating data from your business' normal business activity can be used as a guide in measuring progress. Accounting, production, sales, inventory and other records can be key sources of information. As

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conditions change, these pre-determined control measurements can help business owners identify areas for improvement and objectives for getting performance back on track. In thinking about a control or evaluation system for your business, a first concern should be that it is easy to operate and maintain. Also, the system should be so practical that it becomes a natural part of the management process.

Risk Management Program

In this section, one needs to be prepared to discuss the components of covering for potential risk. This could include such things as: life insurance, liability coverage, disability, and/or long-term healthcare insurance. Protection concerning machinery, livestock and crops needs to be discussed, with appropriate links to various details of policies and coverage.

This section may also include details concerning manure and environmental plans, livestock and farm identification programs. Some plans include an analysis of rental and contractual arrangements for land, livestock, crops and machinery critical to the success of the ongoing operations. The discussion should cover the planned use of risk contracts. This includes demonstrating that management has a clear understanding of how these tools work, the risks involved, and how they are to be used. Medical coverage, potential investment for emergencies, contingency and long-term retirement transition plans can be overviewed in this section as well.

Exit Plan

Sometimes bad things can happen even with the best developed plans. Your plan must recognize potential road blocks and provide alternatives to overcome them. In this section an outline of procedures and processes concerning a systematic exit from the business, specific enterprises or business activities needs to be discussed. An overview of buy-sell agreements and contingencies for adverse events need to be presented.

Having an exit plan procedure up front can result in less miscommunication and adversarial conflicts if a worst-case scenario and/or a breakup of the business occurs. Exit agreements will usually have specifics about notification of partners due to death or incapacity. Exit plans concerning investments, capital improvements (i.e. facilities, structures, fences, and repairs) need to be outlined. Realize that some disputes may require a third-party arbitrator. A good exit plan up front can provide an exit ramp to reduce miscommunication, emotion and possible financial devastation if an orderly exit does not occur.

Appendices

Any relevant and supporting information that does not fit appropriately into the body of the business plan may be placed in appendices. These are usually at the end of the document and can contain just about anything pertinent. Examples include management charts, personnel resumes, brochures, sales trends, letters of recommendation, and/or details on markets, finances, or operations. Placing irrelevant or excessive amounts of material in the appendices should be avoided.

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PODCAST #3: Business Plan Length and Format

The length of the plan will vary, but most plans are between 10 and 50 pages, excluding appendices. If you can't communicate the essence of your plan on a simple napkin, it is probably too complex. Often, a cover page and table of contents are included for easy reference. Depending on the situation, plans should be dated and marked confidential. If appropriate, copies should be numbered before distribution. If one utilizes a consultant or advisor, the owner and manager need to work side by side with the outside advisor/expert so execution and monitoring can be followed through.

Summary

A business does not benefit from a plan sitting on a shelf collecting dust. Oftentimes, business owners view the business plan as a one-time-only document to be used for a specific purpose and then forgotten. In my experience, monthly variance analysis is quite useful in making sure the business plan is used throughout the year. That is, we compare *projected budgets* to *actual results* every month. Deviations from the two are then tested against our marketing, financial and operational strategies to determine whether macroeconomic events such as a change in interest rates, consumer demand or rise in fuel costs were a factor, or a micro event like failure to develop and execute a marketing plan or poor production performance because of machinery breakdowns resulted in the difference. Then adjustments are made.

Realize that business owners who are most successful in following through with their planning process view their business plan as a *living document*. A plan should be updated annually or more frequently if the business is experiencing problems or if the marketplace is changing rapidly.

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Appendix A: Milky Way Dairy, LLC Executive Summary

Milky Way Dairy, LLC is a third-generation dairy and crop farm in Anywhere, USA. The family is in business transition, navigating through the economic cycles of the industry.

The business and family have core values of producing high-quality products from the dairy herd utilizing innovative technology and business practices to maintain a profitable business. Specific short-term goals include: building working capital within a year to 20% of expenses; have a one-week family vacation annually; and reduce variable cost by 2% within the next year. Longer-term goals include: paying down \$2 million of debt over the next five years; examining other enterprises for better utilization of resources and talents; and having an internal audit of risk management, labor, and human resource practices within the next five years.

The business and family are community-minded, giving time and monetary support to youth and community groups, which has been a tradition over three generations.

SWOT Analysis

The major strengths of the business are that they are an economically profitable dairy herd that utilizes high quality genetics along with the support of advisory groups in nutrition and agronomy practices. The partners' talents and skills are highly complementary in crop, livestock, maintenance, and business management practices.

A weakness or area for improvement is to expedite the transition plan of the older generation's phase out and integration of the new generation into management roles. Another potential weakness of the business is the time and effort devoted to caring for elderly parents and grandparents. Given the market conditions, the business has the opportunity to diversify into additional enterprises such as custom farming for others, raising dairy steers, and selling value added products such as ice cream. The possible loss of rented land and general competition for land in the area from an economic standpoint is a constant challenge and threat to business viability.

Production Management

The farm has up-to-date facilities in production and heifer rearing as well as machinery and equipment. A strong agronomy and nutrient management plan complements a highly productive dairy herd.

Financial Management

The financial condition of the dairy business finds strong net worth increasing nearly \$800,000 despite the suppressed economic environment in recent years. This is being accomplished by the reduction of debt and some increase in the amount of physical assets, not through asset appreciation.

Working capital is an area of concern as the business fluctuates from strong to weak working capital positions over the past three years. A good risk management plan with crop insurance, marketing and hedging is used to provide some stability in this area.

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Net cash farm income has been strong historically but is in decline due to the reduced milk prices and sale of crop inventory. Profits have averaged \$500,000 on a cash basis. Further refinement on an accrual basis finds the trend analysis shows accrual profits exceeded the cash basis in one year and were lower than the cash profits in another year. However, with increased efficiency and milk prices, this should improve in the future.

The projected cash flow finds nearly \$300,000 in net cash after all expenses and debt service. Milk price can fluctuate up to \$1.00 per cwt. before moving toward a negative level and milk production could decline by nearly 2,000 pounds per cow before a negative margin occurs.

Action Plan

Kelly is exploring a dairy steer enterprise for better utilization of resources and talents. Leslie, on the other hand, is examining the possibility of doing 500 acres of custom work for the neighbors as an income source and the possibility of enhancing these relationships for future resource negotiations. Leslie's spouse is analyzing the economics of an ice cream and agri-tourism business near the dairy.

A marketing and risk management plan includes crop insurance and some milk being marketed using hedging and options. Analysis of all these risk management and insurance programs will be undertaken to ensure proper coverage and amounts. All facets of human resource management from compliance to job responsibilities and accountability will be facilitated by an outside advisor over the next 12 months.

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Appendix B: Milky Way Dairy, LLC History and General Description

Milky Way Dairy, LLC is a third-generation dairy farm located about five miles from Mars, U.S., a small rural center of 3,000 people. Starting with 12 registered Holsteins in 1953, the dairy farm has grown from a tie stall milking pipeline barn in the 1960's and 70's with 60 cows operated by Granddad and Grandma, to a free stall barn with 200 cows and a double 10 milking parlor operated by Bill and Betty. They also sold excess crops and registered livestock in the 1980's and 1990's. The new century and the decades beyond saw an increase up to 500 cows and approximately 500 replacements with an upgraded milking parlor. Now, the third generation of the family, Leslie and Kelly, are fully engaged and working their way into the business with Mom and Dad, since Grandpa and Grandma have moved on to another chapter in their lives and live in a retirement home.

Bill and Betty are in their early 60's. Bill is responsible for all the crop work, such as planting, harvesting and overall agronomic practices. He is a college of agriculture graduate from the two-year program in dairy science and agronomy and has a goal of producing high-quality economical feed for the dairy herd and replacement heifers. His goal is to phase out of the business over the next decade and enjoy the lake house and traveling in the RV.

Betty is a graduate of the university with a degree in agricultural economics and she worked for a local cooperative in bookkeeping for a decade before returning to the dairy farm. She raises calves and maintains the farm records, handles payroll and pays bills. She has used a commercial farm record system for solid financial statements for business analysis and has worked very closely with the agricultural lenders. Both Bill and Betty have been very active as leaders of local 4-H and FFA programs, with teams that compete in county and state dairy and crops judging contests. In recent years, Betty has devoted more time to caring for her in-laws and her mother, as well as serving state and national dairy organizations. Betty is not sure how much longer she would like to do the farm bookwork, or who will take over this responsibility. Recently, the third generation, which includes Leslie and Kelly, has returned to the dairy after stints away from the farm. Leslie served in the military and then worked at an agribusiness firm as a crop consultant for a few years. Kelly was a livestock nutritionist for two years with a national firm. Both Kelly and Leslie indicated that this was invaluable experience before returning to Milky Way Dairy.