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Farm Business Strategies: Enterprise Diversification

Each winter, Extension agents host and present at meetings offered to the agricultural community on topics including novel crop production methods and business management strategies.

Mercifully, the speaking tour is winding down, but there have been some prevailing themes in audience questions across the meetings.

A grower pulled me aside at one meeting and asked my opinion on whether or not their business should consider growing an alternative grain crop given the declining state of commodity grains.

Importantly, the grower implicitly acknowledged the idea of enterprise diversification. Enterprises, in the agricultural sense, are the various crops, livestock, and services we offer. Growing a new crop, altering livestock-rearing schedules, or offering an additional service could be considered enterprise diversification.

The fundamental misconception of diversification is that it is a profit maximization strategy. Often, we may view adding another crop in the field as a mechanism to take advantage of a favorable price or consumer demand in another market. The more enterprises, the more opportunity for profit!

Unfortunately, oftentimes adding another enterprise allocates resources away from core, profitable enterprises–dragging them into the red. In this instance, the new and existing enterprises compete for current resources.

The new venture can add additional resource requirements like specialized equipment, skills, and labor to the business–all of which can increase overhead costs that eat into profit.

Instead, enterprise diversification may be better seen as a risk management strategy, rather than a profit maximizing strategy. This goes back to the old adage of putting all your eggs in one basket. Businesses that have many different enterprises are putting eggs in many different baskets. This insulates the business to a negative outcome in any one basket.

Seen here, the farmer raising corn and soybeans may be better protected from falling corn prices as the soybean crop could offset losses.

Any grower reading this knows that this is a far too simplistic view in reality. In fact, commodity grain markets are somewhat correlated to each other where falling corn prices could mean falling soybean prices.

Successful enterprise diversification as a risk management strategy should instead work to complement existing, profitable enterprises and open doors into other unrelated (or partially-unrelated) markets.

For example, the above row-crop operation could consider adding a specialty grain (grain sorghum, sunflowers, rye, etc.). The operation could use their existing equipment to raise and harvest the crop with small modifications. Additionally, the grain would be sold on a different market that is mostly unrelated to other commodity grains like corn and soybeans. In this, the new enterprise does not add any additional overhead costs, and operates in a market insulated from the other enterprises.

In effect, the new enterprise should create "synergies" that support all existing operations and simultaneously open new doors.

So, the answer to the inquiring grower at the winter meeting is like all other good Extension Agent answers: "it depends".

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