The Dollars and Sense of Going from Good to Great in the Dairy Business

David M. Kohl, Ph.D., Professor Emeritus
Alicia M. Morris, M.S.
Agricultural and Applied Economics Department
Virginia Tech
Blacksburg, Virginia 24061
E-mail: sullylab@vt.edu

Introduction

In the next decade, the dairy business will see many structural changes driven by the consumer that will require a holistic approach to managing the business. Dairy producers that will drive the business to another level in profitability and sustainability will differentiate themselves through the use of information and human resources with allocation of capital and natural resources in an optimal, timely manner.

Those who provide services and consulting to dairy businesses must be aware of big picture trends of the industry. The ability to work as a team with other professionals for the benefit of the owners, investors, management, and employees will not be an option, but a requirement.

The Landscape of Agriculture

The top end of the food chain, that being the food retailers, is ultimately driving the landscape of the dairy business. Currently five giants control over one half of food retail sales. The implications are that a traceback system from the embryo or seed to the plate will be necessary; since affluent customers require safe, secure, and stable products. To the consultant, integrated information systems will be sought and demanded by your client.

Next, while dairy producers operate the business for profits, balancing this with the lifestyle of owners, managers and employees will be essential. Those providing recommendations or systems must consider this balance if action plans are to be executed.

Women and minorities will be making more management and investment decisions on the 2010 dairy. Today, 63 percent of credit decisions are made or influenced by the spouse, and 80 percent of investment decisions are partially or totally approved by the spouse. Failure to include the spouse in the plan can be a ticket for disaster.

Any management recommendation must be made in an environment of extreme milk price and input cost volatility. Historically, milk price varied by $2.00 per cwt. Now $7.00 per cwt deviations are being experienced and this volatility is not expected to abate in the future. These extremes will require new metrics in business management so that producers can capture profits on the upside and mitigate the risk in the case of adverse events or declining prices.

Analyzing the big picture of agriculture, government policy in the future will orient funds toward conservation, water, environmental, and natural resource management. Consolidation of the dairy industry will occur into 35 regions in the United States. These regions will be rich in land and water resources, with strong support infrastructures and have community areas that will provide the lifestyle desired by owners, management, and employees. These pockets or regions must provide public support for the dairy business and processing plants, as the industry consolidates from today's 80,000 businesses to 15,000 to 20,000 dairy enterprises in the year 2020. Intense global competition from imports and exports will create abrupt changes in plans and recommendations in a period of increasing cost of borrowed and equity capital.

Intergenerational transfer of businesses and business partners will be a major management challenge. The businesses owned by the World War II veteran or baby boomer generation will be passed to the X-er and Next-er generation. Working with these individuals will require a dairy professional with keen awareness of motivations by generation and gender.

The new generations will be technologically advanced, and tend to complete tasks at the last minute, in some cases without advanced planning. Teamwork is desired in an environment that will demand flexibility, power, fulfillment and, yes, immediate feedback. This will challenge experienced professionals who have often worked with the senior generations in the past.

Good to Great with Professionals

As dairy influencers, you will be required to work with other professionals as a team in raising the business' competitiveness. Research finds key influencers to the dairy industry, in order of importance, are: the accountant, lender, specialist consultant, veterinarian, and lawyer.

These teams will be most effective when they meet on a scheduled basis away from the day-to-day activities of the business. These advisor teams will have some members on retainer. Meetings will be conducted with official agendas and written minutes of the previous meetings will be kept with specific recommendations, actions, and metrics. Peer benchmarking and coaching with other key dairy producers and businesses from a region will be methods to exchange information and management practices, raising the business acumen.

Good to Great Management Practices

There are several critical mistakes that must be avoided if the 2010 dairy business desires to go from a good business to a great business.

In expansions that require major capital infusion, most successful businesses will overestimate capital and time to complete the project by 25 percent to avoid under-capitalization.

Second, a sound dairy business has a well-designed working capital strategy. Working capital is calculated by determining the difference between current assets and current liabilities. A minimum working capital divided into expenses of 10 percent is critical because of the extreme volatility in prices and costs. It is suggested a 25 percent ratio be maintained before expansion.

Time management and allocation is important as more dairy owners and managers multi-task. Dairy producers that exceed 3000 hours working on the dairy annually have been found to burn out in the long run.

The location of the dairy in a desirable rural area will be necessary to attract a high performing management team and employees.

As dairy producer's balance sheets and income statements become larger because of size of the business, a written family business transition agreement will be a requirement. A transition plan that treats family members equitably, but not necessarily equally, will require keen advice from the advisory team.

Cash wages tied to profits and equity shares will be a trend of the future. Values placed on fringe benefits and perks will be a common element in the total compensation package.

In building the next family management team, dairy producers should require the children to work and live away from the business for three to five years. Upon returning, they should be making management decisions within a six-year period.

Financially knowing the cost of production and conducting enterprise analysis, (i.e. dairy, crop, heifer raising segments) will be a practice of the performance leaders. This, along with an overhead strategy driving down fixed cost per unit will be necessary in a globally competitive environment.

These elements, under the guidance of a strategic and transition plan, will provide performance characteristics of industry leaders. The implementation of innovative technology with formal planning sessions utilizing an advisory team will be the methodology to take a business from good to great.