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Diversification:
Business Planning Tools to
Achieve Your Goals
Chris Laughton – Farm Credit East
Harvest New England Conference
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Agenda

- What is "Diversification"
- Pros & Cons
- The Diversification Matrix
- Steps to Diversifying Successfully
- Partial Budgeting
- Examples
- Q&A / Discussion

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What is "Diversification"?

- Adding additional revenue streams to your enterprise
- Can mean:
  - Adding additional products or services
  - Expanding into additional markets
  - …or a combination of both

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Example:

- Dairy producer selling milk to a cooperative or processor
  - Adding:
    - Direct-to-consumer milk sales
    - Cheese production for wholesale or retail
    - Maple sap sales
    - Often means moving from producing a commodity to adding a value-added product or new specialty markets

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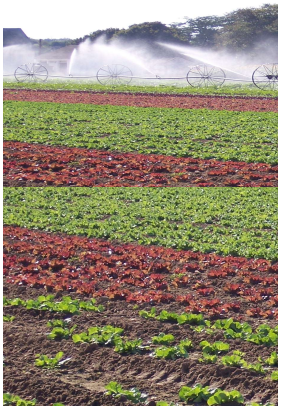
Example:



- Wholesale Fruit Grower
  - Adding:
    - Direct-to-consumer fruit sales
    - Pick-your-own or agri-tourism activities
    - Additional crops
    - Value-added products (i.e. jams & jellies, pies, etc)

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Pros:

- Adds new revenue stream
- Hedges market risk
- Can add higher margin sales
- Further leverage existing facilities and production
- Can extend marketing season – improve seasonal cash flow

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Cons:

- Adds management complexity
- May require new equipment, facilities, or staff
- Makes accounting more complex
- Can divert attention and capital from core business
- Risks to existing operations
  - Will this affect core business in a negative way?

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Enterprise Accounting

- Separates Revenues and Expenses according to divisions, or enterprises, in your business
- Enables profit and loss measurement for each part of your business
- Revenue usually easy; Costs harder
- Labor allocation usually the biggest challenge
- Inventory costing can also be difficult

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The Diversification Matrix

New Products / Same Markets	**New Products / New Markets**
Same Products / Same Markets **(This is where you are now)**	**Same Products / New Markets**

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The Diversification Matrix

New Products / Same Markets	New Products / New Markets
• Existing Customer Relationships • Need to Develop New Products	• Need to Develop New Markets • Need to Develop New Products
Same Products / Same Markets	**Same Products / New Markets**
• Predictable, Tried-and-True	• Existing Products • Need to Develop New Markets

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The Diversification Matrix – Dairy Farm Example

New Products / Same Markets	New Products / New Markets
A2 Milk Organic Grass-fed	Cheese via On-farm Sales Maple Syrup
Same Products / Same Markets	**Same Products / New Markets**
Wholesale Milk to Coop	Retail Milk to Consumers

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The Diversification Matrix – Orchard Example

New Products / Same Markets **Different Fruits or Cider to Wholesale Markets**	**New Products / New Markets** **New Types of Fruits to Consumers Pies to Retail Markets**
Same Products / Same Markets **Wholesale Apples to Packer or Retailer**	**Same Products / New Markets** **Retail Apples to Consumers**

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Steps to Diversifying Successfully

- 1. Self-analysis
- 2. Recognize a need or a market
- 3. Talk and Listen to others – producers, customers
- 4. Regulatory review
- 5. Put appropriate recordkeeping systems in place
  - What are metrics for success?
- 6. Enterprise budget – secure resources
- 7. Be prepared for mistakes – and adjust accordingly

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Steps to Diversifying Successfully

- ***1. Self-analysis*** – look at your business and yourself:
  - Do you have unused capacity or resources?
    - Facilities, equipment, ***time?***
  - If pursuing retail markets – are you "retail-friendly"?
  - Are you ready to take on an additional venture?
    - Is your existing business operating efficiently?
    - A new venture can consume a lot of management time
    - Can distract from your core business
    - Can divert resources from your core business

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Steps to Diversifying Successfully

- ***2. Recognize a need or a market***
  - Is there an unmet need you can serve?
  - Are there additional markets for your types of products?
  - Is there an additional product line you think you can supply profitably?

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Steps to Diversifying Successfully

- ***3. Talk and Listen to others*** – producers, customers
  - Research the competitive market – how to gain market share
  - Why should a customer choose you?
  - *Unique Selling Proposition*
    - Are you: Better?
    - Cheaper?
    - Different?
  - Talk to buyers or consumers to see what they want
  - What *story* are you going to tell with your marketing?

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Steps to Diversifying Successfully

- ***4. Regulatory review***
  - Value-added products may require additional labeling and permitting
  - Many states have "cottage food laws" allowing production in non-commercial kitchens, but they still typically require inspections and permits. State dept of ag can help
  - Labeling requirements vary.
  - Other permits and zoning bylaws may apply. – particularly if converting a wholesale facility to retail
  - **Labor for processing might not be considered "ag labor"**
  - Review insurance coverages

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Steps to Diversifying Successfully

- ***5. Put appropriate recordkeeping systems in place***
  - Account for revenues and expenses separately from your other activities
  - Allocating shared labor can be a challenge
  - Develop system to track and cost inventory
  - What are the metrics for success? For exiting?

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Steps to Diversifying Successfully

- ***6. Enterprise budget*** – secure resources if needed
  - Develop a *realistic* budget for this new venture – cash flow for first 2-3 years
  - Are resources needed? Facilities, equipment, hired labor?
  - Are new skills needed? – can you learn or hire expertise?
  - Does the venture "pencil out?" – is it the best use of time & money?
  - Is there a way to test the market before making a big investment?
  - Cheaper to make mistakes at the drawing board

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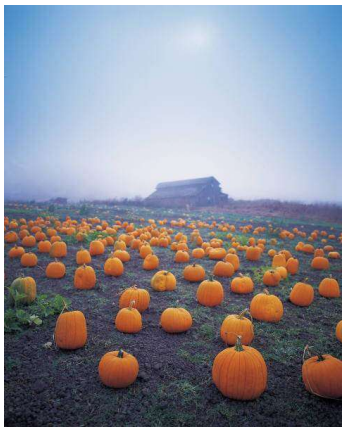
Steps to Diversifying Successfully



- 7. Be prepared for mistakes – and adjust accordingly
  - Missteps *will* happen! Accept them but learn from them
  - Define goalposts for success
  - Consider under what circumstances will you "pull the plug"?
  - Understand that there are things you don't know

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Dairy Farm Scenario

- Farm owns wooded acreage that could be a decent sugarbush
- Hire consultant (experienced maple producer) to evaluate
- Develop marketing plan
- Maybe try selling sap first, before investing in evaporation equip.
- Develop budget for equipment and labor needed – secure capital
- Hire worker with experience in sugaring
- Develop recordkeeping system to allocate labor
- Evaluate and make improvements – or cease

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Orchard Scenario

- Wholesale apple orchard with declining returns
- Evaluate and prioritize investment needs:
  - New plantings – new varieties, orchard renovation
  - New retail venture
- Pivot to retail
  - How to market – PYO & stand
  - Budget for needed investment – does it "pencil out"?
  - How to "enterprise" retail vs. orchard operations

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Greenhouse Scenario

- Retail Greenhouse has excess capacity
- Feels their retail sales are hard to increase
- Looking toward wholesale markets for growth
- Develop wholesale buyers and markets
- Budget needed investment
- Pencil out venture
- Crop budgets

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Diversification for Risk Management

- Pros:
  - Not "all eggs in one basket" – insurance policy of sorts
  - If one venture does poorly another may do well
  - Can add additional revenue beyond core business
  - Offers an alternative to the commodity roller-coaster
- Cons:
  - Adds management complexity
  - Can distract from core business
  - Can be hard to achieve economies of scale with multiple ventures

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The Partial Budgeting Process

For any change in your business….

Things that *increase* net income	Things that *reduce* net income
Added Returns	Reduced Returns
Reduced Costs	Added Costs

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The Partial Budgeting Process

Greenhouse example:

Added Returns:		Reduced Returns:	
Hanging Baskets – Wholesale	$25,000	N/A	
Reduced Costs:		Added Costs:	
N/A		Greenhouse Modifications - 5 yr Amortization	$ 1,500
		Production Labor	$ 9,000
		Materials	$ 8,000
		Sales (prep & delivery) Labor	$ 1,000
Increased Net Income:	$ 25,000	Reduced Net Income:	$ 19,500
		Marginal Return:	$ 5,500
		Marginal ROI	28%

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The DIRTI-5 of Capital Investments

D DEPRECIATION

I INTEREST

R REPAIRS

T TAXES

I INSURANCE

- Depreciation is the cost of the item spread out over its useful life
- Interest is the cost of financing the item or opportunity cost of investment
- Repairs are the anticipated maintenance costs of the item
- Taxes could be property taxes, excise taxes, etc.
- Insurance is the cost of insuring the item

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The DIRTI-5 of Capital Investments

Farm stand construction – (existing land, construction = $100,000)

Item	Annual Cost
Loan Payments (10-year note) (covers "D + I")	$13,000
"R" – Repairs	$2,000
"T" – Taxes – Marginal increase in property taxes	$2,000
"I" – Insurance costs	$1,000
Total Annual Estimated Cost of Building	$18,000

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How Much Will I Need in Sales?

Adding a Farm Stand – (Marginal Costs)

Item	Annual Cost
DIRTI-5 Costs of Building	$18,000
Labor Costs to Staff Store (roughly 2 FTEs)	$75,000
Subtotal – Margin Needed:	$93,000
If goods sell @ 40% Margin: Gross Sales Needed:	$232,500
If open April-December, Sales per week Needed – for *break-even*:	$5,813

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Reasons for Low Gross Margin

- Pricing is too low
- COGS is too high
- Shrink is too high
- ***Shrink*** is any product grown or made (or purchased) but not able to be sold, due to:
  - Lack of demand / seasonality
  - Poor quality
  - Spoilage
  - Theft
  - Or other factors…

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Key Takeaways

- Time and Money are limiting factors for most businesses – use them where they make the most sense!
- Get “better” before “bigger” – optimize your core business first
- Don’t neglect your core business when diversifying
- Plan ahead and research – saves costs later
- Learn from others
- Don’t stretch yourself too thin

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Questions?

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