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Is Alternative Agriculture for You?



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Today, many South Dakota producers are considering alternative agricultural enterprises for their operations. These alternative enterprises range from Christmas tree production to mushrooms to pheasant raising. Every success story spawns new visions of alternatives that may be viable choices for South Dakota producers. Enormous attendance at conferences specifically addressing the alternative agriculture issue attests to its popularity.

The entire issue of alternative agriculture should be examined in proper perspective giving consideration to every aspect. When one considers that Christmas trees can produce \$1,000-\$2,000 an acre profit, or an acre of strawberries could result in \$3,000 profit, one has to open his eyes. However, alternative agriculture is not necessarily the get rich quick scheme it may appear to be. As the saying goes, "if it sounds too good to be true, it probably is". Since most enterprises require intense hand-labor and large initial investments, extreme caution should be taken before diversifying one's current operation to include a new alternative agriculture venture.

How do producers decide which, if any, alternative enterprises are right for them? What are the guidelines for choosing the enterprise that will generate the greatest return for resources committed? The answers to these questions can be found through examining the under-

lying foundation of profitable alternative agricultural ventures. That foundation is economics and agricultural application of economic principles which can provide the necessary guidelines for determining which, if any, alternative agricultural ventures are likely to be profitable.

Budgeting Principles

Budgets are considered the most important economic principle for examining alternative agricultural enterprises. Budgets and the process of budgeting are a virtually costless method of considering alternatives before committing the resources. To be able to develop budgets and complete budgeting exercises, it is important that a farm manager has a clear concept of the costs of machinery, equipment and other inputs necessary to undertake an alternative investment, as well as what returns may be expected.

Two types of budgets are whole farm budgets and partial budgets. Whole farm budgets are prepared to provide analysis for making decisions that will have a major impact on the entire farm. Producers should calculate receipts, costs and total farm profit for the current situation, and then re-calculate taking alternative plans into consideration. Farm managers may find that their current operation needs revamping, so that profits made in the new venture will not be reduced by losses in current enterprises.

Whole farm budgets ought to be calculated every three to four years, or when major changes are anticipated. Partial budgeting, as the name implies, takes a partial look at a certain aspect of an operation. It is used to make decisions for segments of the farm, and compares the profitability of alternative uses for a smaller set of resources. Partial budgeting is less complex and more widely used than whole farm budgeting. A partial budgeting form is shown for those wishing to make use of this principle.

PARTIAL BUDGET FORM

Proposed change:

Additional costs

\$

Additional returns

\$

Reduced returns

\$

Reduced costs

\$

A. Total annual additional costs and reduced returns

\$ _____

B. Total annual additional returns and reduced costs

\$ _____
\$ _____

Net change in income (B minus A)

\$ _____

With either type of budget or budgeting approach, it is suggested to budget each alternative and each current enterprise of the farm or ranch as a separate entity. Budgets are only as accurate as the data entered into them. They can give a manager a realistic picture of the potential cost-benefit trade-offs between each alternative, and which alternative(s) could result in the greatest profit.

Budgets not only help in decision making, they can also be used to compare against accurate, comprehensive records. A successful manager regularly compares the budget to actual performance to target profit-makers, profit-breakers, and areas which need improvement. This implies that farm managers need to have record systems for their operation and to make good use of their records. Record keeping is not a glamorous aspect of the agricultural profession, but it is one of the more important. By keeping records, producers have a source to refer to in order to ask themselves the appropriate cost-benefit questions throughout the budgeting period.

'What if' questions should also be employed to predict the results of a decrease in price, yields and other factors. Computer sensitivity analysis is a useful tool to accomplish this. As part of sensitivity analysis, managers can consider the affect on overall productivity and profits of reducing the resources committed to their traditional enterprises in order to start new enterprises. Sensitivity assessment can also point to areas where improved management can reap the greatest reward.

An economic principle points to one reason why alternative agriculture is being considered by so many producers. They believe their resources (time, labor, or capital) could earn a higher rate of return in an alternative use. The idea that producers will want to allocate resources to the highest and best, or most profitable, use is simply an application of sound economic principles. Resource allocation employs a concept titled by economists as 'diminishing returns'. Due to diminishing returns, the most successful ventures are those where the costs of each additional unit of input exactly equal the additional revenue produced by that input. In order to maximize profits, producers must know the optimum

amounts, combinations and allocation of resources among the current and proposed operations.

Marketing Alternative Ag Products

Since elevators or packaging plants are generally not waiting for specialty crops, it may be up to the farm manager to control all marketing, pricing, packaging and distribution of the products they produce. Many growers are not prepared to commit the time, or do not have the know-how to successfully and profitably accomplish this. Education, training and research are imperative in this area. Many new alternative agricultural ventures are unsuccessful only because producers did not research and understand the potential markets for their products.

Managers must know the market for their products, and whether or not threatening competition exists in the area. Research shows that for direct-marketing, consumers will not travel more than 30 miles to reach the product. Therefore, unless managers intend to transport their products a great distance, the combination of competition, small demand, and low population in a 30 mile radius could prove to be fatal to a new venture.

Several marketing options are available to producers of specialty crops. Besides selling to a retailer, the three most common methods to market specialty products direct to consumers are farmer markets, road-side marketing, and pick-your-own. For many alternative enterprises, pick-your-own markets seem to be the most popular method of reaching the consumers. Managers incur fewer costs, since there are no transportation charges, and harvesting labor is minimal. However, the fields must be maintained, and the customers must be supervised and instructed. In order to remain successful, an optimum customer base must be maintained, as well as ensuring a customer oriented business.

Knowing what to charge for the products produced can be difficult to determine. In setting a price, producers can refer back to the budget. Producers need to know the competitors' prices, but shouldn't necessarily change their prices everytime competitors do; steady customers

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appreciate steady prices. Studies indicate that quality is number one, and that consumers often are willing to pay extra for it. To increase customer base and profits, one should consider improving displays, advertising, and service before reducing the price. Lower prices attract main shoppers, who are not necessarily long-term loyal customers.

Management Concerns

Since alternative agriculture can be a very risky, volatile business and may require several years before steady profits can be earned, obtaining the necessary financing can be a problem. Managers who walk into a banker's office with a comprehensive budget to support a claim for funds will be placed in a much stronger position than those who have just scratched a few ideas on the back of an envelope. Producers must be aware of their current debt/asset ratio, break-even points, projected returns on investment, and the risk of the new venture.

For the last two years the Cooperative Extension Service at South Dakota State University has had a program designed to specifically answer these questions and help producers develop the plans to present to their lenders. Information on this program (Planning For Tomorrow Today) can be obtained by contacting any county extension office.

Before venturing into an alternative ag crop, a manager must realize that it

may take several years to properly juggle the competing demands of traditional crops and specialty crops. Long-range planning is a must. In nearly all cases, specialty crops should be considered as an addition to the current business, not a total replacement of it. Producers must also consider their current resources and the costs of additional investments and inputs needed to increase profits.

As has been shown, sound business management principles must be applied whenever producers are considering alternative agricultural ventures. Successful managers will incorporate comprehensive goals, plans, accounting, budgeting and control factors. Good management skills are typically the significant difference between high and low profit farms. Research indicates that high-profit farms can possibly earn eight to nine times greater return to management while utilizing nearly identical values of land, labor and capital.

Therefore, if producers are considering alternative agricultural enterprises, or in fact any changes to their current operations, it is imperative that they use sound economic principles in the decision making process. Not only will this help to thwart a costly wrong decision, but it may also point out areas of strength and areas to strengthen in the current business to improve the overall profitability of the operation.