Agriculture Notes

Farm Diversification and Compatibility for Existing Farm Businesses

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Introduction

Diversification is one of three important processes through which a farm business can improve its situation.

This Information Note is part of a series that explores aspects of farm diversification and decision making. There are five important aspects to making a decision. These five aspects are: compatibility, observing, trialing, complexity and resource advantage.

In combination, these aspects cover the main issues involved with the decision-making process and people's ability to avoid failure and disappointment. This Information Note discusses the compatibility of a diversification idea within an existing farm business.

This Information Note should be read with the Note on Options for property management and enterprise diversification and the Note on Stages in industry development.

Farms with existing businesses

Diversify means to make diverse, to vary, to extend ones activities especially in business over more than one field.

It is easiest to diversify into an activity that is highly compatible with what is already being conducted within the current business.

It is harder to diversify into a completely new business activity that bears no relationship to the existing equipment, the infrastructure or what has been done in the past. It is made more difficult if a new market has to be found and the customer base established.

In agriculture many farm businesses are exposed to climatic and market cycles that a diversification strategy can be designed to minimise. Hence diversification can be a tactic to manage risk.

Economies of scope

The compatibility of a new enterprise is made more attractive if economies of scope exist. That is when the added cost of the new enterprise is less than the cost of producing it on its own. The opposite is true if there are minimum economies of scope associated with a new enterprise.

Complimentarity of diversification

If diversification is a way to make more profit or to protect the current business from cyclical down turns or to change or preserve a lifestyle then there are a number of ways to diversify.

Introduce complementary products to current or to new customers

A firm can add new products that compliment their current products and which can be supplied to their current or new customer group. There are many agricultural examples such as the ones below.

Supplying fresh apples to the Melbourne markets then supply fresh stone fruit [complementary enterprise to current customer].

Supplying wheat to a grain merchant then supply barley, oats, and canola [complementary enterprise to current customer].

Supplying proteas to the Melbourne markets then supply Australian natives and exotics to the same market [complementary enterprise to current customer].

Craig McClellan worked as a sales manager for an azalea nursery and changed his business to supply Christmas trees to supermarkets [complementary enterprise to new customer].

Mallee Squab Producers supplied squabs then supplied guinea fowl, pheasants, Indian jungle fowl [complementary enterprise to current & new customer].

Introduce complimentary products that are value-added to current or new customers

A farm business can add new products that compliment their current product range but further value is added before it passes on to their current or new customer group. Examples include:

Hermann Schulz went from supplying bulk milk to Bonlac to supply specialty cheese to airline companies [value added product to a new customer]

Jim McMickan diversified a sheep, cattle and grain property to include farm tourism [complementary to current enterprises and value capturing by moving closer to the consumer, also new customer as Jim does not sell sheep, cattle and grain to the consumer].

Introduce unrelated products to current or new customers

A farm business can add new enterprises that bear no relationship to their current technology, current enterprises, products or markets. They can then supply their current or new markets. For example:

Supplying prime lambs and grain then supply Murray cod to the local restaurant [unrelated products and new customers].

Do markets exist and with whom?

The supply chain, sometimes viewed as the value chain, is an important area of consideration for the farm business looking to diversify. The supply chain is how products flow through to the customer and it is where value is captured. The question is who contributes and captures the value?

The customer is the person to whom the producer of a product or service sells their products. For some it might be an intermediary such as wholesaler, distributor, processor, abattoir or agent. For others it might be a restaurant, a retailer or the final consumer. The implication is that products move through a supply chain to the final consumer, the supply chain may be long with many intermediaries or short with a transaction between producer and consumer

When diversifying into a new enterprise it is critical to decide what are the best supply chain arrangements for the farm business. Too often the decision-making process focuses on the enterprise, the farm business and the market but does not question the supply chain, what is looks like, what it could look like and where value can be captured for the producer.

It is easier to develop markets for complimentary products or where resource advantages favor your business.

Table 1 summarises the compatibility of new activities in relation to markets and complimentarity to existing products.

Further information

More information on each aspect of decision, diversification and supply chain management are provided in other Information Notes.

Table 1. Compatibility and ease of adoption of new activities in relation to markets and complimentarity to existing products

Type of Diversification	Current Market	New Market
Complimentary product	Easiest to do: Market already exists, current technology is used and most production capability can be adapted. *Minimal change to the farm system – maximum economies of scope.*	Slightly harder to do: Current technology is used and most production capability can be adapted but market has to be established and serviced. Increased risk of failure.
Complimentary product that adds value to existing products	Easier: Similar technology and capability to current products & market exists but added process steps.	Harder: Market also needs to be developed.
New unrelated product	Difficult: New technology & new capabilities are needed but market already exists. Unexpected issues will arise and need rapid resolution.	More Difficult: Must develop new technologies, new capabilities & new markets. *Maximum change to the farm system or existing lifestyle – minimum economies of scope.* Maximum risk. Need new supply chain.