

Strategic Planning: External Environmental Scanning

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Any planning activity involves thinking about the future. However, the focus of strategic planning is not on predicting the future, but instead on making better decisions here and now in order to reach a desired future. Because the future cannot be known with certainty, farm business managers must make certain assumptions about what the future will hold. An important part of the strategic planning process is to recognize and explicitly state any key assumptions about what the future may hold. To be successful, the farm business manager must find a fit between what the business environment wants and what the farm provides, as well as between what the farm needs and the environment can provide.

Strategic planning requires that, in thinking about the future, managers must have information about both the external economic environment in which the farm business operates and the internal characteristics of the farm business. This information provides data for the development and evaluation of alternatives. One method of collecting needed information is by conducting an environmental scan.

In conducting an environmental scan, the farm business manager is asked to review, evaluate, and disseminate information from the external and internal environments. The external environmental scan will focus on things outside the farm gate. There are two facets of this outside review to address: 1) the societal environment and 2) the industry environment.

Societal Environment

The societal environment includes those general forces that do not directly touch on the short-term activities of the organization but that can, and often do, influence long-term decisions. These forces include economic forces, technology drivers, changes in government policy or regulations or political-legal forces, and sociocultural forces.

Trends in the economic area can have obvious implications for the farm business. A strengthening of the U.S. dollar relative to other currencies can reduce U.S. export demand. This in turn can lead to lower commodity prices and farm incomes for everyone in the industry. Rising incomes of consumers in other countries is another example. With increased income, these consumers will improve their diets. This in turn can lead to an increase in demand for animal protein sources and likely increased exports of U.S. meat products.

Changes in technology can also have a great impact. The evaluation and adoption of production technologies is an aspect of technological change familiar to farm business managers. However, other technological changes such as in information technology can lead to important changes for the farm business. The development of precision agriculture, the use of the Web to gather information or order supplies, and the increased ease with which we can

communicate with farmers in other parts of the U.S. or the world are changing the farm business.

Trends in the political-legal area have important business implications. Most farmers think that there is too much regulation of activities in order to comply with society's environmental concerns. However, many would like to see a more aggressive approach taken to enforce anti-trust laws in order to slow the consolidation of input suppliers or product buyers.

Sociocultural aspects include such things as demographic trends. The demographic bulge in the U.S. population known as the "baby boom" affects many industries. As these people begin to retire but still desire to remain active, they could create a part-time labor pool that can provide seasonal labor for farming.

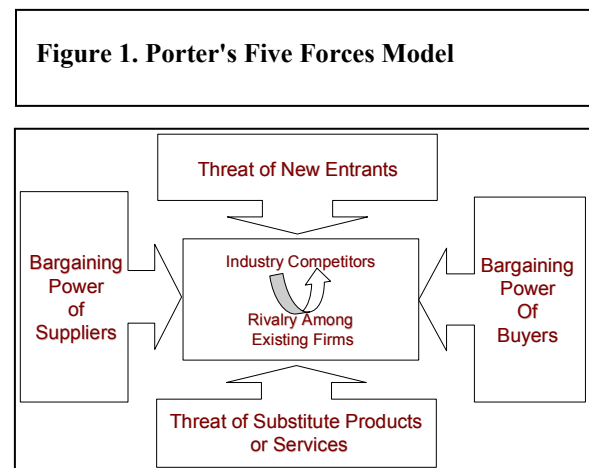
To begin collecting information from "beyond the farm gate," watch the [Agriculture in the 21st Century](#) video clips.

After watching the video, complete the exercise, "The New Agriculture: Implications for Your Farm Business." This exercise asks you to identify four expected changes, the probability that each change will occur, and if the change occurs, the effect the change will have on the business. After you have completed this assignment yourself, you might ask other members of the management team to do the same. Then compare your answers. Did everyone agree on the important changes? Was there agreement on the impact that a change will have on the business?

Industry Environment

In conducting an external environmental scan, the farm business manager also must assess various industry forces. Michael Porter, an authority on competitive strategy, contends that there are five forces that should be accounted for in conducting an industry analysis. "The collective strength of these forces," he contends, "determines the ultimate profit potential in the industry, where profit potential is measured in terms of long-run return on invested capital."¹ These five forces are illustrated in Figure 1.

New entrants usually bring new capacity and competition for customers and resources. This is a threat to existing businesses in the industry. The threat of entry depends on presence of entry barriers. Entry barriers make it difficult for another business to enter the industry. Examples of these barriers include



¹ M. E. Porter, *Competitive Strategy*, New York: Free Press, 1980, page 3.

economics of scale and capital requirements. Because these are large in farming, they prevent new firms from quickly entering the industry.

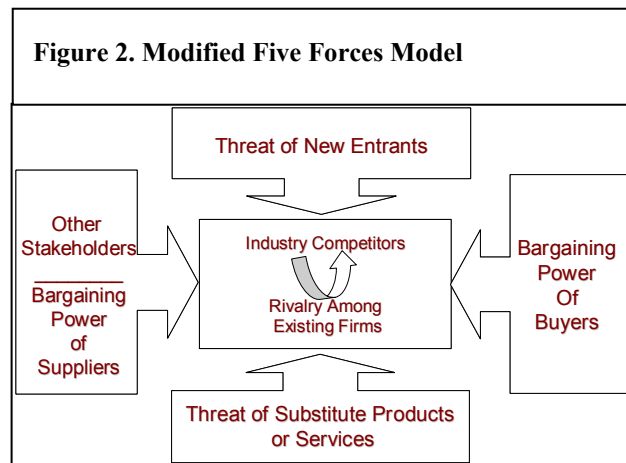
Substitute products are products that appear to be different but can satisfy the same need as another product. Chicken can be a substitute for beef in consumers' diets. When switching costs are low, substitutes can place a price ceiling on products. Market analysts often talk about "wheat capping corn." This occurs because wheat and corn are substitutes in animal feed. If wheat prices are low, corn prices will also be low because, if corn prices rise, millers will quickly shift to wheat in order to keep ration costs low. This will reduce the demand and price of corn.

Bargaining power of suppliers affects their ability to raise prices. Suppliers are likely to be powerful if they are few in number, each individual farmer purchase represents only a small amount of the companies sales, there are not good substitutes of the product purchased, and the product or service is unique.

Bargaining power of buyers affects the industry through their ability to force down prices, bargain for higher quality or more services, and play competitors against each other. Buyers are likely to have power if a buyer purchases a large part of the sellers product, if alternative suppliers are plentiful because the product is undifferentiated, if the buyers earns low profits and is sensitive to cost differences, and if the purchased product is unimportant to the final quality or price of a buyer's product.

Rivalry among existing firms is the amount of direct competition in an industry. Industries that have intense competition are characterized by competitors that are roughly equal in size, slow rates of industry growth, the production of commodities, high fixed costs, and high exit barriers arising from investments in specialized equipment.

Since the introduction of this five forces model for industry analysis, others have suggested that a sixth force should be included. This is force of other stakeholders. These stakeholders include federal, state, and local governmental units. These units of government can impose various limits on the actions that businesses can take. In Indiana, the desire for greenspace in and around communities has resulted in various types of land-use regulations. Other stakeholders also influence cost of inputs. These stakeholders can include creditors, special-interest groups, the government, and local community organizations. Changing our earlier figure to recognize this additional force makes the model more complete.



Additional information about conducting an external analysis for the farm business can be found in the presentation entitled External Environment Analysis.

Exercise

To gather information about these forces, complete the exercise “Scanning the Industry Environment.” This exercise asks you to assess various aspects of these forces for the agricultural industry. As with the previous exercise, it will be useful to share your observations with others on the management team.

Synthesis

After gathering data about societal and industry environments, a number of external factors important to the farm business will be identified. The farm business manager can refine the analysis of these factors by dividing these factors into opportunities and threats. Then, for each of these external factors, the farm business manager should indicate its importance to the business. Finally, the farm business manager needs to assess how well the business is responding to each factor.

Exercise

The “External Factors Analysis Summary (EFAS),” provides a format for completing a synthesis of the factors from the external environment that have been identified².

The following steps should be used to complete the EFAS table

1. In column 1 (External Factors), list the 8 to 10 most important opportunities and threats facing the farm business.
2. In column 2 (Weight), assign a weight to each factor from 1.0 (most important) to 0.0 (not important) based on the factor's probable impact on the farm's current position. The higher the weight, the more important this factor is to the current and future success of the business.
3. In column 3 (Rating), assign a rating to each factor from 5 (outstanding) to 1 (poor) based on the business's response to that particular factor. Each rating is a judgment regarding how well the business is currently dealing with each external factor (5=outstanding, 4=above average, 3=average, 2=below average, 1=poor).
4. In column 4 (Weighted Score), multiply the weight in column 2 for each factor times its rating in column 3 to obtain that factor's weighted score. This results in a weighted score for each factor ranging from 5.0 (outstanding) to 1.0 (poor) with 3.0 as average.
5. In column 5 (Comments), note why a particular factor was selected and how its weight and rating were estimated.
6. Finally, add the weighted scores for all the external factors in column 4 to determine the total weighted score. The total weighted score indicates how well the business is responding to current and expected factors in its external environment.

² J. D. Hunger and T.L. Wheelen, *Essentials of Strategic Management*, Prentice Hall, 2001, page 50.

An example External Factor Analysis Summary has been completed for MBC Farms (Figure 3). Reviewing this completed form may help you in completing yours. The total weight score for an average firm in the industry would be 3.0. From the analysis for MBC Farms, we can see that they are only slightly above average.

Figure 3. External Factor Analysis Summary for MBC Farms' crops business unit

| Internal Factors | Weight | Rating | Weighted Score | Comments |
|--|-------------------|---------------|-----------------------|--|
| Opportunities | | | | |
| Contract production for value-added grains | 0.20 | 3 | 0.60 | Moving this direction but maybe not fast enough. |
| Hay production | 0.05 | 4 | 0.20 | Horse people are willing-to-pay. |
| Demand increasing for identity-preserved (IP) grains | 0.15 | 4 | 0.60 | Expanding procedures for IP grains through production of food-grade corn. |
| Improve varieties | 0.10 | 3 | 0.30 | Potential to reduce costs and improve value. |
| Threats | | | | |
| Reduction of government payments | 0.20 | 3 | 0.60 | Cash flowing commodity grains will be difficult without government payments. |
| Rapid decline in premium for specialty grain | 0.15 | 2 | 0.30 | Too easy for others to enter market but searching for alternatives. |
| Non-acceptance of genetically engineered crops | 0.10 | 5 | 0.50 | Very uncertain. IP capabilities help to reduce uncertainties. |
| Total | <u>1.0</u> | | <u>3.10</u> | |