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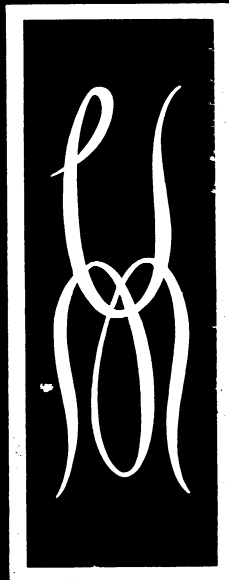

MANAGING THE AGRIBUSINESS FIRM

TEN AREAS

Robert A. Willson and Frank J. Smith, Jr.

UNIVERSITY OF MINNESOTA
Agricultural Extension Service
Department of Agricultural Economics
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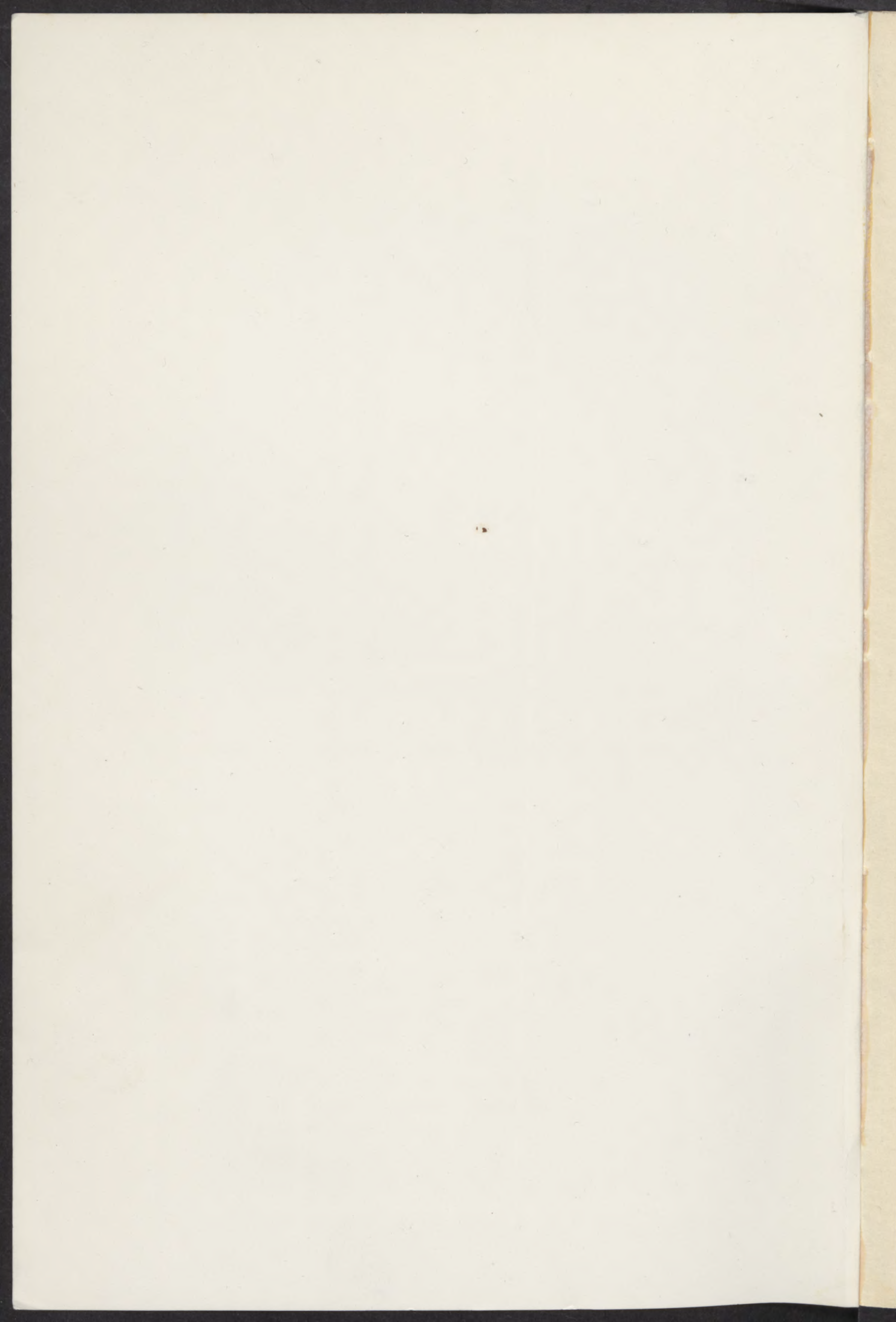

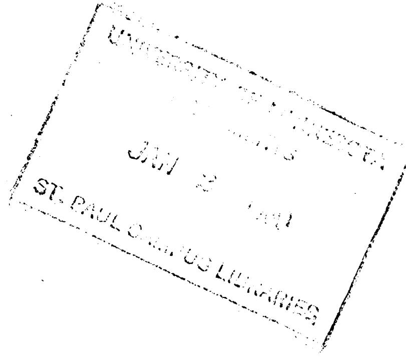

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CHAPTER 1

Introduction

The subject matter discussed in this report was originally published under the title of "Managing the Farm Supply Business — ten areas." After several years of use by extension specialists as well as by college-level classroom instructors it became clear that it could be effectively applied to other forms of agribusiness as well. Hence, it has been revised and issued under its present, broader title.

The original report was based on an intensive study and assessment of management strengths and weaknesses in local farm supply operations. The results of this assessment revealed 23 areas of substantial management weakness, of which the 10 most critical were selected for particular consideration.[1] These are the areas discussed here.

The material presented is designed primarily for use by teachers. Our intention is to provide a general framework to be used by the instructor according to the level of sophistication of his audience. For those who have had little exposure to any formalized management training, the material presented here may require considerable translation by the instructor. On the other hand, for those who have had previous training, additional readings may be appropriate. Selected references are provided for this purpose.

Standard business terminology is used throughout, and can be adapted by the instructor to fit particular needs of groups which may be accustomed to different terminology. Furthermore, the instructor is expected to allow for differences in objectives which may occur between various types of business organizations.

The subject matter may be considered from several points of view — the point of view reflected in this report was derived from the senior author's experiences in the management field. R. A. Willson, presently Dean of the Banff School of Advanced Management, was business administration specialist in Agricultural Extension at the University of Minnesota when this material was developed. He formerly held executive positions at General Foods Corporation and at Studebaker Corporation, where he was responsible for business planning and development, personnel and public relations, and economic studies. He is also president of Willson Associates, Inc., Man-

[1]See Frank J. Smith, Jr., R. A. Willson, et al. *The Farm Supply Industry — A Report on Opportunities and Problems.* University of Minnesota, Agricultural Extension Service Special Report No. 15, Chapter 3. October 1965.

agement Counsel. The junior author, who served as coordinator for the overall project from which this material was developed, assisted in the process of conceptualization and acted as a sounding board and critic for the senior author.

CHAPTER 2

Processes of Management

Technical knowledge of a business is no longer sufficient preparation for the job of managing it. A manager must be trained in processes of management distinct from his unique knowledge of the industry, his company, and his immediate environment if he is to make a proper contribution to his organization. Time does not permit him to acquire these skills by trial and error. The risk incurred by mismanagement is too great to permit dependence on management by intuition.

The manager must be willing to continually seek more effective ways of getting his job done. He must develop skill in the several activities which together may be defined as processes of management. But in our contacts with managers of farm supply retail outlets we found relatively little interest in this point of view. They appeared content to base their efforts on a combination of familiarity with the business itself, a measure of seasoned common sense, and personal relationship with their customers, directors, and the town fathers. Yet they are inevitably engaged in several aspects of managerial practice, regardless of the size of the business.

We have, therefore, selected leadership, organization development, delegation, control, and decision making as those processes of management to which the agribusiness manager should give special attention.

Leadership

Businessmen have finally begun to listen to sociologists, who have insisted for some time that leadership is not merely something that one does to or for another but that it is a relationship between two or more people to which each contributes. Seen in this sense, the manager must not think of his leadership exclusively as a function of command but as a supportive relationship with his organization. It is his primary duty to stimulate and challenge the organization and, as a catalyst, to enable the organization to do the best job possible. In short, his role will be chief advisor to the men who report to him.

The logic of this point of view is increasingly apparent as business employees become better educated, more sophisticated in their expectations, and more independently mobile. The leader can continue

to function in his capacity only so long as he satisfies the needs of the people reporting to him, or conversely, is in a position to deny satisfaction of their requests. The first alternative is usually preferable when a choice exists.

A manager must recognize what is expected of him by his subordinates. It is not enough that he carry a title; it is not enough that he meet the expectations of his shareholders or patrons; it is not enough that he win the confidence of the community or the market he seeks to influence. He must also earn the confidence of the people he leads. Otherwise he is unable to perform his fundamental task as a manager.

The enterprise he seeks to guide cannot possibly achieve its optimum level of operation unless the people involved are committed to its purposes. An able leader will identify the central purpose and supporting objectives of his organization on a continuing basis, insuring that everyone is conversant with the organization's goals and that each person has a sense of personal commitment to it. This can be achieved only by permitting the employees to share to some degree in the definition of what is to be undertaken and by showing the relevance of the company's success to the employees' own personal needs.

If the leader's primary role is to give direction to the business through articulating what is to be done, then his secondary role is to coordinate the human and other resources of the business in such a way that specific tasks can be most effectively undertaken. Here he is concerned with the precise definition of task, how each task relates to another, and how soon each should be completed.

It has been suggested that the leader is, in effect, the conscience of an organization. He must be prepared to set up the rules of the game and exercise discipline and corrective action whenever the objectives of the organization appear to be endangered by undesirable conduct or attitudes. He must insure that reward is given to persons deserving it, not only materially but in terms of personal recognition. Thus he constantly encourages conduct that will contribute to the attainment of the company's goals.

Organization Development

It is axiomatic that a person's efficiency is to a considerable degree influenced by the way his work and his relationship to his colleagues are organized. Indeed, a strong case can be made for the point of view that management receives only as much cooperation as it deserves from the way the organization is established.

Research by the Institute of Social Studies at the University of Michigan has provided much evidence of informal organization, which seldom compares with the picture we see on an organization chart. The manager must be able to identify the informal organiza-

tion, the functions that appear to be centers of influence within it, and the nature of the leadership provided. He must then be able to guide the informal organization to the achievement of the company's objectives. This is as important as directing the formal organization.

Essentially, the task of organization starts with a definition of purpose. Why does this company, department, unit, or function exist? What is it uniquely established to do that other units are not required to do? What contributions should be expected of it by the larger enterprise of which it is a part? Only after the purpose has been clearly recognized and understood by members of the company and approved by the manager can organization be confidently determined. For example, if the major purpose of the enterprise is to sell, primary emphasis within the company must be on the sales function, giving it maximum support. To give major power under such circumstances to the accounting function or the production function would be incompatible with the purpose of the business. Conversely, if the primary purpose of the enterprise is to buy, then less emphasis should be placed organizationally on sales. It is not enough for the manager alone to be aware of this central purpose. All members of the organization must understand it so that they may govern their conduct and their relationships accordingly.

The purpose of an enterprise should never be regarded as static. It must change, however minimally, whenever circumstances within the marketplace or the community change. Due to the continuing technological revolution, the purpose of a business can become obsolete if not updated whenever necessary. What is needed is a periodic review by the manager and his people of the validity of the organization's guiding principles.

Once the purpose has been defined, the manager can proceed to describe the tasks required. He must remember that his starting point is understanding what tasks are required, not what can be done with the people he already has. In short, he must have a conception of the ideal organization, and on this basis, make whatever temporary concessions or amendments are needed in light of the people and skills available to him. Without the ideal organization in mind, he cannot guide the selection of new people or the retraining of present employees.

Definition of the individual tasks will not, in itself, suffice. Many responsibilities of a company are partially shared by two or more people, and it is important to recognize the interrelationship and interdependence of various tasks. Whenever there is any overlapping, it must be determined beforehand who must be consulted before a decision is made, who has authority to make a decision on behalf of the company, and who is expected to initiate action. With this interrelationship clearly defined, persons responsible for the separate

tasks can begin to work more effectively together. To rely on their goodwill alone is wishful thinking.

Another governing principle of organization is the need for making each task as significant as possible in terms of its impact on the fortunes of the company. Unless the employee can perceive the relevance of his function to the company's benefit, there can be little sense of commitment to company purposes. Thus, related responsibilities should be grouped as much as possible or centered in one individual, depending, of course, on his capacity to cope with the job requirements and pressures. The wise manager will give increasing responsibility as he gains confidence in the ability of the individual to handle it.

The individual employee is increasingly a decision maker. Once given adequate direction, he would prefer to select his own method of accomplishing a job, to the degree that managerial discretion permits. Thus, it is important that the manager give decision-making authority as far down in the organization as possible. As a rule of thumb, the right to make a decision ought to be fixed where the action takes place, provided knowledge and perspective are adequate.

In building the organization, the manager should resist the temptation to build symmetrically. There is no particular virtue in the aesthetic appearance of an organization. What matters is its effectiveness, comprised of two dimensions — the lowest possible cost or maximum possible contribution to earnings (whichever criterion may apply), and the opportunity for personal fulfillment of the persons involved. If these two criteria are satisfied, the organization is likely to be effective, whether or not it appears balanced in terms of numbers of people reporting to individual managers.

Throughout the development of the organization, it is essential that the manager keep in mind that each department, each function, and each individual job should have a clearly defined emphasis, a central purpose, and that each person should know what is expected of the others with whom he is to work.

Delegation

While delegation of work is generally acknowledged to be one of the manager's main responsibilities, all parties to the process resist it on occasion. The manager may be fearful of losing his personal control over work that he wants completed in a particular manner; the subordinate may be unenthusiastic about accepting responsibility for an assignment in which he is sure the manager will continue to involve himself actively. The manager may be hesitant to entrust to a subordinate work that is vital to the company's interests; the subordinate may be reluctant to shoulder the responsibility when it

is evident that so much depends on his success. The manager may feel some anxiety about acknowledging a subordinate's ability to perform an important job, for fear of making himself look superfluous; the subordinate may have reason to suspect that the manager's willingness to reward him for his performance will not equal his willingness to let the subordinate assume the risk and in large degree the consequences of failure. In short, both the manager and the subordinate may have equivocal feelings about delegation even while declaring their unqualified endorsement.

Perhaps this is nowhere more apparent than in a small business where the manager has been responsible for creating the entire organization. Having been personally involved in every aspect of the company, he finds it difficult to withdraw his active concern. He may even be reluctant to ask a subordinate to invest the same kind of energy that he himself had earlier committed to the various tasks. This combination of need for personal involvement and paternalism is difficult to shake loose.

Yet, as a rule of thumb, the economic performance of an organization is enhanced by insuring that work is done by the lowest paid employee capable of doing it to the company's satisfaction. (Obviously, it must also be to the employee's satisfaction if the arrangement is to be permanent.) Recognition of this economic truth will cause the manager to seek opportunities of giving increased responsibility to each of his people. In short, he should constantly seek to enlarge the task and responsibility of each of those reporting to him. He is expected to use judgment in determining how much rein to give — and how quickly.

To assure the manager's satisfaction with the performance of a delegated task it is necessary that he specify precisely what he wants. Both manager and subordinate must understand exactly what is to be done. It is not enough for only one of the parties to the bargain to have defined his expectations.

Before the assignment is delegated, however, it is imperative that the manager explain to his subordinate the frame of reference of the job and provide a concept of what is to be accomplished by the manager and the company, as well as by the subordinate. With this background, the subordinate can be expected to address himself to the task with greater conviction.

With vision shared and assignment clearly and comprehensively described, the manager may then consider granting authority. On this point, mutual understanding is vital. The subordinate has no authority unless he has the clearly specified right to make some commitment on behalf of the manager or the company. He must also have the right to select his own method of attaining the end result.

To the degree that the subordinate is prevented from making a commitment or selecting his own methods, his authority is restricted. Since the manager is ultimately accountable, the degree of authority he invests in the subordinate is essentially his own risk. It is therefore desirable that he make sure of both his own and his subordinate's understanding of how much authority is to be exercised.

Only after extent of authority has been agreed upon can the manager deal with the question of responsibility. Seen in proper perspective, responsibility is something that is taken, not given. A sense of responsibility is, in effect, a sense of obligation to achieve. This obligation cannot be commanded; it must be volunteered. Of course, the degree of responsibility to be exercised by the subordinate must be understood and acknowledged by the manager, but an obligation to achieve must be pledged voluntarily by the subordinate.

One tends to feel an obligation only when the reason for accepting it is understood and when the desired goal is compatible with the satisfaction of one's own needs. A powerful incentive is the approval of one's associates. Thus, the skillful manager will make sure that the subordinate understands the degree to which the progress of the group and the company depends upon his successful performance. For example, if a man knows that an associate cannot start a job on time unless his own task is completed by a particular date, this is normally an incentive to deliver on time without need of further reminder from the manager.

In this whole process of delegation the manager has yet one further responsibility — to be on hand to receive the completed assignment at the time that was specified. Few things are more disillusioning to the subordinate than to find that the task on which he has labored cannot be turned in on the specified date because the manager is unavailable without explanation. There is possibly no other act so well calculated to preclude future effective performance.

Control

Basically, "control" can be exercised by the manager only after reaching agreement with each of his subordinates in sufficiently precise terms to enable either of the parties to know when a good job is being done. Par for the course must be determined in advance, not after the job is done. The manager must also have a schedule showing not only the final completion date but intermediate checkpoint dates. Knowledge of intermediate completion points will enable the manager to determine whether the job is progressing on schedule and whether there is time to make any necessary amendments.

Control, as James Harrison has pointed out, rests on the manager's

ability to "keep his hand in."[2] Without giving any impression of lack of confidence in the subordinate's ability to deliver on time, but rather by emphasizing the importance of the job and his confidence in the subordinate's ability to do it, the alert manager will constantly reinforce the subordinate's impression that it is imperative to deliver according to the agreed schedule.

In addition to the schedule of dates, there should be benchmarks of satisfactory performance so that the manager and the subordinate may review and assess attainment at periodic intervals. It should be clearly understood by the subordinate that he has an obligation to report variances from planned performance. Depending upon the style of supervision the manager adopts, he may initiate review or this may be left to the subordinate. The healthiest relationship, in which both parties acknowledge responsibility to each other, exists when either can initiate a review of performance.

In essence, an atmosphere conducive to control is achieved when each subordinate knows that the manager is on the job, is contributing to the success of the operation, and has a personal interest in and appreciation of the importance of the subordinate's work, which he expresses at frequent intervals.

Decision Making

The quality of the manager's decisions is influenced by three considerations: (1) his knowledge of the circumstances surrounding the question to be resolved, (2) his ability to accurately weigh risks and advantages of various alternative solutions, and (3) his ability to anticipate the likely future consequences of the decisions he makes today. He can improve his skill in each of these three areas if he wishes to invest the time and effort. The ability to make sound decisions without excessive effort is a priceless attribute.

A manager's total knowledge alone will not help him to make decisions. More important than breadth of knowledge is understanding what specific knowledge is relevant to the problem at hand. The notion that more knowledge insures greater wisdom in decision making is just as untenable as the idea that longer experience leads to greater skill in handling a situation. It is the relevance of the knowledge, just as it is the quality of experience, that is significant. And it is equally important to be aware of what one does not know as to be aware of what one does know in making a decision.

The manager will frequently find it necessary to fill the gaps in his knowledge with assumptions. Since these assumptions will be the product of his past experience, or colored by his hopes for the future,

[2] James Harrison. "How to Stay on Top of the Job." *Harvard Business Review,* Vol. 39, No. 6. November-December 1961. p. 100–108.

it is essential that he distinguish between fact and assumption in making his decision. Peter Drucker suggests that since assumptions are inevitably part of any decision, the manager should always ask a subordinate to define the assumptions underlying any proposal.[3] If he has confidence in his subordinate, and if he subsequently learns what is fact and what is assumption, he is then in a position to make a responsible decision.

A general observation may be made about what information the manager will need in making any decision. Certainly he will want to be clear about objectives. It helps to set these down in writing, however informally. He will want to know what company policies are affected by or are relevant to the decision he is asked to make; he must know what resources are available to him in terms of money, people, capacity, and skills. He must also know — realistically, rather than optimistically — how much time he has to make his decision and to implement it.

For many of the decisions required of him, the manager already possesses sufficient knowledge. It is then only a matter of organizing the knowledge. But occasionally he is confronted with unprecedented circumstances; he is then faced with the necessity of relying upon the knowledge of another person in making his judgment, or alternatively, if time permits, he can acquaint himself with the new circumstances and absorb sufficient firsthand knowledge upon which to base his decision. The professional manager, incidentally, recognizes that when he relies upon another's advice he does not escape responsibility for the quality of the advice offered him. He is still accountable for the ultimate decision; he must therefore select his knowledge source with care.

As information on almost any conceivable business topic becomes more readily available, the importance of self-discipline in analysis becomes critical. The lazy or irresponsible manager who jumps to a conclusion on impulse and later rationalizes his decision cannot long be tolerated by his company. This is not an argument for delaying decisions. It is rather a plea for an orderly examination of one's knowledge of a particular situation before any conclusion is reached. If there is to be a delay in making the decision, the same disciplined approach requires that the delay be made by decision, not by default. In other words, what is the delay to accomplish? What is to be done during the extra time requested and what is the new proposed time limit?

Achieving this discipline is essentially a matter of greater self-awareness. The manager must know his own values and recognize that his expectations and hopes, as well as his fears, have a direct in-

[3]Peter Drucker. *Managing for Results*. New York: Harper and Row. 1964. p. 16, 220.

fluence on the way he perceives the information presented to him. He must learn to question the consistency, reliability, and authenticity of the information available.

The manager will never have all the data relevant to a particular decision. But he must take time to secure enough and resist making a commitment until he is certain his decision is consistent with the evidence available.

Probably the major reason for delay in most decision making is uncertainty about future consequences. These must not be ignored because, in fact, they are the only criteria of the correctness of a decision. The manager will gain confidence by weighing the risk he believes might be entailed against the gain he expects to receive. As it is unlikely that he can be precise in defining future risks or future gains, it is useful to estimate what he thinks is the maximum and minimum in each case. Confidence can be enhanced by realistically appraising the worst thing that could happen if his decision proves incorrect. Similarly, it is useful to define what might be the best results he can anticipate. This exercise must be undertaken for each of the alternative solutions open to him in reaching his decision, for without a choice of solutions he cannot be truly confident of picking the best.

One other observation needs to be made about the process of making a decision. Once a manager has committed himself to action after gathering knowledge, analyzing it, and anticipating consequences, he must be ready to stand by his decision. There is no room for subsequent doubt. The decision should be reviewed from time to time, not to see if it was right in the first place but rather to amend it as necessary if circumstances change. The manager must be flexible in this regard. His decision today must never prevent him from reacting to future circumstances and needs in a different way. But he has neither time nor energy to waste in useless regrets respecting the original decision.

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CHAPTER 3

Manager-Board Relationships

Our study of the farm supply industry raised questions about the effectiveness of the relationship between executives and their boards of directors. On the one hand, it is doubtful whether managers know the necessary techniques of making effective presentations to the boards. On the other hand, there is evidence that directors do not know how to discharge their responsibility of giving appropriate support and direction to their managers. While this is probably true of industry generally, it assumes particular importance in cooperatives where the manager is under great pressure to recognize the wishes of his board, who are the elected delegates of the patron-shareholders.

Influence of a Board of Directors on the Manager

A board, either overtly or by the very fact of its existence, can act as a restraint on the manager's power. Power is granted only so long as it is exercised in the interest of the people influenced by it. The board, as social conscience, reminds the manager to keep his power service-oriented. This may be particularly true of a cooperative, whose patrons tend to be more conscious of the business's original purpose than are shareholders of proprietary organizations.

A board is a source of additional ideas and advice for the manager, who can turn more freely to his directors for assistance than he can to subordinate members of his own staff who expect him to be informed and infallible — or who are sometimes too eager for proof that this is not so. The board is generally a better source of support than outside advisors because the manager is free to discuss intimate details of the business with his directors, which he would hesitate to reveal to less sympathetic or committed persons.

If a manager is overcautious, or too daring, or if he tends to be overly concerned with the impact of a business decision on his own career, the board can exert a steadying influence on him. While it is difficult for the manager to look beyond his own term of office, the board of directors can supply greater foresight.

For a manager, the board can represent a major source of praise and encouragement during a period when he may fail to get this support from his subordinates.

The board can be a reflection of management, a check upon its actions, or a source of advice to it — sometimes it combines all three functions. The wise manager, therefore, will make it an active ally in the management of the business.

What Might Be Looked for in a Director

A director may be selected for a variety of reasons. Chief of these is his general competence and sound personal judgment. Or he may be chosen because of specialized knowledge or skill that can compensate for a deficiency in the manager's talents and background.

Aside from personal qualifications, a director may be selected to represent a particular constituency of patrons, shareholders, or trade relationships. He may be a sound choice because of the prestige of his name and the influence he might have in a lobby. He might open up commercial opportunities for the business in becoming identified with it and thus implying his endorsement.

In accepting election or appointment, the director might have a financial or personal interest in the business, either as an investor or as a major contributor to its sales volume. He would thus welcome the opportunity offered him of protecting this interest. Alternatively, he may see survival of the business as a challenge to his personal skill. He may accept simply because of his friendship with the manager or with other members of the board. Or he may accept because of the honor involved, perceiving it to be somewhat like gaining "academic distinction" within the business field. If this is the case, his acceptance may be most unfortunate.

A healthy exercise for any prospective member of a board is to consider the reasons for his election or appointment and on this basis decide if he can meet the company's expectations. He might also ask himself if he can enter into a positive relationship with the manager that will let them both make the utmost contributions to the business.

In proprietary business, boards of directors frequently include, along with persons chosen from outside the company, senior managers selected from within the firm because of their judgment and experience. Sometimes a board may be comprised exclusively of "inside" or "outside" directors. Those preferring inside directors cite the advantages of familiarity with the business, personal concern for profitable management, and ready availability of prospective appointees. It must be recognized, however, that an inside director who is also a manager may be less disposed to challenge the opinions or decisions of the general manager or chief executive. Furthermore, he may be overanxious to win the approval of his associates and this attitude might influence his judgment during board meetings.

Those preferring outside directors observe that they bring to the company a fresh viewpoint uninfluenced by knowledge of existing procedures. They are thus likely to be more objective when reviewing the recommendations of the general manager. It is argued too that an outside director counterbalances his lack of involvement in the business's day-to-day affairs with his wider range of experience and less biased judgment of its operations.

For most cooperatives the question is, in a sense, academic. Directors are "outside" persons elected by the patrons. But whether the director is selected because of his close familiarity with the business or for the objective judgment he can bring to it, he can only be useful to the extent that he is willing to become committed to the company's survival.

The Benefits Accruing from a Board

Perhaps first in importance, a board's existence conveys a sense of confidence to the investing public and/or the membership, who are reassured by the knowledge that men of experience and ability are directing their company.

A board can also provide a sense of detachment from immediate operating anxieties. A current crisis should not influence the board's judgment to the same degree as it may influence the manager's.

By remaining informed about its goals and its performance, a board can keep a company stable during a period of recession or even of crisis. There are many examples of such service rendered to small businesses at times of sudden illness or death of the manager, or when a major error by the management threatens the survival of the enterprise.

In favorable times, the board can help to keep the company in tune with public sentiment, reminding the manager of the necessity of maintaining community favor when his very success may tempt him to become more authoritative and perhaps less sensitive.

Here again, such benefits will accrue from the existence of the board only if its members are willing to be involved and are kept sufficiently informed by an alert manager.

Customary Duties

A board of directors will, typically, be assigned certain official duties by the company members or stockholders. These duties include overseeing amendments to the company's charter, formation or change of bylaws, election of officers, and other responsibilities of a quasi-legal nature.

But many duties, though not always assigned, should be assumed

by directors who are serious about their contribution to the business. Included are the following:

1. Declare dividends or patronage refunds.
2. Effect mergers.
3. Sell or purchase assets.
4. Guarantee wise stewardship of invested capital.
5. Seek to perpetuate the company's life economically and politically.
6. Ensure an adequate return to the owners or patrons of the business, not only in the immediate fiscal year but over a period of time.
7. Provide competent management for the business.
8. Interpret the business favorably to the public, having in mind the necessity of public and legislative support.
9. Report on the company's progress to members and shareholders.
10. Judge the adequacy of the company's objectives at frequent intervals, and counsel the manager regarding changes or amplification.
11. Provide adequate executive compensation plans, including senior management incentives and fringe benefits.
12. Give advice on diversification and expansion of the business.

If the members of the board undertake all these duties, their function as directors is raised to a level of greater operational activity than is implied by simple attendance of board meetings. Board members and the manager should recognize, however, where director advice ends and managerial accountability begins.

How the Board Operates

To be effective, a board must have complete freedom to criticize any part of the business without fear. Members must be encouraged to exercise judgment independently of each other and of the manager, in order to contribute their best advice.

It is essential that a board understand the key elements that add up to the success of the enterprise and be closely acquainted with the current and forecast progress of the business in respect to each of these elements. Board members should be familiar with the company's purpose, its history, the market in which it is entered and the share of this market it enjoys, the strength of competition, the degree of obsolescence of physical assets, the sales volume of each product or service, the current value of financial assets, and the long-term objectives of the business. The board should also have an opportunity to review periodically the company's earnings, the soundness of its organization, and the ability of the employees to meet current and future challenges.

The quality of the board's recommendations depends to a great

extent on the quality of the information provided its members. This is a major responsibility for the manager, but at the same time, it is incumbent upon the board members to know how to elicit information. They must gauge the effectiveness of the management even though they may not know how to manage the business themselves.

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CHAPTER 4

Creativity

While in the course of our study we gained an overall impression that managers of farm supply businesses are intuitively familiar with their operations, we seldom encountered genuine curiosity about the enterprise. We seldom came across evidence of probing for new ways of doing business at the local level, although this was encountered at the corporate or regional cooperative management level. Greater innovation at the local level would result in healthier competitive activity than that which depends exclusively on price considerations. In all fairness, it must be recognized that top business executives throughout America acknowledge creative imagination to be the lifeblood of business, but that creative talent is not abundant.

Pressures for Creative Thinking

The growing recognition of the need for creative thinking is evidenced by bigger budgets and more management time allocated to research and development in businesses of every size. Perhaps of even greater significance is the growing consensus of top management that the professional manager must himself be a creative and innovative person; that he must have a healthy dissatisfaction with existing circumstances as well as an insatiable curiosity about how everything can be done better.

The manager finds himself increasingly squeezed between two types of economic pressure. The amount of capital he must invest to get into or support almost any kind of business is increasing steadily. On the other hand, the time available to him for recovering his investment before some new invention renders the process, the plant, or the product obsolete, is shrinking rapidly. The life expectancy of services or products is significantly shorter than it was a few years ago and the proliferation of new products in all industries is proof that the pace is not slowing down. In effect, the manager must be constantly alert to render his own business processes obsolete before his competitor can do so, and he has the added urgency of a sizable investment at stake.

Another reason for the need for creativity is that competition is becoming worldwide. The extension of trade agreements between the United States and other countries to cover an ever wider range

of goods and services puts even the small businessman in world competition. At home, companies are turning away from their traditional business areas to seek out profit opportunities in other fields for which they believe they have technical skills or unique strength. Lacking any certain knowledge of where the next competitor may be coming from, the manager must be flexible and receptive to new ideas if his business is to flourish.

A third reason necessitating managerial creativity is the growing complexity of the managerial job. Vastly more information is now needed to support a decision, but only the manager who knows how to use new sources of information can cope with this pressure. Increasingly, he must learn the language of mathematics; he must learn to anticipate the shape of future events; he must concern himself constantly with new sources of information. Thus, as the job becomes more complex, he must inevitably become more creative.

The fourth reason derives from changes in our society. Work has traditionally been a source of satisfaction to most Americans. But as technological progress steadily shortens the work week, it is highly likely that each individual will seek alternative work satisfaction by participating more fully in the affairs of the business which employs him. What he fails to gain in quantity, he will seek to compensate for in quality. The manager will have to create new methods of organization to accommodate this need to participate, or better, to utilize it to the advantage of the company.

These are but four reasons supporting the contention that the manager must increasingly think in terms of creating rather than reacting, in terms of innovating rather than protecting.

The Creative Environment

A wise manager will seek to stimulate and reinforce creativity in his organization. It may develop spontaneously within the company, but it will survive only if the manager provides the climate for it. Essentially, the organization will take its cue for creativity from the manager. In turn, the attitude of the manager is influenced by his board of directors, if he has one. Much of what is said below, therefore, applies to the board as well.

The most important creative attribute is a "spirit of inquiry" — a restless curiosity about one's environment, a willingness to look for other ways of doing things, an inclination to regard problems as opportunities for change and progress. The manager should ask himself whether he is encouraging such attitudes in his subordinates. One is sometimes inclined to regard the person who brings a problem to light as having had something to do with causing the problem in the first place. Such suspicion voiced by a manager is hardly likely

to encourage the subordinate to identify problems. It is also frequently felt that suggestions for change only distract attention from those things which must be dealt with today. Many managers deliberately avoid subordinates who challenge them with such "distractions"; some subordinates soon learn to restrain their aggressive curiosity about improvements.

To create a climate conducive to innovation, some managers have adopted the practice of calling their key people together periodically for the sole purpose of suggesting and examining new ideas. Nothing else is permitted on the agenda.

The second characteristic which needs encouragement is an ability to redefine business aims and objectives. There is absolutely no room for "immutable policies" or any other sacred cows in a company determined not to become obsolete. Unquestionably, a clearly written definition of standard practices that should be followed in recurring situations will save much time, particularly where consistency of action is desired; but it can also prevent flexibility. Any standard practice should be reviewed and criticized at intervals with the intention of improving it. Even the company's goals require periodic reexamination if they are to remain in tune with changing circumstances. Here again, the manager can set an example for the whole organization by encouraging such reviews, by refraining from rationalizing that "it's company policy," and by insisting upon regular updating of all guidelines by which the company operates. Everyone in the organization should be encouraged to understand this attitude and to participate in the constant search for improvement.

The third valuable characteristic is the ability to hypothesize. In addition to the time-honored questions how, why, and when, the manager must learn to ask "what if?"

It appears that a person's creative capacity is enhanced by encouraging him to consider what course of action he would pursue if existing circumstances were to be changed. This exercise develops the imagination, which is a major component of successful planning for the future. Rather than be impatient with such "hypothetical" thinking, a manager should encourage it among his people.

Unfortunately, one characteristic of a successful manager — the ability to make a decision quickly — can also be a major influence in discouraging creativity. Many managers take pride in the speed with which they dispose of "obvious" matters. To the degree that the manager believes that things are "obvious" and that only a fool would take time to consider any course of action other than the one "obviously" prescribed by the circumstances, he will quite effectively discourage active curiosity by his subordinates. He must train himself to withhold judgment while he gathers evidence, and encourage

his people to do the same. While he cannot command them to be creative, he can insist that they describe their problems in greater detail before judgment is passed. In so doing, he will indirectly encourage a creative climate.

The lack of success of suggestion plans in many companies is often an indication of lack of interest on the part of employees. If employees perceive that a suggestion plan — or any other mechanism for collecting their ideas — is designed for "letting off steam," or merely pays lip service to good employee relations, they are not likely to support it. By contrast, if a manager advises his employees of the problems to be solved and encourages them to share their ideas, he will find a tremendous increase in enthusiasm and participation. In essence, the capacity of an organization to create new ideas is a direct reflection of the manager's encouragement of such conduct.

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CHAPTER 5

Making the Most Effective Use of Time

We gained an overall impression that managers of farm supply retail outlets are constantly pressed for time as they respond to demands from employees, customers — some of whom have come from a distance — supplier representatives, specialists from central management headquarters, and, in the case of some cooperatives, members of the local board of directors. Generally, it appears that the manager copes with this pressure by working harder or faster. We believe that it would be useful for him to consider some of the methods by which he could make more effective use of his time.

Planning the Effective Use of Time

First, one must determine in advance what is to be accomplished within a given period of time. This is true in developing long-range plans for the business; it is equally true in determining the use of one's time on a daily basis. At the beginning of each day, the manager should take stock of the demands on his time that he can anticipate. The exercise is more meaningful if he asks his secretary or assistant to share in the "inventory." Having listed the several activities which he must complete by the end of the day, he should then make a realistic appraisal of how much time each of the activities will require. If the sum total of the time needed exceeds what is available, the manager can follow one of two courses. Less time may be allotted to each activity than was originally thought necessary, or some activity must be dropped from the list. A bonus of the exercise is the decision not to do some things, aside from the determination of what is to be done.

Failure to make such an agenda contributes substantially to the accumulation of wasted hours. The manager is acutely conscious of this waste. His reluctance to leave his desk or shop increases with his awareness that he has accomplished less than he had hoped. Hence the first rule — to set up at the beginning of each day a list of things to be done and a schedule for doing them.

Of course, it seldom happens that a manager's own wishes are the sole determinant of how he spends his time. There will be unpredicted demands by customers or organization seniors who are not to be turned away. Hence, it is useful to rank the list of activities in

order of importance. If the manager discovers that, for reasons beyond his control, the time he thought available has now shrunk, he can adjust his agenda by postponing enough lower priority activities to compensate for the time taken away from him. If the activities on his schedule cannot be postponed, he will, of course, elect to extend his working hours.

The fact that a manager can expect interruptions raises the need for a second rule. Typically, he will decline to be interrupted by a telephone call or by a visitor if he already has someone with him in the office. But if a similar call for attention comes to him at a time when he has no visitors, he will usually admit that he is free to talk. The implication is that a visitor's time is sacred but his own time is expendable. While this is a courteous attitude, it is not calculated to make the most effective use of the manager's time.

The manager should determine in advance the circumstances under which he will accept interruption, advise his assistants accordingly, and block out on his calendar those times of the day that he will be just as "busy" as though he had someone with him. If he permits his secretary or assistant to be party to this planning, they will help to protect him from interruptions.

A third rule for improvement in the use of time is to reach a clear understanding with subordinates concerning their freedom to take action without further consultation. Such an understanding tends to cut down significantly the number of annoyingly unproductive interruptions to which a manager is subjected during a day. An original investment of time is needed to reach agreement but the payoff is satisfying. There is also the bonus of increased confidence and sense of responsibility that the subordinate gains in the process.

A fourth rule calls for the exercise of economy. The manager should reserve for himself only those duties that cannot be done acceptably by someone else at a lower rate of pay. Thus, he will constantly seek to delegate to others an ever-increasing share of his responsibilities, guided by the premise that the person whose time is most expensive should be preoccupied with those activities from which the return is greatest, or in which the risk is most formidable. To follow this rule, a periodic review of what one does as a manager is essential. The discovery of what can be delegated is a continuing process.

A helpful exercise in determining what may be delegated is to analyze a manager's job content under three headings. For a period of a few days he can classify each major activity under one of three headings — "must do," "should do," and "like to do." If the manager has absolutely no alternative but to perform an activity now, then it belongs in the "must do" column. If it is a matter of indifference

whether the activity be performed at the time chosen, then it belongs in the "like to do" column. If the majority of a manager's activities are in the "like to do" column, it is probable that he is not being objective and that some of these activities can be delegated. Alternatively, if most of his activities fall in the "must do" column, there is serious doubt about his effectiveness in allocating tasks. He must delegate some of these activities if the business is to survive. If the majority of his work falls in the "should do" column, free from any sense of emergency but genuinely needed at the time performed, the manager may rightly feel he is in control of his time.

A fifth rule is to concentrate upon one project to conclusion. The more dedicated the manager, the more likely he is to undertake more activities than he has either time or competence to bring off successfully. In juggling too many demands for his attention, he frustrates the assistants awaiting his direction, and his personal effectiveness diminishes. The ability to select from among all of the demands for one's attention that which is of paramount importance and complete the chosen task while resisting the temptation to explore other interesting byways, is of major importance to the manager who wants to be effective.

The sixth rule is related to the discipline of concentration. To make most effective use of time a manager must learn to suspect and, wherever possible, avoid impulsive action. This is not to say that he should deny those moments of quick recognition of a prime opportunity, or a sudden spontaneous insight which breaks the back of a problem; but he must learn to resist the impulse to move off in a new direction not previously intended. A balance between spontaneity and planning can be reached. Impulsive action with no thought to its effect on all the other duties a manager must perform is one of the most significant wastes of a manager's time. If he faces a multitude of demands for service, he is all the more likely to lose effectiveness in this manner.

The seventh rule is to develop standards for one's own performance as well as for subordinates. No recovery can be made of time spent in pursuing an activity beyond its point of usefulness or in building quality into a product or service in excess of the consumer's willingness to buy. Yet the conscientious manager will frequently insist upon performance for himself and for his subordinates at a level beyond what is needed, simply because no satisfactory standards of performance have been determined. This is a waste of time the company cannot afford.

Akin to the lack of standards is the lack of a plan for guiding one's work. The eighth rule is that a plan is essential. A few minutes spent in developing a model — even if only in one's mind — of what a job

should look like when it is completed will save hours of subsequent amendments. There is little satisfaction in plunging into activity only to discover later that it is for the wrong cause. Most effective managers will concede that it is better to do the right thing, even if sloppily, than to do the wrong thing expertly. In those companies whose organization permits more sophisticated approaches, operations researchers can help the manager build a model of the proposed activity and forecast the result of what he proposes to do. But even a one-man shop will invest time more wisely if the desired end result is clearly in mind.

The ninth rule is that decisions should be confirmed in writing. This discipline not only serves to articulate more clearly in one's own mind what is to be done, but it helps to insure that the organization will meet the manager's expectations. It takes time to confirm a decision in writing, but it will later save many hours of rehashing the circumstances and the decision. Putting the decision in writing does not preclude misunderstanding, but it does tend to cut down time spent in recurring discussions of the same situation.

The tenth rule is to resist the temptation to accept and accumulate information that is not actually useful. The manager may protect himself from this temptation by accepting or seeking only that information that he needs for making a decision. If this rule alone could be adopted throughout a company, an astonishing amount of time and energy would be saved. Briefcases would go home less often and considerable filing space would be freed.

Another drain on a manager's time is the growing tendency to call lengthy meetings at the slightest provocation. The larger the company, the more prone management is to indulge in this behavior. Meetings can be extremely useful in bringing fresh evidence to bear on a decision that has to be made, but unless the purpose of the meeting is clearly understood by those participating it can frequently be a waste of time. A manager should insist upon an agenda and a definition of the desired end result, as a precondition of his attendance at a meeting. It is helpful also to have those attending agree upon the time which will be spent, subject to amendment by decision — not by default — if it seems useful to extend the meeting further than originally intended.

The final rule applies to personal behavior and might well be considered in social situations as well as in business. If the manager wants to improve his use of time, he should invest more time than he is normally inclined to do in listening to the advice and ideas of members of his organization. His people can give him information quickly, once they are convinced that he values it, and can inform him of developments and opportunities within the business that

would take him endless time to learn of otherwise. The art of asking questions, as recommended by Socrates, is still applicable in the management world today, but it is insufficiently practiced by the average manager.

To these general rules may be added at least an equal number of personal methods that the individual manager may develop for himself. The reward of more time will accrue to the manager who improves his use of available hours and is determined to get from his time investment the greatest possible return.

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CHAPTER 6

Planning for the Agribusiness Firm

Throughout our study of the farm supply industry we saw distressingly little evidence of planning beyond the activities in which the manager was immediately involved, particularly at the retail level. Larger regional companies involved in manufacturing and distribution tend to plan for the results expected from capital expenditures, although even here the planning process is not clearly worked out in most cases. This is considered by consultants and teachers close to the industry to be the most serious managerial failing.

The Case for Planning

The unique responsibility of the senior manager is to make decisions affecting the company's future. Obviously, some forecast is necessary, for the manager cannot assume that present circumstances will continue. The smaller the enterprise, the more serious the danger may be. Too often, managers of small and medium-sized companies are so concerned with decisions of the moment that they do not take time to consider what the company will be doing 5 years from now. But these short-term decisions have long-term implications, and in many cases are more critical for smaller firms than for larger ones because the impact of a costly error is greater on a small firm.

Interest in planning is much in evidence. Few influential business papers fail to stress it. Surveys among chief executives show that planning is one of their prime functions. Leading management educators are insisting that the executive accept an ever larger responsibility in innovating, planning, and other "creative" functions. The number of seminars in long-range planning and forecasting offered by the professional management associations and major schools of business administration reflects the widespread concern for acquiring understanding and skill in this responsibility. Even in company slogans one can see evidence of the trend. For example, "Progress Is Our Most Important Product" or "Watch Pillsbury Pioneer" — these and others are intended to give an impression of a company's forward-looking attitude.

There are several reasons for this preoccupation with planning. We can recognize an astonishing acceleration in the rate of change in products and services offered and in methods of producing and

distributing them. We see steadily larger capital investments needed to initiate and maintain businesses, coupled with the pressure of diminishing time to recover these investments before new inventions render them obsolete. Increased competition necessitates an urgent search for better internal performance. And there is the sometimes frustrating realization that the manager lives increasingly in a goldfish bowl, subject to the scrutiny — and criticism — of the government, his employees, and the public generally. How each of these pressures helps to create the need for planning is examined below.

Rapidity of Change

It may be observed that the percentage of revenues derived from products introduced by a company within the last 5 or 10 years frequently exceeds the contribution made by products offered by the same company for many years previously. A company's ability to compete appears to rest increasingly upon the introduction of new products and services, and as a result, research people are being brought into senior management ranks. With a greater component of the management team predisposed to innovate and challenge existing methods and processes, the trend toward offering new products to capture an increasing proportion of the market appears to be accelerating.

The consumer, with more money to spend, is more interested in trying the "new improved model" or the interesting substitute for a familiar purchase. And his demand for ever speedier service is causing managers to devise new distribution methods and processing and packaging techniques to retain customer loyalty.

Every manager, regardless of his particular function, recognizes this pressure for change. Personnel executives acknowledge a switch from their former preoccupation with selection of "good" people to the development of the total organization within which they must work — development of an organization capable of attaining the goals the company has set. Purchasing executives are stepping up their search for new materials to substitute for those now used. Engineers are devising ever faster processing methods, made feasible by the advent of the computer and automatic control devices.

The rapidity of change in management styles, organization theories, and marketing methods, in addition to the technological and engineering changes announced regularly in every new business periodical, require changes in management behavior. Facts, not hunches, will underlie decision making; mathematical analysis, not intuition, will govern problem solving; the growth and progress of a company will be secured by the soundness of its organization and its plans rather than by personal genius. The race will go to organizations able to anticipate and cope with change. In short, there is inescapable

necessity for the manager to plan ahead. Changes are occurring too rapidly for him to rely exclusively upon his reflexes, however sharp they may be.

A retailer of agricultural supplies, for example, can be sure that his customers will be fickle unless he seeks out new methods of satisfying their needs. He must not allow present success to deter him from improving what he has to sell and how he sells it. And, precisely because he knows that his product or service will have a short competitive life, he must plan his next offering while his present sales promotion is still in effect.

Bigger Investment — Shorter Paybacks

While personal salesmanship may still play a part in winning trade acceptance for new products, most companies now allocate time and money for estimating the demand for a new product or service long before the decision is made to commit the company to its distribution. In test markets carefully selected to be representative of the company's total market, the reactions of trade and consumer are evaluated and the impact upon the company's funds, production capacity, and human resources is carefully documented before the "go–no go" decision is made. And while the degree of caution is generally a function of the size of the company, small organizations, too, are looking long before they leap.

This is not a matter of fearfulness. Good business ideas travel quickly. The wise manager recognizes that his product or service must be truly unique in satisfying consumer needs if it is to survive the challenge of a competitor who will immediately follow him into the marketplace.

This is particularly true among farm supply retailers. Price concessions alone do not guarantee customer loyalty, for this may be the strategy most easily copied by a competitor. But careful planning of the superior *difference* between one's own offering and that of the competitor is harder to counteract.

Adding to the pressure is the amount of capital required to get into or stay in almost any business. Henry Ford's $50,000 investment in his Model-T engine was unchallenged seriously for many years. What a contrast with the short competitive life of a jet engine whose introduction requires an investment of millions! While the hammer and saw may still be the trademark of the housebuilder, the financial investment he must make today in order to compete bears no relationship to the dollar risk he incurred just a few years ago. New methods and materials and the growing size of investment combine to press the manager in a vise from which forward planning offers the only escape.

Tighter Competition

The luxury of knowing one's competition made life a little easier for the business manager a few years ago. He knew roughly what to expect by way of challenge for his customers' favor. Most companies tended to operate locally or regionally and they knew the capacities, even the intent, of their competitors. But improved communications, distribution, and travel facilities have combined to open the markets of the nation and of the world to any company with the resourcefulness and energy to exploit them. No longer is there any sure way of anticipating competition. Today's customers or suppliers may be tomorrow's competitors. Even more challenging may be the decision of a giant company previously uninterested in a particular industry to enter with a brand new competing product that it either developed or acquired.

The manager cannot preclude the likelihood of the unexpected competitive threat. But he can identify and strengthen the uniqueness of his own offering, analyze and trim all superfluous expense, and generally maintain his ability to compete at as high a level as possible. He can update his assessment of the likely result of today's activities, tempered by an appreciation of his vulnerability. This requires planning. There is no alternative.

Scrutiny of Management Function

The concept of a manager as a command figure is rapidly losing credence. Increasingly, the chief executive is seen as the number one advisor to his subordinate staff. Better trained personnel and improved communications prevent a manager from hiding behind a facade of authority. He is judged on his ability to identify, support, and direct what his people can do for the organization.

Pressure for such increased sensitivity does not come only from employees. The community generally expects the manager, because of his business knowledge, to be the administrative expert in all kinds of community service ventures. A watchful government at both state and federal levels gives him guidelines and ask him for an account of his activities.

Thus, instead of being a law unto himself, the manager is forced to anticipate the impact of much of his work upon a growing number of people. Foresight is the essence of planning. It is a faculty the manager is forced to develop.

Reasons for Resistance to Planning

In face of the evidence that a business manager must plan, why do so many resist the concept? Why is it that so many think of planning as something to be done, if at all, in one's spare time as a kind of

intermission in the normal conduct of the business? There are a number of likely reasons, some deeply rooted in our individual behavior. Three are particularly worthy of comment.

First, there is a fear of restricting one's freedom by "making plans." One of the main reasons managers do not like to put policies into writing is that they may be held to them. One hesitates to become committed to a long-range plan for fear of it becoming inflexible — a kind of mortgage upon the future. The existing circumstances under which the plan is conceived may change — and likely will. Indeed, the argument is heard that a manager who is not committed to a plan will be better able to take advantage of opportunities which may come along unexpectedly. But which opportunities? All of them? Does he have unlimited resources with which he can seize all the opportunities presented? Faced with several choices for which he has no consistent measuring device, is he not in danger of an even graver paralysis — missing most of his opportunities because he can't decide among them?

Even if a case could be made for the intuitive skill with which an effective manager may sometimes seize an opportunity, what of suddenly appearing problems? Should a business change course each time it is challenged or invited to do so? Lacking a plan which anticipates such challenges, this is precisely what happens in many organizations. The business bounces from one crisis decision or "last chance opportunity" to another.

The desire to remain flexible, and not too firmly committed, is understandable. Thus, one can take full advantage of a sudden bonanza. When this flexibility is defined as ability to adjust to changing circumstances, it is a desirable management trait. But flexibility is not in any sense negated by sound planning. The wise manager assumes that conditions will change and thus his plans must be continuously reviewed and updated. If objectives are clearly understood, there need be no hesitation in changing the means of attaining them or even redefining them as new opportunities and new challenges present themselves. Rather than limiting the ability to change, a plan lets the manager change his mind confidently, for he knows what course he is changing *from*.

A second, more subtle, reason for resistance to planning may be found in the traditional image of the business executive. This is the man of crisp decision, a command figure "who gets things done," who quickly discards irrelevant evidence to get to the heart of a problem, and springs into action with a solution. Such a picture is hardly compatible with thoughtful, methodical contemplation of the risks involved. Faced with a choice, the average business manager would far rather be considered a "doer" than a "planner." While he con-

cedes the necessity of doing some planning, he views it as an intermission in his real task, almost a conflict of interest with normal duties. He would prefer to talk with a customer rather than spend the same time planning how he should best talk with customers generally.

Some managers think of planning as "blue sky" or "brainstorm" activity that concerns itself with what *else* the business might be — a kind of daydream of what might be wished for. But planning must not be restricted to hypothetical cases. Indeed, this is not where it begins. The prudent planner starts not with what the business might be, but rather, where it is now. He includes in his planning a procedure for moving the business from its present circumstances to the desired future, stated in operational terms.

Planning is not an intermission. Nor is it for someone *else* to do. It is part of the normal responsibility of every manager.

When an executive is promoted or otherwise rewarded for what he "gets done," without assessment of the quality of his concepts and plans, or when the responsibility of planning is assigned as the exclusive function of a staff or service manager, such company policy confirms the executive's perception of a dichotomy of interest between doing and planning. What must be recognized is that the company's business — or even a single task — will be accomplished more speedily and decisively, with less waste and better results, if it is conducted within the framework of a guiding plan. The man who knows where he is going arrives there much faster.

It will take time and further demonstration to overcome executive reluctance to be seen as "planners." But an increasing number of managers are concerning themselves with the quality and resourcefulness of their plans as well as their skill in discharging them. They realize that planning and effective activity are two sides of the same coin.

A third reason for resistance is that planning is hard work. To think in terms of concepts and programs requires intense concentration and the difficult discipline of withholding judgment while evidence is gathered. It may be true that some managers go on gathering evidence past the point when a decision should be made, but it is equally true that some managers make assumptions early in an analysis and make an unsupported decision because it "feels right."

Faced with deadlines, the executive normally feels better if he plunges into action. It requires considerable self-discipline to spend time appraising a situation and making plans before taking action. This self-discipline is not easy, but the reward to the manager who achieves it is considerable. Intimate understanding of his business, gained by withdrawing long enough from operating pressures to

think about the enterprise in toto, will give him fresh confidence. Having identified what needs to be done through such an appraisal, he will find himself able to reject irrelevant demands on his time and to discharge his operating duties much more speedily and satisfactorily.

These arguments are not new to prudent persons in all walks of life. The farmer's activities today are predicated on the assumption of a desired result tomorrow. Preparation, seeding, and cultivation must precede the harvest. Crop rotation is based upon concern for shepherding one's resources for maximum long-term benefit — precisely what is advocated for management. Teachers have their eye on the end product, a graduating student, as they plan the content and sequence of their lectures. Doctors plead the advantages of preventive medicine, of protecting future health by our actions today. And the manager of the smallest successful business knows that his success is related to his ability to anticipate and be ready for opportunities as well as to correct what may go wrong.

The function of planning should not be regarded as the prerogative of big business. Naturally, there will be more sophistication in the design and the supporting research of plans made by a major organization. Its size makes possible the allocation of specially trained personnel to gather and analyze information. But size of business does not alter the need for planning. What is basically needed, and what is possible for a manager of even the smallest company to achieve, is an understanding that what is done today determines to a considerable degree what is likely to happen tomorrow. And the more precise the manager is in his definition of tomorrow's goals, the more efficient he can be today. This is the essence of planning. Skill in its exercise comes instinctively to some managers of both large and small businesses. But it must be practiced to be effective, and there are some basic routines which may be followed to insure a return for the effort.

The Process of Planning

Briefly, planning for a business involves three appraisals: where the business is now, where the manager wants it to be, and how to get there. The action-oriented manager will want to add an amendment to the third appraisal — how *soon* to get there.

No useful end is served in imagining what the business might become without an objective evaluation of its present circumstances. Optimism will not compensate for an unrealistic or irresponsible appraisal of where the business is now. When planning starts with the crystal ball, the temptation is strong to find support for our wishes in a happy, self-deluding rationalization of the present state

of affairs.

Planning for the future must start with the premise that the desired results are already shaped by today's actions. What we are concerned with, then, is a careful determination of the direction in which our business is presently moving before we decide what we want to make happen in the future.

Company Purpose

The starting point is a definition or restatement of the company's purpose. Characteristically, the founders of a firm have a fairly clear purpose in mind which they share initially with those invited to join. But as the business grows larger or older, the vision of what was intended grows obscure. A steadily decreasing percentage of employees and/or members understand it or have ever heard it discussed. Even the founders may lose sight of the purpose, as will the manager as he becomes increasingly preoccupied with activity and method.

If planning is intended to beget results, it is essential that all the people responsible for achievement share a common perspective of the purpose of the enterprise. Yet one need only ask, first the manager, then, at random, any two or three persons in the organization, to gain an impression of a wide range of understanding of what the company is really trying to accomplish. Even when clarified, the vision must have the dust of procedure cleaned away for fresh appreciation. What was considered possible yesterday may no longer be reasonable; and a purpose which would not have been appropriate yesterday may now be desirable.

It is not enough for the manager alone to review and update the company's goals. The board of directors and other key persons in the company must be invited periodically — and at least annually — to consider with the senior manager why the company exists. If there is no common understanding of fundamental purpose among those most influential in the company's affairs, then progress will be made only by command or by happy coincidence.

These questions may help:

1. What do we understand the purpose of the company to be?

2. At this time, should there be any different emphasis than when we last defined purpose? (e.g., more or less emphasis on quality vs. price; on marketing vs. buying; on specialization vs. diversification).

3. Does any activity in which we are now engaged appear incompatible with the statement of purpose? Should it be continued?

Other queries will suggest themselves.

Once the purpose has been clearly specified and understanding of

it acknowledged to the manager's satisfaction by his key people, the next step in current assessment may be taken.

Major Strengths

It is a reasonable assumption that maximum future rewards will accrue to a business that fully exploits its opportunities and concentrates its resources to do so. But which opportunities? The company's strengths are not the only factor to be investigated, but their exploitation provides a logical starting point. First they must be identified. Some useful questions for a senior manager and his staff to consider are:

1. What strengths does the company possess to which its success to date is largely attributable?
2. Which of these strengths is unique in that no other company possesses it to the same degree?
3. Are we using each of the strengths listed to maximum advantage, giving special attention to those considered unique?
4. What can we do to exploit each strength more fully?
5. Is any activity in which we are engaged prejudicial to any strength? If so, should we stop it?

While careful consideration of the strengths of the business and what is being done about them will likely result in fresh ideas, weaknesses too may suggest profitable pursuits.

Major Weaknesses

Correction of a weakness that may have been on the manager's conscience for a considerable time but postponed for innumerable reasons may reveal fresh opportunities for the business.

These questions may be helpful for the manager and his staff to consider:

1. What are the major weaknesses of the business that give advantage to competitors?
2. What major problems would we like to solve if we had unrestricted power to choose and act?
3. Which of these weaknesses could be corrected this year? How?
4. By what date and under what circumstances can correction of the others be achieved?

As the group considers strengths and weaknesses, the manager's possible tendency to sweep some under the rug is counterbalanced by involving others — and certainly his key subordinates — in the assessment. From the list of strengths and weaknesses should come several opportunities for action.

But for added insurance against complacent rationalization, yet another perspective of the business should be developed. In respect

to each of several criteria of effectiveness of a business enterprise, is the company tending toward improvement or deterioration — is it winning or losing? Here is the next step in the sequence of analysis of where the business is now.

Trends

Each company may select somewhat different criteria of measurement, but at least seven deserve universal consideration, regardless of the size or nature of the firm:

1. Is *the market* for each of our products or services expanding or shrinking? Compared with indices of the national economy and with other indications of customer demand, is this market growing or becoming smaller? Obviously, here are clues to the appropriateness of any substantial expansion of our productive facilities. Is the location of the business, for example, such that its best customers are slowly shifting to another, more accessible, supplier?

It is not enough to anticipate the demand for what we are now selling. Competitors will obviously have something to say about any company's ability to exploit the demand. Is our *share* of the market for each product or service growing or diminishing compared with our competitors?

At this point, we are in a position to identify with some accuracy which of the products or services we are offering hold most promise for further development and which are most seriously in danger.

2. Comparing the company's offerings with those of competitors, do our own possess any *edge of superiority*? Is the edge more pronounced or less so than it appeared to be 2 or 3 years ago? Are the competitors overtaking us or have we widened our lead? Is the superiority we think we have also recognized by customers? If we're losing ground, what needs to be done?

3. The company's *use of funds* is a reliable index of management's stewardship. Has the return on funds employed improved or deteriorated over the past few years? Does the line of credit open to us reflect growing confidence in the company by investment or loan sources — or is this diminishing? Is the return on our invested capital improving? Which activities or assets are influencing this variable favorably? Which negatively? Which areas need our attention?

4. There are various ways to measure a company's *productivity*. In sales, for example, average cost per sale, the relationship of selling expense to gross sales revenue, and various other indices suggest themselves. In production, direct cost of labor, maintenance and service expense, factory cost per unit of product or service — all are useful in determining the trend in productivity. Each department or unit of the business should be examined to discover whether it is

improving or deteriorating in terms of the expense it represents to the business compared with the contribution it makes to the business earnings. Which one needs attention most?

5. Regardless of size, most companies recognize that *favorable public opinion* is necessary for their continued profitable existence. Is the attitude of trade, of municipal government, of regulatory government bodies, of trade associations, and of the public generally toward the company and its products more or less favorable than 2 or 3 years ago? Where is improvement most urgently needed?

6. The degree of dedication and enthusiasm with which employees address themselves to attainment of the company's objectives reveals something of its health. Is *employee spirit* increasing or diminishing? Is the vitality of the organization greater than 2 or 3 years ago — or less? Should an effort be made to improve it in any one part of the company?

7. Giving direction to the organization and its multiple activities is obviously the primary task of management. In terms of competence and vision, is the *quality of the company's leadership* improving or deteriorating? What of the backstop strength? Is the company's ability to replace any or all key managers greater or less than has been the case over the past 2 or 3 years? What positions need to be filled?

There will undoubtedly be some criteria unique to a company's own experience and preoccupations that it can substitute for the above, but these seven are applicable to most businesses.

It is all too easy to become excited about a particular opportunity for improvement as this assessment proceeds, without thinking of its effect on the business as a whole. It may be desirable to effect improvement in production costs — but might this be at the expense of the company's reputation for quality? Or perhaps an increase in sales volume appears necessary — but would the effort to gain it be detrimental to the company's margin of earnings or availability of cash? No improvement in the condition of any activity should be considered without appraising the effect upon the total well-being of the company.

The examination of purpose, strengths, weaknesses, and momentum is of itself a rewarding exercise for the manager, for he gains fresh understanding of what needs to be done. It is an essential responsibility of the chief executive of any enterprise — large or small — to pass judgment upon the company's economic health, but the appraisal is an exercise that should be shared with his senior staff and/or the board of directors. Out of it comes a common perspective of the needs and opportunities of the business, and the impetus to determine individual objectives based upon common purpose.

Needs and Opportunities

With this first appraisal made, the inventory of strengths, weaknesses, and momentum can now be expressed as a series of needs and opportunities for action by the company. Not only is an agenda developed of what is immediately required, but excellent insurance against unrealistic pipe dreams is provided as well.

For each strength, each weakness, and each assessment of momentum, whether favorable or unfavorable, the manager should declare what action he would like to see taken by his organization — this year and as far ahead as he can prudently predict. Here is the point in the development of objectives where imagination is called for: dreaming boldly but sifting out what is not feasible.

Questions like those suggested above, which the manager will have discussed with his immediate subordinates and advisers, will generate answers that can be grouped together to form a "document of needs and opportunities" for the company. The manager should indicate the order of importance of each company need or opportunity. Each subordinate should then be required to answer a basic question: "What activities can I undertake, using the resources and skills at my disposal, to help the company satisfy the needs and opportunities I helped to define?"

This is not an easy exercise. Soul-searching never is. The manager will find it necessary to put a time limit on the submission of definitions of activities each of his subordinates believes he can undertake. It must be done in writing, for the manager will undoubtedly wish to study each list of suggested activities in considerable depth before determining whether the sum total of all proposals will indeed take the company as far as he wishes it to go, for the period being considered. Amendments and additions may be expected, as the manager and each subordinate come to a meeting of minds regarding each person's proposed contribution.

One may question the efficacy of such a "permissive" approach. The operations-oriented executive is sorely tempted to *assign* objectives to his people; to *tell* them what he wants from them by way of commitment. But it is axiomatic that a person is never dedicated to the achievement of another's objectives. He must participate in their development. In actual practice, the manager who allows his subordinates to participate in the definition of objectives will find himself frequently advising them to make less ambitious commitments rather than urging greater effort.

Writing Objectives

As each staff member describes the activities he intends to undertake, he should be as specific and precise as possible. Each activity should be stated as an objective, with intent, method, and schedule

all included. Each "objective" should embody a statement of intent, that is, a description of action to be taken with reasons therefore, related directly to the company's needs and opportunities. Indeed, the sum total of all objectives should be fulfillment of the company's requirements.

Each objective should include a schedule of attainment. The completion date is essential in order to give the senior manager opportunity to make total plans with confidence. Equally important is a series of intermediate dates marking completion of component parts of each objective. These dates enable the manager to be aware of the rate of progress of interrelated objectives and to offer direction as needed.

Each objective should include the names of persons to be held responsible for its completion and an estimate of the money and/or equipment required. Ideally, the company's expense and capital budgets and a summary of its operating objectives should closely support each other.

What is envisaged, then, is an exchange of ideas between subordinate and senior manager culminating in agreement between them upon the contribution to be made by each person to the company's desired progress for the period of time under consideration. When each member of the manager's team has reported in, in similar fashion, the manager must synthesize all objectives into a total work document for the company. This provides an opportunity for bringing together the whole management team to hear the personal commitment of each member.

This process is a powerful stimulus to vitality and forward progress of any company. The steps of (a) overall direction by the senior manager based on recurring analysis in which the organization participates, (b) commitment by each staff member to attainment of objectives he has major responsibility for specifying, and (c) review by the total management team of what each member proposes to do, combine to give the company a sense of refreshed purpose and incentive.

Feasibility of Objectives

As immediately recognizable problems are accounted for in the definition of objectives, more attention will likely be given to exploring new fields. Here the prudent manager will arm himself with economic and social data describing the markets in which he is interested. Such information is available to both the small retailer and the multimillion dollar operation for the asking. Population figures, spending patterns, household formation indices, competitive activities, and trade activities are all described in detail in government and trade association publications. Local branch offices of state

and federal government departments are frequently gold mines of useful industrial information for the business of any size. Accurate appraisal of pertinent economic information will frequently save the company from addressing itself to either overly modest or unattainable objectives.

No manager will survive, nor can his business do so, without painstaking estimation of the results likely to accrue from today's activities. To an ever greater degree, competitive survival will be the prize of the company that purposefully plans for its own future. There are no shortcuts. But the reward is many times worth the investment of effort and imagination.

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CHAPTER 7

The Case for Capital Budgeting

In an industry facing rapid change in both its economic opportunities and in the social pressures brought to bear on it, skill in budgeting takes on added significance. Agribusiness firms are confronted with a dilemma: A recognizable trend to bigness demands greater capital investments if they are to remain competitive; rapidity of change in the nature of customer expectations of marketing and farm supply services means a possibly short life for those investments. The manager cannot afford to guess about his investments because of the large risk involved and the permanence of their impact. Capital budgeting was acknowledged by respondents in our study of farm supply firms to be one of the top 10 areas requiring closer examination, because the survival of any company is determined in large measure by how effectively it uses the money it controls.

The Rationale

Capital expenditures, as distinct from day-to-day expenses, have direct influence on the company's survival. What is presented here is not a discussion of the relative merits of methods of measuring return on investment. This is left for the manager and his financial advisor to decide. What is argued for here is recognition that capital expenditures must be planned ahead in orderly fashion — not determined on impulse.

The smaller the business the more frequently decisions affecting capital investments are made on the basis of a sudden recognition of need or a sudden appreciation of an opportunity. It is seldom that other alternatives for using the same amount of money are investigated, for the time spent in pursuing such an investigation would be at the expense of immediate operating needs. Seldom is there anyone to whom the manager can assign such a study, since an understanding of the total business is required, such as the manager alone possesses.

The smaller the business the greater the tendency to make only a "top of the head" analysis of the assumptions underlying a decision to go ahead with an investment. Seldom is a pro and con analysis made, with a deliberate attempt to define the risk involved and assess the impact of the expenditure upon the company's future total ability to earn. Yet few decisions that a manager ever makes are more important than those relating to capital expenditures.

While a quick analysis might indicate that a particular investment will result in a profitable return to the company, the larger questions[4] remain unanswered:

1. How much return should be forthcoming?
2. What could the company realize from an investment of this size in some other opportunity?
3. Will the particular investment result in lowering the average return on the company's use of money?

So long as money is readily available to the business, one is tempted to overlook some of the implications of tying up capital. It is sometimes only when credit becomes tight, or when the company realizes that expansion of facilities is simply not possible because it has already tied up its funds in less rewarding directions, that the manager makes a firm resolution that his use of capital will be budgeted in the future.

Among larger companies there is increasing emphasis upon developing skill in the process of capital budgeting. Indeed, the best-managed companies that are analyzed from time to time in various management periodicals are usually cited for having outstanding records of return on investments. The willingness of investors to make their money available to a company depends increasingly on the effectiveness of the manager. How good a manager he is considered to be depends largely upon the wisdom he displays in committing company funds to further the development of the business.

If skill in selecting from among the various choices open for the use of the company's money is to be enhanced, the manager will have to set aside a certain portion of his available time to identify not one, but several, courses of action. The broader the range of choices open to him, the better the decision he is likely to make. When no alternative is considered, it is doubtful that the investment selected represents the best use of available money. As in selecting from among candidates for a given job, one's batting average in investment decisions is usually improved by having a number of alternatives from which to choose.

The Process

The manager should constantly update his appraisal of what is needed most in the way of equipment, processes and plant, store, or warehouse extensions to improve the effectiveness of his operation. Rather than waiting until something is needed immediately, he should make at least an annual prediction of the likely demands on the company's funds. This can be done through constant review with

[4]C. G. Edge. *The Appraisal of Capital Expenditure.* Society of Industrial and Cost Accountants of Canada, Toronto, Canada. 1963.

his own people; continuing discussion with his customers; attendance at trade shows where new equipment and processes or methods may be displayed; participation in the affairs of the trade association representing his industry; examination of technical literature, which frequently carries announcements of new developments; and an alert and aggressive interest in what competitors may be doing. From any and all of these sources the manager can obtain ideas for changes in his own business that require the investment of capital funds. In short, he should constantly look for opportunities to improve the facilities he manages—rather than waiting until one of his competitors makes it painfully apparent that he is out of date. This then is the first step: Make a careful and continuing analysis of opportunities. Capital budgeting does not start with the accountant. It starts with an alert manager.

Once he begins to look for them aggressively, many and varied possibilities will become apparent. They should be catalogued in some type of formal record to be considered at regular intervals. For example, a machine may be replaced by a faster or more effective model; production or selling space could be remodeled for better utilization. Perhaps additional warehousing and storage space should be created; perhaps certain purchases should be switched from the present basis to larger-scale bulk buying; perhaps a new piece of equipment would result in a faster flow of cash to the company. All of these possibilities require capital expenditure, and they compete with each other for the money available to the manager. They should be recorded in his inventory as rapidly as they are identified.

The capital budget program for a company of any size will include specific programs for marketing, engineering development, manufacturing, and customer service. In any of these areas, increases in investment in fixed assets may be desirable because of their favorable influence on the earnings of the business. How can the manager choose, when he cannot undertake all of them? The factors he should consider in evaluating the worth of proposed capital expenditures and in determining which of the several alternatives is most desirable should be carefully set out in writing. In the small business, playing a hunch is frequently the only basis for a decision. If it is apparent that the costs of enlarging the space given to the production or sales of particular products or of putting additional equipment into use will be less than the income expected to be derived, it is frequently assumed that no further analysis is needed. The capital expenditure is approved.

Such a superficial analysis, however, gives no basis for comparison with other possibilities, nor does it take into account the time over which the investment will yield return. The earnings that the capital

investment will produce during its expected life and the dollars involved in the investment must be compared with the minimum return on investment that will satisfy the company. This minimum can be worked out by the manager and should carry board approval as being sufficient to perpetuate the business.

Thus, the prudent manager who wishes to manage his capital wisely will have an inventory of opportunities for investing in the business, and a reliable system for making a choice among the alternatives open to him. All of the demands for capital funds that can be anticipated over a future period of time should be determined at least a year before making the expenditure, if possible. The list of likely projects can then be ranked in terms of desirability, first by cancelling out those that do not meet the minimum earnings standard, and then by arranging the others in descending order of size of return. At this point the manager is able to determine the total demand for capital investment and whether this is within the limits of availability of funds. He is then able to recommend to his board a capital expenditure budget and at the same time identify any need to expand the funds available to him. It must be emphasized that standards of return on investment are as necessary for cooperative organizations as they are for proprietary ones. Traditionally, cooperatives have not made sufficient use of such measures. But there is increasing pressure from the various credit sources that serve them for analysis based on such standards.

Capital expenditure projects that should be budgeted are typically found in four categories. First, there are projects that will increase sales volume. For these, the decision is based largely on estimates of the additional earnings that will be generated. Second, there are projects which are essentially designed to reduce costs. The decision here will also be made on the basis of its effect on company earnings. Third, there are projects that are needed to maintain a company's competitive position, such as new merchandise or a change in packaging to attract consumer attention. Here the deciding factor may be the need to protect the earnings that the company now enjoys. And fourth, there are projects that are not directly related to earnings, but that are believed to have a bearing on the company's ability to survive; for example, an investment in equipment to insure the safety of employees, the provision of a lunch room for employee comfort, or new office equipment to avoid frayed nerves. It is difficult to identify a direct dollar return for this type of capital investment, but such projects may be needed, in the manager's judgment, to keep the company productive.

As the manager develops standards of return on investment, it is likely that he will come up with slightly different yardsticks for the

various categories of expenditures.[5] Whatever standards he selects, however, he should recognize the following general principles:

1. Additional capital put into a business should produce earnings that will improve the earning power of the owners' equity. At the very least, it should equal the present return, for to do otherwise would be to misuse the money entrusted to management.

2. Wherever possible, a new capital investment should show an anticipated rate of return higher than the present average rate of return that the company is now experiencing. Only in this manner can a steady improvement in total company performance be protected.

3. An attempt should be made to gain a higher rate of return on one's capital expenditures than the competitor is enjoying. This is the true test of competitiveness over the long term and will be reflected accordingly in investor or patron confidence.

4. When an expenditure is proposed, its influence on the sales, costs, assets, and performance of the business as a whole should be appraised.

Regardless of what method a manager adopts for measuring the rate of return on his alternative investments, he will need the following information in order to make an informed choice:

1. The size of the proposed investment in dollars, including incidental costs. For example, an investment in new equipment creates additional costs in shipping and installation, and perhaps in training a new operator.

2. Annual earnings expected from the investment, including due acknowledgement of the likely increase in company taxes.

3. The earning life of the investment, with recognition of any likelihood of early obsolescence or diminishing market demand as the product or service matures.

4. The rate of earnings on new expenditures that is required to maintain or improve the company's present position.

5. Understanding that an increase in fixed assets investment is frequently accompanied by an increase in working capital requirements, for inventory, accounts receivable, or new cash needs.

Regardless of size, every company must balance the use of its funds between acquiring new assets and maintaining sufficient liquid working capital. Thus, the impact of any capital investment proposed must be measured and anticipated for as long a period ahead as possible.

[5] Ezra Solomon. *The Management of Corporate Capital (A Book of Readings)*. The Graduate School of Business, University of Chicago, Free Press of Glencoe, Glencoe, Ill. 1959. p. 21–34, 282–291.

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CHAPTER 8

Pricing Policy

Pricing is an ever-present concern of the chief executive whether the business is small or large. From the price charged for the product comes the company's ability to pay for all its activities. The influence of competitive pressures, government interest, and public confidence on the company's survival is directly affected by the quality of the pricing decision. Even the security of one's employees is fundamentally connected to prices. There are, of course, limits upon the discretion the manager has in pricing the products his firm sells. In some cases competition may impose an extremely narrow range. But some agribusiness firms can differentiate the products they handle from those sold by others. The degree to which this is possible establishes the range of pricing discretion.

Few of the retail outlet managers encountered in our farm supply industry study had had any training designed with this pricing responsibility in mind. Nor did we meet more than a handful who thought of pricing as an organized, structured management function whose exercise could be improved by discipline and education.

The Pricing Problem

The manager must be certain that the price he asks will adequately cover the cost of functions performed by the company. Whether he is managing a cooperative or proprietary firm, he is constantly confronted with the problem of choosing the appropriate level within the limits open to him. His concern for customer or patron confidence, legality, and the desire not to make the market so richly attractive that additional competitors will be lured into it are all at work to temper his interest in experimenting with how much he might be able to get. On the other hand, he recognizes that for reasons of self-esteem, social responsibility, and personal or corporate survival he must set a price that will insure a flow of income sufficient to maintain his company in a state of economic health.

The manager knows that when he sets a price his judgment might be faulty. The price might be so high that it discourages sales; or it might be low enough to attract customers but fail to generate a sufficient margin to maintain the organization in a financially healthy

condition. Thus, pricing can pose a dilemma affecting the very heart of the business.

When one considers that the price of a product or service represents a combination of company policy, costs, consumer acceptance, and competitive survival, it becomes apparent that pricing is a challenging management function. As each of these variables changes continuously, price must be examined to insure that it reflects changing pressures. Even the product or service itself will be seen in a changing light as it matures. Generally, the older the product the lower the price it can command, unless it has unique and unchallenged properties which no competitor can match and for which the consumer demand does not change — an unlikely static combination.

The manager will typically want to review prices when costs of his business begin to rise, when his control of a particular market is challenged by a new competitor, or when he introduces a new product into the company's line which has a family connection with his existing offerings. Thus, there is a need for almost constant review of the validity of any price. The fact that price yields a profit at the moment of review is not a reason for the manager to "let well enough alone." Perhaps the margin between cost and price is not as much as it should be, or perhaps if it were less, considerably greater volume of sales would result.

Pricing Philosophy

The manager will typically wish to secure the maximum earnings possible over a long-term period commensurate with overall company objectives, a sense of social responsibility, and the competitive environment. It is not simply a matter of considering the revenues that will derive from the price he sets. Indeed, a manager frequently finds that he must accept a prevailing price established by competitors, and that the costs of his business are the only factors that can be manipulated. There are also circumstances of competitive timing which may justify the establishment of a price the manager knows he cannot hold for long. Generally, however, pricing is equated with the long-term survival of the business and is subject to the overall philosophy by which the manager guides his affairs.

Pricing Policies

Because of the lasting effect of a pricing policy on the business, it is essential that the manager be very clear about the results he wishes to achieve. A study of pricing by Kaplan, Dirlam, and Lanzillotti in 1958 identified several different policies that control the pricing

activities of a series of companies.[6] They argue that it is essential for a firm's pricing policy to be understood by all managers making a contribution to the company's progress. Without such understanding, there can be considerable confusion within the company and in its external relationships. It is an area that is all too frequently considered to be the province of the president and the financial officer only, whereas it is actually a consideration that should be discussed and clearly understood by all members of the management team and the board of directors.

A review of several alternative pricing policy objectives might be helpful to illustrate the range of choices.

1. *To achieve a desired financial return.* A company may seek to base all its operations on an earnings figure that will satisfy its investors or patrons. Knowing the costs that must be recovered and the volume of sales anticipated, the price of the product is then forecast to achieve the desired net revenues. Frequently, this kind of pricing policy takes into account the likelihood of competitors' activity only to the extent of its influence on the sales forecast. Insofar as this is true, such a policy is not likely to be valid for long unless the product or service is unique or protected by patent.

2. *To stabilize prices.* The manager may establish a price that recovers costs and tends to stabilize the market while still guaranteeing a workable margin. Cooperatives frequently state this as an aim of their pricing policies. Over the years they have tended to price "at the market" and to refund any surplus over cost to the member-patron in the form of cash or equities in the business. In those cases where the surplus exceeds the requirements of a workable margin, an immediate return can be made in the form of lower prices. Any downward change in price, of course, must be undertaken with caution. A price reduction that touches off a price war can be as disastrous to a cooperative as to any other business. Further, a policy of low and stable prices anticipates that the customer or patron demand for the product will continue for an indefinite period or at least long enough and in sufficient volume to recover the company's investment.

3. *To secure a share of the market.* The manager may set a price at a level calculated to maintain his share of the market against competition, or perhaps to improve his share when competitor prices are high enough to give him an opportunity to come in at a lower level. This is a policy frequently followed by a mature business which seeks to strengthen its market position. By pricing under those companies

[6]Kaplan, Dirlam, and Lanzillotti. *Pricing in Big Business: A Case Approach.* Washington, D.C.: The Brookings Institution. 1958.

who presently dominate a market, a new company may be able to gain a foothold, but in doing so it must recognize the unlikelihood of any early opportunity to increase its price. It must, therefore, have provided adequately for the financial survival of the business over the period of time intended.

4. *To maximize earnings.* Occasionally the manager's purpose is to secure the maximum earnings possible for a specified period of time. He may do this by pricing at the highest level he believes the market will bear, for long enough to recover some of his initial investment, with the expectation that he must drop the price shortly to meet possible competition or simply to offer better value and insure continuing consumer favor.

An alternative application of the same strategy employed for a line of products is to drop the price of one product presently in strong demand and offer it in package promotion with one or more allied products whose sales and earnings the manager seeks to increase. The leverage so gained is intended to improve earnings of the whole product line. However, the price level of the product used as a leader may be difficult to re-establish unless its hold on consumer favor is such that no competitor is offering serious challenge.

5. *To create a particular image.* A price usually conveys an impression of the nature and quality of merchandise and/or service a firm is likely to render. It must be compatible with the impression the customer has of the business itself, and with his expectation of the service he wants from his purchase. If it is an impression of quality, a low price could be confusing. Within these expectation limits, a price level may be set to give a message of quality, or of a bargain. Product performance must justify the message if repeat business is expected.

Whatever the pricing policy may be, one cannot escape the influences of the company's own costs, the confidence of the customers or patrons, and the reactions of the competitors. In essence, a price policy is usually one of three things: It may be a determination to recover costs plus some predetermined margin of profit; it may be a determination to develop as much net sales revenue as possible in excess of costs; or it may simply be a determination to survive at the healthiest level possible in light of competitive pressure.

Joel Dean's book, *Managerial Economics,* identifies two basic pricing attitudes the manager might take. He may be determined to "skim the cream" from the market, or alternatively, to "penetrate" the market.[7] These choices represent two extremes and warrant close examination by the manager before prices are established. The

[7] Joel Dean. *Managerial Economics.* New York: Prentice-Hall. 1951. p. 419–424.

"skimming" point of view calls for the highest price that can be feasibly established. It is a type of financing used by a company seeking to recover its investment as quickly as possible, particularly in the case of products that will probably become obsolete quickly. In fact, "skimming" may be the only sensible policy to follow under high risk situations, if demand conditions permit it. Or it may be justified because the company believes it can achieve a substantial reduction in the costs of manufacturing or distribution in the near future; the firm may wish, therefore, to establish a high initial price from which it can retreat at a later date, when justified by the anticipated cost savings, with resulting customer appreciation.

Occasionally this policy is justified when there is only a small market demand for the product and/or it is doubtful that it will be particularly attractive to competition. Probably the most compelling reason for adopting the "skimming" approach is that a company's product or service has significant uniqueness or is so exclusive in design or in patent protection that the demand is safely predictable. With the passage of time, of course, the probabilities of retaining uniqueness diminish and demand may be expected to change.

In making such a determination, the manager must use careful judgment. He should have competent advice in assessing the elasticity of demand. Is the product a necessity or a luxury? Is it possible that substitutes are already available or can be made shortly after the introduction of his own product? What is likely to happen to the demand for his product if there is a sharp change in buying power in his market or community? What is the customer's perception of the product's price-quality relationship likely to be? Each of these questions requires an informed answer before the manager can embark on a "skimming" price policy with confidence.

While only larger companies can probably afford the type of market and consumer research from which any reassuring evidence could be drawn — and even this evidence can be misinterpreted — the very small company can make some investigation on its own behalf. For example, potential buyers can be interviewed before the initial price levels are established, and customer or patron panels can give advice prior to the decision.

The manager may be sure that unless the superior qualities of the product or service he is offering are clearly demonstrable to the consumer, whatever price he sets will be immediately subject to competitive pressure. Further, there is a limit to what the customer will pay for uniqueness. It can be capitalized upon for a period of time, with discretion, but only as long as value is perceived — by the customer, not by the manager.

It must be remembered that the longer a "skimming policy" is

followed, the more vigorous will be the effort of competitors to claim a share of the rewards. More than one manager has "skimmed" too long and consequently faced a new competitor.

The diametrically opposite point of view which Joel Dean describes is that of "penetration."[8] The sales manager concerned with increasing sales volume typically argues for a lower price as a means of achieving it. It is only when he sees his job as that of *buying revenue* for the company rather than simply increasing sales volume that he can consider the question of a lower price unemotionally.

In determining a "penetration" policy — deciding to get as much volume as possible through an appeal to the widest possible market — the manager must be acutely conscious of the costs his price level must recover. For example, setup costs are sometimes overlooked during a "test" period of assessing what a product should return, even though material and processing costs may be adequately considered. Additionally, the markup from which the company will secure its margin for future growth must be sufficient not only to provide the funds necessary but to allow for occasional disappointments in total sales demand. A "penetration" policy must be entered into with utmost caution.

Nevertheless, this sometimes may be the only choice open to the manager. Where the demand for his product is sensitive to reductions in price and thus has high price elasticity, it would be a precarious venture to claim a particularly high margin for it. Also, where a strong competitive threat already exists or may be anticipated, a low price policy may be the manager's only choice.

Sometimes a manager may be unduly influenced by his enthusiasm for the advantages he believes his product carries for the customer. From the customer's point of view, the "unique" product may be seen as nothing more than another form of a familiar commodity, not at all justifying the price the manager may wish to ask. If this is the customer reaction, the only alternative left to the manager is "penetration." Some writers call it "protective pricing."

It is unwise to underestimate at any time the intelligence or aggressiveness of one's competitors. Unless the barriers against anyone else getting into the business are formidable, it may be assumed that the high margin cannot be protected for long. This is particularly true if the profitability of the product or service happens to be fairly widely known. Another restraining influence would be the existence of large or demanding buyers in a position to demand detailed justification of the price.

Perhaps the most compelling reason for "protective pricing" is discouragement of competition that might otherwise be attracted.

[8] *Ibid.*

Unless the company has patent rights or an exclusive corner on technological processes, or is in a unique position of having more investment power than any potential competitor, the only tactic that will discourage the competitor for a prolonged period of time is a low margin. Support from a unique merchandising or advertising program might be of temporary assistance, but this is normally useful only for as long as it takes a competitor to devise an equally persuasive selling program.

From the point of view of a cooperative, a low-price policy may derive from its perception of itself as a "measuring stick" by which the performance of proprietary firms can be judged. Not all cooperatives see themselves in this role, nor is there any compelling reason that they should. Since they are organized specifically to benefit their own member-patrons they are under no obligation to nonmembers to create a low-price umbrella for the market generally. They can, as was suggested earlier, price at the market level and return the surplus to their patrons.

Another reason why a cooperative may choose a low-price policy is that the membership demands it. Since they are the owners as well as the patrons, members do have some voice in establishing pricing policy. There is some danger, of course, that the patron's preoccupation with a low price may cause him to overlook the firm's need for a margin large enough to maintain the firm in a healthy financial condition. A number of cooperatives are not replenishing their capital for this very reason.

Pricing Practices

After due consideration of which policy to follow, the manager should begin the process of setting a particular price by estimating the demand for the product to be offered. How many potential customers? How many can he win? It would be folly to assume, except in a monopoly situation, that every one of these potential customers would prefer his offering to existing or future products offered by competitors. Since members of cooperatives are usually under no legal obligation to buy from their organization, these considerations are equally relevant to the cooperative manager. Members can and do buy elsewhere. To count on attracting all of them could spell disaster for the organization. It is necessary, therefore, to estimate what percentage of the total demand the product can reasonably secure.

His next step is to determine the price range of comparable products now offered. This should be carefully appraised, preferably through interviews at the point of sale of those offering the products