

Diversification – strategy of building the competitive advantage in agribusiness

Diverzifikace – strategie budování konkurenční výhody zemědělských podniků

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Diversification, as one of the possible strategies suitable for building a competitive advantage in agribusiness, started to be popular in the EU in the 1980s of the last century. The reasons that pushed farmers to use these strategies rose from the continual overproduction growth of agro products all together with problems with decreasing sales rates of these commodities and common changes in agricultural policies. The first essential change in development policy appeared in regulation number 75/268/EEC. Paragraph 16 enabled businessman and small business subject, offering tourist and accommodation services in less favorable areas, to ask for help.

The producers of agro policies see diversification as one of the possible ways how to improve the European as well as the Czech agro status, mainly accessible for small and medium sized agribusinesses. This can be also induced from continuous growth of grants that should motivate agribusinesses to apply for a diversification strategy.

To help to understand the “powerful cure” of European agriculture, to be able to formulate recommendations for owners and managers within agribusinesses, eventually for the creators of agro policies, it is necessary to start to deal with this subject considering the specific conditions of Czech agriculture and the knowledge of recent results of using the diversification strategy within the European conditions. This article is a first step to clear up the questions concerning diversification strategy for small and medium sized

businesses that focuses on the basic definition of the term diversification in agribusinesses and defines the main approaches to it.

MATERIAL AND METHODS

The contribution presents some of the partial results of the project number QH 71110 named “Possible usage of diversification as a factor that strengthens the competitiveness of small and medium sized businesses in the Czech Republic”. The contribution emphasizes mainly on different points of view to the term diversification in agriculture. The main objective is to clearly define the term to be able to use it further in this project.

RESULTS AND DISCUSSION

The diversification trend was extended in the 1960s and 1970s, for the purpose of gaining an independence on other business activities. There were defined three basic types of diversification: concentric, horizontal and mixed diversification (Tichá, Hron 2007).

- concentric diversification – addition of such new products and services, which are related to the current business activities
- horizontal diversification – addition of such new products and services, which are not related to the

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current business activities but they are produced to satisfy the needs of current customers

- mixed diversification – addition of such new products and services, which are not related to the current business activities.

In agriculture, this trend appears later on, in the 1980s. Diversification in agribusiness used two main approaches. The first one described diversification as a possibility to turn profit from various financial sources for farmers. The second focused on the capital use, or more precisely on the production factors within a farm, that were originally used for other profitable activities in terms of conventional agribusiness activities. There are two major problems connected with this definition. The first problem is the definiteness of conventional agribusiness that could change in time, differ regionally and could be even understood differently by people at the same time at the same place. Let's take the organic agriculture as an example. Organic agriculture was several years ago considered as a form of diversification, while today it is considered as one of the mainstream agriculture alternatives. The other problem is trying to associate the diversification only with the new use of the already existing farm's production factors. Whereas minimally in a long term, the production factors are being replaced, therefore they must be purchased recently (Winter et al. 2003).

Diversification as an effective usage of the farm's production factors

In this conception, it is substantial, that in terms of diversification, the sources are being transferred. Moreover, the production factors are transferred from the original allocation to the conventional agro production as a source of new business activities. This confirms the incorrectness of the original allocation in terms of overvaluation of the future profits of these factors in agro production.

Shucksmith and Winter (1990) deal with the conventional and novelty issues in the context of defying diversification. They have defined diversification as an usage of farm's production factors for the future agro production, that is not yet overproduced on the market, or for the production of nonfarm production. They have succeeded with the evasion of the term "conventional" but otherwise they use other multi-valent term "new agro production". This term should be defined at least in the context of time and place. A bigger problem is to define the agro production, that is not overproduced, which associates with the political interventions to the market mechanism and tries to

justify them. If we see the diversification as a business activity that farmers realize to gain profits from, we can leave out the term "non-existing overproduction" from the above mentioned definition, because there is generally no profit gained from products that are difficult to succeed on the market.

As McNerney and Turner (1991) v McNally (2001) state, trying to use farm's production factors even more effectively was presented as the second most frequent motivational factor for realization of diversification activities, right after the ability to use alternative income sources. Therefore, diversification is being defined as an effective utilization of land and farm's capital sources, in other way then just to gain higher profits. In their definition, they include a thought of different use of the production factors in terms of diversification, as a usage of alternative sources of income, which totally corresponds to the results of their research.

Even this approach faces various problems with other possible usage of the production factors and therefore evens the specific production factors that are being used in agriculture. Defying diversification as an effective utilization of production factors is confirmed by results of other empirical researches, mostly by British authors (Ilbery et al. 1991; McNerney, Turner 1991; Shucksmith, Smith 1991) v McNally (2001), where on-farm diversification is used mostly for bigger agribusinesses. In smaller farms, mostly those suffering from low capitalization, there is applied off-farm diversification, in other words to employ the farmer in other company.

Diversification as a usage of alternative sources of income

The second approach used mainly in the 1990s sees diversification of agribusinesses as a chance to use various kinds of financial sources for farmers, including the possibility to be employed outside the farm.

This perception of diversification is significant at the farmers themselves as it confirms McNerney and Turner (1991) v McNally (2001). In spite of the fact that the part of revenue from diversification activities reaches generally only a small part of the total farm's income, for more than 30% of farmers, an additional farm's income represents the main motivating factor to help them to realize these activities. For another 60%, this sort of income represents an important factor.

The purpose of diversifying agribusinesses rests upon creation of an income portfolio with different

risk rate, expected rate of return, liquidity and seasonality and their common adjustment to properly supplement each other. A part of diversification is an allocation of efficient goods of a business to various activities that will generate an income (Delgado, Siamwalla 1999). Therefore, diversification enables farmers to decrease their dependence on agriculture and subsidies given to agriculture sector.

Meert et al. (2005) mention that diversification is one of the strategies that can help farmers to solve their problems with low income in agro production. However, they do not show diversification as the “cure of all cures” for the unsuccessful farmers. On the opposite, they point out the necessity to fulfill the farmer’s personality presumption for a successful realization of this strategy. They consider social capital, the ability to join networking, openness towards new contacts, the ability to search for essential information and putting across the recently acquired knowledge and experience, as a requirement for a successful realization of the diversification strategy.

Diversification as a business

Ilbery et al. (2006) also tried to define the term “diversification in agribusiness”, moreover, they help themselves to understand by introducing the term “pluriactivity”. Pluriactivity incorporates all profitable activities done by a farmer as a supplement to the conventional agro production, whereas the diversification incorporates only such profitable activities that are done within farm.

Ilbery (1991) sees diversification as one of the applicable strategies that could be used by agribusinesses. He ranks among the diversification activities only the “based on farm” business activities, that are not directly linked with crops’ and animals’ production and that are directly linked with production outside the agro production. He also sees farmers as businessmen, but emphasizes the usage of the production factors, originally used for agro production, in terms of non-farm business activities.

McNally (2001) has a similar point of view, he links diversification with development of the non-farm, or more precisely, the non-food production.

The above mentioned definitions of diversification activities discharge business activities that are realized outside the farm, for instance contracting, that generally uses the machines used in farm’s agro production. Such business activities are generally understood as diversification activities.

The more appropriate definition is mentioned by McInerney (1989), who sees diversification as business

activities realized on a farm or that use the farm’s land or capital, thus the farm’s production factors.

However, even more essential is to define another diversification approach, in this case it is connected with the farmer’s effort to lay hold of new profit opportunities. In this case, we see the farmer as a businessman.

From the given information, we can derive 3 major points of view that are related to diversification, whereas some authors tend to mix them:

1. Diversification in terms of using the production factors for other than conventional usage in agriculture. The main aim is to find a more effective usage of the existing farm’s production factors.
2. Obviously the most frequent definition is the source of income diversification, based on the thought that farmers do not reach the optimal income level from the agro production, not even from the subsidies related to agro activities and therefore they are “forced” to search for other sources of income.
3. Diversification in terms of farmer’s new business activity with the main objective to use the identified income opportunity. Whereas the linkages between this activity and the current agro production, or the usage of current production factors are not substantial, in other words, they are not considered as limiting requirements.

The definition of diversification as the objective of a farmer to realize new business activity, in which he sees a new income opportunity, enables farmers to be seen as businessmen and makes the other diversification definitions easier. It also helps to answer the question, why should farmers use the diversification strategy. Alternatively we can put it all together with a question – why should farmers use diversification strategy ask a question – why should farmers do business?

The business role consists of the fact, that they transfer money to owners of production factors and then they use these factors till the time, when they sell the final product. None of the future values or events is known, all of them must be estimated. A businessman buys production factors at present while his product will be sold sometime in the future. Businessmen must at present give out money while they speculatively expect sales that will earn them profits. In the real world, the quality of estimations and the accuracy of estimations play the leading role in estimating the level of business profits.

According to Rothbarda (2005), the source of income is an underestimation and under-capitalization of production factors. Factors were underestimated when it comes to prices of the particular factors,

and under-capitalized in terms of insufficient purchase of mixture of these factors. In both cases, the common market expectations were wrong and the underestimation of future allowances gained from the factors was made. When a businessman finds out that factors were underestimated by the market, he gains business profit but nevertheless some activities leading to the decrease of the profit start to occur. By increasing the production in this field, he pushes up the demand for the appropriate production factors and pushes up their prices as well. This kind of result will be even more intensified if competitors enter this field, attracted by the higher profit rates. Not only the demand growth will increase the cost of production factors but also the increased outputs will lower the price of a product. The result will be a tendency to lower the profit rates.

A businessman, while searching for the new sources of income, noticed that particular production factors were underestimated according to their potential value of their output. By the fact, that he noticed this kind of inconsonance, he transferred production factors to other productions. He discovered, that the prices of production factors do not correspond with their potential discount marginal product value (DMPV) and by purchasing and employing these we was able to transfer them from the low DMPV production to the higher DMPV production. He served consumers by discovering a field in which are these factors even more valuable. The higher value of production factors is mainly caused by a higher rate of consumers' demand for these factors that means that these factors can satisfy consumers' need even more efficiently.

This approach can be also used for defying diversification as an alternative use of production factors, in comparison with their use in the conventional production. Farmer has discovered that the real discount value of a marginal product in agro production is lower than he originally thought and that the usage of production factors in this field does not earn him the estimated profit. Therefore, he is motivated to search for another field in which he could use production factors with a higher value of marginal product. The situation in which the farmer is situated is more complicated, because the farmer tries to find only such profit opportunities in which he is able to effectively use the opportunities that already exist, if you like the owned production factors, that were originally wrongly allocated to agro production, or their current usage does not earn any profit to the farmer.

Vice-versa, this concept does not support the definition in which diversification was compared to usage of alternative sources of income. New investments

will lead to earning new incomes, but they do not guarantee profits to businessmen (Rothbard 2005). Not even the investment rate represents a guarantee of a big profit or some kind of insurance compared to big losses. It is not quite true, that money "makes" money, profit is gained from wise business decisions.

Turner et al. (2006) justify diversification as a development of other farmer's business activities. Implementation of the diversified business project is not principally different from the preparation and realization of any other businessman's business project in any field of business. Regarding special circumstances, we can assume that these activities will always require expenses for the purchase of production factors. New knowledge and experience will be required and, last but not the least, the ability to manage the production with which the businessman is not familiar will be essential. His business abilities and managerial abilities will be put to the test.

It corresponds with the results of the empiric research (Turner v Turner et al. 2006), which testifies that mainly the successful agribusinessmen become the successful diversification problem solvers to those who failed in doing business in agriculture and that is why they look for another source of income.

CONCLUSION

The term "diversification in agribusiness" is not clearly defined. It is generally governed by its future efficient usage. There are three ground approaches to diversification. Some of the authors try to combine them. Obviously, the most frequent definition is diversification of sources of income, which is based on the thought that farmers do not reach the efficient level of income from agro production, not even from the subsidies related to agribusiness. Therefore, they are "motivated" to search for another source of income. The second approach focuses on farm's production factors and tries to use them in other fields than just in conventional agriculture. Improving the efficiency and the usage of existing production factors of agribusiness is the main goal. The third approach emphasizes the business role of a farmer. Diversification is seen as the farmer's business activity with the main aim to use an identified profit opportunity. Whereas the linkage to the current agro production and not even the usage of existing production factors are not substantial, let us say, they do not represent a limiting requirement.

If we consider the third alternative of how to understand the subject of agribusiness diversification, there are other tasks linked with the determination

of successful farmers doing diversification, identifying and determination factors supporting or limiting portfolios of small and medium sized businesses and diversification of their opportunities.

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