CONDITIONS OF SURVIVAL--BUSINESS MANAGEMENT AND MARKETING

(This Industry Isn't What It Used To Be)

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Reprinted from the North Carolina Flower Growers' Bulletin Vol. 38, No. 5

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The joy and subsequent strength of the independent floriculture producer is a source of pride in the industry. The joy derives from producing a wholesome product with increasing favor among consumers; working hand-in-hand with nature to create life and beauty. Strength is obtained from owning a business, accountable only to self, making independent decisions, laboring together as a family, reaping the rewards and bearing the consequences. It is the consummate American success story of the entrepreneur acting simultaneously as innovator, owner, producer, manager, laborer, marketer and risk taker.

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The Problem: In a fresh and expanding industry, success is relatively easy to achieve if one is willing to work hard. An expanding market can accommodate and reward those who can produce the product. As one grower has stated "Up to now, we have succeeded in spite of ourselves." But as the industry matures, competition to capture the rewards increases. Markets become saturated, profit margins narrow and specialization sets in. The industry becomes more sophisticated and complex, often to the chagrin or the "original" entrepreneurs originally attracted by the joys mentioned above. It now becomes increasingly difficult to successfully uphold the all-in-one model of owner-producer-laborer-manager-marketer-risk taker. Greater specialization and sophistication is demanded of each area, and rewards increasingly shift towards those who successfully manage and market. To produce and labor hard, while still necessary, is no longer sufficient. "Produce all you can; sell all you can; at the end of the year see what is left" is no longer a workable business management strategy.

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The Reaction: A common reaction as this subtle change occurs is to respond via what has always been the primary attraction and strength, e.g. becoming better producers and working harder. After all, the prospect of thinking in business management and marketing terms and developing skills in those areas appears rarely, if at all, in the list of responses to "What attracted you to this business?" Few independent producers genuinely desire to shift from production and physical labor, their first love, into management and marketing. Even if the desire is there, the task of acquiring more sophisticated skills in these areas and finding the necessary time to do it is difficult. It is easy to stay in the past, where business management and marketing were not critical issues, sort of taking care of themselves, in an expanding industry.

This reaction, while understandable, will come at a heavy price, the demise of many good and hard-working independent producers, in the future. The greatest competition and subsequent success or failures, as the industry matures, will come from those who bring more specialization and sophistication to business management and marketing practices. Floricultural production cannot survive as a joyful way of life unless it survives as a way of business. The greatest challenge is not to better understand the terms of production but to better understand the terms of business. Owners will need to become as familiar with thinking of their operations in terms of assets, equity, profit margin, turnover, cash flow, liquidity, return on assets, inventory change, withdrawals, etc. as they are in terms of plant varieties and greenhouse space. They will need to be as aware of changes in market trends and of marketing techniques as they are of changes in diseases or pests and of control techniques.

The Response: A beginning point for meeting this challenge of change is to view the greenhouse operation as a combination of production, marketing, and business management activities linked closely together. The owner must make a crucial decision about how to best accomplish each. Is it to become skilled in all three, or is it to specialize in one or two areas and partner with or hire someone in the other areas?

Anecdotal evidence from one concerned producer in this state indicates that the most immediate need is to increase business management skills and practices. Business management can be thought of in broad terms as managing the two critical resources of any business--1) **capital** and 2) **labor**. The terms financial management and personnel management are often used to describe these two functions. Let's zero in on financial management first.

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A typical first approach to financial management is to think in terms of "taxes." Reporting and paying taxes is certainly required; it is pervasive, and it is a visible drain on financial capital. However, it is seldom the major area needing management attention, and it should certainly not be the focal point.

A second approach, also understandable but also missing the mark, is to think in cash-only terms. While cash is a common denominator of day-to-day survival, focusing strictly on cash is short sighted and can lead to inadequate financial management decisions. The failure to distinguish cash-on-hand or cash flow from profitability is one of the oldest mistakes in business. It is essential, if improved financial management is the goal, to move beyond a cash and/or tax approach to a more comprehensive framework.

Basic Financial Framework

The basic framework for gaining financial insight into any business (and personal financial condition as well) is to examine three key "abilities" of the business: 1) the ability to generate and retain profit; 2) the ability to remain feasible at all times; and 3) the ability to withstand risk or to operate within an acceptable range of risk. Figure 1 graphically illustrates this as a financial triangle where each side is simultaneously dependent upon and yet constrained by the other two. Each ability must be in proper balance to the others or the triangle becomes distorted and the business becomes subject to failure.

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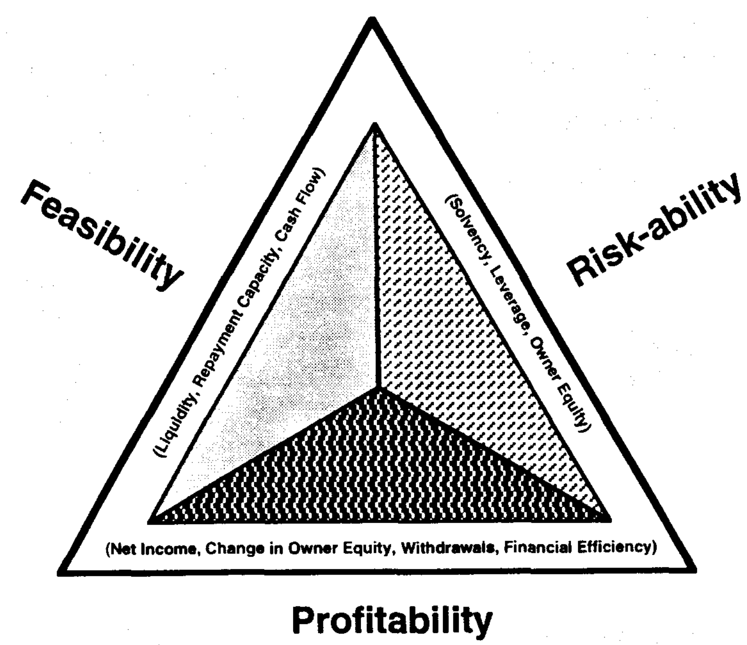

Figure 1. *A framework for financial analysis--business "abilities."*

Profitability. The foundation of any business is of course profitability. Net income is a primary indicator of a business's ability to compete and thus survive and progress. However, equally important is the ability to retain the earnings and have growth in owner equity. A critical link between net income and growth in owner equity is the withdrawal of income or equity by the owners, most often in the form of family living expenditures. A complete report and analysis of profitability must include a comprehensive look at not only net income generated, but living withdrawals and growth in owner equity as well. In addition, it is important to probe for key indicators of financial efficiency that affect the amount of net income generated.

Feasibility. To be feasible means to have the ability to put a plan or activity into practice and to deal with it successfully throughout. Financially, for example, a business can have a profitable or potentially profitable plant but not be feasible, i.e., unable to initiate or continue the activity. This occurs when the net income generated is not properly matched to the cash flow needed to repay debts, purchase inputs, or make necessary capital investments on time. The mismatch may be due to improper timing of revenue and expenditures, inadequate financing, or the simple fact

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that net income may be in a non-cash form for a period of time. Profit may be the foundation in the long run, but cash (financial feasibility) is the common denominator of day to day survival. A business must be profitable to compete and remain alive in the long run, but it must be feasible to survive in the short run and to be able to put its long run profit plan into successful practice. Thus, thorough financial reporting and analysis must closely examine business feasibility through a comprehensive understanding of liquidity, repayment capacity and cash flow.

One common example of the conflict between profitability and feasibility is the purchase of real estate. Numerous studies show that owning real estate is competitively profitable with other investments in the long run when both current income generated and capital gain are counted. However, capital gain is non-cash income until the land is sold, and the cash generated from current income is seldom adequate to fully meet loan payments. Without an infusion of outside income to supplement the earnings or substantial down-payment equity to reduce the loan amount, the purchase of real estate is seldom feasible, although it is usually profitable.

Opposite examples also exist where a business or single activity is feasible but not profitable. Sufficient cash is being generated to meet current financial obligations without generating a profit through a sell-down of inventory, a buildup of accounts payable, living off depreciation, liquidations of capital assets and creative refinancing or rollover of debt. Such activity is a stopgap approach at best that cannot be sustained very long without inflicting serious damage to the business's financial viability.

It is critical to clearly distinguish between profitability and feasibility. Failure to do so was a major factor in the wrenching farm financial crisis of the 1980s and the scandalous losses in the savings and loan industry. Hopefully in the years ahead horticultural production will be both profitable and feasible, but the prudent manager will need to have a distinct measure of both and clearly understand the differences.

Risk. Profitability and feasibility are closely linked to the degree of financial risk in a business. For optimal financial management, one must determine what degree of risk is present and the amount of risk that is acceptable given the profitability and feasibility being generated. From this, the ability to withstand additional risk can be determined. The most commonly used financial indicators of risk are solvency and leverage which focus on the relationship of assets, liabilities and owner equity. These concepts seem straight forward on the surface, but in their fullness they may contain some delicate and unforeseen issues that may go unnoticed without proper financial reporting and analysis.

Basic Financial Tools

Given a framework of three key financial abilities, it is not surprising to find three basic financial tools needed to evaluate these abilities. A set of financial statements consisting of a balance sheet, income statement and statement of cash flows is widely recognized in the financial and accounting professions as the minimum information needed for financial reporting and analysis. Management decisions that rely on less than the full set of statements or poor

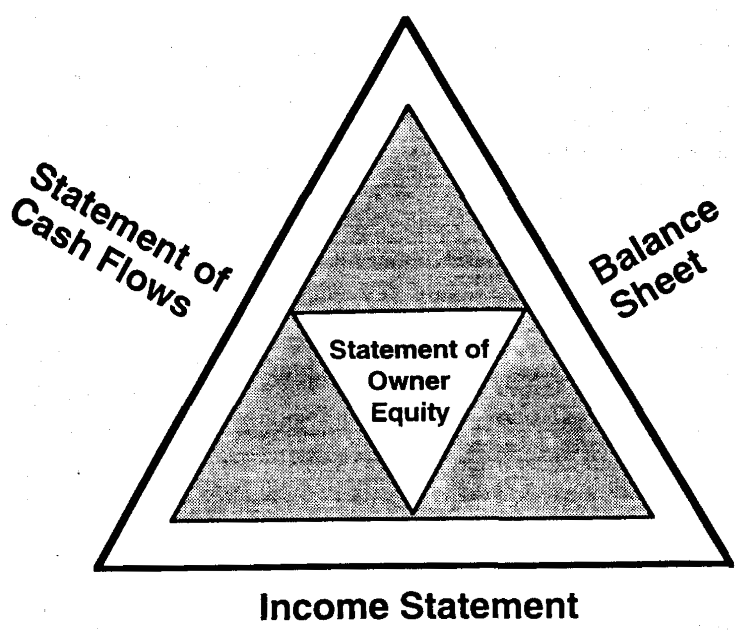

Figure 2. *A framework for financial analysis--financial statements.*

substitutes for any one statement are vulnerable to failure.

Figure 2 illustrates this as a triangle relationship with obvious linkages to the financial framework in Figure 1. The income statement is a primary indicator of profitability, the statement of cash flows in closely tied to feasibility and the balance sheet contains key risk-related information. However, these relationships are not exclusive. The income statement also provides feasibility information as does the balance sheet. The balance sheet also contains some profitability indicators and the statement of cash flows provides risk and profit information as well. Thus, the statements are a coordinated set of integrated information that can be fully accessed only by combined use of all the statements. Just as a business decision for example is concerned with much more than the amount of risk involved, reporting and analysis must involve much more than a balance sheet or an income tax return substitute statement.

The critical linkage of these three statements is recognized by the use of a fourth--the statement of owner equity. This statement reconciles the information being reported in the other three, verifying their accuracy. Then change in owner equity as reported in the balance sheet is explained by the net income reported, cash withdrawals, distributions or additions of capital, and changes in the value of business assets. The statement of owner equity is a relatively new concept that brings important and needed insights into the reporting and analysis process.

Understanding a business in financial terms is a necessary step to improving business management decisions, to staying competitive and thus, to survival itself. It shapes the type of information system that a business needs to establish, which is the next step toward improving business management practices.

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