

Business Decision Making



This fact sheet describes the key factors that need to be considered for making good decisions. Future fact sheets will look in more detail at the resources you can use (such as the VegTool) to help you make decisions in your business.

Making Good Decisions

In business, success comes to the people who get the big decisions right. Making good decisions, however, isn't easy.

To make better business decisions, farmers need to:

- Have a clear vision for the future of their business
- Understand and consider the risks and uncertainty
- Acknowledge the non profit-maximising influences on their decision-making
- Understand that we all have prejudices and biases that impact decision-making
- Talk to the people who are affected by a decision and take into account their views
- Develop the skills to ask the right questions and gather and analyse enough relevant information to be confident about the decision
- Have processes in place to review and improve decisions

All decision making must be guided by a strong, clear direction for the business and family. A useful procedure for establishing this clear direction can be found at: www.makingmorefromsheep.com.au/plan-for-success/procedure_1.1.htm

Everyday, we make hundreds of decisions, most without any conscious consideration. All decisions can be classified into three types:

- Simple
- Complicated; or
- Complex

Most decisions we make are 'simple', including

choosing our clothes or a parking spot. Then there are 'complicated' decisions that require some degree of calculation or information but have a correct answer. Examples include deciding on a specific restaurant or film to attend. The type of decision that we face less often, but often battle with, are known as 'complex' such as the purchase of a new property.

Decisions can be classified as complex when they:

- Involve a high degree of risk and uncertainty
- Incorporate people issues including social pressures and our psychological preferences and/or failings

In addition, simple or complicated decisions can be made complex when there is insufficient good information.

Key Messages

This fact sheet considers three key factors influencing business decision-making:

- **Risk and uncertainty** - farming involves the continual assessment and management of risk and uncertainty. Risk is the source of above average profits and losses.
- **People issues** - social considerations are often more influential on farmer decision-making than profit maximisation. This seems obvious, yet most discussions and tools still focus on profit factors.
- **Access to information** - complex decision-making is made easier by asking the right questions and analysing available information.

Considering how the different components of the farming system interact can be useful in understanding the impacts of decisions (see diagram on last page).

After you have done all the steps in this fact sheet don't be afraid to listen to your "gut feeling".

Risk and Uncertainty

Farmers can make better decisions by overcoming some of the confusion caused by the constantly changing operating environments. Farming involves the continual assessment and management of risk and uncertainty. Risk is the source of above average profits and losses.

For a farming business there is the *business risk* that relates to the operational side of running the business, and the *financial risk* that relates to financing the business.

- Business risk and uncertainty includes the full range of production and price risk. The main sources are variability of weather and variability of prices after production decisions are made and implemented.
- Financial risk and uncertainty refers specifically to the amount of debt a business has relative to the equity, i.e. what proportion of other peoples' money you use to fund the business relative to your own money (called gearing ratio) and the effect it has on the pace of growth or decline of a business. The higher the ratio, the higher the risk.

Managers have little direct control over the occurrence of most business risks, but they do have control over preparation for and responses to these developments.

Importantly risk is subjective, experienced differently by different people. Individuals must therefore consider risk and uncertainty from their personal perspective using tools that are helpful to them.

A useful tool for assessing your business risks can be found at: www.makingmorefromsheep.com.au/plan-for-success/tool_1.10.htm

The Good Decision Maker

Jo Blaggs, a vegetable grower in the Bundaberg district was considering building a new packing shed.

He knew it wasn't an easy or simple decision so he thought about the risks involved by talking to a neighbour who had built a new shed 10 years ago. The neighbour advised him not to over capitalise because he found a couple of years of poor prices had put great pressure on cash flow.

He spoke to his brother and wife and they told him they were nervous about spending too much on capital as they had bought land only two years ago.

He spoke to his bank manager and arranged a good interest rate at a fixed rate. Finally he did an analysis of the investment over a period of 15 years. This showed a rate of return of 18%. This helped provide his wife and brother with confidence.



Adaptive Management

For decisions that are made again and again, it is possible to learn and improve on earlier decisions. This requires a process to be in place to review, record and provide feedback on the results of decisions. This process is called "adaptive management" and is particularly useful in an uncertain and changing environment.

Robust Decision-Making

Robust decision-making requires a risk management approach to decision-making, by enquiring into the uncertainty of a scenario, i.e. what type of risk are we dealing with? How does the uncertainty impact upon our desired outcome? A decision can then be made to cope with a variety of futures.

A robust decision (or solution) is one that:

- Remains viable under the widest range of probable futures
- Increases flexibility and provides options
- Fits in with other proposed actions
- Can be implemented within planned budgets or is based on evidence that is good enough to justify additional investment to a third party

People Issues

'People issues' cover a broad range of social and psychological factors that have a great influence on the decisions we make.

Social considerations are often more influential on farmer decision-making than profit maximisation. This seems obvious, yet most discussions and tools still focus on profit factors.

Social considerations involved in decision-making can involve personal attributes such as:

- Competitiveness, compassion
- Attitude to risk and growth
- Desire to be aligned with peers/neighbours

There are also strong social ties that complicate decision-making including connections to the family, community and the land.

Dealing with complexity requires a higher level of people skills (human capacity) in comparison to production issues that are often solved using technological developments. Farmers require the skills to assess the many options available in order to determine the most appropriate action for their situation. This may involve engaging advisors, working in a collaborative learning environment, and/or improving their level of knowledge.

The VIDP Fact Sheet 'A smooth transition - navigating your way through the family business' provides a structure to assist in working with people in your business. Contact your state vegetable association for a copy.

Access to Information

Finding and analysing the right information will reduce the complexity of decision-making.

Getting Good Information

When we fail to rationally consider risk, simple and complicated decisions can become complex because unnecessary uncertainty is introduced. The best practitioners reduce uncertainty and unwanted risks through thorough analysis, and use their intuition to deal with the uncertain elements of complex decisions.

Clearly, there is a line between too much and not enough analysis. This line changes based on experience and the challenge is to determine at which point further analysis will not reduce uncertainty.

Asking the Right Questions

The first and most important part of decision-making is being clear about what the decision is. It is very useful to turn the decision into a question.

For example, you may want to expand the business. The range of questions relating to this goal includes:

- Will purchasing a neighbouring property improve our profitability?
- Should we build a new packing shed?
- Should we employ another manager?
- Should we introduce a new crop into our rotation?

Sourcing the Needed Information

Having defined the question, you will then need to determine what information is needed to answer the question. For example:

Will purchasing a neighbouring property improve our profitability?

The relevant information is:

- An analysis of farm profitability for the past five years
- An estimate of the profitability of the new property
- The requirement for borrowing and the interest rates
- A list of extra capital required to develop the new property

Analysing the Information

Once you know the question and the information you can analyse the information using the following rules:

- Only count the extra income and extra costs – the things that will change your profit!
- Don't forget the costs saved and income foregone from the change – they are "extra" too!
- Value your capital - whether borrowed or not, it costs you, because you could pay off debt, or invest it elsewhere!

Knowing your Decision-Making Strengths and Weaknesses

Be brutally honest about your personal prejudice and biases when making a choice. For example, Bob Black knows that to meet modern consumer demands he would be more profitable if he implemented a fresh packed line.

However, he has always produced bulk vegetables for the market and this is what his father did as well. This lack of motivation to change means that Bob will forgo potential profit gains and has a conservative attitude to risk.

Bob must acknowledge that he is happy doing things how he has always done them – he is not delaying the decision rather he is comfortable with where he is at.



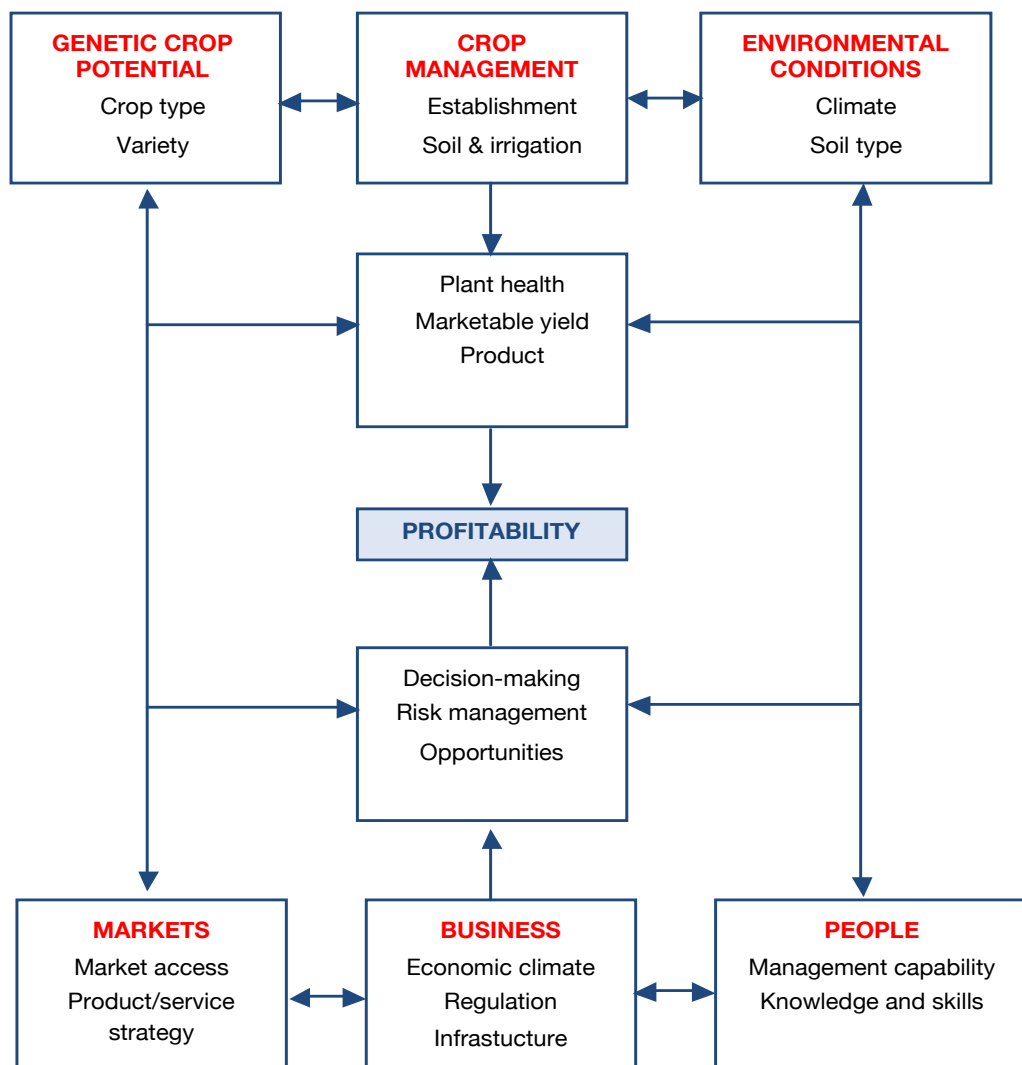
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Integrated Decision-Making

Decisions are never made based on isolated pieces of information – rather they consider the whole farming system incorporating personal, financial and environmental aspects.

Considering how the different components of the farming system interact can be useful in understanding the impacts of decisions. The following diagram describes some of the many interactions that need to be considered (see below).

Some people are highly skilled at putting all of the parts of the process together. People often resort to using “gut feeling”. The reason “gut feeling” is useful and appropriate for complex decisions is because we need to use our experience to take into account many factors at once and come up with the best decision in the circumstances. So, don’t be afraid after you have done all the steps in this fact sheet to listen to your “gut feeling”.



Further Information

Making good decisions can be hard and sometimes reading about it just isn't enough. Support to help with complex decision-making is available. If you would like to work through these issues in a small group in your area please contact Kristen Stirling from the InnoVeg program on 03 9882 2670 or at kristens@rmcg.com.au.



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