THEORETICAL ASPECTS OF BUSINESS DIVERSIFICATION ON FARMS

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The paper presents the research results on theoretical aspects of business diversification on farms, analysing the theoretical evolution of terms and concepts related to business diversification, diversification etc. The aim of the research was to describe and analyse the theoretical aspects of business diversification on farms. The monographic, analysis and synthesis, and comparable methods were applied in the present research. According to the research, it is concluded that the terminologies used in relation to business diversification are different; each terminology includes significant elements for rural business diversification. Yet, the authors developed their own definition for rural business diversification, thus creating a new scientifically significant term to characterise economic processes.

Key words: business management, rural areas, diversification.

JEL classification: Q1, Q5

Introduction

Rural areas are an important source of natural resources and ecosystem services, an environment for work and recreation, and a depository of the diversity of cultural and historical heritage. Each of these functions can gain a leading role or be combined with other functions in a balanced way.

Forests, agricultural land, mineral deposits, and water are the most important strategic resources for sustainable development of rural areas and the country.

Given the trends of socio-economic decline in rural areas – outflows of residents and economic and social activities from rural areas to towns or other countries – as well as the fundamental change that occurred in the economic structure of rural areas, especially in agriculture and related industries, in the sectors of manufacturing and services, an essential future challenge is to preserve rural areas and to shape them as a quality environment for life and work completely exploiting the diverse potential of economic development (Latvia 2030).

Conceptual documents of various levels are periodically elaborated for making rural development policy, improving the overall situation as well as solving certain rural problems. However, after analysing the rural development trends and the progress of present development processes in rural areas, one has to conclude that problems in rural areas get more acute and the overall situation indicates on the increase of economic backwardness of rural territories, a relatively decrease in the standard of living of rural residents, and the increase in the polarisation of incomes between urban and rural employees. Disproportional development trends in the territories of Latvia have already become apparent in the beginning of the agricultural reform in 1988. Before the reform, the existence of large collective farms ensured equal possibilities for economic, cultural, and social life in rural territories as well as infrastructure and its maintenance but a fast degradation of many rural territories consequentially began in the result of the reform of this economic system. The reason for it was the lack of a balanced and reasonable vision for developing the rural economy in the common rural policy of Latvia, as no recommendable farm development models were elaborated appropriate for local conditions.

Many scientists have researched and published their results on the development potential of agriculture and the diversification possibilities for farm businesses in the whole country and its several regions: L. Silina (2007, 2009); H. Jirgana (2008); S. Cingule (2009); D. Saktina (2009); S. Skesters (2009); M. Pelse and J. Felss (2009); and V. Boronenko (2010). Many economists and agronomists have researched agricultural possibilities and problems under the conditions of individual business management and market economy in the area of natural conditions in Zemgale as well as in the Southeastern part of Kurzeme region – the districts of Saldus and Tukums. For instance, A. Boruks (1996, 2000) researched possibilities of natural conditions, economic resources, and agricultural specialisation in Zemgale region. By analysing business performance results in his later pieces of research (2004, 2005), he discovered that the administrative division of territories did not correspond to the territories appropriate for agricultural production. For analysis of farm business
performance, V. Bratka (2000, 2003) has classified Zemgale planning region into two parts – Zemgale-1 (it includes the districts of Bauska, Dobele, and Jelgava) and Zemgale-2 which includes the other districts of Zemgale – Aizkraukle and Jekabpils.


However, theoretical studies on the aspects of business diversification on farms have not been done, which makes this research topical. The research aim is to describe and analyse the theoretical aspects of business diversification on farms.

The research tasks are as follows:
1) to analyse the theoretical basis of farm business;
2) to give a definition for rural business diversification and rural farms.

The monographic method, analysis and synthesis, inductive and deductive methods as well as logic and abstract methods were applied to carry out the present research.

Research results

Research on business diversification has been done in various works of foreign authors (Siegel Paul B., Johnson Thomas G., Alwang J., 1995, Wilson G.A. and Hart K. 2001 et al.). However, the most significant scientific work in this field in Latvia is a research done by H. Jirgena (2008) “Diversification Possibilities of Economic Activity in Latvian Rural Areas”. In relation to the studies done, it has to be mentioned that various explanations of the terms related to business diversification can be found in economics.

Diversification is regarded as the expansion of an enterprise’s activity profile or the foundation of multi-part enterprises whose components are not functionally interrelated. In economics, diversification is defined in a similar way - expansion of the range of an enterprise’s activity directions, expansion of the range of production directions (Explanatory Dictionary of Economics, 2000), expansion of an enterprise’s activity profile, foundation of multi-part enterprises (Dictionary of Foreign Words, 1999), diversification of auxiliary branches and/or additional branches of farms for the purpose of utilising by-products of the specialised industry as well as labour, natural, and other resources available on farms in a more complete and rational way (Spogis, 1999).

The “Rural Development Programme 2007-2013” defines business diversification as one of the four axes, the implementation of which is significantly related to the main goal “Wealthy Individuals in Sustainably Populated Rural Areas of Latvia” set in the Strategic Rural Development Plan of Latvia 2007-2013. Thus, politically, diversification of rural economy is related to overall development of rural territories.

In economic literature, the term economic diversification is also used; it is a process of structural transformation when resources are re-allocated from the primary sector (based on natural resources) to the secondary sector (industry), and the tertiary sector (services) (Siegel Paul, Johnson Thomas, Alwang Jeffrey, 1995). The changes in the economic structure determined by changes in demand, production technologies, and trade flows, actually nowadays characterise the economic development in rural areas as well. The basic assumption of a structural change process is that the economic structure has to be beneficially unbalanced in some sectors relative to the other sectors. The ratios of developing sectors to depressive ones change during the economic development.

The term diversification is used in industrial organisation theory, economic base theory, regional business cycle theory, and trade theory.

The term diversification developed by H. Jirgena has to be set apart, as it includes the goal of business diversification – “expansion of the range of economic activities, the number of products produced, and product sales markets by starting producing new goods or services within or outside the agricultural industry with the purpose of exploiting the disposable resources of farms more efficiently and employment of family members outside the farm to gain extra income” (Jirgena H., 2008). Unfortunately, the disadvantages of the definition have to be mentioned here.

One of the most essential disadvantages is that the definition is too extensive, including both production issues and search for new markets and multi-activity, while the definition is narrowed at its end by relating economic activity only to farms.

The Rural Development Programme 2007-2013, in its turn, broadens the definition of goals of business diversification:
- to fill the employment niche in rural areas and to develop alternative businesses in the sectors of production, processing, and services. It has to be based on a rational use of local labour and natural resources;
- to make rural areas more attractive for work and residence, preserving the traditional natural environment;
- to increase incomes of rural residents and supply new types of services to buyers and consumers.

Business diversification, depending on the place of activity chosen, may be divided into two groups:
- business diversification on the spot on a particular farm (organic farming, tourism, services);
- business diversification outside a farm (paid employment outside the farm).

Given the place of business diversification chosen, the types of business diversification may be various:
- traditional processing of agricultural produce;
- use of tags of high quality and special design on product packages;
- sales of products on a farm, new forms of commerce;
— diversification for the use of forests;
— forestry and wood-processing;
— adaptation of elements of landscape to tourism needs;
— preparation of farms for special tourist groups;
— development of environmental and health tourism;
— rearrangement of farm infrastructure for new non-agricultural activities;
— provision of services appropriate for rural needs;
— application of new information technologies on farms;
— cooperation on all levels of production;
— production of alternative energy;
— fishery, production and processing of fish and crawfish;
— non-traditional agriculture (Roman snails, earthworms etc.);
— production of exclusive home craft products (pear powder, candied cherry, natural raspberry juice, sauces of berries and fruit etc.);
— establishment of a network of foster families and social homes;
— development of handicrafts.

H.Jirgena (2008) has developed a classification of types of business diversification according to the object of diversification, the relation of the goal of diversification to the time of its achievement and the object, the place of origin of causes, and the direction and level of diversification. H.Jirgena summarised the basic theoretical conclusions on the relation of diversification to rural development, the agricultural industry as well as diversification possibilities within the agricultural industry.

One of the main conclusions is that the linkage between rural development and agricultural production weakens and linkages that are more direct emerge with other industries of the national economy. Yet, it does not mean that the role of agriculture declines or it has to be reduced by using political instruments.

Business diversification features important geographic, social, economic, and political aspects as well as globalisation. In the Western Europe, business diversification is classified into four types:

— the so-called para-agricultural activities on farms, for instance, milk processing into yogurt and cheese, not only grape production but also grape processing into wine, and sales of these products;
— non-agricultural activities on farms, for instance, tourism, landscape preservation, and handicrafts;
— paid employment on another farm;
— off-farm activities in other industries of economy – education, transport.

Individuals involved in the first two types are self-employed individuals, while those involved in the latter ones – paid employees (Rivza, Kruzmetra, 2000).

Business diversification is often understood as something quite simple – only as the expansion and diversification of agricultural production or the development of alternative occupations. Yet, the diversification of occupations in rural areas includes all the spheres of life, not only agriculture. It includes social care and services, preservation and improvement of environment and landscape, recreation, tourism, and activities related to interaction between urban and rural areas. A great role in this diversification process is played by new technologies or, in a broader sense, innovations.

Various factors can affect a choice of the types of business diversification and one can agree with H.Jirgena’s classification where the factors influencing business diversification are divided into endogenous and exogenous factors (Jirgema, 2008). The endogenous factors are the factors of national, international, and global levels (for instance, national tax policy, foreign trade flows, and their trends). Unlike the endogenous factors, the exogenous ones may differ not even on the municipal level (Rivza, Kruzmetra, 2003), and they are location of enterprises/farms, market possibilities, available resources, infrastructure, business model, labour consumption, technologies used, and specialisation.

H.Jirgema (2008) has described and stresses several subjective factors – age, gender, education, motivation, experience etc. of an owner. Such a factor as available resources, which, of course, are available in a greater amount and higher quality to large farms, was mentioned above. If the amount of disposable resources of a farm or rural enterprise is small, attention has to be paid to the law of diminishing returns. It means that production diversification is successful only in case if an increase in the output of goods/services, in terms of value, is greater than the cost of factors engaged in production, taking into account that price of the other factors of production or the success of business diversification directly depends on the quantity and quality of the necessary resources.

According to the authors, if only one factor is increased in production as a result of business diversification with the other conditions of production being constant, then it is not possible to ensure an efficient use of all the disposable resources. It means that it is important to determine the amount of factors engaged in production.

The possibilities and ways of business diversification are, to a great extent, affected not only by a farm’s location, cadastral value of land, availability of market and credit resources but also many subjective factors that are directly related to the education, knowledge, experience, age, family status, motivation, and public activity of the farm’s manager and/or owner.

According to the authors, the following very essential factors are necessary for business diversification within the agricultural industry:

— unstable socio-economic environment in rural areas;
— variable agricultural, climatic, and biological conditions in agricultural production;
— increasing competition with farmers of other European Union countries;
Business diversification is inevitably accompanied by various side effects or externalities, and the most significant ones are as follows: increase of farm incomes and tax revenues, improvement of a situation in the labour market etc.

Business diversification problems are formulated in the Strategic Rural Development Plan of Latvia (2007):
- problems of rural and agricultural development are traditionally separated;
- rural problems are weakly associated with general planning in municipalities, regions;
- insufficient skills, lack of innovations;
- a poorly developed economic base;
- infrastructure is inadequate for new conditions;
- an unclear future.

Businesses would better develop in rural areas if all rural residents planned their activity and paid more attention to their farm’s development, i.e. made economic analyses of their farm, which are based on precise accounting data. This disadvantage does not allow them to earn maximum incomes. A motivation to implement business diversification includes the self-determination of politicians – administrators of financial instruments – and rural residents, precisely executed preparations, political decision-making, extensive educational activities, and prudent and rational planning of development. Business diversification begins with actions of any individual and a decision on one or another course of development. Business diversification includes all support systems that have to create the prerequisites to implement it in the entire country and in a particular place.

Along with the term business diversification, some other terms have to be analysed, for instance, farm specialisation, and concentration.

Farm specialisation is the management of an enterprise to produce one or several certain types of products (or one or several certain types of services). It may become apparent on various business levels: international labour division, industries of national economy, technological processes etc., thus developing skills of employees, promoting technological progress, and saving working time, which leads to an increase in the output of lower cost products. Specialisation also features disadvantages: too much specialised work becomes unattractive, blunt; its management becomes complicated, business risk increases etc. (Economic Explanatory Dictionary, 2000).

To make business diversification occur, an object at which it can be done is necessary. Scientific studies provide various definitions of these objects.

A rural farm is an auxiliary farm of individuals living or working in rural areas or a farm on which incomes of households and family are supplemented by obtaining agricultural produce (vegetables, fruit, berries, meat, milk etc.) or by processing and selling these products (Economic Explanatory Dictionary, 2000). K.Spogis (1999) believes that a farm is a technical and organisational unit of production located in a certain place of residence and the factors of production concentrated in it are used for producing and selling agricultural produce.

Scientists from various European countries have studied the location impact of a farm on its business diversification. They have found that a probability to find a job outside a farm decreases with the increase in the distance to a town (Lass and Gemepshav, 1992), and the return on resources invested in diversification declines. It reduces job opportunities outside a farm – the time spent for travelling and the cost of travelling increase; thus, leading to a decrease in the real wage earned and its real value.

The authors classify rural farms into farms, rural craftsman and auxiliary farms, and rural companies. Business diversification is affected by the business model, as it, to a certain extent, is related to the size of farms as well as the quantity of goods produced for the market.

A farm is a one-owner enterprise that produces agricultural produce by exploiting land as the main factor of production. In the Republic of Latvia, it has to be registered at the Register of Enterprises of the Republic of Latvia, specifying the name of the house and parish. In case of bankruptcy, the owner may lose all the property (Economic Explanatory Dictionary, 2000).

Craftsman farms have not been defined in theory so far; therefore, the authors developed their own definition: a craftsman farm is a form of business registered by businessmen who operate in rural areas, at maximum exploit local resources that serve for producing and selling unique products of crafts.

A household plot is an auxiliary farm of individuals working in rural areas in which incomes of households and
family are supplemented by obtaining agricultural produce (vegetables, fruit, berries, meat, and milk). Its area of land depends on the possibility to acquire it as well as on the area desired by its manager or owner for exploitation (Economic Explanatory Dictionary, 2000).

A rural company is an association of individuals and legal entities to do business in a rural territory. The rural territory of a town with rural territory of the territorial units of a municipality may be regarded as a rural territory if more than 5000 residents live in the corresponding town (basic services for the economy and residents in the Rural Development Programme of Latvia 2007-2013, the Cabinet Regulations No. 525 of 7 July 2008).

A rural territory has a certain area of land or waters with their natural or human-set boundaries as well as, in general sense, a certain area of land surface; a confined area or place that is restricted by ownership (state-, organisation-, or individually owned) or use (natural resources).

Land that is owned or rented is exploited for the business diversification of a rural farm.

A definition of rural farm was developed based on the mentioned factors. A rural farm is an agricultural farm, which operates on an owned or rented land, based on any systematic and permanent economic activity producing incomes.

After summarising the mentioned factors and publications by foreign and Latvian researchers and becoming introduced to the research results of various projects and by using their own experience, the authors also developed a definition for rural business diversification:

Rural business diversification is a change or an addition to economic activity, the main goal of which is the diversification of risks and/or their reduction in the operation of a rural farm to increase its profit, stabilise it, and introduce innovative environmentally friendly activities.

Conclusions

1. The term diversification is defined in a similar way - expansion of the range of an enterprise’s activity directions, expansion of the range of production directions, expansion of an enterprise’s activity profile, foundation of multi-part enterprises, diversification of auxiliary branches and/or additional branches of farms for the purpose of utilising by-products of the specialised industry as well as labour, natural, and other resources available on farms in a more complete and rational way, expansion of the range of economic activities, the number of products produced, and product sales markets by starting producing new goods or services within or outside the agricultural industry with the purpose of exploiting the disposable resources of farms more efficiently and employment of family members outside the farm to gain extra income.

2. A rural farm is an agricultural enterprise, which operates on an owned or rented land, based on any systematic and permanent economic activity producing incomes.

3. After analysing the theoretical aspects related to business diversification, it was concluded that there was no single definition for rural business diversification. Therefore, the authors developed a definition for rural business diversification – a change or an addition to economic activity, the main goal of which is the diversification of risks and/or their reduction in the operation of a rural farm to increase its profit, stabilise it, and introduce innovative environmentally friendly activities. The process of business diversification can be ensured only at a particular object, and this object is a rural farm which, according to the authors, is an agricultural enterprise operating on an owned or rented land, based on any systematic and permanent economic activity producing incomes.

Bibliography


