The Business Manager’s Challenge - Evaluating Production Alternatives

The business manager’s challenge is to **be an analyst** to be an informed decision maker. Published information can be useful but managers need their own numbers. **The numbers need to do the talking.** These are the steps I suggest to follow when evaluating an opportunity.

1. Define the final report required to develop or communicate results. This written outline or report should be defined goals and objectives.
2. Generate the data and facts required to utilize your Excel™ spreadsheet calculator (s). Do “what if” analysis to gain confidence in results.
3. Check production, market including consumer and social acceptability, finance and economic feasibility.
4. Check your results against benchmarks, market and price information.
5. Bounce your results off knowledgeable experts.
6. Be willing to go back to step one if conclusions are judged not to be correct.
7. Present the report realizing if it won’t work on paper it most likely will not in practice. Avoiding failure is a cost effective management activity. **Of course implementation is everything.**
8. Measure and monitor results. Realizing in the words of a rancher friend your **conclusions can be – “It was one of those deals that should have worked”** (words of Don Keeling, ranch manager, Pleasanton, TX).

Points to keep in mind

- You manage what you measure.
- **P**rior **p**reparation **p**revents **p**oor **p**erformance.
- **In the end economics wins.** So always keep in mind supply and demand relationships and making profitable and sustainable resource management decisions. Markets are very efficient in agriculture.
- Your commitment to **continued education** is a necessity to be a top ranch manager.
- This old adage fits measuring profits. **If you don’t know or measure profitability, you are in danger of losing it.**
- Either you **are in control of your own marketing** or someone else is in control and they are not looking out for you.
- Science tells us if something can be done or is technically feasibility. Society tells us if it should be done. If it’s a go ahead profitability will win in the end.

Total Unit Cost and Net Income Calculation Components

1. Revenue (net of marketing costs)
2. Direct Costs
3. Indirect Costs
4. Total Production Cost (2. +3.)
5. Finance Cost
6. Total Cost and Total Unit Cost (TUC) (4. + 5.)
7. Net Income (1. – 6.)

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Cost Definitions

Depreciation is the accounting procedure used to allocate a capital investment to the annual use cost of capital assets' like vehicles, cattle equipment and machinery. Capital assets are purchases that have a productive life of more than one year. The number of years the depreciation cost is allocated each year depends on the "productive or economic life" of the asset less the **salvage value** or what the asset is worth after the **economic life** is completed. Information on capital assets is maintained in asset accounts. The tax CPA updates the depreciation schedule annually

Direct Costs are expense items that are directly related to production activity such as grazing and feed costs, health including processing and treatment, risk management and the initial calf or stocker cost. These costs go away when the production activity stops. For crops direct cost examples are seed, fertilizer, chemicals, irrigation and crop insurance. Direct costs account for the majority of production costs in agriculture. Management can control these costs.

Indirect Costs are costs that can't be assigned directly to a production activity. Indirect costs continue irrespective of the level of production activities. Depreciation, repair and maintenance of vehicles, machinery and equipment, labor and management, property tax are examples of indirect costs. **General and Administrative Costs (G&A) are indirect** costs that all businesses incur to cover bookkeeping, professional fees, insurance, office supplies, computer services, phone and utility costs and business travel. Administrative costs include the salary and payroll for support personnel. Owner operator compensation or withdrawals are indirect costs. Often ignored is management time required for retained ownership activity. Retained ownership should pay part of business indirect costs.

Finance Cost is the actual cash interest paid to finance the retained ownership cost. When custom feeding most feedyards will finance all feed and other direct costs and deduct the interest when the finished cattle are sold.

Owner Operator Labor and Management compensation should be included in the production cost calculation at a level equivalent to the salary required to hire a non-family member to provide an equivalent service. Compensation in excess of this amount must be considered capital distributions in order to reconcile the retained earnings and statement of cash flows. This makes a sole proprietor's cost comparable to a corporate business's cost calculation. Owner manager costs need to be included in production costs. Many sole proprietor businesses have withdrawals for family living. Withdrawals beyond an equivalent to the salary would be an equity withdrawal on a production cost.

Total Unit Cost (TUC) is the measure used as a replacement for the often used incomplete breakeven cost used in the beef sector. TUC is total cost divided by the net payweight or a crop yield. The costs included must be defined before being useful to a decision maker. Having direct, indirect and actual interest cost will mean production activity profitability is consistent with the business income or profit and loss (P&L) statement.