Turn a Profit

Producers can make more money by spending less.

by ***Troy Smith***

Ranching has been called a great way of life, but a poor business. It is true that the average return on assets for cattle producers is a meager 2%-3%, compared to the historic average of 10% return for all U.S. businesses. Over the last 30 years, while other sectors of the economy have grown and flourished, many cow-calf operators have floundered.

According to Barry Dunn, a range livestock production specialist at South Dakota State University (SDSU), more than half of South Dakota's cow-calf producers have gone out of business since 1970. Neighboring Nebraska's rate of attrition has been nearer 60%, and other states lament similar trends.

"You hear a lot of reasons for it, including a decline in demand for beef, too few beef exports or too many imports. Oversupply and vertical integration of the industry are blamed. People claim that high land taxes, restricted grazing on public lands and environmental regulations contribute to the problem," Dunn says.

"Yet some producers have faced all of those factors and hung on," he points out. "They have managed to pay the bills and still have something left over."

Manage efficiently

It is possible to generate respectable levels of profit in the cow business, Dunn says. And contrary to popular belief, profitability has little to do with size and scale. Big operators don't have an advantage, but financially smart operators do. Production efficiency is only part of the profit equation — just as important is managerial efficiency.

"Net income has long been the accepted measure of profitability. But which would you prefer — generating $35,000 of net income with a $1 million investment, or netting $35,000 from a $2 million investment?" Dunn asks. "We found producers who were able to reach very high levels of income with very low levels of investment. That's the true measure of managerial efficiency."

A SDSU study of profitability in the 1990s revealed startling differences among cow outfits in eight Great Plains states. According to the Standardized Performance Analysis (SPA) program, animal production and financial information was collected from 185 participants whose cow herds ranged in size from 20 to nearly 5,000 head. Dunn found and used 23 different production measurements that described cow-calf enterprises.

In order to address possible effects on profitability due to geographical location, the study area was divided into three regions. Representing crop-livestock operations was Region 1, including Minnesota and Iowa, plus the eastern third of each North Dakota, South Dakota and Nebraska. Range-based operations fell within Region 2, including the western portions of the Dakotas, Nebraska and Kansas. Region 3 was made up of Wyoming and Montana operations along the eastern slope of the Rocky Mountains, where public land use is of greater significance.

Factors affecting profitability

While production systems varied among the three designated regions, analysis revealed that geographic location was not a factor affecting profitability. Across all regions, the most significant factor was management's response to challenges and opportunities associated with a location, its resource base and the marketplace.

"Producers operating on public land weren't more profitable than those with deeded land. Those in the eastern region, with more cornstalks available, were not more profitable than producers in the West. Regardless of region, some people were able to take the resources they had and manage them in such a way as to create wealth," Dunn says.

Statistically, the research project participants fell into a low-, medium- or high-profit group. Low-profit herds were those whose return on assets (ROA) was lower than negative 6.7%. The medium-profit group included herds whose ROA fell between negative 6.7% and positive 12.9%. An ROA greater than 12.9% was indicative of the high-profit group. That upper 16% of producers was making good money in the cow business.

"The average ROA for high-profit herds was 18%, which is very competitive with returns from other businesses," Dunn explains. "Accordingly, the average producer from the high-profit group could generate $35,000 for family living and pay off all debt in 10 years with a herd of 200 cows. The average medium-profit producer needed 972 cows to provide $35,000 for family living, and no debt was paid."

How do high-profit producers do it? The study shows their weaning weights, death losses, pregnancy rates and replacement rates were not significantly different from enterprises that were barely scraping by or that were going deeper into debt. But high-profit producers marketed calves that were more valuable. Their calves didn't necessarily weigh more, but they brought more money — perhaps due to genetics, health programs or marketing practices. In most cases, Dunn says, "reputation cattle" are the result of a combination of factors that contribute to the perception of greater value.

Set apart

However, what really sets high-profit producers apart is their spending. By spending more appropriately, being more innovative, or just doing without some things, moneymaking producers had a lower total investment in their cow-calf

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enterprises. Compared to the medium-profit group, their average total expense per hundred pounds of weaned calf was $21 less. On a per cow basis, high-profit operators spent $116 less.

"If the most successful operators had any secret, it was that they 'worked' the marketplace. They bought inputs cheaper. By studying when and where to buy, they managed to pay less for things like machinery and baling twine, or even breeding stock," Dunn says. "By selectively shopping for seedstock, many producers are able to purchase excellent quality genetics at a cost much lower than less profitable operators."

Dunn says investment in more and bigger equipment can drive depreciation, interest on borrowed money, maintenance costs and expansion. If increasing production seems to be required in order to pay off the purchase of new machinery or equipment, then maybe the purchase wasn't justified. That doesn't mean producers shouldn't set goals for improving or expanding their operations. But high-profit producers achieve their goals while spending less money.

"I know of two ranches that implemented essentially the same kind of rotational grazing system. Both operators were trying to accomplish the same thing, but one did it at a cost of $5 per cow, while it cost the other one $35 per cow," Dunn says. "Or, if winter weather regularly creates problems during calving season, the answer might not be a new calving shed. It might be more cost-effective to match the calving season with better weather."

It is possible to maximize return on assets by using up an operation's resources. However, Dunn found no evidence of land abuse among the study's high-profit producers. All were applying sustainable production management practices, as were many less profitable producers. The difference was not in management of biological performance, but in management of financial performance.

While most have a handle on net income, Dunn says he fears that few producers calculate return on assets (net income divided by average total assets), which measures the return to invested capital, owner labor and management, and family living expenses. For help in calculating ROA and increasing managerial efficiency, he recommends programs, including SPA, offered through the Extension service.

"We're not telling producers to 'work harder.' We're saying, 'slow down long enough to consider all available resources, look at how they fit together, and how they can be used to generate wealth.' Often, producers can generate more income by improving efficiencies, but without increasing production," Dunn says.

"I grew up in the cow business. It is a great life, but a very challenging business. However, producers who maintain average or better levels of production and market cattle effectively, while keeping their investment low, can make respectable profits," Dunn concludes. "Even with a herd of relatively modest size, it's possible to enjoy the life and make money, too. That's pretty cool."

A look at the numbers

South Dakota State University's (SDSU's) Barry Dunn says actual financial data collected from Great Plains ranchers was analyzed by multiple methods, including a per cow and a per acre basis. And while many cattle producers might be more accustomed to thinking in those terms, Dunn favors analysis on the basis of dollars per hundredweight (cwt.) of weaned calf.

"That was the most sensitive measure, offering the most and statistically strongest differences," Dunn explains. "It's the most inclusive measurement of productivity and efficiency. It's also how cattle, at weaning and as culls, are marketed."

The following table presents a summary of financial data representing low-, medium- and high-profit cow-calf enterprises in terms of dollars/cwt. of weaned calf. Dunn says he draws particular attention to the expense entries for inventory adjustment. Note the 'negative' value for the high-profit group, meaning those producers actually built inventory.

Standardized Performance Analysis (SPA) Financial Summary

	LOW	MEDIUM	HIGH
INVESTMENT:			
Total assets	$352.64	$477.62	$317.34
Total liability	113.00	148.86	95.23
Avg. real estate	103.12	215.55	114.24
Owner's equity	293.63	328.75	222.11
EXPENSES:			
Veterinary medicine	5.95	3.95	3.46
Depreciation	17.98	11.11	6.15
Interest	7.16	8.54	6.77
Labor & management	9.98	7.38	5.84
Purchased feed	15.78	13.97	9.97
Inventory adjustment	26.28	1.28	-2.41
Total expenses	145.52	82.38	60.92
TOTAL REVENUE:	88.92	91.14	112.45
PROFIT:			
Breakeven	$136.43	$66.05	$40.63
Net income	-$56.63	$8.78	$51.53

"Low-profit and high-profit enterprises in our sample population had similar levels of investment and equity, but very different levels of expenses and total revenue," Dunn says. "Analysis would indicate that high levels of profit are a function of lower than average levels of investment and at least average levels of biological production, achieved with lower than average total expenses and above average market values for calves produced."

While cow-calf producers have examined the general economy, production practices and public policy for solutions to the profitability problem, Dunn says this study would suggest that solutions result from a focus on management decisions related to level of investment, cost control and effective marketing.