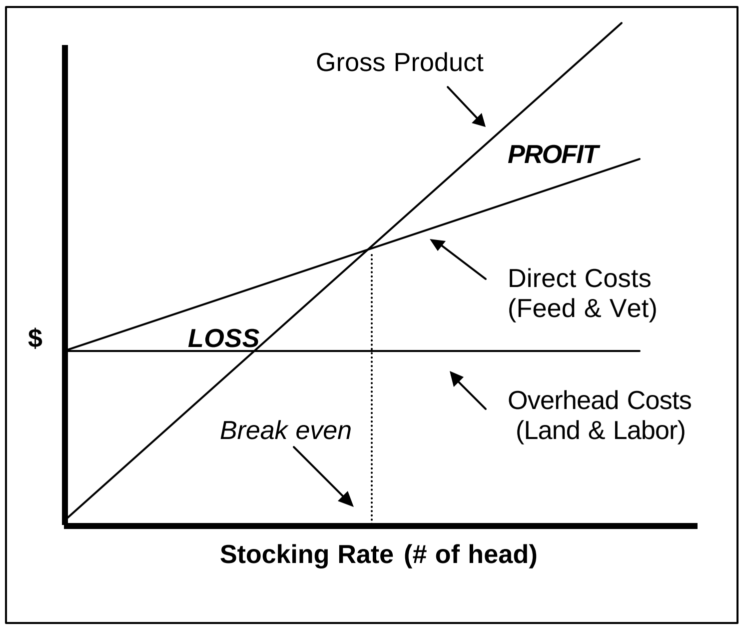
RANCHING FOR PROFIT

THE THREE SECRETS FOR INCREASING PROFIT

There are only three choices in any business: 1. We can make it profitable; 2. We can subsidize the business; or, 3. We can go out of business (bankruptcy). Whether we realize it or not, most of us choose the second option, we subsidize our businesses. I'm not speaking about government subsidies, but rather the ways in which we subsidize ourselves. Living off inherited wealth and appreciating land values, relying on off-farm income to make ends meet and working for less than it would cost to replace yourself are all ways in which we subsidize our ranches.

I'll assume that most ranchers would rather not have to subsidize their ranches and would prefer to make profit. There are only three ways to increase profit. At Ranch Management Consultants we call them the three secrets. They are:



1. Reduce Overhead Costs
2. Improve Gross Margin Per Unit
3. Increase Turnover

Reducing Overhead Costs

Overhead costs are those costs that don't change much as livestock numbers change. There are two types of overheads: land and labor costs. Any costs related to land (e.g. fencing or water trough repairs, property taxes, leases, etc.) are overheads. Likewise, any costs related to labor (e.g. salaries and benefits, vehicles and equipment costs, etc.) are labor overheads. Economists sometimes call these fixed costs. But they are not fixed, they can be changed, and that is one of the three secrets for increasing profit.

Improve Gross Margin Per Unit

Gross margin is a measure of the economic efficiency of your livestock. It is calculated by subtracting the *direct costs* of production from *gross product*. Direct costs are those costs that increase or decrease as cow numbers increase or decrease. Direct costs include feed, health, freight, marketing commissions, and interest on livestock loans. Gross product refers to the gross value of production. This includes livestock sales minus purchases. It also includes changes in the value of your herd. Total gross margin is divided by the number of animals in the herd to calculate gross margin per unit. Increasing gross margin per unit (the efficiency of production) is another way to increase profit.

Increase Turnover

In ranching, "turnover" is the number of animal units carried. If gross margin is positive, increasing turnover will increase profit if it doesn't increase land or labor costs or damage the resource base. However, there is no point in increasing the number of units if each unit makes a negative contribution toward overhead costs.

Historically, as an industry we have tried to increase profit by increasing production (increasing gross product). We have done an amazing job increasing conception rates and weaning rates. In fact, I'm told that the average beef cow in Alberta produces 20% more pounds of beef per year than she did just 20 years ago. So why aren't we 20% more profitable? Part of the answer is obvious: the increased production resulted from, among other things, increasing direct costs (e.g. feed, health products, etc.). But there is more to the story. Those direct costs had to be administered by someone (increasing labor overheads) somewhere (increasing land overheads). On most ranches today, overheads account for 60-80% of total costs. It is the cost of building and maintaining the infrastructure we created to increase our efficiency that has depressed profit.

Imagine a chain with three economic links: overheads, gross margin per unit and turnover. If the gross margin link is weak, strengthening the overhead and turnover links won't make the chain stronger, in fact, they may make the chain weaker by putting more stress on the weak link. In the next article in this series I'll describe how to find the weak link for your business. That's critical if you want to be Ranching For Profit.

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DIAGNOSING PROBLEMS & OPPORTUNITIES

In my previous article I showed that there are only three things a rancher can do to increase profit: 1. Decrease the overhead costs; 2. Improve the gross margin per unit; and 3. Increase the turnover (the number of units). But only one of these three things is the most important. If high overheads are the problem, increases in production efficiency are likely to increase your work load but may not significantly increase profit. If gross margin is the problem, then decreasing overheads won't have much effect and increasing turnover may actually help you go broke faster. It isn't enough to know the numbers. We must now find out what the numbers mean.

The diagram below shows the thought process we teach people at the Ranching for Profit School to diagnose the problems and opportunities in their businesses. Let's take a closer look.

We calculate profit by adding the gross margin for each enterprise and subtracting overheads. If the difference is positive the business made profit. If it is negative the business lost money.

  Gross Margin (enterprise a)
+ Gross Margin (enterprise b)
+ Gross Margin (enterprise z)
- Overhead Costs

  Profit (Loss)

Profit is calculated by subtracting overhead costs from gross margin. So if profit is low it is either because gross margin is too low or overheads are too high.

Gross margin is calculated by subtracting direct costs from gross product, so if gross margin is too low, it is either because direct costs are too high or gross product is too low.

Gross product is a measure of how much we produced and how much we got paid for it, so if gross product is too low it is either because we didn't produce enough (production), or we didn't get paid enough for what we produced (price).

If we didn't get paid enough it is either because the market is too low or our marketing is not adequate.

If the gross product is low but the price is reasonable then production is too low. If production is low it is either because we didn't produce enough things (reproduction) or because the things we produced weren't big enough (gain).

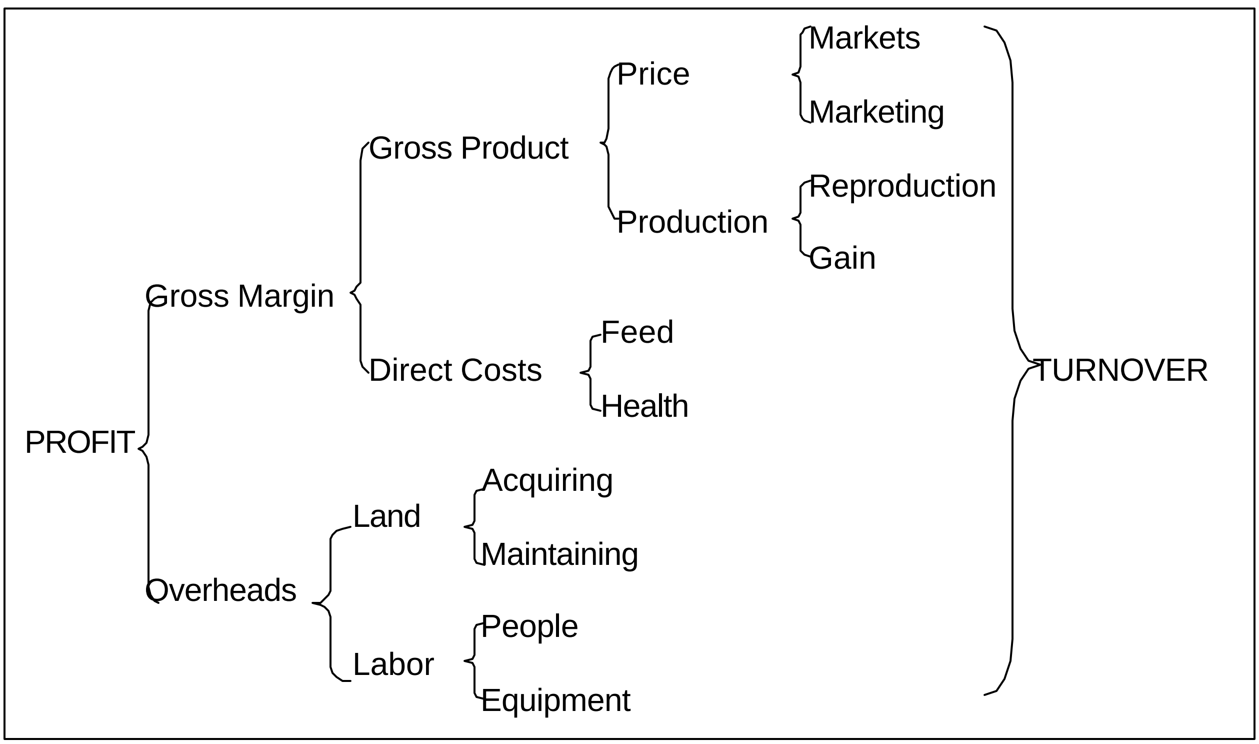
If gross margin is low, but gross product is not the problem, then the focus turns to direct costs. There are only two major direct costs: feed costs and health related costs.

If gross margin is healthy but the business still isn't profitable, the problem may lie in the overhead cost category. There are only two kinds of overheads: land costs and labor costs.

There are only two kinds of land costs: the cost of getting land (e.g. lease payments) and the cost of maintaining the land and the improvements on it.

If land costs aren't the problem, the focus turns to labor. There are two major labor costs: costs associated with people (e.g. salaries, retirement plans, health benefits, etc.) and costs related to vehicles and other equipment.

But we also know that cutting overheads and improving gross margins aren't the only ways to increase profit. Increasing turnover is the third way to increase profit. If gross margins are healthy and there's no room left to cut overheads, then turnover is probably the most promising way to increase profit.



At the Ranching for Profit School, participants review a case study of an actual ranch business in dire economic condition. When asked for solutions on the first day students come up with a shot gun array of possibilities. After using this thought process to guide them they discover the source of the problem and find that some of their original solutions would have actually made matters worse.

This procedure can help you pin point problems and opportunities in your business. And that's essential if you want to be Ranching For Profit.

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