DETERMINING THE REQUIRED RESOURCES FOR MY MARKETING CHOICE

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Introduction and Overview

- Value-added ventures are only successful IF the added value is MORE THAN the added cost
- Most Direct-marketing Value-added ventures fail because they are under-capitalized
  - They have seriously underestimated costs
  - They have greatly overestimated revenue
- To insure success of your marketing venture regardless of the type YOU MUST HAVE a realistic handle on costs and returns.

Outline

- Determining resource inventory
- Determining resource requirements
- Calculating your breakeven price

DETERMINING RESOURCE INVENTORY

Inventory Resources

- Land
  - Number and quality of acres available
    - Crop stubble or residue
    - Pasture/range
    - Timber
    - Waste
- Labor
  - Days/weeks/or hours available
  - Seasonal availability
  - Quality – is some labor better suited to specific parts of the operation?

Inventory Resources-continued

- Capital
  - Liquid
    - Cash
    - Market items such as calves, hay, purchased feed, etc.
  - Leverage →borrowed capital.
  - Fixed
    - Land
    - Machinery
    - Buildings/facilities
- Management → more difficult to quantify
  - Age and experience
  - Expertise
    - Production vs. financial vs. marketing
  - “It”

Basic Questions for Cattlemen

- How much forage can you grow? → acres and land quality.
- How much labor do you have?
- What type of labor do you have?
- What type of facilities do you have?→ fences, working facilities, etc.
- What are your areas of expertise?
- How much will this cost?

DETERMINING RESOURCE REQUIREMENTS

General rules for determining resource requirements

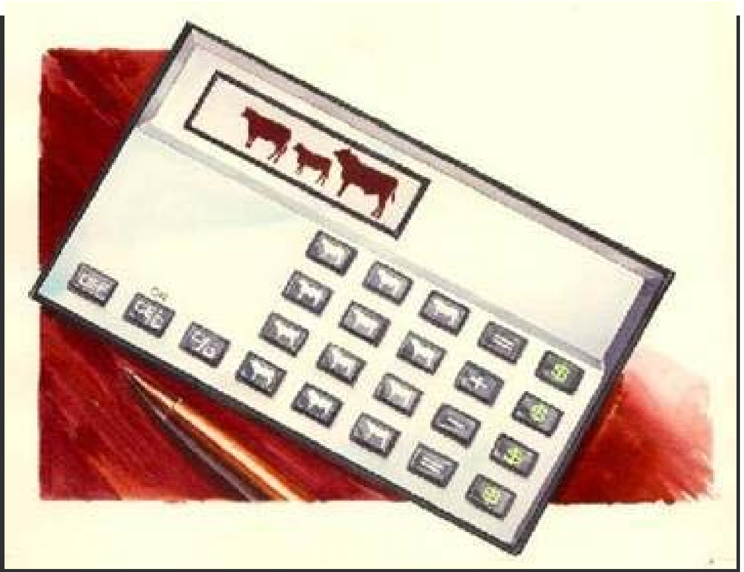
1. Determine the basic unit of production requirements
2. Divide your total resources by the basic requirements to determine how many head you can run.
3. Evaluate the feasibility of this scope.
4. If insufficient, look for ways to add resources
    1. Leasing land
    2. Hiring more labor
    3. Buying more cows
    4. Etc., etc.,

Some general rules of thumb

Animal Class	Acres required per animal	Forage Quality requirements	Labor & Management	
			Labor	Management
Mature beef cow and calf	1.50-2.50	Low-moderate	High	Low-medium
Beef stocker (400-800 lbs.)	0.50-1.00	Moderate-high	Low-medium	Medium
Finishing steer/heifer in a home feedlot	0.10-0.50	N/A-low	Low-medium	Medium
Finishing steer on pasture w/ supplemental grain	0.25-0.50	Moderate-high	Low-medium	Medium-high
Finishing grass-fed steer according to AGA standards	0.75-1.50	High	Low	High

More useful information

- Average cow cost ≈$650 per cow
- Pasture cost
  - Permanent pasture = $100-$200 per acre
  - Winter and summer annuals = $150-$250 per acre



CALCULATING YOUR BREAKEVEN PRICE

So what is an Enterprise Budget?

- Projection of costs and returns associated with the production of an enterprise for some future period, such as the coming year.
- An enterprise is a crop or animal that can be grown to produce a product or products.
  - Think profit/cost center
  - The live animal and the retail product are two enterprises.
- Can have many different budgets for a given enterprise based on various levels of production and types of technology.

It all begins with enterprise budgets

- Estimate Cost of Production
- Determine if an enterprise is profitable
- Determine which enterprise(s) contribute the highest return to fixed resources
- Plan use of limited resources:
  - Amount of labor needed
  - Type and amount of equipment needed
  - Amount of operating capital needed
  - Production practices to use
  - Substitution of inputs
- Obtain financing
- Determine cash or share lease arrangements

Example

Doc is a GA cattlemen that has seen and read about the growth in demand for grass-fed beef and decides he can make a lot of money doing this. He has a 30 cow herd on 50 acres of pasture. He figures he can sell 30 grass-finished steers at 1,000 pounds for $3/pound. By his math he figures that is $3,000 per steer or $90,000 per year. Since it usually costs him about $500 per cow per year ($15,000/year) that should net him a profit of $75,000 per year.

Is there anything wrong with his Math??

Enterprise Budget Organization

- Revenue
- Variable Costs
- Fixed Costs

Enterprise Budgets - Revenue

1. Live animal weight does not equal retail wt. → retail wt. usually 35%-50% of live weight
2. Usually the largest category of retail wt. will be the least valuable cuts--? Ground beef, sausage, etc.
3. How many animals will you lose in the finishing process?
4. Can you really plan on marketing all of your production directly?
5. Can you charge enough to make a profit?

Enterprise Budgets – Variable Costs

- Variable costs are those that "Vary" with the level of production
- Variable costs that may be affected
  - Cost of animal → THIS IS A MUST
    - Finishing is a different enterprise than cow-calf, farrowing, lambing, etc.
    - Many producers neglect to include the additional land requirement for finishing beef and other ruminants.
  - Processing costs if custom processed
    - Hauling
    - Custom Processing Charge, or
  - Processing costs if doing your own
    - Labor including workers comp and other taxes
    - Materials
    - Waste disposal
    - Fuel/Utilities
    - Repairs
  - Marketing → often VERY underestimated
  - Interest on operating capital

Enterprise Budgets – Fixed Costs

- Also known as overhead – costs that have to be paid regardless
- Depreciation and interest or principal and interest
- Taxes
- Insurance
- Management
- Others – Technically variable costs but can become fixed or "lumpy inputs"
  - Labor
  - Utilities
  - Marketing

Profitability Analysis

Returns above Variable Cost (ROVC) = Total Revenue - Total Variable Costs

Returns above Total Cost (ROTC) = Total Revenue - Total Variable and Fixed Costs

Returns to Animal = Total Revenue - Total Costs (excluding animal)

Returns to Labor = Total Revenue - Total Costs (excluding labor)

Returns to Management = Total Revenue - Total Costs (excluding management fee)

If revenue is NOT greater than variable costs,
you cannot make it up on volume

Example Budget

Example Beef Budget

Handling Marketing Costs

- Market development
  - Crucial to selling your product
  - Virtually all producers GROSSLY underestimate the amount they will spend on market development
- Initial and long-term market development – Capitalized as part of fixed costs
  - The initial leg work.
  - Market research, phone calls, samples, etc
- Operational Marketing – Included as variable cost in annual budget.
  - The marketing you will do after the business gets started (circulars, radio, advertisement, etc.)

Key Points

1. The retail product and the live animal are 2 distinct enterprises
2. For the retail enterprise you should only plan on the pounds or retail product you will have to market
3. The cost to convert a live animal to a retail product is more than you think
4. Consider all costs before pricing your products
5. If you are unsure of the cost or returns for something → Double the expenses and half the revenue of what your are expecting and you'll be close

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