Making a Living as a Manager in the Beef Cattle Ranching Business

One of the first challenges as we prepared for this education program was to present a "realistic financial view" of what it takes a young rancher manager to make a living in beef cattle ranching in Texas and Oklahoma. I agree. All young ranch managers should address this question. The only way to plan and work for success is to have a view of reality from the onset. It is much like a strategic planning process where one addresses a business's **S**trengths, **W**eaknesses, **O**pportunities and **T**hreats (S.W.O.T. analysis) for both internal and external factors. To be more positive I have started with strengths and opportunities. Then I will address weaknesses and threats and conclude with some of the challenges faced by young ranch managers.

Strengths

Ranching in Texas and Oklahoma

On the positive side, the beef national cowherd is at a 50 year low. Corn-fed beef export demand is favorable with growing opportunities as incomes rise in Asia and trade barriers are removed. Outside of Brazil, where grass fed beef is produced, there is limited growth potential for world beef production. The strong movement by environmentalists will eventually reduce cattle grazing on public lands favoring private lands in Texas. The quality of U. S. beef has improved over time and the market is sending positive signals for more improvements. Consumers still spend more on beef than other meats.

Proximity to Mexico for feeder cattle provides access to feeders that are improving in quality. Even more important Mexico is the largest U.S. beef export market providing Texas a competitive location advantage. Mexico accounts for 30% of exports in value in 2009.

The U.S. is a "hamburger society" from a beef consumption perspective. More than 50% of the beef consumed in the U.S. is ground beef. Using imported lean trimmings complements the corn fed beef production of ground beef. Hamburger then becomes a competitively priced meat with poultry and pork. The fast food chains are a blessing for the beef industry.

Texas and Oklahoma have a positive cultural attitude toward ranching. The culture clearly understands and support private property rights, human rights and proper animal care.

Cattle production is the most important agricultural sector in these states and its size and location insures this will always be a large and important industry. Texas and Oklahoma in 2010 account for 20% of the U.S. inventory of all cattle and calves. Texas with 5.14 million and Oklahoma with 2.07 million beef cows have 23% of the total U. S. beef cows. These states have 28% of the cattle on feed in the U.S. (USDA-ERS). The cattle feeding and packing industry give ranchers a favorable competitive position in the state and nationally.

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Texas and Oklahoma have abundant grazing lands that are not suitable for crop production. Cattle and wildlife are their highest and best use. Winter wheat stocker grazing is very complementary to the cow-calf, stocker and feedyard industry.

The research and education support system is favorable starting at the 4-H and FFA through the Texas A&M University and Oklahoma State University land grant university system. The scholarship support for students is phenomenal. There is just no place in the world that can match the education, extension and research opportunities these universities provide.

Ranchers have never had greater access to information offered by the internet and computerized accounting, record keeping and decision aids. Combined with the cell phone these tools provide a tremendous communication resource. All need to be managed in a time and cost effective way. Communication can be disruptive if not managed.

Being a ranch manager presents opportunities to the ambitious and educated young person. It is a demanding occupation requiring a systems approach to resource management and knowledge of multiple enterprise production and marketing. Economic reality requires business management skills as well and production skills. Personnel management skills are a necessity for ranch managers for the size of a ranch that will provide a reasonable standard of living. Ranchers must learn to deal with a sometimes-hostile non-ranch consumer that needs a better understanding of agriculture. Managers must deal with lenders, regulators and supporting professionals such as lawyers and accountants. It is not an easy life but a good life style (see reference McGrann "How Ranch Managers Achieve Success")**.**

Appreciation of Ranch Land Value

Cow-calf landowners have two businesses: land ownership and the cow-calf operation. Annual financial or economic operating profitability calculations rightfully do not include grazing land appreciation. The USDA data shows average Texas pastureland value increased from $103 to $1,410 from 2006 to 20108. In Oklahoma, value increased from $760 to $1,020 an acre (UDDA-NASS- 8-2010). This increase on the average of 7% a year over the 5 years had nothing to do with the cow-calf operating earnings or cash flow. Owning land has been a good hedge against inflation, allows for capturing some of the agricultural open space land use tax benefit and income tax savings. Demands for rural recreation and lifestyle have contributed to land appreciation. To realize this appreciation income land has to be sold and capital gains taxes paid.

Operating returns from the cow-calf activity has not been profitable over time when full costs are included. Many landowners can of course lease owned land, earn the appreciation return, and avoid operating losses. In reality, less than 4% of the beef cow-calf operations make their sole living from the cow-calf enterprise. This means that the industry can produce at least 50% of the feeder cattle and not be profitable to owners. These calves support the feedyard and packing industry and lower consumer cost of beef.

Historically the rich oil and gas resources have supported cattle and landowners. It is just hard to beat the black supplement in the Southwest. Off ranch employment and the new wind towers definitely support the ranch lifestyle.

U. S. Beef Sector Concentration

It has not always been fully appreciated but the sector concentration and associated specialization have allowed the sector to capture economies of scale (see table 1.). Of nearly 800,000 cow-calf operations, just 7%, or 53,772 operations, account for 74% of product sales. The seedstock sector, which primarily markets bulls to the commercial cow-calf sector, is relatively small in terms of number of operations and cattle inventory. Concentration exists at each level of the industry, as the top 25% of feedlot companies control nearly half the total feedlot capacity and 75% of sales. The four top packers account for around 80% of steer and heifer slaughter, which has scarcely changed since 1994 (Kay, Steve, May 2010).

Economies of scale will continue to bring concentration in agriculture. This concentration contributes to efficiency production and distribution low food costs to consumers. Consumers spent 9.5% of disposal personal income spent on food in 2009. Americans have the lowest on food expenditures as a percent of income for any country in the world. In addition, fifteen percent of the population received food assistance from the Department of Agriculture in 2009 – your tax dollars at work of course. Seventy percent of the Department of Agriculture proposed budget is to go toward support of nutrition programs.

The old "mom, pop and kids family farm image" is only political rhetoric as far as a major source of agricultural production and land use. The 2007 agriculture census reported there were 2,204,792 farms in the United States. However, the USDA definition of a farm makes this number misleading. To qualify as a farm in the census, "$1,000 or more of agriculture products were, or would be, produced and sold during the census year." With this definition, most of the "farms" reported are resident/lifestyle or retirement farms. This classification makes up 57% of the total number of farms, but accounts for very little agricultural production. Less than six percent of farms, or 125,000 farms, accounted for 75% of the total U.S. agricultural output. The classifications of "large family farms" (family farms with sales between $250,000 and $500,000) and "very large family farms" (sales over $500,000) made up nine percent of U.S. farms, but accounted for 63% of agricultural products sold. Farms with sales of more than $100,000 have 64.2% on the farm, pasture and range land.

Small Cow Herds - Lifestyle and Agricultural Land Use Taxation

Small cowherds with less than 100 cows account for 90% of the operations and about 50% of the beef cows. Herds of less than 50 cows account for 77 % of beef cow operations. A large number of these herds support the rural lifestyle, retirees, and a part time management requirement.

These small herds provide a saving of property tax benefiting from agricultural land use valuation. They live in rural areas, have the favorable agricultural land use valuation of property and can slip a few otherwise non-tax deductible costs of living items into their IRS Schedule F "Profit or Loss From Farming". Non-farm or ranch earnings or wealth supports their lifestyle. Of course these operations must have non-farm income to reduce the after tax cost of these small herds. Rising fuel, fertilizer and feed will make these high cost herds less enjoyable to maintain. One alternative is to lease the land to a cattle producer, reduce operation costs, and still take advantage of the favorable agricultural use valuation of land tax.

Small herds can become very expensive. The way to run up production cost is getting into the beef cattle seedstock business and become prey to the vehicle, machinery, and feed salesperson.

Operators with sufficient off ranch income can afford these small cow-calf herds. Increasing costs of feed, fertilizer and fuel will make these lifestyle herds more expensive.

Table 1. Structure and Components of the Beef Industry

Component	Characteristics, Size and Structure		
Seedstock	Angus Registrations	333,766	
	Hereford	63,943	
	*Specific number of operations not available		
Cow-Calf	**2007 Beef Operations**		**Total: 766,350**
	Herd Size	% of Operations	% of Inventory
	<100	90.3	17.2
	100 to 499	8.9	45.9
	>500	0.8	38
Cattle and Calves	**2007 Beef Cattle**	**6.5% of operations account for 75% of sales**	
	Herd Size	No. of Operations	% of Operations
	1 to 49	607,708	79.4%
	50 to 99	84,253	11.0%
	100-199	43,575	5.7%
	200-499	23,635	3.1%
	500-999	4,413	0.58%
	1,000 to 2,499	1,215	0.16%
	2,500 or more	185	0.02%
	Total	**764,984**	
Stocker/Feeder	Data not available		
Feedlots	**Top 25 Operations**	107 Yards	
		Head Capacity:	**5,192,500**
Dairy Operations	Total Operations:		69,763
	Operations accounting for 75% of sales:		14,417

The 40 head cow-calf producer has two bulls and one pickup. The total depreciation on these assets alone is $5,050 or $126 per cow. This does not account for other depreciable assets such as the equipment, machinery, horse and improvements all “real cattlemen” have to have.

Small herd owners can use economic principles to reduce the cost of having cows. These operators need to avoid the temptation to have too much investment in vehicles, machinery and equipment. The old saying “if it rusts you do not need it” is a good rule. Location is key to gain from land appreciation for these lifestyle operations.

Opportunities to Make a Living as a Ranch Manager

Ranch Management Position Opportunities

This seminar focuses on providing the tools so participants can address this very important question about making a living as well as improve skills to deal with ranch business management. In addressing, the “how managers can make a living question” I have defined three broad ranch ownership situations where managers work.

1. Working as a hired ranch manager with no equity in the business.
2. Being part of a family owned business sharing equity and management responsibilities with other family members.
3. Full business ownership and management control of the ranch business.

Each of these alternatives has a number of realities for young managers trying to make a living. First a brief description of each ownership situation managers face.

Hired Ranch Manager

Although there are limited job opportunities for ranch managers, it is a way to participate in with no equity at risk in the business and enjoy the lifestyle and work. Today's young manager will need to have a good deal of ranch experience and a college education to be competitive. A balanced education including economics, marketing and finance courses with the animal, grazing and wildlife courses will prepare ranch managers for the anticipated tough economic environment. Communication and leadership skills are extremely important. Young managers can expect a low wage irrespective of knowledge and experience. In the best case starting as an assistant operations manager under a good manager would be favorable.

Satisfaction of being a cowboy or just the operations manager is not the route to a business-oriented manager that warrants a salary for a favorable living. In any case the spouse must be committed to the ranch lifestyle and standard of living. Realistically most managers will have the spouse working off the ranch.

When looking for a "ranch business management" job it is important to have personal goals in mind and a clear understanding of expectations of the ranch owner. Being able to review and understand the job description is very important on the front end of employment. Hired managers must expect to have limited decision responsibilities. In most ranches, young managers will have "butler" responsibilities to care for owners, their families and friends visiting the ranch.

Being Part of a Family Owned Ranch Business

There are many ranches owned and operated by families. These businesses have both on- ranch active family participants. Often one member lives on the ranch and others make their living away from the ranch. Often those not living on the ranch have minimal commitment in day-to-day operations. Ideally, the individual (s) that takes the manager role in a family has the same education previously described for the hired manager. It is imperative that the person have experience working away from the family business before coming back into the ranch management job. Having the broad education is imperative. Knowledge and skills in finance, planning, marketing and communications are even more important as the burden of decision making and taking blame for all that goes wrong is part of the job.

Realistically family ranch businesses are difficult to sustain financially especially as they transition between generations that face high estate taxes and low operating rates of return on ranch investments. One can pretty well count on the family members or in-laws that know the least about ranching and the financial reality being a source of family conflict.

Full Ownership of the Ranch Business

Full ownership and control of a ranch business is the ideal situation. It means that their money to own the ranch business from after tax inheritance or outside of agriculture. No one can start a ranch business with ranch earnings and expect to earn $60,000 before self-employed and income taxes (see Table 2). With a 2% return on investment in ranching it would require $3 million in equity. Assets earning 2% can service only limited debt.

Table 2. ROE and Equity Required to Support Living Withdrawals

	Total Debt Free Ranch Equity				
	1,000,000	2,000,000	3,000,000	4,000,000	5,000,000
	Pre-Tax Net Ranch Income to Support Living Withdrawals				
ROE %*					
1.0%	$10,000	$20,000	$30,000	$40,000	$50,000
1.5%	$15,000	$30,000	$45,000	$60,000	$75,000
2.0%	$20,000	$40,000	$60,000	$80,000	$100,000
2.5%	$25,000	$50,000	$75,000	$100,000	$125,000
3.0%	$30,000	$60,000	$90,000	$120,000	$150,000
3.5%	$35,000	$70,000	$105,000	$140,000	$175,000

*Return on equity (ROE) is pretax owners must pay self-employment and income tax before paying living expenses and for savings.

Even when the ranch is owned, there are no short cuts in the education and experiences required to make a living, including the spouse's full commitment. The earning capacity of the spouse off the ranch can reduce family living withdrawals requirements like covering health insurance costs and increase debt repayment capacity. This explains why ownership of many ranches is supported by off-ranch employment.

Making Ranching Successful

When we address making the "ranch business successful," we are only including the cattle and wildlife production and marketing activities but not the mineral or off ranch earnings. Obviously it is a different business and owner consumption situation if there is revenue from oil and gas or off-ranch earnings.

Working with Ranch Owners

1. What is the main financial objective of the owner and what is the specific goal of analysis addressed? Smart goals are specific, measurable, attainable, realistic and traceable over a specific time.

2. What are different ways to accomplish the goals – alternatives?

3. What are the main owner resource, management skills and other constraints that will limit the alternatives?

4. What is the current financial and production status of the business? Does the owner have financial needs that require change?

5. As a manager are you in tune with the decision makers? Do you have an audience to listen or read ranch performance information?

6. Does the management information system (MIS) provide the supporting and performance information to effectively manage the ranch?

7. Does the owner have a prepared business plan and is it update annually?

Getting the answers to the questions is extremely important for data collection and analysis to provide the numbers that will communicate to the decision makers. Results of the analysis need to be provided in a one page written report with back up data and information. Wide swings in prices necessitate sensitivity analysis in all projections.

Financial and economic information should be assembled in many ways to address questions decision makers face. Good cost information, for example, can be used to identify areas for reducing costs, evaluating herd expansion and reduction decisions and comparing alternative cow-calf production systems. The "what if" tools used to develop cost information can be used to evaluate different technologies, retained ownership or capital investment strategies. Costs are used to identify profitable opportunities. Cost data is also used for short and long term planning. Budgeting is increasingly important in the current economic environment. The volatility in prices and costs requires frequent updating of budgets. In developing leases and other contractual arrangements, accurate and timely cost information has never been more important.

Weakness – The Ranch Business

Looking at the Ranch Business

It should be clear that it is a difficult task to make a living owning and operating cattle ranches in the Southwest. Owners of ranchers have a large investment in land, cattle, vehicles and equipment. This investment is characterized by generating a poor operating cash flow and low return on investment (ROI). Wealth with a poor cash flow is a ranch business reality. Because of low operating profit margins, it is difficult to recover lost equity from management errors, poor markets and droughts.

A **ranch business** (not a recreation or part-time ranch) exists to make a profit and to sustain equity growth. If equity growth is not achieved, then the business is declining. The equation that measures any business financial position is Equity = Assets minus Liabilities. Business growth (change in equity) is the change in what you have (assets) minus what you owe (liabilities). Change in equity or after tax profit measures performance. Summarized are the accounting equations to keep in mind.

Accounting Equations

- Equity = Assets – Liabilities
- Assets = Liabilities + Owners' Equity + Net Income / Revenue – Expenses
- To measure business performance requires a complete and accurate measure of Net Income or change in equity.
- The only way to change equity is to earn it (revenue – expenses) or subsidize the business with capital contributions. Equity change is after income taxes are paid.

- Equity is reduced if expenses are greater than revenue and/or if capital distribution (withdrawals) is greater than capital contributions from other sources.

The accounting systems that account for all revenue and expenses, including depreciation and accrual adjustments are the only way equity change can be measured. For IRS tax purpose most ranchers use cash reporting so must do their bookkeeping on a cash basis. Cash accounting, when complemented by accrual adjustments which include inventory change and end of the year calculation of payables, receivables and accrued interest and taxes, can be used to generate accrual adjusted financial statements. This measures profit or change in equity and provides the same information as accrual accounting. Producers are well aware that the IRS Schedule F or cash reports do not measure profit.

There is very limited **published information on true ranch profitability. Cash profit** is a term used by Cattle-Fax, Drovers, Livestock Marketing and Information Center and others in the cow-calf sector. This term is a **wrong use of the financial or economic term profit.** When labeled cash costs it is a **cash margin not profit**. This signals to the reader that the costs are not complete. It is hard to understand why providers of cow-calf cost and profit information under report costs. This incomplete data is reported without explanation. Two major costs not included in cash cost reports are depreciation and withdrawals for living or compensation to the owner operator. All feedyard closeouts report **net income margin** above direct costs **not profit**.

Depreciation is an accounting method for allocating the cost on a capital asset over its estimated useful life. Depreciation is one of the top third or fourth most important costs for a cow-calf operation. Most operations purchase some cows, herd bulls and have vehicles, equipment and machinery. Building, fencing and other improvements are depreciable assets. Depreciation is non-**cash cost** as no one writes a check to pay for depreciation. The check is written when the asset is purchased. Depreciation is the annual calculated cost to reflect the use of the capital assets over time. Enterprise budgets frequently underestimate indirect, general, and administrative costs.

In their long-term trend report Cattle Fax makes a comparison of cow-calf cash margin to feedyard margin. Concluding that "Average returns for cow/calf operations have been positive every year during the past 10 years and will continue in 2010" (Cattle Fax, July 23, 2010). The Cattle Fax article does not state these are cash costs for cow/calf operations that do not include depreciation or recognize a return to owner operator return to labor and management. If there is no depreciation of capital assets that include purchased breeding stock, vehicles, machinery, equipment and improvements these assets are free and owner is not compensated the cow-calf enterprise should have a positive margin. This cash margin is a very poor estimate of profitability. The cow-calf phase is an investment phase. Performance must reflect ROI. If Cattle-Fax had used a full cost and ROI, they would have realized that the lack of profitability in the past 10 years explains a good part of the decline in the cowherd. The feed yard, packer and retail sectors are margin phases of production. Reviewing margins is an indicator if properly full cost calculated. **The cow calf sector is the investment sector** and ROI is the proper measure of financial performance. Review of replacement heifer-cow puts this reality into proper perspective (Bevers, 9-2010).

Be very cautious when using reported cattle industry breakevens, net income and profit projections. Most frequently, beef cattle breakevens do not include all costs, and profit values overstate true financial profitability. Developers of these values often ignore self-employment and income taxes, returns to management and labor and overhead costs.

Truly profitable enterprises provide retained earnings that can be used for savings, capital investments, withdrawals or reduce debt. All costs and taxes are accounted for. Always question what is included in cost and income reports or projections for cattle operations.

Standardized Performance Analysis (SPA)

The (SPA) data provides a true and complete measure of ranch profitability (Bevers). In summary during 2005-2009 the average return (ROA) on market value of assets was 1.19% (weighted average ROA by number of breeding cows was 1.6 %). Through work with the SPA participants, we know top ranchers are doing much better than others are and most can improve performance.

The only small herds that have a chance of making a financial profit are those that are part of a cropping operation. The cowherd benefits from using crop aftermath and marginal land that cannot be cropped. In addition, the producer can avoid the purchase of vehicles, machinery and equipment. The cattle industry benefits from these private owners' outside income and tax **subsided cow-calf operations** that produce nearly 50% of the calves. Predicting the expansion and contraction of this group of operations is difficult but increasing costs will make small herds more expensive than in the past. If the "open space justification" for low property tax does not change small herd part-time operators do have some staying power especially near heavy populated urban areas.

Even for ranches operated for only lifestyle, reason the practices presented can help manage the cost and minimize the equity use. Paying attention to business details and prudent reporting for tax management are necessary even if owners do not have to make a living ranching.

Financial Sustainability

Financial sustainability of a business is measured by the ability to maintain equity and to generate a net after tax positive income and cover withdrawals for owner operator labor and management. The reason withdrawals and distributions are important in evaluation of business sustainability is because frequently the ranch business must provide income for living withdrawals.

Measuring the financial sustainability of a business does not require any new methodology since the business accrual adjusted financial statements clearly show historical financial sustainability. The Farm Financial Standards methodology provides the guidelines for measuring equity change and ROI using the balance sheet and accrual adjusted income statement. At least 3 years of history and projected financial statements can provide information to evaluate future sustainability. Projections are always limited by the ability to forecast future productivity and commodity prices. History is real but one can be misguided by past performance without realistic projections.

Cash is king in the ranching business. In the short run cash income can be maintained by not replacing capital assets, called living on depreciation or not spending money on inputs like brush control and fertilizer.

Remember it is net after tax income that increases equity. For every equity dollar lost it will take $1.15 to $1.28 net income, depending on the tax rate, to earn equity back. Ranch investment cash flow cannot service much debt or support large family withdrawals. This is why so few families make their living solely from ranching in the Southwest. There is no simple way to make this investment highly profitable when one looks at ROI.

Equity can be sustained by contributions from other business activities or salary earnings. However, to measure business financial sustainability, it is advisable to evaluate the ranch business then considers the non-business earnings and oil and gas contribution.

The low rate of operating return on farm and ranch assets creates a major debt service challenge for borrowers. When producers make an investment, the returns generated should be greater than the cost (interest rate). In order to pay the cost of capital, the producer must use after tax return from equity or other sources of income to pay the difference between cost and earnings. Ranches just have a very low repayment capacity and must avoid high leverage.

The beef cattle industry is still often a predator or prey situation. It is wise to have the information to avoid being the prey. All this information improves the communication between decision makers. "Let the numbers do the talking" is a challenge in the cattle industry as it is less common for cow-calf producers to manage by the numbers than any sector in agriculture. Any business decision that focuses on evaluations of alternatives needs to begin with a good set of "numbers" that clearly show the current situation and then present the numbers for alternatives. **The users must understand the numbers so they really communicate.** In addition, as with any communication, the users must have confidence in the numbers. Communication has to take place in a timely manner before decisions are made.

Closeouts from retained ownership are more important than projections. Actual cash flow means more than budgets.

Accounting systems have to meet IRS reporting requirement but can be organized in a way to provide the financial numbers that can used to develop accrual adjusted financial statements that communicate real financial performance. Calculation of return in investment (ROI) is critical in measuring the cow-calf sector – the investment phase in the beef cattle sector.

Opinions and talk without the numbers or mixing emotional reasons for doing things will not provide sound informed business management decisions. **Talk is cheap when it is not backed by good accurate and timely numbers.** Many ranchers and people around them are willing to express opinions with little information or understanding of the decision environment (historical or current situation). Having good numbers is increasingly important for communication with family members, many with inadequate experience and information to judge performance.

Threats - Making a Living Ranching

Likely the biggest treat ranchers have is often self-inflicted in that the ranch is not treated as a business. Too much emphasis is placed on the life style. If capital or off ranch, earnings are inadequate to support the family living and meet debt payments the business in not financially sustainable. Living within your means is a challenge in ranching. Too many ranchers wish to live the lifestyle of urban dwellers. An expensive goal in this world of high energy cost.

Inheritance tax places a major threat to ranch survival between generations. High rangeland values with assets that generate low earnings cannot pay high inheritance taxes. Transfers force breakup of properties that are inefficient and require outside earnings to be sustainable.

The ranching sector is increasingly challenged from a business perspective. The ethanol program has led to much higher costs of gain and market volatility. The availability of ethanol by products has shifted more cost advantage to corn growing areas. This is particularly true for wet distiller's

grains when the plants are close to feedyards. Distiller's grain has proven to be excellent feed to winter feeder cattle and in the feedyard.

Low operating returns means that there is limited repayment capacity. Use of financial leverage must be done with caution.

International trade restrictions make it difficult for all sectors to have dependable markets. Think about the damage misnaming H1N1 flu as swine flu did to the pork industry. The BSE disease did billions of damage to the beef cattle sector even after it was scientifically proven not to be a health threat in the U.S. Japan still has not taken away this trade barrier. The U.S beef industry suffered a tremendous loss from the mad cow disease especially as related to the export market. This scientific trade restriction continues today. One can question if the industry is in any better position to avoid the dreaded foot and mouth or other disease in the future.

There are negative attitudes toward change in the beef sector. Source and age verification and national animal identification systems are in place in all major beef exporting countries of the world except the U.S. This is based on very backward thinking. The same attitude justifies year around breeding seasons and not pregnancy testing cows.

Loss in beef demand due to the recession, rising production costs, high estate taxes, animal right movements on top of the normal drought and volatile cattle priced conditions are reducing profit potentials in the beef cattle sector which historically has not been profitable.

Some Texas and Oklahoma ranches have been blessed with mineral income or owners with off-ranch income. This blessing has allowed many ranches to be managed with less attention to economic efficiency than ranches in states like Nebraska and Kansas. These ranches must make their living from ranching. This reality presents a threat of continued fragmentation of ranch land into non-economic units dependent on off-ranch income. At the same time, there are many opportunities to apply economic principles and good business practices on many ranches.

Increase in land values does make landowners wealthy but makes it prohibitive for young ranchers to enter the sector without equity contribution from parents or off ranch income. The high cost of estate transfer means it is difficult to hold ranches together between generations.

Competition from poultry and pork is very real and these lower cost meats are continuing to take market share from beef. USDA reports all fresh beef being three times the retail price of whole fresh broilers (ERS-USDA June 16-2010).

The promotion of natural, grass fed and organic beef as "being different" has perhaps confused the consumers. Production of beef in these systems results in using inefficient production systems to produce beef that in many cases as a business is not financially sustainable. This perhaps is only an insignificant threat, as most will not survive the economic reality. The press and other promoters would do the industry a favor by providing more objective nutritional information and economics of the production of these products and the distribution system. Producers need to do their numbers because so many times these are "sucker opportunities" that come and go quickly.

Caution is warranted for many of the "branded beef "production and marketing efforts. History has shown very few can survive. The markets will not pay their higher cost of production and distribution. In beef it get down to a very practical reality. Eighty percent of the carcass goes to hamburger or low valued cuts. It is very difficult to market these products higher than commodity beef. Managers are advised do an economic evaluation of the complete production and marketing supply chain before getting involved in branded product efforts.

The return to local food production promotion is described by Greg Henderson's in his article "Farming Without Financial Motive is Gardening" is with empty promises. These gardening alternatives sure do not warrant tax dollar subsidies. The lack of science based study of the nutrition and economics these food from different sources and production systems means a great deal of objective research is needed. Food facts need to be presented when promotion is based on condemning the commercial sector that accounts for 96% of total food production the healthiest food at the lowest consumer cost in the world.

Challenges Young Beef Cattle Managers Face to Be Competitive

Being Competitive

"The only truly sustainable competitive advantage is the ability to learn and adapt faster than competition," stated Jack Welsh, former chairman and chief executive of General Electric. The beef sector in general has not been able to keep up with their competitors in poultry and pork production. These industries have efficient production, rapid technological change and effective, consumer-oriented product packaging, all of which make them highly cost competitive with beef.

Young producers should focus their attention on anything that makes beef the consumer-preferred protein choice. It is important for producers to learn and appropriately respond to consumer preferences. They should also work with everyone in the supply chain to provide the highest quality and safest product possible. In order for the industry to prosper, investors need to be profitable in all segments.

To be successful in domestic markets, beef producers must be focused on what buyers and consumers want at each step in the supply chain. For example, high-valued beef travels through the feedlot phase, therefore cow-calf producers must communicate with this segment. Producers will be able to produce more cost effectively if, instead of fighting the market, they conform to its demands as much as grazing resources will allow. Demand will always be the driver in any market never supply.

Competitive advantage comes in two forms: cost advantage and differentiation advantage. It is challenging for producers at the cow-calf level to differentiate the beef they produce, as quantity is always limited relative to the size of markets. Differentiation comes through cooperative win-win relationships with other segments of the supply chain.

Texas and Oklahoma cow-calf producers must put a focus on the grazing land and grazing system productivity. No cow-calf operation can be cost competitive without effective utilization of the grazing resource. Grazing is what makes the beef cow competitive.

Pinpointing the proper herd size that fully employs resources is important, due to tremendous economies of scale in the different phases of beef production, processing, distribution and marketing. Producers must be honest: Are you in the "cattle business" as a serious competitor, or for the enjoyment? If for the latter, there should be an alternative source of income to accommodate the "consumption or enjoyment" activity.

Cost effective and productive cow-calf operations will generate a higher operating ROA. Larger operations that capture the economies of scale can generate a 3-7 % ROA. In the business world, that is not a high profitable investment. A 15 to 20% ROA would be a high operating return.

Beef Export Markets

Producers need to be competitive in the domestic market first, and consider the international market second. Many beef exporters participating in world trade first serve a large domestic market. Exceptions are Australia, New Zealand and Uruguay, which have high production capacity relative to domestic demand. Beef exporters are constantly faced with a never-ending battle to sustain export markets due to trade restrictions. Asian and European countries, in particular, have proven difficult to deal with, as they have ongoing efforts to protect inefficient domestic beef producers.

In reviewing market potential, look first in neighboring countries. Mexico and Canada, border countries, accounted for 60% of United States exports in 2008. The point suggested is this: capture as much of the domestic market as possible before making efforts to develop export markets, which are inherently difficult, and not always a profitable alternative. It is important to look for marketing opportunities for high quality loin cuts, and import lean trimmings from lower valued beef. This is a major strategy in the U.S., where 55% of the beef consumed is ground beef, or hamburgers. For this product, imported lean beef trimmings complement domestic corn-fed beef.

In matters of world trade, no consideration of international food production and trade can disregard the market growth potential of China. With 1.3 billion residents, it holds 20% of the world population, and has increasing purchasing power. Aggressive by-lateral trade policy with China should be part of all trade efforts for all countries.

Reproductive Performance

Reproduction will always be the number one production performance challenge for the cow-calf producer. Producers should be aware of several important measures of reproductive performance. To begin, the weaning rate based on exposed cows should be calculated for each calf crop. Managers should also identify losses from breeding to calving and weaning, and finding cost effective ways to reduce these losses. Intense management based on calculations will be the driving force behind operating profitably. For cow-calf operations selling weaned calves, the best performance measure is pounds of weaned calf produced per female exposed, or average weaning weight.

Calculation of cow-calf productivity: pounds weaned per exposed cow

A	Total Number of Calves Weaned	
B	Total Weaning Weight of Calves	
C	Average Weaning Weight	**C = A/B**
D	Total Number of Cows/Replacement Heifers Exposed *(add purchased bred cows or pairs, subtract bred cows or pairs)*	
E	Weaning Percentage	**E = (A/D)*100**
F	Lbs. Weaned Per Exposed Cow	**F = B/D**

Reproductive shortcomings will likely be nutritional and be first observed in low pregnancy rates of first-calf heifers being bred for the second calf. Cow longevity is another important economic factor, as it is costly to produce replacement heifers. Annual cost (reflected in annual depreciation cost) is lower for cows with long productive lives.

Sire selection also has significant economic value, as bulls account for such a large part of an operation's genetics, and there is a high economic cost for culling poor producing females. Cross breeding that can produce cattle that meets market demands is another economic opportunity for producers to consider. Economists like "free lunches" which require managers to execute a top production and marketing program to capture real value.

Grazing Land and the Grazing System

There is no low-cost beef production system in the world not backed by a well-managed, productive grazing system. Every competitive exporter of grass-produced beef excels in effective utilization of grazing systems. Young beef producers interested in grass-fed cattle need to travel to New Zealand for the opportunity to learn and observe superior grazing systems and management.[1] Do not expect to encounter the best grazing managers in the United States, as feed costs are too low and supplemental feeding compensates for poor grazing production and management.

Responding to meet the market demand in a way that optimizes the use of grazing resources and high reproductive performance will be a driving force behind success in beef production.

Cattle Management Information System

High costs and narrow margins within the beef industry call for superior management of information and cost effective decision-making. The old saying, "You manage what you measure," places a focus on complete cost and profitability measures. It may be time to incentivize the business bookkeeper and/or accountant to provide more complete and timely financial information related to production.

Genetics

Beef cattle genetics and all the talk concerning breeds and selection often occupy undue attention from a business perspective. If producers focus on beef market demands, reproduction, grazing systems and maintaining high-quality cost and performance information, these measures will guide them in deciding which breeds fit the production, resource and management environment. Genetic improvement in beef cattle **is a low cost inpu**t with the artificial insemination options, including sexed semen, and synchronization technologies available today, especially when compared to the alternative—producing cattle that do not fit the market or environment. Bulls are an investment and costs must be viewed in terms of total calves sires during their productive life.

No single producer can control the beef cattle market. The key is to find a way to conform to market demand, rather than attempt to fight or ignore the market. In addition, the proliferation of beef cattle breeds can get a bit out of hand. The U.S. beef market would be better served with 4 or 5 beef breeds, rather than 60 breeds. Beef cattle market economics has forced concentration in the Angus breed, which is not a bad choice for many ranches. Likewise, the dairy industry is dominated by the Holstein breed. The breed has made rapid progress in genetic selection to meet market demands.

Beef cattle genetics is cheap. There is more money lost in the beef cattle seedstock business than any activity other than the small recreation herds. The average business life of a seedstock herd is

[1] See the international congress opportunity in the reference list.

estimated to be five years. If you operate a ranch, businesses stay away from the seedstock business.

Information on carcass value that corresponds to retail sales is highly valuable for genetic selection. Yet, good cost information should be collected to determine the true profitability of producing the high value carcass. Managers should always remember it is never simply a production issue, but a cost issue as well. If the chosen genetics fit the environment, management system and market, they are seldom a constraint on reproductive performance and profitability. Normally, it is a matter of management limitation—plan execution makes the difference.

Retained Ownership beyond the Cow-Calf Phase

Cow-calf producers are always challenged to consider retaining ownership of calves beyond weaning. The margin segments in beef production. The choice is between selling calves the best way possible at weaning, or adding the cost, risk and time to take them to another phase, with the goal of increasing net revenue above the added cost.

The weaned-calf growing cattle phase, preconditioning, backgrounding and stocker grazing" and custom feeding of cattle are activities for many cow-calf producers. Each phase of the beef production chain has added price and production risk, and beef cattle producers should have a feel for production economics within each segment.

*Retained Ownership Decision—Using Economics**

In cow-calf production, the cost of producing the weaned calf is a "sunk cost"—it cannot be reversed. If net revenue can be added by retaining ownership, it will contribute to the total business net income or reduce losses from the cow-calf phase. The initial calf value for retaining ownership is the net price the producer could receive by selling at weaning. In economic terms, this initial value is the "opportunity cost" of not selling at weaning. Once the weaned calf value is established, the potential for retaining ownership can be determined. The same procedures should be followed for retained cattle (closeout analysis). Examining the numbers after retained cattle are sold provides an opportunity to evaluate projections.

Retained ownership of cattle is, by definition, a margin business. It is cattle value added, compared to the cost of gain, or added cost. The feeding or grazing margin is most frequently offset by a negative marketing margin, as the initial cost of lighter cattle is normally greater than sale price. This is the difference in feeder cattle selling price and purchase price, referred to as the buy/sell margin, or rollback (sale price minus cost of the calf). These margins are key calculation procedures useful for evaluation of retained ownership.[2]

You Achieve Nothing Breaking Even through Retained Ownership You achieve nothing financially by breaking even in backgrounding or feeding cattle. Yet, retained ownership and feedyard projections most often calculate breakeven as if it were the ultimate goal. It is extremely important to understand what is included in the cost to arrive at breakeven or net returns. Most calculations only include the feedyard's direct cost of production, and they calculate the feedyard net margin. Nothing is included in the cost to cover indirect or overhead costs, the owner's labor and management (living withdrawals) or taxes. Your business will go broke if there is no income to pay overhead costs. Many producers must have something to live

2. This seminar provided retained ownership decision aids to address this topic.

on. If you earn a taxable income, self-employment taxes and income taxes have to be paid. Financial profit is properly defined as return to the producer's equity capital at risk after all direct, indirect, and management costs (owner operator equivalent to living withdrawals) are paid. Revenue minus direct cost is the gross margin.

When doing projections or evaluating closeouts, always include overhead or indirect costs (phone, utilities, accounting, and secretarial services) of the business plus returns to owner's management and labor. The latter can be arrived at by estimating how much it would cost to have a non-family member perform the labor and management activities. A review of your overhead costs and family living withdrawals in past years can provide good information for projections. Add these costs to the direct cost to calculate your breakevens. Consider these costs as a margin that must be covered to justify taking on the additional management responsibility.

In projections, establish your target net return and determine what sale price is necessary to cover total costs to justify taking on the additional risks. It is good to consider at least three levels of possible outcome (pessimistic, likely, and optimistic prices). Calculate what the target net return to risk (profit) and equity capital will be for each price situation. Always remember you achieve nothing by attaining breakevens that only include the direct cost of production.

Most cattle producers have sustained considerable equity loss in the past years. Many need to use caution as well as risk management tools to avoid further deterioration of their financial position. Recovery of equity is a painful process requiring top management. It is not only when margins are narrow, but also when income is generated that could rebuild equity. A good percentage first must be paid for self-employment and income tax.

Ranch Financial Statements and Cash Flow

Successful business managers have financial information to monitor and measure performance and progress toward business objectives and goals. The projected cash flow based on the production and marketing plan is the first priority. This is a component of the systems approach to management. The notion "Cash is king" is not an understatement of importance. Accounting systems should be arranged to monitor monthly planned versus actual cash flow. Cash flows must include the capital asset replacement plan. Knowledge of business repayment capacity, risk bearing ability, lender communications, and cost effective cash flow management are all products of a well-developed and utilized cash flow system.

Enterprise budgets, which combine production and financial information, are tools managers should use. Again, these reports need to be a product of the production and accounting system. Comparing projected to actual returns keeps managers humble and honest. Total unit cost of production information by commodity provides key information for enterprise selection and marketing. The Excel™ spreadsheet system is an essential tool to facilitate this activity.

Owner managers must insist that the bookkeeping is done at the ranch. Using software like QuickBooks ™ is a necessity to control costs and to keep informed.

Quarterly income statements and at least semi-annual balance sheets with associated ratio calculation are simple tools to keep managers informed. Financial performance history should also be a product of reporting. This is a backward view, but it is difficult to create a realistic view of the future without looking at past performance. Key measures to monitor are change in earned equity, working capital, return on assets and equity, and equity to asset or percent ownership.

Knowledge and use of financial statement analysis will strengthen the working relationship with farm lenders. Managers can hire professional help to prepare cash flows and financial statements. However, managers cannot turn over evaluation of the statements or use of the information in implementing changes to the business plan, which is a high priority task of the business manager. Lenders should not have to request financial statements or cash flow projections; these should be automatically provided and a normal communication with the lender.

Risk Management

Successful mangers must deal with risk in production, political policy and taxation, finances, input and product prices, and personnel issues, which affect performance. Of course, if these sources of risk did not exist, it would not be necessary to have ranch managers with capabilities described here. The sources of risk are country, area and farm specific, as is the availability of ways to manage risk.

Risk has increased as international interdependence has grown, and as ranches have become more dependent upon purchased inputs. Books could be written on the sources of risk agriculture has faced in the past ten years which were previously unforeseen. Urbanization has pressured governments to seek low cost food for consumers and create invasive political policies, often without a scientific basis. In the United States, and many parts of the world, the futures market and contracting are tools farm managers utilize to help manage risk. Unfortunately, the time and capability required to manage risk will continue to grow. Risk management must be part of a successful rancher's job.

Cost Effective Decision Making

For a decision or an alternative to be "cost effective," the added revenue must be greater than the added cost, or the cost reduction must be greater than the revenue loss. Alternatively, in economic terminology, marginal revenue (added revenue) must be greater than marginal cost (added cost).

The key to planning for cost effective decisions is dependent on production and cost information. Information must also be timely and understood by the decision makers.

By definition, "cost effective decision making" involves dealing with the unknown or risk. The best information, particularly for costs is from measuring past performance. This is where the management accounting system can prove profitable to decision makers as this data provides information prevent repeating mistakes.

We are now in the age of the management of the big four "F": fuel, feed, fertilizer and family costs. Focusing on cost effective managing these costs is a challenge for the manager that needs to make a living or even needs to make the ranch cash flow.

Responding to meet the market demand in a way that optimizes the use of the grazing resources and high reproduction performance will be a driving force behind cow-calf producer success. High input costs and narrow margins call for superior management information and cost effective decision-making. The old saying "you manage what you measure" put a focus on complete cost and profitability measures. Those who use written business plans and focus on implementation – execution, can accomplish goals.

With your quality and timely production and financial numbers let the numbers do the talking.

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