Ranching For Profit

Healthy Land, Happy Families & Profitable Businesses

ELECTRONIC NEWSLETTER

We are happy to continuing sending newsletters by snail mail, but if you'd like to receive your copy electronically let us know. Sending newsletters electronically saves us resources, time and money. Please e-mail us at rmc@ranchmanagement.com if you would like to receive the newsletter on line.

WHEN PROFIT ISN'T PROFIT

At an *Executive Link* meeting last year, a board was reviewing financial statements in a member's business report. The numbers looked good. The gross margin appeared healthy and the business appeared to be profitable. There was only one problem. The business was making a loss!

The numbers hadn't been doctored, but two important numbers had been left out: the opportunity cost of cattle and the opportunity rental of the land. The conventional definition of an opportunity cost is the return that you could achieve if the money invested in land or livestock was invested in the next best investment. Some people roll their eyes when we bring up "opportunity costs" thinking that these aren't real costs and don't make a difference to them. Opportunity costs don't involve cash, but they are real. They provide critical information about <u>*real*</u> opportunities facing your business.

Take for example a ranch with a herd of 1,000 cows valued at $750/head grazing 20,000 acres of rangeland. The total value of the herd is about $750,000 (1,000 cows x $750/head). If gross income generated from the herd is $400,000 and direct costs (not including the opportunity costs) are $150,000, the Gross Margin would be $250,000. That's a gross margin return of 33% of the value of the inventory. According to the benchmarks we use at the Ranching for Profit School, that's not bad. All of the land is owned. Total overheads equal 160,000 leaving $90,000 profit.

Gross Income	$400,000
- Direct Cash Costs	- $150,000
Gross Margin	**$250,000**
- Overhead Cash Costs	- $160,000
Profit	**$90,000**

Now let's throw in the opportunity costs. In the *Executive Link* program we charge opportunity interest of 10% on the conservative value of the cattle. That adds $75,000 to our direct costs, making our gross margin only $175,000. That's a 25% return on the beginning inventory value. According to our benchmarks we ought to do better. Now, let's see what happens if we add opportunity rent. Let's say we could have rented our pasture to someone else for $150/head/year. That's a total opportunity rental of $150,000. Add in the labor and our total overheads equal $310,000. Instead of a $90,000 profit, our business

Gross Income	$400,000
- Direct Cash Costs	- $150,000
- Opportunity Interest	- $75,000
Gross Margin	$175,000
- Overhead Cash Costs	- $160,000
- Opportunity Rent	- $150,000
(Loss)	**(135,000)**

really made a $135,000 loss! We would have been dollars ahead to sell the cows, invest the money and rent out our land. Our decision to ranch cost us $135,000! That's why Stan Parsons calls his book: *If You Want To Be A Cowboy Get A Job.*

An Opportunity To Buy Cattle

Some ranchers are still not persuaded that opportunity costs are real, so let me propose another valuable definition. *An opportunity cost is the cost of pursuing increased profit.* We all know from the Ranching for Profit School that there are three ways to increase profit: 1. Lower Overhead Costs; 2. Improve Gross Margin/Unit; and 3. Increase Turnover. We'll have interest costs on our loan to finance our livestock purchase if we increase turnover. By including the costs of pursuing this opportunity in our Gross Margin calculation it becomes clear if expansion makes sense.

You can argue that 10% on a loan to buy cattle is too high. You're right. But remember, we valued the cow herd at its liquidation value, not its replacement value. Using that conservative value makes the 10% interest rate come out just about right.

Opportunity Rent

Ranchers must also charge rent for the land they own to their cattle business. Failing to account for land rental makes it impossible to determine which part of the business makes the money: the land or the cattle. As with the opportunity cost of cattle, opportunity rent can be looked at two ways. The conventional view would be the income you could receive if you leased the land out for someone else to graze. I prefer to ask, what would I have to pay to lease a similar property if I wanted to expand my enterprise.

Base the opportunity rent on the rental value of the grass, not the purchase price of the property. As we've discussed at the school and in previous newsletters, grazing is only one of many values contributing to the total value of land in most areas.

Most ranchers ignore opportunity costs, but then most ranchers are failing economically and only survive financially because of internal subsidies like off-farm income, borrowing against appreciating land values, living on inherited wealth and relying on low-cost family labor. The profit targets established by including opportunity costs may seem daunting, but returns in each of the Executive Link benchmark businesses exceed these targets. You'll never hit the target if you don't aim for it.

FARMING FOR PROFIT

In March I attended the "Bio Business Farming School" (BBF) in Australia. BBF is a farming version of the Ranching for Profit School. It is run by our Australian counterpart, Resource Consulting Services, Ltd. Ranch Management Consultants will hold our first farming school in Springfield, Illinois, February 9-14, 2004. As a Ranching for Profit School alumnus you are entitled to attend the farming school for $1,000 (US$) (half the regular school tuition).

LIVING IN THE BUSINESS

Too much WITB and too little WOTB is a huge problem for many farmers and ranchers. WITB isn't the only problem. We also suffer from LITB (Living In The Business). When we live inside our business it makes it very difficult to separate who we are from what we do…to separate our life from our business.

A great question they asked participants in the BBF School in Australia was: "Are you a human-*being*, or a human-*doing*?" When most of them responded that they were humans-doing, they realized that their identity was so wrapped up in their work and their business that they didn't have an identity beyond that. What they do has become who they are. "What's so bad about that?" you might ask. First, it makes us more susceptible to stress and depression. When prices fall or drought hits, it isn't just an attack on the business, it is an attack on us. As a result, we are less able to manage effectively through these recurring phenomena. Second, we've all heard about people who retired from whatever it was they did, and died. When they stopped doing, they stopped living.

Your Business or Your Life

Your business is not your life…or at least it shouldn't be. This first struck me years ago, just after my son Jack was born. I'd been setting up a research trial with a rancher on a spring evening. We'd stopped for a moment to enjoy the evening. We were talking about the thrill of having a baby when he started sobbing. He said he'd worked so hard to put food on the table and to build up his ranch for his kids, that he had become a stranger to them. Now his adult children wanted no part of him or the property. He was questioning, what it had all been for. A good question, but one he should have asked when they were still in diapers.

A lot of ranchers assume one of the primary purposes of their business is to pass it on to future generations. That paradigm leads to debilitated management and a floundering business until teen-age and adult children decide what they want, which ironically, probably won't be a floundering business run by debilitated management. The next generation would be more excited about getting involved if we built a business that excited ourselves.

What is it all for?

What is the purpose of business? Not long ago I heard someone say *"Profit is to business as breathing is to life."* In "Built to Last," a book about "visionary" companies, the authors support that sentiment in writing, *"Profit is like oxygen, food, water and blood for the body; they are not the point of life, but without them, there is no life."*

"I think many people assume, wrongly, that a company exists simply to make money. While this is an important result of a company's existence, we have to go deeper to find the real reasons for our being."

David Packard, 1960

People don't work for you to make you rich. In fact research shows that money is an inefficient motivator. After all, you can buy someone's hands, but you can't buy their mind or their heart and that's where their creativity and their loyalty lives. Research backs this up, showing that "achievement" is 6 times more powerful a motivator than "salary." It is no accident that companies that have a purpose beyond profit were about 6 times more profitable than similar companies whose primary objective was profit. Engineers and technicians didn't work on the Apollo space program because it paid more than other projects. They did it because they were going to the moon!

***Profit**Probe™*

"If you aren't keeping score its just practice." ***Profit**Probe™* records the economic, financial, production and personnel score of your business by thoroughly and objectively measuring "Key Performance Indicators" in your business and comparing your statistics to benchmarks established for the most profitable businesses in similar areas. There is still time to submit your business's 2002 data for analysis. Call or e-mail Owen at our office to learn more about completing a ***ProfitProbe™*** analysis for your business.

UPCOMING RANCHING FOR PROFIT EVENTS

Ranching for Profit Schools	
Regina, SK Nov. 30 – Dec. 6, 2003	Springfield, MO Jan. 18 - 24, 2004
Boise, ID Dec. 7 - 13, 2003	Billings, MT Jan. 25 – 31, 2004
Colorado Springs, CO Jan. 4 - 10, 2004	Calgary, AB Jan. 11 - 17, 2004
Farming for Profit Schools	***Ranching for Profit Conference***
Springfield, IL Feb 9-14, 2004	Calgary, AB July 17-19, 2003
***KIT** (Keeping in Touch Field Day)*	***Executive Link Program***
June 3, 2003 Stan Baker Ranch, Lisco, NE	All chapters meet July 15-17 in Calgary

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We are in the business of putting profit into ranching!