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).

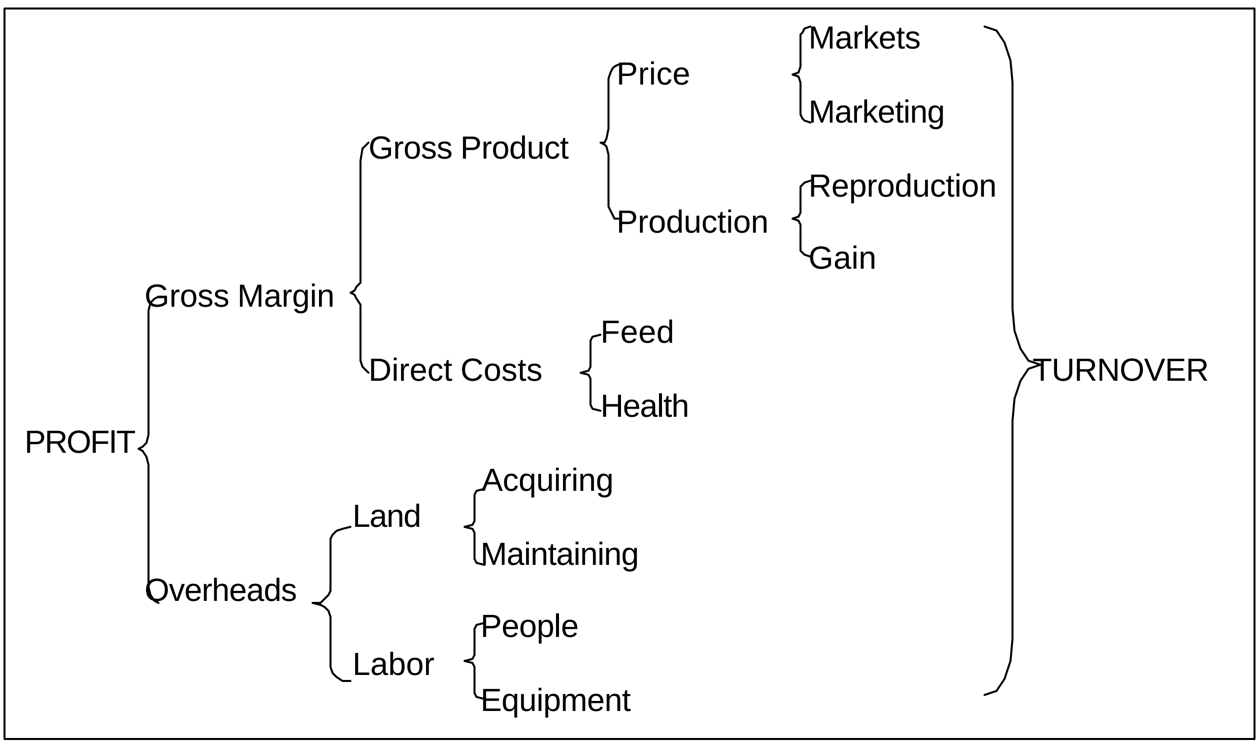
If gross margin is low, but gross product is not the problem, then the focus turns to direct costs. There are only two major direct costs: feed costs and health related costs.

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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