

RIGHT RISK™

RIGHT RISK NEWS

DATES TO REMEMBER

Crop Insurance Sign Up
(Most Spring Planted Crops)
- March 15, 2015

Noninsured Crop Disaster Assistance Program (NAP)
Deadline for spring-seeded forage and all other crops
- April 1, 2017

For more information see:
<http://www.rma.usda.gov>
<http://www.fsa.usda.gov>

Assessing Enterprise Performance

Farm and ranch managers make choices every day. Some decisions have significant financial consequences for the business, while other decisions are not as critical. Because many decisions have important financial implications, managers should evaluate alternatives in a consistent fashion. Following a decision framework can help assess the profitability of enterprise alternatives.

Enterprise budgets accumulate the income, expenses, and profits associated with specific enterprises. Budgets can be used to:

1. Itemize the receipts received from all products and by-products of the enterprise;
2. Identify the inputs and production practices required for the enterprise;
3. Evaluate the efficiency of the enterprise;
4. Estimate the benefits and costs of changes in production practices;
5. Provide the basis for a total farm plan; and

Enterprise budgets accumulate the income, expenses, and profits for specific enterprises.

6. Support applications for credit.

Enterprise budgets are usually constructed on a per-unit-of-production basis. For example, per acre for crops and a typical animal unit, head, flock, herd, or another basis for livestock.

Revenues: The enterprise budget should include receipts for every product and by-products of the enterprise. This may mean a breakdown of receipts by grade or market outlets, grain and straw, type of animals, or grades of wool, eggs, or other products. Prices used in an enterprise budget should reflect market values and the productivity of enterprise resources.

Variable Costs: The enterprise budget should include those expenses that vary with output within the production period and result from the use of purchased inputs and owned assets. For crop enterprise budgets, variable costs will include seed or plants, fertilizers, pesticides, fuel, machinery repairs and maintenance, crop insurance, irrigation, labor, marketing, rents, custom hired operations, and interest on operating capital. In livestock budgets, variable costs will include feed, veterinary, breeding, labor, marketing, pasture and building rents, and interest on operating capital. The enterprise budget should include not only the specific inputs but also the application costs.



Fixed Costs: The enterprise budget should also include those expenses that do not vary with the level of input and stem from the ownership of assets. These include depreciation, real estate taxes, land, repairs to buildings and fences, and insurance. Depreciation should be accounted for using a consistent method approximating the reduction in asset value, such as straight-line. The method should be based on actual years of use and salvage values, rather than accelerated methods allowed for income tax purposes. The purpose here is to match the cost of asset use in the production process to the revenues they contribute to. In addition, a management fee and the costs of salaried employees are sometimes included as fixed costs.

It can be difficult to allocate fixed costs to the various enterprises of the farm or ranch business. One method is to allocate fixed costs evenly across all enterprises. Another method is to prorate fixed costs to the various enterprises based on the revenues generated by each enterprise. A third method is to prorate fixed costs based on the total hours it takes to operate and complete each enterprise. The specific method is not as important as it is to be consistent in the approach used.

How Much Risk is Right for You?

HIGHLIGHTED TOOL

Most farms and ranches involve more than one enterprise in their production mix. Production risk spread over several enterprises often contributes to their financial successes. Enterprise risk analysis – estimating net returns for an enterprise and the variability in those returns (risk) – is an often-neglected but a necessary part of developing an overall risk management strategy.

Enterprise analysis helps producers obtain an accurate picture of enterprise profitability by evaluating enterprise net revenue and its effect on the entire operation. Such analysis helps identify not only the range of possible farm returns but also the development of contingency plans should returns decline below reasonable levels.

The Enterprise Risk Analyzer (ERA) tool helps evaluate farm/ranch financial performance once the necessary data has been entered. Analysis includes whole farm/ranch net return, enterprise net return, break-even prices, and break-even yields. Comparing enterprise performance and determining how much each enterprise contributes to whole-farm/ranch profitability is then possible. The ERA tool also provides risk estimates based on user projections for commodity prices and yields. The ERA tool estimates probabilities for earning a given level of net income, a break-even price, or a given break-even yield.

To access the *Enterprise Risk Analyzer* see: <http://RightRisk.org> > Resources > Risk Management Tools



ASSESSING ENTERPRISE PERFORMANCE CONTINUED FROM PG. 1

Breakeven Analysis: Enterprise budgets are also useful for completing breakeven analysis for prices and yield. Breakeven analysis is a useful management approach where it allows for the calculation of various combinations of prices and yields that will cover projected costs. When the expected price received or yield produced is greater than the breakeven price or yield, all costs will be covered and a profit realized.

The breakeven price is the minimum price per unit required to cover all projected costs at the expected yield. It provides a marketing target price that must be received to cover all costs in the current production year. The breakeven price is calculated by dividing projected total costs by the expected yield. For example, if annual cow costs total \$700 and the average calf sold weighs 550 pounds, the breakeven price is calculated at \$1.27 per pound (breakeven price = $\$700 / 550 = \1.27).

Similarly, the breakeven yield is the minimum yield required to cover all projected costs at the expected price per unit. It provides a production target that must be achieved in order to cover all costs in the current production year. The breakeven yield is calculated by dividing projected total costs by the expected price. For example, if the annual total cost to produce an acre of corn is \$685 and the expected price is \$3.25 per bushel, the breakeven yield would be calculated as 211 bushels per acre (breakeven yield = $\$685 / \$3.25 = 211$ bushels).

Enterprise budgets are also useful in selecting a mix of enterprises and to project cash flows for the entire farm or ranch. Additionally, enterprise budgets can be combined to form a whole-farm budget. Whole farm budgets are useful for projecting the profitability of the entire farm or ranch and when considering major changes to the business.



RIGHTRISK™

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*How much risk
is right for you and your operation?*

*RightRisk helps decision-makers
discover innovative and effective
risk management solutions.*

RightRisk News is brought to you by the RightRisk Team

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