Volume 11, Issue 6 June 2023

RightRisk™

RightRisk News

What Price Is Right?

Most farms or ranches include more than a single enterprise. These enterprises or profit centers are the various activities of the business which generate a product for use in the business or for sale in the marketplace. Examples may include beef calves, vegetables, eggs, meat poultry, sheep, flowers and barley.

Before determining a price that you are willing to sell a given commodity, product or service available from your farm or ranch business, you must determine: (1) What you have to sell, (2) How much you have to sell, and (3) When the item is ready for sale. If you have a chicken enterprise, you may have 10 dozen eggs to sell each week and 20 meat birds ready for sale each month.

What is the price are you willing to sell eggs at? Birds? How do you know it is the right price? That is, will the income cover your costs? Will it increase your wealth?

Setting the price

Take What You Can Get: the easiest method for determining the sale price is to "take what you can get". A problem with this method is that the income generated from the sales may not cover your costs. The price may be too low to result in a profit. Hence, funds must flow into the enterprise from other enterprises or from non-farm sources to cover the costs.

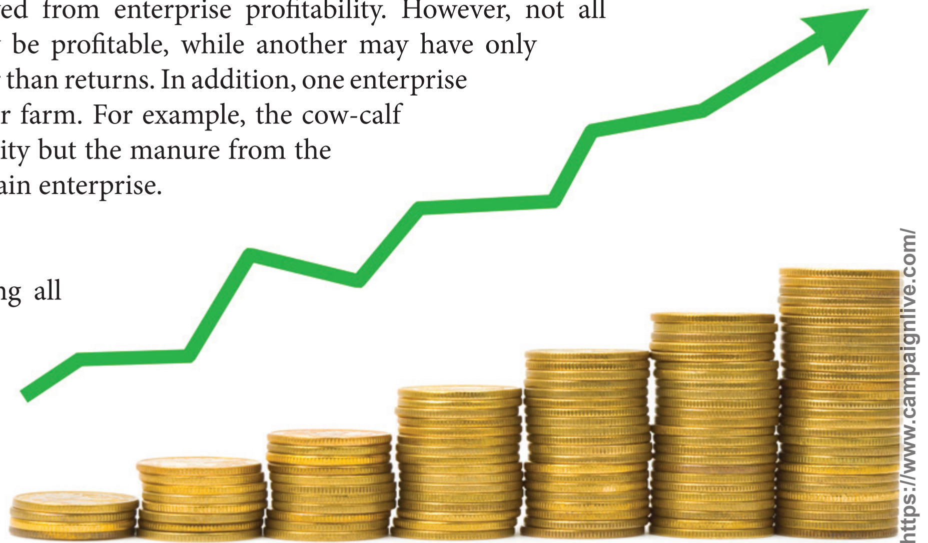
Wild Guess: without accurate information, you could just simply set a sales price. You might do this by pulling a price out of thin air, pick a card with an assigned price, flip a coin, or ask a neighbor. As with the "take what you can get" method, the income generated from Wild Guess sales may not cover your costs.

Scientific Wild Guess (SWAG): to increase your odds of a profitable sales price, you could include outside data from reliable sources. Sources of data could include the USDA Farm Service Agency, USDA Risk Management Agency, a state department or division of agriculture, a university, lenders or commodity organizations. This method is only slightly better than the first two methods listed above and, as a result, the selected price may not be sufficient to cover all your costs.

Your Numbers: the best method for determining a sales price for your commodity, product or service is to use your own numbers. By computing your total cost of production, you can determine a sales price that covers all your costs and results in a profit. A problem with this method is that you must keep good financial records, develop financial statements for your business, as well as prepare an enterprise budget.

How Much Risk is Right for You?

Profitability: Where does it come from?
Whole farm or ranch profitability is derived from enterprise profitability. However, not all enterprises are profitable. One activity may be profitable, while another may have only marginal profitability or result in costs greater than returns. In addition, one enterprise may complement another enterprise on your farm. For example, the cow-calf enterprise may have only marginal profitability but the manure from the animals may reduce fertilizer costs for the grain enterprise.


https://www.campaignlive.com/

Enterprise budgets
An enterprise budget is a budget containing all costs and returns associated with a single enterprise. These budgets may be projections of expected costs and returns or the result of compiling the actual costs and returns. Accurate enterprise budgets – both projections and actual – include both variable costs and fixed costs.

Variable costs: also known as operating, production, or direct costs – are the costs that result from production of your product. These costs are expected to vary with the number of units of production in the enterprise. Examples of variable costs include feed, vaccines, seed, chemicals, fertilizer, crop insurance, and baling twine, to list only a few.

Fixed costs: also known as overhead and indirect costs – are not related to production. Such costs must be paid regardless of the level of production. Examples of fixed costs include term debt payments, real estate taxes, professional fees, general insurance, repairs, and insurance.

Some costs are may seem like they are both variable and fixed. For example, a certain amount of fuel is needed by the operation regardless of the enterprise or number enterprises (fixed cost). However, fuel costs increase with certain enterprises (variable costs). Other examples include labor and utilities. A portion of such costs will be included as fixed costs, while the variable portion will be included with variable costs.

Allocating fixed costs
There are a number of methods for allocating fixed costs to each enterprise – and all costs must be allocated to one or more enterprises on the farm or ranch. Some analysts allocate each specific category of fixed cost to the various enterprises, while others allocate the totality of all fixed costs to each enterprise. The former allocation leads to the most accurate results, but requires significantly more time.

https://www.google.com/imgres

The least accurate method for allocating fixed costs is to guess. The problem is that such allocations are likely to be wrong, leading to results that may lead to poor decision making. A manager who does not accurately evaluate the costs of production cannot determine a profitable sale price nor otherwise manage the enterprise.

More accurate methods for allocating fixed costs to all the enterprises of a farm or ranch include: (1) applicability of the fixed cost to an enterprise. For example, real estate taxes are less applicable to a chicken enterprise than to a grain enterprise because of the differences in

acres of land required by the two enterprises; (2) the portion of time required by each enterprise; (3) the projected gross revenues generated by each enterprise as a percentage of total projected farm or ranch revenues; (4) the actual variable expenses associated with each enterprise as a percentage of total variable expenses; or (5) the acreage or production unit method.

Each method has strengths and weaknesses which are typically determined by the availability of good financial and production records. The key to allocating fixed costs to enterprise activities is to find the method which works best for the farm or ranch business and use it for a number of years.

A wise business manager can only determine a profitable sales price by knowing the total costs of producing a commodity, product or service. As a result, if total costs are unknown, the manager will struggle to accurately and effectively make decisions about the management of the enterprise.

A number of resources for enterprise budgeting and analyzing enterprise risk are available at **RightRisk.org**. The Enterprise Risk Analyzer (ERA) helps evaluate enterprise costs and returns. Analysis includes whole farm/ranch net return, enterprise net return, break-even prices, and breakeven 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.

See **RightRisk.org** under the Resource > RightRisk Analytics tab for more details.

~ Other RightRisk News ~

News Release - May 15 | RightRisk

AG CREDIT SURVEY: Credit Conditions Hold Strong as Interest Rates Rise

AGRICULTURAL CREDIT CONDITIONS in the Tenth District remained strong and farm real estate values continued to increase, but growth has softened. Strength in farm real estate markets eased, but farmland values continued to increase despite downward pressure from higher interest rates . . .

For more see: RightRisk.org\News

Highlighted Publication: *Enterprise Risk Analysis*

An eBook designed to accompany the *Enterprise Risk Analysis* online module. With over 40 pages, materials include definitions of enterprises and risk in agriculture, outlines what risk management is, how risk is managed, steps of the risk management process--establish context, risk assessment, treatment implementation, and much more.

To read more or to access the text, see:
RightRisk.org > Courses > Enterprise Risk Analysis

May 2 | Social Media Post
¿Cuáles son los reglamentos Estado Unidenses para el trabajo de menores en agricultura?

May 4 | Social Media Post
Ag Survivor | RightRisk

May 9 | Social Media Post
Lasting Legacy Course #1

May 11 | Social Media Post
What Are Risk Controls?

May 16 | Social Media Post
Job Descriptions Why Waste the Time?

May 18 | Social Media Post
Estimating Custom Rates and Machinery Costs

May 23 | Social Media Post
What is the Fair Labor Standards Act?

May 25 | Social Media Post
Online Publications | RightRisk

May 30 | Social Media Post
Enterprise Feasibility

Follow us on:

Click here to see current posts:
RightRisk.org\news

Follow us on:

- Education
- Coaching
- Research

E-mail: information@RightRisk.org
Web: www.RightRisk.org

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

RightRisk News is brought to you by the RightRisk Team
Contributing authors:
John Hewlett, Ranch/Farm Management Specialist - University of Wyoming, hewlett@uwyo.edu
Jay Parsons, Risk Management Specialist - University of Nebraska-Lincoln, jparsons4@unl.edu
Jeff Tranel, Ag and Business Management Specialist - Colorado State University, Jeffrey.Tranel@ColoState.edu
Editing and Layout: John Hewlett, hewlett@uwyo.edu

Past issues of RightRisk News are available at: RightRisk.org/News
To subscribe/unsubscribe, email information@RightRisk.org subject line "Subscribe/Unsubscribe RR News"

How much risk is right for you and your operation?

N EXTENSION

COLORADO STATE UNIVERSITY EXTENSION

UW Extension