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With Prices Like This, Who Needs to Know Cost of Production?

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Market Report	Yr Ago	4 Wks Ago	4/27/12
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	$116.78	$127.00	$120.91
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.. . . .	157.75	182.70	186.48
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	134.25	154.88	151.85
Choice Boxed Beef, 600-750 lb. Carcass.	184.56	184.65	190.00
Western Corn Belt Base Hog Price Carcass, Negotiated.	91.80	80.44	79.03
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean..	93.39	80.00	77.11
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct..	190.00	147.50	*
National Carcass Lamb Cutout, FOB.	406.63	374.54	365.55
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu..	7.75	6.20	5.69
Corn, No. 2, Yellow Nebraska City, bu..	7.43	6.37	6.38
Soybeans, No. 1, Yellow Nebraska City, bu..	13.98	13.64	14.62
Grain Sorghum, No. 2, Yellow Dorchester, cwt..	12.00	10.88	10.48
Oats, No. 2, Heavy Minneapolis, MN , bu.	3.42	3.71	3.58
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton..	140.00	225.00	225.00
Alfalfa, Large Rounds, Good Platte Valley, ton..	72.50	145.00	145.00
Grass Hay, Large Rounds, Good Nebraska, ton..	*	97.50	97.50
Dried Distillers Grains, 10% Moisture, Nebraska Average.	217.00	215.00	231.50
Wet Distillers Grains, 65-70% Moisture, Nebraska Average.	78.50	77.50	77.75
***No Market**			

A few months ago I was talking with a producer and I mentioned that I worked with farmers on calculating cost of production, among other things. He posed the question of why do farmers really need to know their cost of production? Sure, five or six years ago when margins were tight cost of production was important in marketing their crop, but what's the point with the increase in crop prices and wide margins?

Marketing

When most farm producers think of cost of production they've been trained to correlate that with marketing. It's easy to connect your selling price with your production cost, and know that the first must be higher than the second. In reality, for the past few years there have been very few producers I've worked with whose cost of production has been anywhere close to their marketing price, so I understand the thought, especially from the low cost producer.

This winter I even heard a nationally based marketing group speak about the most important things you can do on your farm: 1) produce a good crop, 2) market it at the top, and 3) protect it with Multi-Peril/Crop Revenue Insurance. They went so far as to say that if you did those things well, you didn't need to worry about your financials. I can't argue that those things are important, and if you do them well you will have a large gross income. The problem comes in the fact that the equation for profit is still:

Profit = Gross Income (Production x Marketing Price) - Gross Expenses

This hasn't changed, and even if your cost of production isn't close to your marketing price, the larger that margin the more competitive advantage you have.

Competitive Advantage

Whether you like it or not, your business is in competition with your neighbor's for growth. You need to find a competitive advantage or a quality that sets your farm apart from your neighbors' and leaves you open to opportunity.

For the most part, you and your neighbor have the opportunity to grow similar crops. Similar land types, similar weather and the opportunity to buy similar inputs, if you choose. You also have the opportunity to market your crops in similar places. You may get a better deal for quantity delivered or quality delivered, but for the most part you deal with the same swings in the market, the same basis battles and the same cash price opportunities.

When it comes time for you and your neighbor to compete for that piece of land that lies between you, whether to rent or buy, what makes your options different? Yes, you may have gotten lucky in the market and gotten a better price, or you may have finished harvest a day earlier and missed the fall storm that knocked half his field down, but the amount of cash available to spend or your borrowing capacity will largely be based on how large your margin or your profit has been.

If you can keep your cost of production below your neighbors you will be able to expand faster, reduce debt or eliminate debt faster and maybe even take that family vacation that you keep hearing needs to happen!

So Why?

Being competitive in today's agricultural economy has been pretty easy. But with all the farms I work with, I see a major divide; those who are prepared to take advantage of a downturn in the agricultural economy, and those who are betting with all they have that the downturn won't come anytime soon.

It may be hard to imagine a farm that is struggling in today's economy, but the filing of bankruptcy of farms such as Illinois Family Farms is a reality that could repeat itself in your area. The numbers associated with that case are unimaginable, with debts exceeding assets by almost $30 million in one company and almost $17 million in another. The farmer was well known for driving cash rents up and gathering assets at all costs. I have no knowledge of this operation other than research done online, but I wonder what could make a farm that size not profitable for the past five years, and how could the associated lending institutions let it get that far? My best guess is that no one was paying attention to the details, assuming that he had to be doing well and clawing to the front of the line to be the one he bought his inputs and assets from.

So why do you need to know your cost of production? It's not all about marketing. Do you have the competitive advantage it will take to be able to capture the opportunity if one presents itself? Are you going to be caught by surprise when your cost of production exceeds $5 corn and $12 beans? Knowing you're not close and assuming you're not, are two very different things. I challenge you to make the business end of your farming operation as important as the production end. I understand it's not as fun and not why you went into farming. You hire crop and marketing consultants, so maybe it's time to hire a financial consultant to prepare accurate and timely financial statements. I'm not talking about a tax return and not once a year. Accrual basis financial statements including cash flows, balance sheets and income statements, as well as cost of production estimates on a quarterly basis are all an expected reality in any other business, and should be in farming as well. It may just be what keeps you farming.

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