

University of Nebraska - Lincoln

DigitalCommons@University of Nebraska - Lincoln

---

Cornhusker Economics

Agricultural Economics Department

---

6-23-1999

## Declining Profit Margins - A 10 Year Trend

Larry Bitney

*University of Nebraska-Lincoln*

Follow this and additional works at: [http://digitalcommons.unl.edu/agecon\\_cornhusker](http://digitalcommons.unl.edu/agecon_cornhusker)



Part of the [Agricultural Economics Commons](#)

---

Bitney, Larry, "Declining Profit Margins - A 10 Year Trend" (1999). *Cornhusker Economics*. 861.  
[http://digitalcommons.unl.edu/agecon\\_cornhusker/861](http://digitalcommons.unl.edu/agecon_cornhusker/861)

This Article is brought to you for free and open access by the Agricultural Economics Department at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Cornhusker Economics by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

# Cornhusker Economics

## Cooperative Extension

Institute of Agriculture & Natural Resources  
Department of Agricultural Economics  
University of Nebraska – Lincoln

### Declining Profit Margins - A 10 Year Trend

Market Report	Yr Ago	4 Wks Ago	6/18/99
<b>Livestock and Products,</b>			
<b>Average Prices for Week Ending</b>			
Slaughter Steers, SE/CH 65-80%, Weighted Avg. for Nebraska Feedlots. . .	\$63.75	\$63.80	\$66.29
Feeder Steers, Med. Frame, 600-650 lb, Dodge City, KS, cwt. . . . .	77.63	81.32	83.50
Feeder Steers, Med. Frame 600-650 lb, Nebraska Auction Wght. Avg. . . . .	*	82.50	*
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt. . . . .	96.23	100.50	105.73
Hogs, US 1-2, 220-230 lb Sioux Falls, SD, cwt. . . . .	42.80	35.00	36.75
Feeder Pigs, US 1-2, 40-45 lb Sioux Falls, SD, hd. . . . .	*	36.71	31.83
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt. . . . .	110.70	111.00	97.30
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt. . . . .	102.88	85.25	80.90
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt. . . . .	184.00	184.00	177.00
<b>Crops,</b>			
<b>Cash Truck Prices for Date Shown</b>			
Wheat, No. 1, H.W. Kansas City, bu. . . . .	3.15	2.73	2.87
Corn, No. 2, Yellow Sioux City, IA, bu. . . . .	2.36	1.89	1.94
Soybeans, No. 1, Yellow Omaha, bu. . . . .	6.56	4.26	4.47
Grain Sorghum, No. 2, Yellow Kansas City, cwt. . . . .	4.25	3.21	3.32
Oats, No. 2, Heavy Sioux City, IA, bu. . . . .	*	1.27	1.25
<b>Hay,</b>			
<b>First Day of Week Pile Prices</b>			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton. . . . .	*	100.00	82.50
Alfalfa, Lg. Round, Good Northeast Nebraska, ton. . . . .	45.00	*	*
Prairie, Sm. Square, Good Northeast Nebraska, ton. . . . .	80.00	55.00	*

\* No market.

In the May 12 issue of this newsletter, Gary Bredensteiner discussed the drop in farm income for 1998. He used data from the Nebraska Farm Business Association (NFBA) and the Nebraska Farm and Ranch Management Program (NFRMP) annual summaries to show the impact on typical farms. Low prices for all major commodities was the primary cause of the sharp reduction in income for 1998.

The low farm income in 1998 accentuated a declining trend in profit margins for this group of producers. "Profit margins" may be defined in a variety of ways, but the "Net Farm Income Ratio" is used in this article as an indicator. The "Net Farm Income Ratio" as defined by the Farm Financial Standards Council, is Net Farm Income (accrual adjusted) divided by Gross Farm Income and expressed as a percent.

The chart below shows the average "Net Farm Income Ratio" for farms in the NFBA & NFRMP annual summaries from 1982 through 1998. In 1988, the peak year in recent times, these producers realized net farm income equal to 34% of gross farm income. In 1997 their net averaged 14% of gross. In 1998 they realized only 1.5%.

Using the 1997 Net Farm Income Ratio of 14%, a farm



that produced a Gross Farm Income of \$250,000 would have a Net Farm Income of \$35,000. This is not enough to pay family living expenses and taxes for these families, and there is nothing left for growth. Many families are using income from non-farm jobs to pay part or all of their family living expenses so that their net worth does not decline, or so that they can increase their farm net worth.

What is causing the decline in profit margins? While the record summaries do not answer this question precisely, they do give us a general answer. The Farm Financial Standards Council defines three other revenue-related ratios. These are the Interest Expense Ratio, the Depreciation Expense Ratio and the Operating Expense Ratio. These three, added to the Net Farm Income Ratio, equal 100% of Gross Farm Income. These four ratios are shown in the chart below for the 1982-1998 period.

The “rule of thumb” or benchmarks for these ratios that have been used are: Operating Expense 60%, Depreciation 10%, Interest 10% and Net Farm Income 20%. This was based on experience in the late 80's and early 90's. While producers in the records programs have, on the average, held interest and depreciation expense ratios each to 10% or less, operating expenses have consumed an increasing portion of gross revenue in recent years. Thus, the cause of the decline in the Net Farm Income Ratio. While the Operating Expense Ratio averages 60.1% for the 1982-1998 period, the average for the last four years is 72%. If interest and depreciation each require 10% of gross revenue, there is only

8% remaining for net farm income. This is not enough to sustain most farm businesses.

Implications -- To change this trend in declining profit margins, Gross Farm Income must increase without appreciable increases in the expense items, or the expense items must be reduced without reducing Gross Farm Income. There are actions that might be taken at the farm level or at the national policy level. We are beginning to hear discussion of changing the government farm program. While additional government payments would certainly help, keep in mind that the downward trend in the Net Farm Income Ratio started several years before 1996 -- when our current program began. There are market forces causing this trend in farm earnings. A major change in farm policy, not just programs, would be necessary to alter this trend.

On individual farms, the records show that some producers are doing better than the average, and some worse. What can individuals do to change these trends for their farms? Basic management approaches that seem to be working for some producers are; exercise cost control while maintaining output, enhance the value of products sold, explore alternative product mixes and understand government programs so they can be used to reduce risk and enhance net income.

Larry Bitney, (402) 472-2047  
Professor and Extension Farm Management Specialist

**Remember to renew your subscription for 1999-2000!!!**