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Cornhusker Economics

Strategically Making Your Farm or Ranch Profitable

The word ‘strategically’ sounds sophisticated and is often used to imply the presence of some secret idea that will always work to increase profit. The word seems to suggest that to be strategic requires special knowledge or an almost magical method of accomplishing something. In truth, however, strategy is simply a plan of action or policy designed to achieve something desired, and it can be complex or basic, as each occasion requires. Strategy can be good or bad, a successful endeavor or a disaster. The key to good strategy is to have clear understanding of desired outcome, as well as the factors that create success, continued motivation, and practice to work at making the best plan possible. The alternative is to merely go with the flow. As a youth, I spent hours at the beach, playing in the surf. I would get so wrapped up in playing that I would lose track of where I was and, as time passed, the currents would pull me far away from where I was supposed to be, sometimes into areas I did not belong. A strategic plan can act as a warning, informing us that we are drifting from our desired outcome(s). As a farm/ranch operator, it is an exciting prospect to organize the business in such a way that dreams can be achieved. Strategic planning, then, should be viewed as an opportunity to implement philosophy and knowledge into action and results. While strategic plans provide direction, they may need to be adjusted from time to time, during implementation.

One important factor that seems so basic is recognizing the type of business in which producers find themselves. Professional economists often claim that farmers/ranchers operate as ‘price takers,’ modeling them as ‘perfectly competitive firms.’ Why do they say

this and what does that have to do with developing a strategy to increase profit? If farmers/ranchers are price takers, then they have no real market power, which leads to no control of the market price at which they sell their products, when they decide to sell. This does not mean price is stagnant, but that on any particular day, a single producer has no legitimate control of the price he is offered. Of course, producers may gain some leeway, based on when they participate in the market, which depends on what and when they are producing. For example, strawberries and hogs both have limited windows of marketability. At times, a large producer who is selling a large quantity may receive a premium to sell to a local buyer. Even in this case, however, the price differences are relatively small. These facts, along with others, such as seasonality, annual production variation, high capital investment costs, etc., create opportunities and present challenges that increase the likelihood of success when there is strategic planning in place. Another thing to consider before developing a specific strategy is the individual strengths and weaknesses of each unique operator and their operation. Each producer has specific talents and things that they do well, in addition to other things that they may not do well. Any strategy used should leverage strengths and ameliorate weaknesses. Again, strategies may be simple or complex depending on the operator, management system, and desired outcome, but the most important fact is that these plans need to be doable and consistent with said outcome.

The past four years, I have been part of the University of Nebraska-Lincoln extension team at the West Central Research, Education and Extension Center (WCREEC) that has worked with the Testing Ag Performance Solutions – (TAPS) program. TAPS is a real-time, real-life farm simulation contest, which encourages contestants to make production and marketing choices for corn, sorghum, and wheat. As a result of this work, I have noticed that winners of these contests have won in very different ways. These different paths establish themselves as various producer strategies. In the next few paragraphs, some of these strategies will be described and discussed. The hope is that the discussion will provide some insight into what comprises a successful strategy.

In the TAPS contest, profits have a wide range that usually spans hundreds of dollars, (<https://taps.unl.edu/reports>). This range is due to one or more reasons, including a lower market price received, higher cost incurred, and/or lower yield. In most cases, the winners had above-average yield, below-average cost per-unit or per bushel produced, and an above-average market price. Rarely have any of the individual teams won due to a single factor. Yet, most teams performed adequately in all areas, and/or excelled in one. Important to remember is that those TAPS teams who have been profitable are all winners. In the case of profit, some profits are good and having more is even better. There are those competitors who obtained the highest market price, but also had poor yield, ultimately causing money loss. Still, others have had good yield and poor market value, also resulting in a less-than-optimal profit. Some contestants had low per acre cost that resulted in low yield and high per-unit cost. Contestants with high per acre cost and medium to low production resulted in high per-bushel cost and net loss. Observed are some cases of high cost per acre resulting in the lowest per bushel cost. This resulted in improved profit and is ideal, since it simultaneously resulted in overall higher revenues, at the lowest cost.

To best illustrate this, assume two competing farms have the same cost per bushel and they each receive the same average market price. This would mean that they both receive the same per bushel profit. Now, suppose that this profit is calculated at \$0.25/bu. So far, these two farms appear equally competitive, but they are not. Farmer #1 produced 220 bu/acre and Farmer #2 pro-

duced 290 bu/acre. With 70 bu/acre more, Farmer #2 made \$12.50/acre more than Farmer #1. These results suggest the value of considering price and cost when thinking strategically. Developing an individual strategy is not easy and takes some careful thought. As just evidenced, a strictly low-cost strategy is not always optimal, but does require additional consideration of productivity and, importantly, the value of the resulting production. This, then, brings up the question of how per bushel value affects the cost strategy. Continuing with the example, Farmer #2, who had 290 bu/acre corn production, is known to have received an average market price of \$3.50/bu. Therefore, if this producer was able to increase production by just 1 bu/acre for a cost less than the average of \$3.50/acre, say \$2.90/acre, figuring at about \$.01/bu, then the operation would increase overall profits by \$0.60/acre, about \$60/hundred acres or \$600/thousand acres, which is about a 20% return on investment.

Often, producers consult with their agronomist or crop consultant and decide upon the upcoming season's yield goal(s). Given the method of production is known, this means that they are deciding on the type of seed, plant population, fertilizer levels, etc. They have effectually planned for a specific production at an expected cost. This plan is an implied strategy. Hopefully, in developing this strategy, the cost and value of the related products are considered and play an integral part in the plan's formation. To not consider these other two factors is to ignore building a profit-centered strategy and to focus solely on productivity; while this is not an inherently bad thing, it does imply that price and cost are irrelevant, which is opposite the truth. It is admirable to have a reputation for the highest production, but money in the bank is more practical. From TAPS, I have learned that similar yields can be obtained at very different costs, and is therefore important to keep constant interest in pushing the envelope, particularly by increasing overall productivity and keeping the cost per unit produced low. It is imperative to remember that cost minimization usually does not lead to optimal profit, which requires the chosen level of productivity to be set at the correct level. The case can be argued that yield maximization does not lead to

profit maximization, either. Profit is maximized solely where cost minimization is used to achieve the appropriate yield goal. Marginal cost is vital, seen in the cost of producing the next bushel of grain not exceeding the value of that grain.

The take home key concept from this whole discussion is that having a strategy in place is important to provide guidance in making decisions that are consistent with the objective(s). The simplicity or complexity of each producer's strategic plan depends on the individual and their situation, and there is no specific requirement of how a proper strategic plan looks for each operation. A low-cost strategy should be related directly to productivity and crop value. A high production strategy needs to completely consider cost, risk, and market value. Every strategy is improved by extracting the highest possible price that can feasibly be obtained in the markets, and some call this a market strategy. Getting the highest possible price is not necessarily the single highest price that the market has to offer for that season. Strategies can be detailed, but the greater the detail, the more information is needed to justify the strategy. Too generalized and the strategy is likely to be ineffective. In summary, what might work well in one year's strategic plan may not work well in another. Strategies provide guidance yet should not be so rigid that they overshadow reason or critical thought, as circumstances and goals continue to change and evolve. Interestingly, the low-cost strategy nearly always results in optimal profit when paired with the selection of the correct level of production, (<https://agecon.unl.edu/cornhusker-economics/2019/difference-between-max-profit-max-production>).

Whereas low-cost strategies with yield levels set too high reduce profit, just as setting yield levels too low does the same, (<https://www.farmprogress.com/management/if-profit-your-goal-be-marginal-thinker>).

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