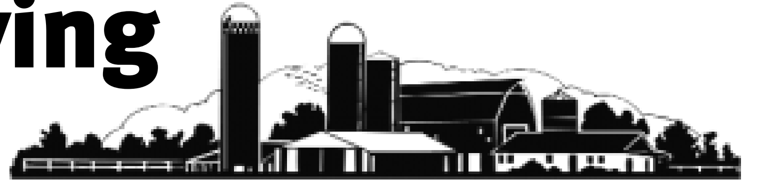
When the Farm Isn't Living Up To Our Expectations



Commentary by **VERN PIERCE**

As far as I can tell, you are free to make as much money as you like in the cattle business. Yes, there are constraints in this marketplace. However, the constraints are largely self-imposed.

I was reminded of this recently while working with a financial plan for a young farm couple. The couple had purchased about 300 acres of land, a nice house, a barn and machinery to go after their dream of being cattle producers. Of course, they had all of the personal toys they needed as well — two cars, a boat and lots of other things they "needed."

Their dilemma came swiftly as they began to realize that the farming operation was not generating all the money needed to pay bills. You've heard the speech I got when I went to visit them to begin a financial plan.

The explanation

"Well sir," the young man began, "when Daddy was young the farm provided an income for all of his brothers and sisters and my grandparents. I understand those packers are making it so my generation can't do the same."

My work was cut out for me!

The young man brought up the concept of parity, which used to be discussed all the time in the world of U.S. farm policy, and still is discussed in coffee shops and over feed bags across the heartland. It is very true that a generation ago the family farm provided income to support the whole family. Sure money was tight, but all mouths were fed. You've heard that story, too, along with the one about how far your parents had to walk to school — in the winter, uphill both ways with no shoes!

Now let's break down these two visual pictures to see just why the farm is not supporting our lifestyle at the level we desire.

The young couple I mentioned above enjoy their two small children, but recall their parents grew up in a house with five kids. Let's get a better visual of how that family farm from the last generation supported the family. The parents had one vehicle. That's not one each, but one for the whole family. There was no boat, no summer cottage up north and no three-week vacations. They had good clothing, but it wasn't new every month. The kids were not involved in activities from the minute they got out of school each day until bedtime, and there were no soccer

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moms and no sport utility vehicles (SUVs).

Making ends meet

The point is that our parents' farms supported their families, and they supported them reasonably well. However, they didn't have such high financial expectations from the farm income as we do today. A family can live today on a small family farm and enjoy the same lifestyle that families enjoyed 50 years ago.

That's not the lifestyle we want though, is it? The couple I was working with was really saying they want the same farm to support a much better lifestyle. As a result, they put many constraints on their farm's ability to cover expenses and tried to complain their way out of debt.

Making money in the cattle business is more difficult today than it was a generation ago. Decision-making requires a greater skill set to manage the operation, the finances and the future direction of the business. Margins of the past were not that much greater than today. However, today we are placing much higher expectations on those margins. Let's be clear, I am not trying to start a movement that we all should have 20 acres and a mule and be happy with it. On the contrary, I want you to make as much money as you want. The difference is in the approach.

The young couple we have been discussing set up a business plan that stretches the limits of the farm's money-producing capability and minimizes their flexibility. That plan is not sustainable. Family and farm expenses need to be matched with the capabilities of the farm and the manager to produce income.

Oftentimes, the problem occurs in the planning stage. Cash flow planning really should start before the checks start bouncing. Cash flow planning and budgeting involves looking at the difference between covering variable costs and covering all costs of production. Variable costs are those that change with the amount of production and would not exist if you no longer produced any output but still had all of your assets.

If you were following economic theory, you would only operate in the short run (say, this year) if your income were greater than your variable costs. This would allow you to cover the short-run costs and put something aside for paying for the assets of the business.

For example, if a cab driver picks up a passenger in downtown Chicago, Ill., and the passenger wants to go to Milwaukee, Wis., the cab driver has to cover his gas and oil charges (variable costs) and then put anything extra toward his payments to the bank for the cab. If the gas and oil would cost the driver $20 to get to Milwaukee, he should only take the job — again if he was following economic theory — if the passenger was willing to pay something greater than $20 to cover the variable costs of the trip. Let's assume the passenger pays the driver $30 for the trip. The driver can put the extra $10 toward paying his car loan and, if anything is left after that, to paying himself for his time.

In agriculture we call that last bit "return to ownership and management." Of course, if the cab driver had another job or a spouse that worked in town and just enjoyed his way of life, he could just ignore the unpleasantness of economics. Know anybody like that?

Editor's note: *Vern Pierce is a beef economist at the University of Missouri-Columbia.*