Outside the Box: Expansion

by **TOM FIELD,** *director of the Engler Agribusiness Entrepreneurship Program, University of Nebraska–Lincoln*

Herd expansion, although delayed, is under way according to most industry prognosticators. Price signals during the past decade were sufficiently strong to stimulate higher heifer retention rates under normal conditions. However, the combined effects of widespread drought, economic uncertainty, generally high agricultural commodity prices, and rising land values offset one of the longest periods of profitability in the history of the U.S. cow-calf sector and kept a brake on inventory growth.

Lagging national herd numbers, however, resulted in a drop in beef production tonnage. Less beef supply coupled with a reasonably strong export market pressured beef pricing for domestic consumers and resulted in a 15-year run up in retail and foodservice prices that have tested demand levels. Somewhat surprisingly, beef sales on a per-capita basis did not plummet during the economic downturn and have risen steadily throughout the past half decade.

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Changing pace

Given the aforementioned scenario, what route will producers take in regard to the rate and tactical approach to expansion, and how will the beef supply chain and its buyers react?

Inventories of nearly 34.5 million head in 1997 were shaved to current historic lows during a 17-year period. If the industry is to attain mid-1990s inventory levels, then nearly 6 million females must be added. Frankly, it is difficult to construct a scenario that would suggest conditions will support a gradual herd-rebuilding process of nearly two decades back to mid-1990s levels.

Keys to sustaining herd expansion include continued growth of beef exports; strengthening of the U.S. and world economy, particularly within the buying power of the middle class; and providing consumers exceptional value in terms of palatability, nourishment and wholesomeness. Additionally, precipitation patterns, land prices, grain and forage prices, and governmental policy will affect both the momentum and duration of expansion.

A final important consideration is the size of the cattle-feeding and processing infrastructure. Capacity decisions by cattle feeders and packers will affect both expansion rates and horizons. In light of these many variables, it is more likely that expansion will occur in several phases characterized by interspersed periods of growth and regression. Additionally, it would be surprising if the U.S. beef cow herd reaches much beyond 32 million head in the next quarter century.

Decisions

On the consumer side of the equation, beef offers a versatile product mix of ground, whole-muscle and byproduct items that opens the door to meeting diverse needs in both domestic and international markets. In some cases, especially in regard to items such as some byproducts and beef trimmings, the industry will compete on a lower-priced/higher-volume model.

However, beef cannot compete and win with a strategy of being the lowest-priced protein. Instead, a value-attribute approach will be required to assure sufficient dollars are generated at the consumer interface to generate rational herd expansion to levels that can be profitably sustained. Beef's future depends on the ability to build a premium-product reputation.

While these macroeconomic forces play out, individual producers must make decisions in the short term whether to expand and to determine a path forward to herd growth if that is determined to be the desired alternative. Factors that influence expansion plans for enterprises include debt position, and access to and cost of additional pastures and feed resources, labor availability, age of producer and level of enthusiasm for the cattle business. Local precipitation conditions, competing uses for land and profitability of other agricultural commodities also play a role.

Assuming that expansion is the desired option, alternatives for growth must be evaluated — increase internal herd replacement rates or purchase bred females or heifer replacements. These alternatives have varying levels of economic and operational impact, and all are accompanied by trade-offs that must be weighted and compared.

For example, increasing the number of replacements retained offers a route to expansion, but has the slowest rate of return given the slow production cycle. A replacement heifer retained in 2015 won't return income for nearly a year and a half. Furthermore, as internal replacement rates increase, the number of calves available for sale and, thus, cash flow are going to decline.

On the other hand, purchasing replacement females is an option. Buying virgin heifers is one route, but has the same lagging income stream as increasing internal replacement rates. Buying bred females assures a faster income stream, but the decision is complicated by issues such as biosecurity, ability of the purchased female to adapt to the new production environment, and whether or not the new females are of similar quality to the existing herd.

At the same time, increasing premium attributes of the herd means culling those females that undermine the ability to meet consumer expectation. Trading dollars from the sale of marginal-producing cows for either the purchase of females or to offset heifer-development costs offers another alternative.

The cost of financing expansion will also be a consideration. Today's interest rates are bullish to herd growth, but an upward trend in the cost of money will certainly ratchet down expansion.

This round of expansion will be more strategic and will be characterized by more conservative rates of growth as producers sort through the options and trade-offs. As expansion occurs, it will be critical for beef producers to keep an eye on the expectations of consumers so herd rebuilding yields a better product designed to sustain beef demand at profitable levels for the long term.

Editor's Note: *Tom Field is director of the Engler Agribusiness Entrepreneurship Program at the University of Nebraska–Lincoln.*