

Economic Considerations for a Profitable Life in Agriculture

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Why are you in agriculture?

- Lifestyle?

- Money?

Would you like to retire
someday?

How are you going to fund your
retirement?

In retirement ...

- Farm/ranch income goes to **zero**
[for some, this is an improvement!]
- Household consumption continues

Therefore, to retire an agricultural household needs to **accumulate wealth** during operators' lifetime.

Sources of wealth during one's life:

- Farm/ranch operating income
- Farm/ranch capital gains

- Non-farm income
- Non-farm capital gains

Where has agricultural household wealth come from recently?

My research looks at changes in wealth nationally, by regions and farm size.

Change in Wealth, 1996-2004

	N. east	Lake States	Corn Belt	Appalachia	S. east	Delta	S. Plains	N. Plains	Mountain	Pacific
Farm income										*
Non-farm income			*					***		**
Change in Farm Capital	***	***	***	***	***	***	***	***		**
Change in Non-Farm Capital		***		***	***	**	***			***
Consumption			*	**						

Farmland Value, 1996-2004

	N. east	Lake States	Corn Belt	Appalachia	S. east	Delta	S. Plains	N. Plains	Mountain	Pacific
Revenue/ac			**			*				
Gov payments/ac						***				
Cost of Capital									**	
Productivity					***	*				
Population density	***	***	***	**	***	***	*	***	***	***

Change in wealth, by farm size

	Farm Size 1	Farm Size 2	Farm Size 3
Farm Income			
Non-farm income	**		**
Change in Farm Capital		***	***
Change in Non-farm Capital			***
Consumption			**

Farmland value, by farm size

	Farm Size 1	Farm Size 2	Farm Size 3
Revenue/ac		***	
Gov payments/ac			
Cost of Capital			
Productivity			
Population density	***	***	***

Capital gains are not liquid

- Asset must be sold to capture gains
- Borrowing against capital gains is possible, but adds debt

So, during your lifetime you may be gaining **wealth** through **capital gains**, but you need **cash flow** to pay the bills.

If you do not want to work off-farm, you need to make your agricultural lifestyle profitable.

Profitable farms/ranches have a plan that provides data needed for operating decisions.

- A written Business Plan is usually required by lenders.
- Business Plans focus on issues affecting **profits**.

Profit (gross) = Revenue – Costs

Revenue = Price X Quantity

Costs = Fixed costs +
(Variable costs X
Quantity)

Long-run Strategies to Improve Profit

Price strategies:

- Add value to commodity (process, etc.)
- Strategic alliances/or integration of producers and processors

Long-run Strategies to Improve Profit

Cost strategies:

- Reduce cost/unit by increasing scale of operations
- Reduce cost/unit with technological advances in production/harvest methods and machines

Price Risk

Sources:

- Variable market prices over time
- Uncertain access to markets

Tools:

- Forward contracts
- Marketing groups (clubs, co-ops, etc.)

Quantity Risk

Sources:

- Variable yield per acre over time

Tools:

- Crop insurance
- Geographic diversification of production
- Risk-reducing inputs
- New technologies and/or varieties

Risks associated with Fixed Costs

Sources:

- Variable interest rates over time
- Variable cash flows over time
- Family living costs
- Land ownership and structural issues
- Environmental liability

Risks associated with Fixed Costs

Tools:

- Farm records and financial analysis
- Financial structure of firm
- Insurance on business & family

Risks associated with Variable Costs

Sources:

- Variable labor supplies & costs
- Variable input costs
- Changing production methods and/or tools

Tools:

- Farm labor contractors
- Employee benefits plan
- Supply contracts
- New technologies and/or varieties

Other Risks

Sources:

- Retirement and asset transfer
- Variability of income across enterprises

Tools:

- Retirement and estate planning
- Diversification across enterprises

In conclusion ...

- An agricultural lifestyle must be managed like any other business
- Successful management requires information in the proper form at the time needed
- Automating the household's management information system (MIS) is easy and cost-effective with accounting software