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Managing the margins

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These are certainly exciting times for people involved in agriculture. Farmers have expressed concern for years that prices for their products were too low while the price that they paid for production expenses was too high. Indirectly, they were referring to the margin but the comments were usually directed at the relative price levels of the products. They knew they were price takers and not price makers and could do little to change the situation. Farmers have traditionally looked at controlling the level of their expenses as the only way to compete domestically and internationally. Some types of farmer production expenses allow for farmer manipulation more easily than others. Farmers do have control over what they choose to pay in cash rent or at what price they will purchase land and building resources. They also have control over the type of farm equipment they purchase as related to brand, size, function, and serviceability. Farmers have much less influence or no influence on the price that they must pay for herbicides, fertilizers, seed, and fuel. Quantity purchases or seasonal timing do make some differences, but the general price levels are well beyond the control of the individual farmer.

In recent years, farmers have had the opportunity to exert some control on the price that is received for the commodities they sell by growing specialized crops under contract for small premiums over the general market price. They have also had the opportunity to use more flexible marketing programs that could add or subtract from their usual marketing practices. Some of these special contracts require activities that raise the cost of production for the products in addition to raising the price received. The bottom line figure that needs to be watched is the "margin" between the cost of production and the revenue generated by the enterprise. When the prices paid for products or the cost of purchasing inputs changes radically, the margin swings may take a while to get back to long term expectations for returns that allow producers to continue to use that enterprise. Farmers have traditionally been satisfied with lower rates of return on their resources than have other segments of the economy. This has kept many of the large companies that depend on farmers from integrating down to the farm level. It has been easier for

them to raise input prices to the point that the market will bear and to keep corn and soybean prices at the lowest levels required to obtain their raw materials. As their expense structure changes, they pass up to the final product those cost that they can not extract from their resource providers.

So what does this current demand increase for row crops mean for farm producers? It means that in the short run, margins are getting larger and crop farmers have more cash. Livestock producers are struggling with higher production expenses related to raising meat and milk. Their reaction has been to look for ways to change the animals' diet to include cheaper feedstuffs. It will take a little time for everyone involved to adjust to the large changes that we have recently been experiencing in agriculture, but eventually the margin will return to a more normal level. The problem is that if the general price level remains higher, the risk to the farm producer is also much higher.

Grain farmers are now seeing huge increases in their cost of production. Suppliers are working on adding part of the farmers increased margins to their bottom line. The increased margins for grain farmers are attributable to the bio-economy emphasis. Profit margin projections for the 2008 crop year are still good but look to be half of what was there in 2007. Contrary to the feeling that things are beyond the individual farmers' control, farm producers can do a lot to control their competitive position for the upcoming years.

Farmers need to start working on the things that they can exert the most control. The first decision area relates to how they use their increased amount of cash. Many react by spending the increased money in a manner that will reduce their tax liability the most. Although tax planning is important, it should not drive the use of excess cash. It obviously is a good time to update machinery purchases that have been deferred during leaner years, however care should be taken not to encumber future farm production cost with increased debt financed purchases. Tax deductions help with present income downsizing but often prove troublesome in later years when the tax breaks have

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been used up and the debt still remains. Size equipment property for the operation and use as much cash as possible for the purchase.

Another area that needs attention is the risk associated with paying high cash rents. Make sure that product selling prices are locked in to allow for rental payments that still leave a profit margin for the producer. Flexible leases may help share the risk and may result in a more long term relationship with owners while reducing the need for yearly negotiations. A similar philosophy can be applied to land purchases based on the operations cash flow ability to make the payments.

Your marketing program is very important as prices and risk levels rise. Historic basis levels and relationships have changed and continue to evolve. Time needs to be spent comparing markets continuously. Tools like crop revenue insurance are available to help reduce risk exposure. Higher risk levels mean less room for forgiveness when mistakes or judgment errors occur. On the input side of the farm operation, make sure that the decisions relating to fertilizer levels and pest control are based on the most efficient production methods. It is easy to pad needs or try unproved things when there is higher income. The emphasis should still be on the margins, remembering that

maximizing profits when things are good is easier than trying to find a profit when things are less than good. The Ag Decision Maker website has a variety of spreadsheets designed to help producers fine tune production decisions.

Paying down debt with excess cash flow makes your operation more sustainable over time. The bottom line is that producers need to know their cost structure so they can plan the operation to maintain margins. Too often people get caught up in paying the going rate or fertilizing the way that everyone else does. Fertilizer and other inputs can come in many sources and should be evaluated for the least cost method and product form. Individual farmer production costs vary tremendously. Each producer needs to analyze the situation and procure a profit margin that allows their business to thrive. The result may and probably should look different for each operation. The point is that in dynamic times, farm producers need to continue to do what they do best. Farmers have a reputation of being innovative and they need to continue to "think outside the box" and find ways to maintain profitable margins. Having good data and analytical tools helps make things happen.

Value-added business success factors -- the role of investor attitudes and expectations

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(First in a series of six)

There has been a surge of interest in farmer-owned business ventures that seek to capture additional value from commodities past the farm gate. Some of these ventures have been very successful, some marginally successful, and some have failed. Supported by funding from the Ag Marketing Resource Center at Iowa State University, we conducted in-depth interviews with farmer-owned businesses to determine the key factors that influenced the relative success or failure of these ventures. A better understanding of why some ventures succeeded while others failed provides valuable insight for the success of future farmer-owned businesses. This article focuses on the role of investor attitudes and expectations in business success.

Research Method

To identify factors having the greatest impact on the success or failure of farmer-owned business ventures, a cross-section of seven farmer-owned commodity processing businesses formed since 1990 in North Dakota, South Dakota, and Minnesota were selected. Extensive interviews were conducted with individuals who played, or continue to play, an important role in the formation and operation of the business. This included leaders in the formation of the business, key members of the management team, selected board members, lenders, local leaders and others.

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