

like whether to lease a pasture or not. We use the process to identify markets and to decide which tasks we need to do next. Before it was more like a dictatorship. Our sons are now more engaged in the business. They brought up how they had been feeling which gave us an opportunity to explain some of the background, like the financial situation. Now we let them see the full financial picture and then we split the profit with them afterwards since they are helping with the work.

It's been a learning curve for all of us, but it's been rewarding to know that they are interested."

As the Cooperative's efforts grow to meet the demand for healthy local produce, there will be more opportunity for Veronica's family as well as other community members. Veronica is excited about the possibility of selling the family's cattle as grassfed beef with their own label rather than taking the cattle to the sale barn. Likewise, she is in the process of working with a local restaurant to

use their commercial kitchen to make some value-added products like coleslaw and broccoli mix. "We want the farm to be something that both of us can work on in our retirement," say Veronica. "We also want it to be something that Miguel and Julio can fall back on. By making data-driven decisions and adding value, we can grow our farm with very little investment." That sounds like a recipe for family and community self-sufficiency. ↓

## The Key to Increasing Profit No One Talks About

BY DAVE PRATT

**A**t a recent workshop, I told the audience that if they looked in any farming or ranching publication, they would find articles about cutting feed costs and improving production efficiency, but they wouldn't find anything about reducing land, labor and other overhead costs.

There are two reasons for that. First, no one stands to make any money when you cut overheads (except you). Second, most people believe that overhead costs are "fixed." At the Ranching For Profit School, we contend that there is no such thing as a fixed cost.

Clients around the world have increased profit by radically reducing their overheads, proving that overheads don't have to be "fixed." That's an essential paradigm shift if you want to ranch for profit.

There are only three ways that any business, including yours, can increase profit. We call them "the three secrets." They are:

1. Reduce overhead costs (land, labor and administrative costs)
2. Improve gross margin per unit (the economic efficiency of production)
3. Increase turnover (the total volume produced by the business)

Overhead costs are those costs that don't change much as livestock numbers change. Most overheads fall into one of two categories: land or labor.

Any costs related to land (e.g., repairs to fences, corrals or pipelines and water troughs, leases, etc.) are land overheads. Likewise, any costs related to labor (e.g., salaries and benefits, vehicles and equipment costs, etc.) are labor overheads.

Overhead costs account for 60 to 80 percent

of the total costs in most ranch businesses, yet it is pretty rare to hear anyone discuss them. Historically, ranchers have focused on increasing the productivity of our cows and calves (you'll notice this is not one of the three secrets).

A recent article in one well-known beef industry publication is typical of the prevailing wisdom. It claims that there are four key factors that determine profit: controlling feed costs, managing reproduction, planned marketing and optimizing performance.

Each of these so-called "keys" focuses on

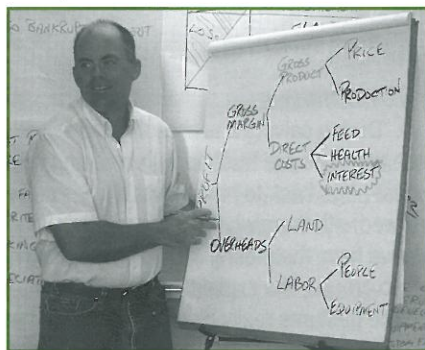
improving gross margin, but none will help reduce overhead costs or do anything to increase turnover. Since overhead costs account for most of the costs on most ranches, and most ranches work well below economies of scale for the labor and equipment they have, reducing overheads and increasing turnover are

at least as important as improving gross margin.

In the workshop, I flipped through a popular beef industry magazine and asked the audience to identify what the ads were encouraging them to do besides spend money.

There were ads for vaccines, wormers, supplements, ear tags, bull sales and DNA testing (all direct costs). These things won't help us carry more cattle. They help us make each animal more productive, but they don't help us reduce overheads. In fact, since inputting these inputs takes labor, equipment and facilities, they increase our overheads.

One reason people believe overhead costs are fixed is because changing them often requires structural change in the operation. Examples of structural change include replacing haymaking with stockpiling and grazing forages,



Dave Pratt outlines expense and the relation to overhead costs.

PHOTO COURTESY OF DAVE PRATT

synchronizing the production schedule of a cowherd to get it in synch with the forage cycle or shifting from year-round enterprises to seasonal enterprises.

People are quick to look at the reduction in input costs that accompany these changes. But most people realize even bigger reductions in the overhead costs no longer needed to input the inputs.

When we think about ways to cut our overheads, we need to consider turnover and gross margins per unit too. If your gross margin is negative, it doesn't matter how low your overheads are, you will lose money. If the gross margin per unit is high, we may still lose money if we don't have enough units (turnover) to cover our overheads, even if the overheads are low.

It is pretty hard to pay for a pickup and a cowboy with 100 cows, even if the gross margin per unit is good. It's a lot easier with 500 cows. We'd probably still only need one pickup and one employee with 500 cows (although it may be a different employee).

If we have machinery or labor with unutilized capacity, we'd be better off finding ways to increase turnover to reach economies of scale. But if you are serious about increasing profit, cutting overheads needs to be on the table too.

Some agricultural economists are uncomfortable with our contention that there is no such thing as a fixed cost. Responding to an article I wrote on the topic, one university economist offered his services to "set me straight." In response to the same article, one of our Australian alumni wrote, "That was close to the best bit of advice I've read."

The approach we take to assessing the economic and financial health of businesses is unconventional. It isn't intended for accountants, the IRS or academics. It's for people who want to make a sustainable profit from farming and ranching. ↓

Dave Pratt has taught the Ranching For Profit School and the Executive Link program for more than 20 years. This article was reprinted by permission of author and previously printed in Progressive Cattlemen.