

Bluegrass Farm Analysis Association

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Annual Meeting!

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Annual Meeting

Bluegrass Farm Analysis will hold the 2000 Annual Meeting November 8 at the Fayette County Extension Office. The meal will be catered by Midway College of Midway, KY. A formal invitation will be sent out in a few weeks.

On your Farm!

The time has come for fall visits to begin. I will be making visits very shortly and we will be bringing your records up to date for the year 2000. I would like to spend the majority of this visit out on your farm. It is important for me to see your farm and become more aware of the things that are not always seen directly in a financial report.

Preparing for the Fall Visit

If you are one who sends your checks in to be coded please get them in to the office as soon as you can. The check-in process is made a lot easier if we stay up to date on check coding. For those of you who have sent your checks in already, please go over the reports that you get back. In most cases I have made notes and asked questions about the reports. Please have the questions answered as soon as you can.

Also please have your record books handy. Ideally, you should have most of your production recorded. Should you need any additional pages or have any questions please call me.

Welcome New Cooperators!

Bluegrass Farm Analysis would like to welcome the following new members:

The Cleveland Home Farm
David Craig
Rusty Thompson

These members come by way of a grant that was facilitated through the Woodford County Extension Office. A special thanks goes out to Michael Duckworth who initiated the work to obtain the grant.

If you know of anyone who may be interested in the services of Bluegrass Farm Analysis please give me their name and number and I will follow up with them. Testimonials are the best sales piece and if you have one to share, please do so. Thank you for your years of service and your assistance in keeping this program strong.

Tax Implications

The spate of government payments tobacco farmers receive this year makes it important to do some tax planning.

“Some of our farmers may end up with four different payments in this calendar year,” says Darwin Foley, Kentucky Extension farm management specialist. “There will be no production expenses to charge against this income the way there would be from actual tobacco sales.”

This might be the season to try to sell your crop after Dec. 31. Or consider prepaying some expenses for next year before Dec. 31.

¹*Progressive Farmer*, "Progressive Strategies-Tobacco-Tax Implications." September, 2000. Page 82.

Management - The Key to Success

Professor Jim Endress, a University of Illinois Extension farm business educator, does not, at first glance, appear to be a controversial figure.



It seems, though, that he has stirred up a bit of debate at the otherwise placid halls of academia that comprise the University of Illinois.

The cause of the controversy?

He doesn't think grain marketing is as important as most people at U of I think it is. Instead, he sees cost management techniques as the principal way to separate good farmers from poor ones, and great farmers from the merely good ones.

He freely admits that his ideas have been controversial. "I've agreed to disagree with some people at the University of Illinois," said Endress.

"Most producers think that if their neighbor made more money than them then they must have did a better job of marketing their grain," he said.

Not so, Endress noted.

He used the Farm Business Farm Management database at the University of Illinois as a starting point and then compiled the data to see which factors – such as commodity price, yield and cost management had the largest management return.

His results divided up farmers into thirds, ranking them by their management returns – farmer's profits on the time, money and

effort of running a farm – and they showed that price, contrary to conventional wisdom, had a very low impact on management return.

On a correlation scale of -1 to 1 – where -1 means no correlation and 1 means complete correlation – price came in .18 to .21. This means that marketing does not really effect management return, Endress explained.

By contrast, cost management came in at .72, a strong, almost casual relationship. This was followed by yield, which came in at .52.

Looking at the numbers, all this may not seem too surprising. If prices are pretty much the same for everyone, then the better cost controllers and managers would be expected to make more money than other, less capable farmers.

The difference, said Endress, is that his study points out which management traits are the most important to a farmer's total profitability.

Since his numbers show cost management as the most important business factor, Endress believes that is where they should concentrate most of their time and effort.

"The goal is to get top things done and then worry about marketing. It's not rocket science to control costs and then develop a marketing plan," said Endress.

Endress also disagrees with the growing idea that farmers have reached the point of diminishing returns on cost control.

"You can always do better," said Endress.

This view is almost heresy in some circles. Endress reported that he has had long arguments with fellow educators with the U of I Department of Agricultural and Consumer Economics. Some doubt his claims outright or think that if one analyzes the numbers differently a different outcome will result.

Regardless of the controversy, Endress hopes his findings can help farmers in running their business by prompting them to look at their management techniques and policies in an objective manner, or to call in someone to do that for them.

"I want to challenge people to look objectively at their record of managerial skills, to take advice and criticism and work to improve their farms," said Endress.

"Producers should ask their management professionals for an honest and objective assessment of their farm. It is critical in today's farming environment that we sharpen our pencil and get as much return as possible," he said.

²*Illinois AgriNews*, "Professor: Cost management, not marketing, key to success." February 18, 2000. D1.

Bad Advice-Take 1

You may have recently read an article appearing in *Cow Country News* stating "8.3 cows will generate the same income above cash costs as an acre of tobacco". Many readers may have mistakenly interpreted this simple illustration to mean that an additional 8.3 cows is equivalent to one acre of tobacco in terms of farm profitability. That is clearly not the case. It was not the authors' intent for the readers to conclude that income would remain stable if the producer would just add 8.3 head of cattle for each acre of tobacco lost due to quota cuts. The point of the article was to show that for some farmers, beef cattle may be an important part of replacing lost tobacco income. In other words, beef cattle can play a role in making up some portion of lost tobacco income and partially offsetting some of the lost cash flow that will result from reduced tobacco quotas. When looking for alternatives to tobacco and, for that matter, any change in a producers enterprise mix it is important to make sure that accurate comparisons are made between the existing



enterprise and the alternative. This article will attempt to portray such a comparison.

Probably the most frequent error made when doing a comparison study is the failure to maintain a consistent relationship between the variables under the said comparison. "Apples must be compared to apples!" We have all heard this saying time and time again, but the premise is often violated and can lead to unintended consequences for the end user of the information. As Kentucky farmers try to search for answers in replacing reduction of tobacco income it is important to be consistent in comparing two or more enterprises.

The aforementioned article presented the conclusion that 8.3 cows will generate the same income above cash costs as an acre of tobacco. Under certain assumptions such as average weaning weight of 500 pounds, a 90% calf crop weaned and sold per cow exposed and an average price of \$0.90 per pound this statement is true. However, while covering cash costs is sufficient for maintaining a positive cash flow in the short run, it is by no means sufficient to ensure the long-run viability of the beef enterprise. In the long run, all costs—both cash and non-cash—must be covered. This even includes fixed costs such as taxes and insurance as well as depreciation on facilities and equipment. In a beef enterprise cash costs only make up a small portion of total costs of production. Total costs easily double and can often triple when we add non-cash costs, most noticeably the cost of home raised feed.

Using Kentucky Farm Business Management Program 1998 Enterprise Analysis studies we can perform the following analysis. Data used here is a result of information provided by cooperators who participate with the Kentucky Farm Business Program.

This sample of data illustrates that 8.3 cows compares favorably to an acre of tobacco *only* on a cash flow basis. However, cash costs make up a large portion of total costs for a tobacco

enterprise. On the other hand, cash costs make up only a small portion of total costs in a beef enterprise. In short, cash costs alone do not reflect enough information to comprise a complete analysis of a beef cattle enterprise in the farm business.

Note that non-cash costs in the beef enterprise include the value of home raised feed. Note also that Tobacco Returns are to Management, Labor and Quota whereas Beef Returns are to Management. A more complete analysis would assign cost to land and quota (both owned and leased) to arrive at a Return to Management figure. Thus we would be comparing the *profitability* of tobacco and beef enterprises on the basis of total costs.

1998 Tobacco	Per Acre
Yield (pounds)	2,255
Gross Returns	\$ 4,097
Cash Costs	\$ 1,829
Return Above Cash Costs	\$ 2,268
Non-Cash Costs	\$ 1,020
Return to Land, Management & Quota	\$ 1,248
1998 Beef	Per Cow
Gross Returns	\$ 276
Cash Costs	\$ 137
Return Above Cash Costs	\$ 139
Non-Cash Costs	\$ 294
Returns to Management	\$ (155)

Keep in mind that the data presented here is merely a sample of producers across the state of Kentucky for the year 1998. Figures presented here may not be representative of all producers. In addition, year-to-year variations in input and output prices will obviously be reflected in costs and returns. Another lesson to be learned from this is that feed costs make up a large percentage of total costs in a beef cattle enterprise. It is thus imperative that producers try to make the most efficient use of low cost feeds such as standing forages and also try to keep a

lid on the remainder of the costs involved in producing beef. Beef production can be a profitable enterprise but, as with all farm enterprises, management is essential. Kentucky Farm Business Management is a firm believer that better management is attained through better records. Record keeping is essential to helping one become aware not only of what the bottom line is for a particular enterprise but also of where that bottom line is located.

Kentucky Farm Business Management prides itself in providing clear and accurate data analysis. One way the organization does this is by utilizing record keeping to provide apple to apple comparisons. When looking for such comparisons and farm management expertise contact your area specialist in Kentucky Farm Business Management.

³*Economic & Policy Update, "8.3 Cows = 1 Acre of Tobacco?" Anderson, John D., Colby A. Blair and Rick Costin. June 9, 2000.*

Bad Advice-Take 2

I once went to a field day at a University of Kentucky experimental farm, where one of the stops on the tour was a demonstration of clearing wooded hillsides for alfalfa production. The end result, lying beyond the speaker's chart boards, was impressive: a beautiful stand of the newest variety of super-achiever alfalfa, which brought oohs and ahhs from the wagonload of farmers listening to the presentation.



What troubled me then, and remains with me still, was the economy of the proposition. Regardless of the productive capability of that new alfalfa, it could never pay for itself. The list of bulldozer hours, tractor hours, man-hours, fertilizer and lime tonnage required just to get that land ready to sow were awesome. Any Owen County farmer could have gone out and bought better land, already cleared, for less money.

If there was any lesson for me that day it was probably unintended: that you cannot economically clear forested land for alfalfa production, at least not in the way the university does.

Over the years, which have included several 100-year-category droughts, any number of too-wet seasons and one huge cattle-market collapse, I have grown leery of help from experts. I realized this the other day when I found myself at another Farm Field Day, again amidst a wagonload of farmers and agribusiness dealers. We were audience to a presentation called "How many beef cows does it take to replace an acre of tobacco?" by an expert who had apparently been on sabbatical during some of the defining experiences of the last decade.

The question posed in the presentation's title must have been rhetorical, for it was never answered – perhaps because it is an obvious apples-to-oranges conversion. Still, despite the tattered weariness of the overall information (keep good records, rotate intensively, treat it like a business), some advice of gravity awakened me from the lull. And it is advice that is being echoed now throughout the state by a variety of official voices, with such volume and synchronization as to suggest a high-level agreement on strategy to overcome the tobacco crisis.

The head-turning advice? Double your production. Fill those empty tobacco fields with cows. Now, such advice is not noteworthy for its creativity or novelty. Increasing production has been the all-purpose salve applied to most agricultural scrapes since long before I started farming. Its present noteworthiness in the cattle industry depends simply upon memory, and not a particularly long memory. Because, for all the attractive profitability in cattle today, just three years ago times were different: disastrous prices, herd dispersals and bankruptcies resulting from an oversupply of cattle.

A slightly longer memory would remember grain farmers being urged to plant fencerow-to-fencerow. It would recall the

existence of dairies, which, 25 years ago, were the golden niche of farm advisers. The dairies' cash flow was touted as the new standard. You could hardly borrow farm money without promising to milk a herd of Holsteins. Today, mentioning milk to a lender will get you thrown out the door. Yet, ironically, as our few remaining dairies teeter on the brink of survival, they, too, are being given incentives to double their production.

But what's past is past. We have gone on to bigger and better things. Kentucky, you see, has moved to 8th ranking among the states in cattle numbers, a source of inestimable pride for our officials. We bumped around down there out of the Top 10 for an eternity, but now we're getting somewhere. Forget the liquidations, the increasing gap between farm incomes and the rest of the civilized world. They are but a few sour notes in the fanfare for a modern economy, surely insignificant compared to the possibility of moving up another notch or two in the rankings.

Still there are doubters. When the question "Won't we flood our markets?" arose at the field day, the answer was quick and amazingly simple. "Not if Kentucky alone increases production." Repeat that silently to yourself. Three times. Then click your heels together. Are you still in Oz? Or do you find yourself in the brutal world of NAFTA and GATT, where Kentucky farmers must take Mexico, Canada and Argentina into their considerations just as certainly as Texas and Tennessee?

Even as yellow bricks are being hauled to the road site. I gather from recent media releases and newspaper articles that there are assets and stumbling blocks to the new strategy. In the asset column, there exists a pool of money, namely the Tobacco Settlement Fund, which requires some sort of cohesive plan to access. In the stumbling block column reside those rogue farmers with their pesky memories.

Already the campaign has begun to discredit them, trivialize their views. They have become "people who don't belong in this business." Their "old-fashioned

mentality" stands in the way of progress. They are chastened to adapt or fall behind, much as they were told years ago, to get big or get out. And finally, they are rendered replaceable. The desirable future lies with our "younger farmers who are willing to make the changes and adapt to new ideas."

Well, I am not young. I have already lived more years than I can expect yet to live. The hairs on my head that are not gray are fewer than the full-time farmers left in this county. Still, I must assume myself to be one of those younger farmers they're counting on. For those younger than me are, indeed, few. (The dictum to find farmers under 40 to put on the local settlement fund committees has reputedly run aground on the reality that there are practically none.)

But I fear their hopes for me are misplaced. Their desirable future has eluded my reality for too long. My alliances run more and more to those old-fashioned rogues, those survivors. We share soil types. Their counsel and example have served me more consistently through the hard times, which have been numerous. Some of those times were inevitable, and some were brought on by the foolishness of men. A good memory obliges consideration of both. Common sense demands avoidance of the latter. And I would go a long way out of my way to avoid 40-cent calves ever again in my life.

⁴*Lexington Herald-Leader*, "Experts' try to stampede farmers with bad advice." James Gash-Owenton Cattle Farmer. coachjim@kih.net.

Agricultural Consultants- A Wise Investment?

Wally Amos, the founder of Famous Amos cookies is reported to have said, "You have to do what you do best and fill in with the people who do well at the rest." Essentially, Mr Amos was saying in business operations everyone needs some

help. This is also true in production agriculture, perhaps more so due to the increased complexity and size of modern farm businesses.

As prices are squeezed downward and input prices nudge upward, most farm operators respond by working harder on the production side of their business. While these efforts may result in added production efficiency, time may be taken away from management issues that have greater impact on farm business profitability. Harlan Hughes, of North Dakota State University, in an article entitled "Lack of Management Power is Threatening the Survival of the Mid-sized Family Farm and Ranch", stated "They just don't have enough hours in the day to collect and analyze on-farm data and to turn that data into management power." This need for "management power-assistance" has long been recognized by Cooperative Extension Services in some states (including Kentucky) and is also being addressed by private firms and some Farm Credit Services. The University of Kentucky has offered a partially-subsidized, fee-based Farm Business Management Program (often simply referred to as "Farm Analysis) since the late sixties in some areas. Private firms all over the U.S. offer farm business consulting services. Northern California Farm Credit Services (NCFCS), in response to market surveys, recently created a new division to provide consulting services to producers in their area. According to Bruce Strickler, CEO of NCFCS, producers have told them, "they need assistance with management decision support. Their support is being provided in the form of strategic planning, feasibility studies, financial forecasting and inter-generational business planning."

Pick up any farm trade magazine and you will likely see articles referring to estate planning, risk management, alternative business structure, and various tax and marketing strategies. While it is possible that a farm business manager could spend the time to research these topics and become well-versed in one or all, the time required most certainly would be

prohibitive. As a result, most would seek counsel of an off-farm professional. Obviously, these services cost money. The question for the farm business operator is, "can these professionals and the services they offer positively affect the net financial position of my business?" On the front-end, the cost may seem too high, until the client realizes the consultant's work prevented him from choosing a course of action that could have cost many times the fee paid.

Sometimes a farm business manager is too close to his particular situation to see the larger picture – the "can't see the forest for the trees syndrome." However, less recognized is the fact that people often do not realize what is seen as correct may be incorrect because of previous understandings or biases. This phenomenon has a scientific name – scotoma. A common example is a person overlooking obvious spelling errors in a document they have written who would otherwise instantly recognize the mistakes. A farm business manager may overlook opportunities, pitfalls and obvious errors due to being "too familiar with the situation." A professional consultant, without the same preconceptions or at least different ones, can help operators remove biases that limit profitability. No one likes to admit they have inherent biases, however most business managers have developed preferred methods of dealing with issues and challenges that arise. Someone from outside the farm business may be able to expand or change the viewpoint in a way that was not visualized by someone inside the business. Given this reasoning, it is probably important to hire consultants with no biases or at least different biases regarding the subject to be covered.

Consultants may be able to eliminate conflict or at least reduce the appearance of conflict. Management typically has some level of self-interest to protect or advance. Examples include preservation of operational control, maintenance of compensation or fringe benefits and incorporation of family members into the business. Especially in multi-family

businesses, these conflicts (real or imagined) may subvert the credibility and implementation of internally-produced strategies and plans. Oftentimes too, even if the strategy or plan is well-founded, farm business managers find comfort in the knowledge that an idea is supported by an objective outside observer.

Outside consultants often bring to the table new technologies, methodologies, processes and information not currently contained in the present set of management resources. Utilization of these newly-acquired resources can expand the skills and capabilities of business managers open to new ideas to increase profitability. Even if the farm business manager is fully knowledgeable of current production and business information, he may not be the most effective person in facilitating utilization of these new technologies. When companies gather their "brain trust" for a strategic planning retreat, seldom do they allow one of their top executives to facilitate important discussions of business matters. Instead, they hire a professional facilitator to moderate the discussion and process. A facilitator would especially be useful in delicate discussions of family business planning and inter-generational transfer. These matters are often buried, only to surface at a most inopportune time, because no one facilitated the subject in a professional and objective manner.

Oftentimes a farm business manager must prepare materials and proposals, with supporting documentation, to their lender, investors or legal counsel. Clear, concise, professionally prepared documents will be more convincing and may reduce verbal presentation time. If the manager does not have the time nor resources for adequate preparation, the results could be detrimental to the current and the future financial stability of the farm business. A consultant can assist in quantifying, organizing and compiling the information necessary for important and necessary presentations. Additionally, a properly-qualified consultant can assist in comparing alternative scenarios and analyzing the impacts of selected business

variables within the operation. Outside assistance in forecasting financial probabilities can flatten the learning curve and reduce time and expense compared to trial and error methodologies.

In summary, the hiring of an outside consultant CAN benefit a farm business. The question to be asked by each farm business manager is, WILL it? To determine if hiring an agricultural consultant is financial foresight or folly, re-examine the functions a consultant can provide. Would engaging a consultant:

- *Remove or offset a bias?
- *Reduce conflicts or the appearance of conflicts?
- *Provide new technology or insights?
- *Expand resources?
- *Facilitate important discussions?
- *Improve credibility?
- *Improve preparation?
- *Provide improved comparative analyses?

Obviously, hiring a consultant is not always the best use of limited funds. However, if you answered any of the above questions affirmatively, paying for the objective counsel of a qualified farm business consultant may be money very well spent. As indicated before, the University of Kentucky Farm Business Management Program (UKFMB) is an excellent source of "management power." Contact your local county extension office for information. Outside Kentucky the National Association of Farm Business Analysis Specialists (NAFBAS) and American Society of Agricultural Consultants (ASAC) – www.agri-associations.org are excellent starting points for contacting qualified consultants.

⁵*Economic Policy & Update. "Hiring an Agricultural Consultant - Financial Foresight or Folly?" September 8, 2000.*

Tobacco News

Kentucky tobacco farmers are always concerned with Congressional action dealing with the tobacco program, but recent action was certainly good news for the industry. As part of an ag

appropriations bill, the U.S. Congress declared the drought-stricken 1999 crop as a disaster and consequently will forgive over \$500 million dollars in loans associated with 220 million pounds of pool stocks originating from the 1999 crop. These stocks have been described by tobacco buyers as simply undesirable at current prices given its quality characteristics.

This is significant news because it takes these excessive pool stocks out of future quota formula calculations. Following the 1999 marketing season, the burley cooperatives possessed over 400 million pounds of stocks. Stock levels of this magnitude could have easily resulted in another double digit percentage cut in the burley basic quota for 2001 and an effective quota reduction of more than 30 percent. However, recent pool stock sales, combined with the forfeiture of the 1999 crop now reduces non-committed pool stocks levels down to just over 100 million pounds. **If manufacture purchase intentions remain relatively flat**, which of course is very uncertain at this time, but if they remain similar to this past year, the reduction in pool stocks levels could translate in a significant increase (around 30 percent) in the 2001 burley basic quota, while stabilizing the effective quota. The loan forgiveness on the 1999 crop will also aid in reducing future no-net-cost assessments.

One issue that is not clear at this time is what will happen with the 1999 crop? The Commodity Credit Corporation may attempt to discount this tobacco and sell it in the international market. However, burley leadership is concerned on the potential impact this could have on future U.S. burley trade if it is not directed to non-traditional markets. In fact, burley leadership is pursuing attempts to simply destroy this tobacco so that it does not impact world burley supplies. Whatever, the outcome, forgiveness on the 1999 loan should allow quota to rebound in the short-term and give burley leadership some time to address other serious problems associated with the program and industry.

⁶*Dr. Will Snell, University of Kentucky Department of Agricultural Economics.*

Quotes

Minds are like parachutes; they work best when open. - Lord Thomas Dewar

The only reason some people get lost in thought is because it's unfamiliar territory. - Paul Fix

To the man who only has a hammer in his toolkit, every problem looks like a nail. - Abraham Maslow

The brain is a wonderful organ; it starts working the moment you get up in the morning and does not stop until you get into the office. - Robert Frost

One's mind, once stretched by an idea, never regains its original dimensions. - Oliver Wendell Holmes

Only the mediocre are always at their best. - Jean Giraudoux

The greatest revolution of our generation is the discovery that human beings, by changing the inner attitudes of their minds, can change the outer aspects of their lives. - William James

Die when I may, I want it said of me by those who knew me best, that I always plucked a thistle and planted a flower where I thought a flower would grow. - Abraham Lincoln

Your Suggestions are Welcome

I encourage you to make suggestions for future BFA Newsletters. If you would like to hear about a specific topic please call the office and I will research it for you and provide a story for the next newsletter.

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