Know Your Cost Of Production: Develop An Enterprise Budget

BLUE SPRINGS, MO.

Whether you raise cattle, corn or cucumbers, accurate enterprise budgets are crucial in gauging the potential profitability of your operation, says a University of Missouri Extension agriculture business specialist.

"In addition to predicting profits, enterprise budgets help producers evaluate alternative strategies for making the most out of their land, capital and labor," said Whitney Wiegel.

By definition, an enterprise budget is a financial management tool for projecting costs and returns for an activity-such as livestock, grain or vegetable production, Wiegel said. A typical enterprise budget will include five main sections:

1. A summary of the projected total revenue from the enterprise. "The revenue or income section of an enterprise budget must contain a description of the expected yield or amount of product produced-such as bushels, pounds or number of head of livestock," Wiegel said. This section must also specify a projected market price. Total revenue is calculated by multiplying total production (expected yield, number of head, etc.) by the market price per unit of production and then adding any other payments received, such as government payments.

2. Expected variable costs of production. Variable costs are the costs of inputs that are used up during one production period. These costs vary with changes in the number of head, acres or other units produced in the enterprise. The variable cost section of an enterprise budget outlines the expected inputs and amounts of inputs to be used in the enterprise. It also assigns a cost figure to each input. Examples of these inputs/costs include fertilizer, chemicals, feed, minerals and labor.

3. Fixed costs of production. Fixed costs are those that do not change with the level of production. These include items like interest on intermediate and long-term loans, depreciation, taxes and insurance.

4. Total cost of production. The projected total cost of production is the sum of variable and fixed costs.

5. "Returns" or profit. This part of the budget compares the revenue of the enterprise to its costs. Often, this section will be segmented to describe both returns over variable costs and returns over total costs. While an enterprise should earn a profit above total costs, this is not always the case. Income received is sometimes less than total production costs. Should an enterprise be continued if total revenue is less than the total costs? The answer may be yes if (1) income is above variable costs and (2) this is a short-term condition. If fixed costs are not covered in the long run, however, reinvestment in capital items (such as tractors, implements, buildings and equipment) cannot be made and existing capital stock is eventually depleted.

Numerous examples of enterprise budgets are available on the Internet, Wiegel said. "Most of the budgets available on the Web will contain some suggested cost and return figures. However, be cautious about using figures without doing cost and market research first."

Links:

-Cost and Return Estimates for 2011 (MU Food and Agricultural Policy Research Institute): http://www.fapri.missouri.edu/farmers_corner/budgets/.

-Farm Budgets (MU Agricultural Electronic Bulletin Board): http://agebb.missouri.edu/mgt/budget/.

-Links to many budgets can be accessed through the Ag Risk Education Library (University of Minnesota): http://www.agrisk.umn.edu/Budgets/. Δ