



Overhead analysis

A real estate agent once bragged on his home area in Montana: It was such natural cattle country, you needed only a pickup and blue heeler to set up ranching. I guess the ad would read, “Big Sky, Low Overhead.”

It has nothing to do with the sky falling. Overhead is an economic term often used in place of “fixed cost,” the price of being in business that must be subtracted from gross profit to get at what you really made or lost.

On a chart, this cost could be represented as a flat line across time, the sum of land cost, depreciation, taxes, interest, utilities and anything else that remains about the same regardless of production level.

Unfortunately, those charts look different from one business advisor or computer program to the next. That’s because there are no absolute rules as to whether a cost is fixed or variable. Think about all the potential gray areas.

Repairs and maintenance are often considered fixed costs, but do they vary with volume of use? With machinery, yes. With fences, no. You may pay the same basic wages as herd size varies, and that’s why labor is sometimes considered overhead. Laborsaving machines may cut back on wages, but their depreciation and maintenance become overhead.

What about living expenses? If you have no other means of paying these costs, even food and clothing may be considered overhead. That’s why ranchers appreciate thriftiness in certain family members or worry about their “hard keepers.”

Capital expenditures are separate, but their amortization over an estimated useful lifespan goes into overhead. They can also lead to interest, insurance, and repairs and maintenance, increasing a fixed cost of doing business.

Overhead is easier to justify with 1,000 cows than with 100, and much more difficult with 10 head or two. You may buy a more expensive bull when he can be used spring and fall on more cows. You can divide ownership costs on a \$30,000 pickup by the number of producing units in the herd.

Overhead has been called a necessary evil, but that's not quite accurate. Some of it may not be necessary, and if it is, the expense is no more evil than the enterprise.

When calf prices are relatively high, ranchers may have opportunity money—if drought allows for it. At this turn of the cattle cycle, overhead tends to increase, from new pickups to machinery and land.

A key to controlling overhead cost is to identify all the components. That can help you assess the productive value of assets and determine whether any components of cost are getting out of hand. You may even find some “unnecessary evils.”

This analysis may also identify items or services that you need in order to operate the business more efficiently. Overhead management means more than cutting costs. You may discover assets that still fit your goals but are not being fully used. Strategic planning can find ways to diversify or expand to make better use of overhead.

Brush control and water development are a couple of examples that need attention so that you can continue to spread land costs over a stable or growing number of cattle. Make sure any expansion in beef produced per acre is sustainable in the long term.

Even though you can afford some machinery, consider the likely return on your investment. Will you be able to use it more than a few days out of the year? If not, perhaps you can rent equipment for seasonal or occasional use.

You may be able to buy equipment with neighbors or family, owning just a fraction of it to be amortized as overhead. You or the group of owners may be able to hire labor to make occasional-use equipment into a custom enterprise. That spreads all costs over more units and increases efficiency.

Remember that what works across the road may not work for you. Justifiable overhead expenditures vary with the many unique resources of each farm or ranch and the people who manage them.

Next time in *Black Ink*, we'll look at reproductive efficiency. Questions? Call toll-free at 877-241-0717 or e-mail cabsteve@aol.com.

END