

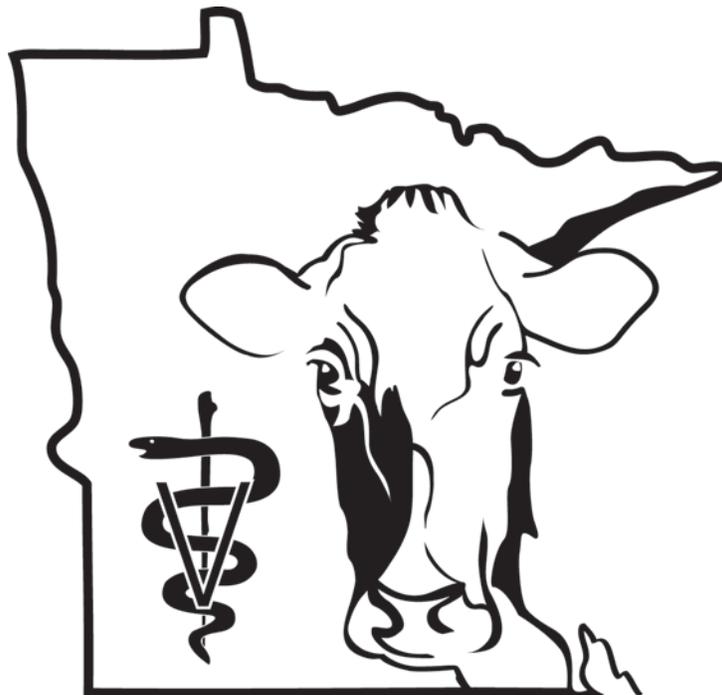
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UNIVERSITY OF MINNESOTA

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VETERINARY CONTINUING EDUCATION



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Production Decisions From An Economic Perspective

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“Successful farming... demands clear business organization and management for the efficient use of capital, labor, machinery, and horses. The success of the individual farmer is as dependent on the application of business principles as it is on crop yields and production of animals.”

This quote is one that is just as applicable to day as it was in 1913 when it was written, (accept for the horses). I am always struck by the fact that, as far as we have come technologically, business success still depends on the basic strategies of good business management.

The dairy industry is currently in a time of significant change. As one prominent agricultural economist has stated, “We are entering a time when ability to compete will be dependent of wise use of capital not just ability to generate cash flow”.

Let’s look at some of the ways this statement might apply more specifically to a dairy.

Operating Efficiency

Typically when we think of operating efficiency we think of cost control...how cheaply can I produce milk. It is extremely important to remember that cost is only one part of the equation and always needs to be compared to the return generated. From this standpoint, cost control is not so much a matter of how cheaply something can be done, but more a question of consistently focusing the “costs” towards generating the highest returns. The concept of marginality or thinking in terms of fixed and variable costs as they relate to potential returns is absolutely fundamental to this process. Access to accurate, timely financial data for your business is also essential.

Enterprise Accounting

Once, we have a system in place that allows us to effectively judge profitability or the margin between productivity and cost, we can begin to look beyond the dairy enterprise. What other “investments” are we making in areas such as cropping, or young stock, which may actually be draining resources away from milk production, rather than contributing.

Assets such as equipment or land need to be reviewed critically to ensure they are contributing fully to earnings potential.

Heifer raising programs need to be critically evaluated both from a cost and quality standpoint to ensure access to as many high quality heifers as possible while controlling costs.

The Idea of Liquidity

“Focus on liquidity” is a commonly made statement. I tend to think about this in a couple of ways.

First, liquidity is affected by profitability or how effectively the operating expenses are turned into revenue. It is important to remember, however that other cash demands such as debt, personal living expenses, levels of investment in equipment, etc. all impact liquidity. In some situations one may find that increasing productivity may not be enough to overcome things like higher levels of debt for example. In these cases your ability to stay focused on the productivity of the dairy enterprise may be affected by high cash demands elsewhere.

Second, the types of investments we choose to make affect liquidity. To be even more specific, the timing between when we make an investment and when we generate a return will affect liquidity.

For example, during low milk prices or tight cash flow conditions focusing on investments that pay off quickly as well as postponing investments that don't contribute to current milk flow may be wise decisions.

On the other hand it is important to remember that businesses, which are structured to allow more flexibility in the types of investments they make, are at a distinct competitive advantage.

Finally, it will become increasingly important to create time to manage. Peter Drucker states, “That before we can begin the task of managing more effectively for the future we have to learn to manage the business more effectively today”.

The first step in creating the time to be a better financial decision maker is many times to more effectively address the demands being put on your time today.