**Farm and Ranch Economics Glossary**

**Asset**: In financial accounting, an asset is any economic resource owned by the business or individual. Simply put, it is anything that can be converted into cash (including money.)

**Break Even**: Gross Product – Direct Costs – Overheads = 0. This means you are only keeping your head above water. **This is not sustainable!**

**Break Profit**: Gross Product – Direct Costs – Overheads = Profit. You determine the amount of profit you want the business to generate. **This is sustainable!**

**Capital Expenses/Purchases:** Capital purchases are generally purchases of over $250 that have an expected useful lifespan of more than 2 years These are the big ticket items that you will buy, which convert the business’s cash into an item of value. The value is still held with the business, but will depreciate over time. For example: a tractor, implements, a greenhouse, a farm vehicle, breeding animals, or a livestock trailer. These are also called “non-cash overheads” when referencing items after the year that they were purchased.

**Crop Profit**: Total income generated by a crop minus the direct crop expense. This is the amount of money that can contribute to paying overhead expenses and profit. May also be called “gross margin” or “contribution margin.”

**Direct Costs:** Costs that change as units of production change. For example, if one more animal or acre was added to your business, the cost to support that would change. Examples of direct costs would include: veterinary expenses, crop fertilizer, or livestock feed. These are also called “variable costs” and “direct expenses.”

**Direct Cost per Unit:** The direct costs per standardized unit produced (pounds, bunch, etc.)

**Enterprise:** An enterprise is any part of a farm or ranch operation that could be run as a separate business and has direct costs. A cattle ranch might have cow-calf, stocker, finishers, and meat as enterprises. A vegetable farm might have vegetables, plant starts, and cut flowers as enterprises. An enterprise must have direct costs. An exception to this would be custom grazing (few/no direct costs).

**Enterprise Analysis:** Enterprise analysis is the process of examining how profitable an enterprise is and how efficient it is compared with other enterprises. This can be thought of as the comparative economic efficiency of the enterprise, calculated by your gross margins.

**Gross Margin:** The difference between gross product and direct costs is the gross margin. Can also be called the “contribution margin” and “crop profit.”

**Gross Margin per Unit:** The amount of gross margin per standardized unit (1 cow, 1 acre, 1 foot of bed space). This allows us to compare enterprises.

**Gross Margin Ratio:** The proportion of gross product to direct costs. This tells us how much of each dollar of gross product we get to keep after paying direct costs. Also called the “profit margin” or “contribution margin ratio.”

**Gross Product:** The value of all production on your farm or ranch. **For vegetable and fruit crops, gross product is generally equal to sales and is referenced as the “total crop income.”** For breeding livestock, gross product is determined by the following equation:

***Closing Inventory Value + Sales – Purchases – Opening Inventory Value = Gross Product***

*Example:*

December 31 Inventory Value (Ewes, Ewe Lambs, Rams) $10,000

+ Sales (lambs, culls) $15,000

- Purchases (ewes, rams) ($500)

- January 1 Inventory Value ($9,000)

GROSS PRODUCT $15,500

**Loaded Labor Rate:** An hourly wage that includes the cost of added taxes and insurance including payroll tax, workers compensation insurance

**Net Worth**: Total assets of a business or individual minus total liabilities. Also called “net” or “net wealth.”

**Non-Cash Costs**: Non-cash costs may significantly impact the net worth of the business. They can also be called “non-cash overheads.” Below are two examples:

1. **Depreciation**

* Depreciation is the decline in the value of the things we own.
* Must be included in the analysis (even though it does not involve cash)
* Depreciation on machinery is a labor-related overhead
* Depreciation on facilities is a land-related overhead
* Depreciation of cows is automatically accounted for by valuing animals conservatively in the inventory. (For example, if you bought 5 young cows worth $750 each. The value listed in the closing inventory is $500. That’s $250 of depreciation per cow automatically accounted for in the inventory valuation).

*Note: this is not how depreciation is calculated for cashflow or tax purposes.*

1. **Opportunity Costs**

* Opportunity costs are the non-cash costs reflecting the lost opportunity to spend your time/money/other resources doing something else.

For example, you could choose to sell the cattle and invest the money elsewhere. The potential income on the capital formerly invested in the herd is an opportunity cost. Likewise, since you could lease the ranch to someone else for $20/acre, you could charge the business a $20/acre opportunity cost on the land. If you own the land, this is an overhead cost. The opportunity cost for farming is calculated using the projected start-up costs for the production year.

* It is necessary to include opportunity costs in an economic analysis for several reasons:
  + Opportunity costs reflect the real economic cost of not capitalizing on an alternative investment.
  + Charging opportunity interest is necessary to compare enterprises within a business or between businesses.

**Overhead Costs:** Costs that occur at roughly the same level regardless of how much we produce on the ranch or farm. These are also called “fixed costs.” There are three basic types of overheads:

1. **Land-related overheads**

* Land costs (rent, property taxes, etc.) are always overheads. Even if a lease is paid on an AUM (animal unit month) or per head basis or % of crop sales, it should be considered an overhead. While it may seem to contradict the definition, if we are to diagnose problems and opportunities, like costs must be grouped with like costs.

1. **Labor related overheads**

* Generally, labor costs are overheads. Labor costs include salaries, payroll, taxes, housing, and vehicle costs. Interest, insurance, depreciation, repairs, and fuel costs of machinery are also labor overheads. (You can do the same job with a shovel as you can with a backhoe---it will just take a tad longer). All of the costs associated with a farm vehicle (i.e., truck, tractor) are labor overheads. ***Note: the only exception to this is hired crop labor (weeding, harvesting, etc.), which increases with acreage or the number of crops. In this case, crop labor is considered a direct expense.***

1. **Administrative overheads**

* Administrative costs are those that are not directly involved in producing the product. For example: office supplies, a business computer, or a business phone.

**Banker Definitions of Profit and Loss**

**Profit** is an increase in net worth.

**Loss** is a decrease in net worth.

**Farm Business Planning Definition of Profit**

**Profit**: From the value you produce, could you pay: cash rent for land, full cost of labor, interest on all assets used, all other production costs, and still make a good return on your investment?