Economics Glossary

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 - Capital expenses are things for which we pay money but which still have value. (A pickup purchased for $20,000 cash is still worth $20,000. The value has not been lost, it has simply been transferred from cash to truck. However, the moment the pickup became ours its value declined due to depreciation. The principle we paid for the pickup was not a cost to the business because we retained that value. However, depreciation, tax, license, insurance, interest, fuel, and maintenance are costs. They are overhead costs.)

Direct Costs – Expenses that vary in direct proportion to the enterprise. If one more animal or acre was added or subtracted, the cost would change. Examples would include: veterinary expenses, interest on capital invested in livestock, and fertilizer (farming).

Enterprise - An enterprise is any part of a ranch operation that could be run as a separate business. A cattle ranch might have cow-calf, stocker, finishers, and meat as enterprises. An enterprise must have direct costs. The only exception would be custom grazing which normally have little to none in direct costs.

Enterprise Analysis - Enterprise analysis is the process of examining the economic efficiency of an enterprise.

Gross Margin - The relationship between direct costs and gross product is called *gross margin*.

Gross Income – Direct Costs = Gross Margin

Gross Margin/ # Head exposed to the bull = Gross Margin per head

Gross margin measures the relative profitability of enterprises in your business.

The ***gross margin per unit*** (per acre or per head) is a measure of the economic efficiency of an enterprise. Gross margin/unit can be used to compare your enterprises to enterprises on other ranches.

Gross Product – The value of what you produce. This takes into account opening and closing inventories, sales, and purchases. The calculation is as follows:
Closing Inventory
+ Sales
-Purchases
- Opening Inventory
= Gross Product

Non-cash costs - noncash costs may significantly impact the net worth of their business. Below are two examples:

Depreciation
- Depreciation is the decline in the value of things we own.
- Even though it does not involve cash, depreciation must be included in the analysis.
- 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 $200 of depreciation/head automatically accounted for in the inventory valuation.)

Opportunity costs
- Opportunity costs are the noncash costs reflecting the chance to do something else with our resources. (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. This is an overhead cost if you own the land.

It is necessary to include opportunity costs in an economic analysis for several reasons including:
- 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. For example, Willie borrowed money from a bank to purchase the stocker cattle, but he owns the cows. He pays real interest as a variable cost in the stocker enterprise, but pays no interest on the cows. To compare the economic efficiency of these enterprises, Willie must level the playing field by charging interest on the cows.

Overhead Costs

Overhead costs are costs that occur at roughly the same level regardless of how much we produce on the ranch.

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, 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.

2. Labor related overheads.
   Labor costs are ***always*** overheads (except for fertility and pregnancy testing). 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 the pickup are labor overheads.

3. Administrative overheads.

Banker Definition of Profit and loss

Profit is an increase in net worth.

Loss is a decrease in net worth.

Net worth is the difference between what you own and what you owe.

Ranching for Profit Definition of 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?