Enterprise budgets are useful tools especially during uncertain times

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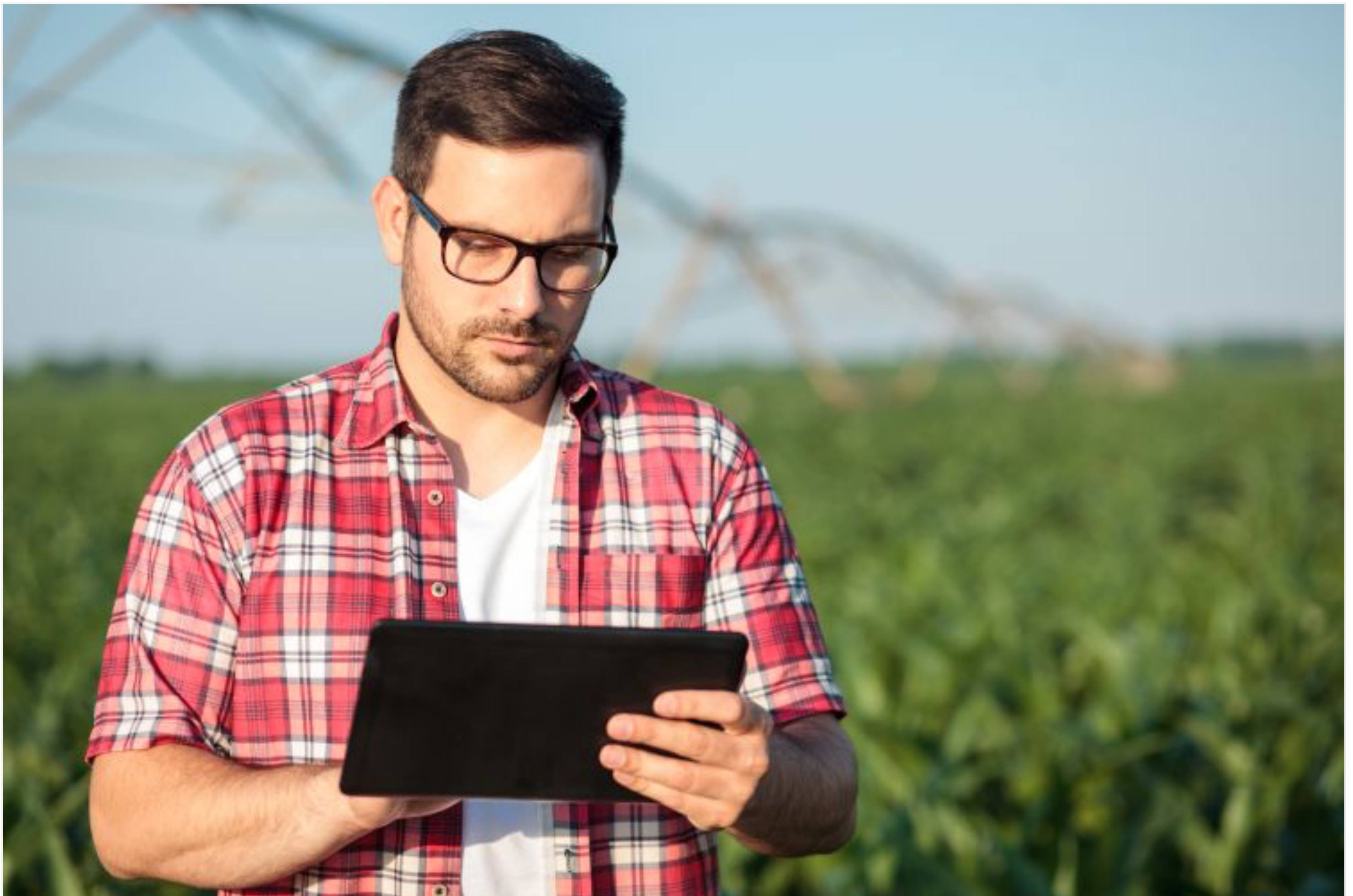
Understanding your assumptions about costs and revenues helps you better predict future profitability.



Enterprise budgets can help you make simple and strategic farm management decisions.

The current market, with rising input prices and potential downward pressure on output prices, is stressful. Given this “squeeze” your farm might be experiencing, and to predict future profitability, it is important to take a step back and evaluate your projected costs and revenues. Fortunately, there are tools, such as enterprise budgets, available through Michigan State University Extension to help with this process.

What decisions can enterprise budgets help you make?

Enterprise budgets can help you make simple and strategic farm management decisions. On the simple decision front, you could project fertilizer costs will be higher this year, so you can either look for ways to reduce this cost or explore other cost reductions. As another example, suppose after creating the enterprise budget, you determine you have a high equipment depreciation and decide to sell an underutilized tractor.

In previous articles, we have written about strategic planning and discussed the importance of internal assessments. This process includes evaluating the profitability of each farm enterprise. For example, how profitable is the blueberry enterprise compared to the wine grape enterprise? Are we producing the right mix of products, or should we be doing something different? Should we be adding this new tomato enterprise or disinvesting in a cucumber enterprise? Regardless of your commodity mixes, understanding how profitable your individual enterprises are or might be can help you answer tough questions and make the best decisions for your farm.

Additionally, enterprise budgets can be useful in forward contracting and hedging decisions. Using enterprise budgets can help you determine if the prices offered in the forward contract or with the hedge will return a profit or a loss.

Basic structure

Revenue (including cash and non-cash revenue) is usually listed first. When reporting anticipated revenue, use futures prices (plus or less basis) or current forward contract prices to estimate output prices and use historical yields as estimates for output quantity (total production). Remember to include all revenue sources such as cull cows for cow-calf and dairy, or byproduct prices like straw for wheat.

What is an example of a non-cash revenue? Assume that you have a cow-calf and a backgrounding operation. Through this approach, you would count the calves you retain as non-cash revenue (the amount you could have sold them to someone else) for your cow-calf enterprise. The backgrounding operation would then count the calves as a variable cost. Variable costs are those expenses that only occur when production happens. Examples of variable costs could include fuel, feed, fertilizer, hired labor, and veterinarian costs. Recall purchased feed is valued at the purchase price, while raised feed should be valued at its opportunity cost, or the price you would have received had the feed been sold to someone else.

Fixed costs, also known as indirect or ownership costs, are those costs that would need to be paid even if there was no production. Examples of fixed costs include, but are not limited to, depreciation, taxes, rent or mortgages, and property and vehicle insurance. If there are multiple enterprises on a farm, consider allocating the appropriate proportion of the fixed expense to each enterprise. For example, you may use a tractor for peaches 40% of the time and asparagus for 60%. With this example, you would allocate the tractor's depreciation to each enterprise according to those proportions.

Caution on profitability interpretation

There are many enterprise budgets available on the internet. However, it is important to note that the profit calculation may not be the same across tools. Some enterprise budgets may not account for the opportunity costs of your management, land, and capital. Opportunity cost is a way to assign an economic value to resources you use for which cash may not trade hands. For example, as the farm operator, do you write yourself a paycheck?

Suppose an enterprise budget reports “returns to land and management” as profit. Therefore, the opportunity costs for management time and land are not included in the budget. As such, the “profit” reported is the funds left to pay for the land use and your management time. However, other budgets may include estimates for these costs and thus would report a more accurate (and lower, all else equal) economic profit.

Sensitivity analysis

Enterprise budgets are forecasts and thus rely on assumptions. Given this, take time to test how sensitive your profitability projections are to different assumptions, such as outprice price, labor hours, and major input costs.

Related is the concept of break-even analysis. Sometimes production/yields or market prices are not what you expect them to be. When this happens, it helps to know the minimum price, or the lowest production level needed to pay bills or cover debt.

On the MSU Extension farm business management Budgets and Cost of Production webpage, there are budget tools for cow-calf, feedlot, and field crops enterprises, among others. If you need help finding a budget tool, please email us mckend14@msu.edu or laportej@msu.edu.

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