

Management Implications for
Individual Idaho Wheat Growers

by
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My topic for today is "Management Implications for Individual Idaho Wheat Growers". Dr. Schermerhorn has discussed the future environment that is likely to be faced by Idaho producers and in so doing, has discussed the broader industry-wide implications of various trends which we are now observing in agriculture. Dr. Sargent examined a number of the more immediate problems related to the marketing of wheat by individual Idaho wheat growers, pointing out some of the important factors that have recently influenced the market for wheat. He emphasized the changes in attitude and in information usage that are going to be required in order to competitively merchandize wheat. The remarks by both Dr. Schermerhorn and Dr. Sargent have, I believe, very definite implications for the management process here in Idaho.

Emphasis on Production

Most Idaho wheat growers, as well as most beef cattle operators, dairymen, sheepmen, and other farmers have become very proficient in growing more tons or more bushels of crop per acre, weaning more pounds of calf per cow, or lamb per ewe, producing more pounds of fluid milk per cow, more eggs per chicken, and obtaining better feed conversion

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rates in the feed lot. The typical producer has become very aware of the technical information and latest recommended practices that apply to his primary crop and livestock enterprises. The traditional grower has, however, lagged far behind in terms of making equal progress in learning and using the marketing and management tools that are available to him. He has been interested in and emphasized the technical production oriented aspects of his crop or livestock enterprise. Consequently, adequate attention has often not been focused upon the development of useful and needed management and marketing skills.

The above emphasis on a past neglect of business management techniques does not suggest a downgrading of the importance of production problems—but rather an additional increased attention directed to management problems.

Effects of Market Price and Competition Among Producers

The market price of grain at any point in time is determined by factors totally beyond the control of an individual wheat grower. A current or futures wheat price represents a consensus of a great many producers, processors, speculators and others as to the present and future levels of the supply of and demand for grain and other related products as influenced by the uncertainty of world production, politics, etc. This most definitely does not mean that the individual wheat producer cannot obtain higher prices by carefully selecting the time and method of selling. He may sell at harvest or store his grain and sell later; or he may forward contract or hedge his crop. Regardless of the marketing approach taken, he does not determine or even influence the price of grain that day. Instead he merely chooses to accept or reject the price being offered at that

point in time. This does not mean that marketing considerations are not important. On the contrary it emphasizes the necessity to carefully monitor the current and futures prices and the outlook information relating to the crops one produces in order to consistently obtain satisfactory selling prices.

The grain and particularly the wheat industry is very competitive. Each wheat grower is effectively in competition with all other wheat growers and to a lesser extent with producers of all other products for satisfactory rates of return and farm growth. In the competitive wheat industry, the average selling price of a bushel of wheat will in the long run just about equal the average total cost of producing that bushel of wheat. (Included in total cost is the economic concept of a normal profit - that profit necessary to keep the producer in business in the long run.) This price = cost relationship generally holds even when the selling price/bushel of wheat appears to increase much more rapidly than does the cash cost of production. When the price of wheat increases in response to increased demand for wheat, the new "profitability" of wheat tends to be very quickly capitalized into the market value of wheat land. As a result the overhead cost, i.e. interest on land investment, increases and cost per bushel again approaches the selling price per bushel.

Implications of Price and Competition

What then are the implications of these price and competition restraints? Two major conclusions implied are:

- 1) The producer who is able to consistently do a better-than-average job in timing the marketing of his products is going to contribute increased earnings to his farm operations.

2) The producer who is able to effectively control the costs of production while maintaining economically optimum levels of production is going to also add to the profitability of his farm operations.

The efficient producer, by reducing his cost per bushel below the industry's average cost and increasing his selling price per bushel above the industry's average selling price, will earn economic profits from both marketing and management activities. Even though the long-run industry equilibrium will be one where the average selling price per bushel of wheat = the average cost of producing wheat, the position of the efficient producer will be that of average selling price greater than the average cost of production. It should also be noted that for every efficient producer with costs less than selling price, there must be a poorer-than-average producer with costs > selling price.

Given these three categories of producers we would expect to observe the following:

<u>Category</u>	<u>Result</u>
average price > average cost	higher income, rapid growth in size of farm business
average price = average cost	remain in business, low levels of income, little or no expansion of the farm business
average price < average cost	will be forced out of business in the long run, cannot effectively compete with other growers.

Implications For Marketing Management

Other than the implications of the timing of sales that were previously discussed, attention should be focused upon:

1) Developing an understanding of the operation and usage of the futures market for hedging the wheat crop. Developing the ability to know how, when and why to hedge requires considerable study, observation,

and "feel" of the market. Planned hedging programs need to be developed and carefully managed. A good hedging program must include definite plans for when to hedge and when not to hedge and must include plans for liquidation and exit from the market under all possible future conditions. The traditional view that once one hedges, he is "locked in" and therefore "safe" is not necessarily accurate. The producer must develop the ability to, with professional assistance, avoid premature hedging, minimize the loss of a poor hedging decision, and at the same time make sure that he is properly hedged during a major downtrend in price.

2) Increasing the ability to understand and use wheat outlook information.

3) Developing the ability to economically evaluate alternative marketing programs i.e., what are the long run costs and benefits of on-farm storage vs. storage at the local elevator? What other factors, such as lack of accessibility to the storage structures due to adverse weather or due to reduced road weight limits, affect this decision? What effect, if any, on quality of product will result from a change in storage programs?

4) The potential for improving the quality of the product. Can the grade be economically increased? Can variety selection and improved fertility provide higher premiums for protein levels?

In a very real sense, most of the above marketing decisions are production decisions and vice versa. Nearly every production decision has implications for marketing. Thus the grower should realize that when selecting varieties and types of wheat and fertility levels, he is also determining the quality and quantity of products to be marketed.

Implications For Business Management

The importance of effectively adapting management to present and anticipated changes in the dynamic physical, financial, and marketing environment of U.S. agriculture in general, and the wheat industry in particular, cannot be overemphasized.

Proper year end tax planning, and careful consideration of the tax implications of all decisions made (not only for the year in which they are made, but also in terms of their long-run implications), can significantly increase the number of after-tax dollars the farmer will be able to retain for family living expenses and expansion of the farm business.

Goals and Objectives

The successful wheat farmer will have to improve his management capability as related to the determination of what he wants to achieve and what he wants to be doing at some time in the future. In other words, one of the factors determining the future success or failure of today's wheat farmer, is the quality of the decisions that are being made today, particularly in relationship to long-run goals and objectives. Far too often the average agricultural producer has set as his goal that of completing this year's crop and livestock enterprises, paying off operating loans, making payments on long-term loans, and being in a position to be able to borrow the necessary operating capital required for producing crops the following year. Unfortunately, this unplanned and undirected approach does not provide the necessary management direction to efficiently utilize all of the producer's resources in a way likely to allow him to maximize his potential for personal and business growth. Thus it is going to be very important

for the producer to be able to determine where he wants to be five, ten, twenty, even thirty years from now. Not that these goals will become fixed and not subject to modification, but that these goals will serve as management objectives toward which the rational producer will work.

Business Planning and Evaluation

The successful producer is going to have to continually increase the effectiveness of his business planning and evaluation. Having traditionally given primary attention to the physical problems of production, the typical producer has tended to remain largely unaware of the business management implications of his actions. For instance, the producer may have difficulty in trying to determine the relative costs of renting vs. buying of equipment, or buying vs. custom hiring of equipment. Only by developing the ability to utilize straight forward business analytical methods (such as partial budgets, present value formulas, marginal concepts, concepts of diminishing returns, costs, economies of scale, and other business and economic tools) is the farmer going to be able to keep his costs to a minimum and make the types of difficult decisions relating to alternative usage of resources that are required in order to successfully compete in the environment of tomorrow. The successful producer will have to become more proficient in keeping records of farm operations and in analyzing those records—not just for income tax purposes—but for purposes of enterprise planning and evaluation.

Income Tax Management

By understanding and utilizing current income tax regulations the impact of taxes upon the farm business can be minimized. As a result

of the recent high rates of inflation in the last few years, we have seen farmers moving into much higher income tax brackets with a relatively much larger percent of their income going to pay federal and state income taxes. Due to the progressive nature of federal and state income tax schedules, we can expect this effect to become even more pronounced in the immediate future.

Estate Tax Liabilities

One very serious and relatively little understood problem facing many of our producers involves the very large tax liability which their heirs may face at death. A wheat producer in the Palouse area who has 800-900 acres of land and the extensive amount of equipment and capital needed to operate this size of farm, may upon his death, leave an estate which could owe \$300,000 or more in federal and state inheritance taxes. The heirs of very few farmers or ranchers who have farm operations of this size have \$300,000 in liquid assets that might be available to pay these inheritance taxes plus probate and legal fees. Thus, in terms of adding to the profitability of your operation and to its continued growth and productivity, the single most important use of your time may be spent developing with your accountant, lawyer, insurance agent, and perhaps others, a comprehensive estate plan designed to minimize the impact of estate taxes upon your heirs at the time of your death. The typical farmer who has completed a will which says little more than, "I leave all my worldly belongings to my wife and at her death, to my children," will often leave an estate which is subject to excessively high amounts of taxation and by so doing will place a genuine hardship upon the wife and the children who remain. Frequently, all or part of the farm must

be sold or very large mortgages must be placed on the operating farm unit in order to provide the money necessary to pay the tax bill. By careful tax planning, these inheritance taxes can be reduced very significantly to a fraction of what they would have been in the absence of careful planning.

Other Considerations

The management implications discussed above are representative of the numerous and important business management problems facing the wheat producer. The treatment of each topic has been very elementary and designed to provide basic introductory information for your consideration.

Other important business management topics such as labor and machinery management, business organization and management, the use of contracts for sales and procurement, financial strategies and profitability analysis were not included due to the limitations of time.