



Making Decisions in Tight Times
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Are you making the correct decisions to ensure your dairy is positioned to be competitive in a dynamic business environment? In a challenging business environment, such as the one dairy producers are currently facing, many dairy business owners make decisions based on emotions, rather than facts, due to a lack of information. Armed with adequate and accurate information and the tools to analyze it, producers can make the decisions that will position them to survive and thrive in the future.

A key to making the correct management decision is to realize there is a difference between profitability and cash flow. In times of tight margins producers may make different decisions than they would make under normal economic conditions. Making management changes that improve the long-term profitability of an operation makes sense, except in periods of tight margins. An example of this would be having heifers custom raised versus raising the heifers. Some of the expenses of raising the heifers that are fixed costs under the current management system become variable expenses when heifers are custom raised. The dairy producer's labor and heifer housing are two of the obvious costs that fit this category. The producer will draw a fixed amount from the business, whether the heifers are custom raised or not. In many instances the facilities used to raise the heifers are not convenient or suitable for housing additional milk cows. Therefore, when having heifers custom raised, the producer is now paying for resources already covered when the animals are raised on the farm. Adopting this change in management in times of tight margins could create an additional strain on cash flow and create problems without careful analysis of the situation. If a better quality animal is raised by the custom operator and the dairy producer can utilize his time and other resources to generate additional income, the decision to have heifers custom raised should improve the profitability and cash flow of the business.

There are a number of methods producers can use to evaluate the decisions that must be made on a daily basis. Producers do not want to develop a whole farm budget

every time they are faced with making a decision. Considering the current price environment, what decision would you make if your nutritionist or consultant recommended increasing feed costs by 50 cents, or more, per cow per day? Given the fact that this recommendation would cost \$15.00 per cow per month or \$1,500 per 100 cows per month, many producers would back away from this recommendation. However, armed with accurate information, there are those producers who would implement this recommendation and improve the overall profitability of their businesses, due to increased milk production that more than pays for the added feed cost. Conducting a simple ***breakeven analysis*** in this situation would help determine the production needed to cover the added costs. If milk price is \$12.00 per cwt. and the added costs are 50 cents per cow per day, production must increase by 4.2 pounds of milk to pay for the added expense. If there is sound research or reasoning behind the recommendation that indicates production should increase by 6-8 pounds, the decision is a fairly easy one to make.

Another option for evaluating decisions is to examine ***return on investment*** (ROI). This is not the same as return on assets of a comprehensive business analysis. ROI examines only the return generated on the specific investment in the cost of making the decision. In the previous example, if a seven-pound response in milk production was achieved, the producer would net 34 cents more per cow per day, which equates to a 68 percent ROI. Not a bad investment by any standards and one that would help in times of tight cash flow.

Still another example of a decision-making tool is the ***theoretical payback period***. If an investment of \$15,000 to improve cow comfort issues of a 100-cow dairy results in five pounds more milk per cow per day, we could easily calculate the payback period. In this case the decision to make this investment results in over \$1,500 additional net income per month and the payback on this investment is 9-10 months. Again, in tight economic times, this would be a sound investment.

In situations where a decision would result in more than one effect on a specific segment of the business, we can use a partial budget to analyze our decision. A partial budget is a tool that examines only the specific area of the business that is affected by the management change. It examines the ***increased income and reduced expenses (positive***

effects) to the reduced income and increased expenses (*negative effects*) that result from making the decision. If the positive results are greater than the negative results, then the decision is good for the business. In a challenging economic environment, one must be sure to examine the decision based on cash flow as well as profitability, as the results may be different. If a negative cash flow situation is created by the decision, but it is profitable in the long term, the producer must find ways to offset the negative effects on cash flow or defer making the change until economic conditions change.

The key to evaluating any decision is to monitor the results of the change so they can be documented and analyzed. Most decisions must be made on assumptions that the decision will result in a change. Having information that supports the assumptions can improve the chances that the right decision will be made. Managing a dairy business is challenging, even in the best of times. Wrong decisions can lead to considerable losses in profits and cash flow. However, armed with adequate and accurate information and knowing which decision-making tool to use in each situation, making the correct decision becomes easier.