To Expand Or Not, What Are The Risks?

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Dairy producers are continually confronted with numerous decisions. These decisions involve different levels of risk, depending on the types of decisions and the potential outcomes and consequences of the choices available.

Day to day production decisions carry with them the risks of variable responses. For example, what is the milk response with a change in feed ration formulation or what is the impact of varying price on the profitability of the farm enterprise?

Longer-term decisions also have built in uncertainty and risks. Risk and uncertainty are areas of critical analysis for dairy farmers considering whether to expand or not.

Dairy farmers who choose to expand face a different set of risks than those who choose an alternative means of increasing the viability and sustainability of the dairy farm business.

Those who choose to expand must consider, for example: the risks of borrowed capital; the social risks of a larger agricultural enterprise within a community; the personal and psychological risks associated with managing a large multi-person workforce; or the financial risks of generating sufficient and stable returns to maintain the economic viability and sustainability of the dairy business.

For those who choose not to expand the risks may include: generating sufficient income to sustain a reasonable standard of living; or the risks associated with the selection of an alternative means of dairy production that enhances economic viability.

Dairy farmers may choose not to expand for several reasons. These reasons can include: constraints on the availability of resources, such as land, labor, or capital; the lack of adequate management skills required for a relatively large business operation; production problems, such as low milk yields or low reproductive rates, that would require the farmer to remedy the problem before expansion is a viable option; the lack of a proven financial or production record necessary for a large loan, or simply a lack of desire to expand.

Despite what some may think, farmers who choose to maintain their current herd size and milk production level are still faced with risks in many facets of their business.

The principal risk associated with not expanding is a relatively narrow profit margin. The profit margin is the difference between the milk price and the variable costs of production on a unit basis.

The margin reflects the funds available for fixed expenses, debt reduction, capital replacement, and family living. The risk is that over time, both input and output prices could change, resulting in reduced margins.

This is particularly true when one considers the impact of inflation over time in eroding "real" margins. The impact of reduced margins on farm profit and family living expenses may be severe.

A producer may choose to expand the dairy business to take advantage of economies of scale that arise with larger operations. Other reasons for expansions include the requirement that the business generate increased income to support a larger farm family, or so that the dairy business can remain competitive with other units that have expanded.

Compared to the risks of not expanding, the risks of expansion, particularly in the early stages of expansion, are numerous and potentially disastrous to the dairy business. However, with proper planning and management, these risks can be reduced to ensure the survival and growth of the new operation.

The management of any risk will depend on the type of risk and the tools available to reduce the impact of the risk on the viability of the dairy business.

Day to day price risk can be reduced using futures and options, or forward contracting. Input and output price variability can be lowered by knowing the potential problems that could occur and to plan accordingly to reduce the impact of these problems on the business.

Longer-term financial risks can be managed by using different combinations of leveraging, borrowing types and alternative resource acquisition, such as leasing, renting, contracting, or partnering.

When making the decision to expand or not, the dairy business management team needs to consider all the risks that may arise and develop plans to counter or reduce the impacts these risks may have on the survival of the business.

Choosing whether or not to expand, should be made based on which choice reduces the whole set of risks, and not a sublet of the risks, to a level acceptable to the dairy business owners.

Over the next several months, I will continue the discussion of the types of risks a dairy business may face, whether the business expands or not.

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From the Department of Dairy and Animal Science

This regular column from Penn State's Department of Dairy and Animal Science features the research findings, student opportunities, and reports on other important topics generated in the Department. The back issues of the column are archived on *Lancaster Farming's* Internet *www.lancasterfarming.com* home page. Look for them.

Junior Simmental Board Elected

BOZEMAN, MT — In balloting held at the American Junior Simmental Association's (AJSA) National Classic XX in Stillwater, Oklahoma, the AJSA elected six new members to serve on the organization's 16 member Board of Trustees. Each trustee is elected to serve a two-year term.

Emily Koch, Wichita, Kansas was elected president, representing over 5,000 members of the AJSA. Four area vice-presidents are: Matt Beck, Mt. Gilead, OH, Eastern region; Mike Behrhorst, Iowa Falls, IA, North-Central region; Denise Demoin, LaVernia, TX, South-Central region; and Josh Mavencamp, Hagerman, ID, Western region.

Newly elected board members are as follows: Chanda Hoppe, Winters, TX; Cari Rincker, Shelbyville, IL; Amber Richman, Tooele, UT; Jonathan Sant, Pollack, LA; Paul Allen, Versailles, KY; and Megan Zimmerman, Stevensville, MT. Hold-over board members are: Shannon Jensen, Salem, OR; Kit Rennison, Braymer, MO; Ben Brown, Petersburg, TN; and Trish Cunningham, Prospect, OH.

Formed in 1975, the AJSA is the youth organization of the American Simmental Association (ASA). ASA maintains headquarters in Bozeman, MT, and has a total adult and junior membership of more than 11,000.

Mexican Antidumping Debated

By Bill Henning
Penn State

On a trip to west Texas last fall, we heard complaints about exorbitant duties being imposed on ground beef to be shipped to Mexico.

The North American Free Trade Agreement (NAFTA), was exposed to eliminate tariffs of product being shipped to Mexico.

One packer reported that the tariff for ground beef shipped from Texas to Mexico would be 40 percent, yet product from IBP, ConAgra, or Excel had little or no tariff.

This packer had Mexican customers who wanted to buy his product, but could not afford to pay that much tax. Yet, those companies that had trade status, did not have product to ship there.

Recently, Mexico's Secretariat of Commerce and Industrial Development (SECOFI) announced the first request for a panel review of its final decision on the beef antidumping claim.

IBP had asked NAFTA panel to review the antidumping duties.