

# THE BUSINESS ENVIRONMENT OF BEEF



## UNDERSTANDING THE BUSINESS

### ENVIRONMENT OF BEEF

The farmers and ranchers who raise cattle for beef face many of the same, if not more, unpredictable and forceful influences that affect most businesses. From changing product demand, rising input costs and market fluctuation to weather patterns and even consumer nutrition and lifestyle trends, farmers and ranchers must balance a long list of variables in order to be successful.

Simply put, by raising cattle for beef, cattlemen transform grass and grain into a nutritious product that meets consumer demand.

“We create both food and economic activity by sustainably harvesting those resources,” says Gregg Doud, chief economist for the National Cattlemen’s Beef Association (NCBA).

### **Moving Cattle From Pasture to Plate**

Despite this relative simplicity, the U.S. beef supply chain is a complex partnership among a variety of independent and mostly family-owned businesses. It begins with seedstock operators selling breeding stock to cow-calf operations where calves are born and weaned. All beef cattle spend their lives grazing on pasture before heading to a feedyard, also known as a feedlot, to be “finished” on a balanced, grain- and forage-based diet. Cattle farmers and ranchers may be involved in one or several steps of this process, depending on their individual business model.

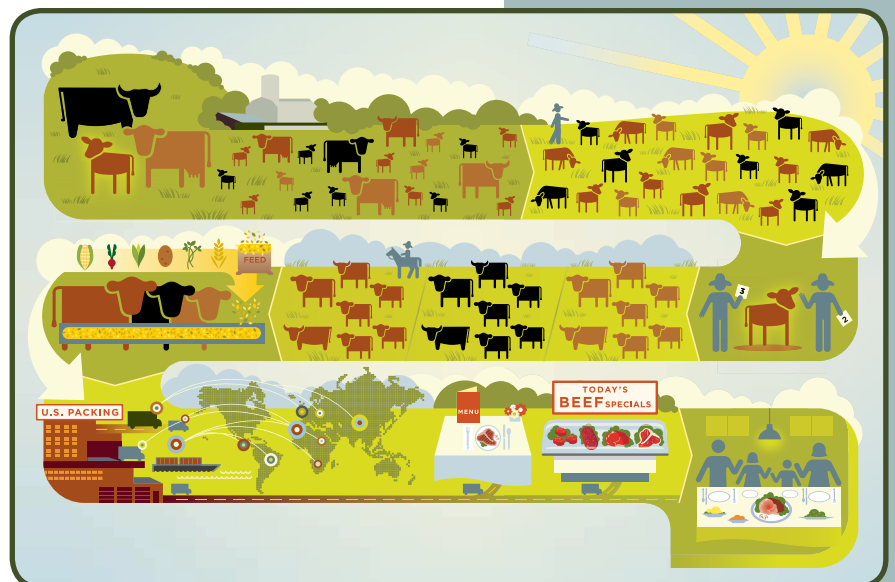
To reach the consumer in the form of a steak, roast or other beef cut, beef is processed at packing plants and distributed from those facilities through supermarket and restaurant channels or may be exported to other countries.

Learn about the Beef Lifecycle on page 13.



### **A Family Business**

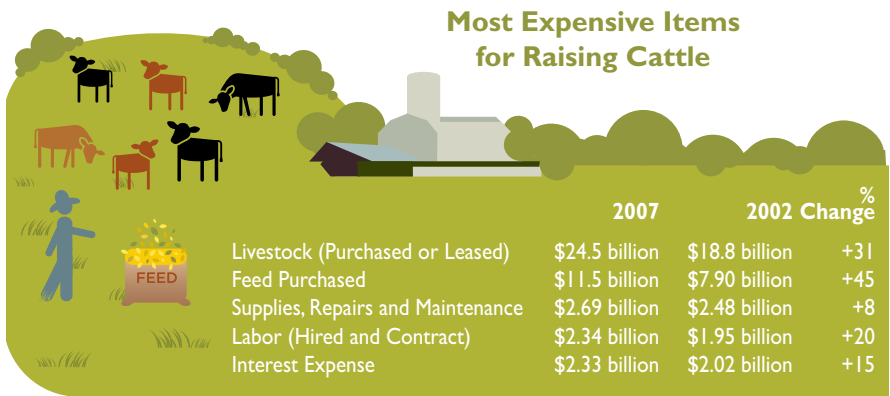
97 percent of all beef cattle farms and ranches are family-owned.



## Increasing Costs of Raising Beef

The 2007 U.S. Department of Agriculture (USDA) Agricultural Census found that beef cattle farms and ranches spent an average of \$79,752 per operation to raise beef cattle during 2007, an increase of \$21,000 or 37 percent, from 2002.<sup>1</sup> The five largest

expenses for cattle farmers and ranchers were purchases of livestock, feed, suppliers/repairs, labor and interest expenses. The steepest cost increases were for feed (up 45 percent) and livestock (up 31 percent). Total production expenses on all cattle farms increased between 2002 to 2007. A closer look at these factors demonstrates how farmers and ranchers manage and respond to the many challenges involved with running any business, as well as some that are unique to the beef industry.



Source: U.S. Department of Agriculture, 2007 Ag Census

## Investing in Beef Businesses

Starting or maintaining farms and ranches takes significant capital investment, which includes land, livestock, equipment, feed and more. The high price of entry and capital required in the cattle business creates an often insurmountable barrier to the startup of new cattle farms and ranches.

“The value of the business is in the land, equipment and livestock.”

Gregg Doud, NCBA

“Most people don’t understand the amount of money at risk, the capital or the skill required to manage the risks and volatility in the beef marketplace,” Doud says.

Land is the most significant upfront cost and asset for existing farmers and ranchers, which is one of the reasons agricultural land does not change ownership frequently. In fact, the land tends to stay within families—97 percent of all beef cattle farms and ranches are classified as family-owned and more than one-half of the beef operations in the United States have been in the same family for three generations or more.<sup>2</sup>

## Passing Down Farms and Ranches

The fact that the beef industry is dominated by family-owned businesses means cattle-raising traditions are passed from generation to generation. That is a point of pride for farmers and ranchers. However, it also presents another challenge. The significant capital investment and high operating expenses means the farms and ranches typically are not “liquid.”

That can mean a hefty tax bill when it is time for the business to be passed down. According to USDA, the estate tax, commonly called the “death tax,” is considered one of the leading causes of the breakup of multi-generational operations. The appraised value of rural land is often inflated when compared to its agricultural value. Prior to 2001, estates were taxed at 55 percent, with the first \$1 million exempted. When the value of land, animals, buildings and equipment are taken into consideration, even a small cattle farm or ranch can easily exceed that exemption, making it difficult for some small business owners to stay in business. In December 2010, Congress passed a tax package that included estate tax relief. The action reduced the top rate of the estate tax to 35 percent; increased the exemption level to \$5 million; indexed exemptions to inflation; and included a stepped-up basis. In addition, the new law allows a deceased spouse’s estate to transfer to the surviving spouse without the complicated rules under the previous law. The current estate tax levels are set to expire at the end of 2012.

“Farmers and ranchers have limited liquidity,” says Doud. “The value of their business is in the land, equipment and livestock. Significant value exists in the assets of their operations, but the limited liquid assets, like cash, make it more difficult for them to make large cash payments for taxes or any large expenditures. This means farmers and ranchers often have to sell off some or even all of the land to afford the tax.”

But Barry Dunn, Ph.D., professor at South Dakota State University, says the cattle industry is certainly not a bad investment.

“If 15 years ago a ranch on a per cow basis cost \$2,500, and the profit from a cow in 2010 was \$150, the return would be 6 percent. And that would not have included the appreciation of the assets. That’s a good investment when compared to others, including stocks, bonds and other businesses,” says Dr. Dunn.

## Working with Many Beef Business Models

As with many businesses, economies of scale benefit every segment of the beef industry. Larger operations tend to have more cash flow to cover capital investments, improvements and fluctuating input costs. The average beef cow-calf herd is 40 head<sup>3</sup>, meaning most cattle operations are small family businesses. However, the beef industry is characterized by its diversity and numerous business models can be successful. The more than one-half of a million farms and ranches spread across the United States vary in many ways, with size (amount of land and number of cattle) being just one.

“There are thousands of successful business models for beef,” Doud says. “Compared to poultry, for example, which has just a few business models, with cattle, numerous models can be successful if you’re a good businessperson. There’s no standard template business model for the beef industry.”

That is because the beef industry is not vertically integrated like other livestock industries. In the case of poultry and pork, each segment of the supply chain is overseen by the same entity, whether it is a company or individual farmer. For example, the same farm or ranch breeds and raises young animals, then finishes and processes them into meat. In contrast, the beef industry is made up of a large number of small businesses and independent suppliers who work together to move cattle through the supply chain and deliver beef to consumers.

Numerous characteristics of the beef industry contribute to this difference, according to the report, “Vertical Integration Comparison: Beef, Pork, and Poultry,” produced by Oklahoma State University Extension. The report addresses many of the differences that make it more difficult or less desirable for the cattle industry to integrate. For example, cattle production requires significant land and forage compared to the pork or poultry industries. As a result, farms and ranches that raise

## Family Tradition

54 percent of U.S. cattle farms and ranches have been in the same family for three generations or more.





“ Cattlemen’s ability to raise beef in the United States is far superior to anywhere else in the world. ”

Gregg Doud, NCBA

cattle are not as geographically concentrated as other protein segments, and herd size is more variable among different operations. Further, integration is not as desirable among cattlemen and women due to the large amount of capital required to be involved in just one segment of the business.

## Supplying Beef Through Market Foresight

The beef supply chain is consumer-driven. When consumer demand shifts, cattle farmers and ranchers must adjust their business models to remain profitable. An intricate balance among the number of female cows calving, the number of calves and the number of cattle on feed determines whether the right amount of beef is available at the right time.

Doud explains that calving season in the beef industry primarily takes place from March through May with an estimated 70 percent of calves born in the spring. Yet unlike other food products, such as fresh apricots or cherries, which are only “in season” at certain times of the year, beef is available to consumers 365 days a year and usually at a stable price point.

The ability to bring a steady beef supply to consumers at a more consistent price requires a combination of business savvy and a multitude of business models. Futures markets for feeder cattle, corn and live cattle help cattle farmers and ranchers, stocker operators and feedyards predict how many cattle might be available at a certain period of time so they can make adjustments in their herds and inventories of cattle and feed.

Even when farmers or ranchers decide to expand their herd size, it will take approximately three years before any additional beef supply will be available to the consumer, due to the amount of time it takes for cows to mature and produce offspring to be raised for beef or added to the breeding herd. Beef prices are kept fairly consistent through futures exchanges such as the CME Group (formally the Chicago Mercantile Exchange). These exchanges allow farmers and ranchers, end-users (hedgers) and speculators to trade standardized futures contracts to buy specific quantities of commodities at a specified price with a delivery time set at a specified time in the future. This provides all participants in the production chain the ability to lock in prices in advance of selling live cattle or purchasing beef, which helps remove the uncertainty of price fluctuations or the requirement of taking the price the market is offering on the day of sale. Today, the CME Group helps cattlemen better manage risk so they can consistently deliver beef to consumers at steady prices.

## The Economy Impacts Beef Demand

Consumer demand refers to the amount of beef consumers are willing to purchase at a given price. Cattle farmers and ranchers aren’t subsidized, so consumers are the ultimate judge and sole source of price. Numerous factors influence demand, some more obvious than others, and many are far beyond the control of the farmer. An economic downturn is a good example.

Data from the checkoff-funded Consumer Beef Index shows the average number of beef servings Americans consumed per week, both in and away from home, began decreasing when the most recent economic recession hit. Average beef consumption dipped to 2.3 times per week in March 2009 (from 2.5 times per week previously) and has, for the most part, remained at that same level ever since.<sup>4</sup>

The Consumer Beef Index also shows that consumers are more likely to have recessionary behaviors when eating out at restaurants versus buying food to cook at home. Twenty-four percent of consumers in July 2009 said they were purchasing fewer steak meals and more hamburgers when eating out.<sup>4</sup>

“A downturn in the economy means higher unemployment rates and lower disposable incomes,” says Doud. “People will do a couple of things—they will eat out less and if they do eat out, they’ll change their eating habits to be more frugal.” Accordingly, restaurants will therefore lose customers and volume of sales, meaning that they will be buying less food—including beef—to feed to their customers.

## Celebrating with Steaks

When there is an increase in employment and growth in the economy, beef demand increases. According to the Consumer Beef Index, in July 2010, 20 percent of consumers said they have been eating more beef in the past six months, up 4 percent from February 2008, when recessionary pressures were strong.<sup>4</sup> Research conducted on behalf of the beef checkoff from Kansas State University indicates on average, a 1 percent increase in overall U.S. consumer expenditures results in a 0.9 percent increase in beef purchases.<sup>5</sup>

However, lingering effects from an economic recession can still be seen as consumers look for more value from their money. According to the Consumer Beef Index in January 2007, 74 percent of consumers said that it was extremely or very important to them that their dinner entrée be a good value for the money, compared to 78 percent of consumers who felt this way in July 2010.<sup>4</sup>

## News and Exports Influence Beef Demand

Recent news coverage and new developments in health and nutrition information, food safety and diet trends also can influence demand for beef. For example,

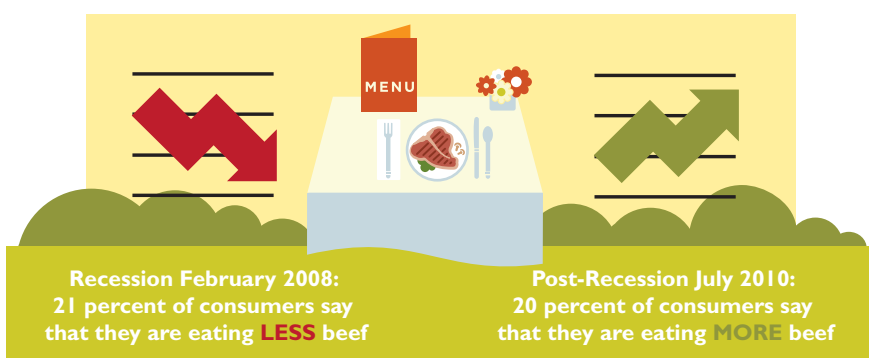
## Chicago Mercantile Exchange

The first live cattle contract was offered by the Chicago Mercantile Exchange on Nov. 30, 1964. By 1997, a typical day saw the trade of 15,000 to 20,000 cattle contracts.

## Cattle Farmers and Ranchers: Who We Are

- Raising cattle for beef is the largest single segment of American agriculture.
- USDA estimates there were 742,000 beef cattle operations in 2010.
- There are more than 93 million head of beef cattle of various breeds in the United States.
- The average age of a U.S. cattle farmer or rancher is 61 years old.
- More than 10 percent of cattle farmers and ranchers in the United States are women.

## Economy Impacts Beef Consumption



Source: Consumer Beef Index, July 2010



the Kansas State University study conducted for the Beef Checkoff Program found a 268 percent increase in the number of medical journal articles published noting the importance of zinc, iron and protein from 1982 to 2007 helped to boost beef demand by approximately 7 percent.<sup>5</sup>

Export opportunity also influences demand, particularly the access to key international markets positioned for growth. According to USDA, the projected growth rates of beef exports from major exporters of beef, including the United States, is 1.7 percent annually during the 2011 to 2020 projection period. Rising per capita incomes combined with population growth in a number of countries are the driving factors behind the projected growth in global beef demand.<sup>6</sup>

## Weather a Formidable Foe for Cattlemen

Weather is an obvious factor in the success of all farmers and ranchers. For example, growing conditions that influence the grain market greatly affect the availability and cost of feed for livestock. Any adverse weather conditions, such as drought, means less (and more expensive) grain for feed, as well as diminished grass on the range.

“Raising cattle is about a way of life and passing legacies and learnings down from one generation to another.”

Gregg Doud, NCBA

“It is a domino effect,” says Doud. “Adverse weather conditions could mean that a cattle farmer has to reduce the size of his or her herd, either by selling off female breeding cattle or sending them to harvest. Therefore, the farmer will have fewer offspring to sell into the marketplace, reducing the number of cattle available for feeding and ultimately, the amount of beef produced.”

For example, severe drought in 2006 led to a decrease in the number of beef cattle with nearly one-quarter of cow-calf farmers and ranchers and stockers reducing their herd size. While grain-growing conditions in 2010 were favorable, tight grain supplies worldwide will continue to push up feed costs. This, in combination with other market signals, means cattlemen are hesitating to build their herd size.

## VISION FOR THE FUTURE

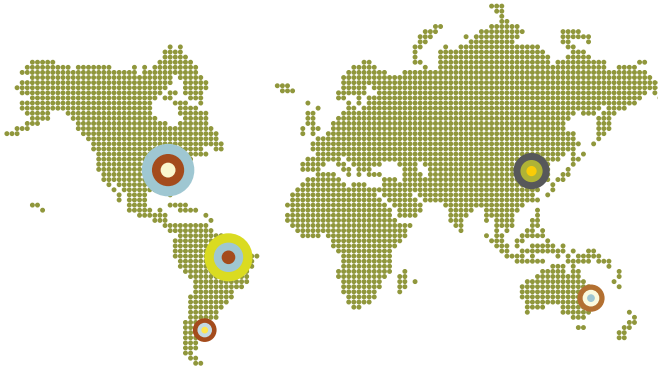
Today, the United States is a leader in the global beef marketplace. In fact, the U.S. beef industry produces 20 percent of the world’s beef with only 7 percent of the world’s cattle.<sup>7</sup> Although the business climate for farmers and ranchers is increasingly complex, there are opportunities for success. For example, the unprecedented volatility of the global marketplace makes the industry more susceptible to price fluctuations based on the strength of the U.S. dollar, but it also opens doors to new international customers.

“My family has been in the beef business for more than 100 years,” says Doud. “It is not a business for the faint of heart, it is more about a way of life and passing legacies and learnings down from one generation to another.”

More young people, in fact, are showing interest in taking over the family beef business. According to the 2007 USDA Census of Agriculture, there was an increase in younger farmers and ranchers on each farm operation, suggesting that younger family members are positioned to take over these family businesses.

“Cattlemen’s ability to raise beef in the United States is far superior to anywhere else in the world,” says Doud. “That is something to take pride in.”

## Beef Raised Around the World



Country	Domestic cattle inventory as a percent of global inventory	Domestic beef production as a percent of global production
Argentina	4	4
Australia	2	4
Brazil	13	13
China	6	9
United States	7	20
<b>Five nation total</b>	<b>32%</b>	<b>50%</b>

Source: U.S. Department of Agriculture, National Agricultural Statistics Service, 2011

### Living the Life

30 percent of cattlemen say that raising cattle is more about the lifestyle than about the business.

## BUSINESS ENVIRONMENT OF BEEF REFERENCES

- <sup>1</sup> U.S. Department of Agriculture (USDA), 2007 Ag Census.  
[http://www.agcensus.usda.gov/Publications/2007/Online\\_Highlights/Fact\\_Sheets/beef\\_cattle.pdf](http://www.agcensus.usda.gov/Publications/2007/Online_Highlights/Fact_Sheets/beef_cattle.pdf)
- <sup>2</sup> Profile of U.S. Cattlemen, Aspen Media & Market Research, July 2010
- <sup>3</sup> USDA Economic Research Service.  
<http://www.ers.usda.gov/briefing/cattle/background.htm>
- <sup>4</sup> Consumer Beef Index, July 2010
- <sup>5</sup> J. Mintert, et al. "U.S. Beef Demand Drivers and Enhancement Opportunities: A Research Summary" Kansas State University, Department of Agriculture Economics. 26 Jan. 2011.  
[http://www.beefboard.org/news/files/factsheets/Beef\\_Demand\\_Drivers\\_January\\_2009.pdf](http://www.beefboard.org/news/files/factsheets/Beef_Demand_Drivers_January_2009.pdf)
- <sup>6</sup> USDA Agricultural Projections for 2011-2020.  
<http://www.ers.usda.gov/Briefing/Baseline/#highlights>
- <sup>7</sup> USDA National Agricultural Statistics Service, 2011.