Business Options Available to Improve Profitability

Options to Improve Profitability

When faced with financial stress due to low prices, agricultural producers and fishermen have several options to improve profitability. There are four general options available to increase profits. They are:

- Improve the profit margin
- Expand the business
- Create innovative niches
- Exit and transition to a new business or job

The first two options are described by one of the most basic equations in economics:

\[ \text{Profit} = (\text{Price} – \text{Cost}) \times \text{Volume} \]

Profits can be improved by increasing the margin between the market price received for a product and the cost to produce the product or by increasing the amount of the product produced.

Improving the Profit Margin

There are two components to increasing the profit margin:

- Reducing the cost of production
- Increasing the market price received

Economic forces are squeezing profit margins, but successful managers continue to pry the profit margin apart with a critical eye toward cost control practices and improved marketing.

Controlling the cost of production is always an essential management function of successful businesses. Data shows that there is rarely one area where significant cost reductions can be attained, but rather the more profitable businesses manage many costs two to five percent more efficiently than their competitors.

With tight profit margins, marketing actions that improve the sales price even a few cents may increase profits by a significant percentage.
Expanding the Business

Expanding the business is an option that many producers have pursued. As profit margins have tightened, expanding the size of the business has been the most feasible option for many producers.

Additional sales volume may be necessary to cover the overhead costs of the business and to allow the families involved to meet their financial needs. But when considering an expansion, care should be taken when doing financial planning to verify that the expansion will improve your financial situation. If the profit margin is in fact negative, or the added volume will cause overhead costs to increase, an expansion may just put your business in a deeper financial hole.

Creative and Innovative Strategies

Over time, agricultural producers have developed many creative and innovative strategies to help increase profitability. These range from adding value to their products through cooperatives or on-farm processing, direct marketing, niche products and markets, marketing recreational and agri-tourism opportunities, and contracts with businesses and municipalities.

Today’s producers need to determine which strategy they will pursue—a commodity production strategy or a creative alternative strategy. The commodity strategy generally involves expanding to an adequate size and focusing on being a low-cost producer. The creative alternative strategy generally means focusing on markets, customers, and innovative niches. Some high-capacity producers are able to pursue both of these strategies.

Transitioning to a New Career

Exiting the business is always an option, although not one that many people want to consider. Commodities that have been certified as eligible for Trade Adjustment Assistance (TAA) are facing financial challenges. Some producers may elect or need to exit the business. Producers should evaluate the skills and resources available or needed to transition to a different business or career. For some, finding off-farm employment or downsizing by selling some assets may also be options.
TAA provides retraining and educational resources to help producers who are transitioning to a different career. The Department of Labor provides TAA services through which eligible producers and fishermen may receive reemployment and educational assistance. Reemployment services include employment counseling, case assessment, job development, and self-directed job search services. Education assistance (Trade Readjustment Allowances) pay for up to 104 weeks of full-time education, including classroom training, on-the-job training, and employer-based training.

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