

Creating a Budget



value-added & alternative agriculture

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OVERVIEW

The budgeting process is an important piece of the business planning process. A well thought-out budget gives the entrepreneur a numeric picture of potential income, expenses and profitability. While the way in which costs are determined may differ (i.e., per acre, per farm, per activity), the basics of a budget are the same, and the information it provides is needed to make informed business decisions.

EXPENSES (COSTS)

Every business has two types of expenses: fixed and variable.

Fixed expenses are often referred to as overhead. These are the expenses incurred whether or not the business generates any revenue. Typical fixed expenses include:

- Rent or mortgage payments on land
- Equipment payments
- Insurance premiums
- Salaried employees

Hourly labor and utilities are two expenses that may be fixed, in that they must be paid each month, but the amounts may vary from month-to-month depending upon your activity level and the time of year.

Variable expenses are those expenses that are affected by the decisions you make regarding the overall activities of your business enterprise. Expenses can be affected by one or more of the following decisions:

- what crops or livestock you raise
- how much you plant or feed
- the fertility method used
- how you market and sell your product

BREAK-EVEN ANALYSIS

A traditional method that is used to determine how much needs to be produced before the business begins to clear a profit is called a "break-even analysis." The break-even point occurs when revenues equal costs. This is the point at which all of the enterprise's fixed costs have been covered by earned revenues. The enterprise then begins to show a profit from revenues earned.

There are two types of break-even points that can be figured: break-even based on units and break-even based on sales.

A value-added enterprise that is selling produce, jams or other processed foods, or products in large quantities would most likely benefit from computing a break-even point based on sales. The formula is:

$$\frac{\text{Annual Fixed Cost}}{[1 - (\text{Average Per Unit VC} / \text{Average Per Unit SP})]}$$

where VC = variable cost and SP = Sales Price

A value-added enterprise that sells defined units of product, such as a limited number of hogs, cattle or goats, would most likely benefit from computing a break-even point based on units. The formula is:

$$\frac{\text{Average Annual Fixed Cost}}{(\text{Average Per Unit SP} - \text{Average Per Unit VC})}$$

where SP = sales price and VC = Variable cost.

As is the case with every aspect of business, the break-even point is not a fixed number. The value will change as the business moves forward with its operations, gains experience and better understands both its profit potential and its operating expenses.

ESTIMATING REVENUE

A new enterprise often must make its best guess when it comes to estimating potential revenue without having prior operating experience. Large-scale (macro) data is available on the total sales per crop or per type of livestock for a given state or region, but the challenge is refining that data so that it is useful in making realistic income projections. One formula that can help value-added producers identify income possibilities estimates market potential.

That formula is:

$$MP = n \times q \times p$$

where MP = total market potential, n = the potential number of buyers in the market, q = the average quantity purchased and p = the average price per unit. As is the case with the break-even point, revenue estimates change with experience and time.

BUDGET ASSUMPTIONS

All budgets are based on a set of assumptions that are the result of the understanding we have at the time the budget is constructed. Budgets, as do other aspects of the business plan, need to be refigured as new data and new experiences reflect a need to change our initial assumptions.

RESOURCES

For another discussion on the use of enterprise budgets, visit: http://agalternatives.aers.psu.edu/farmmanagement/enterprise/enterprise_budget_analysis.pdf

To gain access to various generic enterprise budgets, visit: <http://www.cals.ncsu.edu/value-added/profitable-agriculture.html>

North Carolina-based budgets are available at: http://www.ag-econ.ncsu.edu/extension/Ag_budgets.html

For additional guidelines on budgeting, including a budget for aquaculture, visit: <http://extension.agron.iastate.edu/sustag/enterprisebudgets/default.htm>

To access enterprise budgets for other regions of the country, visit: <http://newfarm.osu.edu/enterprisebudget/enterprisebudgetindex.html>