The Preservation of a Way of Life

A Look at the Sustainability of Family-Operated Ranches

Hannah Austin

A Senior Thesis submitted in partial fulfillment
of the requirements for graduation
in the Honors Program
Liberty University
Fall 2015

Acceptance of Senior Honors Thesis

This Senior Honors Thesis is accepted in partial fulfillment of the requirements for graduation from the Honors Program of Liberty University.

____
Gene R. Sullivan, Ph.D.
Thesis Chair

____
Jamie Stowe, M.S.A.
Committee Member

____
Nancy Kippenhan, J.D.
Committee Member

____
Brenda Ayres, Ph.D.
Honors Director

____
Date

Abstract

Ranching – the breeding, raising, and selling of cattle – is one of the long-established occupations of the American workforce. This labor-intensive industry is confronted with the struggles of fierce industry competition, government regulation, and a fluctuating market. As a result of the evolution of the industry and alteration of the ranching demographic, ranchers are being forced to restructure their profession. This thesis seeks to explore the many factors that affect sustainability of small family-operated ranches in the United States, as well as to investigate the alternative business models left to ranchers with which they can salvage their way of life.

Keywords: ranching, sustainable, business model

Introduction

Agriculture in America has a rich history and has been a major component in America's growth in wealth and influence worldwide. The condition of the agriculture industry is very important to American policymakers. It supports overall economic growth by ensuring a safe domestic food supply, improving U.S. energy security, and also strengthening the local economy through small businesses (Klobuchar, 2013, p. 2). A unique quality of the agriculture industry is the high percentage of family-owned ranches and farms. In the United States there are more than two million farms and ranches, of which "more than 90% are family owned" (Bank of America, 2013, p. 4). These farms and ranches, while mostly owned and operated by one family, are businesses and as such, must manage the economic and environmental factors that affect their profitability.

The ranching industry is fiercely contending against internal and external circumstances that threaten the continuity of the business. Family-operated ranches are particularly vulnerable to these conditions because they often lack the resources and leverage of larger corporations. Ranchers are constantly being impacted externally by strong corporate competition, government regulation, and industry trends. There are also the internal concerns of estate planning and the preparation of ranching operations for future caretakers. These factors have such a substantial impact to the current trajectory of the industry that ranchers are being forced to consider alternative practices if they want to preserve their business and way of life.

This thesis will analyze the current demographic of ranchers, the economic environment of the cattle industry, and tax regulations that affect the financial profitability of ranching. The results of this analysis will then be used to propose

alternatives to operation that are potential substitutes for family-operated ranches in the projected cattle market.

The Ranching Demographic

There are several categories of cattle ranching: cow-calf operation, seedstock production, stocker operations, and feedlots (“How Cattle are Raised,” n.d.). This thesis will focus on information concerning the cow-calf sector whenever possible, which is the breeding and raising of cattle in one operation and then selling the calves once they reach a marketable weight or age. Data concerning cattle ranching is often recorded along with information about different livestock operations as well as farming. For purposes of relating statistical and industry data, this thesis aims to be as specific as possible. Due to the presentation of information, material on ranchers and the ranching industry may sometimes be represented through that of farmers and agriculture as a whole.

According to the United States Department of Agriculture (USDA) 2012 Census of Agriculture, 88.1% of farms and ranches fell under the category of a small farm. In 2010, it was documented that 60% of these small farms relied on off-farm employment as their primary source of income (Hoppe, MacDonald, & Korb, 2010, p. 1). These figures prove the prevalence of small farms but are a premonition as to the economic sustainability of the field. The numbers demonstrate the necessity of many farmers and ranchers to hold jobs off of their land, which is known as “off-farm income.” Off-farm income on average “accounted for 83 percent of … household cash income in 2011” for agricultural operators (United States Department of Agriculture [USDA], 2013, p. 3). Ranching families often supplement or fully depend on off-farm income to fund the continuing operation of their farm or ranch. The culminating conclusion of this data is

that owning and operating a small farm is oftentimes not a financially profitable endeavor. This is an indication that many people in the ranching business have chosen this career for non-monetary reasons.

Farming as a whole and ranching in particular is an industry run by a primarily aging population. There are several factors that influence this, but the result is that many ranching operations are soon to be left without future caretakers. This reality is reflected in the Bank of America-Merrill Lynch statistic (2013) that notes, “more than two-thirds of farmers are aged 55 or older, and one-third are at least 65 years of age” (p. 4). This fact is crucial to understanding the problems facing ranchers today. In a changing industry, farmers and ranchers have to strategize how best to adapt to industry changes. They also must formulate a practical plan of succession if they desire to preserve their ranching legacy.

Economic Condition

Bill Bullard, an advocate for beef producers, observed that, “the cattle industry is the single largest segment of American agriculture… with gross receipts averaging $50 billion annually” (2013, para. 1). While this news is promising for the industry as a whole, the forecast is not as favorable for the independent operators. According to The Bureau of Labor Statistics’ *Occupational Outlook Handbook*, the 2022 projection for farmers, ranchers, and other agricultural managers is that there will be a 19% decline in employment (U.S. Department of Labor, 2014a, para. 5). This is because the agricultural industry continues “to produce more with fewer workers [which] will result in less demand for farmers and ranchers” (para. 5). For the nearly one million workers who consider themselves farmers and ranchers, this drastic forecast necessitates a change in

the current business model. For ranchers, this change requires an investigation into the divergent components that affect the ranching industry.

A cursory glance at the cattle market reveals that cattle are mainly sold in two different ways: through the cash market or through an agreement known as a contracted sale. The cash market “operates through a buyer and seller concluding their transaction immediately, with the price of the livestock determined by the current market” (Sutton, 2013, p. 5). The opposite of cash market sales are contracted sales, which are prearranged agreements between the cattle producer and the meatpacker to sell the cattle at a certain date for a certain price (Curtis, 2007). Both of these methods of trading consist of inherent risks and benefits that influence the individual rancher and the market as a whole. These sales methods are explored in further detail in the section concerning alternative business models.

When selling their cattle, most ranchers do not sell directly to the consumer. They deal with the meatpackers who then butcher and process the meat to be sold to the grocers. In the United States, there are four big names when it comes to beef meatpacking companies: Tyson, Cargill, JBS, and National Beef. Together they process over 75% of the beef in the U.S. (Jones, 2014). This statistic is indicative of a market stronghold in the meatpacking industry, which gives the meatpackers significant bargaining power in the buying market. Many advocates for ranchers and cattlemen believe that these four meatpackers have too much control over the purchasing of beef and livestock and, therefore, can unlawfully influence the price at which they buy cattle. Some fear the meatpackers have the power of a monopsony: an economic condition where “there is only one buyer” for a product (“Monopsony,” 2011). Many cattlemen see the compound

market presence of these corporations as a group of exclusive buyers that are a threat to a competitive market.

Barring all of the controversy and intrigue concerning the influence that meatpackers have on the price of cattle, it is important for ranchers to note that the size of these four meatpackers drastically impacts the beef market. Since the 1990s these meatpackers have begun vertically integrating. Vertical integration is when a company acquires another operation along the supply chain. It is “the combination in one company of two or more stages of production normally operated by separate companies,” which increases the power of the acquiring company in the industry (“Vertical integration,” n.d.). “By taking part in livestock production, entering into long-term marketing agreements with producers, and purchasing downstream firms to increase efficiency,” the meatpackers accurately depict vertical integration (Sutton, 2013, p. 4). In this situation, the meatpackers are purchasing their own livestock operations instead of purchasing cattle from ranchers. In consideration of the percentage market control that these four companies hold, vertical integration has the potential to encompass every level of the beef supply chain.

Campaigners for cattlemen’s rights believe that “the maintenance of a viable cash market is essential for a competitive livestock market” (Sutton, 2013, p. 6). The results are showing that because of the vertical integration by the meatpackers, the cash market for beef is declining. With the increase in contracted sales and the subsequent decline in the cash market, the information implies that the livestock market is facing an unsustainable future (Bullard, 2013, para. 90). There is, however, a large group of ranchers who believe that ranching will continue to be successful if “competition in the

marketplace for… products grown in rural America" is maintained (Frerichs, 2011, para. 1). The cash market is the means by which the current market price for beef is established and, therefore, is the competitive marketplace for beef. Without a successful cash market, the price of beef would be controlled by the limited buyers who pre-establish the value of the commodity, oftentimes through contracts. This imbalance leaves no power to cattle producers whose interests are fundamentally opposed to those of the corporate buyers.

There have been several attempts by lobbyists and other activist groups to ban meatpackers' ability to vertically integrate, but this has largely been met with dismissal. In 2002 and 2008, there were versions of anti-integration legislation in the farm bill passed by the U.S. Senate, but in both instances this section was removed in the House-Senate conference. At the 112th Congress, Senate bill 2141 presented the ideals of anti-integration, however, the bill was not enacted (Library of Congress, 2012). Anti-integration legislation is advocated by people who believe that "the ability of meatpackers to manipulate livestock markets is further increased by the concentration of meat processing in the hands of a few large corporations" (National Sustainable Agriculture Coalition, 2012, para. 5). The ventures by meatpackers to vertically integrate are frightening supporters of family-operated ranches. The fear is that vertical integration will eventually replace all levels of the supply chain for cattle.

Ranching has historically been known as a profession with high barriers to entry. This is not only because of the significant costs of feeding and raising beef livestock, but also because it is so difficult to raise and produce a meaningful supply of cattle (Lawrence & Mintert, 2011). The phrase, meaningful supply, refers to the threshold a producer must attain in order to compete with the economies of scale of the other

industry players and achieve profitability. In response to the size of their competitors, many ranches have begun looking for different methods of conducting their business that will increase their profitability. In order for these new models to be sustainable, they need to take into account the internal and external components that affect ranching operations.

One factor that hinders a ranch from attaining the size required to maximize operating capacity, is the exorbitant cost of land. The value of land has been one of the most drastic changes to ranching economics. From 2003 to 2013, “average land prices rose by 213 percent” (Mittal & Moore, 2014, p. 6). This significantly affects the entire nation but particularly ranchers. The majority of ranch assets are tied up in what is known as fixed assets, assets that are not easily converted into cash, land being the largest contributor (“Fixed assets,” n.d.). This figure is evidence of the importance of land to the operation of a ranch and also indicates that land can have a considerable impact on the economic profitability of a ranch.

When it comes to accounting for their assets, most family-operated ranches do not follow the Generally Accepted Accounting Principles (GAAP) in the documentation of their assets, liabilities, and equity. Ranchers will also use the depreciation methods that they filed on their tax return, which are often not a true representation of the value reduction of the ranches assets. James McGrann is a former professor at Texas A&M and “a recognized professional in beef cattle economics” (“Tyrus R.,” 2011, para. 1). McGrann conducted a study where he measured the sustainability of the cow-calf sector of ranching by analyzing its current financial and economic profitability. To ascertain these figures, McGrann could not rely on many rancher-provided numbers because there was no way to verify their accuracy. McGrann calculated his findings by determining the

accrual-adjusted revenue and expenses to indicate financial profitability. He would then add the opportunity cost of land to ascertain economic profitability. The conclusion McGrann came to was that, "the cow-calf sector is not being sustained" (2014, p. 3). The results of McGrann's analysis concur with the preceding data concerning cattle ranching. This information is consequential to planning for the future of family-operated ranches.

Government and industry are affecting ranches externally. Internally, ranches are suffering the repercussions of an aging demographic and caring for the family's estate. These factors are jointly impacting family-operated ranches in a detrimental manner. In order to sustain their position in the current market, farmers and ranchers must modify their business model by entering into alternative markets or attaining a competitive scale of production (University of California, 2014, p. 10). This cursory analysis of the economic environment in which cattle ranchers operate aids in evaluating how a rancher should prepare for the future. Having this knowledge of the economic condition of the cattle industry is the initial act in generating a prosperous business model.

Present Tax on Ranchers

Taxes on U.S. ranchers affect the stability and growth of the agriculture industry in the U.S. as a whole. According to Ron Durst and James Williamson of the USDA (2013), the majority of farms and ranches in the U.S. are organized as either a sole proprietorship or a partnership for tax purposes (para. 4). This means that the income made from farming and ranching flows through to the taxpayer and is taxed at the individual tax rates. Therefore, tax laws that affect ranchers will be based on the assumption that the rancher is paying taxes at an individual tax rate. Tax legislation that lowers the income tax for the individual taxpayer has largely benefited ranchers.

Ranchers can take advantage of individual and farm-related exemptions that result in deductions on taxable income, which are helpful to farmers and ranchers trying to maintain their business.

The Farmer's Tax Guide for 2015, published by the Internal Revenue Service (IRS), highlights the changes to tax standards in 2015 affecting farmers and ranchers. This guide stipulates what income is included to compute taxable income and what deductions are allowed from farm or ranch earnings. In addition to income made from agricultural activities, most farmers and ranchers also have off-farm jobs by which they earn income. This off-farm income often makes up the majority of household income (Durst & Williamson, 2013, para. 4). The farm income either increases or decreases a farmer's taxable income from off-farm sources.

The recent economic recession has caused a subsequent decline in profits for many agriculture operators. For tax purposes, this has provided many farming and ranching operations the ability to write off their taxable income. Many organizations have been able to record a net operating loss (NOL) for their taxable income (Durst & Williamson, 2013, para. 4). This loss can be beneficial since most agricultural operators report their farm or ranch income on their personal tax returns. Ranchers can then use the loss to reduce taxable income made from off-farm jobs.

Historically, ranching individuals have recognized a loss from their farm or ranch income that then reduces their total taxable income. Ron Durst and James Williamson (2015) reported that "since 1980, farm sole proprietors, in the aggregate, have reported negative net farm income for tax purposes, and over the last decade, both the share of farmers reporting losses and the amount of the losses reported have increased" (para. 5).

It was also noted in the review that about half of agriculture partnerships and small corporations report a farm or ranch loss (2015, para. 5). This information demonstrates that farms and ranches, no matter their business classification, are highly likely to experience a loss from the operation of their business.

Net operating losses from agriculture operations are given a special benefit. An individual who incurs a loss due to agriculture business is allowed to carry the loss back to reduce previous taxable income up to five years, as opposed to two years for other taxpayers (IRS, 2014a, p. 3). Also, NOLs from agriculture are able to flow-through to the individual if the farm is classified as a sole proprietorship, partnership, or a limited liability company (2014a, p. 3). As a result of this NOL, the taxpayer has a tax benefit of decreased taxable income and, therefore, a decreased tax liability.

The prevalence of recognizing a NOL from agriculture activities is due to many different components besides total income. A significant factor is the eligibility of farm and ranch income for many of the IRS deductions. The majority of business expenses for agriculture are similar to those for other businesses in that they must be “the ordinary and necessary costs of operating a farm for profit” (IRS, 2015b, p. 19). What makes ranching different from other professions is that the expenses for the ranch are often closely tied with the expenses accumulated from personal use. For example, most ranches use a personal home to conduct the administrative work for their ranch. For tax purposes, ranchers can choose to deduct from their taxable income the “Business use” of their home (Internal Revenue Service [IRS], 2015b, p. 22). This deduction must adhere to the stipulations for allocating expenses between business and personal use laid out in the Farmer’s Tax Guide.

The stipulation by the IRS that only expenses classified as a “business expense” may be used as a deduction against taxable income can sometimes adversely affect small family-operated ranches. The problem for ranchers is that a business expense can only be incurred from “an activity is carried on for profit [and] if it makes a profit during at least three of the last five tax years, including the current year” (IRS, 2012, para. 5). The IRS prerequisite for conducting a ranch as a business includes specific characteristics. The primary quality of these characteristics is that the operations of the ranch must be conducted in a manner that is meant to generate profit (Hobbs, 2010, pp. 2-3). For small, family-operated ranches that file their taxes as an individual, partnership, S Corporation, or LLC, this condition has the potential to drastically affect their total taxable income.

Ranchers who have engaged in raising livestock for non-monetary causes could be found culpable of misapplying business expenses on their tax returns. When a person engages in an activity without the intent of producing a profit, the IRS can investigate to determine whether the activity is more appropriately defined as a hobby than a business. The burden is upon the IRS to prove that “the operator has no intent to make a profit or is attempting to generate tax loss to offset other taxable income” (Hobbs, 2010, p. 1). Once the IRS has made this determination, operators can no longer deduct expenses from ranching on their tax return, and may even be subject to a penalty. It is ranchers’ duty to prepare and manage their ranch as a business operation in order to avoid the reclassification of their ranch as a hobby.

A deduction that is particularly helpful to ranchers is the Domestic Production Activities Deduction (DPAD). Agriculture, forestry, fishing, and hunting only claim 0.5% of the domestic production activities deduction used, but have the largest qualifying

percentage of income at 85% (Committee for a Responsible Budget [CRFB], 2013). It is almost by definition that ranches based in the U.S., who produce and sell goods domestically, are qualified for the DPAD.

In addition, the production of cattle is especially vulnerable to the effects of nature. The IRS created a provision for farmers and ranchers in the case of bad weather. This benefit allows farmers and ranchers to postpone any gain they realize on the sale of produce or animals if they are forced to sell because of bad weather (IRS, 2013, para. 7). This postponement is meant to assist in situations that are out of a cattlemen’s control. An example could be a storm taking out a rancher’s barn in the winter. This forces a rancher to sell his cattle because they might not make it through the winter without shelter. As a consequence, the rancher had to sell his cattle for less money but the alternative was losing them altogether. This provision directly aids farmers and ranchers by creating a tax buffer to help offset the loss and expenses incurred as a result of bad weather, giving recipients aid in the continuance of their operation.

Agriculture operators are also three times more likely to report a capital gain or loss from farming or ranching than the average taxpayer (Durst & Williamson, 2013, para. 8). Capital gains are taxed differently than ordinary income. Capital gains typically result from the sale of a capital asset, which categorizes a sizable proportion of ranch operating investments, such as land and equipment (IRS, 2014b, para. 3). By being able to categorize some of their gains as capital instead of ordinary, farmers and ranchers are able to decrease their total tax liability, if their qualifying tax bracket is higher than the capital gains tax rate. However, this benefit has been negatively affected by the additional taxes enacted to fund Obama Care, which put into legislation an increase in the net

investment income tax. This additional tax of 3.8% applies to capital gains as well as taxes on a person's estate (Wood, 2014). The market value of land and buildings are higher per farm or ranch than any other product, and have increased in value more than any other asset from 2007-2012 (USDA, 2014, p. 4). What many ranchers are concerned about is the increased capital gain and estate tax that will hit their operation once the head of the family ranch dies or at the transfer of ownership.

Estate Tax

Benjamin Franklin's famous quote, "in this world nothing can be said to be certain, except death and taxes," still holds true today, especially for ranchers. With the demographic of ranchers progressively getting older, one of the largest threats to the continuation of the ranching operation is the estate tax. The estate tax is the tax on the transfer of property at death. In many respects, the estate tax can be especially harmful to ranches. Compared to other families in the U.S., ranching families are more susceptible to be pushed over the tax-exempt threshold because of the capital-intensive nature of ranching (IRS, 2015a). This is because ranches embody the proverb "land rich and cash poor." These capital assets, while significant indicators of wealth on paper, are not easily turned into cash and are considered by ranchers as an investment in the operation.

The considerable amount of fixed assets that ranchers have in their operation is what sets ranches apart from other estates. Capital gains taxes drastically impact farmers and ranchers because "production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple" (American Farm Bureau Federation [AFBF], 2015, p. 1). Ranches that have been around for decades, without changing hands, are the definition of this estate that is

adversely affected by the rise in the value of land. Caretakers put a weighty portion of their capital into land and equipment as an investment. Therefore, an increase in the capital gains rate for estate taxes could prove too hefty a burden to bear.

The estate tax has undergone significant changes in the past ten years. The tax exemption threshold is currently 5.43 million dollars and any amount over that is taxed at 40% (AFBF, 2015, p. 1). While this threshold seems high, the exponential increase in the value of land in the past 50 years has been a large contributor in forcing ranch assets over this exemption limit. When assets officially change hands, often on the date of death or a previous property ownership transfer, the assets are revalued and then taxed on the increase (Tax Policy Center, 2011). For families that have owned and operated a ranch for 100 years, with the current operator having ownership for at least 40 years, the tax incurred by the revaluation of assets can be debilitating to the resources of a ranch.

While these circumstances can impair ranchers, the government has legislated certain provisions to mitigate the harm the estate tax can have on a ranching or farming operation. Some of the intervening legislation allows “farm real estate to be valued at farm-use rather than at its fair market value, and an installment payment provision” (Durst & Williamson, 2015). The tax code can be intricate and difficult to understand. If ranch operators take the time to examine the agricultural provisions and work with their accountants, they can find exemptions and benefits that help mitigate their total tax liability.

Alternative Business Models

When it comes to the future of a ranch, operators already have an excessive amount of factors to account for: costs of operation, choosing a successor, estate taxes,

etc. A foundational issue in planning for the future is something that can get overlooked while one is occupied with the other details. This issue is creating a viable business model for the ranching operation that can be sustainable into the future. Based on industry competition and the cost of creating an efficient ranch, most family-owned and operated ranches will not be able to sustain their position in the projected economy. Once ranchers recognize this dilemma, there is still hope for the preservation of their way of life and their ranching legacy.

In her master's thesis, Megan Christensen interviewed 18 different ranchers making up 16 ranch units in Larimer County, Colorado. From these interviews she found three general current business models that classify operational ranches. Ranches operate by either losing money from the ranching operation and being financed through outside income, earning a minimal amount of income that then supplements other on/off ranch income, or the ranching operation is the main source of income for the rancher (Christensen, 2011, p. 29-30). No matter the model that ranchers categorized themselves in, all of the participants in the survey were interested in a diverse ranching business model if it would prove feasible and successful (Christensen, 2011). This result begs the question: what are alternative business models for ranchers?

Contracted Sales

The method of selling one's calves at the cash market is being replaced by contracts with the meatpackers. A contracted sale is an agreement between a cattle producer and a meatpacker at least 14 days before the delivery of cattle to a meatpacker (Matthew, Brorsen, Hahn, Arnade, & Dohlman, 2015, p. 5). This marketing system is relatively new but has become increasingly popular among cattle producers who desire to

reduce their market access risk. In these agreements, cattle are priced based on a pre-determined formula or an estimate of the future market price and are sometimes referred to as formula contracts. In a survey on how cattle in the U.S. are sold, the USDA found that “the volume of cattle procured in the national cash market has fallen from over 52% in 2005 to only 26% in 2012, while formula volumes increased during this period from less than 34% to nearly 55%” (as cited in Bullard, 2013, p. 10). Contracted sales are becoming increasingly popular among farmers and ranchers because they offer specific benefits that reduce the threat of market risk in the cattle industry.

For ranchers, who are particularly susceptible to short-term price changes, contracts can be a secure alternative to the cash market (Lacy, Knight, & Mckissick, 2012, p. 14). Participating in a contract agreement is an indicator that ranchers are seeking to mitigate their potential risk of loss by securing a price for their cattle at or above the cost of production. This is why engaging in a contract is a practice in price risk management. Ranchers who are risk-averse and desire to stabilize future flow of income commit to contracts as attractive alternatives to the volatile cash market.

Contracted sales with meatpackers offer numerous incentives to ranchers. By agreeing to a contract, ranchers have a guarantee that they will be able to sell their livestock for a certain price. In a market where supply and demand are exceptionally vulnerable to external and environmental circumstances, this contract can be a relief to many ranchers. Another incentive of this commitment is that the government has guaranteed loans for producers who are a part of a forward contract (Sutton, 2013, para. 26). This incentive could prove to be very agreeable to a rancher in need of cash. Contract sales also add value to the buyer by allowing them to better regulate input

supply, quality of product, improve efficiency, and more effectively meet customer demands (Curtis, 2007, p. 2). This contract has the potential to facilitate secure revenue to the seller and protect the quality and quantity of the product for the buyer, which results in livestock that successfully meets consumer demand.

Drawbacks. The fundamental adverse effect of contracted sales is that since the price is agreed upon prior to the date of sale, the price established has the risk of being lower than what a rancher could have received from the cash market (Lacy et al., 2012). While this loss in profits can be damaging to cattlemen's net income, many choose these contracts because the risk of selling cattle for less than they are worth is too high. Nevertheless, a rancher always has to take the chance that he is giving up potential earnings when he commits to a contract.

Contracts abate market risk to cattle producers but are controversial because of the impact they have on the cash market. What is being discovered is that the cash markets "shrinking volume is increasingly insufficient to discover a competitive price for fed cattle, even though it continues to serve as the determinant of the base price for the growing volume of cattle procured through formula contracts" (Bullard, 2013, p. 10). Contract sales, while they offer safety to an individual operator, have a negative impact on family-operated ranches and the cattle industry in the aggregate. This is because contracts take trade away from the cash market, which is the source of the competitive market price for cattle (Sutton, 2013, para. 24). Without the cash market, contractors will have unreasonable market power when it comes to setting a selling price, which is indicative of a monopsony.

Investor-Owned Land

Perhaps the future of ranching will go the way of "investor-owned, farmer-leased agriculture business" (Bank of America, 2013, p. 3). This alternative to owning an operation provides security to ranchers who now have a stable source of income via the investor. Paul Pittman is a Wall Street investment banker turned multi-million dollar farmland owner. He believes that investor-owned land is an opportunity to consolidate land used for agriculture in the U.S., which currently has fragmented ownership. When acquiring land for agriculture use, many investors practice the sale-leaseback approach. This is when a farmer or rancher sells land to an investor for the purpose of renting it back to continue operating (Willibrand, 2011). This strategy is mutually beneficial to both the investor and rancher. For investors, agricultural land "tends to rise along with overall inflation and it generally pays a steady income" (Robaton, 2015, para. 3). The benefit to ranchers is that this agreement "free[s] up capital without having to disrupt operations" (2015, para. 20). In many respects, investor-owned land is mutually beneficial to the investor, rancher, and even the land.

Investors who lease land can also meet their stewardship goals, have a regular stream of revenue, increase local food production, offer an opportunity to a new farm/ranch family, and also add value to the land (Kowell et al., 2012, p. 1). Leasing gives many ranchers the opportunity to grow in their business by providing access to land at a rate that frees up capital to buy other equipment (2012, p. 2). Leasing land from an investor can be a strategy to free up fixed assets and increase capital, which is especially agreeable to a new rancher with limited finances and minimal resources.

There are two types of investors: owners of agricultural land that is fallow (unused) who desire to lease it, and investors who are buying agricultural land for the capital gain value. Some investors have started to notice the surging value of land and have capitalized on the "overlapping crisis of retirement, farm access, and corporate consolidation" as a buying opportunity (Mittal & Moore, 2014, p. 9). Many recent buyers are expecting to realize the profit from their investment when they sell the land and subsequently recognize a capital gain because of the increase in value.

Drawbacks. What concerns the opponents of investors owning farm and ranch land is that some of these new owners "have no long-term interest in the well-being of the land, and may only be entering the market in order to leave it later for a profit" (Mittal & Moore, 2014, p. 21). This is mainly referring to new investors who are buying agricultural land for the capital gain received from selling the land when they believe they can achieve the maximum turnover. Tenants who lease from this kind of investor are concerned that the future of their ranch is at risk if and when their investor sells the land that they rely on for operation. Renting or leasing ranchland is a risk because it hinders ranch operators from being able to plan for the future with the security of knowing that they will have the land necessary to continue operation.

Ranch Coalitions

Family-operated ranches are being threatened by corporate ranching operations that can produce more livestock for less cost. This is because the "proportionate saving in costs gained by an increased level of production" gives larger organizations a competitive edge, known as "economy of scale" ("Economy," n.d.). In an effort to compete with the economies of scale of industry competitors, many ranches are joining together into

groups structured as ranch coalitions. State and local governments, universities and colleges, non-profit organizations, or even an informal agreement between ranchers can form these coalitions. A ranch coalition is commonly known as the adjoining of two or more separate operations to mutually reduce costs and increase profitability. These coalitions are founded on the idea that "an interdependent network of family [ranches] is the key to maintaining a resilient farm sector and healthy rural communities" (National Young Farmers, n.d., para. 4). Many coalitions also believe that "[Ranchers] must own their farmland in order to make capital improvements on their farms and to build equity for long-term financial security" (n.d., para. 6). A coalition provides the opportunity for ranchers to be a contender in the market while increasing the capital and resources needed to continue operations.

There are numerous coalitions that have been formed in the United States that appeal to a wide-range of demographics. Many of the coalitions are open to both produce and livestock producers. Some popular coalitions are the National Family Farm Coalition, the National Young Farmers Coalition, Farmers Market Coalition, and the Recirculating Farms Coalition. The advantages of an interdependent coalition include the leverage that comes from the combination of "buying power, influence, and voice" (Triccord Group, 2011, para. 2). It also expands safety in planning for the future and addressing risk, as well as extending the opportunities of the business (2011, para. 2). For ranchers who are feeling threatened by the competitors in the cattle industry, a ranch coalition could be a feasible replacement model to help perpetuate their business.

Drawbacks. When it comes to interdependence between people, there is always the possibility for conflict. Even in a healthy partnership among the members of a

coalition, there will still come times of opposing interests. By surrendering individual autonomy, a member of a coalition is required to cooperate, compromise, and communicate with the other members of the coalition (Tricord Group, 2011, para. 3). This can be particularly unpleasant to operators who like control and value the independence they had while operating the ranch as a sole business owner. An unhealthy relationship between members of a coalition can drastically hinder the success of the group as a whole, which is why it is very important for ranchers to handpick those they choose to engage in business with.

Specialized Niche Market

Darrell Mark, an agricultural economist from the University of Nebraska, commented on the current beef economy in an interview with BEEF magazine. He noted that "today, we see more branded products and beef-production systems aligned to meet specific consumer demands" (Ishmael, 2010, para. 20). He notes that those who specialize effectively will be "more profitable and have more incentive to expand" (2010, para. 20). The Bureau of Labor Statistics notes that despite the projected decline of farmers, ranchers, and other agricultural managers, "an increasing number of farmers have developed successful market niches that involve personalized, direct contact with their customers" (USDOL, 2014b, para. 6). Niche marketing, a strategy of specialization, is when a company creates a market by finding a specific need or demand that it can meet in a more efficient way than its competitors ("Niche marketing," n.d.). The company then concentrates its marketing efforts to this one segment. There are endless possibilities for niche marketing. Whatever an operation is able to produce and people are willing to buy can become a sustainable alternative market.

The practice of niche marketing can be currently observed in the beef industry. This tactic is tied to the popularity of words like “hormone-free,” “grass-fed,” “organic,” and “local” in the labeling of beef. All of these phrases are advantages that certain ranchers have found benefit their beef over others at the consumer level. These phrases are defining characteristics that set beef products apart from one another. Customers with particular environmental or economic concerns often change their buying habits as a result of the labeling of the product. This market is a sector in the cattle industry that is difficult for larger organizations to emulate. This is why niche marketing creates a competitive advantage for small ranches. In a market with low profit margins and strong competition, these specialized markets become a viable alternative for ranchers who are struggling to find an edge in their current market.

A recently popular trend in consumer purchasing habits has been the Locavore Movement. This is when a person adheres to the principle of buying food and other resources from local producers (“Locavore,” n.d.). Scharber and Dancs (2015) conducted an in-depth analysis on the economic critiques against the Locavore Movement in order to ascertain the credibility of this market. In the end, Scharber and Dancs came to the conclusion that “much of the disagreement between local food supporters and these critics can be chalked up to differences in discourses and the values underlying them” (Scharber & Dancs, 2015, p. 9). All in all, the conclusion is that the locavore movement is a potential portal to a profitable, specialized consumer market. This is just one example of a specialized market that is proving a profitable alternative for agricultural producers.

Drawbacks. Despite the freedom, opportunity, and other benefits that a niche market allows agriculture operators, there are still possible adverse effects that need to be

taken into consideration. One of the dangers of specialization is that after a business has put all of their efforts into honing production to meet a specific need or demand, the market could prove unprofitable. Due to the nature of a niche market, there is only a limited consumer base with specific demands. These characteristics limit the opportunities for growth and diversity. As a result of the smaller market it is "difficult to enjoy a larger profit margin in the market" (Erel, 2014, para. 9). If a ranch is planning to grow and increase its operation and production capacity, then a niche market may be more of a hindrance than help in the long run.

Conclusion

Family-operated ranching is a business that oftentimes reflects a lifestyle choice rather than a business choice. Ranching is often thought of as an old-fashioned and most likely unproductive business that was chosen because someone either inherited the ranch, or fell in love with the way of life, not because of the money in the business.

The ranching population is largely made up of an aging demographic that is expected to retire in the near future. How a rancher prepares for the future sustainability of its business model is consequential to the successful change of ownership for these ranches. A viable business model in the current market is impacted by numerous economic factors as well as government regulation. The cattle industry is predominantly under the influence of four major buyers, which makes it difficult for small operators to produce a meaningful supply of cattle in comparison to these large competitors. Also, the importance of costly fixed assets like land, in the operation of a ranch make capital a scarce commodity for many ranchers. Ranching is beneficially affected by the current tax code that provides many farming or ranching individuals the opportunity to net their

operating loss from agriculture against income from off-farm activities. Ranchers have also enjoyed the eligibility of many special deductions such as the DPAD as well as special provisions for weather. What concerns many family-operated ranches is the effect the estate tax will have on their operation at the death of the current caretaker. This changing ownership is just one factor that affects the continuation of their family's ranching operation.

As a result of the influence of large industry competitors, government regulation via taxes, market vulnerability, and lack of sustainability, the ranching industry is in need of remodeling. The cash market that was used by the majority of family-operated cattle ranches has been surpassed by contracted sales with the major meatpackers. In response to the market conditions and the transforming rancher demographic, many ranches are turning to replacement business models. These alternative models include forward contracts, ranch coalitions, investor-owned and farmer-leased properties, or specialized niche marketing. All of these alternatives are motivated by a desire to preserve the business of family-operated ranching and the way of life that it promotes.

References

American Farm Bureau Federation (AFBF). (2015, August 1). *Estate tax repeal*. Retrieved from http://www.fb.org/issues/docs/taxes-estaterepeal15.pdf

Bank of America-Merril Lynch. (2013). *Farming the globe*. Retrieved from http://corpx-pp.bankofamerica.com/documents/10157/67594/Farming_the_Globe.pdf

Bullard, B. (2013). Under siege: The U.S. live cattle industry. *South Dakota Law Review*, *58*(3), 10. Retrieved from http://go.galegroup.com/ps/i.do?id=GALE%7CA352493083&v=2.1&u=vic_liberty&it=r&p=AONE&sw=w&asid=e650fb89a5984b0c0c14dfc4f36142a8

Christensen, M. (2011). Diversifying ranch business models: Challenges and opportunities in Larimer County, Colorado. Retrieved from http://ezproxy.liberty.edu:2048/login?url=http://search.proquest.com/docview/889134851?accountid=12085

Committee for a Responsible Budget (CRFB). (2013, September 4). The tax break-down: Section 199, The domestic production activities deduction. *The Tax Break-Down*. Retrieved from http://crfb.org/blogs/tax-break-down-section-199-domestic-production-activities-deduction

Curtis, K. (2007, February 22). *Managing market and price risk in agriculture: The case for forward contracts*. Retrieved from https://www.unce.unr.edu/publications/files/ag/2005/fs0535.pdf

Durst, R. & Williamson, J. (2013, February 21). Federal income tax reform and the potential effects on farm households. Retrieved from USDA-ERS website: http://www.ers.usda.gov/amber-waves/2013-february/federal-income-tax-reform-and-the-potential-effects-on-farm-households.aspx#VTflcLrxZSU

Durst, R, & Williamson, J. (2015, May 6). *Federal tax issues: Federal estate taxes*. Retrieved from USDA-ERS website: http://www.ers.usda.gov/topics/farm-economy/federal-tax-issues.aspx

Economy of scale [phrase 1]. (n.d.). In *New Oxford American dictionary*. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/economy

Erel, O. (2014, September 9). The advantages and disadvantages of niche marketing [Web log post]. Retrieved from http://product2market.walkme.com/advantages-disadvantages-niche-marketing/

Fixed assets. (n.d.). In *New Oxford American dictionary*. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/fixed-assets?q=fixed+assets

Frerichs, J. (2011, July 21). *A bright future for farming and ranching*. Retrieved from https://www.whitehouse.gov/blog/2011/07/21/bright-future-farming-and-ranching

Hobbs, J.C. (2010). Farm losses versus hobby losses: Farmers must plan ahead to avoid adverse tax consequences. Retrieved from http://ruraltax.org/files/uploads/Hobby_Loss_RTE_2010-04.pdf

Hoppe, Robert A., MacDonald, J., & Korb. P. (2010, February). *Small farms in the United States: Persistence under pressure,* EIB-63. Retrieved from USDA-ERS website: http://www.ers.usda.gov/media/147007/eib63_1_.pdf

How cattle are raised. (n.d.). Retrieved from http://www.calcattlemen.org/cattle_101/how_cattle_are_raised.aspx

Internal Revenue Service (IRS). (2012). Business or hobby? Answer has implications for deductions. Retrieved from https://www.irs.gov/uac/Business-or-Hobby%3F-Answer-Has-Implications-for-Deductions

Internal Revenue Service (IRS). (2013, March 26). *Ten things to know about farm income and deductions.* Retrieved from http://www.irs.gov/uac/Newsroom/10-Things-to-Know-about-Farm-Income-and-Deductions

Internal Revenue Service (IRS). (2014a). *Net operating losses for individuals, estates, and trusts*. Retrieved from http://www.irs.gov/pub/irs-pdf/p536.pdf

Internal Revenue Service (IRS). (2014b). *Ordinary or capital gain or loss*. Retrieved from https://www.irs.gov/publications/p544/ch02.html

Internal Revenue Service (IRS). (2015a, January 9). *Estate tax*. Retrieved from http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-Tax

Internal Revenue Service (IRS). (2015b, October 13). *Farmers tax guide: For use in preparing 2015 tax returns*. Retrieved from https://www.irs.gov/pub/irs-pdf/p225.pdf

Ishmael, Wes. (2010, August 5). Expanding your ranch in today's cattle market. *BEEF*. Retrieved from http://go.galegroup.com.ezproxy.liberty.edu:2048/ps/i.do?id=GALE%7CA234021721&v=2.1&u=vic_liberty&it=r&p=ITOF&sw=w&asid=fb57ab816f31737dfdad363ca321f867

Jones, A. (2014, December 11). *Welcome to market realist*. Retrieved from http://marketrealist.com/2014/12/tyson-foods-commands-24-of-the-beef-market/

Klobuchar, A. (2013, September 1). *The economic contribution of America's farmers and the importance of agricultural exports*. Retrieved from U.S. Congress Joint Economic Committee website: http://www.jec.senate.gov/public/_cache/files/266a0bf3-5142-4545-b806-ef9fd78b9c2f/jec-agriculture-report.pdf

Kowell, B., Coffin, C., Westover, P., Ghia, M., Ruhf, K., Buswell, E., . . . Martin, J. (2012). *A landowner's guide to leasing land for farming*. Retrieved from http://www.thegreenhorns.net/wp-content/files_mf/1344531092 landownersguide.pdf

Lacy, R., Knight, C., & Mckissick, C. (2012, July 1). *Profitable cattle marketing for cow-calf producer*. Retrieved from http://www.agecon.uga.edu/extension/pubs/documents/ProfitableCattleMarketingfortheCow-CalfProducer-B1078_3.pdf

Lawrence, J., & Mintert, J. (2011). *Fundamental forces affecting livestock producers*. Retrieved fromhttp://www.choicesmagazine.org/magazine/article.php?article =165

Library of Congress. (2012). S.2141 - A bill to amend the packers and stockyards act, 1921, to make it unlawful for a packer to own, feed, or control livestock intended for slaughter. Retrieved from https://www.congress.gov/bill/112th-congress/senate-bill/2141/cosponsors

Locavore. (n.d.). In *New Oxford American dictionary*. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/locavore

Matthew, K. H., Brorsen, W. Jr., Hahn, W. F., Arnade, C., & Dohlman, E. (2015, September 1). *Mandatory price reporting, market efficiency, and price discovery in livestock markets*. Retrieved from USDA website: http://www.ers.usda.gov/media/1896210/ldpm-254-01.pdf

McGrann, J. (2014). Best measure of ranch sustainability is economic profitability. *Beef.* Retrieved from http://beefmagazine.com/cattle-industry-structure/best-measure-ranch-sustainability-economic-profitability

Monopsony. (n.d.). In *New Oxford American dictionary*. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/monopsony

Mittal, A., & Moore, M. (2014). *Down on the farm Wall Street: America's new farmer*. Retrieved from http://www.oaklandinstitute.org/sites/oaklandinstitute.org/files/OI_Report_Down_on_the_Farm.pdf

Niche marketing. (n.d.) In *Business dictionary* online. Retrieved from http://www.businessdictionary.com/definition/niche-marketing.html.

National Sustainable Agriculture Coalition. (2012, March 1). *Bill to ban packer ownership of livestock introduced.* Retrieved from http://sustainableagriculture.net/blog/packer-ban-bill-introduced/

National Young Farmers Coalition. (n.d.). Our mission, vision, and guiding principles. Retrieved from http://www.youngfarmers.org/about/our-work/

Robaton, A. (2015, January 21). *Farming REITs*. Retrieved from https://www.reit.com/news/reit-magazine/january-february-2015/farming-reits

Scharber, H., & Dancs, A. (2015). *Do locavores have a dilemma?* Retrieved from http://www.truth-out.org/opinion/item/31997-do-locavores-have-

a-dilemma

Sutton, K. K. (2013). The beef with big meat: Meatpacking and antitrust in America's heartland. *South Dakota Law Review*, *58*(3), 4-5. Retrieved from http://go.galegroup.com/ps/i.do?id=GALE%7CA352493085&v=2.1&u=vic_liberty&it=r&p=LT&sw=w&asid=c060971d4916e72661f970d0c8de1d05

Tax Policy Center. (2011). *Capital gains and dividends: How are capital gains taxed?* Retrieved from http://www.taxpolicycenter.org/briefing-book/key-elements/capital-gains/how-taxed.cfm

The Tricord Group. (2011). *The pros and cons of interdependence*. Retrieved from https://pharmacystrategy.wordpress.com/2011/06/08/the-pros-and-cons-of-interdependence/

Tyrus R. Timm Honor Registry. (2011). *McGrann, James M*. Retrieved from http://tyrustimmregistry.org/?q=content/mcgrann-james-m

University of California Santa Cruz. (2014). *Small farm economic viability*. Retrieved from http://casfs.ucsc.edu/about/publications/Teaching-Direct-Marketing/pdf downloads/Unit.1.pdf

United States Department of Agriculture (USDA), Economic Research Service (ERS). 2013. *Beginning farmers and ranchers at a glance.* 2013 Edition. Retrieved from *http://www.ers.usda.gov/media/988138/eb-22.pdf*

United States Department of Agriculture (USDA). (2014, May). *2012 census of agriculture*. Retrieved from http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume _1,_Chapter_1_US/usv1.pdf

U.S. Department of Labor Bureau of Labor Statistics (USDOL) (2014a, January 8). *Farmers, ranchers, and other agricultural managers*. Retrieved from http://www.bls.gov/ooh/management/farmers-ranchers-and-other-agricultural-managers.htm

U.S. Department of Labor Bureau of Labor Statistics (USDOL) (2014b, January 8). *Job outlook*. Retrieved from http://www.bls.gov/ooh/management/farmers-ranchers-and-other-agricultural-managers.htm#tab-6

Vertical integration. (n.d.) In *New Oxford American dictionary*. Retrieved from http://www.oxforddictionaries.com/us/definition/american_english/vertical-integration?q=vertical+integration

Willibrand, T.C. (2011). *Sale-leaseback transactions: A financing alternative for middle market companies*. Retrieved from http://www.srr.com/article/sale–leaseback-transactions-financing-alternative-middle-market-companies

Wood, R.W. (2014, April 10). *Paying Obamacare's 3.8% investment tax? Like your investments, keep your investments*. Retrieved from http://www.forbes.com/sites/robertwood/2014/04/10/paying-obamacares-3-8-investment-tax-if-you-like-your-investments-keep-your-investments/