Western Beef Resource Committee *Third Edition*

Cattle Producer's Handbook

Finance Section 925

Partial Budgeting

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A partial budget is used to calculate the expected change in returns for a proposed change in the ranch business. Partial budgeting is useful as an intermediate term analysis because it is best adapted to analyzing relatively small changes in the whole ranch plan. It differs from an enterprise budget in that several enterprises might be involved in the change. A partial budget contains only those income and expense items that will change if the proposed modification in the ranch plan is implemented. Only the changes in income and expenses are included. The result is an estimate of the increase or decrease in returns.

To make this estimate, a partial budget systematically organizes the answers to four questions relating to the proposed change.

1. What new or additional costs will be incurred?
2. What current income will be lost or reduced?
3. What new or additional income will be received?
4. What current costs will be reduced or eliminated?

The first two questions identify changes that will reduce returns by either increasing costs or reducing income. Similarly, the last two questions identify factors that will increase returns by generating additional income or lowering costs.

By comparing the total reduction in returns found by answering the first two questions, with the total increase in returns shown by the answers to the last two, the net change in returns can be computed. A positive value indicates the proposed change in the ranch plan will increase returns. However, the ranch manager may want to consider additional factors, such as additional risk, uncertainty, and capital requirements, before implementing the change.

A widely used format for partial budgeting is shown in Table 1. Other forms with slightly different organization are also used, but all contain some form of the four basic headings to organize the information relating to the four questions presented in the previous section.

Additional Costs

A proposed change may cause additional costs because the new or expanded enterprise requires the purchase of additional inputs, or a new input will be purchased as a substitute for another. The additional overhead costs should be included, as well as additional operating costs.

If the proposed change requires the purchase of new machinery, buildings, land, or breeding livestock, there will be additional overhead costs. These should be averaged annual values so depreciation should be computed using the straight line method. A basic assumption in partial budgeting is that these additional investments will continue to be used over their expected lifetime on the ranch.

Reduced Income

Income may be reduced if the proposed change would eliminate an enterprise, reduce the size of an enterprise, or cause a reduction in yield or production levels. Proper estimation of reduced income requires careful attention to estimating average yields, production levels, or changes in these values, as well as output prices.

Additional Income

A proposed change may cause an increase in total ranch income if a new enterprise is being added. If an enterprise is being expanded or if the change will cause yields or production to increase, as with all parts of a partial budget, only the additional income expected as a result of the proposed change is listed under this section—not the total income. Accurate estimates of output prices and yields are important for completing this section, as they were for estimating reduced income.