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Farm financial monitoring

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ABSTRACT

The financial data gathered by Shand Thomson & Co has highlighted the gap between the average and the top 10% or top 25% of farmers. The sharing of this information among farmers helps individuals identify the strengths and weakness of their business and is an important step in making the changes required to increase profitability.

Keywords: Sheep farms; monitoring; profitability.

INTRODUCTION

The purpose of monitoring is to give farmers information to help them improve profitability. Increased profitability gives farmers choices that include spending on capital development on the farm; investing off farm on a holiday house, sharemarket, private superannuation schemes etc; going on a holiday; sending children to preferred schools; assisting with children's tertiary studies; changing the family car etc.

Most benchmarking focus has been in the area of production monitoring, with the aim of maximising production. Less emphasis has been placed on the efficiency of production, which has to consider the costs of production. Profit is as much about generating farm revenue as it is about monitoring and controlling costs. Therefore, to effectively monitor a farming business both components of profitability, which are income and expenditure (cost of production), should be monitored and this is called financial monitoring.

GETTING STARTED

The very first step to increasing farm profits is knowing what performance levels are currently being achieved. For a few farmers finding this out has a demotivating effect, but fortunately most view this information as a challenge and the first step to making real progress.

A concern is that farmers generally lack an understanding of their basic financial and statistical data. Those who do not understand what they are measuring or do not know how benchmarking can help them, need to learn the skill from their business advisors.

It must be recognised that while the figures provide standards and targets, they do not directly assist in indicating how changes should be made. However, identifying income and expense areas which are out of step with district averages or industry benchmarks, should put a farmer on enquiry as to the reasons for the variations and be the first step to making a real difference to his farm profitability. By doing this critical self-analysis a farmer is identifying some of the strengths and weaknesses of his operation. This is a similar process that is necessary for non-farming businesses.

The important message for farmers in relation to monitoring, is that what can be measured can be managed.

KEY FINANCIAL MEASURES

There has been concern throughout New Zealand that the farm benchmarking has not been standardised. Meat NZ facilitated a benchmarking workshop at the end of September 1998 and invited a number of leaders in the agricultural sector including farm advisors, chartered accountants, meat companies, tertiary institutions, trading banks etc to identify the key financial monitoring measures. These were identified as follows:

Gross Farm Revenue per hectare
Gross Farm Revenue per stock unit
Average Price per head of livestock sold
Average Price per kilogram of produce sold
Farm Working Expenses per hectare
Farm Working Expenses per stock unit
Farm Working Expenses as a % of Gross Farm Revenue
Economic Farm Surplus per hectare
Economic Farm Surplus per stock unit
Economic Farm Surplus as a % of Gross Farm Revenue
Debt Servicing (interest and rent) as % of Gross Farm Revenue

CLUTHA DISTRICT BENCHMARK

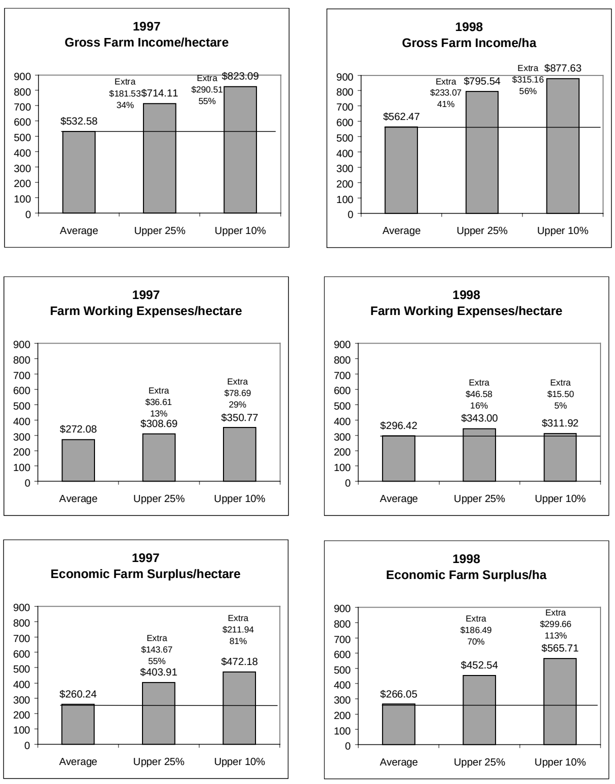
Table 1 is an extract taken from the Shand Thomson "Clutha District Farm Statistics" for properties running between 2,001 – 3,500 stock units. The 1998 results are provisional only, as these were being compiled in February 1999. These statistics are compiled by pooling client's individual statistics and bringing this information together in a summarised form. This allows clients to objectively monitor or benchmark their results with the "average" and "upper 25%" in the Clutha District for three property size groupings: <2000 stock units; >2001 <3500 stock units; and >3501 stock units. The clients benchmark or compare their results with the average and upper 25% of farms.

TABLE 1: 1998 sheep and beef farming statistics for farms carrying 2001 – 3500 stock units (from Shand Thomson and Co. Balclutha).

	1995	1996 Average	1997	1998 (Provisional)	1998 (Provisional) Upper 25%	Upper 10%
Income and Expense Measures						
Gross Farm Revenue ($)	113,097	105,838	125,618	137,372	168,835	174,987
Gross Farm Revenue/su	42.53	39.26	47.15	50.73	65.65	71.45
Gross Farm Revenue/ha	486.62	441.75	532.58	562.47	795.54	877.63
Farm Working Expenses ($)	61,171	62,396	64,665	73,103	73,104	62,218
Farm Working Expenses/su	22.96	23.09	24.27	26.99	28.32	25.30
Farm Working Expenses/ha	259.91	256.21	272.08	296.42	343.00	311.92
Farm Working Expenses %GFI	49.51	61.58	53.18	58.12	43.30	34.99
Economic farm surplus ($)	51,926	43,442	60,952	64,269	95,731	112,769
Economic Farm Surplus/su	19.57	16.18	22.70	23.74	37.33	46.15
Economic Farm Surplus/ha	226.71	185.55	260.24	266.05	452.54	565.71
Economic Farm Surplus %GFI	50.49	38.42	46.87	41.88	56.70	65.01
Debt Servicing ($)	18,030	20,113	21,203	21,614	19,536	18,417
Debt Servicing/su	6.68	7.40	7.87	7.83	7.28	7.35
Debt Servicing/ha	76.65	82.62	89.42	83.69	83.23	88.64
Debt Servicing % GFI	16.54	20.69	17.59	16.86	10.68	10.21

Gross Farm Revenue= Total Revenue earned from the year's farming operations (Minus stock purchases and direct wool expenses). 1998 and 1997 Gross Farm Revenue have been adjusted for expected retentions
Farm Working Expenses= Excludes Debt Servicing and Depreciation
Economic Farm Surplus= Total Gross Farm Income minus Farm Working Expenditure
Debt Servicing= Interest, Rent and Payments on Account Rent

FIGURE 1: Gross farm income, farm working expenses and economic farm surplus in 1997 and 1998 for the average, upper 25% and upper 10% of farms.



POTENTIAL FOR IMPROVEMENT IN THE CLUTHA DISTRICT

An illustration of the potential that exists in the Clutha District alone is presented in Figure 1. It shows the economic farm surplus per hectare being achieved in the "upper 25%" and "upper 10%" of farmers in the 1997 and 1998 income years.

This information is the catalyst for farmers to look at their own results and compare them with an objective benchmark to see where their business is at. It is this self-analysis that is the first step to making real progress.

RETURN ON CAPITAL

The other aspect of financial monitoring is to consider assets, and measures such as the return on capital. The average return on capital in sheep and beef farming between 1980 and 1996 has been 3%, with a low of 0.8% in 1995/96 and a high of 5.6% in 1987/88 (Anon, 1999).

There are two aspects to return on capital:

1. Asset Values

Most land prices are influenced by commercial reasons (return on capital), emotive reasons (personal factors, way of life) and individual needs. Land values in recent years have been influenced by alternative land uses, particularly the expansion of dairying, the popularity of forestry until recently, and the demand for lifestyle blocks. These have pushed up traditional farm land values beyond their ability to produce economic returns.

2. Income Generated from those Assets

Farmers have little control over what happens outside of the gate. However, they do have considerable control over what happens within the farm gate in terms of production and profitability.

It is therefore important for the sheep and beef farming industry that there is greater emphasis on returns on capital.

CONCLUSION

Financial monitoring and benchmarking is a management tool which will assist farmers in improving their profitability and contribute to the enjoyment factor, which are both essential to their farming careers and achieving family goals.