Financial management :The Key to Farm-Firm Business Management

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Farm-Firm Financial Management

- The objective of Farm-Firm Financial Management is to help farmers improve their business management skills to improve management productivity, increase profitability, and fulfill their long-term goals.
- To enable us achieve good business management for our agriculture sector we need to ask ourselves the questions below

Farm-Firm Financial Management – Cont’d

- Is my Production efficient? Do I achieve all I can from my resources?
- What is MY cost of production?
- Do I have a marketing plan? Does that plan include market analysis and account for the breakeven price needed for what I produce?
- Have I prepared an appropriate business plan?
- Does the business provide adequate income for family living?
- Do I have a risk management plan?
- Is the record system up to Date and providing the necessary management information?

Developing Financial Management skills

- Farmers will need to embark upon an intensive educational program to gain the essential farm business management skills and the confidence to use them successfully.
- Farmers who want to succeed need to develop a farm business plan that outlines, in detail, how they plan to generate a profit and manage business risks.
- They should start by outlining specific business/personal goals and objectives and preparing complete inventories of resources available. That is, they can not prepare a meaningful plan unless they specifically outline what they wish to accomplish and the basic "resources" available to accomplish this "objective."
- The resource inventory should cover all areas of the business and include such items as farm maps by productive capacity, soil analysis, water resources, machinery, labor skills available, management capabilities, detailed crop/livestock production history, analysis of market information, and complete financial statements.

Planning and Budgeting

Factors to be considered in planning.

- Document available resources.
- Identify your goals and objectives.
- Develop a time frame to included in the plan to move through any transition in production and financing that may cause significant fluctuations in the year-to-year cash flows. E.g. a 5 year crop/livestock rotation.
- Capital improvements needed immediately (first planning year), in the intermediate terms (1 to 5 years), and long term (5 to 10 years).
- Capital needed for operating the business and for the long term.
- A physical production plan by commodity and for the whole farm. A calendar of events by month and by year, outlining all of the required production practices and resources, should be prepared for each commodity and for the whole farm.
- A long-term strategic assessment based on both historical data and current outlook information. This should include an assessment of government farm programs, the general economic outlook and technological developments.
- A marketing plan for the enterprises being considered

Planning and Budgeting Cont’d

Budgeting – the following are the key indicators.

- Enterprise budgets represent estimates of receipts (income), costs, and profits associated with the production of agricultural products. The information contained in enterprise budgets is used by agricultural producers, extension specialists, financial institutions, governmental agencies, and other advisers making decisions.
- Budgets are used to:
  - Itemize the receipts (income) received for an enterprise
  - List the inputs and production practices required by an enterprise
  - Evaluate the efficiency of farm enterprises
  - Estimate benefits and costs for major changes in production practices
  - Provide the basis for a total farm plan
  - Support applications for credit

Planning and Budgeting Cont’d

- Farm-Firm budgets are usually developed based on an acre for crops and a typical animal unit for livestock. This may mean per head, per animal unit (e.g., a cow calf unit), per flock, or other basis. The Farm-Firm budget should contain receipts for every product and by-product of the Farm. In the case of crops, this may mean a breakdown of receipts by grades or market outlets. It may also mean listing 2 distinct products like grain and straw in the case of a small grain crop. For livestock, it often means breaking out the sale of types of animals (e.g., sale of slaughter and breeding livestock and accounting for culled breeding livestock) or by grades of meat, hides, wool, eggs, or other products. Prices used should reflect market values and productivity of farm resources (land, labor, capital, and management).
- Key points to bear in mind
  1. Break-even point
  2. Operating leverage – after break-even you should check increase/decrease contributed by fixed costs
  3. Contribution margin – identify the contribution margin per commodity/cost/volume/profit analysis
  4. Capital budgeting for short-term and long term

Sourcing of Financiers

The following is required to enable you get financiers

- Farm recordkeeping system facilitates the preparation of financial statements and the monitoring of business performance.
- Properly prepared balance sheets and income statements.
- Cash flow projections will be needed. A projected cash flow statement is a listing of all anticipated cash inflows and outflows for a specified future period. It includes both farm and non-farm income, and all projected cash outflows, including operating expenses and capital outlays, family living expenses, borrowing transactions and tax payments
- Farm businesses have failed simply because the farmer or his lender recognized problems and took corrective action too late.

Examples of financiers

- Banks
- Partnerships
- Credit unions
- Government grants

Risk Management

Classification of risk in a farm-firm business

- ***Market or price risk*** is associated with the purchase of inputs as well as the sale of commodities. Fluctuations in input and output prices cause income gains or losses. These fluctuations can occur within a marketing year as well as between years. Net worth may also be affected if prices of inputs such as land and machinery change. Availability of inputs is also a risk. And, in the longer run, the variability of prices, interest rates, and relative prices are risk factors which influence many decisions.
- ***Production risk*** is the random variability inherent in a farm's production process. Weather, diseases, and pest infestations lead to production risk in crop and livestock activities. Fire, wind, theft, and other casualties are also sources of production risk.
- ***Technological risk*** is the potential that current decisions may be offset by dramatic technological improvements in the future. There is the risk that durable assets will become obsolete. The rapid changes in personal computers and conservation tillage are current examples. Developments in the nonfarm sector can also affect farming; for example, more sensitive instruments to detect residues may change production practices.

Risk Management – Cont'd

- ***Legal and social risks*** include things like government prices and income programs, tax, trade, credit, and environmental policies, all of which have impacts on the operating environment. These risks may increase as firms get larger. New risks may result from new developments. Forward contracts and minimum price contracts, for instance, introduce the risk associated with the integrity of the contractor.
- ***Human sources of risk*** are associated with the labor and management functions in farming. Health problems of key individuals can severely disrupt farm performance. Furthermore, changing objectives of individuals and family members can have major effects on a farm's long run changes and viability.

Risk Management strategies

- Production Responses – this involve trading a reduction in the level of average income for reduced year to year variability of income. Production responses have traditionally been very important in risk management, but they have declined in relative importance as farms have become larger, more specialized, and more capital intensive.
- **Choosing Low Risk Activities**
- **Diversifying Enterprises**
- **Dispersing Production Geographically**
- **Selecting and Diversifying Production Practices**
- **Maintaining Flexibility**
- **Production Management Implications**
- **Marketing Responses - most farmers attempt to increase knowledge**
- **Obtaining Market Information**

Risk Management strategies – Cont’d

- Participating in Government Programs
- Spreading Sales
- Forward Contracting
- Hedging
- Financial response
- Options Trading
- Insuring Against Losses
- Maintaining Reserves
- Pacing of Investments
- Limiting Credit and Leverage
- Working Off Farm

Risk Management strategies – Cont’d

Area of Farm Business	Reduce chance of Events occurrence	Provide Protection Against event’s consequences
Production	• Choosing low risk activities • Diversifying enterprises • Dispersing production Geographically	• Selecting and diversifying production practices • Maintaining flexibility
Marketing	• Obtaining market information • Spreading sales • Forward contracting • Hedging	• Participating in government programs • Options trading
Financial	• Working off farm	• Working off farm • Maintaining reserves • Pacing investments • Acquiring assets • Limiting credit and leverage

? Time!