Farm business management

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The Oxford Dictionary's definition of management in a business sense is to "control" or "succeed in ones aim", which would normally be to make a profit. Unless a business is run profitably, then clearly it is not sustainable, and serious questions should be asked as to why it should continue to operate. A farm business should be no different to other businesses in this respect.

Many farm business managers operate in isolation and are not accountable to anyone, unlike managers of larger concerns who are answerable to a board of directors. This helps to explain why many small businesses including farms fail to operate profitably, and eventually have to sell out. The saving grace in farming has often been that the value of the asset base has increased in value due to inflation, and this has helped to cushion the business from financial disaster.

The three key elements of business management are planning, monitoring and control. Management requires discipline, to plan, set targets, and monitor outcomes.

There is a very strong correlation between productivity and profit. Farm Business Management commences with physical planning to produce a production plan which optimises productivity. This involves matching enterprises to the physical resources available, mainly land and labour, to optimise input output ratios and maximise labour efficiency.

From the production plan a financial plan is derived which considers costs and returns, profit-ability and the efficiency of which capital is utilised.

Both the production and the financial plan are the main ingredients of the business plan, which sets out what the aims of the business are, how they are going to be achieved ie strategies, and what the likely end result is going to be. The business plan becomes the recipe for the business, and is continually monitored, revised and updated as circumstances change and more information becomes available.

Farming businesses are dynamic and continually changing. Therefore, successful managers must be able to change and adapt to different situations readily. They need to be continually monitoring their situation and questioning where they have a competitive sustainable advantage over other businesses. Unless a business has an element of competitive advantage somewhere, it is difficult for it to succeed in the long term.

Production planning

Pastures and their management play a key role in successful farm business management as pastures are the "engine room" of the whole operation, be it livestock production or crop production. Given the strong correlation between productivity and profit, the physical management of pastures is therefore very important.

Pastures feature strongly in production planning as they are the key ingredient in broadacre livestock enterprises and have a significant impact on the productivity and sustainability of cropping enterprises. Reproductive performance, wool cuts, and liveweight gain are largely determined by animal nutrition rather than breeding or anything else. Pastures, their quality and management obviously play a major role in the nutrition of livestock.

The successful management of pastures to maximise livestock production therefore involves choosing the appropriate species and cultivars to suit the soil type and environment, having regard to growth patterns, persistence, plus tolerance to insects and diseases. The use of perennial species rather than annual species has important implications in terms of year round production, and sustainability factors such as acidity, salinity and water table management.

Annual crops and pastures are unable to utilise all of the annual rainfall in the southern slopes of New South Wales. The utilisation of perennial species eg lucerne, can help to maximise water use which reduces additions to the water table, and reduce leaching of nitrates which would otherwise result in induced acidity. Some difficulty has been experienced with the establishment and persistence of lucerne in high rainfall areas of New South Wales. This presents a challenge to management.

The maintenance costs of perennial pastures may be less than those for annual pastures, especially in terms of weed control. Perennial pastures provide more competition for weeds due to their deeper rooting systems and growth patterns.

From a cropping perspective perennial pastures have a valuable role in competing with weeds, reducing induced acidity and recharge to the water table. Also, the maintenance or improvement in soil organic matter which maintains structure and fertility, and improvement in the soil nitrogen status from pasture legumes. However, vigorous annual legume pastures can increase soil acidity.

Financial planning

Financial planning involves allocating and deriving costs and returns for the business based on the chosen physical plan, and producing a cash flow budget for the business to evaluate working capital requirements, and surpluses available for capital expenditure on plant and improvements, or for debt reduction.

The financial plan should also include a sensitivity analysis, to investigate the variability of the projected financial outcome with changes to key parameters such as crop yields, wool cuts and prices received.

Monitoring

Monitoring of the production plan involves recording of livestock reproductive performance, wool cuts, crop yields and other parameters which have a large bearing on productivity, such as liveweight gain in fattening enterprises. Actual physical performance should routinely be compared with targets set in the production plan, and differences investigated. The status of the resource base also requires monitoring through soil testing and water table measurement where applicable, to ensure that the farming practices are in fact sustainable.

Financial monitoring involves regular, *eg.* monthly budget/actual comparisons to ensure that the business is on track. Regular monitoring of the financial situation will give early warning signals of possible working capital shortfalls, or on the other hand will identify cash surpluses which can be put to better use, *eg.* early retirement of debt, off-farm investment, productivity improvement measures. Monitoring of the financial situation is also critical for effective and timely tax planning. An adequate monitoring system also leads to more accurate budgeting as costs are better defined.

Another important aspect of financial monitoring is the calculation of profitability, return on capital and movements in net worth (*ie.* assets minus liabilities) over time. It is important to con-sider the true profitability of the business after allowances for owner operator's labour and plant replacement as opposed to taxation profit, and to calculate the return on capital achieved. Capital is generally the most limiting resource in a business, so it is important to know that it is being utilised efficiently.

There are two aspects of profit, operating profit and capital gain (particularly in an inflationary period). Therefore, it is important to monitor changes in the owner's equity in the business. For wealth to be created, net worth (*ie.* assets minus liabilities) must increase over time.

Performance indicators

Physical and financial farm performance indicators are useful for monitoring the performance of a business over time, particularly against targets set by management.

Performance indicators are sometimes used to compare performance between operations. This is known as Benchmarking. However, caution should be exercised in this approach, as it is easy to read too much into these comparisons. Valid comparisons can generally be made only between operations in the same or similar geographic area, which have similar or potentially similar resource bases.

Some useful indicators of farm business performance are as follows:

- Return on Capital and Management
- Return on Equity
- Change in Net Worth/Average Total Assets
- Operating Surplus/Land Value
- Operating Costs/Gross Income
- Machinery Value/Gross Income
- Finance Costs/Gross Income

Control

Effective management of a business implies that one must have control over the business ie the manager must be pro-active in steering the business in the desired direction, rather than being purely reactionary. Good managers are decisive, and are prepared to make tough decisions to achieve the required outcomes. To do this they must be in possession of the facts as to where the business is heading, which is where monitoring is so important. Unless good monitoring systems are in place, changes resulting from management decisions cannot be evaluated.

Control means being active rather than passive. This not only applies to production, but also to marketing. More recently this includes quality control. Those producers who have taken an active role in marketing have been able to cut out middle-men and forward contract. However, producers must know a lot about their business and have confidence in their production system, to know what they are going to produce, and the cost of doing such.

Characteristics of good managers

In looking at the ways farming can be run as a business, and the role which pastures play in this, it is useful to consider the characteristics of successful farm managers or their businesses. These are not necessarily in order of importance.

- Simple production systems with few enterprises
- Excellent perennial pastures - usually lucerne based where appropriate
- Concentrate on what is best suited to their resources and on what they do best
- High productivity from enterprises eg wool cut, crop yields
- Simple streamlined operations - very efficient utilisation of labour and machinery
- Employ little or no labour outside family
- Outsource labour-intensive or specialised services
- Adopt sound production principles eg lambing in spring, broadleaf/cereal crop rotations
- Have good cash reserves to take advantage of situations
- Make decisions based on merit, not on availability of cash
- Have a disciplined approach to management of resources, especially time and money
- Separate business expenditure from personal expenditure eg pay owner/manager a salary from which personal expenses are paid
- Exercise control over spending
- High gross farm income
- Good marketing plans and strategies
- Simple but effective recording and monitoring systems - not necessarily computerised
- Recognise their strengths and weaknesses in management
- Farm is run as a "business"
- Highly focused on the important aspects of management
- Have sufficient scale to be efficient in terms of fixed costs.