BASIC CONSIDERATIONS IN FARM FINANCIAL PLANNING 1/

- Net Farm Income
- Net Cash Farm Income
- Family Living Costs
- Annual Debt Repayment Obligations
- Progress during the past three to four years in net worth
- Farmer's Management Ability
- Projected Budgets for Future Alternatives

Farm Business Analysis Report

A good place to start in analyzing the past year's farming operation is the Farm Business Year-End Analysis reports. Last year's report is most important, but one can arrive at the wrong conclusions by not considering the last few years reports. These reports can give us an idea of the volume and efficiency of the business. The net farm income tells us what the overall earnings were over the years including inventory changes and depreciation deductions. Subtract from the net farm income a charge for interest on the farmer's equity and you have what is left for labor and management income for the operator. However, this residual for labor and management may not be all available to spend since some of it could be part of the inventory change.

The net cash income relates the cash available above all farm cash costs including interest payments but unless we go deeper and subtract the annual debt obligations and the family living cost we can have a very distorted picture of the farmer's financial health.

1/ J. E. Moore, Extension Economist, Farm Management, Ohio State University, Columbus, Ohio, September, 1973.

Family Living Costs and Debt Obligations

An operation may show a $14,000 cash net income, but if the farmer is spending $11,000 per year for family living and has principle debt payments of $7,000 he is in serious trouble. He either has to cut back drastically on the family's standard of living, or refinance over a longer period of time, or re-allocate capital to more profitable enterprises. A basic step is to intensify the use of present buildings and machinery without additional capital commitment in this area. This means look for the possibilities of more units of productive livestock and/or acres within the bounds of labor available. In any case, in the short run he has to borrow more for family living or make less principle payments.

Financial Statement

To completely analyze the business a net worth statement over the past few years must be compared. If growth is indicated it must be determined whether it was a result of net earnings or appreciation of land and other asset.

It is important to determine the ratio of assets to liabilities and the terms of the various debts. List the different types of assets (machinery, livestock, land, etc.). Visualize the assets and liabilities picture by constructing a listing as follows:

		Total Assets		Total Liabilities		Annual Debt
TERMS		Item	Value	Item	Value	Payment Due
Short-Term	1		$		$	$
1-2 yrs.	2					
	3					
Intermediate	1					
3-7 yrs.	2					
	3					
Long-Term	1					
7-30+ yrs.	2					
	3					
Total						

Total Assets $____ minus Liabilities $____ = Net Worth $____. Total Annual Debt Payment Due $____ subtracted from Net Cash Income = what is left for Family Living $____.

All the information listed so far must be available to appraise an operation's present situation. The analysis to this point shows what is actually available for family living. It is also basic information for future planning.

Projections for the Future

One of the most difficult resource inputs to analyze is the level of management available. If the farmer has been keeping records for the past few years, then you can determine to a great extent his performance at his present size of operation. Management becomes more critical as size increases.

After analyzing the operation to determine the past performance, a budget must be prepared for the coming year taking into consideration the demands for family living, debt repayments, and additional capital replacement needs. If expansion is planned the budget should cover the added annual debt obligation and interest for the number of years the investment is to be amortized.

What are you going to use for yields levels for crops and livestock? The past record on the particular farm is an important consideration. You are kidding yourself if you budget using standards attained by above average or superior managers when your client is average or below. Year-end analysis summaries of farms of like enterprises are a good source of help in determining cost inputs that are not already available. Select the realistic level of performance. Generally, as an operation expands the yields per livestock units and per acre usually decrease slightly. However, usually the decrease in overhead costs per unit (labor, buildings, machinery, etc.) more than compensates for any yield decrease from an overall economic standpoint.

ILLUSTRATIONS IN ANALYZING FARM RECORDS AND DEBT PAYING ABILITY

by Dr. Ronald Tongate, V. Pres., F.I.C.B.
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USING 1971-72 DATA ON ELECTRONIC FARM RECORD OWNER-OPERATOR DAIRY FARMS

	A. DEBT SITUATION		B. DEBT SITUATION	
	PERCENT EQUITY IN BUSINESS-50% RE - Long Term, $50,000, $2,000 P.Pyt. PCA - Term, $40,000, $6,000 P.Pyt. PCA - Operating, $10,000 Total Debts - $100,000 PERCENT EQUITY IN BUSINESS - 50%		PERCENT EQUITY IN BUSINESS-30% RE - Long Term, $50,000, $2,000 P.Pyt. PCA - Term, $75,000, $11,000 P.Pyt. PCA - Operating, $15,000 Total Debts - $140,000 PERCENT EQUITY IN BUSINESS - 30%	
	TOP 1/3 EFR* DAIRYMEN	AVERAGE 1/3 EFR* DAIRYMEN	TOP 1/3 EFR* DAIRYMEN	AVERAGE 1/3 EFR* DAIRYMEN
Total Investment	$200,000	$200,000	$200,000	$200,000
Projected Cash Farm Receipts (% of Investment - 37.2)	74,400	(27.6%) 55,200	(37.2%) 74,400	(27.6%) 55,200
Projected Net Farm Income (% of Receipts - 32.1)	23,882	(21.9%) 12,088	(32.1%) 23,882	(21.9%) 12,088
Additional Interest on $40,000 Debt @ 7.5%	-0-	-0-	3,000	3,000
Adjusted Net Farm Income	23,882	12,088	20,882	9,088
Projected Cash Available 1/	30,882	19,088	27,882	16,088
Projected Family Living	11,145	11,145	11,145	11,145
Debt Principal Payments	8,000	8,000	13,000	13,000
Cash Surplus or Deficit 2/	11,737	/-57/	3,737	/-8,057/

* Electronic Farm Records

1/ Budgets for more than one year usually show inventory change to be zero - i.e., inventory changes are reflected in receipts. Therefore, add estimated depreciation ($7,000 in this example) to projected profit to get the amount of cash available for debt repayment. (This is not true for the past management year unless inventories remained unchanged.)

2/ A surplus can be used for additional capital purchases, savings, etc. A deficit indicates that debt obligations cannot be met.

SUMMARY

The first step is to seek ways to increase income without adding new capital investments. This might mean more high quality brood livestock, adequate fertilization, etc. In other words get better before you get bigger. Intensify the use of your present land, labor, and capital before you expand.

However, expansion has been the way to increase labor and management productivity on most farm operations where the operator is spending full-time on the farm. This process requires much planning because once you are committed to new capital investments the only other way to lower overhead costs per unit is to plan the greatest use possible.

Note the illustration on the following page prepared by Dr. Ron Tongate of the Federal Intermediate Credit Bank of Louisville, Kentucky. This shows that top-notch dairymen can handle businesses with up to three-fourths borrowed funds, while average dairymen have difficulty in handling 50 percent equity. Below average dairymen may have trouble even with 100 percent equity unless they are satisfied to live on interest on their own equity and depreciation in the short run and in the long run they would have to improve or move out of farming.