Does a dry spring mean I have to give up beer?

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The Whole Farm Approach

Whatever the goals of your business – having a social Friday-night beer with your mates or heading out for a fish – it's important to keep track of your income and costs. Using this information to analyse your business in terms of cash, profit and wealth will help you achieve your goals.

For young farmers, it is important to be technically good at what you do. What is equally important, often overlooked and frequently a defining factor in success, is a sound understanding of farm business management. The whole farm approach to business management combines the physical, economic and human aspects of a farming system into a logical format for analysis.

The whole farm approach incorporates:

- People
- Technology
- Economics
- Finance
- Risk
- Beyond the farm gate

Farm economist, Associate Professor Bill Malcolm comments on the whole farm approach:

> "…. It involves putting together all the different aspects of the farm business in a way that generates a profit. Making profit is important because it enables you to build wealth and wealth leads to choices. The ultimate aim is not to grow a tonne of wheat, but rather to build wealth to give you choices to be able to do things you want to do".

The underlying message here is that for most farm businesses understanding the structure of the business and whether the business is making a profit, that goes beyond cash, will enable you to make better (profitable) decisions about the future.

Agriculture Victoria have developed an eLearning module with templates to help you analyse your business using the whole farm approach – so you don't have to give up that beer. You can find it here.

Business health – case study

The whole farm approach to analysing a business means looking at the business as a whole, not just as individual activities, and starts with the business health check. This method of analysis involves estimating and questioning the total value of assets and debts (wealth/equity), cashflow, and profit (efficiency).

- **Cash**, can the business produce enough cash to pay the bills?
- **Profit**, how efficiently are the resources being used?
- **Wealth**, is equity growing over time?

When these measures are compared to the business goals, we can start to form a true understanding of how the business is performing and begin to plan for a profitable future.

In table 1. Profit, cash and wealth are calculated for a typical livestock business.

TABLE 1. Profit, cash and growth *(The Farming Game, 2005)*

Profit		**Cashflow**	
Total Gross Margin	**$450,000**	**Gross income**	**$850,000**
Overhead Costs	-$200,000	Cash Variable Costs	-$400,000
Operating Profit (EBIT)	**$250,000**	Cash Overhead Costs	-$125,000
Interest	-$100,000	Machinery replacement allowance (cash)	-$75,000
Net Profit	**$150,000**	Interest paid	-$100,000
Income Tax	-$15,000	Principal paid	-$100,000
		Income Tax	-$15,000
Growth in Equity	**$135,000**		
		Net Cash Flow	**$35,000**

Return on Capital **= $250,000 / $4,500,000 x 100** **=6%**			
Wealth – Balance sheet (year-end)			
ASSETS Land Livestock Machinery and Plant	 $4,000,000 $425,000 $75,000	**DEBTS** **Bank Debt**	 **$900,000**
TOTAL ASSETS	***$4,500,000***	***TOTAL DEBT***	***$900,000***
Total Equity = $4,500,000 – $900,000 / $4,500,000 x 100 ***= 80%***			

Cash

Cash or Liquidity is the measure of performance that most farmers are familiar with, most people deal with it every day and it is often the only measure of performance that farm managers are concerned with. The reason why cash is important is because it shows if a business can service debt and pay bills.

The critical number in a cashflow budget is Net Cash Flow (table 1). This is the total of all incoming receipts (gross income) minus all cash expenses and gives us information about how appropriately the business is geared (debt to equity). If there is not enough cash left over to service debt, then we may need to set the business up differently to be confident about financial obligations.

Profit

Profit measures the efficiency of the business and gives an indication of how well the resources (Land, Labour and Capital) are being managed. Profit is calculated as Earnings Before Interest and Tax (EBIT) and expressed as a percentage of total capital (Return on total capital) (Table 1). Profit is different from cashflow because it incorporates cash and non-cash items like inventory change, unpaid labour and livestock trading profit.

The important aspect of the profit calculation is that it gives us a means to compare the farm business to other farm businesses or to other uses of capital in the economy. Cash and profit give a

good indication of how well a business is being managed and whether the business is a good use of your time and money.

Wealth

Wealth is important, because with it comes choice. Wealth is measured as equity or net worth and is what would be left if the business was sold and all debts were paid.

Wealth can be measured over time as growth and is calculated in the balance sheet (table 1). When combined with cash and profit it completes the evaluation of how a business is performing.

Goals

It is important to compare the farm business performance to the goals of the business owners. Common goals are not necessarily financial and may include:

- To farm well and be recognised for it
- To improve the physical state of the farm
- To have a reasonable standard of living
- To educate children
- To set challenges and overcome them
- To have a satisfying rural way of life
- To make enough profit to retire easily
- To have enough time for leisure
- To have good quality crops and animals
- Business Growth
- To survive the farming game

Last but not least… social Friday-night beer with mates.

Once the calculated business performance measures are compared against the goals of the owner/operator we get an indication of how well the business is going.

Is your business being run in a way that enables you to achieve your goals?

The eLearning module provides more information on the whole farm approach and templates to calculate this on your farm.

Note: Much of the information contained within this article is borrowed directly from The Farming Game (Thanks Bill). For a detailed (better) explanation of the ideas explored here, please see this text. Alternatively, Agriculture Victoria offer an interactive eLearning module that is available by clicking on the link provided.

References

Malcolm, B. Makeham, J. Wright, V. (2005). *The Farming Game – Agricultural Management and Marketing* (2 ed.). Melbourne, Cambridge University Press.

Sinnett, A. Malcolm, B. Lewis, C. Ho, C (2019). The whole farm case study as the unit of analysis for research in farm management economics. *Presented at the annual conference of the Australian Agricultural and Resource Economics Conference, Melbourne.*