Learning module 9

Financial Plan & Record-keeping

EQF Definition

Knowledge	Skills	Competences
• Understanding terms relevant for a financial plan, as well as description of the structure of different income statements and balance sheets with the help of simple, clear examples from the agricultural field.	• Being able to create your own financial plan including income statement and balance sheet, to identify and describe your capital requirements (e.g. for an expansion of your company or the establishment of a new business idea).	• Structuring, presenting and communicating the key financial aspects of your business: 1. to yourself and your colleagues / family to control your cashflow and allow correct planning and pricing; 2. to others (e.g. to get access to financial resources).

Financial Plan: What Is It Good For?

Planning

Budgeting

Pricing

Obtaining Cashflow

Controlling Credits

Source: www.pixabay.com

Income Statement (1)

- An *income statement* summarizes the earnings and costs of a business for a given period of time (usually one year).

- The costs can be grouped into two categories: variable costs and overhead costs.

  - *Variable costs* change with the level of production. Examples of variable costs are the costs of seed and fertilizer.

  - *Overhead* or *fixed costs* are spent regardless of the level of production and are common to all crops. These costs include depreciation of the farm structures, equipment, and other facilities and costs like interest, repairs, insurance, taxes, and salaries of overhead personnel (the manager, salespeople, growers, secretaries, bookkeepers, etc.).

- Your *total cost* of production is the sum of variable and overhead costs.

Income Statement (2)

Some tips for income statements:

- Do not assume that you will sell 100% of crops produced.
- Don’t forget to pay yourself. Many new business owners forget about this because income is low. However, the first few years of being in business are often not profitable, you need some source of income. Consider paying yourself what you would pay someone else to operate your business.
- Don’t forget to budget for retirement. At some point, you will no longer want or be able to operate the farm. Start saving as early as possible.
- You also need health insurance, and should consider disability insurance in case an injury prevents you from working as well as life insurance if others are depending on your income.
- If you lack skills in certain areas, budget to hire consultants that all jobs are done right. Look for professionals who have had experience with your industry.

Income Statement (3)

A simple income statement contains:

- Sales (amount of money you received for your goods/services);
- Direct costs;
- *Gross margin* = sales - direct costs;
- Utilities;
- Overhead costs;
- Total expenses = direct costs + utilities + overhead costs;
- *Net profit* or *loss net income* = sales - costs; (including depreciation).

Income Statement (4)

Source: www.pixabay.com

An example from Bob`s farm and greenhouse:

	Total	Percent of Sales
Sales	**137,600**	**100%**
Direct Costs		
Seeds, cuttings of plants	13,760	10%
Fertilizer	3,440	2.5%
Herbicides	4,128	3.0%
Insecticides	2,752	2.0%
Sales commissions	25,731	18.7%
Labour	38,528	28.0%
Other	2,752	2.0%
Total Direct Costs	**94,531**	**68.7%**
Gross Margin	**43,069**	**31.3%**

Income Statement (5)

Source: www.pixabay.com

An example from Bob`s farm and greenhouse:

Utilities		
Heating and machinery fuel	3,440	2.5%
Electricity	2,752	2.0%
Telephone	275	0.2%
Water	1,376	1.0%
Total Utilities	**7,843**	**5.7%**

Income Statement (6)


Source: www.pixabay.com

An example from Bob`s farm and greenhouse:

Overhead Costs		
Depreciation	5,504	4.0%
Interest	825.60	0.6%
Repairs	2477	1.8%
Taxes	1,651	1.2%
Insurance	2,064	1.5%
Miscellaneous	6,880	5.0%
Total Overhead Expenses	**19,401**	**14.1%**
Total Expenses	**121,775**	**88.5%**
Net returns (profit)	**15,825**	**11.5%**

Income Statement - Enterprise Budget (1)

With the help of the income statement, farm managers know the profitability of their entire business at the end of the year. However, because most farms produce many enterprises (crops, livestock, milk, honey, or other products), they often do not know which enterprises are making money, which ones are losing money, and which are making the most money. To determine the profitability of **each** enterprise, develop an *enterprise budget* for each product or service. An enterprise budget is basically the costs and returns for that enterprise. Based on that regularly performed enterprise budget, you can decide whether you should keep all enterprises, invest in some of them for a higher production rate or profitability, or, maybe, even think about adding new enterprises.

Income Statement - Enterprise Budget (2)

Example:

Bob's tomatoes

Source: www.pixabay.com

	Total
Sales	**29.928**
Direct Costs	
Seeds, cuttings of plants	1.520
Chemicals	902
Labour	3.730
Custom Hire	293
Machinery Maintenance	29
Drip Lines	199
Irrigatin Maintenance	9
Other Expenses	265
Sales Commissions	2.295
Transportation	270
Total Direct Costs	**9.511**
Overhead Costs	**16.029**
Total Costs	**25.540**
Profit (Sales - Total Costs)	**6.782**

Ratio Analysis and Benchmark (1)

- Profitability ratios measure the ability of the business to earn a good profit and generate a satisfactory return on investment. These ratios are typically a good indicator of management's overall effectiveness.

- The *net profit margin* is the most common. It is a measure of the operating efficiency of the farm business. It measures how effectively the business is controlling expenses relative to its value of output. A high profit margin indicates good cost control.

Interpretation

- Net profit margin = profit per Euro/Currency Unit of sales after paying the owner's salary and accounting for opportunity cost of capital invested.

- The *gross profit margin* is another measure of profitability. Gross profit margin is the amount of contribution to the business enterprise, after paying direct costs.

Ratio Analysis and Benchmark (2)

Source: www.pixabay.com

Let‘s try with the example from Bobs‘ Farm and Greenhouse:

Measure	Your Figure	Recommendation	Formula
Profit	4,816 €		sales-total costs
Gross margin	31,3%	30-40%	$\frac{\text{sales-total direct costs}}{\text{sales}}$
Profit margin	13,0%	10-15%	$\frac{\text{net income}}{\text{sales}}$

Bobs‘ profit margin of 13,0 % is within the recommended range of 10 -15%

Ratio Analysis and Benchmark (3)

But what if the profit margin is too low?

Have a close look if one or more of the following issues apply to your business:

- Wrong pricing system;
- Prices have not been increased as costs have increased;
- Costs are too high relative to size of the farm;
- Not enough sales for the resources allocated;
- High overhead costs;
- Wasteful spending on inputs;
- Poor production.

Balance Sheet (1)

- A balance sheet shows the assets in your business and who owns them.
- It helps you understand your financial situation, especially net worth.
- *Assets* are things of value in the business and money in the bank
- *Liabilities* are the debts you owe.
- Unlike the income statement, which shows a period of time, the balance sheet shows a single moment in time

Source: www.pixabay.com

Balance Sheet (2)

- *Net Worth* measures how much of your business is owned instead of financed

Net worth = assets - liabilities

- Net worth is important for thinking about how financially safe or risky your business is and for considering future borrowing options. Increasing net worth is usually one of the major goals of a business. A *Balance Sheet* or *Net Worth Statement* is a financial snapshot of business on a specific date. It shows:

  - Assets: Valuables the business owns
  - Liabilities: Claims of outsiders
  - Net Worth: Claims of owners

Balance Sheet (3)

A balance sheet separates assets and liabilities into:

Current

Assets	Liabilities
• Cash • Inventory • Accounts receivable • Prepaid expenses	• Current expenses (rent, electricity, etc.) • Administrative costs (fees, etc.) • Current claims of bank, suppliers, etc.

Long-term

Assets	Liabilities
• Vehicles • Equipment • Securities • Buildings • Land	• Mortgages • Long-term loans

Balance Sheet (4)

Example Bobs‘ farm and greenhouse:

Source: www.pixabay.com

Assets	**Total**
Current Assets	
Cash / Checking / Savings	43,687
Accounts Receivable	22,464
Other Current Assets	
Other Current Assets	
Total Current Assets	**66,151**
Long Term Assets	
Buildings and Improvements (Owned)	1,709,294
Machinery and Equipment (Owned)	87,129
Other Fixed Assets	
Total Long Term Assets	**1,796,423**
Total Assets	**1,862,574**

Balance Sheet (5)

Example Bobs‘ farm and greenhouse:

Source: www.pixabay.com

Liabilities	**Total**
Current Liabilities	
Accounts Payable	168,723
Operating Debt	8,026
Other Current Liabilities: This year's mortgage	10,455
Total Current Liabilities	**187,205**
Long Term Liabilities	
Mortgage	361,387
Long-term loan	394,832
Total Long Term Liabilities	**756,219**
Total Liabilities	**943,425**
Net Worth (Owner's Equity)	**919,150**

Capital Requirements

In order to know what financial resources you will need to expand or restructure your business or even start a new one, you will need to consider and make decisions about the following initial and ongoing investments and cash flow needs:

- Equipment and facilities: lease versus purchase;
- Beginning inventories: cost of storage, lead times for delivery, payment cycles;
- Start-up costs: overhead components, incidental costs, initial advertising and promotions, utilities installation costs, renovations, working capital start-up, timing and source of investment, insurance, licensing, and accounting fees;
- Typical annual and monthly estimates of income and expenditures;
- Desired mix of financing: equity, long-term loans, short-term or working capital loans, equipment or facilities loans, leases or rentals.

Capital Requirements: Business Plan (1)

A table can help to keep the overview. **Bobs‘ example**:

Source: www.pixabay.com

Purchase Land	3.240 €
Rent Land	270 €
Rent Tractor	162 €
Total	**3.672 €**

If you‘re planning on borrowing or getting money from an institution, bank or investor, you should include a table like this in your business plan, so that they can see how much money is needed and how the money will be used.

Additionally, you should write a description of how you will acquire and manage capital assets. Will you purchase, lease, or custom-hire to meet equipment needs? If you plan to rent land or buildings, describe the lease arrangements.

Capital Requirements: Business Plan (2)

Bobs' example:

Source: www.pixabay.com

"The greenhouse that we manage is owned in full, as it was inherited. Our land is owned in full, but we are looking into purchasing 1.5 hectares of the surrounding land and rezoning it. To do this, we will have to take a loan. We want to purchase the land and rent more land. We own a tractor, but we may consider buying or renting another one soon, because the one tractor that we have is small and suited for a greenhouse. It is also relatively old, and a more modern one would be more efficient. A newer model would be more sustainable and would be helpful on the new 1.5 acres of land that we will have. We rent 465 € worth of our equipment. We have no off farm assets other than the house we live in. We have owned it for four years, but our mortgage will probably take another 26 years to pay off.

Capital Requirements: Business Plan (3)

A well-prepared plan is the road map to the future of your business. Make the document work you. Skip sections that are not relevant, and add others if your business requires them. A business plan must pass three tests:

1. *The reality test* proves that a market really exists for the products or services, and the business can actually build it for the costs estimated in the plan.

2. *The competitive test* evaluates the business's position relative to its key competitors and management's ability to create a business that will gain an edge over its rivals.

3. *The value test* proves investors or lenders will receive an attractive rate of return or a high probability of repayment.

It is important to periodically revise your business plan to measure the progress toward meeting your financial, marketing, and other goals. Business managers tend to be overly optimistic, underestimating costs and overestimating returns. Reviewing the plan will help identify deviations from the plan early before they become serious problems. Early reviews will allow for modifications if needed.

Your financial plan might feel overwhelming when you get started, but it will make running your business way easier very soon!

Good luck!

Agriskills

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References

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For further notice: Parts of the content of this module are based on the teaching material from the following Erasmus+ project: EMWOFA Empowering Woman Farmers With Agricultural Business Management Training

https://www.up2europe.eu/european/projects/empowering-woman-farmers-with-agricultural-business-management-training_85787.html