Developing a Business Plan for Farms and Rural Businesses: Training for New and Beginning Farmers and Entrepreneurs

 MODULE 2.5: WHAT RESOURCES DO YOU HAVE? 
Current Situation – Financial

Online Training Program for New & Beginning Farmers and Agricultural Entrepreneurs

Cooperative Extension Programs
Florida A&M University
MODULE 2.5: Farm History and Current Situation

**What Resources Do You Have?**

- Prepare a brief history of your family, farm and business.

- Conduct a **SWOT** analysis.

- Assess your current situation in:
  - **Marketing** – product, customers, unique features, distribution, pricing, promotion, anticipated changes
  - **Operations** – physical resources, production systems, management systems
  - **Human Resources** – work force, unique skills, anticipated changes
  - **Finances** – needs, performance, risk, financial environment and anticipated changes

- Conduct a whole farm **SWOT** analysis.

- Prepare the History and Current Situation section of your Business Plan.
Detailed information on current finances is a key component of any business plan. A certain level of financial planning is necessary for a farm operation to be viable in the long term.

- An accurate assessment of the current financial situation provides:
  - A comprehensive summary of the value of the physical resources available to the operation.
  - Income generated by the physical resources in combination with human resources through the operation and marketing strategies.

- Strength of financial position will determine the ability to access capital resources needed to add and use new resources in the operation.

- Assessing the farm’s financial resources should answer:
  - What are our financial needs (current family living expenses)?
  - What is the operation’s financial position (how well has the business performed in the past, and how strong is the current financial position)?
  - What type of risk is the business exposed to?
  - What is the current business environment and how is it changing?
Financial Needs:
What are our current family living expenses?

- The farm operation can only be sustainable in the long run if it provides enough income to meet the basic living expenses.
  - If you and your family rely on the farm business as the only source of income, or
  - Farm business is the major source of income supplemented by off-farm sources

- Making a realistic estimate of current family living expenses is the starting point for assessing the financial status of the farm operation.
  - Estimate annual family living expenses and earnings from off-farm sources
  - The difference between the two is the amount of income needed from the farm operation.
  - Use worksheet 14 below.
Financial Performance:
*How well has our business performed in the past, and how strong is our current financial position?*

- The ability to assess the past financial performance of the farm operation depends on the financial information that you have available.

- This information may include detailed past financial information or past tax documents.

- There are five recommended financial performance measurement areas.
  - Profitability
  - Liquidity
  - Solvency
  - Repayment Ability
  - Efficiency

- In order to evaluate past financial performance of the farm business, the following statements evaluate profitability, liquidity and solvency.
  - Income statement
  - Balance sheet
  - Cash flow statement *(See supplemental module, “The Cash Flow Statement”)*
  - Statement of Owner’s Equity
Defining Financial Performance

- **Profitability**: Evaluates whether the business is making money.
  - An indication of the level of income produced by the farm business.
  - Determines whether income (or revenue) covers costs (or expenses).

- **Liquidity**: If a business is **liquid**, then it has available funds or can easily access funds to meet ongoing or unforeseen cash requirements.
  - A business can still be **liquid**, even though there is not much cash in the bank, if assets are available that can be sold and converted into cash easily without interrupting the normal flow of business.

- **Solvency**: A business is **solvent** if it has an adequate net worth to make the business attractive to lenders or others who may want to invest in the business.
  - Adequate assets relative to claims on the assets (debts) makes lenders and investors comfortable investing their assets in your business.

- **Repayment Ability**: Determines whether the business generates enough income to repay debt on time.
  - Related to profitability in that a profitable farm business will usually generate sufficient funds for debt repayment.
  - Also, related to debt-structure; for example, too much short-term debt with high repayment requirements may be problematic even for a profitable business.

- **Efficiency**: Measures how much income is being produced, how much it costs to produce it, and where the money is going.
  - Efficiency is important if you are interested in evaluating cost control.
Common Financial Statements

The **Income Statement** is a basic tool used to determine farm income.

- It shows whether or not the farm business has generated sufficient income to cover family living and tax expenses.

*Use worksheet 15 to develop farm Income Statement from your available records.*

- List gross revenue (or income) from livestock sales, crop sales, services, government payments, etc.
- Include any gains or losses from changes in inventory of livestock, crops & feed, etc.
- List all farm business expenses, including purchased livestock, production inputs, accounts payable, etc.
- Net Farm Income is equal to the value of gross farm income minus total farm expenses.

*For more help with preparing the Income Statement, use the supplemental module, “The Income Statement.”*
Common Financial Statements

The **Balance Sheet** is a basic tool used to determine farm income.

- Lists all the business’ **assets** (what is owned) and **liabilities** (what is owed)
- Depicts your claim to the business’ financial assets (called **net worth or owner’s equity**)
- The basis for the balance sheet is the fundamental accounting equation:
  \[
  \text{Assets} = \text{Liabilities} + \text{Owner Equity}
  \]
- Balance sheets are prepared at the **same time each year** for successive years to show the change in the farm business’ financial position and progress.
- Balance sheets typically break farm business assets and liabilities into three categories: Intermediate & Long-Term
  - **Current** – cash and other assets that are easily converted to cash, and liabilities due within the current period (usually within one year).
  - **Intermediate** – assets not normally for sale, but held for production (breeding livestock, machinery & equipment, etc.), and liabilities due beyond the current period (beyond one year, usually 2-10 years).
  - **Long Term** – usually include real estate, and debt owed on real estate (beyond 10 years).

*Use worksheet 16 to prepare the **Balance Sheet** for the farm business.*

*For more help with preparing the Balance Sheet, use the supplemental module, “The Balance Sheet.”*
Common Financial Statements

The **Cash Flow Statement** summarizes cash inflows (receipts) and outflows (expenditures) over a given period of time (usually one year divided into 12 months).

- Can be used as a *long-range projection of future operations* and *historical (after the fact) record containing actual financial data*.
- Ideally, you can use both to develop a yearly projection followed by an actual record of each month’s financial transactions as they occur.
- Cash flow statement allows the manager or lender to estimate the amount and when cash will be available.
- It also allows manager and lender to estimate the debt repayment capacity of the business.
- It helps to determine the amount of debt that can be incurred, as well as the timing of repayment and repayment period.

- **Use worksheet 17 to prepare the Cash Flow Statement for the farm business.**

*For more help with preparing the Cash Flow Statement, use the supplemental module, “The Cash Flow Statement.”*
Common Financial Statements

- Usually for most small farm businesses, the earned net worth calculation includes nonfarm components since the nonfarm withdrawals for family living purposes are the primary draw on income.

- Growth in net worth can generally occur by increasing nonfarm income and/or reducing living expenses.

- Use this worksheet to calculate the overall change in wealth earned from farm and nonfarm income after adjusting for living expenses.

- Use worksheet 18 to prepare the Earned Net Worth Change Analysis for the farm business.