

BENCHMARKING FACT SHEET

HOW CAN BENCHMARKING ASSIST IN THE MANAGEMENT OF YOUR BUSINESS?

KEY POINTS

- ▶ The benchmarking process is commonly used for comparative analysis to improve business performance.
- ▶ No two businesses – or business people - are the same, so care is needed when comparing your business to others, as you may not be comparing ‘apples with apples’.
- ▶ Defining your goals will help clarify what is most important to measure.
- ▶ Benchmarking figures alone may be of little use without understanding their context.
- ▶ Benchmarking figures may be best used to identify the correct questions to ask of your business - they rarely provide solutions! You may need to use other tools to get those answers.
- ▶ In practice, the best comparison to make is against your own business – its performance over a number of years and its progress towards reaching your business goals.

Benchmarking

Measuring, monitoring and interpreting physical and financial performance are vital in guiding the management of all types of business. They are especially valuable in guiding the management of farm businesses (see Figure 1).

Benchmarking services are provided by an increasing number of farm consultants, advisers, banks, accounting firms and extension providers. Some farmers like

to consider a variety of comparative performance indicators to support their decision making and help identify key ‘drivers’ to improve business performance.

Understandably, business operators are often reluctant to discuss publicly the performance of their own business. Using anonymous benchmarking data has provided valuable information for many farmers to begin assessing their business performance.

Most benchmarking focuses on key performance indicators in one of two areas:

1. **Physical performance indicators**
- relating to production outcomes or yields, physical inputs, productivity and production efficiency.
2. **Financial performance indicators**
- relating to whole farm profitability, capacity to generate revenue, liquidity, solvency, cost efficiency and capacity to repay debt.

While there are benchmarks for just about anything that can be measured, some of the more common and most useful ones for a farm business are listed in Table 1 (see Page 2).

Typically, benchmarks are often used as an indicator to compare a farm business with:

- the performance of the same farm in previous year/s or against a budget/plan;
- other similar businesses in the same district; or,
- the performance of many producers across an industry segment.

A number of benchmarking service providers publish their results annually and distribute the results amongst their

member businesses. Some also offer their published results for sale to the general public. The results of such benchmarking services typically seek to categorise performance as good, average or poor in a variety of areas. They may also be expressed as falling within a percentage range of other businesses e.g. “the Top 20%” of similar farms.

Limitations in Using Benchmarks

Benchmarks are usually easily calculated and readily available. However, one of their limitations is that they commonly focus on components of the business rather than the whole farm and it can be difficult to interpret such indicators in isolation. A more complete business profile will be gained through an understanding of profit, cash flow, balance sheet and return on capital.

Over the years, strong debate has ensued about the role of benchmarking in agriculture. Much of this debate

Figure 1 What should you measure?



Source: P2PAgri Pty Ltd

stems from how data is collected and interpreted. Doubts over the usefulness of benchmarking are generally raised for the following reasons (refer also to Table 2):

- When data from **unrelated businesses are used for comparison:** The key concern here is the accuracy and consistency of data recording methodology and also the variances in physical resources and managerial impact on each business.
- When **average benchmarking figures are used:** For more appropriate farm decision making, information about marginal effects of changes is required. The impact of marginal costs and returns is discussed in detail in another fact sheet in this series, 'Production Economics' (refer to Useful Information).
- Benchmarking typically **focuses on distinct parts of the business:** There is concern that this information is used to direct business decisions, when the likely impact of these decisions on the whole farm business is not well known.
- Benchmarking **involves an implied cause and effect:** In practice, the actual response to inputs should be assessed on a case-by-case basis.
- Benchmarking is **generally based on historical data:** This may not reflect future performance. Sound farm business management is about the future.

A good example illustrating these challenges is using the machinery value per hectare benchmark across farm businesses. This will vary greatly depending on whether the farmer is a continuous cropper, has a mixed crop/livestock farm or does contract machinery work for neighbours. Each can be a valid and profitable strategy when applied in the right situation and structured correctly. The machinery requirements are different for each farm business and average industry numbers rarely take this into account.

Potential Benefits in Using Benchmarks

Table 3 outlines a number of benefits in using benchmarking figures in agricultural businesses. These, as well as the limitations listed above, need to be taken into account when considering benchmarking the performance of your own business, either against itself, or against others.

There is some value in knowing benchmarks for basic performance (such as maximum crop yields, stocking rates and lambing percentage) to give context within

Physical Benchmarks		Financial Benchmarks	
Parameter	Units	Parameter	Units
Yield (crop)	t/ha	Profit per ha	\$/ha
Yield (livestock)	kg/ha	Income per ha	\$/ha
Stocking rate	DSE*/ha	Machinery investment ratio	\$/ha
Labour (cropping)	ha/labour unit	Asset turnover	%
Labour (livestock)	DSE/ labour unit	Profit as a % of gross income	%
Labour	\$ Revenue/labour unit	Disposable income/family	\$
Price received	\$/t or \$/kg	Overhead cost ratio	%
		Production system	\$ Income/100mm
		Interest cover	No of times
		Off farm income	\$
		Gross margin (crop)	\$/ha
		Gross margin (livestock)	\$/dse
		Gross margin	\$/ha/100mm

*DSE: Dry Sheep Equivalent

Source: P2P Agri Pty Ltd

your district, if for no other reason than to gain an understanding of what is possible. What *could be* achieved is not necessarily the same as *what should be* achieved. Benchmarking may tell you that something is wrong, but it may not accurately identify where the problem lies or what is most profitable for your business.

Similarly, there can be valuable learning from others on the physical production aspects of the business – what is 'best practice' and what might be achieved if it is implemented? However, such information should be used in context. There is no other farm quite like yours – all farms are different in terms of size, soil type, subdivision, enterprise selection, debt levels and management, and each business will have different goals and attitudes to risk. Benchmarking production parameters about other businesses do not tell you how well they are achieving their broader objectives – whether they are successfully creating wealth, generating profit or achieving a variety of other goals.

So although benchmarks may be of some use, remember that they represent numbers which are achieved on someone else's land under someone else's management towards achieving someone else's goals.

Of far greater value to your business is using benchmarks to compare your business against its own historical and budgeted performance i.e. measure the performance of **your land** under **your management** towards achieving **your goals**.

Using benchmarking in this way will largely eliminate the vagaries of data collection, accuracy and interpretation, as long as you collect and measure your own data in the same way every year. A sample set of farm business benchmarks provided in Table 4 (see Page 4) demonstrates 4 years of a farm's performance. Obviously, context is still useful and the numbers you generate may tell part of the story. However, benchmarking can be a highly valuable analytical tool for many farm businesses.

For example, from the benchmarks in Table 4, a farmer may ask the following questions of his business:

Q: Is my farm viable?

A: Just! Over this ten year period, it made an average annual profit of only \$45,000, which does not provide much leeway for risk.

- What do I need to focus on to improve profitability?

Q: Is the business wealth growing?

A: Yes. However, as profit levels have not been excellent, this growth in business wealth may be due to increased land values.

- Is this growth sustainable? If land values do not continue to increase at this rate, how does my business generate wealth?

Q: Am I over-capitalised in machinery?

- A:** Yes, slightly. Anything above \$260/ha is viewed by industry as being the average. If you are above \$300/ha, you would be viewed as heading toward over-capitalisation.
- ▶ How do I improve this? Do I increase productivity (area of production) or decrease machinery capital costs?

In order to benchmark the performance of your own business against itself, you must first establish clearly defined goals, both at a whole farm/business level and then at an enterprise level. Business performance can only be judged against goals. Business drivers fundamental to achieving these goals must be identified, then used to determine specific and measurable objectives which will propel the farm towards achieving *your* goals. What the neighbours do is of far less relevance to you than identifying your own goals and striving to achieve or surpass those goals year after year.

The role of benchmarking information can therefore be seen as an important supporting source of background information. It is not a replacement for a proper farm business analysis. This requires asking questions specific to your particular business, based on your own goals and the resources available on your farm. Farm business analysis focuses on the balance sheet, profit and loss, enterprise gross margin analysis and cash flow. Preparing sound budgets for each of these reports and using them as a starting point for whole farm benchmarking is fundamental to good farm business management. Information on these budgets is provided in other fact sheets in this series (refer to Useful Information).

Take home message:

No amount of information about other farms will be as valuable as good budgeting, business planning and excellent record keeping based on your own business.

Figures (ratios) contained within each of these budgets measure business liquidity, solvency, profitability, cost efficiency and debt servicing capacity. These ratios can then be used to compare your business against a variety of accepted industry-wide financial ratios. More critically, however, they measure the yearly progress of the business against its own budgets or plans. Financial institutions have long relied on this type of financial analysis when assessing the creditworthiness of a business. There is significant discussion of a number of key financial ratios commonly accepted

Table 2 Limitations of benchmarking

Inconsistencies	<ul style="list-style-type: none"> • Some financial ratios are not consistent with management accounting standards • Terminology can be confusing and inconsistent, particularly if considering figures from two different data providers • Data collection methods may not be consistent or accurate
Information they do not provide	<ul style="list-style-type: none"> • It is difficult to quantify management input into outcomes • Good physical or financial performance may not reflect sustainable practices or long term viability of agricultural systems • Benchmarks say very little about the subject business' appetite for risk • Using whole farm benchmarks may tell you that you are performing well or poorly, but will not tell you why, or what to do differently • Often take no account of debt/leverage within the business • May vary on whether or not off-farm income is included
Validity of comparisons	<ul style="list-style-type: none"> • No two farms are the same, but comparing data assumes some similarity • Numbers mean little unless you truly understand them • Benchmarking is only one tool, not the panacea that some suggest. Benchmarks of another business may have very little relevance to you

Table 3 Benefits of benchmarking when used well

Individual Farm Assessment	<ul style="list-style-type: none"> • Provides a useful matrix for self-assessment • Provides useful additional information to whole farm analysis • Helps build a profile of strengths and weaknesses within the business • Provides a framework to test accepted beliefs
Physical Information	<ul style="list-style-type: none"> • Physical benchmarking can support improved enterprise management
Financial Information	<ul style="list-style-type: none"> • Helps identify and focus efforts on key 'business drivers'
Comparative information	<ul style="list-style-type: none"> • Comparison of your business performance to similar businesses (within limits) • May provide motivation to improve your own business

Source: P2PAGri Pty Ltd

within agriculture in the 'Key Financial Ratios' fact sheet in this series (refer to Useful Information).

A Word on Cost of Production

This fact sheet focuses on the many uses and risks of using benchmark data to drive decisions about how to manage the farm. Another extremely useful tool for farmers is the ability to calculate the Cost of Production for each of the commodities you produce. For example, if you can sell wheat for \$100/t more than it costs to produce in the majority of years, the decision to grow wheat may not require a lot more analysis than knowing your various costs, yields and some research on historical and projected pricing.

Keys to maximising benefits from benchmarking:

Focus on your goals:

- Establish clearly defined and measurable goals for your business.
- Know what questions you really want answered and remember benchmarking may not give you those answers.
- Focus on issues which your management can influence or control.
- Ensure your use of benchmarking leads to changes for the better in how things are done on the farm.

Data analysis:

- Focus on your own performance – it is much more important than the neighbours.

Table 4 Actual farmer benchmarking data from a low rainfall region

Individual farm analysis	Years	1	2	3	4	Average 10 year
Net Farm Profit:		-\$36,078	\$60,056	-\$4,975	\$82,976	\$45,517
Gross Farm Income:		\$195,313	\$340,401	\$398,855	\$645,836	\$312,441
Net farm Profit as % of Gross Farm Income:			17.6%		12.8%	30.4%
Closing Net Assets		\$1,098,090	\$1,422,828	\$1,461,165	\$1,554,334	\$1,087,836
Closing Equity		85.2%	88.5%	87.6%	87.4%	90.3%
Gross Farm Income from Cropping %		71%	90%	88%	91%	81%
Gross Farm Income from Livestock %		28%	10%	12%	8%	18%
Total Overhead Costs/Gross Farm Income		18.1%	10.4%	7.4%	6.6%	16.6%
Total Financial Costs/Gross Farm Income		5.7%	6.2%	4.7%	5.4%	4.2%
Cash Flow return per dollar spent		\$1.26	\$1.69	\$1.27	\$1.35	\$1.94
Machinery Value/Cropped ha (\$/cropped ha)		\$270	\$319	\$306	\$209	\$290
Average Overdraft Interest Paid			7.42%	9.17%	7.22%	7.94%
Total Chemicals (\$/cropped ha)		\$13.39	\$18.23	\$21.88	\$24.77	\$16.18
Fertiliser (\$/cropped ha)		\$16.57	\$15.24	\$22.87	\$46.96	\$20.48
Holidays per Labour Unit (days)		9.1	9.1	13.6	9.1	12.8
Training Days per Labour Unit (days)		4.5	4.5	36.4	3.6	8.8
% Arable Land Cropped		66%	100%	78%	90%	65%
Land Value (\$/ac)		\$96	\$181	\$202	\$222	\$155
Cropped land/labour unit (ha)		760	854	912	1,307	773
Hard wheat Farm Gate Price (\$/t)		\$200	\$163	\$365	\$301	\$226
Feed Barley (\$/t)		\$110	\$121	\$228	\$198	\$167

Source: P2PAgri Pty Ltd

- Compare 'apples with apples' – make sure data is relevant to *your* business.
- Drill down on what **is** really being measured and **how** it is being measured.
- Make sure you understand the numbers and how they are calculated.
- Remember, benchmarking has significant limitations.
- Track budget to actual performance.
- Combine benchmarking with sensitivity analysis when making decisions.
- Your best long term financial benchmark is growth in Net Worth.

Take home message:

'When you have a forest of benchmarking data, don't lose sight of the essential 'trees' you should be looking at: profit, cash flow, net worth and return on capital'.

Record keeping:

- Develop a robust physical and financial recording system.

Develop budgets:

- Calculate the cost of production for the commodities you produce – these are of more value to your business than any other benchmark.
- Undertake good farm budgeting and business planning.

NB: There are dozens of things that can be measured, but ultimately, whole farm profitability is the key. The farm business must provide enough profit to cover costs, living, pay tax and allow for debt reduction and/or reinvestment into the business to grow assets and create wealth – simple really!

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Copies of all the above fact sheets are FREE plus P&H and available from: Ground Cover Direct Freephone: 1800 11 00 44 or email: ground-cover-direct@canprint.com.au

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Plan to Profit (P2P), a whole-farm financial management program – this will assist with calculating a farm's financial budgets: Cash Flow, Profit and Loss, Balance Sheet and Gross Margins. www.p2pagri.com.au

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