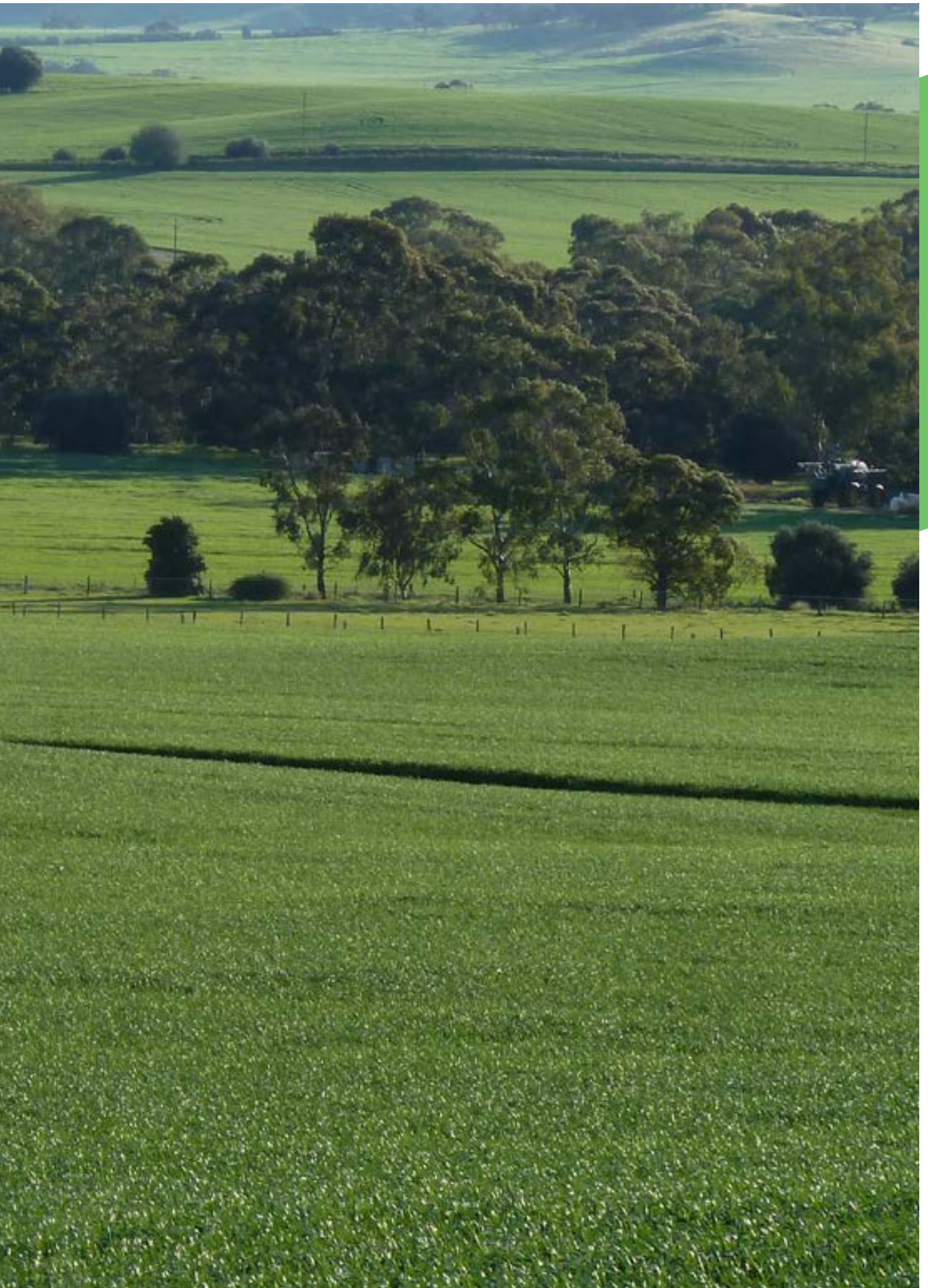


MODULE 1
**WHAT DO I NEED
TO KNOW ABOUT
BUSINESS TO MANAGE
MY FARM BUSINESS
SUCCESSFULLY?**



MODULE 1

WHAT DO I NEED TO KNOW ABOUT BUSINESS TO MANAGE MY FARM BUSINESS SUCCESSFULLY?

The aim of Module 1 is to provide an overview of farm business management. Effective farm business management has elements of good judgement, which is subjective, and sound logical thinking with effective monitoring and planning processes in place. While you are encouraged to explore all the topics, some will be of more interest than others. Module 1 will identify areas on which to focus in Modules 2 and 3.

Module 1 covers sections 1 - 3 and provides an introduction to farm business management thinking:

1 THE WHOLE FARM BUSINESS SYSTEM

The future is shaped by forces both within and beyond the farm gate, most of which are beyond the farmer's control. The better we understand the forces that affect our business and how they work, the more effectively we are able to manage their impact:

- How well do I understand these forces and their effect on my farm business?
- What parts of the whole farm system are in my control?
- Which forces are likely to have the greatest impact on my business in the near future?

2 LEADERSHIP AND PEOPLE MANAGEMENT

This section of Module 1 deals with the 'soft' side of management: working with people and communicating effectively about the direction of the business. A large number of courses and books already address these topics. Rather than duplicate them, this section aims to provide a broad coverage of this issue to highlight areas for further investigation:

- Do I know where my business is going?
- How effective is my leadership?
- Is everyone in the farm business on the same team?
- Are we harnessing the power of synergy?

3 FARM BUSINESS MANAGEMENT

Historically, farm business management originated from a focus on farm budgeting. A great deal of this thinking was developed in the 1950s and 1960s, and is important for measuring and monitoring farm business financial performance. Farm business management is a broader and more important topic than farm accounting, which is mostly done for tax purposes. Farmers often focus on financial recording for tax, rather than for monitoring, controlling and improving business performance. Focusing on farm business management, measuring and monitoring farm performance is important as it helps answer essential business questions such as:

- Is my farm business viable now and will it be viable in five years' time?
- How can I improve the profitability and efficiency of my business?
- What is the risk profile of my business?
- How do I prepare my business for the next generation?
- Section 3 provides an introduction to and overview of essential farm business management thinking and budgets.

'I've always been a 'big picture' type of person. Looking to the future to see where agriculture was going, with neighbours taking over neighbours and people expanding, and knowing economies of scale was what it was all about, I guess it left me asking the question, 'Where are we going to be in ten years' time? Am I going to be owning my neighbour's farm, or is he going to be owning mine?' Strategic thinking is working out where you want to be, and how you're going to get there.'

John Gladigau
'Bulla Burra', Allawoona, SA

1 THE WHOLE FARM BUSINESS SYSTEM

Having an understanding of the whole system helps you to better manage your farm business.

1.1 ECONOMIC ENVIRONMENT

1.1.1 Exchange rates

1.1.2 Interest rates

1.1.3 Prices on export and domestic markets

1.2 POLITICAL ENVIRONMENT

1.3 NATURAL ENVIRONMENT

1.4 FARM SYSTEMS MANAGEMENT

1.5 LEADERSHIP AND PEOPLE MANAGEMENT

1.6 FARM BUSINESS MANAGEMENT



1 THE WHOLE FARM BUSINESS SYSTEM

This section covers the ‘big picture’ of farming. While a manager cannot control all parts of the business system, it is important to know what you can control, as this will be the focus of your management.

KEY POINTS

- A number of components make up the farm business environment, some of which are beyond the farmer's control.
- Understand all the components that affect the business, but focus only on those that you can influence.
- Business is challenging, but managed well, provides opportunity.
- Measure and analyse your farm business performance to help answer questions of sustainability, growth, profitability and debt servicing capacity.

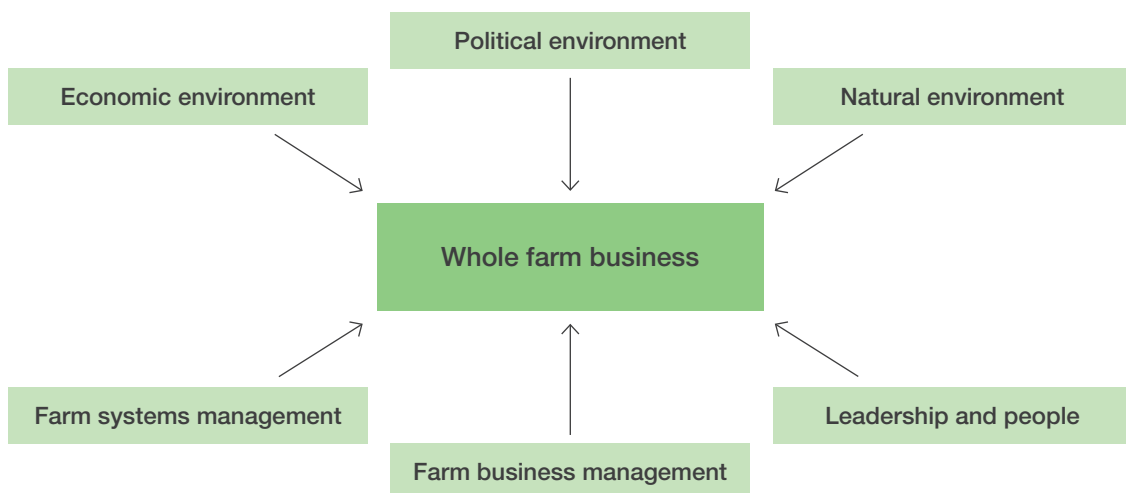
The business of farming is complex, with many parts that interconnect and significantly affect the performance of the whole farm business. The term ‘whole farm business’ refers to each enterprise and component of the business that needs to be considered, then combined to provide the overall performance of the business. Some elements of this system that impact on business performance are outside the farmer's control. Figure 1.1 illustrates the areas that affect farm business performance.

A brief description is given of each of these elements and how they overlap and affect each other. For example, the

impact of climate change has implications for the political environment as governments enact policies to manage climate change. It also has an impact on the economic environment, as international markets react to the outcomes of significant droughts, floods and cyclones. Understanding the impact of factors in the external economic environment on the performance of the farm business can help in managing the likely outcomes and consequences. This is a significant part of risk management.

➤ **Risk management** is covered in greater detail in section 7, Module 3.

Figure 1.1 The whole farm business system



Source: P2PAgri P/L

‘We run it as a business. Fortunately, more often than not, that’s resulted in being on the right side of the ledger. This operation is all about risk and that’s where the three enterprises (pigs, sheep & cropping) all complement each other. We use business management principles and implement operating efficiencies to fight declining terms of trade, which agriculture seems to have been facing forever. That’s where education has given me the tools to be analytical and link theory and practice. So many family farms have gone because there hasn’t been that high level of business management.’

Lachie Wilson
‘Murdeduke’, Winchelsea, Victoria

1.1 ECONOMIC ENVIRONMENT 1.1.2 Interest rates

The economy is a complex system, and the following areas significantly impact the farm business:

1.1.1 Exchange rates

Exchange rates have a significant impact on the income and costs of farm businesses as most of Australia’s agricultural production is exported, especially grains, and most export markets are priced in \$US.

The floating exchange rate was introduced in the mid-1980s. With a free exchange rate, the value of the Australian dollar at any time is determined by the balance of our demand for overseas currencies (such as buying imports), and the supply of overseas currencies (which reflects overseas customers’ willingness to buy Australian goods and services). The value of the \$A depends on the state of the Australian economy and the state of economies around the world. The exchange rate, inflation and interest rates all impact on each other and the federal governments face a tricky balancing act trying to achieve a stable economic environment that is conducive to economic growth.

From a farm business viewpoint, the critical point is that the value of the \$A will fluctuate and is unpredictable, and that these changes in the value of the \$A end up affecting the returns farmers receive for the products they export. When the \$A is strong, Australia’s exports are expensive compared to our competitors, in foreign currency terms; when it is weaker, our exports are less expensive than competitors. Conversely, a strong \$A makes imports such as fuel and machinery much cheaper.

While no farmer can influence the \$A exchange rate, it is useful to have some understanding of the effect its movements will have on farm incomes and costs. One of the few strategies to protect against exchange rate movements is to forward sell grain and ‘lock in’ the \$A at the same time. With our large grain production and small domestic grains market, the strategy to not export is not an option for most farmers.

Interest rates are the price of capital, affected by the demand for and supply of capital and expectations about future inflation in the economy.

Interest rates and the level of farm debt became a significant issue when the financial system and interest rates were deregulated in the mid-1980s. Through a combination of economic circumstances in the late 1980s, farmers were struggling with interest rates as high as 24% on their overdraft loans, which created an unexpected and large interest cost burden for their businesses. In contrast, there has been an extended period of relatively low interest rates over the past two decades.

There are two main drivers of interest rates:

- **Monetary policy:** The Federal Government’s monetary policy is managed by the Reserve Bank of Australia (RBA). The RBA reviews Australia’s interest rate setting monthly and use this to manage the Australian economy, in line with the policy aims of keeping annual inflation within a tight range. If the economy appears to be growing too strongly, interest rates are increased to slow down domestic demand and reduce inflationary pressures. The reverse can also occur, as has happened during 2013/14, when interest rates have been kept at historically low levels in order to stimulate growth in the economy.
- **Business confidence and the demand for borrowed capital:** Strong demand for borrowed funds will push interest rates up, regardless of the RBA’s directive.

When managing your farm business, you need to assess how important interest rate movements are to your business. The size of your debt and the interest rate you are paying will determine your exposure to movements in interest rates. Having a good relationship, and being in good communication with your bank, is critical to managing this exposure. This risk can be reduced by using a mix of fixed and floating rates to try to maintain some stability in annual interest burdens.

Australian interest rates also have an effect on the \$A exchange rate, as relatively high interest rates in Australia compared to overseas economies will also attract international investors to bring money into Australia. This in turn will strengthen demand for the \$A and increase its value.

1.1.3 Prices on domestic and export markets

The movement of commodity prices on the domestic and overseas markets has a direct impact on farmer prices received and paid.

Under free trade, the price of commodities on the domestic market depends on global supply and demand. World wheat prices and Australian wheat prices tend to increase when a major producer, such as the USA or Russia, experiences a serious drought. If all major world producers of wheat have a reasonable production season, prices tend to be lower due to greater supply. Australian domestic wheat prices are volatile because while 80% of production is exported, traded wheat makes up around 20% of global wheat supply in any year. A small increase in production around the world has a marked effect on the quantity of wheat entering world trade, which causes sharp changes in export price – the price Australian wheat growers depend on.

Action points

- Have a marketing plan for each of your commodities.
- Continually monitor the market to determine the best opportunities to sell.
- Manage your interest rate exposure; watch and monitor interest rate discussions in the media.
- What impact would a 10% improvement in commodity price have on your business 'bottom line'?

1.2 POLITICAL ENVIRONMENT

The political environment in Australia tends to be relatively stable compared to many parts of the world.

The political environment also impacts on exchange rates. When investors around the world view Australia as having a stable economic and political environment, the \$A is more attractive for foreign capital investment.

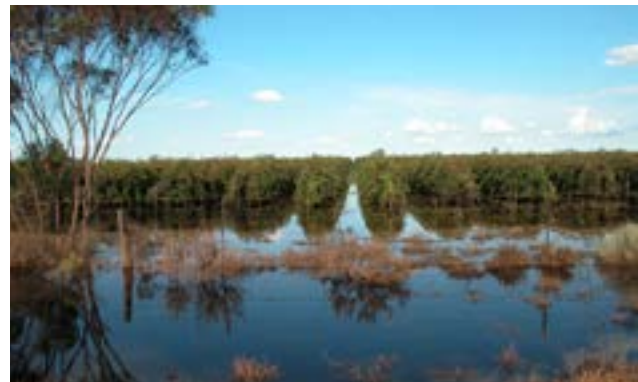
Government policies can have an impact on farmers to varying degrees, such as drought policies which provide interest rate subsidies and household support to farmers affected by drought. Loss of access to overseas markets, such as when a foreign country acts to protect their own farmers from imports, can have major immediate implications for farmers competing to sell into these markets, and subsequent implications for all farmers as supplies are redirected into other markets. The impact of government regulation is also felt on land use, natural resource management, pesticide use, workplace health and safety standards, and tax reporting (BAS, payroll and superannuation).

1.3 NATURAL ENVIRONMENT

The natural environment consists of climate, soil, plants and animals. Farmers manage most of Australia's natural environment challenges from pests and diseases, which are also the result of climatic and soil conditions.

The natural environment has the greatest impact on farm financial performance as it directly relates to levels of productivity. This explains why research has tended to focus on managing and improving productivity, with some significant success over recent years.

More recently, focus has moved to environmental change and predictions of its likely impact on agriculture. The evidence increasingly points to climate change resulting higher temperatures and changing rainfall patterns. It is still relatively early to quantify the added impact of climate change on Australian agriculture, as droughts, floods and fires have always been part of the Australian experience. However, more variable weather increases uncertainty around production, which in turn increases business risk.



The extremes of Australia's climate contribute to risk in farming.

Source: P2PAGri Pty Ltd

1.4 FARM SYSTEMS MANAGEMENT

Farming systems are the combinations of enterprises used in a farming business.

Management of the competitive and complementary components of a farm system has a significant impact on the eventual financial performance of a farm business. A classic example of complementary and competitive effects in a farming system is the combination of annual crops and sheep, where sheep are an integral part of the crop rotation. At sowing time, these enterprises are competitive as crops require some of the total farm land for planting while sheep require land for pasture. The competition for the limited resource of land largely determines the number of sheep that the property manages.

However, these enterprises are complementary during the summer months when there is stubble available for sheep feed, and sheep provide a complementary service to crops by keeping summer weeds under control. The best farm managers are good at thinking 'systems' and the key to their success is putting all the elements together in a profitable 'whole', effectively managing the competitive-complementary relationships.

Examples of farming systems include:

- Continuous cropping, which entails rotation management.
- A purely grazing system where only sheep and cattle are managed.
- Raised bed cropping systems to assist with water management in high rainfall areas.
- The use of summer and winter cropping systems in various parts of Australia.

Managing farming systems successfully requires a thorough understanding of the natural relationships on the farm between soil, rainfall, plant and livestock nutrition, crop selection, rotation selection, disease and pest control, tillage selection and the timing of operations. Research organisations such as

'We grow a variety of crops – sorghum being the major one and chickpeas. Have grown cotton once but there's got to be a lot more money in it before I do it again. The sorghum ends up either in a feed lot in Australia or exported as feed overseas. Last year they bought a fair bit to make alcohol in China, which was really good for us. Because we are pretty close to the coast, in the tropics, we have major rain events in the wet season. We've got deep black soil which stores a lot of moisture so at the beginning of the wet season, we can grow crops right through the year on that moisture. The minus is if we've got crops in, quite often you get a bit of flooding. Two years ago, one 1500 acre paddock had 12 floods over it in a year. We lost two crops, but that's the exception, not the rule. Like this year we've had no floods at all. We've been desperate for rain this year; that year, we were wishing it would stop.'

Brian Gregg
'Kolora', Emerald, Queensland



What enterprise mixes provide the most profitable outcome for your business over different seasons?

Source: P2PAGri Pty Ltd

‘Most people, when they talk about risk, talk about the downward risks, but there is a huge risk in not maximising the really good years, those years you can really put some fat in the system. I don’t think people always see that coming and make the most of the opportunity.’

Vicky Geddes
Yallock, Holbrook, NSW

the Grains Research and Development Corporation (GRDC) invest in R,D&E projects to help farmers solve problems and further improve productivity.

A good example of this is GRDC’s continued research into soil and water management, and their effect on plant production. Bill Long (Agronomist and GRDC Southern Panel member) points out that effort is currently focused on matching crop inputs to moisture availability. Farmers are good at managing the average seasons from Decile 3 to 7 with their inputs. However, it is in the very good seasons that improved input management can greatly increase farm profitability. It is in these good years that improved profits can be achieved and have an influence on business performance in the long-term.

Farmers’ detailed knowledge of their farming systems is a key to business performance and productivity. This manual does not go into this detail of farming systems, as there is significant information available through the many primary industry research organisations, such as the GRDC and other government agencies. However, the importance of the farm manager’s knowledge in this area is critical, and continual learning in this area is encouraged.

1.5 LEADERSHIP AND PEOPLE MANAGEMENT

In recent years, there has been a growing focus on leadership and people management within a farming business and how effectively people communicate and are managed.

This includes working with family members and staff, as well as people external to the business such as accountants, agronomists and bankers.

If a business has a clearly defined and shared ‘vision’ outlining what the owners wish to achieve, with clearly defined goals to help fulfil this vision, a number of things are more likely to occur:

- Improved communication between all members of the farming business where goals and aims are clearly understood.
- Synergy within the workforce, providing a tightly focused commitment to achieving the goals.
- More effective advice from external advisers, as they understand more clearly what the business wants to achieve.

1.6 FARM BUSINESS MANAGEMENT

An important part of farm business management is measuring and understanding the financial performance of the business in order to answer questions of growth and sustainability, risk management, profitability and debt servicing capacity.

This process is the fuel to the financial ‘engine’ of the business and goes far beyond the regulatory requirements of completing a tax return. The saying, ‘If you don’t measure it, or understand it, how can you manage it?’ is very true for farm businesses. Monitoring financial performance greatly improves understanding of the operation and potential capacity of the business and informs the assessment of future opportunities.

Traditionally, farmers have found the financial management aspects of managing their farm business to be challenging and, often, relatively difficult compared with the actual farming. There are not many advisers equipped to undertake this work and many accountants are not trained in farm business management. This manual aims to help farmers address this ‘information gap’.

‘Farm management is the process by which resources and situations are manipulated by the farm family in trying, over time, with less than full information, to achieve their goals.’

Prof. John Dillon

All elements of the farm business system influence business performance. Leadership and people and farm business management are the focus for this module for two reasons. Firstly, these are the areas that can be most significantly influenced by management, and secondly, they have not been the focus of the vast amount of research undertaken in farming systems by organisations such as GRDC. While it is important to have an understanding of all components of the system, good managers focus on what they have direct influence over. Leadership and people, and farm business management are two of the areas that can be most influenced by management.

Action points

- Each farm business is unique – learn what issues have the greatest impact on your business.
- Monitor GRDC research findings that affect your farming system: www.grdc.com.au/resources

