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Strategic Business Plan Guide

Business Name

Duration of Plan (e.g. 2015-2018)

Prepared by: [Name]

Business name:

Date:





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Introduction to the template: Filling in the Business Plan

What this guide is about

Strategic management is critical but is overlooked by many farmers who generally prefer to focus on tactical and operational management. As a result, farmers often fall into the trap of being efficient at getting the wrong things done! Hence the need for this Strategic Business Planning guide.

Strategic management considers the decisions that have a big impact on the long term future of a business. For instance; to change the balance of sheep to cattle; to buy extra land; to hand the farm over to the next generation; to diversify into industrial storage or install a biomass boiler.

Having decided about the longer term direction of the business, tactical management is about making sure the business moves in that direction. By implication, the focus at the tactical level is on within year management adjustments, such as; improving ewe body condition to lift lambing %, improving grazing management to get more litres of milk from pasture. While operational management drills down to getting specific activities completed efficiently (e.g. milking routine, drenching lambs, reseeding a pasture).

How to use this guide

Think of strategic management like reading a map;

- Where am I now?
- Where do I want to go?
- What is the best way to get there?
- How do I stay on track?

Each question is covered below in turn, but feel free to flick through the various sections to get a feel for the whole process of planning and implementing long term changes to your business. Once you have a broad understanding of what the workbook covers, it is best to complete the workbook in the logical order of the above questions.

It is very easy to get 'bogged down' in strategic planning as the urge is to try to "get it right first time". It is better to get quickly through a draft, put it down for a day or so, then go back to it and refine that draft. Expect to go through several drafts before you are satisfied. That is all part of the strategic planning process.



Business details

Farm business name:

Address:

Telephone number:

Legal status:

Key contacts:

Name:

Address (if different from above):

Phone number:

Mobile number:

E-mail:



Executive Summary

Complete this section last.

Use bullet points to keep the summary concise (no more than a couple of sentences per bullet point).

- Why undertaking the report.
- Overview of farm and current system, including any diversification enterprises and off-farm work.
- Describe farm's cross-compliance position.
- State recent profitability and main factors driving it.
- State up to date net worth at realistic market values.
- State current cash needs.
- State current BPS (Basic Payment Scheme) and projected BPS after full change to area based payment, plus involvement in other grant schemes.
- Outline likely consequences (profitability, cash flow, riskiness, etc) of continuing with current system (Option 1).
- Outline likely consequences of Option 2.
- Outline likely consequences for other options (a bullet point for each).
- Conclude by stating what strategic decision taken and outline of action plan.



1. Scope and Purpose of Plan

Briefly state why this report is being written (e.g. opportunity to buy farm next door, thinking of expanding herd). If the report is addressing a number of questions, use bullet points to help get to the point. A third of a page is adequate.



2. Where am I now?

Like reading a map, before you can plan a route to your destination, you must be sure of your starting point. This section therefore shows you how to critically review your current farm business, using a SWOT analysis to organise your thoughts. SWOT stands for;

<u>S</u>trengths (Internal)	<u>W</u>eaknesses (Internal)
<u>O</u>pportunities (External)	<u>T</u>hreats (External)

Reviewing strengths and weaknesses involves looking inwardly at your business. For instance, the quality of your land, the capacity of your slurry storage. The long term success of your business is best achieved by building on strengths and improving, or avoiding, weaknesses.

By comparison, the second part of a SWOT analysis evaluates the external opportunities and threats that exist. Being aware of, for instance, new technologies and CAP reforms are important in deciding which direction to take the business.

2.1 Current farm and farm system

Complete an audit of the farm's resources and system. There is no need for a long-winded report; just key figures and, most importantly, your judgement as to whether a resource limits a potential option for improving the business or alternatively offers an opportunity.

For instance, a dairy farm looking to expand may be limited by the available number of cubicles. Or, an old woodland could be rejuvenated through Glastir to benefit both the farm and the Welsh economy's carbon footprint.

Get to the point. If the current machinery force is adequate for the current system, simply say so. Don't list every machine.



The most important resource on the farm is the farmer. Be honest about your good and not so good points. Would this self-assessment be consistent with that of the younger (or older) generation?

<p>Land</p> <p>Location Access Total area Adjusted area Woodland area Quality / LFA status</p>	
<p>System</p> <p>Farm type (e.g. dairy) Livestock enterprises Crop enterprises Pasture and forages Stocking rates / ratio of cattle to sheep Farm diversification Off-farm work</p>	
<p>Buildings</p> <p>Livestock buildings Crop storage including silage pits Slurry towers, etc Yards</p>	
<p>Infrastructure</p> <p>Fences (and walls) Internal tracks Stock handling Water Drainage</p>	
<p>Plant & Machinery</p> <p>Milking parlours Slurry pumps, scrapers, etc Grain driers Use of contractors Operations covered by farmer</p>	



<p>Labour</p> <p>Family Paid Casual</p>	
<p>Ownership & Management</p> <p>Trading structure (e.g. a partnership between...) Succession plan in place?</p>	
<p>Environment & Conservation</p> <p>Environmental and landscape features Environmental schemes Waste and pollution management Nutrient and energy conservation Biodiversity management strategies</p>	
<p>Other areas</p> <p>Animal health & welfare Plant health New entrants and women Health & Safety</p>	



2.2 Recent financial performance

The accounts capture in figures what has physically happened on the farm over the past couple of years. The next step is to use the accounts to help answer the following questions:

- How profitable is the business (relative to cash needs)?
- How much is the business worth?
- How strong is the cash flow?
- How shockproof is the business?

While accounts are a key source of information about how well the business is performing, there are a few things to be aware of:

- Don't focus on a single year. Performance may have been badly hit by simply being unlucky with the weather, having the wrong milk contract, or selling at the wrong time. Therefore view over a few years to look for trends.
- The balance sheet does not reflect actual worth as key assets are not shown at current market value. For instance, land is shown at original cost, while crops are typically shown at cost of production.
- Accounts are historical however quickly completed. Often they reflect performance, prices and costs from two years back.

Understanding the relationship between the profit, balance sheet and cash flow is important for any business.



2.2.1 Cash Needs

Before analysing the accounts, it is useful to first ask: What level of profit does the business need? Answering this question involves estimating personal and capital spending requirements, known as “cash needs”. As spending on buildings and machinery typically involves large sums, but often years apart, the estimate needs to be averaged over a number of years to get an annualised figure.

The cash needs of a farm business will vary because of;

- The number of partners (families).
- Farm type (e.g. dairy, hill).
- Tenure (tenant, owner-occupier).
- Size (ha, turnover).
- System (e.g. extensive vs intensive).
- Machinery policy (use of contractors vs self).

For example, a large dairy farm with a few partners may have annual cash needs of over £100,000; an extensive hill farm run by a husband and wife team may be less than £40,000.

Estimating cash needs requires some ‘feel’ therefore don’t be too exact. Broadly right is better than accurately wrong! Complete the following table including the final column to show your workings and assumptions.

	£	Assumptions
Drawings & tax* Personal and capital taxes, but not VAT. Pensions, life assurance, medical care, etc. Private share of light, heat, phone, etc.		As a broad guide £25,000 a family (husband & wife). Look in the capital account for the actual drawings. They may well be much lower (and supplemented by off-farm work), but what should drawings be to get the next generation interested in farming?
Machinery investment Machinery and farm vehicles are often bought on HP or contract hire therefore makes averaging easier, though smoothing is required where preference is to buy outright.		The machinery depreciation figure in the trading account gives a reasonable indication of how much a farm spends annually on machinery. Outstanding HP will be shown in the balance sheet.



<p>Property investment This covers major works like milking parlours, sheds, silage pits, grain stores and slurry towers. Plus the purchase of land. Typically covered by bank loans. An exception being the reinvestment of the sale of land for building development.</p>		<p>Outstanding loans are shown in the balance sheet. Care is needed when using loan repayments to estimate reinvestment needs as the early years of a loan repayment are largely comprised of interest. It is often better to average over the life of the loan (e.g £100,000 borrowed over 10 years equates to £10,000 in the annual cash needs).</p>
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**Assumes a sole trader or partnership. In farming companies, the farmer is typically paid a “wage” by the company, so is treated as a trading (not personal) expense.*



2.2.2 Profitability

The next step is to analyse the accounts to find out what drives profitability. Based on the accounts, summarise recent profitability into the table shown below to allow easy comparison with whole farm benchmarks for Welsh farms.

Definition of key terms used in summary:

- **Effective area** = total area – area occupied by roads, woodland, wasteland and buildings, plus rough grazing expressed in terms of improved pasture.
- **Average Grazing Livestock Units (GLU's)** = the average number of cows, sheep and other stock classes carried in the year converted to GLU's based on feed requirements.
- **Annual milk production** = total liquid milk produced in trading year including an estimate for milk fed to own livestock.
- **Enterprise outputs** = sales adjusted for valuation changes less livestock purchases (for livestock enterprises) for each enterprise (e.g. dairy herd, flock, winter barley, etc).
- **Other trading income** = BPS plus miscellaneous income (e.g. Glastir, diversification, wayleaves).
- **Total output** = enterprise outputs + other trading income.
- **Variable costs** = cost of inputs (adjusted for stocks) that directly influence enterprise output (e.g. purchased feed, roughages, grass keep, vet & med, seed, fertiliser, sprays and sundries like sheep tags).
- **Total gross margin** (also called gross profit) = output + other trading income – variable costs.
- **Labour** = covers all wages for hired labour whether employed on a casual or full-time basis.
- **Power & machinery** = machinery repairs, fuel & oil, electricity and business share of domestic fuel, contracting and hire, haulage, vehicle tax and insurance.
- **Overheads** = property repairs, rates, council tax, water, general insurance, professional fees, office, phone, general subscriptions plus sundry overheads like bank charges and work clothes.
- **Depreciation** = the proportion of the cost or value of machinery, plant and buildings charged as a cost in the trading account to cover how much that asset has “worn out” in the trading year.



- **Rent & interest** = rents (excluding grass keep) plus interest due on bank accounts, HP agreements and loans.
- **Total fixed costs** = labour + power & machinery + overheads + depreciation + rent & interest.
- **(Net)Profit** = total gross margin – total fixed costs.
- **Profit before depreciation** = profit with depreciation added back.
- **Cash needs** = personal and capital spending (e.g. loan repayments, machines bought).
- **Surplus (deficit)** = profit before depreciation – cash needs.

	Upland cattle and sheep			Output analysis		Per effective ha		Per GLU		Per £	
	Yr1	Yr2	Yr3 £	You	Bench* %	You	Bench £/eff.ha	You	Bench £/GLU	You	Bench
Farm type	Upland cattle and sheep										
Total area	138ha										
Effective area	135ha										
Average GLU's	150										
Annual Milk production	-										
Enterprise outputs	100,000										
Other trading income	25,000										
Total output	125,000			100	100	926	1,509	833	1,035		
Variable Costs	44,000			35	32	326	490	293	336		
Total Gross Margin	81,000			65	68	600	1,019	540	699		
Paid Labour	1,000			1	2	7	27	7	19		
Power & Machinery	24,750			20	11	183	162	165	111		
Overheads	12,500			10	9	93	130	83	89		
Depreciation	18,750			15	11	139	168	125	115		
Rent & Interest	6,250			5	4	46	55	42	38		
Total Fixed Costs	63,250			51	36	469	542	422	372		
Net Profit	17,750			14	32	131	477	118	327		
add back depreciation	18,750										
Net Profit before dep'n	36,500										
Cash needs	45,000										
Surplus (deficit)	(8,500)										

*Benchmarks calculated from Welsh Farm Income 2013/14 top third.



When analysing the accounts, start with the big question:

“Over the past few years has profit before depreciation covered cash needs?”

If not...why? Is it:

- A low gross margin?
- High fixed costs?
- Both?

Simply looking at one year’s figures is unlikely to explain why. A benchmark is needed. If the business is doing well and leaving a surplus after cash needs, it is still important to benchmark to confirm why.

While the focus below is on benchmarking against industry standards, comparison with past performance is the obvious and easiest place to start. Was last year better because the general level of milk prices was better? Were lamb sales down because of the bad weather at lambing hitting lamb numbers?

Benchmarking against similar type farms takes out some of the factors that cause variation between years. Output analysis, also termed ratio or proportional analysis, is popular because it allows quick comparison between businesses of different size and land qualities. In the above case, for example, the top third of Welsh upland cattle and sheep farms kept 32% of their output as profit, compared to 14% for the example farmer. That is,

$$\frac{\pounds 17,750}{\pounds 125,000} \times 100 = 14\%$$

Benchmarking on a per hectare basis is also popular but be mindful. It works well for dairy, arable and drystock farms where land quality is reasonably consistent, but for extensive LFA (Less Favoured Area) farms with rough grazing, it can significantly bias the figures. Adjusting lower value grazing into equivalent better hectares, can become very subjective, hence the recommendation to use output analysis in the first instance.

Likewise, comparing a farm to others on a per litre basis, for dairy farms, and per Grazing Livestock Unit (GLU) for sheep and beef farms can help you identify your weaknesses and strengths.

However always watch with “per” figures, whether per ha, litre or GLU. You can have wonderful per head performance, for instance, but if stocking rate is low and the area farmed small, the overall level of profitability may still be low. Therefore always keep total figures in view.



Profitability analysis – Comments

The big idea of whole farm analysis is to quickly indicate what is going well and not so well. Having, in the above example, identified that profitability is low because of a lower intensity of production, the next step is to drill down to find out why. This involves calculating Key Performance Indicators (KPIs), including gross margins, for the farm's main enterprises for checking against industry standards. Using KPIs, a root-cause analysis should quickly pinpoint weaknesses and strengths.

Be mindful, calculate too many KPIs and you can confuse yourself. Moreover, keep in mind that technical KPIs, like milk yield, are not always consistent with bottom line profitability.

Profitability analysis – Comments



2.2.3 Balance sheet and Cash Flow

While the liabilities in the balance sheet shown in the tax accounts should be accurate, the assets are typically valued at cost not current market value. Therefore, a “farmer’s balance sheet”, which includes all assets at current market values is calculated to produce a realistic net worth. If unsure of asset values, it is worth paying for a professional valuation. An example balance sheet including key ratios is shown below.



BALANCE SHEET (at Market Valuation)

ASSETS	AS AT dd/mm/yy	£	£	
Land	1,002,535			
Buildings and Fixtures	56,000			
Plant & Machinery	95,000			
Breeding Livestock	120,000			
			1,273,535	Fixed Assets
Trading Livestock	30,000			
Stores / growing crops	3,000			
Cultivations	2,000			
Crops in Store	15,000			
Debtors	5,000			
Cash at bank	0		5,000	Liquid Assets
			55,000	Current Assets
			1,328,535	TOTAL ASSETS
LIABILITIES				
Creditors	15,000			
Bank Overdraft	75,000			
Leasing & HP	36,000			
			126,000	Current Liabilities
Loans	50,000			
Mortgages	0			
			50,000	Long Term Liabilities
			176,000	TOTAL LIABILITIES
			1,152,535	NET WORTH
Key Ratios				
% Equity	87%	Target >70% for owner occupiers		
		Target >50% for tenants		
Liquidity Ratio	0.04	Target >1	30,000	PROFIT (eg from tax accounts)
Return on Tenants Capital	11%	Target >10%		
Return on Equity	3%	Target >3%		



A typical set of tax accounts does not include a cash flow, or disposal of funds, statement. Fortunately, by looking at the balance sheets in the tax accounts for the past few years, the strength of a farm's cash flow can be deduced.

A farm with cash flow problems has:

- Rising creditors and debtors.
- A deteriorating bank balance.
- Problems paying off loans and finance.

A farm with a strong cash flow has:

- Low creditors.
- An improving bank balance.
- No problem paying off debt.
- Surplus cash to save or invest.

Therefore by analysing recent tax accounts, drawing up a true balance sheet based on realistic market values and checking the monthly bank statements for the past couple of years, the following key questions can be answered:

- What is the net worth of the business?
- What is the percentage equity?
- The size of the borrowings and how structured?
- Has the bank overdraft (and creditors) deteriorated over the past few years?
- Whether hardcore debt (the minimum overdraft each year) is worsening year-on-year?

But be aware, a balance sheet provides a "snapshot" of a business on one day in the year. For arable farms in particular, seasonal borrowings can vary significantly. Also, most farm balance sheets do not include the personal assets of partners (e.g. pensions, shares and off-farm assets like property).



2.2.4 Classifying business health

Having analysed the accounts, classify the overall financial health of the business using the following checklist.

A strong business	<ul style="list-style-type: none">• Achieves good profitability• Can finance growth without borrowing• Easily meets ongoing cash needs• Saves surplus cash
A secure business	<ul style="list-style-type: none">• Achieves good profits• But borrowing needed to finance growth
An insecure business	<ul style="list-style-type: none">• Does not cover cash needs from profits• Has gradually rising borrowings• Invests little in business
A serious business problem	<ul style="list-style-type: none">• Makes little profit• An accelerating rise in borrowings• No investment
An acute business problem	<ul style="list-style-type: none">• Suffers ongoing losses• Has high and increasing levels of debt• Can't pay bills when due



2.2.5 CAP and other support

The old historic based Single Payment changes fully over to the new area based Basic Payment System (BPS) between 2015 and 2019. Use the Welsh Government Basic Payment Scheme example calculator (see link below) to estimate how the farm's decoupled support payment will change over the next five years.

<http://gov.wales/topics/environmentcountryside/farmingandcountryside/farming/schemes/basic-payment-scheme/basic-payment-scheme-payment-calculator/?lang=en>

Scheme details	2015	2016	2017	2018	2019
Trading income <ul style="list-style-type: none"> • BPS • Glastir • Other 					
Total Trading Income					
Capital grant <ul style="list-style-type: none"> • BPS • Glastir • Other 					
Total Capital Grant					
Comments					



2.3 Risk assessment

Farm businesses are subject to five types of risk; production, price, legal, human and financial.

Farming is very vulnerable to production risk because of the vagaries of working with the weather and animals. Consistently achieving both good yields and high quality will be critical to overall performance in future. Prices have become more volatile over the past 10 years as old support mechanisms have been lowered, opening up Welsh farmers to world commodity markets. Attention to legal or institutional risks will also be important. Failure to meet cross-compliance requirements could jeopardise the BPS and other grant income. And, failing to have a will can make a tragic situation even worse.

Breaking down risk into convenient categories is useful in defining risk. But it must be stressed that the key risk facing the farm business is financial. Poor yields, for instance, are ultimately reflected in the bottom line. If poor production is an ongoing problem borrowings will have to rise to make ends meet. Of course, increasing the overdraft can only be a temporary solution. Regulators should also note that farmers, as price takers, cannot pass compliance costs on.

The following table shows the main types of risk, examples of how these can affect a business plus some of the options available to manage these risks

Types of Risk	Examples	Options for limiting risk
Production	<ul style="list-style-type: none"> • Catchy harvest weather • Disease outbreak • Poor genetics 	<ul style="list-style-type: none"> • Increase range of enterprises • Animal health & biosecurity plan • Use EBVs to select tups/bulls
Price	<ul style="list-style-type: none"> • Volatile grain price • Uncertain fertiliser cost • Weak store price 	<ul style="list-style-type: none"> • Storage or price pools • Buy forward • Finish cattle (vertically integrate)
Legal / Institutional	<ul style="list-style-type: none"> • Contractual problems • Straying livestock • Soil erosion 	<ul style="list-style-type: none"> • Seek professional advice before signing • General liability insurance • Sow winter cover crops
Human	<ul style="list-style-type: none"> • Broken ankle • Death of a partner • Staff problems 	<ul style="list-style-type: none"> • Personal accident and illness insurance • Succession plan (including will) • A formal employment contract
Financial	<ul style="list-style-type: none"> • Large borrowings • Rising interest rates • Low liquidity 	<ul style="list-style-type: none"> • Sell surplus assets to reduce debt • Fix rate • Off-farm work

Good risk management involves taking a methodical approach to drawing up a plan, then implementing and monitoring that plan.



3. Where do I want to go?

3.1 Goals and objectives

Goals should not be confused with objectives. The former are meant to provide a long term focus, while objectives are much shorter term and through their achievement help you reach your long term goals. While goals are descriptive (e.g. “to double the size of farm”; or, “to give my children the opportunity to farm”), objectives should be based on cold, hard numbers, that are;

Specific

Measurable

Attainable

Realistic

Timely

SMART objectives provide the milestones for keeping a business on track and are integral to good action plans, which are covered in the final section.

List the long term goals of the business (no more than three):

List the long term goals of the business (no more than three):	
1.	
2.	
3.	

3.2 Market and competitor analysis

Remarkably, farm strategic business plans rarely include a market analysis unless looking at the potential of some form of diversification project. Even for traditional farm products like lamb or suckled calves, it is important to “look at your business from the customer’s viewpoint” (e.g. the consumer of beef, not just the cattle finisher that buys your store cattle) and “size up the opposition” (e.g. the impact of a weaker NZ dollar on the competitiveness of their lamb exports). Only then can the farm system be set up to produce what the market wants.

Besides the farming press, market reports and analysis of mainstay farm markets are available from websites like HCC and AHDB Dairy and events run through Farming Connect. While good background information on the market for diversification enterprises is available on the internet.

Comments



3.3 SWOT analysis

On one side of paper you should now have a concise list of your strengths, weaknesses, opportunities and threats. For example;

Strengths (Internal)	Weaknesses (Internal)
Good net worth (87% equity)	Profit before dep < cash needs
Limited loans	Overdraft up a 1/3 in two years
Scale	Fixed costs on high side
Hi-health status breeding stock	Sheep GM below average
Surplus farm cottage	Building capacity tight
Good balance of land quality	Slurry stores need renewing
	Distance to outlying block of land
Opportunities (External)	Threats (External)
Neighbour's farm for sale (expand)	CAP reform (lower BPS)
EID	Pollution incident
Make better use of Glastir	Stronger £
Rotational grazing management	Price volatility
Change cow breed	Health (future physical input)
	Sale of neighbour's farm to someone else

By this time, options that may meet the long-term goals of the business should be emerging. Note them down in the opportunities box. These options will be examined in the next section.



4. What is the best way to get there?

At this point, there should be a good understanding of the farm business (system) and a clear idea where the farmer wants to go (long-term goals). The question is: will the current system be capable of achieving those goals, or does the system need to change in some significant way?

The broad options are:

- Continue with the current system (status quo).
- Improve performance of the current system.
- Fundamentally change system (including farm diversification)
- Scale up (or down).
- Get out and do something else.

Budgeting provides the opportunity to test a range of potential systems to gauge which is likely to best meet long term goals. While no budgeting can predict the future with certainty, it can reduce the chances of making a bad decision and taking the business down a wrong path.

What are the tests?

Profitability	When up and running will option more than meet cash needs?
Feasibility (cash flow and capital requirement)	Is cash flow good enough to cover bills in the months, even years, before the option is fully established? If not, will a lender support the business through this period?
Practicality	Can the levels of performance built into the budgets be delivered? Are the farms resources, including the farmer, up to it?
Riskiness	What happens if performance levels, prices and costs are much worse, or better, than expected? Will cross-compliance rules be breached?
Flexibility	How much wiggle room is built into the system? Does it have potential bottlenecks where things must go right?
Personal	Does this option have all partners' complete commitment?



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4.1 Option 1 – Continuing with the current system

Always start by budgeting the current system to provide the benchmark for measuring the other options against. That is, the current system is the “without change” option that can be compared to the “with change” options.

If an annual budget is completed as part of ongoing farm management, the status quo option is already available. However most farmers don’t complete an annual budget, therefore one will need to be produced to get a robust baseline.

For farmers not familiar, or confident, with this type of budgeting, employ a good consultant. The aim is to produce a budget that can be summarised into the following format, which includes an example. Note how gross margins per ewe, cow and per hectare of winter barley are used to summarise the contribution of these enterprises to profitability.



OPTION 1 - CONTINUE WITH CURRENT SYSTEM (based on 2015/16 budget)

System:	Effective area farmed	135 ha				
	System based on:					
	- 60 suckler selling yearlings in April sales					
	- 600 ewe flock producing finished lamb					
	- grow 6ha winter barley for own use					
	Grazing Livestock Units	150	or	1.11	GLU/ha	
	Employs casual at lambing					
	Contractors only used for silage harvesting					
	No capital expenditure required					
				£	£	£/ha £/GLU
Capital	Buildings			0		
Budget:	Fencing, infrastructure			0		
	Total Capital Expenditure			0		
	Annual charge (added to rent & interest)			0		
Trading	Sucklers	60 hd @ GM	300 =	18,000		
Budget	Flock	600 hd @ GM	35 =	21,000		
	Winter barley	6 ha @ GM	450 =	2,700		
	Other trading income (eg. wayleaves)			500		
	Farm diversification income			0		
	Basic Payment			27,000	200	180
	Pillar 2 grant income (Glastir)			5,100		
	Total Gross Margin			74,300	550	495
	Paid labour			1,200	9	8
	Power and machinery			25,000	185	167
	Overheads			13,500	100	90
	Depreciation			18,000	133	120
	Rent & interest			6,500	48	43
	Fixed Costs			64,200	476	428
	Net Profit			10,100	75	67
	Add back:					
	Depreciation			18,000		
	Net Profit before depreciation			28,100	208	187
	To cover:					
	Drawings			25,000		
	Property investment			4,000		
	Machinery investment			16,000		
	Total Cash Needs			45,000	333	300
	Surplus / Deficit			-16,900	-125	-113



The budget should indicate the profitability of continuing with the current system based on realistic estimates of performance, prices, subsidies and costs. What are the key questions to check off?

- Is this system likely to make enough profit to cover cash needs?
- If not, what's the root-cause of the gap? Should be fairly obvious given earlier analysis of recent performance.
 - Total gross margin too low?
 - Per head performance (e.g. low lambing %)?
 - Too much expensive seasonal grazing?
 - Stocking rate?
 - Balance of enterprises?
 - Lack of scale?
 - Big drop in BPS caused by CAP reform / lower exchange rate?
 - Fixed costs too high?
 - High (fixed) cost system?
 - Too much paid labour and machinery?
 - Lax control of overhead spend (e.g. insurance)?
 - High interest charge owing to high borrowings?
 - Cash needs too high?
 - Locked in to heavy debt repayments?
 - Spending too much on machinery?
 - Trading status not tax efficient?
- Will there be pressure on the bank overdraft? When is this likely?
Estimating the impact on the bank balance does not require a formal cash flow budget. Remember, it is better to complete a broad, quick review of the options available in the first instance. Preferred options will be looked at in greater detail later, especially if borrowed funds are required.
- How sensitive is profitability and cash flow to different levels of performance, prices, subsidies and costs? For example;
 - Lamb and calf prices 20% lower (and higher) to capture impact of potential changes in market prices and weight of stock available for sale (e.g. poor lambing, disease outbreak).
 - Impact of volatile exchange rate on the BPS.
 - Consequence for costs and performance if a key machine breaks down at the start of harvest.

In this example, the answer is 'no' – the status quo will probably not deliver. So the next step is to cost out alternative options. Of course, in many instances profitability may well be good enough to cover cash needs, but the budgeting of other options continues if such businesses want to look at potential changes to achieve long-term goals like increasing farm size or reducing the tax bill.



Indeed, successful businesses tend to be successful thanks to periodically completing a strategic plan as part of an underlying drive to continuously improve.

In this example, the budget suggests that the farmer's profitability is likely to be back on recent levels thanks to lower lamb prices. While the farmer can cut his drawings to make ends meet, looking at options for lifting profitability is the better course of action.

4.2 Budgeting the alternatives

Having established the yardstick, the alternatives must be budgeted on the same basis; that is, when fully up and running. Even if the changes take three years to fully implement, the option must be budgeted when established but at current costs and prices. Remember, at this stage, the aim is to get a 'feel' for which alternatives are most likely to succeed. Preferred options will typically be considered in greater detail, especially if their financing requires help from your bank.

Returning to this example, the farmer has identified a number of options for further examination.

Option	Main changes
Continue with current system	<ul style="list-style-type: none">• None
Improve current system	<ul style="list-style-type: none">• Lift sheep performance to top third
Change current system (including farm diversification)	<ul style="list-style-type: none">• Finish calves• Reduce flock size• Cut machinery force
Scale up (or down to include off-farm work)	<ul style="list-style-type: none">• Buy neighbouring 80ha farm (thereby spreading current fixed costs over bigger area)
Exit	<ul style="list-style-type: none">• Not under consideration

Notice how the changes become bigger as you descend through the options. That is, in most instances it is natural to look at the easiest to implement changes first. Improving the performance of the current system may well be enough to lift profitability to required levels. Also, the options are not mutually exclusive (e.g. sheep performance can be lifted as well as changing overall flock size). Looking at each in turn, however, is less confusing than budgeting an option with lots of changes.



4.2.1 Option 2 – Improve current system

A root-cause analysis of the flock has pin-pointed that lambs reared (i.e. number sold/retained divided by ewes tugged) is far lower than that achieved by the top third of upland livestock farmers (135% cf. 155%). All other flock KPI's are similar. A simple partial budget (i.e. only looks at marginal changes) suggests that profitability will change as follows:

Extra trading income	Income foregone
<p>600 ewes @ 155% = 930 lambs 600 ewes @ 135% = 810 lambs Extra = 120 lambs</p> <p>Extra lamb sales @ £60 gross = £7,200</p>	
Trading costs saved	Extra trading costs
	<p>Extra fertiliser, 1t @ £300 = £300 Extra concentrates, 2t @ £200 = £400 Extra vet & med, 120 @ £1 = £120 Deductions & haulage, 120 @ £4 = £480 Extra = £1,280</p>
Total £7,200	Total £1,280
Extra Profit = £5,920 Or a lift in ewe gross margin of £9.87	Overall profitability improves from £10,100 to £16,020) but still too low.

What about the other tests?

Feasibility (capital and cash flow)	<p>No capital investment required. Purchase of extra fertiliser and concentrates will not cause a working capital problem in the spring. But assume that may take a couple of years to fully increase extra lambing sales, so annual cash flow will improve over a couple of years.</p> <p>However, based on expected prices and costs, profitability is still unlikely to cover cash needs.</p>
Practicality	<p>Has identified the husbandry changes required to lift lambing % through involvement in local Farming Connect discussion group. Stocking rate not a constraint. So, confident that can achieve full lift in two seasons.</p>



Riskiness	Subject to risk of lower lamb price because of commodity nature of sheep market. But low financial risk to business given limited cost outlay. Main risk is making sure that flock is fed correctly in the run up to lambing.
Flexibility	Has the extra space available in the lambing sheds and labour to deal with extra lambs.
Personal	Has farmer and family's full commitment.
Conclusion	Worth pursuing, but not enough alone.

Note: cross-compliance cuts across most of the above tests (e.g. increased lambing % will require extra feeding in late pregnancy and early lactation to meet animal welfare requirements).

4.2.2 Option 3 – Change current system

The farmer thinks that finishing his 55 calves at 20-24 months old will lift profits (currently sells them in spring sales as yearlings). However, he reckons that the flock will have to be cut by 100 (to 500 ewes) because of the extra grazing and silage required by the cattle. While no shed space is available at home, he can rent a semi-retired neighbour's shed for the winter finishing period. He has also identified opportunities to lower his machinery costs. Again, a partial budget is completed to help think through the consequences for profitability (note how enterprise gross margins are used to shortcut the budget).

Extra trading income	Income foregone
55 cattle @ GM of £200 = £11,000	100 ewes @ GM of £35 = £3,500
Trading costs saved	Extra trading costs
Saved machinery costs = £3,000 Less working capital (interest) for flock = £540 Extra = £3,540	Shed rental = £1,000 Extra fuel costs = £500 Extra working capital (interest) for cattle = £550 Extra = £2,050
Total £14,540	Total £5,550



And the other tests?	
Feasibility (capital and cash flow)	<p>Initial cash flow improvement thanks to sale of breeding ewes. However, more than offset by retention of young cattle for extra 8-12 months and reduction in number of lambs sold through the summer and autumn.</p> <p>Without the availability of a neighbour's shed nearby, this option only possible if built a new shed. A £60,000 shed amortised over 20 years at 7% would cost £5,640 annually (capital and interest), making the option unattractive.</p>
Practicality	<p>The farm is, by type, a rearing rather than cattle finishing farm, so does not have the natural advantages of a lower ground finishing farm. The farmer will also need help from the local buyer on assessing when a beast is ready to kill. Neighbouring farm is close by so very limited time lost travelling. But neighbour will benefit from manure left by cattle and handling system will need careful planning to ensure the safety of man and beast.</p>
Riskiness	<p>Finished cattle prices have been volatile in the past couple of years, so the gross margin could vary widely. Successful finishing also depends on making high quality silage to achieve good growth rates at least cost. Could reduce risk by still selling bullocks as yearlings and retaining, easier to finish heifers.</p>
Flexibility	<p>No real bottlenecks in terms of time commitments. Though cattle selling may coincide with lambing, the flock would be smaller.</p>
Personal	<p>Has farmer and family's full commitment.</p>
Conclusion	<p>More profitable, but probably more risky than Option 2 (improving flock performance). If combined, cattle finishing with a smaller but better performing flock (500 @ extra £10GM/ewe = £5,000) could lift profitability by perhaps £14,000. With cash needs reduced thanks to lower investment in machinery, combining options 2 and 3 could work.</p>



4.2.3 Option 4 – Expand by buying neighbouring farm

The semi-retired farmer next door may be tempted to sell 80ha of bare land next door (he wants to retain the steading, 10ha and the farm house), if the price is right. An offer of £400,000 may seal the deal, but this will have to be fully funded by a bank loan. Although one or more of the buildings may remain available to rent, the farmer thinks the best option is to keep the prospective farm system simple so that no extra machinery is needed. So cow numbers will stay the same, with the flock doubled in size and switched to an easicare, largely out door lambing system (i.e. singles and triplets lambed indoors). This will minimise shed and labour requirements, though lower per ewe performance is expected. Capital required from the bank totals £460,000, to include purchase of a flock of 600 mixed age ewes and handling improvements.

The impact on profitability is, again, assessed with a partial budget against the baseline (without change) Option 1.

Extra trading income	Income foregone
600 ewes @ GM of £30 = £18,000 BPS, 80ha @ £200 = £16,000 Extra = £34,000	600 original ewes @ GM of £5 = £3,000
Trading costs saved	Extra trading costs
	Extra casual labour = £2,000 Extra fuel and machinery costs = £1,500 Extra contracting costs = £7,000 Interest @ 6% averaged over 20 years = £17,020 Extra = £27,520
Total £34,000	Total £30,520
Extra Profit = £3,480	Overall profitability therefore little changed.

And the other tests?

Feasibility (capital and cash flow)	The large loan increases cash needs significantly. At 6% over 20 years, a repayment loan costs £40,020 annually. On average, £23,000 of this is capital and £17,020 interest. In practice, interest would account for most of this annual payment in the early years, which is helpful from a tax viewpoint. By implication, cash needs would also rise steadily as the loan matured, requiring a matching rise in profitability. The partial budget indicates no marked improvement in profitability. Cash flow would therefore appear unsustainable given the size of loan budgeted,
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	even if the term of the loan was extended to 25 years.
Practicality	Moving from a conventional to an easy care sheep system is not easy requiring a marked change in management approach. Will the farmer be up to it? Under a best case scenario, may well take two to three years to fully establish the new system.
Riskiness	Based on prices, costs, subsidies and performance near levels assumed in the budget, bank support is unlikely. Indeed, based on a BPS that may be closer to £130 in 2019, the profitability will be less (though Option 1 profitability will be lower by the same amount). If sheep performance was on par with that currently achieved (£5 more, at a gross margin of £35/ewe), the flock would add an extra £6,000 to net profit. Lifting per ewe gross margin to £40+ would be necessary to make the option attractive. However, weather at lambing is a major risk given that more than half of the flock would be lambed outside.
Flexibility	Opting for a conventional, indoor lambing could be achieved by staggering lambing dates. But workload would remain an issue requiring extra casual help. Moreover, indoor lambing is not without its welfare problems.
Personal	The farmer is uncomfortable with this level of borrowing given the limited improvement in profitability forecast.
Conclusion	A non-starter unless the land can be bought for much less.

4.3 Choosing the best option

Having costed out and looked at the various options, it's time to decide which one to take. This is not as easy as it sounds as much depends on how people take decisions. As individuals we can make markedly different decisions when faced with the same hard, cold figures, let alone a range of 'feel' factors. Where big decisions in farm businesses involve a couple of generations of family members, arriving at a decision upon which all are agreed can be very difficult.

Drawing all analysis onto a single sheet of paper will help. How would you score the example farm budgeted above?

	Options			
	1	2	3	4
Profitability				
Feasibility				
Practicality				
Riskiness				



Flexibility				
Personal				
Overall score				

When completed, the boxes will contain both hard figures (e.g. estimated profitability) and qualitative judgements (e.g. farmer comfort with debt). Critically, the preferred option may not be the one “promising” the best profit. Research indicates that many farmers are not profit maximisers, so given profitability is sufficient to cover cash needs, the preferred option is often down to other criteria (e.g. low risk, prefers cows to sheep).

If, in this example, the above analysis indicated that the best option was buying the neighbour’s farm, a formal business plan would be required for the bank manager to consider. The farm’s accountant and solicitor should also be involved. Typically this involves a formal business plan structured like the following example:

CONTENTS	
1.	EXECUTIVE SUMMARY 3
2.	INTRODUCTION 4
3.	PROPOSED PLAN 4
3.1	PLAN DESCRIPTION (APPENDIX 1) 4
3.2	FARMER’S PRESENT RESOURCES 5
3.3	CAPITAL REQUIREMENTS 5
4.	PROFIT WHEN FULLY ESTABLISHED (APPENDICES 2A & 2B)..... 6
5.	FORECAST FOR YEAR 1 7
5.1	OVERVIEW 7
5.2	CASH FLOW (APPENDICES 3A AND 3B)..... 7
5.3	PROFITABILITY AND BALANCE SHEET (APPENDICES 3C, 3D AND 3E) 8
6.	FORECAST FOR YEAR 2 8
6.1	OVERVIEW 8
6.2	CASH FLOW (APPENDICES 4A AND 4B)..... 9
6.3	PROFITABILITY AND BALANCE SHEET (APPENDICES 4C, 4D AND 4E) 9
7.	CONCLUSION 9
Appendices	
	1 – New farm details
	2a – Profit when fully established
	2b – Enterprise gross margins – fully established
	3 – Forecast for year 1
	4 – Forecast for year 2

The level of budgeting required for a formal business plan generally requires the help of a consultant. Not only does a good consultant have the skills and experience to complete a business plan in the required form. In the process of completing the plan the consultant will challenge the farmer to justify, often amend, and defend what the farmer is proposing. As a result, the plan stands a better chance of gaining a lender’s support.



5. How to stay on track?

Having picked an option – the plan for achieving the business’ long term goals – the next step is to implement that plan. Far too many good plans fail because of poor implementation. This section briefly explains how to stay on track.

Before going on, however, it is important to stress that new challenges or opportunities may arise just weeks into a big change to the business, triggering a new strategic look at the options. That is, good strategic management is an ongoing process. Indeed good management is about seeking continuous improvement.

5.1 Action plans

An action plan is a powerful, flexible tool. Regardless of whether the preferred plan can be implemented within a year, or will take 10 years, a good action plan will help “make it happen”. As explained in section 3.1, while long-term goals are descriptive, objectives should include numbers, and the actions required by whom and by when to deliver the objectives.

In our example, the farmer decides to implement the changes examined in options 2 and 3. Below is part of the action plan for lifting the sheep gross margin.

Objective	Action	By whom/when
Lift scanning to 180%.	<ul style="list-style-type: none"> Wean earlier (100 days from mid point of lambing). 	Self (15 July).
	<ul style="list-style-type: none"> Review sheep health plan. 	Self and vet (late July).
	<ul style="list-style-type: none"> Target having all ewes at body condition score (BCS) 3.5 for tupping. The bottom 20% of the flock often drags the scanning % down so making sure that all of the flock are at least BCS3. Separate ewes into good condition (at 3.5), thins and culls once everything dried off a few weeks post weaning. 	Self (7 August).
	<ul style="list-style-type: none"> Then go through thins every few weeks and draft off good condition ewes. 	Self (late August, early Sept).
	<ul style="list-style-type: none"> MOT tups. 	Self (early Sept).
	<ul style="list-style-type: none"> Worm any thin ewes a month prior to tupping (keep a close eye on gimmers). 	Self (mid Sept).
	<ul style="list-style-type: none"> Check NADIS forecast and fluke accordingly 	Self / vet (October).
	<ul style="list-style-type: none"> Build pasture covers through late summer so that ewes can be flushed two weeks prior to tups going in, and also have plenty of feed through the following month. Achieved by saving pasture from early August onwards by tightening up low priority stock classes (e.g. good condition ewes) and destocking (e.g. selling lambs, trading cattle, culls). 	Self (ongoing from weaning).
	<ul style="list-style-type: none"> Maintain body condition through to scanning. 	Self.
	<ul style="list-style-type: none"> Leave hoggs untupped but target 45kg LWT by tupping to ensure early puberty. 	Self (weigh monthly from weaning).



Moreover, action plans can be used at various stages of the strategic planning process to set priorities and improve communication between all parties to get the important things done. In this example, if the final option (buy the farm next door) had been pursued, the farmer may have drawn up the following interim action plan.

Objective	Action	By whom/when
Seek funding (c.£500k) from bank.	<ul style="list-style-type: none">• Get accountant's thoughts.• Call bank manager.• Investigate availability and cost of farm consultant to help draw up a formal business plan.• Discuss succession implications with solicitor.• Preparation of draft business plan.• Finalise business plan• Submit plan to bank manager.	Self (today). Self (by end of week). Son to research via Farming Connect website (by end of week). Self (by end of week). 1 st visit by consultant (by end of week 3). 2 nd visit by consultant (by end of week 5). Self (by end of week 6).

5.2 The annual budget

Drawing up an annual budget and monitoring it, is the best way of making sure you stay on track toward long-term goals. Effectively, these plans involve setting key annual targets and actions and periodically checking to ensure these are achieved. Annual budgeting is part of the ongoing management of a business which is part of tactical management.