The road to economic and financial success

Dr Louis du Pisani

A significant percentage of South African livestock farmers are under economic and financial stress. Some of them have no concrete plans to tackle this situation head-on. They instead live with the hope that their situation will improve by itself over time. When it comes to business management, hope is not a strategy. The goal with this article is to motivate farmers to rather take control of the situation to devise and put into operation economic and financial recovery plans.

The very step first step in devising a turn-around plan is to determine if the farm can meet its current financial obligations. **This can be done by means of a quite simple procedure, i.e.:**

- Calculate the farm's annual expenditure requirements, which include all operating costs, debt and interest payments, tax responsibility and the owner's remuneration.
- Divide this amount by the number of animal units on the farm. This figure reflects the revenue that each animal unit must produce to break even with the farm's expenses. If the actual earnings per animal unit on the farm is lower than this required break-even outflow of funds, the next step is to consider a series of alternatives to turn around the situation, either by increasing revenue and/or decreasing expenditure and/or disposing of non-farm assets.
- The following may sound harsh, but if it appears that the business's production potential exceeds its economic and financial requirements by far and that it will not be able to do so even with the necessary adjustments, it is better to face the inevitable than to hope for the best and sink into deeper financial distress.

Suppose it appears that the business has a better than average prospect to be able to service its financial obligations with the necessary adjustments. In that case, the second step is to consult a specialist in the field to conduct a comprehensive diagnosis of the farm's current economic and financial status and to compile a turn-around plan. **Particular attention must be paid to the following aspects:**

- Is the business maximally profitable? If not, where are the problem areas? Is it because of poor production and income levels and/or too high input costs? Is it due to a lack of economies of scale (is the farm too small)?
- If the gross profit is insufficient to service monetary obligations such as debt repayments, income tax and the owner's remuneration, is it because of excessive debt levels or debt that is structured incorrectly? Is private expenditure inordinate?

COMMON MANAGEMENT PITFALLS

- The absence of a proper and realistic farming and personal budget.
- The absence of an admin system to evaluate the farm's performance regularly.
- No distinction is made between the farm's and the owner's finances, for example, the business's bank account is used by the owner for his own personal transactions. It is best practice that the owner opens a personal bank account and pays himself a monthly salary into that account. All personal spending is only made from that. The owner's personal account must have its own overdraft facility.
- The farm's balance sheet is used to obtain personal financing - which is not necessarily bad - but the repayment of such debt must be recovered from the farmer's salary.
- The monthly bank statement is often the only source of financial information available to farmers. This can cause cash flow problems, especially for businesses registered for VAT on a six-monthly basis. There are often substantial amounts of VAT money in the bank account to be paid over to SARS at a later stage. A false sense of available funds can arise in the event of cash flow emergencies, such as when a vehicle requires urgent repairs.
- Impulsive purchases without a proper feasibility study.
- Ego capital such as beach houses and luxury vehicles.
- Capital expenditure to pay less tax. Do not try to reduce tax – rather aim for maximum after tax profit.
- Most farmers see the annual cash flow budget required by the bank as a burden and thus pay little attention to the accuracy thereof. Banks follow their client's budgetary situation. Sizeable deviations from the budget create the impression of poor monetary management and may put further financing at risk. It is good practice to create reliable budgets and stick to them as best as possible. This creates confidence with the bank.

- The bank manager should be your friend, not your enemy. Be mindful of what the bank looks at when evaluating a loan application. Your historical fiscal management ability and discipline are two important aspects.

- When under cash flow pressure from the bank, farmers often resort to selling livestock that is either not optimally market ready or that is not yet in production, i.e. under-weight lambs and replacement animals. This only creates bigger cash flow pressure. Negotiate with the bank for an extension of the time of repayment.

- An overdraft limit that increases annually is usually an indication of a lack of gross profit to cover the farm's financial obligations. The result is a persistent increase in cash flow pressure. This situation is often exacerbated by taking on other short-term credit, such as production loans and advances on wool.

- Albert Einstein once said that "insanity is doing the same things over and over and expecting different results." If the results achieved on the farm are unsatisfactory, seek help from specialists, eliminate poor habits and cultivate new ones that will contribute to financial success.

- It does not make sense to expand your farming enterprise before the current farming is 100% profitable. The first step is to first develop the current business to its maximum capacity.

- A family business has several advantages. Simply dividing the "cake" without the necessary growth and expansion into a successful and profitable family business does not justify family members' entry into the existing business.

- Start making provision for retirement timeously. Too often the next generation is regarded as the current land-users retirement plan with dire consequences for that generation.

SUGGESTIONS TO IMPROVE YOUR FINANCIAL SITUATION

- Take control of your finances, otherwise, the finances will take control of you.
- Emphasise maximum profit and not maximum production. Maximum profit is rarely achieved at maximum yield. Instead, maximise revenue by negotiating the best prices, optimise direct costs, and minimise or optimise overhead costs depending on each situation and cost centre. Measure the farm's economic results at least once a year and make the necessary adjustments timeously.
- Surround yourself with the best advisors possible. Make sure that their advice is the best for your pocket and not just for theirs.
- Prepare honest and realistic cash flow budgets - for the farm, for the bank and your personal spending. Keep all records of transactions up to date. Regularly monitor the progress of the cash flow to manage deviations promptly.
- Save VAT money in a separate bank account. This will prevent it from being inadvertently used for something else. A good place to temporarily transfer the money into is a mortgage account with a so-called "ACCESS" facility.
- Focus on the 20% of the business that determines 80% of its financial success.
- Be timely. This means doing the right thing at the right time. The right thing at the wrong time can be catastrophic.
- Do the basics exceptionally well. There is no need to do anything extraordinary.
- Build up a capital reserve which can off-set poor profit during unfavourable periods, i.e. droughts. The closer you are to retirement, the more important this becomes.
- Start making provision for retirement and succession planning – the earlier the better.
- If something sounds too good to be true, it usually is! Stay away from get-rich-quickly schemes.
- Be on the lookout for strategic alliances, such as considering cooperative farming through the sharing management skills, land, livestock and equipment to reach economies of scale.
- Strive for vertical integration at all levels of the business and keep ownership of your produce for as long as possible to add maximum value on-farm. Sometimes we give our produce away just before maximum profit is achieved.

(Dr Louis du Pisani is an independent agricultural consultant who offers consultancy services and training in livestock, veld and money management - Ldupisani@gmail.com).