



Benchmarking in Agriculture

Paul was home from college on break and was talking to his parents about a class he had just completed. He told his parents that he learned about a powerful management tool called benchmarking that is becoming popular for agricultural producers to use.

He pointed out how benchmarks allow producers to measure both their financial and production performance compared to previous years and/or other producers and agricultural businesses.

Jack, Paul's dad, said that he had just read about benchmarks in a recent farm magazine. The magazine article compared benchmarks in agriculture to going to a doctor's office for a check-up. When you go to the doctor, they

gather information; such as your blood pressure, your pulse, your temperature, and other information they deem necessary for determining your medical health. Each measurement has some general guideline of what the measure should be.

For example, the temperature for a healthy adult should be between 97.8 and 99.1 degrees F. Anything outside this range might indicate a potential health problem. Being outside the range does not specify what the problem is, but it gives the doctor and patient an indicator that some action may be necessary.

Jack said the magazine article identified several financial benchmarks or industry guidelines that have been established for agricultural businesses to use to help them identify strengths and weaknesses in their business.

Paul told his dad that that is exactly what they talked about in his class as well. In class they used athletes instead of doctors as the comparison.

They noticed they could use the internal trends as an early warning system to make adjustments when performance measures worsened.

Athletes use benchmarks all the time to help them measure their performance. Points per game, average yards per rush, time to run a race, and batting average are all good examples of a benchmark for measuring performance.

Paul continued to point out that farmers and ranchers often calculate benchmarking informally. A farmer may see another farmer getting a better price for his products at the same market and ask

“Why is this so?” Or a farmer may hear another farmer talk about how a new technology reduced his operation expenses.

Paul pointed out to his dad that their farm had improved its performance by observing and learning from neighbors and other farmers.

Formal Benchmarking

In class, Paul learned about formal benchmarking. Formal benchmarking is a more systematic approach for identifying similar farms that are performing better, comparing the performance of your farm with the benchmarks, and studying in detail to determine what that farmer or group of farmers does better.



The final steps are to plan and introduce changes based on what is learned.

Liquidity Benchmark

The Current Ratio:

Measures cash flow and ability to pay bills on time

Current Ratio = Current Farm Assets divided by Current Farm Liabilities

Source of Information:

Balance Sheet

Benchmark:

Greater than 1.5

Solvency Benchmark

Debt to Asset Ratio

Measures long-term ability to repay all financial obligations

Debt to Asset Ratio = Total Farm Liabilities divided by Total Farm Assets

Source of Information:

Balance Sheet

Benchmark:

Less than 0.30 or Less than 30 percent

Profitability Benchmark

Rate of Return on Assets:

Measures profits over a period of time

ROA = (Net Farm Income + Interest – Value of Operator Labor/Mgmt) / Avg. Farm Assets

Source of Information:
Income Statement, Balance Sheet, Statement of Owner Equity

Benchmark:
Greater than 0.05 or 5 percent

Financial Efficiency Benchmark

Operating Expense Ratio:
Measures how efficiently the business is using operating inputs to generate income

Operating Expense Ratio = Operating Expenses (minus interest and depreciation) divided by Gross Farm Income

Source of Information:
Income Statement

Benchmark:
Less than 0.70 or 70 percent

Paul and his parents decided to use formal benchmarking as a management tool on their farm. They agreed to start with the financial benchmarks that Jack had found in the magazine article to help them identify possible weaknesses. These financial benchmarks are designed to be industry guidelines to compare against.

It was interesting to see how their farm compared to other agricultural businesses. However, doing internal comparisons with previous years to see if they had made improvements was perhaps more interesting.

They noticed they could use the internal trends as an early warning system to make adjustments when performance measures worsened.

Paul and his parents decided to start using the following benchmarks with the expectation to add additional benchmarks, including production benchmarks, in the future.





Summary

Paul and Jack feel these four benchmarks will provide a good starting point for measuring the financial performance of the family's farm business. Over time, they will monitor not only how well the farm meets these performance benchmarks but also changes and trends from year to year within their farm business.

Overall, they feel this sort of disciplined approach to managing the farm will maximize the probability that it will remain a profitable family business for years to come.

Additional Resources:

[RightRisk Courses](http://RightRisk.org)

<http://RightRisk.org>

[RightRisk Tools](http://RightRisk.org)

<http://RightRisk.org>

[USDA Risk Management Agency](http://www.rma.usda.gov)

<http://www.rma.usda.gov>

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