Financial analysis promotes sustainable growth in agriculture

The financial sustainability and effectiveness of a business can only be determined if it has been subject to technical analysis, says Nico Groenewald, head of agribusiness at Standard Bank. According to Groenewald, certain criteria that measure the effectiveness and sustainability of your farm can help to either sustain or even impede your financial growth, depending on how you utilise it.

Image via AgriOrbit

Keeping score of your profitability

According to Groenewald, financial experts are prioritising analysis and record-keeping so that farmers can keep score of their profitability. He emphasises the importance of keeping track of your financial records so that you can measure and manage your growth more effectively. "Today’s farmers are required to develop a diverse set of skills in multiple agricultural arenas. Although South African farmers are technically very advanced, slow growth or a lack of substantial profit can indicate that the farmer’s time and energy can be better invested.

"When you are struggling within a technical arena, it will be evident in your financial statements. Therefore, it is of critical importance to make sure that everything you do can be measured so that it can be financially analysed," he adds.

Various business analyses

Groenewald explains that there are various types of business analyses. "A financial analysis gives you an overview of your farming business whereas a diagnostic analysis zooms in on the cause of either financial progression or regression. During a sustainability analysis, the source of your financing is evaluated including how you make use of your capital.

"It is not a question of one type of analysis being prioritised over another. You should rather regard it as a process of integration regarding all three types of analyses. Depending on the maturity of your farming enterprise, the focus will shift towards the type of analysis that will currently benefit your business the most," he says.

An emphasis on liquidity ratios

In terms of a financial analysis, liquidity and profitability ratios can be used to determine the financial position of a farmer, adds Groenewald. "Although we stress the importance of both these ratios, we put a bigger emphasis on liquidity because it is responsible for generating finances. It is also the first ratio we look at after we have conducted a financial analysis," he explains.

According to Groenewald, another ratio that enjoys attention from financing institutions, is the solvency ratio. "A solvency ratio depicts the relationship between your assets and liabilities. If that relationship is skewed and your liabilities outweigh your assets, then you are insolvent. However, this is just one important aspect in the bigger financial tapestry of a farmer’s business and is not the sole defining factor of a farm’s financial status," he adds.

Perform timely comparisons

Comparing your financial status at the beginning and the end of the month shows the month’s cash flow and whether you will be able to meet short-term financial needs, says Groenewald. “This data is important for ensuring financial stability and sustainability. A lack of revenue during a non-harvesting season is usually countered with diverse farming practices that prevent your cash flow from coming to a halt.

"A liquidity crisis can start to influence your solvency or even your asset and liability ratio so when adding a multitude of crops and livestock to your farming roster, the importance of financial planning and management cannot be overemphasised," he explains.

Groenewald also sheds some light on several underlying factors that significantly affect the profitability of a farm. "This can include price, quality or supply and demand with respects to a specific market. Another factor that can also play a major role in your farm’s profitability is the effectiveness of your cost structure."

The capital turnover ratio

According to Groenewald, the capital turnover ratio indicates how effectively you are using capital within your business to generate a profit. "In general, the agricultural sector has a relatively low turnover. However, within the different agricultural industries, there are still varying capital turnover ratios. For example, extensive livestock farming would have a lower capital turnover ratio compared to the poultry industry.

"In terms of feeding costs that make up the majority of a poultry farmer’s operating costs, one would look at your cost ratio and determine whether your feeding costs are in line with industry standards and the previous year’s expenses – which brings us back to a diagnostic analysis," says Groenewald.

Determining your financial status

Groenewald explains that one’s financial status is a snapshot of your financial position at any given moment in time and won’t necessarily be determined by only undergoing a diagnostic analysis. "After determining your financial status, you can start to investigate your financial position and compare it the previous year’s financial report as well as with that of other role-players within the industry. This will also affect your future planning and help you to track the growth of your business."

In conclusion, Groenewald adds that there are a multitude of ratios one can use to ascertain the health and sustainability of your farming enterprise. "The biggest danger, however, is when one focuses only on one or two financial ratios and then basing your planning on a limited amount of information, instead of looking at the bigger picture. The integration of all of these ratios and analyses form a process that every business needs to go through in order to get a comprehensive financial summary."