

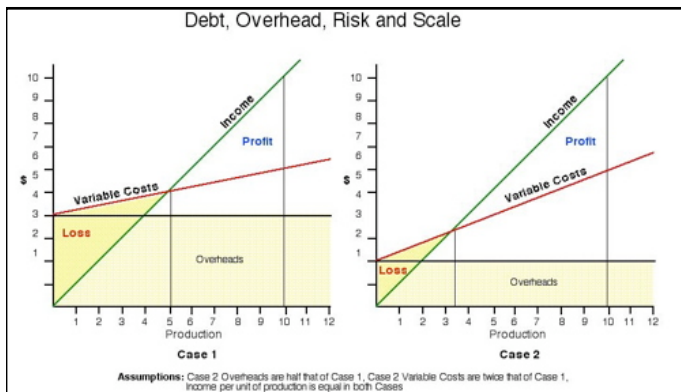


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Holistic financial planning

This article was written in September 2006, soon after a particularly difficult season across much of Australia.

Just recently I saw some figures that showed, yet again, that farmers who have invested the most in overheads have a tendency, over time, to do the worst, economically. Caveat: This is clearly a tendency and not an absolute statement. I have been bantering on about this for a long time now, because, in many cases it is very real. If you want a refresher on why I do so, take a look at these 2 graphs to see what can happen.



If you have not yet worked it out, the farm on the left has double the overheads of the farm on the right. Even though the left hand farm has the benefit of variable costs per unit of production that are only half those of the right hand farm, his break-even point is nearly 50% higher than the farm on the right.

The figures I saw the other day suggest that in the USA the return on assets managed is seriously lower on high input farms when compared to more extensive, low overhead businesses. What this is saying is that there is often a very poor economic gain flowing from well intentioned 'capital improvements'. If the development is not aligned to both the short

and long term biological needs of the land under management, then frightening consequences can be expected. By that I mean, if the capital improvement does not improve the biological wealth of the land, it will send the business backwards, financially. And guess what – more often than not the high input farms are sending ecological performance into a nose-dive, as they are relying increasingly on high inputs of salt based fertilisers to maintain or increase yield. In short, farmers end up "buying" their yield improvements.

Now of course, not everyone is in that boat, and some people we work with are successfully kick-starting their biological capital by applying considerable amounts of money and technology. However, without exception these people are also knowledgeable about, and focused on, the biological aspects of their business. Unfortunately, not everyone is so focused or knowledgeable.

So why do people keep moving on down this high input path? What is the seduction? Well here are three common reasons:

1. Firstly, the farmers' involved do see a physical increase in productive capacity for their effort. As they are paid per kg of product (meat, milk, wool, grain etc), they naturally think they will make more money if they produce more of their product. Sales-people certainly encourage this viewpoint. Nobody ever asks the farmer to assess exactly what the increase in productive capacity will do to their bottom line, especially if the increase in production will be created by heavy investments in overheads, just like in the graphs.



2. Secondly, they are told that by increasing their technology they will be more able to match their output to market demands, and perhaps be able to gain some price premiums along the way.
3. Finally, farmers are human. Bigger is better. Having more cows, ewes or nanny-goats feels better than having less of them, even if the lesser numbers are more profitable. Growing a larger area of crop feels better than being a small-time grower, just as heavier crops are better for the ego than lighter crops are. Size does matter!

In recent months people have struggled with very difficult seasonal conditions on both sides of Australia. It has been the people with low input, biologically sound farming practices who have weathered the storm far more easily than those dancing the high input jig. Why? High inputs, and especially high overheads, dramatically damage ones flexibility.

During the July Telebridge some of the WA farmers were describing the process they went through before concluding that entire herds of stock had to go to market. Because these people are relatively low input producers – they have virtually no overheads these days when compared to five years ago, they could easily (financially) make these decisions, even if they

were emotionally difficult at the time. None of the low input producers have spent money on expensive pastures and fertilisers, and they have each successfully timed the construction of new fencing to match their weak-link indicators. When feed was abundant new fencing slowed or stopped.

Such massive sell-offs of animals create a vacuum in ones business. It's like cleaning out the wardrobe in order to make room for new clothes. Nature abhors a vacuum, and you can be sure that all sorts of unexpected opportunities will come up for those who "cleared the decks" early, and gave themselves time, space and flexibility. Time will tell what opportunities will come their way, but we can be sure they will come.

Unfortunately over the same few months I have watched over the fence as some high input producers have really struggled, because without realising it, their lack of flexibility has stolen opportunities from underneath their feet. Almost without exception these people saw themselves by what they do – as hereford producers, merino producers, canola growers etc, rather than by what they wish to create – their true 'quality of life'.

Whatever the scale of your business, keep it flexible. It will win every time in the long run. And the best way to retain flexibility is to keep overheads very, very low.