



Planning for Financial Success: Where Are You in Your Plan?

Rod Sharp & Jeff Tranel
Agriculture Economists

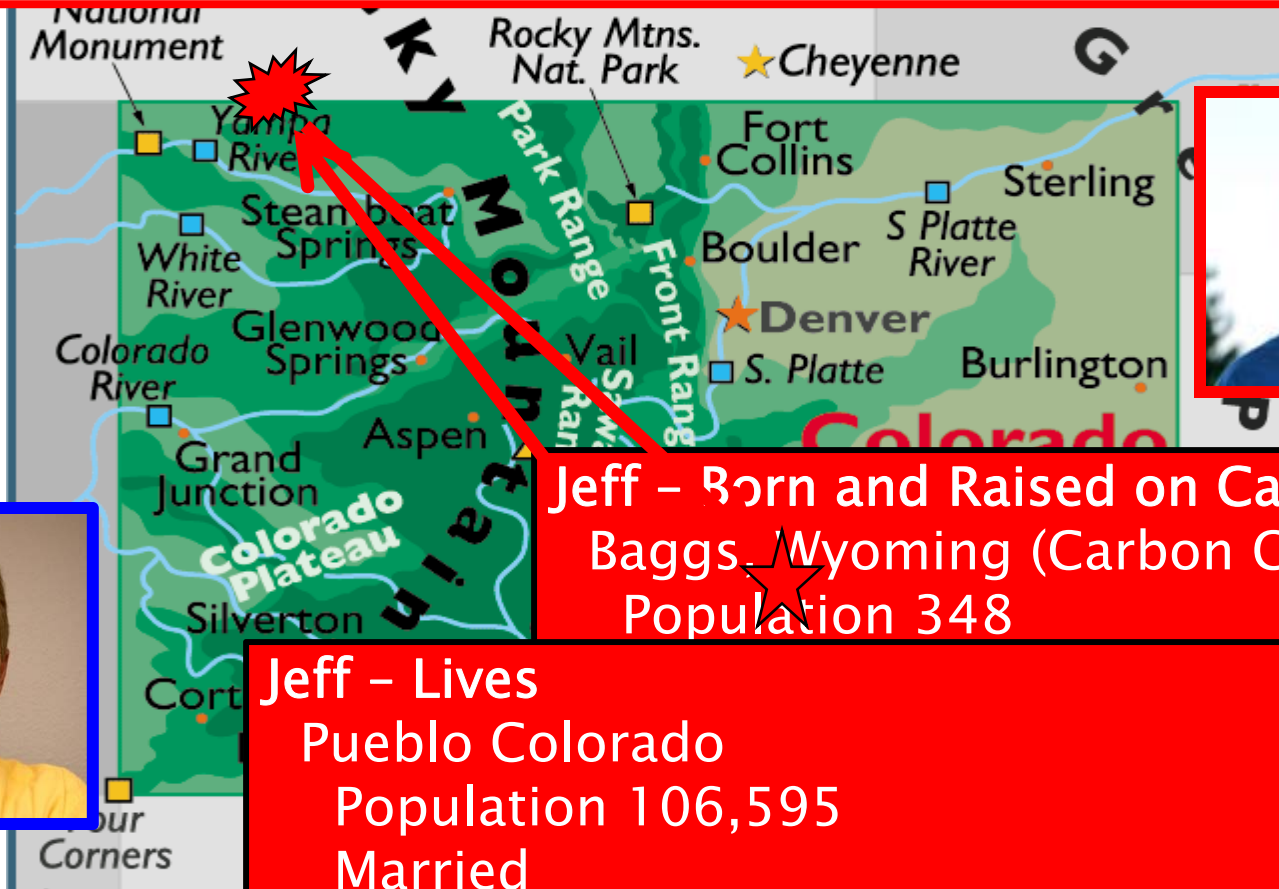
January 27, 2012
Boise, Idaho



Project funded by:
USDA Risk Management Agency

Jeff Tranel

Agriculture and Business Economist at CSU
27 years of experience



Jeff – Born and Raised on Cattle Ranch
Baggs, Wyoming (Carbon County)
Population 348



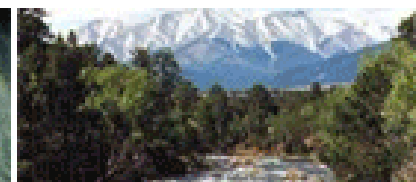
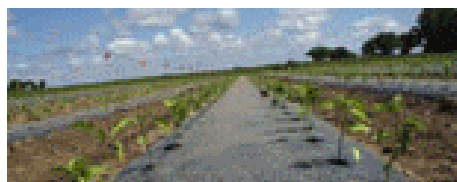
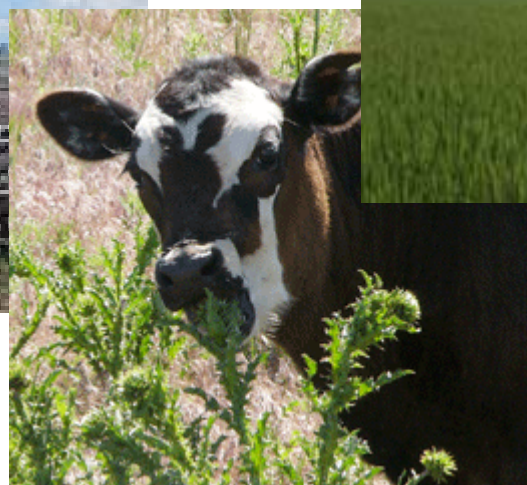
Jeff – Lives
Pueblo Colorado
Population 106,595
Married
2 Grown Sons

Rod Sha

Agriculture & Business Management Economist at CSU
31 years of experience







Agriculture in Southeast Colorado



Rod – Born and Raised on Sheep & Cattle Ranch

Last Chance, Colorado

Sparsely Populated

Crop Sales \$ 71,990,000

(Grains \$67,521,000)

Livestock Sales \$ 58,183,000

(Cattle and Calves \$51,493,000)



Rod – Lives

Grand Junction, Colorado

Population 58,566

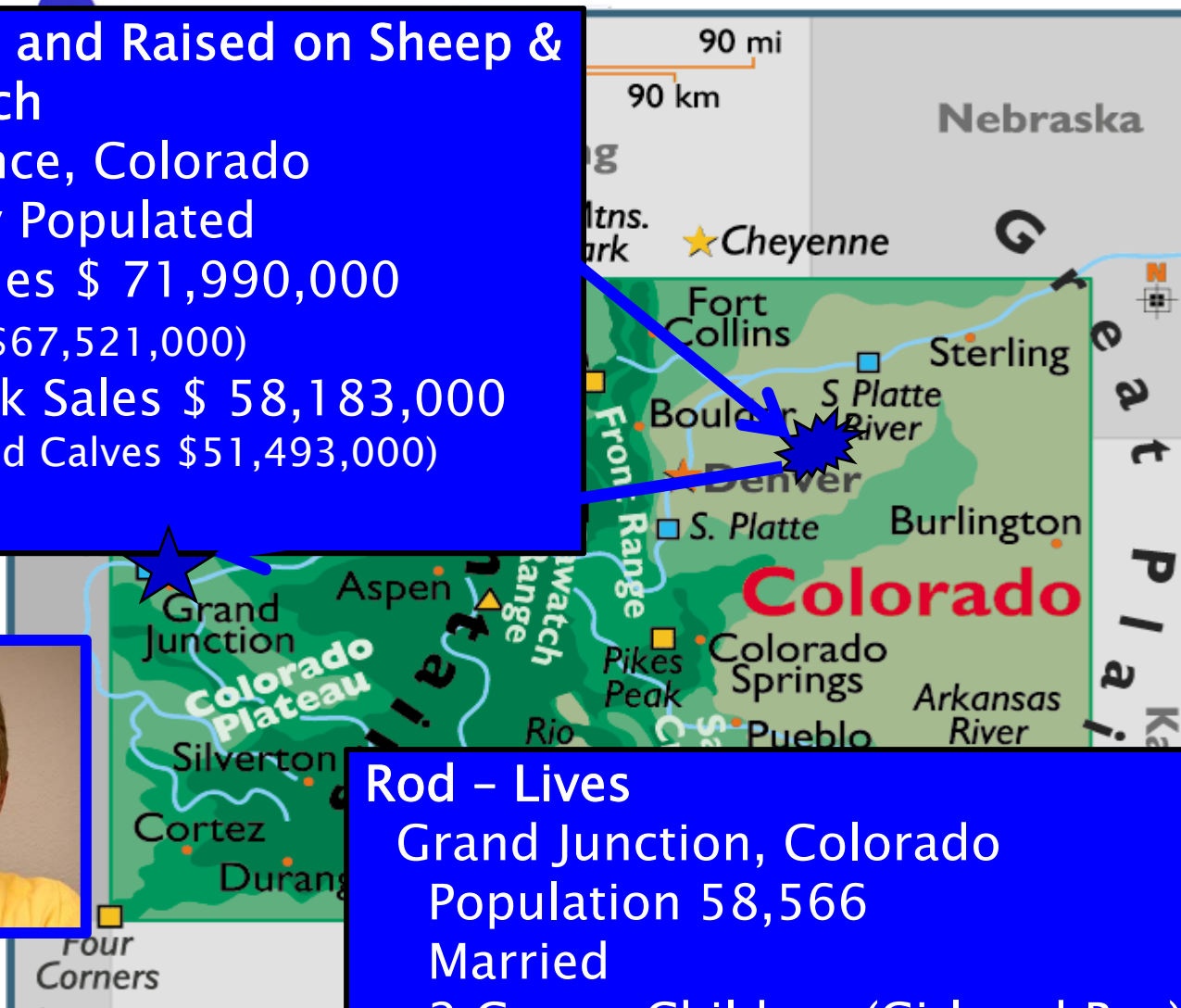
Married

2 Grown Children (Girl and Boy)

Rod Sharp

Agriculture & Business Management Economist at CSU

31 years of experience



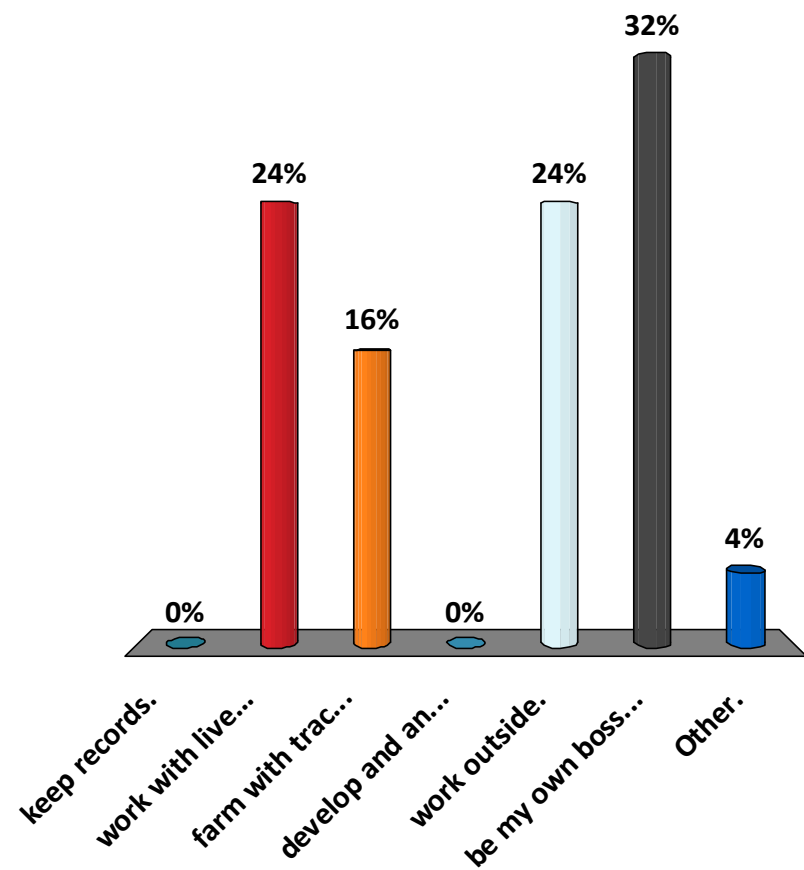


Headwaters of the Colorado River Near Granby



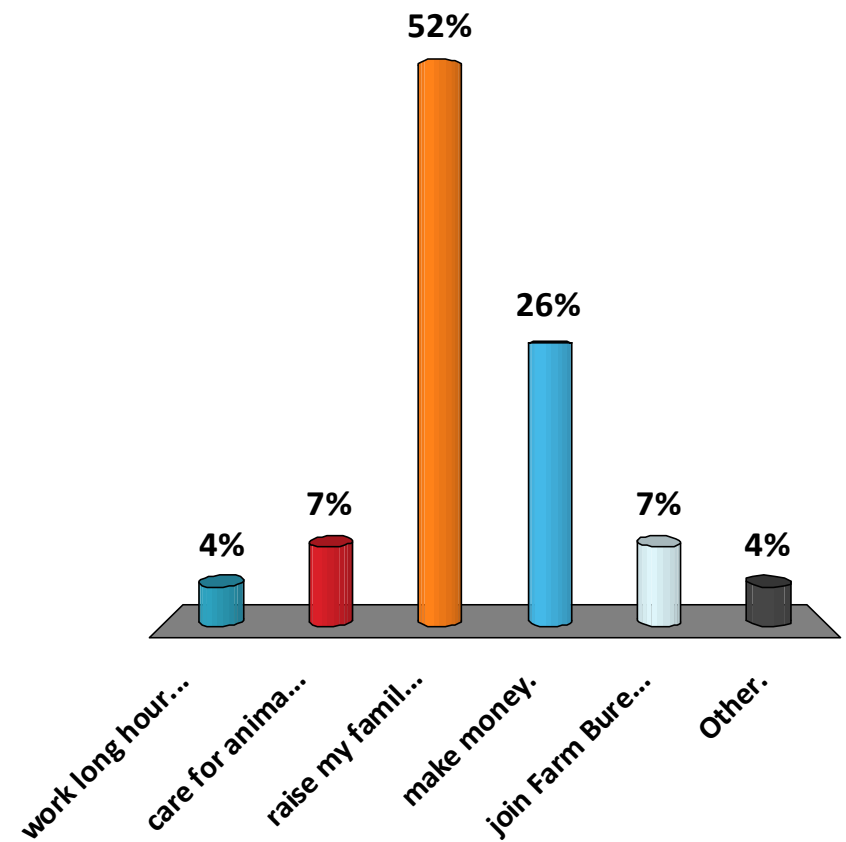
I decided to work in an agricultural business because I love to...

1. keep records.
2. work with livestock.
3. farm with tractors and equipment.
4. develop and analyze financial statements.
5. work outside.
6. be my own boss.
7. Other.



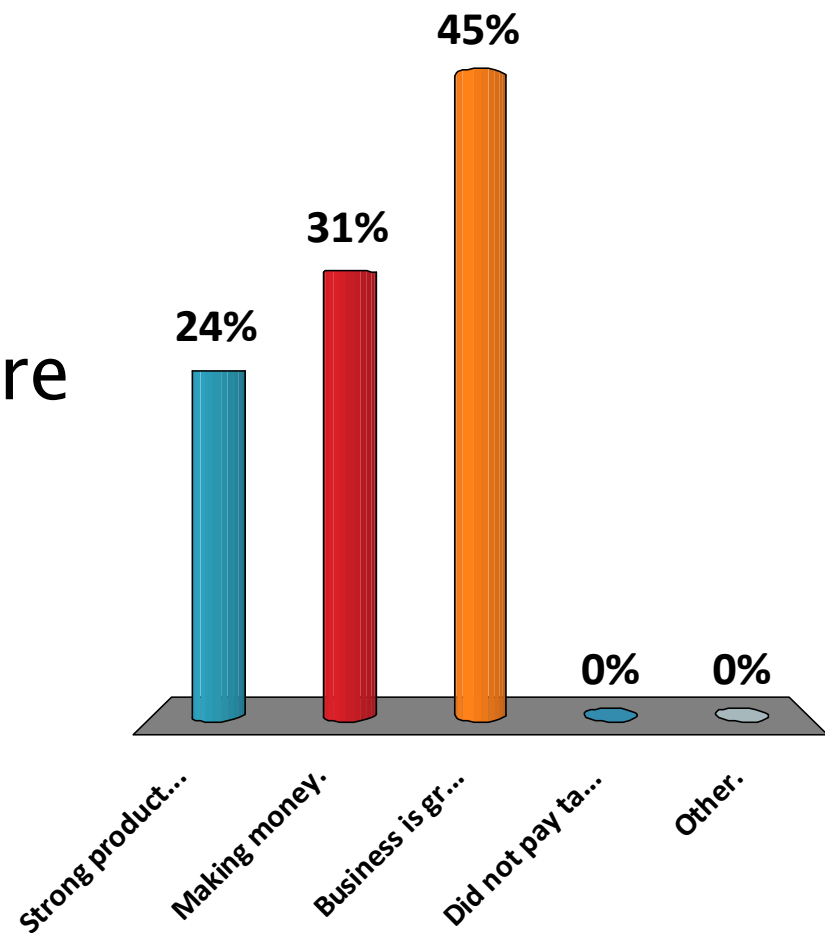
My primary purpose for working in an agricultural business is to...

1. work long hours.
2. care for animals.
3. raise my family in an agricultural lifestyle.
4. make money.
5. join Farm Bureau.
6. Other.



How would you define success in your business?

1. Strong production (high yields, weaning %).
2. Making money.
3. Business is growing (more assets, acres operated).
4. Did not pay taxes.
5. Other.





What is financial planning for success?

The process of **meeting your life goals** through **proper management** of your finances.



Planning Steps to Success

- ▶ Step 1: Where are you?
- ▶ Step 2: Where do you want to go?
- ▶ Step 3: How can you get there?



Where Are You?

- ▶ **First Requirement: Keep good records**
 - Use information to make **management** decisions
 - Use for preparing **financial statements**
 - Use for **tax** preparation
 - Use for acquiring and maintaining **credit**
 - Use for crop and livestock **leases**
 - Use to participate in **government programs**





Getting on Track: *Better Management Through Basic Ag Records*

Basic Record Keeping: 5 Easy Steps

Authors:

Trent Teegerstrom, University of Arizona

John P. Hewlett, University of Wyoming

Rodney L. Sharp, Colorado State University

Jeffrey E. Tranel, Colorado State University

Basic Record Keeping: 5 Easy Steps

Five Steps:

- Step 1: Keep all income and expense receipts
- Step 2: Record business transactions
- Step 3: Transfer entries into Monthly Ledger
- Step 4: Estimate farm profit or loss
- Step 5: Enterprise analysis

Where Are You?

- ▶ **Second Requirement: Use Records to Prepare Financial Statements**
 - Balance Sheet (net worth statement)
 - Cash Flow Statement
 - Income Statement (profit & loss statement)
 - Statement of Owner Equity



Getting on Track:

Better Management through Basic Financial Statements

Authors:

Rodney L. Sharp

John P. Hewlett

Jeffery E. Tranel



Where Are You?

(Are you healthy?)

► Medical Health

- Blood Pressure
- Temperature
- Pulse
- Respiratory Rate

► Financial Health

- Liquidity
- Profitability
- Solvency
- Financial Efficiency



Liquidity

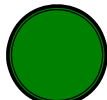
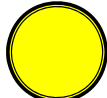
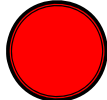
- ▶ Measures the ability to generate sufficient cash inflow to pay your bills as they come due!



Liquidity Measures

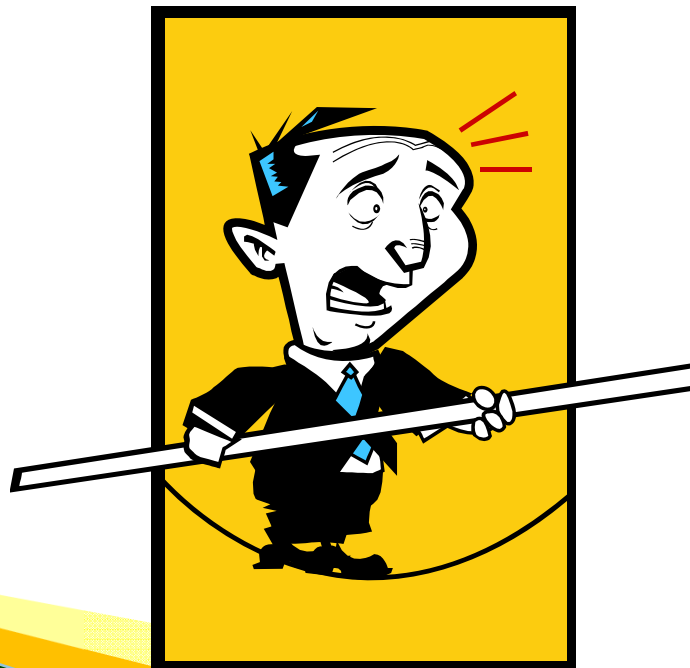
► Current Ratio

Current Assets ÷ Current Liabilities

Resilient		greater than 1.5
Caution		1.0 - 1.5
Risk		less than 1.0

Solvency

- ▶ Measures the **long run** ability to pay all obligations and ability to **withstand adversity!**



Solvency Measures

▶ Debt to Asset Ratio

Total Liabilities ÷ Total Assets

Resilient		less than .35
Caution		.35 to .50
Risk		greater than .50

▶ Equity to Asset Ratio

Total Equity ÷ Total Assets

Resilient		greater than .60
Caution		.50 – .60
Risk		less than .50



IN THE BUSINESS WORLD

PERFORMANCE IS MEASURED
BY THE CHANGE IN NET WORTH



Measuring the change in **Net Worth** is much like balancing a check book

Beginning Cash Balance

+ Inflows

- Outflows

= **Ending** Cash Balance

**These are
Linked**

A large, thick, blue curved arrow that starts near the "Beginning" text and points down towards the "Ending" text, indicating a link between the two.

Beginning Net Worth/Equity
+ Net Income (Profit)

Withdrawals

Beginning Equity

**Profits must exceed
withdrawals!**

~~+/- Change in Valuation~~

= Ending Net Worth/Equity



Profitability

- ▶ Measures the ability of a firm to generate **profits** over a **period of time**!





4 Ways to Increase Profits



1. Maintain the **same** value of production while **lowering** production costs

► Before

► After

Examples: Overfeeding,
renegotiate crop leases,
reduced tillage, alternative
rations

To
Revenue

sed

sed

Expenses

2. **Increase** the value of production while maintaining the **same** production costs

► Before

► After

Increased

Examples: Higher market prices (premium quality), timing of marketing, intensive management (crop yields, weaning %).

To
Rev

3. **Increase** the value of production more than the **increase** in production costs.

► Before

► After

Increased
Profits

Examples: Marketing efforts,
better health maintenance,
improved genetics, forage
testing.

T
Rev

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4. Decrease the value of production less than the decrease in production costs.

► Before

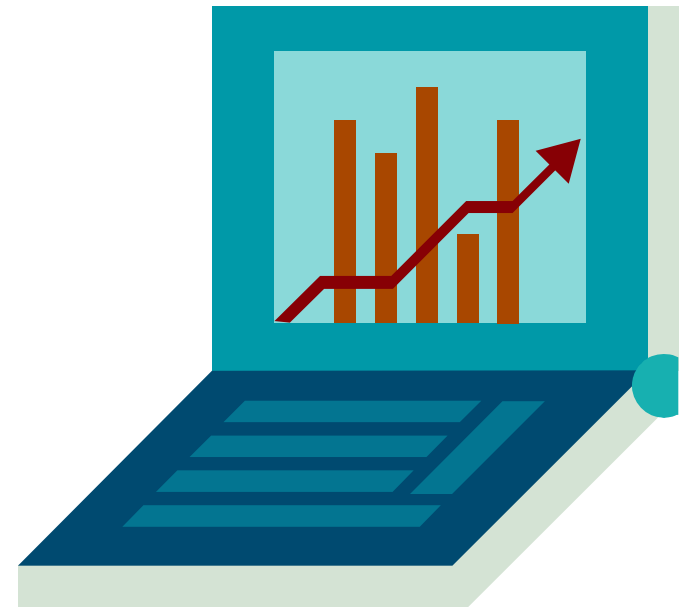
► After

Examples: Smaller cows, reduced tillage, feeding poorer quality feeds, less fertilization.

Expenses

Investment Analysis: Analyze before you invest

- Complicated to analyze
 - Generates returns over a long period of time



Two Things to Consider

1. Economic Profitability of the Investment

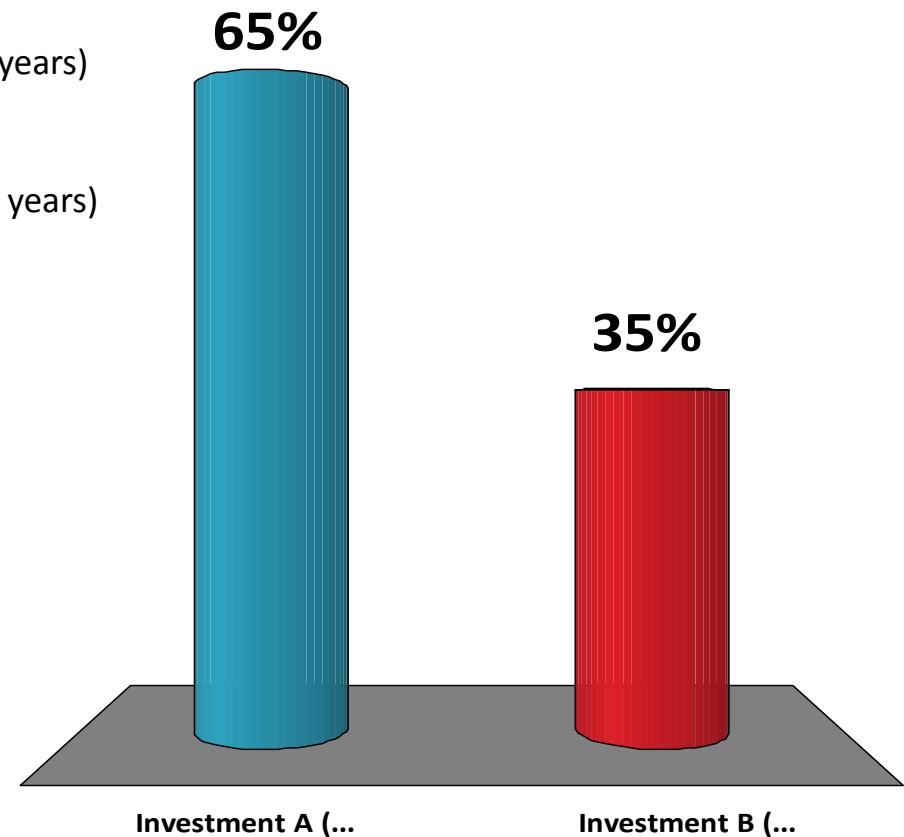
- payback period
- simple rate of return
- net present value

2. Financial Feasibility

Year	Investment A	Investment B
Initial Cost	\$10,000	\$10,000
1	\$2,500	\$4,000
2	\$2,500	\$4,000
3	\$2,500	\$4,000
4	\$2,500	\$0
5	\$2,500	\$0
6	\$2,500	\$0

Which investment would you select?

1. Investment A (\$2,500 for 6 years)
2. Investment B (\$4,000 for 3 years)



Payback Period

Year	Investment A	Investment B
Initial Cost	\$10,000	\$10,000
1	\$2,500	\$4,000
2	\$2,500	\$4,000
3	\$2,500	\$4,000
4	\$2,500	\$0
5	\$2,500	\$0
6	\$2,500	\$0
Total	\$15,000	\$12,000

4.0
Years

2.5
Years

Payback Period

- Widely used
- Has some disadvantages
 - Does not consider the time value of money
 - Difficult to compare to other investment options.

Simple Rate of Return

Investment A:

$$\text{Rate} = \frac{I - D}{O} = \frac{\$2,500 - \$1,667}{\$10,000} = 8.33\%$$

2

\$2,500

\$4,000

Investment B:

$$\text{Rate} = \frac{I - D}{O} = \frac{\$4,000 - \$3,333}{\$10,000} = 6.67\%$$

Total

\$15,000

\$12,000

Simple Rate of Return

- Superior analysis to payback period
 - Analyzes earnings over the entire expected life
 - Can be more easily compared to external criteria
- Still has some disadvantages
 - Numerous methods are used to calculate
 - Does not consider the timing of the capital outlays and benefit stream

Net Present Value - Investment A

Year	Investment A	Discount Factor 5%	Present Value
Initial Cost	\$10,000	1.0000	-\$10,000
1	\$2,500	0.9524	\$2,381
2	\$2,500	0.9070	\$2,267
3	\$2,500	0.8638	\$2,159
4	\$2,500	0.8227	\$2,056
5	\$2,500	0.7835	\$1,959
6	\$2,500	0.7462	\$1,866
Net Present Value			\$2,688

Net Present Value - Investment B

Year	Investment B	Discount Factor 5%	Present Value
Initial Cost	\$10,000	1.0000	\$10,000
Investment A: NPV = \$2,688 Investment B: NPV = \$ 893 Both are acceptable investments Investment A: More Profitable			
6		0.7462	\$0
Net Present Value			\$893



NPV



Net Present Value

- One of the more desirable methods to evaluate investment alternatives
 - Reflects the time value of money
 - Reflects opportunity cost of having funds tied up in the investment

Profitability Measures

- ▶ Rate of Return on Assets
 $(\text{NFIFO} + \text{Interest} - \text{OUL}) \div \text{Avg. Farm Assets}$

Resilient		greater than 5 percent
Caution		1-5 percent
Risk		less than 1 percent
- ▶ Rate of Return on Equity
 $(\text{NFIFO} - \text{OUL}) \div \text{Average Farm Equity}$

Resilient		greater than 10 percent
Caution		5 to 10 percent
Risk		less than 5 percent
- ▶ Net Farm Income

Financial Efficiency

- ▶ Measures whether or not the **physical resources** of the farm business are being utilized and combined in a profitable manner.

Assets
Borrowed Funds
Operating Inputs

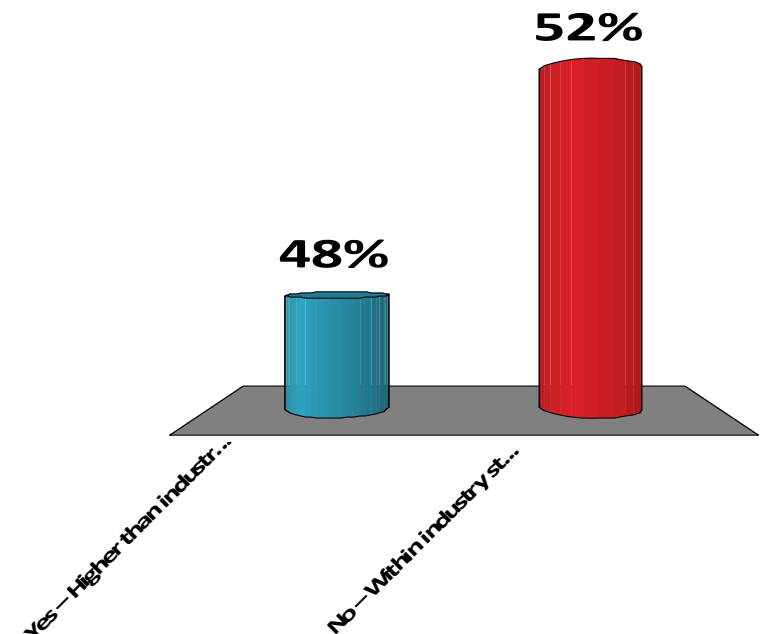
Are Production Costs Too High?...

Total Projected Revenues \$560/cow

Total Projected Cash Costs \$437/cow

Percent of Revenues (\$437/\$560) 78 percent

1. Yes – Higher than industry standards
2. No – Within industry standards



Need to Cut Costs
and/or
Increase Revenues
at least
\$45 per cow

Financial Efficiency Measures

▶ Asset Turnover Ratio

Gross Revenue ÷ Average Farm Assets

Resilient		greater than .25
Caution		.10 to .25
Risk		less than .10

▶ Operating Expense Ratio

Operating Expenses ÷ Gross Revenues

Resilient		less than .70
Caution		.70 to .80
Risk		greater than .80

Financial Efficiency Measures

- ▶ Interest Expense Ratio

Interest Expense ÷ Gross Revenues

Resilient  less than .12

Caution  .12 to .20

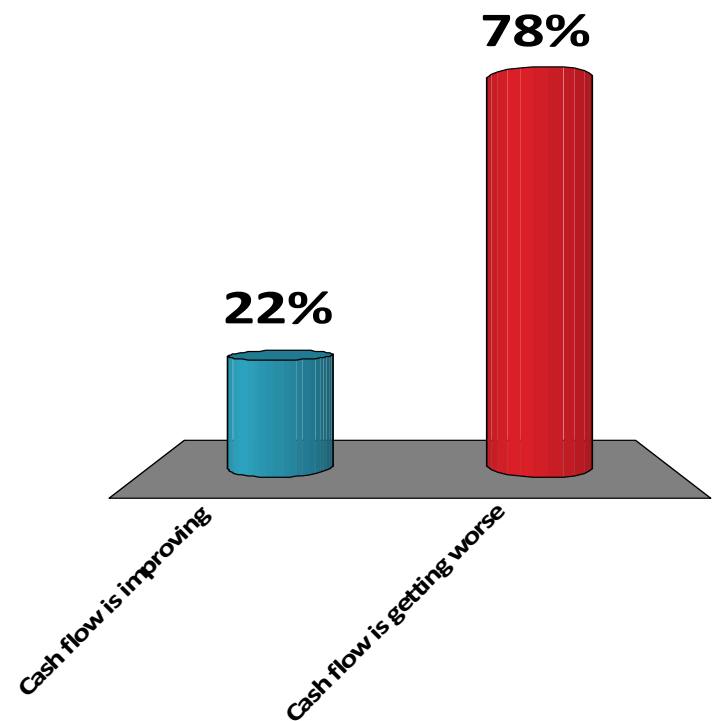
Risk  greater than .20

What does this current ratio trend tell you?

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
5.01	4.69	2.22	2.21

1. Cash flow is improving
2. Cash flow is getting worse

Remember: CA/CL
Resilient: > 1.5
Caution: 1.0-1.5
Risk < 1.0



What does this debt to asset ratio trend tell you?

<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>
0.62	0.41	0.21	0.18

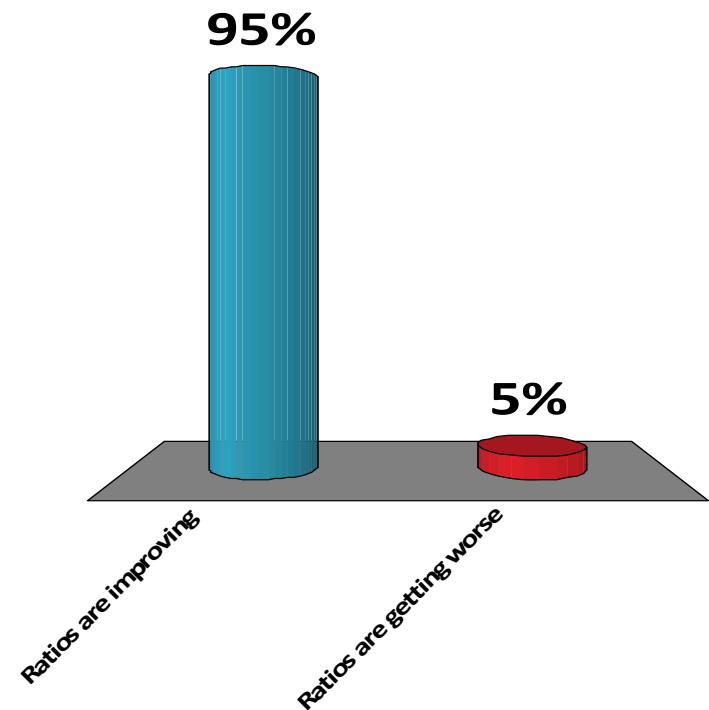
1. Ratios are improving
2. Ratios are getting worse

Remember:

Resilient: < 0.35

Caution: $.35-.5$

Risk > 0.50





Where Do You Want To Go?



Where Do You Want to Go?

First Requirement: Set clear **goals**
(SMART)

Does your family have
a common set of goals?

Relevant

- Time Bound

Where Do You Want to Go?

Advantages of Setting Goals

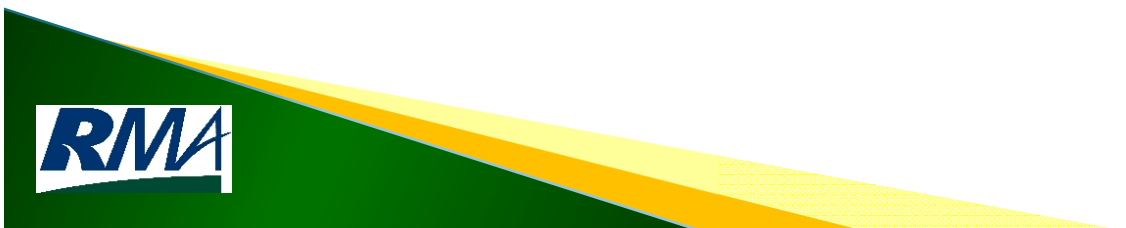
- ▶ Shows where you want to go (provides a road map or **long-term vision**)
- ▶ Gives you **short-term motivation** to get where you want to go
- ▶ Prepares you for the future
- ▶ Gives purpose and direction to your decisions and actions



Where Do You Want to Go?

Disadvantages of Setting Goals

- It takes **time** and **effort**
- It can be a **difficult task**
- It may cause **conflict**
- It may appear to be a **waste of time** to some people



Where Do You Want to Go?

Goals: Some Examples

- Generate net farm income (profit) of at least \$63,000 every year.
- Reduce operating costs or increase revenues by \$50 per acre by 2013.
- Increase weaning percentage by 2 percent this year (without increasing costs).
- Cut family living expenses by \$100 per month.
- Reduce debt by \$40,000 over the next 5 years.
- Save \$4,000 a year for retirement.



Where Do You Want to Go?

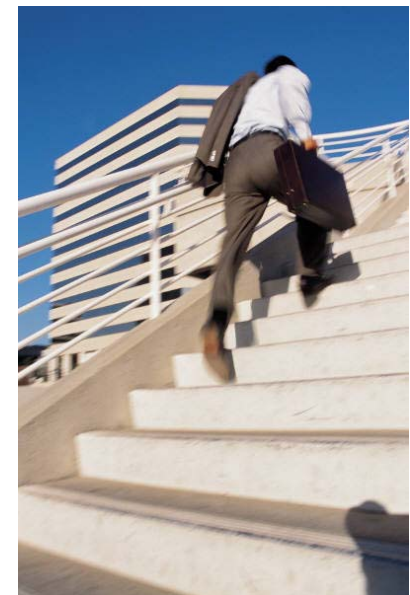
Goal Setting Activity

- ▶ Develop one goal
- ▶ Some guidelines to consider
 - The goal should be yours (all individuals have different goals)
 - Remember SMART: specific, measurable, attainable, realistic and time bound



How Can You Get There?

Requirement: Set clear
objectives (the required steps
to achieve your goals)



For Example: I will increase the profits of my cow/calf enterprise by 10% next year.

- Objectives:

- Increase night supervision to keep more calves alive during calving.
- Use put options to protect against downturns in market prices.
- Reduce feeding costs (cheaper rations, reduce waste, do not overfeed)



How Can I Get There?

Objectives Activity

- ▶ List at least 2 objectives to accomplish your goal
 - Prioritize your activities
 - Identify the resources required to accomplish your objective





Take Home Messages

- ▶ Don't move to Last Chance, CO. or Baggs WY.
- ▶ Keep adequate records.
- ▶ Use records to develop financial statements.
- ▶ Analyze your financial health (at least annually).
- ▶ Business performance is measured by the positive change in net worth.
- ▶ Profits must exceed withdrawals.



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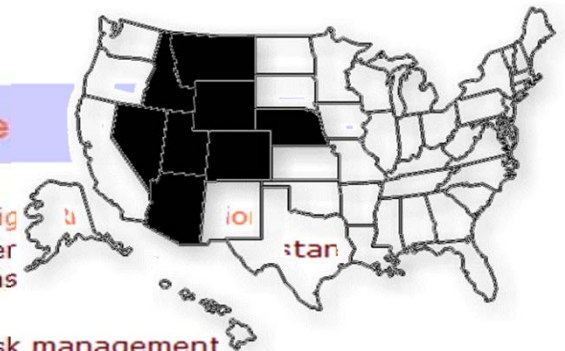
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Ag Survivor does not make decisions for you. Using the simulator, you explore risk management strategies, you build your decision-making skills, and you learn about your personal risk management style.

Ag Survivor uses real world farm/ranch settings and agricultural economics. It allows many kinds of risk and risk management strategies and lets you compare one strategy against another. You use real probabilities and you see the results. With **Ag Survivor**, you can run a simulation as many times as you like to determine if you are doing well or poorly because of luck or bad strategy.

In the end, the knowledge and practice you gain through **Ag Survivor** will help you make better decisions for your farming/ranching operation.

<http://RightRisk.org>



The RightRisk Mission: RightRisk helps decision-makers throughout the world discover innovative and effective risk management solutions.

Send comments or questions to information@rightrisk.org
Site last updated on 09/01/2010

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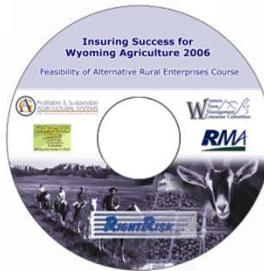
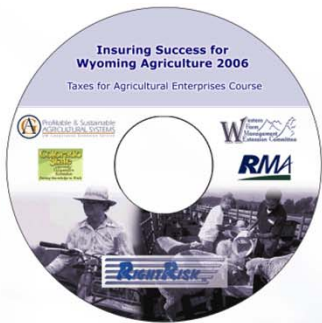
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<http://RightRisk.org>



Risk Management Coaching

Working Together to Manage Risk in Agriculture

- ▶ Risk Management Coach
 - Work privately with workshop participants
 - Allow open communication and collaboration
 - Focus efforts on the goals of the producer





Risk Management Coaching

Working Together to Manage Risk in Agriculture

- ▶ The focus is on “you”.
 - **You** decide what goals to achieve.
 - **You** take actions to achieve your goals.
 - **You** have control over the management process.
 - **You** develop skills to make better management decisions.





Risk Management Coaching

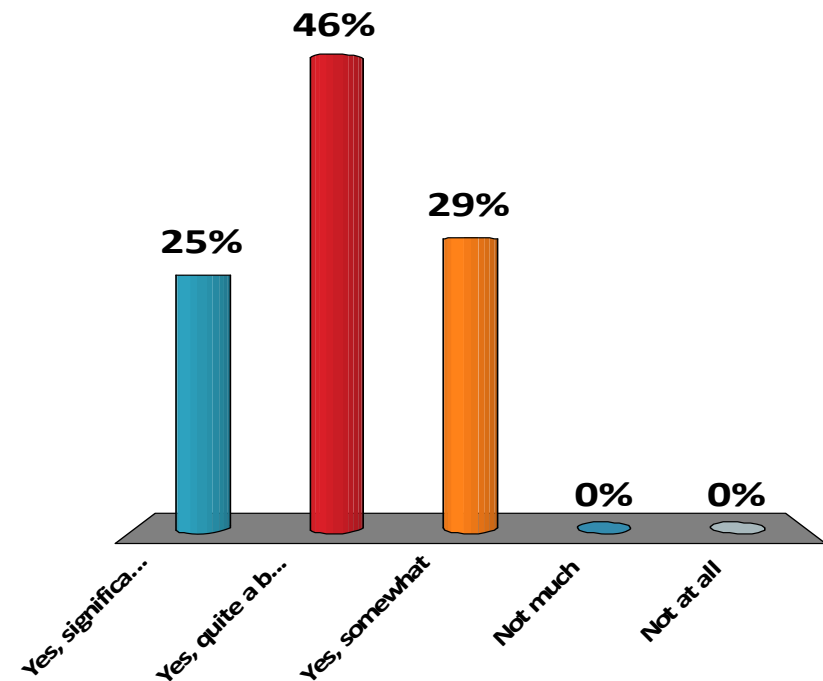
Working Together to Manage Risk in Agriculture

- ▶ Coaching can assist you to:
 - Establish risk management goals and actions to achieve those goals.
 - Focus on solutions and overcoming obstacles.
 - Share and discuss ideas.
 - Develop risk management skills.



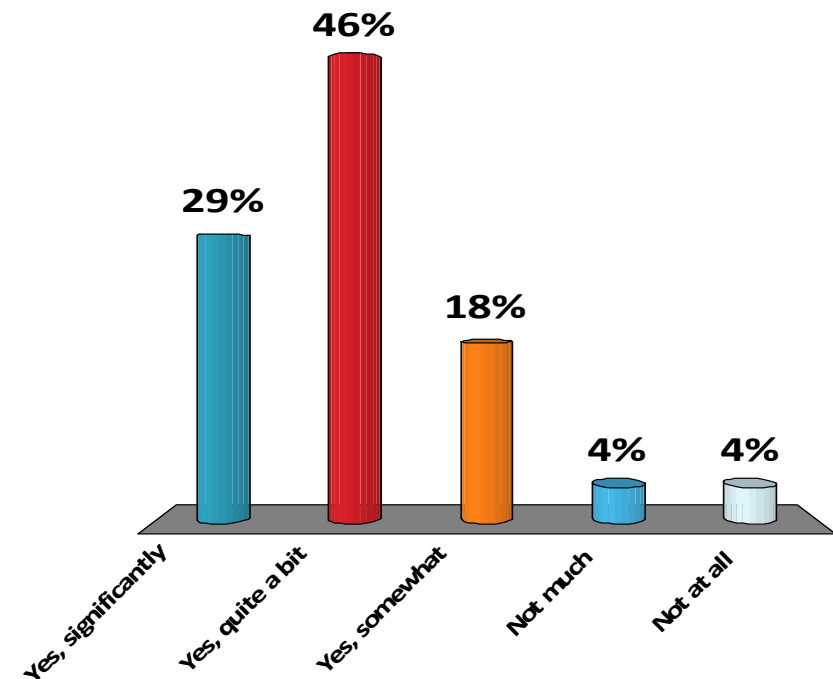
Has your understanding of **setting clear goals and objectives** increased?

1. Yes, significantly
2. Yes, quite a bit
3. Yes, somewhat
4. Not much
5. Not at all



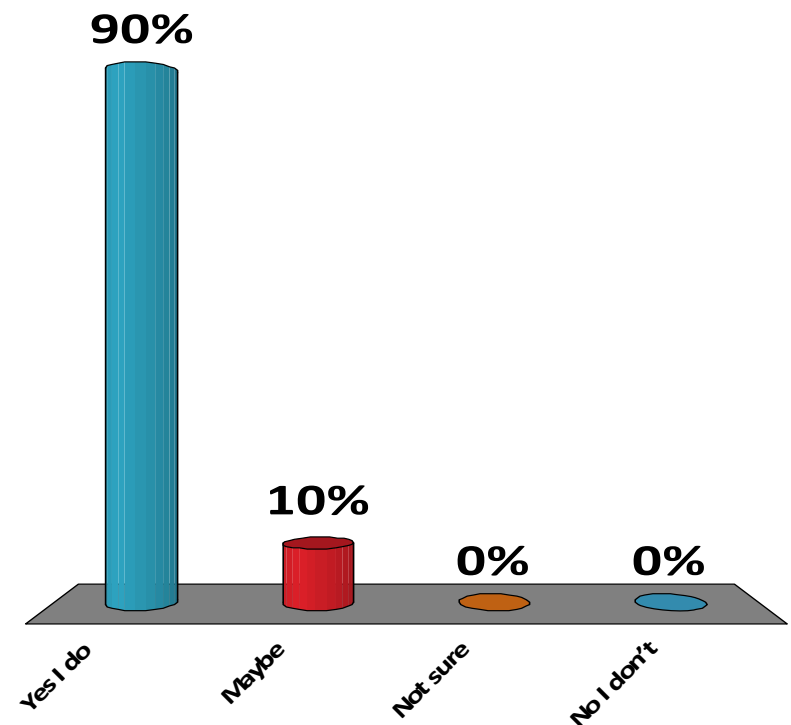
Has your desires to **set clear goals and objectives** for your operation increased?

1. Yes, significantly
2. Yes, quite a bit
3. Yes, somewhat
4. Not much
5. Not at all



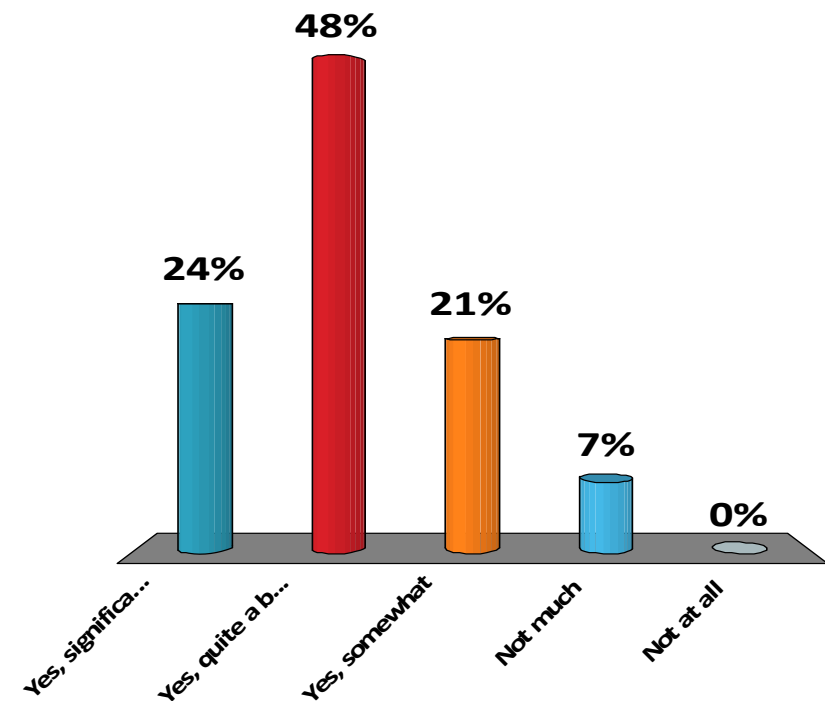
Do you plan to **set new goals and objectives** for your operation?

1. Yes I do
2. Maybe
3. Not sure
4. No I don't



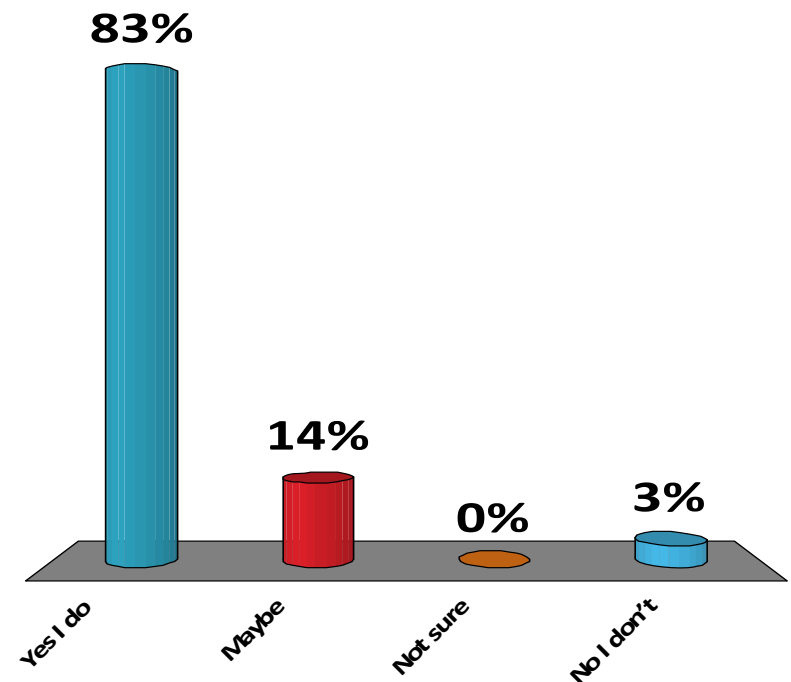
Has your understanding of **financial management and analysis** increased?

1. Yes, significantly
2. Yes, quite a bit
3. Yes, somewhat
4. Not much
5. Not at all



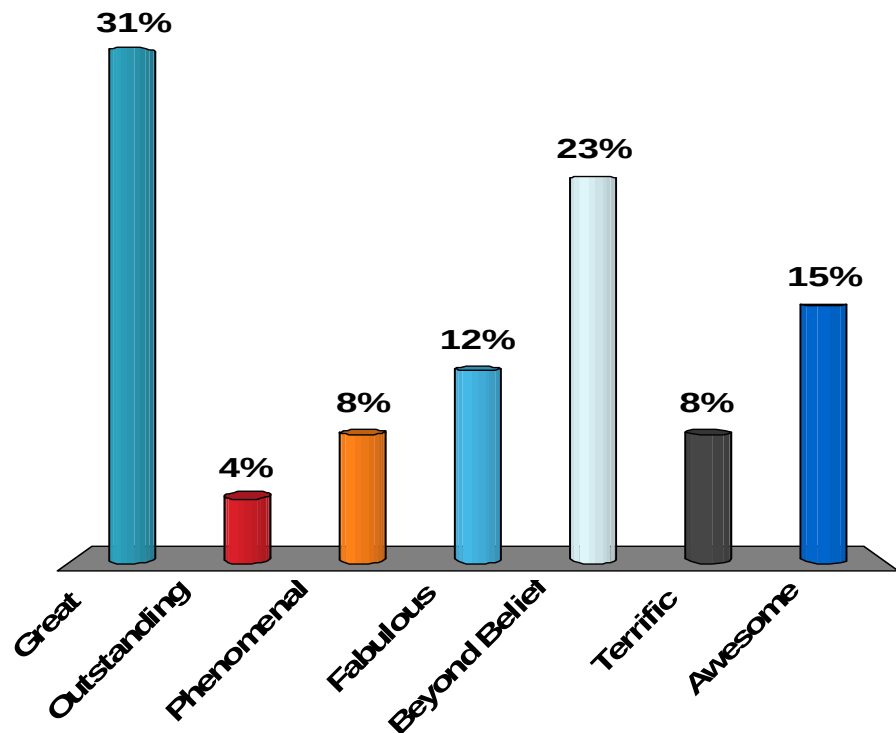
Do you plan to do more **financial analysis** on your operation?

1. Yes I do
2. Maybe
3. Not sure
4. No I don't



Overall, how would you rate the value of this educational opportunity?

1. Great
2. Outstanding
3. Phenomenal
4. Fabulous
5. Beyond Belief
6. Terrific
7. Awesome





Thank You!

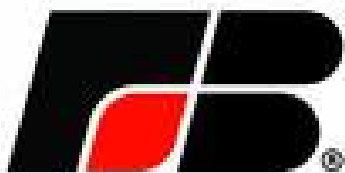
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Speakers

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