

WHERE WILL YOUR EXTRA PROFIT COME FROM?

Promar International National Dairy Consultant Derek Gardner unravels some farm accounts to explore the reasons that successful farms are more profitable.

In any sample of dairy farms, some farms are more profitable than others. Some of this difference is down to the size of the business, some will be due to prices received but most is down to attitude and their approach to business. A detailed look at farm accounts can highlight some interesting differences.

The table compares the performance of businesses recorded using the Promar Farm Business accounts scheme and looks at the average and top 25% of farms selected on profit. It uses an approach called proportional analysis where costs, margins and profits are expressed as a percentage of turnover. This allows a comparison of management while taking out many of the effects of business size.

Promar FBA 2008-9

2008-9	Average	%	Top 25%	%	
Gross Output	490,752	100	701,716	100	Plus £211k
- Variable costs	253,768		314,073		Cost an extra £60k
= Gross Margin	236,984	48.3	387,643	55.2	
- Direct overheads	149,514		211,292		Cost an extra £36k
= Operating Profit	87,470	17.8	176,351	25.1	Extra £115k profit
- Depreciation	25,161		38,247		
- Rent + interest	36,535		50,432		
= PROFIT (from farming only)	25,774	5.3	87,672	12.5	
+ subsidies	37,305		70,178		
= PROFIT	63,079	12.9	157,850	22.5	For reward, tax, reinvestment

While the top 25% farms are bigger, what is more relevant is their cost structure. They produced over £200,000 more output but only spent £60,000 more on variable costs. They retain a gross margin equivalent to 55.2% of their turnover compared to the average performance of 48.3%. This is a reflection of their technical skill.

They are achieving good control of costs combined with good technical performance. They achieve higher milk yields from the same amount of bought feed per cow, they get cows in calf quicker, have a lower herd replacement rate, will be calving heifers nearer to two years old, make good quality forages and use

purchased feed more precisely. Remember these herds were analysed by profit, not their yields or margins, so this is what the more profitable farms actually do.

But gross margin is not profit. The top farms spend more on direct overheads such as labour, electricity, contracting, machinery costs etc but this is in part a function of business size. As a percent of turnover they spend less and achieve an operating profit of 25.1% of turnover. The average farm achieved 17.8%. This reflects their business skill in managing overall costs and an attitude that few costs are actually fixed.

They will challenge how many machines they have and look at reducing machinery costs through more use of contracting or machinery sharing. They will look at getting the best from their staff through training and involvement in the business. They will get quotes on everything, regularly review contracts for electricity etc and benchmark all costs.

One area where they spent a higher percent of turnover was on depreciation, interest and rent. These should be considered as 'risk costs'. This is the cost of borrowing money to fund assets you don't own but is the investment that can drive growth and performance, either through scale or efficiency. The top farms have taken the risk to invest but this has paid off because of their better technical and business management.

Looking at profit from farming activities alone, the top 25% achieve a profit equivalent to 12.5% of turnover which is more than double the average performance of 5.3%. When subsidies are added back in, the average farm makes a profit of 12.9% of turnover, the top 25% make 22.5% of turnover. This is the money available for personal reward, pay tax and fund re-investment.

It is important to focus on the profit before subsidies as the CAP cheque will only be paid for the next two years. For the average farmer it represents £37,000 out of a total profit of £64,000. The challenge is to use the next two years to increase the profit from farming alone, and so minimise the impact of the loss of the subsidy cheque after 2012.

The start point must be to understand business costs better. Where are costs out of proportion with the more profitable farms? Which enterprises or area of performance are lowering gross margin earned or pushing up overhead costs? It might be heifer rearing, or it might be the beef store enterprise, or the arable, but it is probably a lack of profitability in the core business of the dairy herd itself.

Forage production itself is another huge area. Overall forage will represent around 70% of the total diet so improvements to forage quality and quantity can have a huge impact on costs and performance.

It is important to keep your finger on the pulse regarding costs and performance. Keep dairy costings and other recording systems up to date. You need the data regularly, not occasionally. You need to know where every £ is earned, and what the real return is for every £ that is spent.

Once you have a detailed picture of costs and performance, develop a plan to improve performance. What do you want to achieve and how will you achieve it? The plan needs to include meaningful comparisons with other businesses to assess performance and progress.

This analysis shows that many businesses could improve profit by focussing on the areas within their control. Time invested dissecting your accounts will be time well spent.