Measuring Your Business's Financial Performance

Tracking the performance of your business is essential in making good management decisions. Over a number of years, this will show trends on where the business is going and hopefully identify issues before major problems occur. It's difficult to change or fix something effectively if it hasn't been measured.

In addition to comparing your own business's numbers from year to year, there are industry benchmarks and guidelines that can also be used to see how things stack up with similar operations.

Start by completing a net worth statement every year-end. It's important to do this at the same time of year, generally December 31. Completing a net worth statement has the added benefit of gathering much of the information you require for AgriStability, such as crop and livestock inventory, accounts payable, deferred income and receivables and purchased inputs such as fertilizer.

In basic terms, the net worth statement identifies your business assets, debt and equity. It's good to know if you are gaining equity and whether it's earned or from inflation on assets. Once completed, there are several financial management measurements that can be determined. **RatioPlan** can help you complete analysis on your farm business.

Solvency

Solvency is defined as having enough asset value to cover the liabilities of the business. It can be calculated in several ways:

- **Debt ratio = total farm liabilities / total farm assets.** This indicates the number of dollars of debt for every dollar of asset value. Generally, a ratio of less than 0.25 is considered very strong, a 0.25 to 0.40 ratio is satisfactory and more than 0.40 is weak.
- **Equity ratio = total farm equity / total farm assets**. Generally, a ratio of more than 0.75 is considered strong and 0.60 to 0.75 as satisfactory.
- **Leverage ratio = total farm liabilities / total farm equity.** Sometimes referred to as a debt/equity ratio. Usually, a ratio of less than 0.40 is considered strong, with a 0.40 to 1.0 as satisfactory and more than 1.0 considered weak.

Liquidity

Liquidity is defined as having enough current assets to cover current liabilities and can be expressed in several ways:

- **Current ratio = current farm assets / current farm liabilities**. A ratio of more than 1.5 is considered strong, 1.0 to 1.5 is satisfactory and less than 1.0 is weak.
- **Working capital = current farm assets - current farm liabilities**. This calculation shows how many dollars are available to cover current debt owing and what would be left after paying it. It shows what is available to operate the business, so the higher the amount, the stronger the business.

Debt structure

One last management measure is debt structure. It indicates how much of the total business debt is due in the next 12 months and can indicate pending cash flow stress on the business, depending on the number.

- **Debt structure ratio = Current farm liabilities / total farm liabilities**. A ratio of less than 20 per cent is considered strong, 20 to 35 per cent is satisfactory and more than 35 per cent is considered weak. In other words, the more total debt due in the next 12 months is harder on the business, though this also depends on the total amount of debt.

Once completed, this work can be used to file AgriStability. It can also be used to complete management analysis and trend analysis on your business. This process is valuable for identifying potential problems and gives an opportunity for corrective action.

Contact us:

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