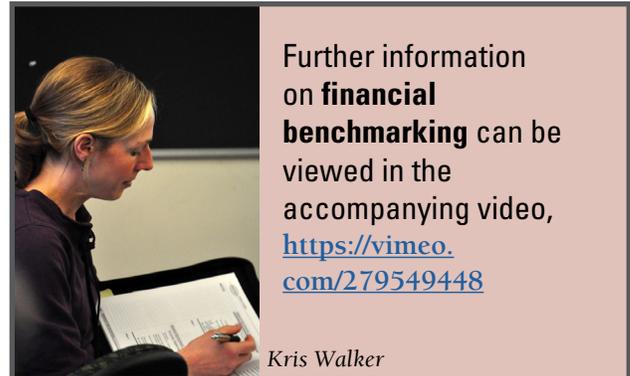

Risk Management Practices: Financial Benchmarking

Benchmarking is a very useful strategy that producers can use to assist in the management of their business. Benchmarking allows producers to compare themselves to others in the industry to see where they excel and where they can improve. It allows producers to share with others, such as lenders, as to how competitive they are in their business. It also helps producers analyze how efficient they are and where improvements can be made that will have the biggest impact on overall profitability. Benchmarking can be an “internal” or “external” process.

Internal benchmarking looks at changes within your business from one accounting period to the next. It could be the annual change in working capital or monthly change in sales. Or it could be weekly change in pigs born or fuel usage per machine or per field operation. You can look at financial data such as profitability, liquidity, current ratios, return on assets, and debt repayment capacity.

External benchmarking compares your operation to others in similar type businesses or in completely different businesses. One might compare the expected return on assets for investing additional capital in your current business or investing in a different business. Some people form benchmarking groups, generally in the same type of industry, but from wide geographical locations, to share data on how well they compete within the group. The idea being that they help each other analyze their data and share ideas on how to improve.

The first step in benchmarking is to find references to use to compare your operation with. There are numerous sources of data, including land grant universities, the United States Department of Agriculture (USDA), as well as private companies. Generally, the private companies are fee based programs. Often larger lenders will also have data that they are willing to share.



Iowa State University Extension and Outreach publishes financial benchmarking information on the Ag Decision Maker website. **Financial Performances Measures for Iowa Farms** (www.extension.iastate.edu/agdm/wholefarm/pdf/c3-55.pdf) is based on data supplied by the Iowa Farm Business Association (www.iowafarmbusiness.org). It includes data on comparing liquidity, solvency, profitability, financial efficiency, asset turnover ratio, and machinery investment. Another publication, **Iowa Farm Costs and Returns** (www.extension.iastate.edu/agdm/wholefarm/pdf/c1-10.pdf), goes into greater detail looking at five years' worth of information. The most recent year's data is sorted by four different sizes based on “gross sales” as well as being ranked in terms of “return to management” based on high, middle, and low returns.

Another example of land grant based benchmark data is the University of Minnesota Center for Farm Financial Management FINBIN website, <https://finbin.umn.edu>. This data set includes information from several Midwestern states on whole farm, crop, and livestock financial records. The site provides whole farm, crop, livestock, or financial reports. There are standard reports or you can custom build a report for your own individualized use. This site also provides multiple years of data to compare performance over time.

Another useful source is the University of Illinois FarmDoc website which features a section on benchmarking <http://farmdoc.illinois.edu/finance/benchmarks.asp>. This site provides a drop down menu with a choice of variables and then generates a pdf file of the results. You can select from categories such as debt-to-asset ratios, net worth trends, net farm income, or more, etc. There is a downloadable spreadsheet to use for comparisons.

Kansas State University also provides benchmark data. The following publication highlights their information and contains a link to a spreadsheet that can be used for benchmarking. www.agmanager.info/sites/default/files/pdf/Farm%20Financial%20Benchmarking%20Tool%20August%202017.pdf. Other recent articles can be found at www.agmanager.info/search?searchkeys=benchmarking.

Large banks and lenders, such as members of the National Farm Credit System, often have large databases that can provide data for benchmarking specific types of farm operations. Lenders may also have access to private data sources that they subscribe to that can be used when working with your lender.

The second step is to compile your data to match the same format. There can be some variance in how formulas for ratios and benchmarks are calculated, but the generally accepted method is based on the Farm Financial Standards Council (www.ffsc.org) handbook that publishes the calculations. Note that most benchmark data is based on accrual accounting. An example of an entry on balance sheets that impacts the ratios is if “deferred income tax liability” is included in the current liability section. This can often have a significant impact on the calculation of the “current ratio” and other ratios.

Compare your data to the benchmark data and look for key areas where you think you can improve. Focus on areas that will have the greatest impact. If an area looks out of the normal range, then drill down to discover the reason. For example, if you have a very low current ratio, compare it to past years. Then look for things that may be the reason. You may have had operating losses and high family living, or you may have had a large inventory of grain that was impacted by dropping prices. On the other hand, you may have had a very profitable year and invested in capital assets such as equipment and grain storage facilities and paid for them in one year.

The next step is to make changes that will improve your situation. If you need to improve your working capital you could take out a loan on the equipment you bought so you keep your cash reserves in line with your needs.

The last step is to go back and evaluate the impact of any changes you have made and determine if there are other areas where you need to focus.

More Information

Farm business analysis using benchmarking, David Kahan, 2010 www.fao.org/uploads/media/4-BenchmarkingInternLores.pdf

AgDM Financial webpage, www.extension.iastate.edu/agdm/wdfinancial.html

Further information on financial benchmarking can be viewed in the accompanying video, <https://vimeo.com/279549448>. Also see the complete series on Risk Management Practices, www.extension.iastate.edu/agdm/wdothet.html.

Prepared by Kelvin Leibold, Farm Management Specialist,
kleibold@iastate.edu, 641-648-4850
www.extension.iastate.edu/agdm

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