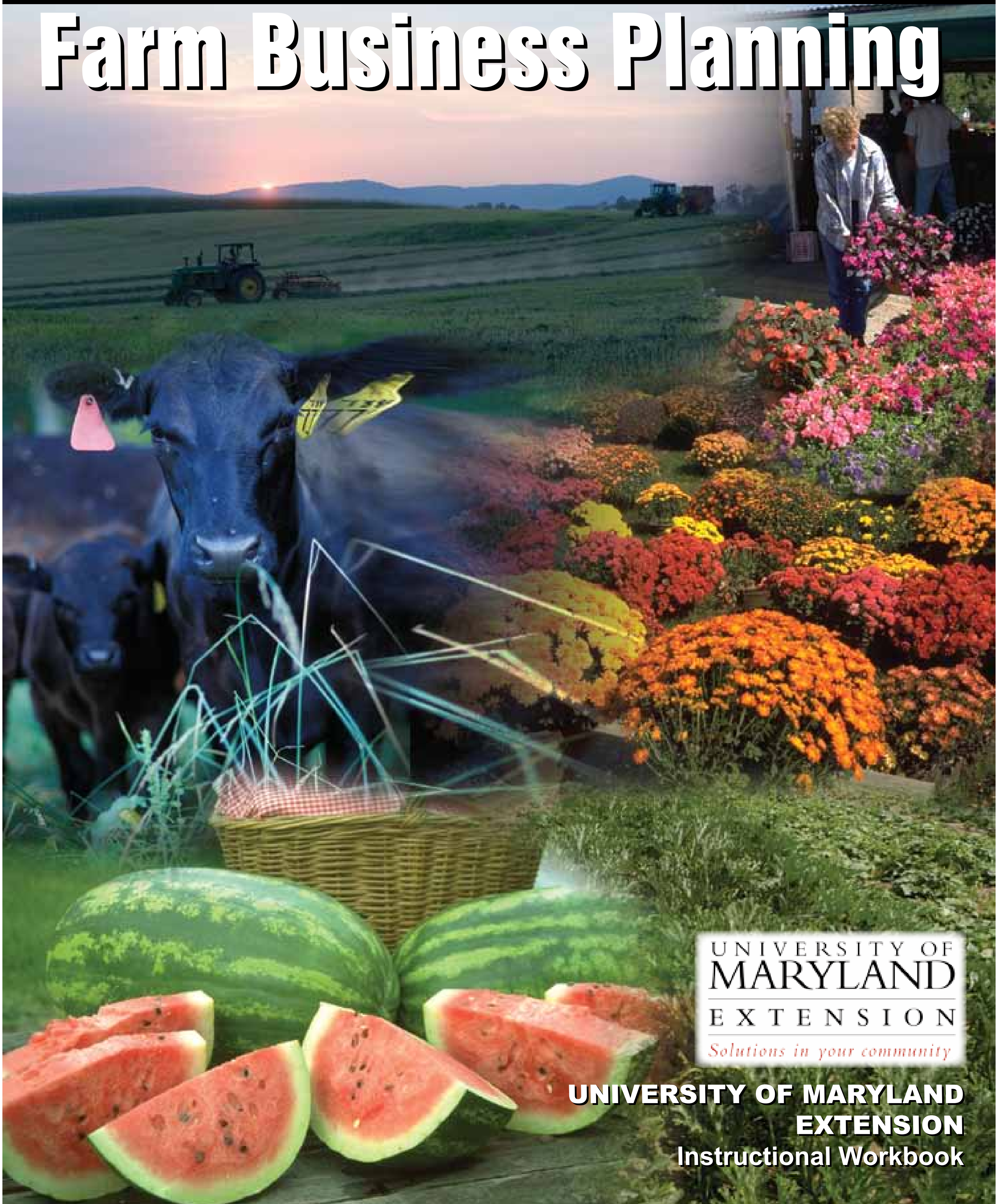
Farm Business Planning



UNIVERSITY OF MARYLAND EXTENSION
Solutions in your community

UNIVERSITY OF MARYLAND EXTENSION
Instructional Workbook

UNIVERSITY OF MARYLAND EXTENSION

Solutions in your community

Farm Business Planning

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FORWARD

Planning is essential to any business, no matter how large or small your inventory, payroll, and bank account. To be successful a farm operation must know its current position and future plans. Having these plans in your thoughts is not enough! Taking time to formulate ideas, evaluate your business, devise a strategy, and anticipate possible problems will help your business be succesful.

This workbook was designed so that thoughts and objectives for your business can be organized and thoroughly documented. In the long run your business plan will serve many purposes, such as:

- Defining a new business
- Setting goals and planning steps to achieve those goals
- Evaluating the effectiveness of business and marketing strategies
- Setting a direction for the business for the next five years
- Planning, growth and development for established businesses
- Supporting a loan application

A good business plan should be realistic, simple, specific, and complete.

- ✓ Is your plan realistic? Are your goals and dates realistic for your farm operation?
- ✓ Is your plan simple? Can you and others read and understand the farm business plan?
- ✓ Is your plan specific? Are your goals and objectives measurable?
- ✓ Is your plan complete? Does your plan include all aspects of your farm business?

HOW TO USE THIS WORKBOOK

Write your plan so that it is easy to read and understand by anyone. The business plan may be used to communicate to partners, employees or others who are directly involved in the business. It may also be read by lenders and financial institutions, that may not be familiar with agricultural terms and production. Make the plan easy for other audiences to understand.

There are various ways to use this workbook. You can develop your business plan simply by filling out the pages in this workbook. If you use this method, you will find that most of the sections are useful in helping you plan your business. However, if there are sections that don't apply to your business then just leave them blank.

You may use this workbook as a guide to developing an electronic version of the business plan. This is a better method if you find that the space allotted is too small or too large. An electronic version is also easier to update. Business planning tools are available at the Maryland Rural Enterprise Development Center www.MREDC.umd.edu. These tools include: a business plan template, spreadsheets, a case study and business assessment tool.

In order to develop a good business plan you will need to gather information to organize it into a concise summary. Some needed information is:

- Personal or Household Budget – what are you family income and expenses.
- Production Timeline – calendar planting and harvesting dates or breeding and sales dates so you have a clear picture for labor, expenses and income decsions.
- Production Records – these are needed for many purposes on the farm so keep very clear and concise production records.
- Financial Records – any financial records you have such as tax records, loan information etc. will be benefical in completing your business plan.
- Contact List – these are friends, family and/or professionals that you trust and value their expertise, advice and opinion. The farming and business community is a very strong network of talented individuals that can help your business succeed.

And remember, the planning process is never complete. Continue to use, review, and analyze the plan as your operation grows and changes. The end of the calendar year is always a great time to pull it out and review.

EXECUTIVE SUMMARY

The Executive Summary is located in the front of the document but is the last task in writing a Business Plan. Write this when the workbook is finished. It is an overall summary of your business goals and objectives and how you plan to meet them in the next five years.

MISSION STATEMENT

A mission statement succinctly defines your business. It describes what you are trying to accomplish and what you value. It explains "who we are, what we do, where we're headed." A mission statement gives you a clear direction for the future and should motivate and compell you. It is the foundation upon which you operate your business.

A good mission statement should clearly answer:

- ✓ Why does your business exist?
- ✓ What purpose does your business serve?
- ✓ Where is your business headed?

Mission statements must reveal more than a motive of profit. A mission should contain values, activities, and identity of the farm. Write your statement in a short paragraph with enough detail to provide clear direction while still being flexible. A mission statement is like a book cover. It provides the reader with a glimpse of what story lies ahead.

Refer to University of Maryland Extension Fact Sheet FS668 for help in writing a mission statement.

GOALS

Businesses must plan for change and growth by setting goals. Effetive goals have five characteristics. They should be specific, measurable, attainable, rewarding and time bound. If goals have these five characteristics we call them SMART goals. If you set SMART goals, you have a better chance of accomplishing them. Your business plan will have short term goals and long term goals. Short term goals are accomplished in less than a year. Long term goals take a year or longer to accomplish. List you long term goals under the mission statement. These are incorporated into other sections of the business plan. Refer to University of Maryland Extension Fact Sheet FS670 for help setting SMART goals.

SMART Goals are:

Specific
Measurable
Attainable
Rewarding
Time Bound

A business's goals can include:

- Production (yields, quality, efficiency)
- Marketing (sales, distribution, percent market share, advertising)
- Financial (profit, net worth, cash flow, cost per unit of output)
- Legal (estate, land preservation)
- Personnel (management, employee retainment, hiring, skills)

MISSION STATEMENT

HINT: *Mission and goal statements can be good marketing strategies for advertising and promotional pieces.*

LONG TERM GOALS

BACKGROUND INFORMATION

Business Name and Address:

____

____

____

Email Address: Website Address:

Telephone:

Business: ____________ Mobile: ____________

Home: ____________ Fax: ____________

Type of Ownership: ☐ Sole Proprietorship ☐ Limited Liability Co.

☐ Partnership ☐ Cooperation ☐ Other ____________

Business Advisors:

Accountant	Attorney
Name:	Name:
Address:	Address:
City, St, Zip:	City, St, Zip:
Phone:	Phone:
Bank	**Insurance Agent**
Name:	Name:
Address:	Address:
City, St, Zip:	City, St, Zip:
Phone:	Phone:
Extension Agent	**Other (crop/livestock advisor etc..)**
Name:	Name:
Address:	Address:
City, St, Zip:	City, St, Zip:
Phone:	Phone:

Who is Involved in the Operation?

Name:	Position:
Name:	Position:
Name:	Position:
Name:	Position:
Name:	Position:

History and Overview of the Business

This is approximately one page on the history of the operation and a summary of current activities. This information is helpful to have in the business plan so that the reader understands the past and present farm operation.

Some questions that should be addressed:

- Where is the operation located?
- How and when did the operation begin?
- How is the farm currently operating?
- What is the general productivity, management, and situation of the farm?
- What are general practices of the operation? (i.e., conservation, environmental, tillage, marketing, risk)

Operation Layout

Provide a brief summary of the operation layout. Aerial photos or maps can be included in the appendix to show location and fields.

History and Overview of the Business

Contracts

This part of the business plan lists the farm and owners' legal and contractual obligations (verbal and/or written). Contracts include mortgages, marketing agreements, land leases, and federal entitlement programs (equipment, land, etc. will be listed with resources). Discuss areas where the farm is in a good position and where improvement can be made. Be as detailed as you can.

Insurance

List any insurance policies on farm, crop, health, life, home, liability, and auto.

Estate Plan/Will

Provide a brief summary of your farm transition plans and how property and assets will be divided. This summary is not intended to take the place of an estate plan. Farms should have a separate and detailed transition and estate plan.

Retirement

What are your retirement options and plans? Take into consideration savings, Medicare, social security, IRA, and others.

Conservation/Environmental

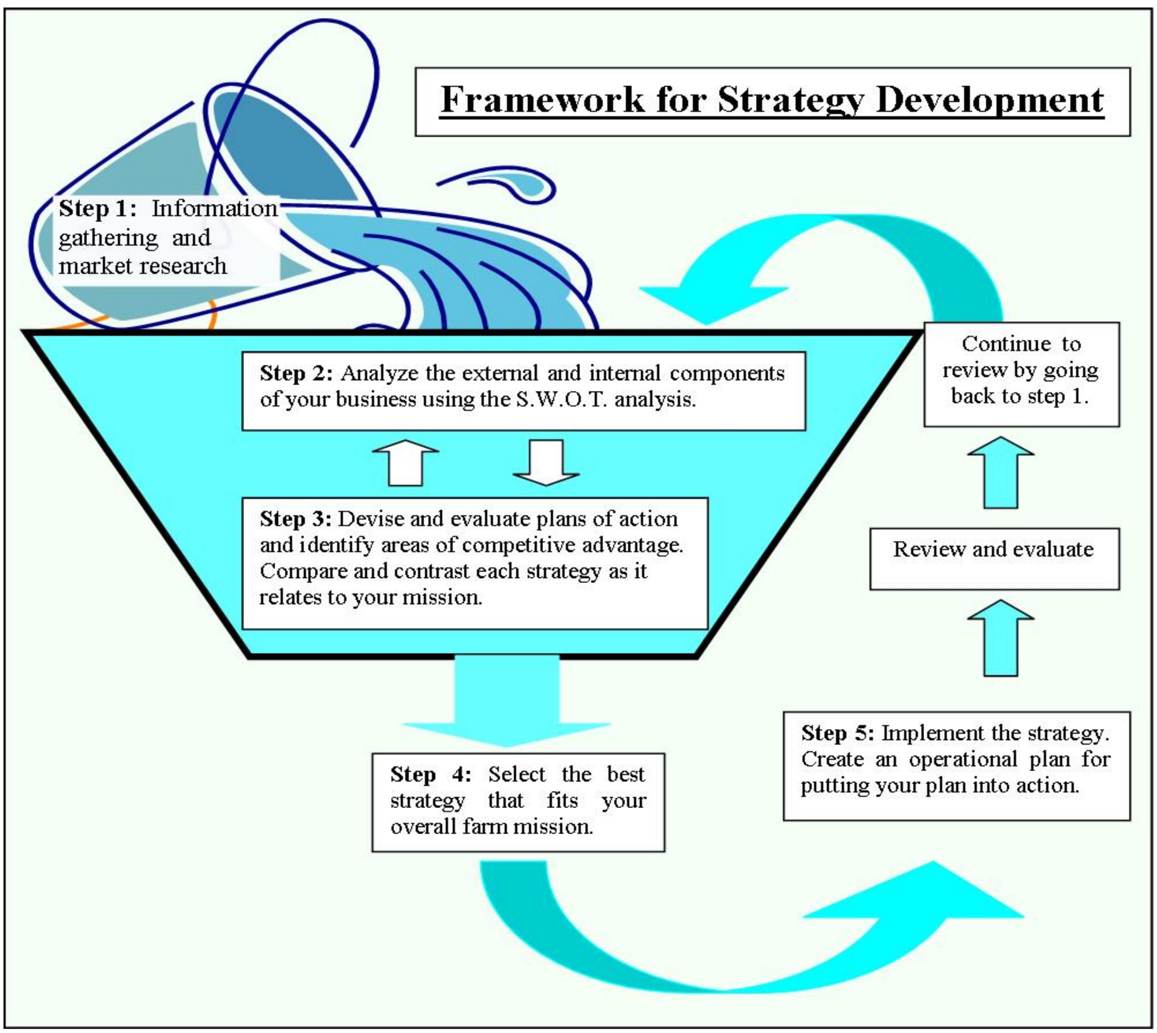
Best Management Practices on the farm for conservation, water quality, and the environment are essential on today's farm. List conservation plans, nutrient management, and tillage practices. These can be included in the appendix.

FORMULATE A FARM STRATEGY

Developing an overall farm strategy is an important component of business development. This strategy includes a number of steps focused on market segments, attributes of those segments, and forming a strategy around the needs of each segment. Formulating a strategy is an ongoing process of discovery and creativity. Strategy formulation is not easy, but it doesn't have to be hard either.

Developing a strategy is a series of steps:

Step 1: Gathering information and market research.
Step 2: Analyzing the external and internal components of your business using the S.W.O.T. analysis.
Step 3: Creating plans of action and identifying areas of competitive advantage.
Step 4: Selecting the best plan that fits your overall farm mission.
Step 5: Implementing and evaluating the strategy.



Step 1: Information gathering and market research

Some small farmers already know exactly what it is they want to do, how they are going to do it, and why they want to do it. However, many farmers never take the time to consider what the *customer* wants, why the *customer* wants it or how the *customer* wants it. Many of these same farms never consider why their products or services would be sought after more than their competitors. The notion of creating and maintaining a "competitive advantage" is a key component of the strategy formulation. It is no surprise then that the first component of strategy building is information gathering and market research.

Market Research—Research your current and potential markets to identify trends, competitors, needs, and buyers. Be sure to take time to collect data. Obtaining good data serves as the foundation for the formulation of an effective strategy. The better the information, the better your strategic plan will be.

Never rely only on your opinion of what the market wants. There are a number of tools that you should consider using for your research:

- *Networking:* A one-on-one interview can also be helpful for generating ideas. Do not forget to interview other business owners or operators who may be able to provide good information on what has or has not worked for them. Be sure to talk with similar farms and producers. Attending tradeshows, conferences, and business functions may provide an opportunity to meet, talk, and network about market trends. Sales representatives are also good sources of information.

- *Demographics:* Information about the consumer in your area can be very helpful in marketing to them. The U.S. Census is a great place to find this information.

- *Observation:* Simply taking time to observe can be a powerful tool. What are people buying? What are competitors offering?

- *Surveys:* Surveys can be written or oral. A written survey can be distributed to a wide range of the population. Consider using an incentive to increase survey response rate, such as free products or coupons.

- *Focus Groups:* A small group of potential consumers who are asked specific questions about the product/service.

List what type of market research tools you plan to use:

List results of market research. Because markets change, include the source and date of information.

Industry Trends and Analysis: In the space below, identify the major trends in the industry. Start with a broad overview, and then get more specific to identify trends that are significant to your product or service.

HINT: Trade journals, census information, government studies, traffic surveys, and professional data sources can be helpful.

List key industry trends here:

Step 2: S.W.O.T. analysis

The S.W.O.T. analysis is an analytical tool used to collect information and guide the decision making process in order to obtain strategic advantages.

S.W.O.T. is an acronym for:

- **S**trengths
- **W**eaknesses
- **O**pportunities
- **T**hreats

Strengths and Weaknesses—Evaluation of the Internal Environment

The internal analysis identifies the strengths and weaknesses of your business. The strengths and weaknesses section is internal to the organization and provides insight into what components are available to provide for competitive advantages. When developing a strategic plan, the competitive advantages will be a key determinant of profitability.

Identifying weaknesses allows the organization to develop methods for improvement, and set priorities based upon future organizational direction. Examples of weaknesses include: *internal operating problems, inexperience, lack of infrastructure, low worker productivity, old or obsolete technology, worn equipment and facilities, poor financial situation, bad community reputation, or inadequate leadership capacity.*

The factors above may also be sources of strengths to the organization. For example: *excellent operating efficiency, high worker productivity, leading edge technology, good financial standing, high industry reputation, excellent brand image, and effective leadership capacity.*

The internal strengths and weaknesses allow the organization to acknowledge the factors it may need to build upon or exploit to gain a competitive edge in the external environment. Be open and honest with yourself about your operation.

Areas for exploration include:

- Financial Resources
- Management Capability
- Infrastructure
- Land Capacity
- Location

List the internal strengths of the farm business.

List the internal weaknesses of the farm business.

HINT: Ask for Advice - Have you ever looked at a neighbor and wondered why they purchased piece of equipment or made a particularly poor decision. Why didn't someone advise them? It can be beneficial to have a third party view of your operation to assess your strengths and weaknesses. Sometimes the most obvious strengths or weaknesses are not recognized by farmers due to denial, modesty, or some other reason. Finding someone you can trust to give you an honest evaluation can be critical to an accurate assessment.

Opportunities and Threats—Evaluation of the External Environment

This part of the S.W.O.T. analysis focuses upon the external opportunities and threats that exist. This section of the S.W.O.T. analysis allows the organization to identify strategies that take advantage of opportunities for growth while avoiding potential threats.

Opportunities and threats are external to the organization and thus cannot be changed by the organization. Rather the organization must change with and react to the changing external factors.

Examples of opportunities and threats include *new markets, expanding markets, government regulations or incentives, new technology, increasing competition, lower or higher barriers to entry, or economic conditions.*

HINT: Be sure to research your state, county and town regulations on building construction, signage, animal numbers, processing and other laws that may affect the production or sales of your goods and services. This will be an important step in starting your business and reaching your goals. Calls to your County Extension Office, Zoning Office and Health Department should be made.

A major focus of the external analysis is an evaluation of the competition. Chronicle all businesses competing in a similar area (product area and geographic area) as yours. List - who their main customers are, market share, product offerings, pricing objectives, and their perceived marketing strategy.

Competitor #1
Name and Location of Company:
Product and Price Offerings:
Promotional Activities:
Competitive Advantages:
% Market Share:

Competitor #2
Name and Location of Company:
Product and Price Offerings:
Promotional Activities:
Competitive Advantages:
% Market Share:

Competitor #3
Name and Location of Company:
Product and Price Offerings:
Promotional Activities:
Competitive Advantages:
% Market Share:

Competitor #4
Name and Location of Company:
Product and Price Offerings:
Promotional Activities:
Competitive Advantages:
% Market Share:

List the external opportunities of the farm business.

List the external threats of the farm business.

S.W.O.T. Analysis

Use this chart to summarize your S.W.O.T. Analysis.

Internal Strengths:	**Internal Weaknesses:**
1. ______	1. ______
2. ______	2. ______
3. ______	3. ______
4. ______	4. ______
5. ______	5. ______
6. ______	6. ______
7. ______	7. ______
8. ______	8. ______
9. ______	9. ______
10. ______	10. ______
External Opportunities:	**External Threats:**
1. ______	1. ______
2. ______	2. ______
3. ______	3. ______
4. ______	4. ______
5. ______	5. ______
6. ______	6. ______
7. ______	7. ______
8. ______	8. ______
9. ______	9. ______
10. ______	10. ______

Step 3: Creating plans of action and identifying areas of competitive advantage

At this point, you have collected information and identified external opportunities and internal strengths. Now is the time to bring these two together and develop alternate plans that will capitalize on your farm business's strengths and opportunities, and mitigate weaknesses and threats.

As you think through the strategic planning process, do not try to come up with the ultimate best strategy for your operation right from the start. You will need to consider all of the possible strategies you could employ based on the findings from the information discovery and S.W.O.T. analysis. Compare and contrast the competitive advantages each strategy may offer and select the best after you review all of the areas of competitive advantage. This should be an ongoing, creative process. If you find this phase difficult, break apart the process and start with information discovery first, followed by focusing on the marketing strategy phase.

HINT: Plans of action include specific areas that utilize your strengths with competitive advantages such as efficiency, market access, and market penetration.

Things to think about when developing a plan of action:

Businesses will create competitive strategies to set themselves apart from others in the market. Types of competitive strategies can include least-cost and differentiation.

Least-cost strategy focuses primarily on the price or cost of the product. Being the least expensive in the market gains the product competitive advantage. This strategy is known for cutting input costs and often the product is a "no frills" product. This type of strategy is normally focused on efficiency of operations. Most commodity-based industries such as the grain industry utilize a best or least-cost strategy.

Generally small farms lack economies of scale and will not want to compete in a commodity market based solely on price. Instead, you will want to compete based on some unique or differing attribute that offers the customer perceived value.

A differentiation strategy distinguishes the differences of a product to make it more desirable to a specific market. The strategy focuses on goods and services needed to satisfy the customer where the value outweighs the increased cost. A differentiation strategy also sets your product apart from the competition, creating a competitive advantage by offering a unique or different product or service that other companies either cannot or will not offer.

For small farm enterprises, especially those with specialty crops, the differentiation strategy is most popular.

The questions below will provide some tips for outlining a differentiation strategy including your product, attributes, and pricing:

1) What is unique or different about your farm business (products and/or services)? Unique attributes may include: production methods, packaging, location, availability etc. What is the competitive advantage garnered from your strategy?

2) The product/service attributes should be unique enough that other competitors cannot easily copy it, but adequate enough to capture a sustainable market share.

List why your product or service will not be easily copied and why your customers will buy from you:

HINT: Think about consumer benefits, market research, and competition. What do your consumers want in the product and what are they willing to pay?

List the various strategies that you could implement on your farm

Step 4: Selecting the best plan that fits your overall farm mission

It is now time to review the previous steps 1-3 and select the plan that best fits your overall farm business. Keep in mind your business's strengths and weaknesses as well as external opportunities and threats. Once all of the possibilities have been laid out and the best strategy chosen, be sure it fits with your farm mission and objectives. Can you see yourself doing this in 5-10 years?

The overall strategy is derived from component strategies including marketing strategy, production/operational strategy, financial strategy, and management strategy. Be sure to include the main components of marketing, production, finances, management, and your key competitive advantage points.

HINT: *At this point in your plan you may want to wait and complete this task after analyzing the marketing and financial sections.*

My Overall Farm Strategy:
This is a short and concise summary of your strategy stated in 3 or 4 sentences.

Step 5: Implementing and evaluating the strategy

An Implementation Plan is very important. This is how you will "get it done." The section following the Management Plan focuses on how to implement your strategy.

Be sure to **review and evaluate** your plan periodically. Demographics, markets, competitors and SWOT may all change over time. As you update your plan, you will also want to update your farm strategy.

MARKETING STRATEGY AND PLAN

Marketing products and services is essential to farm profitability and viability, yet many farms lack a specific, organized plan. A producer should have a detailed plan describing how he/she will market commodities, services, and/or attractions.

Now that you have formulated an overall farm strategy, much of your marketing homework is complete. You understand what customer's value and why they would buy your product. The marketing plan will describe in detail how you will create and convey value to the customer. The four areas where consumers derive value are the product, the price, the placement, and the promotion. These are considered the 4 P's of marketing and should be components of your marketing plan.

It is important to recognize that the marketing plan is much more than just the advertisement of your product, it is the entire plan of how you will convey value, both real and perceived, to the customer. The advertisement piece of the plan fits in the promotion section.

When developing a marketing strategy think about ALL possible alternatives. Be creative.

Target Market—It is important to understand who is purchasing your products so that your marketing efforts will reach that segment. You cannot be everything to everyone. In order to effectively market, you need to cater your product and services to the set of customers who will see value in the product you are offering. *Who are you marketing to?*

Your target market identifies who is mostly likely to purchase your product therefore allowing you to appropriately market that product to them. Understanding your target consumer will make your marketing efforts more effective.

A target market can be developed by:
- Demographics—age, gender, family size, education, occupation
- Geographic—location, city, urban, rural
- Psychographic—behavioral patterns, lifestyle similarities, common interests, beliefs, and hobbies

Refer to University of Maryland Extension Factsheet FS846 for more information on marketing and the UME Ag Marketing website at www.agmarketing.umd.edu

Marketing Situation

We covered market research in the "Developing a Strategy" section. Use that information in your marketing plan and to develop a specific target market.

Who are your target market(s)?

How can you reach these target markets?

Marketing Objectives

An important part of the marketing plan is your marketing objectives. This is where you record your short and long-term marketing goals. Objectives can include: new product lines, market expansion, sales goals, customer base and promotional efforts. These may change with time and market trends. As with your business goals, be sure to keep them SMART.

Components of a Marketing Plan

This section of the marketing plan addresses the 4 P's of marketing.

Product— *What sets your product apart from others? What are the product's main attributes? What are you really selling?* This includes anything that has to do with the product or service including production, packaging, and quality. It is a detailed listing of the features and benefits that your product offers a consumer. Sizing, slogan, and logos are other considerations for your product.

Price— *How much value does your product offer? How are you going to make pricing decisions?* The price of a product is an important factor in your marketing plan. Find a price that will satisfy both you and your buyer. The starting point is to determine your cost of production and break-even price using an enterprise budget that includes a return to labor and management. This establishes the lowest price you can charge and still cover your costs. You will then choose one of three pricing strategies that take into account your cost structure and you competitor's strategies.

- <u>Low price</u> – This strategy is used by low cost, high volume producers who can compete directly with other producers on price. Most small businesses do not have the economies of scale or the volume of production to use this strategy.
- <u>High price</u> – The strategy is used by producers who have higher quality products and services in comparison to other producers. Customers want your product because it is the best and are willing to pay a higher price. This strategy is used when a producer has a niche market. You are the only one that is producing a product that customers want and so you can charge a high price. Examples of this are ethic/heirloom vegetables or early/late season vegetables or organic vegetables that your competitors do not have. This strategy is also used when you have added value or your products are somewhat different than your competitors. Examples of this are products that are processed or packaged to provide extra value. The price differential between your product and the standard product should not be so great as to outweigh the value of the difference. This is a common pitfall for small farmers and should be carefully tested with focus groups and sampling offerings as part of the marketing plan.
- <u>At-the-Market</u> – This is the most common pricing strategy. Undercutting your competition would just lower your profit because you decrease your profit margin and you do not have the quantity to make up for it. Your product quality is not noticeably higher than your competition so customers will not pay a higher price. So you charge the same price as your competition and try to improve profit through "Place" and/or "Promotion" strategies.

Place— *Where will you sell your product? Where does your target market shop?* This focuses on where your product is being sold and how it is distributed. Small farmers selling directly to the customer capitalize on this marketing point. Also remember that consumer's value convenience, which means time can be an important component of the distribution theme. Logistical issues should be addressed such as transportation, warehousing, direct selling, wholesaling, storage, and inventory management. The distribution avenues have changed incredibly in the last decade due to the local food movement and Internet sales. Selling via the Internet and delivering to the customer's door in another state, region, or country is much easier than ever before.

Promotion— *Where is the best value for your promotional money and efforts and how will you determine if they are working?* This connects your product to the consumer. Advertising, market position, sales, and media are included. Ideas for promotion include brochures, websites, print ads, and signage. Promotional materials should focus on attributes, features, and benefits that are valued by consumers. Think creatively about how you communicate your product to the consumer. Promotion of a product should be designed for the target market.

In the marketing plan think of each enterprise, product, or service that you produce and consider the product itself, placement in the market, pricing, and promotion.

Use the following charts to develop marketing ideas and ultimately a plan to sell. A separate chart should be used for EACH product/service that you offer:

- **Product:** Describe your product or service in detail, including product features and benefits.
- **Price:** Describe your pricing strategy and payment policies.
- **Place:** Describe how and where you will place your product so customers have access to it and how you will make the sale.
- **Promotion:** Describe the promotional tools or tactics you will use to accomplish your marketing objectives.

Be sure that marketing duties are addressed in the Management Plan. Who is responsible for jobs within Product, Price, Place and Promotion?

Product	
Price	
Place	
Promotion	

Product	
Price	
Place	
Promotion	

Product	
Price	
Place	
Promotion	

Product	
Price	
Place	
Promotion	

Marketing Budget Plan

Category	Quantity	Cost	Total	Notes
Research				
Research hired				
Web research				
Research publications purchased				
Communications				
Promotional brochures				
Radio/Television				
Web design/maintenance				
Networking				
Memberships/Affiliations				
Events				
Subscriptions				
Promotions				
Product giveaways				
Product discounts				
Special offers				
Advertising				
Brochures (development/printing)				
Logos/Labels				
Packaging				
Signage				
Mailings/Postcards				
Radio/Television				
Newspapers				
Public Relations				
Charity events				
Advertising				
Employee promotions				
Sponsorships				
Distribution				
Shipping				
Transportation				
Marketing Total				

***Marketing labor should be included in the enterprise budget.**

ENTERPRISE BUDGETING

Small farms will often consist of many different enterprises that contribute to the whole farm operation. For instance, one farm operation may have a retail produce market, horse hay sales, and a fall petting zoo. It is important to understand the returns, various costs, and ultimately the profitability of each enterprise versus another. The "Enterprise Budget" enables you to do that.

It is important to generate good estimates for sales quantity. Your sales are a factor of yield and price. As you estimate your gross income, remember that income should be based on products sold not total production yield. Production can be affected by harvest lost, damaged goods, transportation loss, storage loss and unsold production. The general term used for this loss is shrinkage. Shrinkage should be considered when entering the quantity of goods sold in the enterprise budget.

The enterprise budget separates and allocates the various farm expenses and receipts to a particular enterprise. As a result, you can understand break-even cost and pricing points for that enterprise. It is also helpful to understand the input structure such as shelf space pricing structure, raw material inputs, fixed equipment cost and labor inputs. Operator and family labor costs are an important and often overlooked expense. Be sure to include an expense line in your enterprise budget to address these costs. Often overlooked labor expenses include office work, marketing, repairs and networking.

The enterprise budget also forces you to analyze the profitability of each enterprise so the proper enterprise mix for the farm can be achieved. In order for enterprise budgets to be effective, you must have accurate information on each enterprise being planned. This requires careful recordkeeping of existing enterprises and detailed projection of activities of planned enterprises.

The budget is calculated based on a one-year time frame for a certain unit of production such as acre or per head of livestock. Enterprise budget components are illustrated in the following graphic.

Example enterprise budgets are available at the Maryland Rural Enterprise Development Center www.MREDC.umd.edu. Refer to University of Maryland Extension Fact Sheet FS 545 for help in completing enterprise budgets.

Components of an Enterprise Budget

Total Income: The total sales of product or services from the enterprise. Revenue can be calculated with the following formula:
Price x Units Sold= Total Income

⇩

Variable Cost: Cost items that vary with production volume. Examples of such items include fertilizer, seed, fuel, electricity, labor charges, pesticides, packaging cost, and custom charges.

⇩

Fixed Cost: Those cost that you will incur regardless of whether you produce any output. These costs are determined using the DIRTI 5 method which includes Depreciation, Interest, Repairs, Taxes, and Insurance. Often a piece of equipment or building will be used for more than one enterprise. In these cases it is important to estimate the percentage of use for each enterprise and allocate the cost accordingly.

⇩

Net Income: Net income is the money left after subtracting variable and fixed cost. This is the bottom line.
NET INCOME = Total Income – (Variable + Fixed Costs)

ENTERPRISE BUDGET FORM Enterprise> Unit>

ITEM	UNIT	QUANTITY	PRICE	TOTAL
Income				
Total income				
Variable/operating expenses				
Total variable expenses				
Fixed/overhead expenses				
Total fixed expenses				
Total variable and fixed expenses				
Net income over variable and fixed expenses				
Break-even price (total expenses/yield)				
Break-even yield (total expenses/price)				

Methods of Analyzing the Enterprise Budget

The enterprise budget can provide a producer with much more information than just net income. The budget can help determine sales needed to cover variable cost, fixed cost, and total costs per unit. This information can be utilized to determine pricing points, to identify efficiencies within the enterprise, and for the continuation of an enterprise. The chart below describes various analysis methods.

Break-Even Analysis		
Enterprise Analysis Methods	**Formula**	**Comments**
Variable Costs per Unit Sold	Total Variable Cost/Output in Units	You must make at least the variable cost per unit sold, or the enterprise should be discontinued.
Fixed (overhead cost) Costs per Unit Sold	Fixed Cost/Output in Units	In order to be profitable over the long run, you must be able to cover the fixed cost as well as variable cost. Knowing the fixed cost per unit enables you to better understand cost structure.
Break-even Price	Fixed Cost + Variable Cost/Output in Units	This is your break-even price. A pricing point above the break-even point will be needed to generate profit.
Break-Even Output	Fixed Cost + Variable Cost/Price per Unit	This is the output needed at a given price to reach the break-even point. At the given price, output will need to be increased to net income.
Net Income per Unit Sold	Net Income/Output in Units	This is the net income per unit produced.

FINANCIAL PLAN

It is important for your farm business to project financial statements for the next 3-5 years depending on a loan application, long-term goals, or a new enterprise decision. Projected financial statements are also referred to as *pro forma* budgets. By projecting your business's financial statements, you discover whether your business will anticipate a profit over the long term.

Creating a financial plan can be a complex process. You may need additional spreadsheets to assemble information and budget totals. For help and examples visit www.mredc.umd.edu.

The income and cash flow statements are used to make projections. Projections are a businesses' best estimate of income and expenses over a period of time. Being conservative and realistic with your projections will help your business in the long run.

The best way to start making any projections is to review your enterprise budgets and financial statements. From there you will be able to predict average costs and expenses over time. Your implementation strategy and sales projections should be reflected in the pro forma financial statement.

Along with projections your farm may also want to conduct financial ratio analysis. This will look, long term, at projections and costs and answer questions regarding liquidity, profitability, and debt.

The financial position and performance of a farm can be described with three financial statements. These statements are generated by organizing and analyzing your business's accounting activities. While financial statements take some research and homework, they are very beneficial to your farm business.

Financial Statements help you:

- Determine your farm's solvency, profitability and liquidity
- Make important production, financing, and investment decisions
- Help with credit and lending applications
- Develop budgets for farm enterprises

The three financial statements show different financial measures for a business.

Balance Sheet (Solvency)—is a detailed listing of assets, liabilities, and net worth at a given point in time. It answers the basic question, "How much is your farm business worth?"

> Importance—Net worth is the best measure of a farm business's financial position. It organizes what the business owns (assets) and what it owes (liabilities), which ultimately determines farm solvency. *What is your farm business's financial position?*

Income Statement (Profitability)—is a listing of income, expense, and profit for a farm operation in a calendar year. This statement includes inventories and depreciation.

> Importance—Profitability is the summary of all resources that have come into the farm (revenue) and all resources that have left the farm (expense). This equals the net income or net loss. *How did the farm business do last year?*

Cash Flow (Liquidity)—records time and size of cash inflows and outflows that occur over a calendar year. Liquidity differs from profitability because the cash flow statement only includes cash income or expenses, whereas the income statement also includes non-cash items such as depreciation and inventory adjustments.

> Importance—Liquidity is the ability of your farm to generate enough cash to meet financial obligations as they come due without disrupting the normal operation of the farm business. The cash flow statement is a critical component of the business plan and will be reviewed by lenders. *Where is cash used and can bills be paid on time?*

The following table summarizes the differences between the projected income statement and cash flow budget:

Projected Income Statement	Cash Flow Budget
	Beginning cash balance
Cash income	+ Cash income
- Cash expenses	- Cash expenses
- Depreciation	+ Capital sales
= Profit (Loss)	- Capital purchases
	+ Loan receipts
	- Loan principal payments
	+ Nonfarm receipts
	- Withdraws
	= Ending cash balance

Balance Sheet

The balance sheet is formatted with assets on the left hand side and liabilities and net worth on the right hand side.

Assets—are items owned by the farm business, such as land, buildings, machinery, livestock, crops in storage, and supplies.

Liabilities—are the debts owed by the farm business, such as notes payable, interest, taxes, loans and rent.

Farm assets and liabilities are divided into three categories according to their length of life, cash liquidity, and effect on production in the farm business. The categories are current, intermediate, and long term. A fourth category lists non-farm assets.

When estimating asset value there are two possible methods: Market Value or Cost Approach.

Market Value:	values assets at the estimated current market value.
Cost Approach:	values assets at their original cost plus cost of improvements minus depreciation.

Current Assets/Liabilities—are those with a life less than one year. Assets include cash, accounts receivable, and other assets easily converted to cash within a year. These can include prepaid expenses, supplies, crops, and livestock on hand. Liabilities consist of accounts payable and accrued expenses such as rent, interest, and taxes that will be paid within one year. Short-term notes and the current principal due on longer-term liabilities are also listed.

Intermediate Assets/Liabilities—are those with a life more than one year but less than 10 years. Assets include breeding livestock, tools, vehicles, machinery, and equipment. Liabilities consist of loans for breeding livestock, machinery, and equipment.

Long-term Assets/Liabilities—are those with a useful life of more than 10 years. Assets include farmland, buildings, and improvements. Liabilities consist of mortgages and contracts owed on farmland and loans for buildings and improvements.

Non-farm Assets/Liabilities—these are personal items not considered part of the farm operation. Assets include the home, furnishings, and vehicles.

Net Worth is sometimes referred to as owner's equity. It is the difference between the value of farm assets and the liabilities against those assets.

ASSETS – LIABILITIES
= NET WORTH

Refer to University of Maryland Extension Fact Sheet FS540 for help in completing the balance sheet.

BALANCE SHEET | Date

ASSETS			LIABILITIES AND NET WORTH	
Current farm assets		**Value**	**Current farm liabilities**	**Value**
Cash, checking, savings			Accounts payable and accrued expenses	
Prepaid expenses and supplies				
Accounts receivable				
Inventory held for sale/feed	Quantity			
			Intermediate/long-term principal due <12 months	
Other current farm assets				
Total current farm assets			Total current farm liabilities	
Intermediate farm assets			**Intermediate farm liabilities**	
Total intermediate assets			Total intermediate farm liabilities	
Long term farm assets			**Long-term farm liabilities**	
Total long-term farm assets			Total long-term farm liabilities	
Non-farm assets			**Non-farm liabilities**	
Total long-term farm assets			Total long-term farm liabilities	
Total farm assets			**Total farm liabilities**	
			Net Worth	

Projected Income Statement

A projected income statement, sometimes called the projected profit and loss statement, is developed to forecast farm profitability. It estimates future income, expenses, and profit for the business. The projected income statement will cover a given accounting period such as a calendar year or other fiscal period.

Projecting an income statement is made easier if there are historical income statements to use as a reference point. Another aid in projecting an income statement is the enterprise budgets. Enterprise budgets estimate income and expenses on a per unit bases. Taking the various enterprise budgets for the business and multiplying the income and expenses by their respective total number of units in the business and then adding them together will approximate the projected income statement.

During start up and transition periods some businesses will need to develop projected income statements over several years. Long-term projections are especially important for businesses that will have escalating sales volume over multiple years, large inventory differences from year to year such as perennial crops or nonperishable goods and businesses with enterprises starting on different years.

Cash Farm Income - List sources and values of your cash farm income. Include revenues from sales of crops, livestock, livestock products, and government payments from commodity programs. Also include income received for custom work, co-op dividends, and others.

Cash Operating Expenses - Include those expenses associated with the operation of the farm business. In addition to variable production expenses such as feed, seed, fertilizer, short-term interest on operation capital and supplies, include fixed cash expenses such as taxes, insurance, and interest on intermediate and long-term loans.

$$\text{Depreciation} = \frac{\text{beginning value} - \text{ending value}}{\text{years of useful life}}$$

Depreciation - Even though depreciation is not a cash cost to the operation, it should be included in the income statement because it represents the loss in value of buildings, machinery, and other assets that wear out as a result of production. Without it, the income statement will not account for these economic losses. Historical depreciation can be a starting point for estimating future depreciation, but you must also consider the depreciation for future machinery and building purchases that are included in the business plan. A simple way to estimate the annual depreciation is to take the purchase price (beginning value) of the equipment and buildings, subtract out the salvage value (ending value) that will exist at the end its life and divide by the number of years of useful life

Profit or Loss - The projected income statement should give a picture of future business profit. As the business changes there is often a transition period where profits may vary year to year. If this is the case, you may want to develop and projected income statement for each year until the business reaches a steady state. As your plans progress you will want to have a good accounting system in order to construct historical income statements to analyze the progress of your business. For additional help with income statements, refer to University of Maryland Extension Fact Sheet FS539.

PROJECTED INCOME STATEMENT   Period covered>

CASH FARM INCOME		CASH FARM EXPENSES		
Source of income	Value	Description of expense		Value
Crop sales		Production expenses		
Livestock sales				
Government payments				
Other income		Other expenses		
Total cash farm income		Total cash operating expense		
Depreciation schedule				
Asset	Beg. value	End value	Years	Depreciation
Total depreciation				
	Net cash farm income (income - expense)			
	Profit or Loss (net cash - depreciation)			

Cash Flow Budget

Another important financial statement is the cash flow budget. This budget estimates the flow of money in and out of the business. It is similar to the projected income statement in that it estimates the cash income and cash expenses. However, there are important differences. The cash flow budget does not include depreciation since this is not a cash expenses. Rather it will include the actual purchase prices for capital purchases - machinery and buildings. It will include sales of capital assets. It will include cash flowing into the business from loans including loans for machinery and buildings. It will also include loan principal payments. It includes other receipts from non-farm sources as well as withdrawals from the business.

The cash flow budget estimates the timing and size of cash inflows and outflows that occur over a given accounting period, normally one year. The period is broken down into smaller time periods such as quarters or months. Think of the cash flow budget as a checkbook for the farm with an accounting of deposits and withdrawals. Here is an explanation of these.

Cash inflows

- *Crops and livestock sales*—these are the primary source of cash for your farm business and are critical to maintain the liquidity reserve.
- *Other farm receipts*—this includes payments from government programs, custom work, and co-op dividends.
- *Non-farm receipts*—include items such as income from an off-farm job, savings, investments, interest earned and capital.
- *Capital sales*—includes the sporadic cash inflows from the sale of land, buildings, machinery, breeding livestock, and tools.
- *Borrowed money*—is considered a residual source of cash used to maintain your liquidity reserve when cash outflows exceed the sometimes sporadic inflow.

Cash outflows

- *Production expenses*—are a large draw on your liquidity reserve. They include seed, feed, fertilizer, chemicals, hired labor, and repairs.
- *Capital expenditures*—include cash outlays for replacing and adding machinery, breeding livestock, land, and buildings. These are important to your farm but should be planned with care.
- *Loan payments*—are payments on borrowed money. Consider this when formulating your loan payment schedules and the seasonality of your farm business.
- *Family living expenditures or withdrawal*—are sometimes overlooked as being secondary to the other cash outflows

The cash flow budget is projected at the beginning of the year to forecast the inflows and outflows and estimate the ending cash balance for each quarter or month. As the year progresses, keep an **actual cash flow statement** to record cash transactions as they take place. Then compare the actual cash flow statement with the projected cash flow statement to see if things are going as planned, to devise remedies for previously unforeseen problems, or to take advantage of opportunities not anticipated. At the end of the year, use the actual cash flow statement to estimate the projected cash flow for the next year. This is especially important for agricultural businesses because of production cycles and the seasonality of the business. Refer to University of Maryland Extension Fact Sheet FS541 for help in developing a cash flow budget.

CASH FLOW	Last year	Year 1 or 1st quarter	Year 2 or 2nd quarter	Year 3 or 3rd quarter	Year 4 or 4th quarter	Total
CASH INFLOW						
1. Beginning cash balance						
2. Crop sales						
3. Livestock sales						
4. Other farm income						
5. Capital sales						
6. Non-farm receipts						
7. Total cash inflow (total 1 to 6)						
CASH OUTFLOW						
8. Chemicals						
9. Custom hire						
10. Feed purchased						
11. Fertilizer and lime						
12. Freight and trucking						
13. Gasoline, fuel, and oil						
14. Insurance						
15. Labor hired						
16. Rent or lease						
17. Repairs and maintenance						
18. Seeds and plants purchased						
19. Supplies purchased						
20. Marketing						
21. Taxes						
22. Utilities						
23. Vet., breeding, medicine						
24. Other farm expenses						
25. Capital purchases						
26. Family living or withdrawals						
27. Term loan payments						
28. Total cash outflow (total 8 to 27)						
CASH FLOW SUMMARY						
29. Inflow minus outflow (lines 7-28)						
30. New borrowing: term						
31. New borrowing: credit						
32. Credit line payments						
33. Ending cash balance (29+30+31-32)						

MANAGEMENT PLAN

Farms need people just as they need land, equipment, and materials. Writing a management plan identifies jobs needed on the farm and whose responsibility they will be. Having this clearly communicated within any business is an important consideration. A management plan should try to capture the "people element" of what a farm is hoping to achieve.

A management plan addresses:
- Are the right people in place?
- Does the farm business have the appropriate mix of skills?
- Do employees display the proper attitudes and behaviors?
- Are employees developing in a suitable way?

A management plan also identifies legal and liability issues of hiring and managing employees. Depending on the type of farm business and employee structure it is important to research Maryland's employee laws and what may apply to your business before hiring.

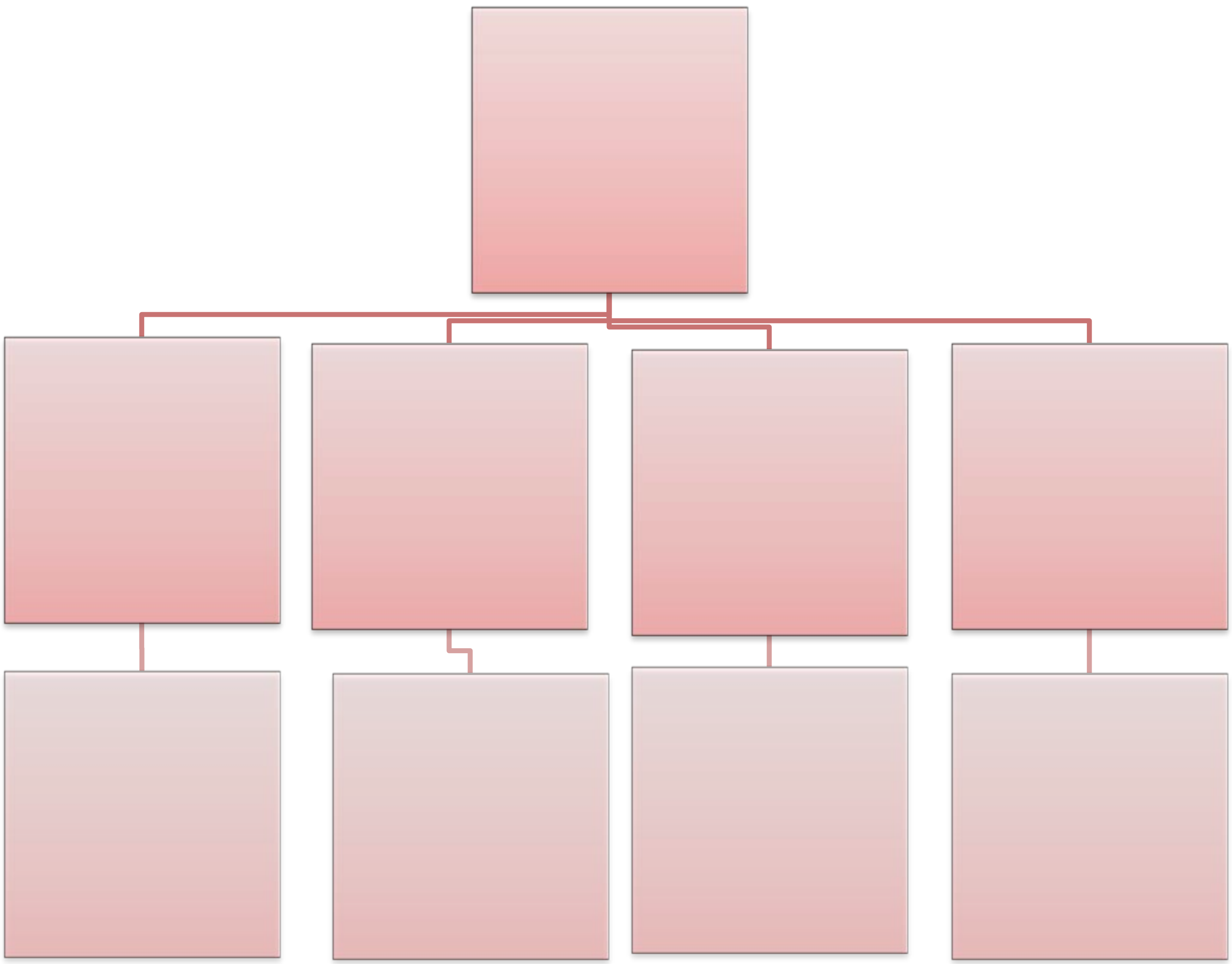
Parts of the Management Plan
- Position and Duties
- Organizational Chart
- Skills and Training

Use this chart to layout positions within your farm business, the duties of each position, and who is responsible.

Farm Business Positions and Duties				
Position/Name	**Duties/ Responsibilities**	**Skills/Talents**	**Salary/Wages**	**Work Schedule**
1.				
2.				
3.				
4.				
5.				
6.				
7.				

Farm Business Organizational Chart

An organizational chart arranges the structure of a business by rank. This chart is helpful to know who is responsible for parts of the business.



The last component of the management plan is skills, training, and continuing education. What skills are needed or necessary for the farm business? Are there any new technologies or skills that can be adapted to the farm business?

Skills and Training		
Skill	**Training Available**	**Responsible Party**

IMPLEMENTATION STRATEGY

You have done your homework, conducted market research, and developed areas of competitive advantage. All that is left is collecting the paycheck, right? Not so fast. The formation of an optimal strategic business plan is useless, unless the plan is implemented. In other words, a correctly devised business plan is often said to be "The right thing to do," while the implementation of the plan is considered "Doing things right." An organization must be able to accomplish both if it is to remain successful.

The implementation plan will contain a timeline for steps that need to be taken in order to meet objectives. Consider the implementation plan your ultimate "To-Do List." The timeline will cover the production, financial, management and marketing goals that are set forth in the business plan. As you develop the implementation plan you may begin to notice areas where the best made plans have no practical way to be implemented. Taking time to go through this process will help you identify bottlenecks and avoid these pitfalls. The implementation plan contains the following information:

Time:
- This is the timeline for tasks. It can be days, months or years.

Production:
- Products or services being produced and projected production
- Timeline of production changes, new enterprise development

Marketing:
- Sales projections
- Expected price
- Marketing locations and customer base
- Market entry—promotion

Finance/Accounting:
- Identify funding mechanisms
- Timeline of when capital will be needed or purchased
- Method of accounting and recordkeeping
- Method of paying taxes and meeting

Management:
- Division of duties and responsibilities for tasks.
- Labor sources needed
- Labor management plan—training, skills development
- Plan for payroll, taxes, and benefits

Implementation Plan

Time Period	Production	Financial	Management	Marketing

EXIT STRATEGY

Operating a farm business includes many risks. Though you may never intend to quit sometimes it may be the best decision for your farm and family. Common reasons for exiting the business can include poor profitability, illness, death of a partner, generational transition, financial and age.

It is prudent to consider an exit strategy from the market. The exit plan should include a set of criteria that signal to you that it may be time to exit the business.

Such signals can include:
- Farm profit/loss
- Set age
- Estate plans and farm transfer
- Change of markets

Exit Strategy

RESOURCE INVENTORY

Gathering and analyzing resources is an efficient and prudent exercise for any farm business. Many small businesses and small farms purchase brand new and sometimes unnecessary equipment, buildings, and machinery. These expensive capital purchases can overextend a business if planning and analysis has not been done.

A resource inventory can help:

- Complete a balance sheet
- Summarize collateral for a loan
- List the conditions of assets and identify problems
- Evaluate options and needs for growth and/or diversification

The first step in creating a resource inventory is to step back and look at your operation as a whole. Evaluate what resources are available to you and include all those that are needed to carry out goals of the operation. As the inventory is completed multiple uses or complementary use may stand out.

This section includes:

- Building and facility requirements
- Building and structure inventory
- Equipment inventory

Building and Facility Requirements	
Physical Resources	**Description of Resource and Use**
Land:	
Livestock:	
Equipment: (more detailed worksheet follows)	
Facilities: (more detailed worksheet follows)	
Transportation:	
Expertise: Computers, marketing, record keeping, etc.	
Other:	

Building and Structure Inventory				
Building	**Purpose**	**Square Feet**	**Required Features**	**Location**
1.				
2.				
3.				
4.				
5.				
6.				

Equipment Inventory

Name	Model	Size	Year Purchased	Age	Condition			Ownership			Book Value	Market Value
					G	F	P	O	L	B		

Condition—G=Good, F=Fair, P=Poor
Ownership—O=Owned, L=Leased, B=Bought

APPENDIX

Documents that can be included in your Business Plan Appendix:

- Corporation or partnership documents
- Personal resumes of owners and key personnel
- Credit report
- Farm maps
- Copies of leases, significant agreements, and contracts
- Enterprise budgets
- Other documents relevant to the business plan

Contact List				
Name	**Address**	**Phone**	**Email**	**Website**

Business Web Resources

eXtension—Entrepreneurship
www.extension.org/entrepreneurship

FormNet—Free Business Forms
www.entrepreneur.com/formnet

Maryland Agriculture
www.marylandagriculture.info

Maryland Department of Agriculture
www.mda.state.md.us

Maryland Rural Enterprise Development Center
www.mredc.umd.edu

National Sustainable Agriculture Information Service
www.attra.ncat.org

Purdue Extension's Ag Innovations Center (AICC)
www.agecon.purdue.edu/planner/

Small Farm Success
www.smallfarmsuccess.info

United States Small Business Administration
www.sba.gov
    Small Business Readiness Assessment Tool
    www.sba.gov/assessmenttool/index.html
    SBA Delivering Success Videos
    www.sba.gov/tools/audiovideo/deliverysuccess/index,html

University of Maryland Extension
www.extension.umd.edu

United States Department of Agriculture, Farm Service Agency
www.usda.gov
www.fsa.usda.gov

United States Census Reports
www.census.gov

Value-added planning and business development
www.agmrc.org/business_development