Benchmark Your Performance

Danny Klinefelter

Most producers don’t know how they stack up against their competition in terms of key performance metrics. The majority of people I talk to at extension meetings think they’re about average or a little above, and that’s not possible.

It’s not enough to know how you’re doing compared to the average. How do you stack up against the top 25 percent or the top 10 percent. Numerous university studies have found $100 or more differences in average net income per acre between the top third and the bottom third of farmers in the same region, producing the same crops even after adjusting for differences resulting from owning versus renting land. A study by Terry Kastens at Kansas State several years ago found about half the difference was due to revenue (price and production) and about half due to costs. One of Dave Kohl’s recent articles indicated that a summary of FINBIN data from the University of Minnesota showed that the top 20 percent of producers earned an average rate of return on assets above 15 percent while the average ROA for the bottom 20 percent was negative.

My point is that it’s hard to get better if you don’t know what your strengths and weaknesses are. This covers all areas of management - finance, operations, marketing and human resources.

Producers participating in state farm business farm management associations and those working with some of the more progressive farm accounting firms have a better idea of how they’re performing, but mostly at the production and whole farm financial level. Very few have drilled down to the specific enterprise level that would let them really understand the detail needed to fully analyze their performance. Whole farm data can mask offsetting strengths and weaknesses.

The Farm Financial Standards Council developed recommendations for standardized financially reporting guidelines and common definitions for key financial ratios almost twenty years ago, but as of yet have not developed a national database similar to the RMAs annual financial summary for non-farm businesses. Some ag lenders have developed their own databases, but only a few make the information available to the public. The Standardized Performance Analysis (SPA) developed by the National Cattlemen’s Beef Association gets close; but, the number of ranches in the database is still fairly limited. By the end of August, the Association of Agricultural Production Executives website will contain links to many of the publicly available
databases. You can go to
http://associationofagriculturalproductionexecutives.org to see what is
available. Let me know if you are aware of any links we haven’t included.

One of the biggest issues is to make sure the data is actually comparable, i.e., that you’re comparing apples to apples. For example, is the balance sheet information for the farm only or does it include farm and non-farm assets and liabilities. Are assets valued on a cost or market basis, and are deferred taxes included? Is the income statement data farm only or farm and non-farm, is it on a cash or accrual adjusted basis, etc?

Some of the best examples I have seen come from peer groups who have developed common reporting standards and include very detailed metrics deemed important by the members.

One of the advantages that peer groups have is their ability and willingness to discuss and learn from their differences. If a member is at the bottom of the group, they can explore why the differences exist and possible ways to improve. One dairy group member told me that it drives a continuous improvement mentality. He says that the members are so competitive and interested in self improvement, that even if they don’t see exactly why they are in the bottom of the group on a particular metric, they find ways to get better simply because they know what they need to focus on. His group looks at 30 different metrics for the breeding, calving and heifer raising enterprises, and another 30 for the milking enterprise. If these were just whole farm financial metrics, the number would be excessive. However, they also include production and health measures, functional level efficiency indicators, and specific expenses category measures.

Another thing to keep in mind is who you’re comparing yourself to. What are the differences in geographic location, size, production systems and marketing/purchasing arrangements? Some of the peer groups formed by TEPAP graduates are comparing themselves to producers in the top 1-2 percent of the industry, so being at the bottom of the group may still mean they are among the best.

Remember, the function of a competitive market is to drive the economic return to the average producer to breakeven through supply and demand responses. At that point the top producers are still profitable and growing, the average producers are just hanging in there, and those on the bottom end are losing money and being forced out of the industry. Your job is to stay out of the back of the pack.