Financial Benchmarking: Getting Started
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Since the Farm Financial Standards Council (FFSC) was formed in the late 1980s, one of the objectives has been to create a national database of comparative financial benchmarks similar to the RMA Annual Statement Studies. To date, it hasn’t happened; but, this reflects that fact that it’s difficult, not that it is unimportant. It would be great if more of the commodity groups would do like the beef industry did when it developed the Standardized Performance Analysis (SPA). I’m hopeful that the formation of peer advisory groups will serve as the impetus to get at least the more business oriented commercial producers off the fence.

Continuous management improvement is the key to staying ahead of the pack. Staying ahead isn’t about change for change sake, it’s about getting better. Every business and manager has weaknesses and blind spots. Many of them aren’t aware of what they are because they have no basis for in depth comparisons against their competition. As I noted in a previous article, everyone exists in four states of knowledge:

1. They know what they know.
2. They know what they don’t know.
3. They don’t know what they don’t know.
4. They think they know something and they’re wrong, i.e., it just ain’t so.

If you are part of a group that recognizes the need and the potential benefit, start off by understanding that financial benchmarking is a process and will never be perfect or finished. Most problems will result from the fact that financial reporting in production agriculture is highly variable and inconsistent. The remainder of this article will look at some of the issues you’ll need to consider. There isn’t always one right answer; but, the group needs to be consistent and make a decision on where to start.

Below are some common issues and recommendations. As much as possible, the objective is to compare apples to apples.

1. If possible, follow the FFSC’s guidelines on financial reporting, http://www.ffsc.org
2. Use accrual adjusted revenue and expense data rather than cash basis when comparing profitability measures.
3. Depreciation expense is almost always a point of contention. Because of different accepted methods for tax purposes and accelerated 179 expensing, consider starting with actual cost for
depreciable assets and use a common class life and straight line
depreciation for expense comparisons, even if it isn’t what you use
for taxes.
4. Because of seasonality, use the same dates or periods for balance
sheet, income statement and cash flow data.
5. If your farm is comprised of multiple entities, use consolidated
information for comparisons. Also, decide whether to include or
exclude non-farm and personal assets, liabilities, revenues and
expenses.
6. Because of different percentages of owned versus rented land,
consider treating land as a separate cost center and charge the
operating entity a current market rental rate on owned land.
When the information is consolidated the rent for owned land will
cancel out.
7. When deciding whether to use the cost or market value of assets in
balance sheet or profitability ratios, conservative current market
values are often more consistent for comparisons between firms.
However for tracking changes in earned equity and valuation
equity, The FFSC recommends using double column balance
sheets (one column with market values and a second with cost or
modified cost basis values).
8. Don’t overlook deferred taxes or accrued assets and liabilities.
9. Decide on how owner compensation is to be handled.
Corporations differentiate dividends from salaries, while
proprietors and partnerships often don’t pay the owner(s) a salary;
but, treat withdrawals as the salary equivalent. Decide on a
consistent and comparable approach, even if it isn’t the same as
tax treatment.
10. Consider using both per acre or head and per unit (bu., lb, cwt)
metrics.
11. Finally decide on a consistent method for allocating overhead
expenses.

Financial benchmarking can be extremely insightful in identifying
strengths and weaknesses, and in improving decision making. Recognize it will
evolve as members of peer groups develop better and more consistent
information systems, and understand their businesses better from a financial
standpoint. Initially, be willing to compromise, focus on consistency and
comparability, remember the KISS principle, and recognize that it’s more
important to get started than it is to delay by attempting to work out all the
bugs before you begin.