Monitor Your Budget
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The typical producer treats planning and analysis as a beginning and end of the year exercise. Even then, most of them see it as a chore rather than an opportunity. The most successful managers spend a great deal of time regularly monitoring and analyzing performance. By staying on top of things, they are much more likely to spot problems and opportunities before it’s too late.

Business problems are like a cancer, they eat away at profits, liquidity and owner equity. But, spotted and addressed early enough, they are often treatable. Similarly with opportunities. Most of the best opportunities are only there for a short period of time and if they’re not capitalized on, they’re gone.

The simplest and one of the most useful monitoring tools is the annual projected cash flow budget prepared on a monthly basis. The process involves comparing actual month-to-month and year-to-date cash flows with projections. The focus is on the significant variances or differences on a line item basis. The question is why the difference occurred - was it timing, a quantity difference or a price difference? Any number in a budget ought to be tied back to the basis or assumptions on which it was developed.

Unfavorable variances can point to problems that need to be addressed immediately. In other cases the cause may be something that can’t be corrected, but it may mean that plans for the remainder of the year need to be revised. Planned investments or purchases may need to be deferred or you may need to talk to your lender about any changes in borrowing or repayment plans.

Likewise, recognizing opportunities to forward price inputs or products when you can do better than your plan is equally as valuable. For example, more producers are using commodity options to set a price floor or ceiling when input or output markets offer the opportunity to beat the budget while retaining the potential to benefit from future price changes. Options obviously involve a premium, but that needs to be netted against or added to the price when evaluating the opportunity.

Monitoring also involves tracking leading indicators outside the business. Changes in the interest rate yield curve, energy prices, commodity stocks reports and carryover: use ratios and exchange rates are some commonly used economic indicators.
This external focus is too often overlooked. Comparing actual to budget is important, but it is only a historical perspective, i.e., looking at what has already happened. Regular budget analysis should also examine the assumptions built into projections and consider whether the bases for projections have changed and whether plans need to be revised. Timely action to address problems, to capitalize on opportunities, avoid problems or mitigate risks are what separate the winners from the average producer. It’s much like a top coach or general who develops a detailed game or battle plan. Those who have been the most successful are those who are able to make mid-course adjustments in light of new information or because they recognized things weren’t going as originally planned. Remember, the definition of strategic management is the ability to anticipate, adapt to, drive and capitalize on change.

The discussions that go into developing a budget or business plan also present an opportunity for learning and better communication both for the management team and for the development of potential successors. The ongoing review and adjustment process is equally as important. One study of farm borrowers over a period of several years found that, on average, they overestimated cash receipts by 15 percent and underestimated cash expenditures by 17 percent. If the errors were purely a function of market and production variability, revenues should have been underestimated as often as they were overestimated, and the same should have been true for expenditures. The identification of where errors occur most frequently can direct greater attention to the need for better information, where risk mitigation efforts need to be focused, and where biases tend to occur in assumptions. It’s a critical part of continuous improvement and learning from mistakes.

As a final comment, one of the most frequently overlooked uses of the process described is for family living budgets.