PROFITABILITY & SUSTAINABILITY

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Madame Chairperson, ladies and gentleman, good morning and welcome to my presentation on Profitability and Sustainability.

OUTCOMES

1. Define sustainable agriculture.
2. Why benchmark?
3. How benchmarking has helped the top growers make twice as much profit as the average.

1. SUSTAINABLE AGRICULTURE

A definition:

Sustainable agriculture is that practice which allows the landowner to achieve:

- Long term profitability;
- Environmental stewardship; and
- Community quality of life.

More on sustainable agriculture:

To isolate the measure of sustainable agriculture to a financial benchmark will in fact lead to financial and environmental suicide. In isolation, money can be a lousy means of keeping the score.

Sustainable agriculture is directly tied to the concept of reporting against the three components or "bottom line" of economic, environmental and social performance.

For an organisation or community to be sustainable it must be:-

- Financially secure;
- Minimise or eliminate negative environmental effects; and
- Act in conformity with social expectations.

Triple bottom line reporting appears to be easier to talk about than to actually do. The consensus is that the financial aspects are best established, followed by environmental and then social.

There is not as yet – and many would argue there is unlikely ever to be – a single currency into which these three dimensions can be assessed.

For the moment, convergence is the intended aim identifying a limited set of key performance indicators for each bottom line with a constant eye on the degree to which, and how, progress can be measured and integrated into an overall set of accounts.

Benchmarking in an extended format of the existing report will provide the industry with the document that can best represent this convergence. Imagine a comparative analysis that measures the financial returns and reports under a framework of environmental and community measures. That information could then be used at all levels within the industry to take us forward. The revolution continues.

2. WHY BENCHMARK?

"If you want to be the most profitable grower in the district you need to find the growers who continually make the most money and copy them shamelessly."

Most industries facing the requirements to be world competitive have developed BENCHMARKS and have adopted BEST PRACTICES.

In my life as a Chartered Accountant I am fortunate to serve on the board or work with various secondary industry organisations. The need to benchmark and adopt best practice is not just an option for these organisations, it is an essential part of good governance and survival.

If secondary industry is using this management tool with great success it follows that the same application in primary industry is likely to produce similar results. *In our experience it does!*

Benchmarking studies are not new in farm management, but if they potentially hold the *key to the profitability* of the top performers why haven't they been more widely used?

I believe the reason for this is that they have almost all been based on a gross margins concept.

To illustrate a serious weakness of this approach, a gross margin measure of the cotton comparative analysis would only include one third of the expenses. The other two thirds would traditionally be regarded as fixed costs and excluded from the calculations.

In our benchmarking studies every expense is allocated to an enterprise. In this way the full cost of growing a bale of cotton can be determined and compared between farms and districts.

BOYCE EXPERIENCE

BOYCE Moree have been committed to management accounting since 1978. Our management accounting service has been based on the preparation of annual cash flows and budget vs actual reporting. These have been very well received by our clients and their stakeholders.

Although this service is valuable it does not address the problem:

> *"Why some growers make twice as much profit per hectare as their neighbours".*

To address this we had to establish the benchmarks and best practices of the top performers.

From benchmarks to best practice: From the simple presentation of the numbers with minimal comments from us where we let the numbers tell the story. We have progressed through a number of stages to interpret the profit drivers and develop BEST PRACTICE and action plans for participants.

STAGES IN THE DEVELOPMENT

- Simple numbers
- Expansion of the measurement to include new items
- Interpretation and assistance by guest consultants and growers
- Cotton conferences
- Workshops and group discussions
- Individual action plans
- Expansion of the participants
- Inter valley comparison
- Industry wide acceptance
- Triple bottom line reporting

I believe that if the commitment continues, the exciting advancement we have seen with our clients and participants will be translated to a new era of productivity improvement for our industry.

3. HOW BENCHMARKING HAS HELPED THE TOP GROWERS MAKE TWICE AS MUCH PROFIT AS THE AVERAGE.

Over the past fifteen years, many cotton farmers have consistently been able to achieve top-class results, even in years when seasonal or financial related circumstances were less than favourable. They analyse emerging trends as well as the current crop results.

In the past five years, the top 20% of farmers made 98% more profit (after interest) than the average, this equates to $636/ha.

The difference is attributable as follows:-

Land productivity (yield)	64%	or	$406
Price (marketing)	19%	or	$124
Direct cost savings	20%	or	$128
Interest	(3%)	or	($22)
	100%		**$636**

SO HOW HAVE THE TOP GROWERS USED THIS INFORMATION?

• YIELD

It is a lot easier to react than it is to think. The top growers have not reacted to this trend – they created it.

In our report in 1985 the following observation was made:-

> *"Despite the broad range of marketing strategies available, the top 20% of growers achieved their excellent results through cost savings rather than achieving above average yields."*

From 1989 onwards the focus moved away from cost savings to yield. Many costs escalated out of the control of growers and yield became and still is the major focus for the top growers.

• WHAT IS THEIR MARKETING STRATEGY?

> *The answer lies in the linkage between the cost of production per bale and yield.*

The first and most critical step to a successful marketing strategy is to know what your average cost of production per bale is. (Full absorption costing gives you this information – gross margin analysis does not.)

Add enough for capital repayments on machinery and your targeted profit per bale and this then represents the starting point for marketing. Not having this information is like betting at a race meeting without a form guide.

Our benchmarking studies highlight the fact that for the last five years the top 20% only achieve an average of 4% improved value per bale ($16/bale), however their improved yield for the same period (.91 bales/hectare) is the major contributor to profit differential.

The top growers bed down their average cost of production per bale from a marketing perspective and then focus on improving yield to increase their profit.

• FINANCIAL MANAGEMENT

Benchmarking has given successful growers the tools to properly structure their financing arrangements.

Finance organisations can use a clients benchmarking information when reviewing existing arrangements or looking at new proposals. The report provides these organisations with both historical and current results on a physical (yield, acres, labour etc) or financial platform. Information that would otherwise not be available.

This independent information enables participants to negotiate stronger finance arrangements and emphasise the contribution that management makes to the bottom line.

Strategies on tax planning, cash flow budgeting and strategic business planning are linked to the information provided in the comparative analysis. The top growers gain leverage from their benchmarking results when financial information is prepared.

• OPERATIONS

All operations are carried out "on time" on the best farms. This has been a result of the top growers using information to support the following:-

1. Access to reliable machinery is critical. The top growers are more responsive to the use of contractors and often attach yield bonuses.
2. Top growers invest in re-levelling, field geometry, inflow rates and measurement of infield water usage. This investment will directly impact on labour efficiency.
3. Investment in technology is researched and measured after implementation. Further investment is made in training employees.
4. Varietal development is followed closely and the top growers support on farm trials to monitor varieties that may be more suitable to their location and soil. The value shift from higher insecticide costs and yield differentials to licence fees is carefully measured.

WHAT ELSE CAN GROWERS GET FROM BENCHMARKING?

As technology continues to make information readily accessible our industry needs to position itself to capture the greatest benefit.

Ongoing productivity improvement is the key to the future. Adopting best practice across all facets of your operation can only happen if best practice is measured and communicated. Benchmarking provides that link.

Madame Chairperson, thank you.

5 YEAR AVERAGE FOR TOP 20% & AVERAGE PARTICIPANTS (PER HA)

	ALL FARMS AVERAGE	TOP 20% AVERAGE	DIFFERENCE
INCOME			
Cotton proceeds - Lint	3580	4105	525
Cotton proceeds - Seed	73	82	9
Ginning	(86)	(99)	(13)
Levies	(6)	(7)	(1)
Cotton proceeds - Hail claims	27	37	10
	3588	4118	530
EXPENSES			
Administration	44	37	7
Cartage	81	98	(17)
Chemical application	136	134	2
Chemicals - Herbicides	131	130	1
Chemicals - Insecticides	426	411	15
Chemicals - Defoliants	88	87	1
Chemicals - Others	15	14	1
Chipping	87	82	5
Consultants	42	43	(1)
Contract picking	177	178	(1)
Contract farming and ripping	61	62	(1)
Cotton picking sundries	14	12	2
Electricity	23	20	3
Fertiliser	206	179	27
Fuel and oil	130	124	6
Hire of plant	12	8	4
Insurance	73	71	2
Leasing depreciation & hire purchase charges	229	200	29
License fee - Ingard	34	36	(2)
Motor vehicle expenses	18	19	(1)
R & M - Farming plant	127	106	21
R & M - Pumps and earthworks	79	66	13
Seed	44	43	1
Water charges	69	61	8
Wages - Employees	278	281	(3)
Wages - Proprietors	63	51	12
Other farm overheads	47	41	6
	2734	2594	140

PROFITABILITY & SUSTAINABILITY

	ALL FARMS AVERAGE	TOP 20% AVERAGE	DIFFERENCE
OPERATING PROFIT/(LOSS)	854	1524	670
ADD:			
Wages - Proprietors	63	51	(12)
FARM OPERATING PROFIT/(LOSS)	917	1575	658
DEDUCT			
Interest and bank charges	248	272	(24)
Interest - Crop terms	21	19	2
	269	291	(22)
FARM NET PROFIT/(LOSS)	$648	$1284	$636

(Ignore minor computer rounding differences)

CROP RESULTS			
Hectares of cotton grown	848.26	953.15	104.89
Total yield (bales)	6675.62	8430.32	1754.70
Yield per hectare (bales)	7.89	8.80	0.91
Value per bale	$452.86	$468.95	$16.09
Cost of production per bale	$348.68	$296.36	$52.32
Operating profit per bale	$106.14	$172.59	$66.45
No. of bales per hectare required to cover operating expenses	6.03	5.53	0.50
No. of bales per hectare required to cover total expenses	6.62	6.16	0.46
LABOUR			
No. of hectares per permanent man (excluding proprietors)	179.02	206.72	(27.70)
AVAILABLE TRACTOR HORSEPOWER			
Tractor horsepower per 500 hectares	454.65	396.65	58.00
AVAILABLE PICKING CAPACITY			
Picker heads per 500 hectares	2.43	2.02	0.41
ROTATION			
Percentage of the current years crop being grown on fallow fields or new fields (developed within the last 3 years)	43.00%	37.93%	-0.0507
WATER USAGE			
Megalitres per hectare	8.72	8.24	0.48
Megalitres per bale 1.10 0.94 0.16			