

# Benchmarking as a means of improving the financial wellbeing of organic dairy farms

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## ABSTRACT

Benchmarking is an important management tool enabling the comparison of actual financial data on a similar basis. Currently there is little data available on the actual costs of farming to organic standards. Limited financial or incomplete management information tends to lead to poor decision taking. The objective of the exercise is to identify the practices, which lead to enhanced financial performance, either low costs of production or high levels of profitability. The identification of these most profitable practices enables informed decisions to be made about the way the farming business needs to change. The main problem areas include the collection of detailed information broken down into the required cost centres. The allocation of costs between enterprises on small and medium sized farms is often difficult. Obtaining either a large enough sample of farms, if the farming system is different, or a sufficient number of farms with a similar farming system is essential. Analysis is normally undertaken on a cost of production basis as this allows for better comparison between units of a different size. Finance costs are normally excluded, but depreciation charges are included to reflect the level of investment in the business. A realistic value of family labour needs to be included to allow for the production of a Comparable Farm Profit (CFP).

*Keywords: organic farming; cost of production; benchmarking; economics*

## INTRODUCTION

All businesses need to achieve a level of profitability to fund amongst other items living expenses and capital repayments. Until the last 12 months the organic dairy sector had been in receipt of a high milk price and this had enabled many businesses to generate a profit that is no longer attainable. This dramatic change in fortunes has led producers to look at the cost basis of their business. The comparison of financial information between similar businesses is key to identifying best practice. There are a number of areas that need to be addressed in obtaining a meaningful data set

## **Objectives**

- 1) To collate a data set that allows identification of systems and practices that lead to either a low cost of production or a higher level of profitability.
- 2) To compare individuals businesses to an average of a sample. This is now done on a cost of production basis i.e. cost per litre of milk output but has historically been per cow or per acre.
- 3) To obtain data from a group of producers who are either working within a close geographical area, or are of a similar size and operating to a similar system.

## **What is benchmarking?**

In my opinion benchmarking is the procedure of comparing the performance of an individual to the average. Normally this is of a financial nature but it can be more wide ranging. For organic producers cell counts and mastitis incidence are important and comparing these is useful.

Examples of bench-marking are wide spread and perhaps the best known is the annual survey carried out by universities under the heading of the Farm Business Survey. These regional studies are limited by the number of farms that make up each sector, typically 20-40.

A wider study was the "Economics of milk production in England and Wales" carried out by John Farrar and Jeremy Franks. This study looked at a sample of 314 farms.

Another popular study is the Midland Bank / ADAS sample of top herds.

Within the organic sector there is no regular sample of the costs of production.

## **Where does benchmarking fit in?**

Benchmarking is part of the management process and is most appropriate when used regularly to compare the performance of a business or enterprise against a sample of other businesses.

There are 3 stages to the process of bench marking

- 1) The collection of the detailed information
- 2) The comparison of the information in a standard form, often on a per litre basis or per cow.
- 3) The open discussion about the results. Information always remains confidential to the individual and an average is always produced. Having highlighted the range in costs those who are closest to achieving the goals can be questioned.

I like to use it with groups of farmers, who are prepared to discuss the reasons as to how they achieve the success.

## Problem areas

There are a number of problem areas: -

- 1) Producers are not used to sharing financial information. It is worth stressing that normally there is more interest in the costs of production and not the profit that a system generates.
- 2) Producers do not record the information in sufficient detail for meaning full comparison.
- 3) It is difficult to obtain a meaningful sample of farms. There are two alternatives
  - a) A small sample of farms, a minimum sample would be 10, from within a similar system or geographic areas. This could be seasonal calved herd, grazing systems or all year round calving herds or herd size.
  - b) A larger sample, perhaps of 30 farms, where one is trying to obtain a wider range of information.
- 4) Even where information is recorded there is a lack of willingness to be open and frank about the problems of the business. In reality one is looking for the good points and so the poor results tend not to get discussed.
- 5) The division of costs between enterprises is difficult on all organic farms and the smaller the farm the more difficult it becomes. This is particularly true for machinery costs, for example, which enterprise is the Landrover run on?

## RESULTS

Table 1 is an example of results that were produced by one group of farmers for the last 3 years. This discussion group has carried out this survey on a cost per litre basis. This has the real advantage of looking at the costs of production rather than some other meaningless figure such as per cow or per acre. The group initially wanted to leave out quota and finance costs, as is normally done in preparing results for comparable cost of production or Comparable Farm Profit (CFP). However, last year because of the wide range in costs from 11.16 p. per litre to in excess of 17 the group also now records quota and interest charges.

The summary table is always accompanied by a more detailed breakdown of individual costs as shown in Table 2.

This enables the individual business to compare in more detail with the average. The detailed figures always get discussed because the group meets to discuss the results. For example other livestock costs average 2.13 p.p.l but the range is from 1.11 to 3.78 p.p.l.

## Conclusion

For those businesses that are prepared to record their information in a way so that the analysis can be done, the results are considerable. The odd 0.5 p saved here soon adds up. The annual costings meeting for the discussion group above is often referred to as the best meeting of the year.

Table 1 Group averages 1999-2001

FARM	AVERAGE		
	2001	2000	1999
Livestock units/ha	2.14	2.12	2.13
Litre/ha	12634	12161	12141
<b>INCOME</b>	<b>ppl</b>	<b>ppl</b>	
<b>TOTAL INCOME</b>	<b>19.5</b>	<b>20.9</b>	<b>21</b>
<b>EXPENSES</b>			
<b>Total Feed Costs</b>	<b>3.33</b>	<b>2.96</b>	<b>2.70</b>
<b>Other Livestock Costs</b>	<b>2.12</b>	<b>2.16</b>	<b>1.99</b>
<b>Parlour Costs</b>	<b>0.44</b>	<b>0.57</b>	<b>0.49</b>
<b>Labour</b>	<b>3.87</b>	<b>4.00</b>	<b>3.88</b>
<b>Power &amp; Mach</b>	<b>2.11</b>	<b>2.67</b>	<b>1.99</b>
<b>Depreciation</b>	<b>1.11</b>	<b>1.42</b>	<b>1.13</b>
<b>Sundry Overheads</b>	<b>1.00</b>	<b>1.23</b>	<b>0.99</b>
<b>Buildings</b>	<b>0.45</b>	<b>0.42</b>	<b>0.38</b>
<b>Total Expenses</b>	<b>14.44</b>	<b>15.42</b>	<b>13.55</b>
<b>Comparable Farm Profit</b>	<b>5.11</b>	<b>5.51</b>	<b>7.41</b>

Table 2 Detailed returns

	AVERAGE		Farmer 1	
Year Ending				
Livestock units/ha	2.16		1.55	
Litre/ha	12775		8493	
<b>INCOME</b>	<b>p/litre</b>	<b>£/ha</b>	<b>p/litre</b>	<b>£/ha</b>
Milk	18.39	2,349	19.52	1,657
Stock sales less purchases	0.23	29	0.41	35
Other dairy income	0.46	59	0.70	60
Inventory change	0.47	61	-0.44	-37
<b>TOTAL INCOME</b>	<b>19.55</b>	<b>2497.36</b>	<b>20.19</b>	<b>1714.92</b>
<b>EXPENSES</b>				
Purchased feed				
Cow feed and minerals	3.03	387	2.55	217
Calves and replacements	0.30	39	0.00	0
<b>TOTAL</b>	<b>3.33</b>	<b>425.45</b>	<b>2.55</b>	<b>216.57</b>
<b>Other Variable costs</b>				
Vet & Medicines	0.58	74	0.11	9
Breeding AI Milk recording	0.30	39	0.42	36
Fertiliser & Lime	0.59	76	0.00	0
Seed & sprays	0.34	44	0.37	31
Straw silage adds plastic	0.31	40	0.13	11
<b>TOTAL</b>	<b>2.12</b>	<b>271.43</b>	<b>1.02</b>	<b>86.86</b>
<b>Parlour sundries</b>				
Consumable	0.26	33	0.18	15
Service & Maintenance	0.18	22	0.25	21
<b>TOTAL</b>	<b>0.44</b>	<b>55.87</b>	<b>0.43</b>	<b>36.44</b>
<b>Labour</b>	<b>3.87</b>	<b>494</b>	<b>6.27</b>	<b>533</b>
<b>Power &amp; Mach</b>				
Repairs & Spares	0.49	63	0.61	52
Fuel & Oil	0.27	34	0.61	52
Electricity	0.26	33	0.17	15
Tax & insurance	0.08	10	0.11	10
Contractors	1.01	128	0.00	0
<b>TOTAL</b>	<b>2.11</b>	<b>269.41</b>	<b>1.51</b>	<b>127.89</b>
<b>Deprecation &amp; Leasing</b>				
Plant & Mach	0.65	83	1.71	145
Buildings	0.46	58	0.62	52
Mach leasing	0.00	0	0.00	0
<b>TOTAL</b>	<b>1.11</b>	<b>141.83</b>	<b>2.32</b>	<b>197.39</b>
Sundry overheads				
Water	0.28	35	0.20	17
General insurance	0.15	20	0.25	21
Office phone bank charges	0.18	23	0.13	11
Professional fees	0.28	35	0.86	73
Subs	0.12	15	0.00	0
<b>TOTAL</b>	<b>1.00</b>	<b>128.12</b>	<b>1.43</b>	<b>121.81</b>
Repairs maintain on builds	0.45	58	1.12	95
<b>TOTAL EXPENSES</b>	<b>14.44</b>	<b>1844.38</b>	<b>16.66</b>	<b>1414.92</b>
<b>COMPARABLE FARM PROFIT</b>	<b>5.11</b>	<b>652.98</b>	<b>3.53</b>	<b>300.00</b>

From: Powell et al. (eds), *UK Organic Research 2002: Proceedings of the COR Conference, 26-28<sup>th</sup> March 2002, Aberystwyth*, p. 293. (expanded version).