FARMINFIN

Farming concepts and innovative funding/financing

MODULE B: Financial aspects

Basic knowledge and competences

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INTRODUCTION

This Module is focused on knowledge and competences needed for farm economic financial management with insights chapter by chapter.

The main issues addressed and which are applicable to the agricultural sector are:

- Financial planning.
- Financial statement.
- Budgeting and reporting.
- From the financial to the business plan.

LEARNING OBJECTIVES

The main learning objectives of this module are:

- To understand the key tools needed for farm economic and financial management.
- To know and manage the documents required for the financial statement.
- To gain adequate competences for the budgeting and reporting procedures.
- To acquire skills to assist you in your farm planning development from the financial to the business plan.

INDEX

Duration of the module: 3 hours

1. WHY APPLY FINANCE TO AGRICULTURE

1.1. Financial aspects: what they are and how you can use them

Agriculture is not only about farming activities, it also includes financial planning. The financial plan should be always part of the entrepreneurial works because, as the farmer needs to plan the works on field, he is also called to organize and take under control the cashflow, the financial costs, all the related matter to the labour activities and all the factors of production necessary to generate income and, supposedly, net profit.

FARMING ACTIVITIES

- Land processing
- Harvesting
- Seeding
- Best Agronomic practices
- Vehicle maintenance
- Pruning
- Sales
- Blockchain

FINANCIAL PLANNING

- Financial costs
- Cashflow
- Investment
- Reporting activities
- Balance sheet
- Budget
- Taxes
- Profit & loss
- Net revenue

1.2. The Financial plan

The financial plan is an integrated tool necessary to go deeply into the farm running operations. Farmers need to work closely with the financial plan to keep expenses, running cost, financial cost, cashflow and sales forecast under control. Farmers need to get acquainted with the financial plan to take strategic decisions for the future that include budget and reporting activities necessary to "adjust the route" during the entire year.

1. **Start by setting financial goals.**
2. **Track your money, and redirect it toward your goals.**
3. **Get your employer match.**
4. **Make sure emergencies don't become disasters.**
5. **Tackle high-interest debt.**
6. **Invest to build your savings.**

A financial plan is a comprehensive picture of your current finances, financial goals and any strategies you have set to achieve those goals. Good financial planning should include details about your cash flow, savings, debt, investments, insurance and any other elements of your financial life. Moreover, it is important because it allows you to make the most of your assets, and helps ensure you meet your future goals.

Financial planning isn't just for the wealthy: creating a roadmap for the financial future is for everyone a way to follow during the entire year in order to respect the principles of effectiveness and efficiency.

A good financial plan is guided by your financial goals. Make your financial goals inspirational and start with goals because they will inspire you to complete the next steps and provide a guiding light as you work to make those aims a reality.

2. INSIDE THE FINANCIAL PLAN

2.1. Sales Forecasting

It is a very precious tool for management because it allows strategic decisions to be made with greater accuracy, starting from a basis of real information. The usable methodologies are traditionally divided into two large families: quantitative sales forecasting techniques and qualitative techniques. In the first case, the approach to forecasting is mathematical, based on formulas and statistical data. The other type of approach includes all those methods used when there is not sufficient historical data. In this way, one is forced to predict the results starting from more subjective elements such as, for example, the experience of a group of expert sellers, surveys or market surveys conducted on customers.

Key activities

1. **Sales planning:** famers can better organize their activities anticipating and managing any periods of low activity.
2. **Preventing the demand for the product:** knowing the future potential volume of sales reduce the risk of being left with an empty warehouse and consequently delays in deliveries.
3. **Organize and financial planning:** Forecast the sales helps to predict what will be the volume of the turnover and the consequent profits for the company.
4. **Plan company activities:** If you know the size of the future sales, it is easier to have a precise idea of the financial needs of the company.
5. **Continuous improvement:** by analyzing past sales cycles, it is possible to identify more clearly any effective working models, successful strategies and get an overview of the sales forces performances.
6. **Strengthening of marketing activities:** a good sales forecasting activity allows the department to organize specific promotions or strategies to deal with any periods of low seasonality.

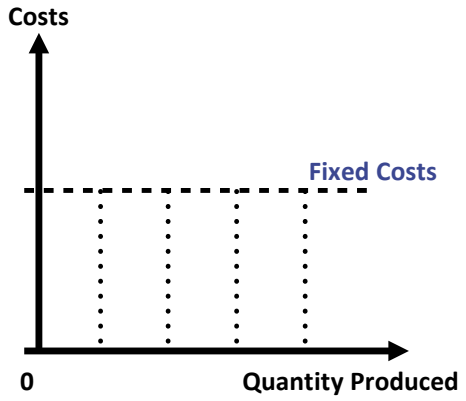
2.2. Expenses outlay (production costs)

The costs of production are all the costs that the farm has to incur to carry out a specific production of goods and services. Obviously, the entrepreneur has an interest in keeping costs as low as possible, since profit arises from the difference between revenues and costs. However, this does not mean that it is always necessary to aim only at cost reduction. Reducing production costs, in order to maximize profit, is sometimes not possible because, some costs are incurred for compliance with legal regulations and for ethical/social reasons.

TYPE OF COSTS → **FIXED COSTS**

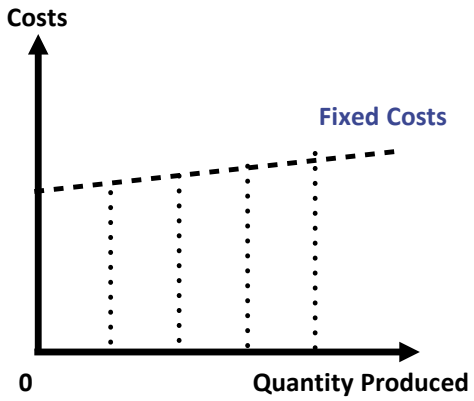
Fixed costs do not change as the quantity produced varies.
Fixed costs are costs for wages and salaries, rents paid for the premises where the business is carried out, interest on mortgages. However they don't vary limited periods and have a typical scale trend

FIXED COSTS MODEL 1



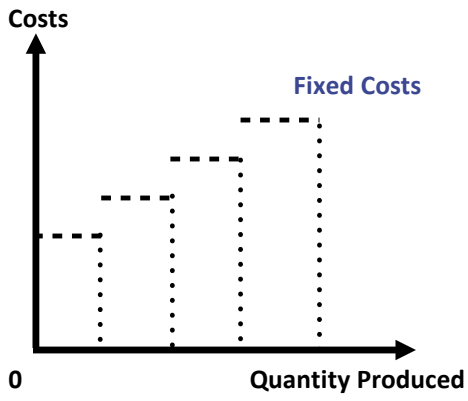
Regardless of the quantity produced, the fixed costs remain unchanged so they can be significantly reduced only by maximizing the production; the line of fixed costs remains perfectly linear and does not undergo deviations.

FIXED COSTS MODEL 2



As the quantity produced increases, fixed costs tend to increase, but in a slight way and with little impact on production, since the variation is proven by an increase in maximum production; the line of fixed costs therefore undergoes a slight increase.

FIXED COSTS MODEL 3

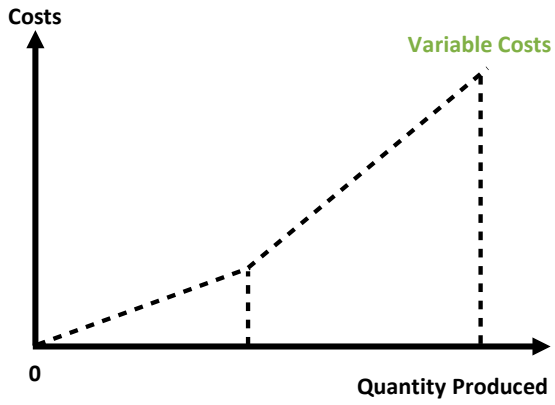


In particular cases, the trend of fixed costs assumes a "scale" conformation where, the increase in productivity is associated with an increase in fixed costs which tends to make a net increase (e.g. acquisition of a new warehouse to increase the production).

TYPE OF COSTS → **VARIABLE COSTS**

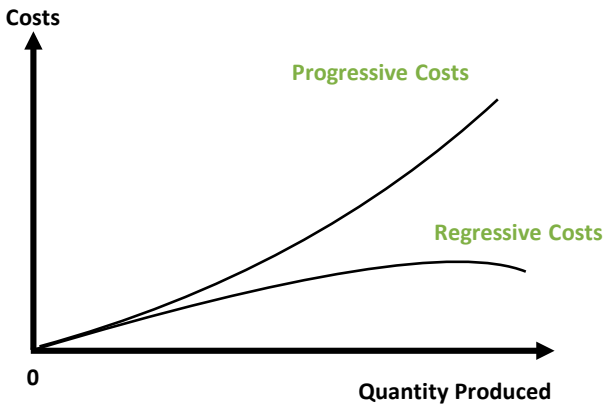
Variable costs are costs that vary as the quantity produced varies; the variables are the costs for raw materials, electricity and fuels.
They are equal zero when production is inexisting and grow as the quantity produced increases at first slowly, then more rapidly.

VARIABLE COSTS
General trend



Progressive costs are those variable costs whose total amount increases more than proportionally with respect to the quantities produced. Example: maintenance or personnel costs when used overtime.

VARIABLE COSTS
Progressive and regressive outlay



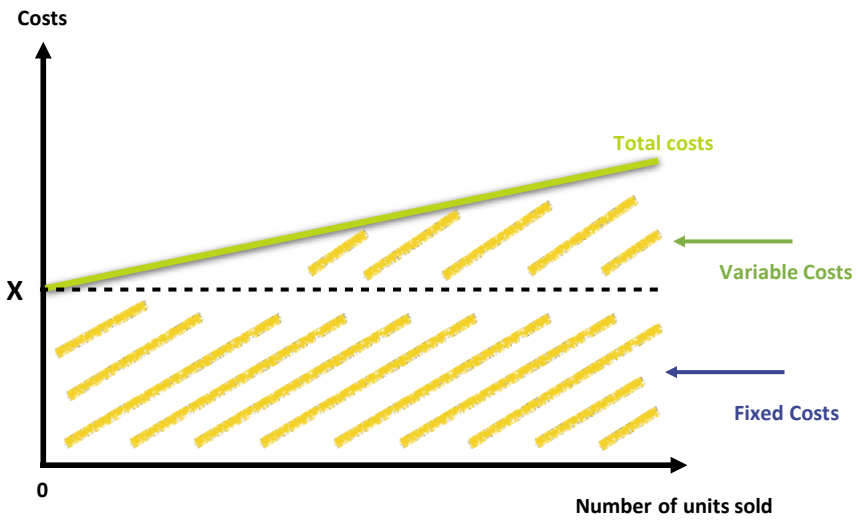
In the regressive variable costs, the quantity produced increases in less than proportional way. Example: the purchase costs of raw materials which, after certain thresholds, benefit from quantity discounts.

TYPE OF COSTS → **TOTAL COSTS**

The total costs incurred by the company are given by the sum of fixed costs and variable costs.

To draw the total cost curve it is needed to add the fixed cost curve to the variable cost curve.

The total costs curve does not start from the origin of the axes, but from a specific point (called X in the graph on the left) which represents the total costs incurred even if the production is equal to zero (in this case the costs for fixed assets remain in place even if the production process stops).



Fixed costs do not vary as the quantity produced varies, but this is true only within certain limits.

If the demand for goods grows and the farm has to increase its production capacity, the fixed costs will increase.

Therefore, we could also say that the fixed costs are fixed during a short-term period, while in the long run all costs are variable.

By 'short-term', we mean the period of time in which the company does not change the size of its plants.

2.3. Cash Flow

Cash flow indicates the positive or negative changes in the farm's liquidity that occur in a given period of time, generally a year. It is also called primary flow after tax. In practice, it is obtained as the difference between the total of cash inflows and cash outflows and represents the amount of cash that the company owns at a given time in its life.

Cash flow is a measure of the company's ability to self-finance itself without having to incur into new debt. In practice, cash flow analysis is one of the main tools for controlling the financial management of the farm which aims to optimize treasury management by containing financial charges. If the farmer is able to estimate the cash flows at a certain date with a good approximation, he will be able to negotiate in time any hedges necessary to cover the liquidity deficit. However, this also means that more profitable uses for the current liquidity can be provided, while still guaranteeing the financial solvency of the company even in the face of unforeseen events. Cash activities are closely related to risk management operations.

How to better manage your company's cash flow

Business management must aim to reach a positive cash flow. With the right liquidity, in fact, the company is able to pay taxes, suppliers and other creditors, as well as employees, without problems and, why not, make additional investments to support business growth. Here are some focus points to keep always in consideration:

1. **Implement effective risk management strategies:** Identifying and controlling business risks (risk management), allows you to prevent possible scenarios of illiquidity.
2. **Better manage payment extensions:** It is a good idea to keep track of all the payment extensions granted, and schedule them so that the collection flows are constant over time.
3. **Periodically update budget forecasts:** The budget is the document that indicates the forecast of the equity and economic-financial situation at the end of a period. Its reliability increases as time passes and the set deadline is approaching, because the forecasts in it, are replaced with final data.
4. **Carefully calculate depreciation of machinery and equipment and inventory:** it will allow you to avoid massive write-downs in the terminal phase of their useful life, which could penalize cash flow.
5. **Equip yourself with technologies to manage cash flow in advance:** There are very good software on the market to reduce or avoid liquidity risk (e.g. platforms and services offering cash flow projection and anticipated management capabilities).

2.4. Construction of the selling price

It is above all entrepreneurs who are initially hit with the question: How should I calculate the price for my product or service? What is a reasonable price? The calculation of the sale price should absolutely not be entrusted to instinct, but on the contrary, be based on a precise calculation in which the perfect price for your offer is determined based on certain factors. Ideally, you should have completed the pricing calculation even before product development is finished or before offering your service.
It is recommended to calculate the sale price already during the drafting of the business plan.

	Costs of single materials	→ **Variable costs**
+	General costs of materials	
=	Costs of materials	
+	Single cost of production	
+	General costs of productions	→ **Fixed costs**
=	Costs of production	
+	Single admin expenses	
+	General costs of sales	→ **General costs**
=	Costs production effective	→ **Total cost of the product**
+	Margin profit	→ **Mark-up**
+	Discount	
=	Final Price List (VAT excluded)	→ **Selling Price**

Inexperienced entrepreneurs often make the same mistakes when calculating their prices. It often happens, for example, that they set a price too low and therefore endanger the entire company. Once the sale price has been set, it is difficult to change it again: customers usually react angrily to price increases, especially if there are no innovations or improvements to the offer. Here below some common mistakes to avoid:

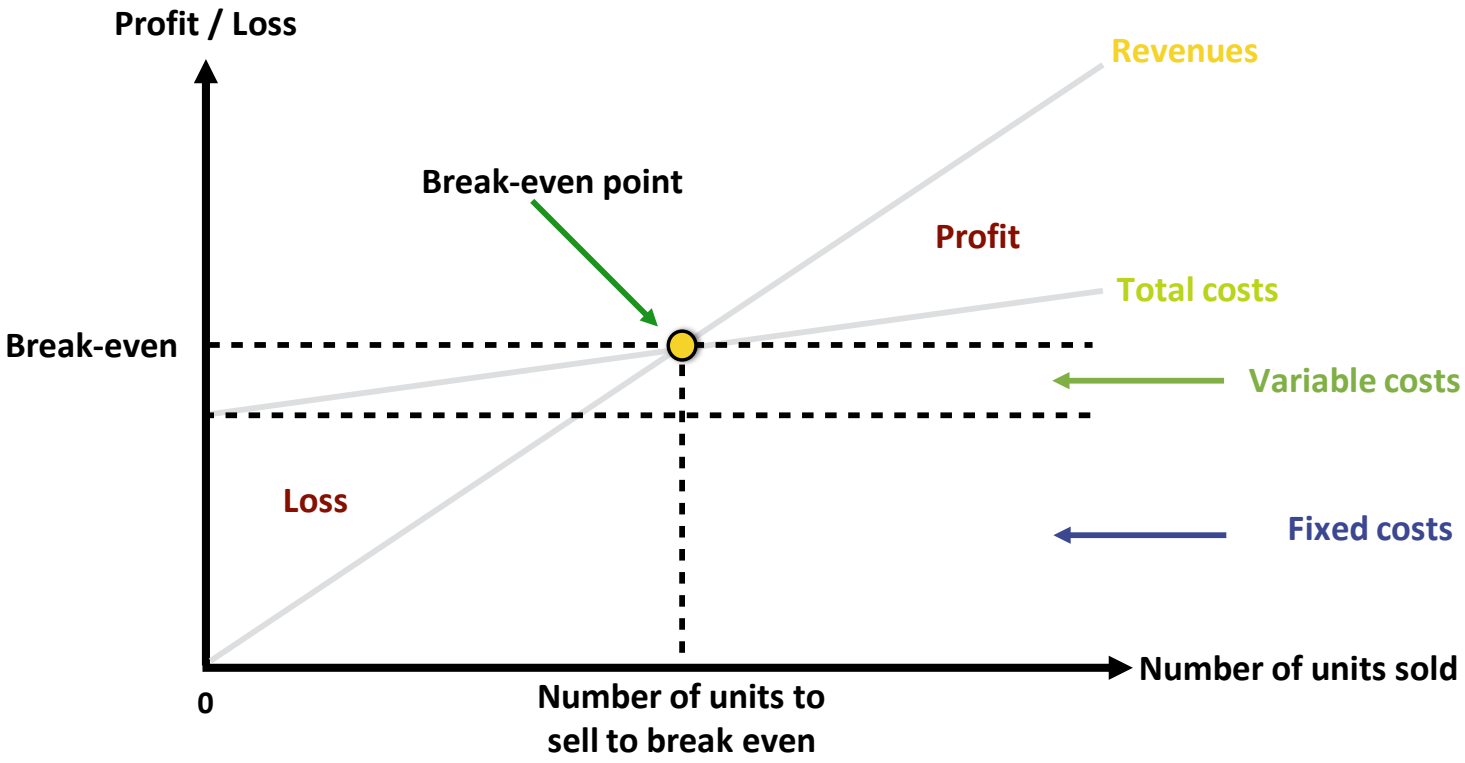
- Don't include all costs;
- Incorrect estimates of demand;
- Generating too high costs;
- Forget about your remuneration.

You can find more information related to «Price» from a financial perspective in the «Business Plan» Module .

2.5. Break-even analysis

Break-even analysis entails calculating and examining the margin of safety for an entity based on the revenues collected and associated costs. In other words, the analysis shows how many sales it takes to pay for the cost of doing business. Analyzing different price levels in relation to various levels of demand, the break-even analysis determines what level of sales are necessary to cover the company's total fixed costs. A demand-side analysis would give a seller significant insight into selling capabilities.

Break-even analysis is useful in determining the level of production or a targeted desired sales mix. The study is for a company's management use only, as the metric and calculations are not used by external parties, such as investors, regulators, or financial institutions. This type of analysis involves a calculation of the break-even point (BEP). The break-even point is calculated by dividing the total fixed costs of production by the price per individual unit minus the variable costs of production. Fixed costs are costs that remain the same regardless the number of units sold.



3. THE FINANCIAL STATEMENT

Financial statements are written records that convey the business activities and the financial performance of a company. Financial statements are often audited by government agencies, accountants, firms, etc. to ensure accuracy and for tax, financing, or investing purposes. Financial statements include:

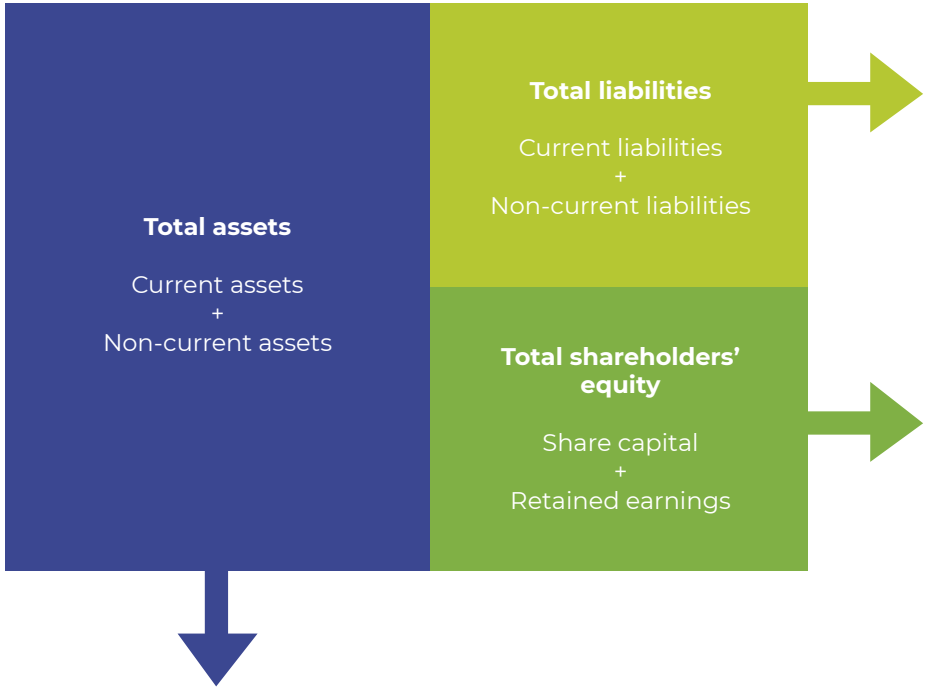
BALANCE SHEET

PROFIT & LOSS

3.1. The Balance Sheet

A balance sheet it is a significant part of financial statement that reports company's assets, liabilities and shareholders' equity at a specific point in time, usually the end of the year, and provides a basis for computing rates of return and evaluating its capital structure. The balance sheet provides a snapshot of what a company owns and owes, as well as the amount invested by shareholders.

A Simple Balance Sheet



Liabilities and equity are two sources that support these assets. Owners' equity, referred to as shareholders' equity, in a publicly traded company, is the amount of money initially invested into the company plus any retained earnings, and it represents a source of funding for the business.

Shareholders' equity is the initial amount of money invested in a business. If at the end of the fiscal year, a company decides to reinvest its net earnings into the farm (after taxes), these retained earnings will be transferred from the income statement onto the balance sheet and into the shareholder's equity account. This account represents a company's total net worth. In order for the balance sheet to balance, total assets on one side have to equal total liabilities plus shareholders' equity on the other side.

The assets are balanced by a company's financial obligations, along with the equity investment brought into the company and its retained earnings.

It is important to note that a balance sheet is a snapshot of the company's financial position at a single point in time.

CURRENT ASSETS	**CASH AND EQUIVALENTS**	The most liquid of all assets, cash, appears on the first line of the balance sheet. Cash equivalents are also lumped under this line item and include assets that have short-term maturities under three months or assets that the company can liquidate on short notice, such as marketable securities. Companies will generally disclose what equivalents it includes in the footnotes to the balance sheet.
	ACCOUNT RECEIVABLES	This account includes the balance of all sales revenue still on credit, net of any allowances for doubtful accounts (which generates a bad debt expense). As companies recover accounts receivables, this account decreases, and cash increases by the same amount.
	INVENTORY	Inventory includes amounts for raw materials, work-in-progress goods, and finished goods. The company uses this account when it reports sales of goods, generally under cost of goods sold in the income statement.
TOTAL LIABILITIES	**BONDS PAYABLE**	This account includes the amortized amount of any bonds the company has issued.
	LONG TERM DEBT	This account includes the total amount of long-term debt (excluding the current portion, if that account is present under current liabilities). This account is derived from the debt schedule, which outlines all of the company's outstanding debt, the interest expense, and the principal repayment for every period.
TOTAL SHAREHOLDER EQUITIES	**SHARE CAPITAL**	This is the value of funds that shareholders have invested in the company. When a company is first formed, shareholders will typically put in cash.
	RETAINED EARNINGS	This is the total amount of net income the company decides to keep. Every period, a company may pay out dividends from its net income. Any amount remaining (or exceeding) is added to (deducted from) retained earnings.

Example of balance sheet

	X	X+1	X+2
Assets			
Cash	100	130	30
Account Receivable	90	50	110
Inventory	10	20	80
Current Assets	200	200	220
Property & Equipment	200	300	330
Total Assets	400	500	550
Liabilities			
Short-term debt			
Account Payable	40	10	40
Current Liabilities	40	10	40
Long Term Debt	100	80	70
Total Liabilities	140	90	110
Shareholder's Equity			
Equity Capital	160	190	190
Retained Earnings	100	220	250
Shareholder's Equity	260	410	410
Total Liabilities & Shareholder's Equity	400	500	550

The farmer has to "investigate"

- THERE IS A IMPORTANT DECREASE OF CASH BETWEEN X+1 AND X+2 YEAR, WHY?
- THE ACCOUNT RECEIVABLES IS INCREASING, WHY ARE WE NOT COLLECTING MONTHLY PAYMENT FROM OUR CUSTOMER?
- THE INVENTORY VALUE IS HIGHER? WHY? IN X+2 WHY HAVE SOLD LESS THAN X+1?
- EQUIPMENT IS INCREASING, WHY? ARE WE INVESTING IN FIXED ASSETS?
- LONG-TERM DEBTS ARE DECREASING, IT'S A GOOD TREND FOR THE FARM AND THE INVESTORS
- WE ARE RETAINING PROFIT, WHY? IS THERE A PARTICULAR REASON? SHOULD WE TAKE OTHER ACTIONS LIKE DISTRIBUTE OR INVEST IN SOME WAY?
- THERE IS A YEARLY INCREASE EACH YEAR: WE APPEAR STRONGER TOWARDS INVESTORS, BANK SYSTEM, CUSTOMER, SUPPLIER AND EMPLOYEE, THE TREND IS POSITIVE AND MUST CONTINUE IN THE FUTURE

3.2. The profit and loss

The profit and loss it is another part of the financial statement that summarizes revenues, costs, and expenses incurred during the year; include depreciations, interest paid and tax computation. These records provide information about a company's ability or inability to generate profit by increasing revenue, reducing costs, or both.

The income statement follows a general form as seen in the example below. It begins with an entry for revenue, known as the top line, and subtracts the costs of doing business, including the cost of goods sold, operating expenses, tax expenses, and interest expenses. The difference is net income, also referred to as profit or earnings.

It is important to compare income statements from different accounting periods, as the changes in revenues, operating costs, research and development spending, and net earnings over time are more meaningful than the numbers themselves.

A. VALUE OF PRODUCTION

1. Revenue from sales and service
2. Change in inventories of work in progress, semi-finished and finished products
3. Variation work in progress on demand
4. Increment of fixed assets for internal works
5. Other Revenues

B. COSTS OF PRODUCTION

6. Raw and consumable materials
7. For services
8. Usage of third party assets
9. Staff costs
10. Depreciations and write-downs
11. Change in inventories
12. Change in inventories of work in progress, semi-finished, finished products and goods
13. Other provisions
14. Different management charges

GROSS OPERATING PROFIT OR **EBITDA**

C. FINANCIAL INCOME AND EXPENSES

15. Income from equity investment
16. Other financial income
17. Interest and other financial charges

EBIT

D. FINANCIAL ADJUSTMENT

18. Revaluation
19. Write-down

PROFIT BEFORE TAX

20. Taxes
21. Net Profit (Loss)

This structure is the one that is internationally recognized by internal regulations on the subject of financial statements.

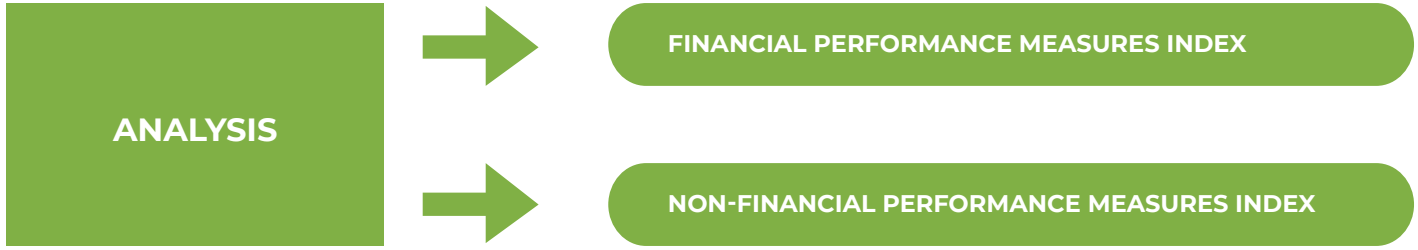
IAS (International accounting Standards)
IFRS (International Financial Reporting Standard) standards comply.

The income statement, in order to be analyzed, must be reclassified according to specific productions and groupings, which will then give the opportunity to analyze the financial statements by index and compare the management of different financial years to investigate the state of the company's health. Such analysis is particularly useful for the owner to understand what is happening, what is wrong and how to intervene, but also for potential investors and the banking system for the issue of loans for various reasons.

3.3. Financial performance measures indicators

Analyzing a financial statement means reading the accounting and extra accounting data of various kinds, in more detail and using them to formulate evaluations and judgments on company management.
The analysis is useful for determining the "state of health" of the company and its positioning with respect to 3 balances:

- **Economic:** the company's ability to produce income, for a sufficiently long time, capable of remunerating all the factors of production;
- **Assets:** the balance between assets and liabilities;
- **Financial:** the ability of a company to respond in a timely manner to the commitments undertaken.



The financial statement analysis is an activity carried out with the use of mainly quantitative data processing techniques. Surveys are carried out on the financial statements, to obtain information on management and company as well. Through the comparative balance sheet analysis of the various elements available, it is possible to formulate a "judgment" on the company's health. The analysis aims to transform the balance sheet and profit &loss data into usable information for suppliers, customers, banking system, potential investors, etc. It is also a fundamental tool for the entrepreneur to investigate the situation of his/her company with clear tools that can provide important strategic indications.

The financial statement analysis, through the index technique, is carried out via the elaboration of specific relationships that are established between the different quantities represented in the entire report.

The best results in terms of interpretation and evaluation are therefore achieved by analyzing a series of financial statements and studying the trend over time of the most significant indices, in order to understand in which direction the farm is moving.

Once the financial statements have been reclassified, it is possible to calculate the indices that will return the company situation on numerous aspects.

ROI, ROE, ROS, ROD, LEVERAGE, EBITDA, EBIT and others indices are used to check the financial health of the farm; most of them are important indexes analyzed by the bank system to allow grant, loan and so on,. Therefore, farmers are called to keep them under control and make sure that their level can help the farm to have good reputation and be attractive to the external stakeholders.

ROI → **RETURN ON INVESTMENT** →

is a ratio between net profit (over a time period) and cost of investment (resulting from an investment of some resources at a point in time).

What qualifies as a "good" ROI will depend on factors such as the investor's risk tolerance and the time required for the investment to generate a return. Investors who are more risk averse will likely accept lower ROIs in exchange for a reduced risk taking. Likewise, investments that take longer to pay off will generally require a higher ROI in order to be attractive to investors.

$$= \frac{\text{Net Income (Gross profit - Expenses)}}{\text{Shareholder's Equity}}$$

ROE → **RETURN ON EQUITY** →

is a measure of financial performance calculated by dividing net income by shareholders' equity. Because shareholders' equity is equal to a company's assets minus its debt, ROE is considered the return on net assets.

A sustainable and increasing ROE over time can mean a company is good at generating shareholder value because it knows how to reinvest its earnings wisely, so as to increase productivity and profits. In contrast, a declining ROE can mean that management is making poor decisions on reinvesting capital in unproductive assets.

$$= \frac{\text{Net Income (Gross profit - Expenses)}}{\text{Investment (Stock+Market Outstanding+Claims)}}$$

ROS → **RETURN ON SALES** →

Return on sales is a ratio used to evaluate a company's operational efficiency. This measure provides insight into how much profit is being produced per euro of sales. An increasing ROS indicates that a company is growing more efficiently, while a decreasing ROS could signal impending financial troubles.

ROS is used to compare current period calculations with calculations from previous periods. This allows a company to conduct trend analyses and compare internal efficiency performance over time. It is also useful to compare one company's ROS percentage with that of a competing company, regardless of scale.

$$= \frac{\text{Operating Profit (EBIT)}}{\text{Net Sales (Revenue)}}$$

ROD → **RETURN ON DEBTS** →

The return on debt (ROD) can be expressed as the quantification of a company's performance or net income as allied to the amount of debt issued by the company.

The return on debt refers to the amount of profit generated for every dollar held by a company in debt. ROD is a financial modeling skill rather than being a commonly used financial reporting factor. Moreover, companies carrying a significant amount of debt related to capital and/or assets are more prone to economic downturns during a decline in earnings and credit measures might be tightened.

$$= \frac{\text{Net Income (Gross profit - Expenses)}}{\text{Long Term Debts}}$$

LEVERAGE →

The term leverage or debt ratio is an indicator used to measure a company's debt.

Firms use debts (e.g. use of third-party capital such as banks or other lenders) as a source of financing, both for its cost, generally lower than that of risk capital (especially long-term debt), and for the tax advantage that it generates. The higher the debt ratio, the more the company and its economic activity will be considered risky.

$$= \frac{\text{Shareholder Equity (Equity share capital+reserves+surplus)}}{\text{Total Capital (shareholder equity+bond+long-term Loan)}}$$

EBITDA → **EARNINGS BEFORE INTERESTS, TAXES, DEPRECIATION AND AMORTIZATION** →

EBITDA, also called Gross Operating Margin (GOM) is a profitability indicator that highlights the income of a company based only on its operational management, therefore without considering interests (financial management), taxes (fiscal management), assets depreciation and amortizations.

This indicator is suitable for comparing the results of different companies operating in the same sector. Since EBITDA is a quick approximation of the value of the cash flows produced by a company, it is used (often together with other methods) to approximate the value of the same companies in the sector in which it operates.

EBITDA is a more important figure than profit for financial analysts because it allows you to clearly see if the company is able to generate wealth through operational management, thus excluding the manoeuvers made by the company's administrators (depreciation and provisions, but also financial management), which do not always provide a correct view of a company's performance.

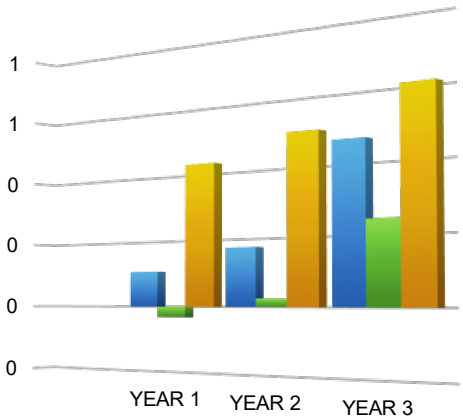
EBIT → **EARNINGS BEFORE INTERESTS AND TAXES** →

EBIT expresses the income that the company is able to generate before the return on capital, including both third-party capital (debt) and equity capital (equity).

In the formulation of the financial statement ratios it is used to obtain the ROI (EBIT / Net Invested Capital). EBIT is often associated with the net operating margin (NOM), but does not conceptually coincide with it: in addition to the operating income components, EBIT in fact includes the charges and income deriving from ancillary operations, as well as the financial income deriving from financial management.

Balance sheet

DESCRIPTION	YEAR 1	YEAR 2	YEAR 3
CURRENT ASSET	100,00 €	110,00 €	80,00 €
LONG-TERM INVESTMENT	250,00 €	220,00 €	200,00 €
PROPERTY, PLANTS, EQUIPMENT	50,00 €	100,00 €	110,00 €
TOTAL ASSET	**400,00 €**	**430,00 €**	**390,00 €**
CURRENT LIABILITIES	80,00 €	100,00 €	10,00 €
LONG TERM LIABILITIES	150,00 €	180,00 €	180,00 €
EQUITY	170,00 €	150,00 €	200,00 €
TOTAL LIABILITIES	**400,00 €**	**430,00 €**	**390,00 €**



Profit & loss

DESCRIPTION	YEAR 1	YEAR 2	YEAR 3
SALES	100,00 €	150,00 €	300,00 €
COST OF PRODUCTION	60,00 €	80,00 €	130,00 €
EBITDA	**40,00 €**	**70,00 €**	**170,00 €**
FINANCIAL INCOME AND EXPENSES	30,00 €	50,00 €	60,00 €
EBIT	**10,00 €**	**20,00 €**	**110,00 €**
FINANCIAL ADJUSTMENT	15,00 €	15,00 €	45,00 €
PROFIT BEFORE TAXES	**-5,00 €**	**5,00 €**	**65,00 €**
TAXES	0,00 €	1,50 €	19,50 €
NET PROFIT (-LOSS)	**-5,00 €**	**3,50 €**	**45,50 €**

In order to obtain a concrete analysis from which one can lean on to make strategic choices, it is necessary to reclassify the financial statements according to certain standards by examining at least 3 subsequent years, preferably 5, in order to evaluate the performance of the various economic and financial indicators.

3.4. Non-financial performance measures indicators

Usually when we talk about indexes to measure performance, we only consider the financial aspects. However, there is another “side of the same coin” given by the non-financial performance measures index, not closely related to finance, that are going to have an impact on other aspects of the farm life and operations such as customers, internal processes, learning and growth.

The easiest way to define non-financial performance measures is to explain what they aren’t. Non-financial indicators are not expressed as monetary values but they focus on other aspects of the business and are often leading measures.

These types of measures can be either quantitative or qualitative; many organizations view employees “soft skills” as the biggest contributors to non-financial performance, which can be measured in various ways.

Key performance indicators, or KPIs, are an important part of the information needed to determine and explain how an organization progresses towards its business and marketing objectives.

A key performance indicator is a quantifiable measure that a company uses to determine to what extent its operational and strategic objectives are being achieved.

This means that different companies have different KPIs depending on their respective performance criteria or priorities and, at the same time, the indicators usually follow industry standards.

These indicators are important in addressing marketing vehicles for management: without these indicators and the guidance they provide to businesses, it is nearly impossible for them to reach their full potential.

Non-financial KPIs are important primarily for two key reasons:

1. They help explain and provide context for financial KPIs. Financial measures are typically lagging indicators, which are fairly easy to collect and analyze because they are backward-looking. Lagging measures report what has already happened, such as revenue generated or orders fulfilled for a specific time period. Non-financial performance measures can fill in the gaps and give answers on monetary fluctuations. For example, if marketing efforts missed the mark for a quarter, you can expect sales to be slow in the next quarter;
2. Non-financial KPIs are easier to link to certain aspects of your overall strategy. Most organizations don't have a finance-based mission (e.g. if your mission is to provide the best customer service in the industry, revenue numbers aren't a good way to track that but something like customer satisfaction scores are).

- **Quantifiability:** KPIs can be presented in the form of numbers.
- **Practicality:** They integrate well with current business processes.
- **Directionality:** Help determine if a company is improving.
- **Operability:** They can be related to the practical context to measure effective change.

Why should companies track non-financial performance measures?

There's no doubt that tracking financial KPIs is critical and the top priority for some organizations, but that doesn't mean you should overlook other KPIs when managing performance. Companies need to track non-financial performance measures because they:

- **Help capture strengths and weaknesses.** If you excel at customer service but have long waiting times before a customer reaches a representative, that will show up in a non-financial KPI such as a feedback survey. These measures can reveal your core competencies and highlight other areas you didn't realize were suffering.
- **Affect business performance.** Over or underperformance is eventually going to show up in your bottom line, and you can trace it back to the source with non-financial performance measures. For example, if the HR recruiting budget skyrocketed, you can see it's because of the high employee turnover rate and exorbitant cost (in time and resources) of hiring.
- **Give employees better feedback on how to meet strategic objectives.** When properly built, non-financial KPIs are specific, measurable, and ladder up to the organization's big-picture strategy. Team members are able to see exactly what they need to do to hit their goals and they also understand why they need to produce the same report every month or how their attendance rates lead to productivity. There's a clear connection between daily tasks and strategic direction.
- **Be better at adjusting to external factors.** Every business faces external risks outside its control that can negatively impact measures like revenue and expenses. Recessions, war, and unexpected events are unavoidable and unpredictable.

Non-financial KPIs - CUSTOMER

- **Conversion Rate:** The percentage of interactions that result in a sale. Formula: (Interactions with Completed Transactions) / (Total Sales Interactions) = (Conversion Rate)
- **Retention Rate:** The portion of consumers who remain customers for an entire reporting period. Formula: (Customers Lost in a Given Period) / (Number of Customers at the Start of a Period) = (Customer Retention Rate)
- **Contact Volume By Channel:** The number of support requests by phone and email. This allows the organization to not only compare which method customers prefer, but also to track the number of support requests month-to-month.
- **Customer Satisfaction Index:** Gauge of a company's success at meeting customers' needs.
- **Net Promoter Score:** The likelihood that customers will recommend a brand to others. A score from 1-10 that qualifies promoters (usually 9-10) and detractors (under 6). Formula: (Number of Promoters) - (Number of Detractors) = (Net Promoter Score)

Non-financial KPIs - INTERNAL PROCESS

- **Customer Support Tickets:** The number of new tickets, the number of resolved tickets, and resolution time.
- **Product Defect Percentage:** This will give you the percentage of defective products in a specified timeframe. Formula: (Number of Defective Units in a Given Period) / (Total Number of Units Produced in a Given Period) = (Product Defect Percentage)
- **On-Time Rate:** The percentage of time products were delivered promptly as scheduled. Formula: (Number of On-Time Units in a Given Period) / (Total Number of Units Shipped in a Given Period) = (On-Time Rate)
- **Efficiency Measure:** Efficiency can be measured differently in every industry, so this common KPI will vary. For example, the manufacturing industry can measure efficiency by analyzing how many units are produced every hour and the plant's up-time percentage.
- **Overdue Project Percentage:** The number of projects that are late or behind schedule. This can be pulled from your project status dashboard. Formula: (Number of Overdue Projects in a Given Period) / (Total Number of Projects in a Given Period) = (Overdue Project Percentage).

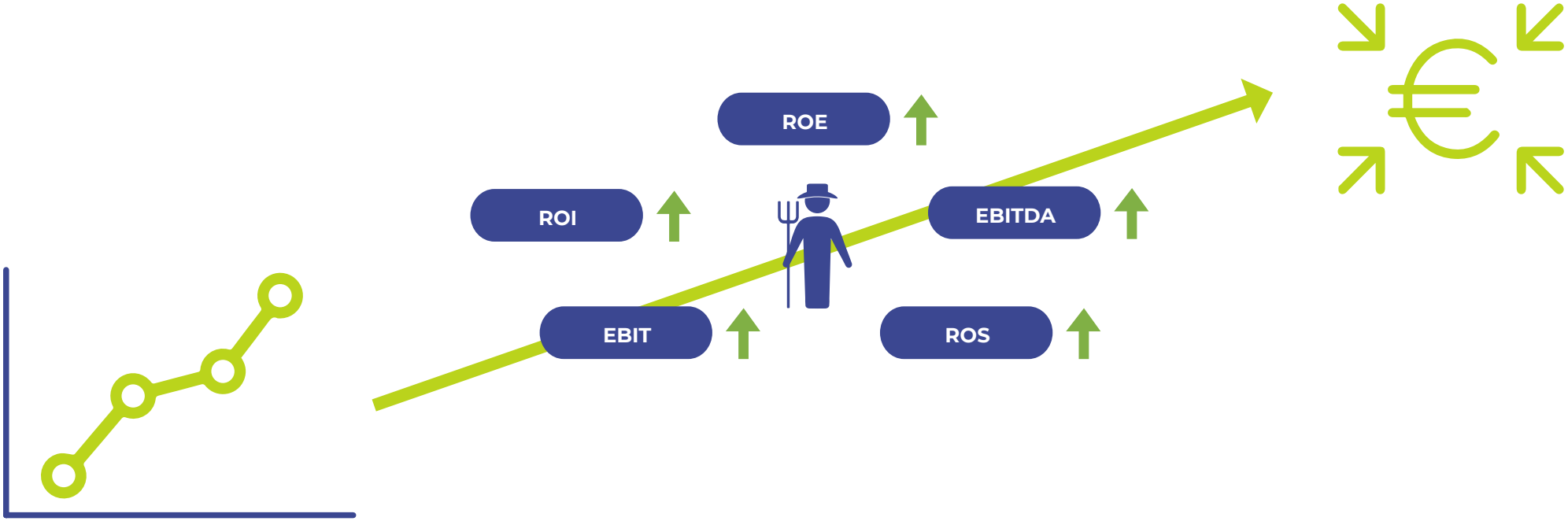
Non-financial KPIs - LEARNING & GROWTH

- **Salary Competitiveness Ratio (SCR):** The competitiveness of compensation options. Formula: (Average Company Salary) / (Average Salary Offered from Competitors or Average Salary Offered by Industry) = SCR.
- **Employee Productivity Rate:** Workforce efficiency measured over time. Formula: (Total Company Revenue) / (Total Number of Employees) = (Employee Productivity Rate).
- **Turnover Rate For Highest Performers:** The success of retention efforts for top performers and plans for talent replacement. Formula: (Number of High Performers Who Departed in Past Year) / (Total High Performers Identified) = (High Performer Turnover Rate).
- **Average Time To Hire:** The efficiency of the hiring process measured by time to recruit, interview, and hire.
- **Internal Promotion Rate:** The successful retention and growth of top performers. (The Number of Promoted Individuals) / (Total Number of Employees) = (Internal Promotion Rate).

3.5. Good Financial and non-financial performance generates wealth

Good financial performance indicate wealth for the farms and the farmers as well; good indicators mean good health and this will positively act on the bank system, investors, customers and all the stakeholders with relevant concern on farm operations.

Farmer need to approach finance in a new and innovative way because the future will bring new tools and possibilities. Good finances management will be key in order to get all the chance offered by the market of finance. Complex tools are already available at different levels and many others are going to be available in the near future in the context of the new CAP and other farm policies at the national and EU level. Finances and operations need to be taking together into account to face upcoming challenges and embrace opportunities.

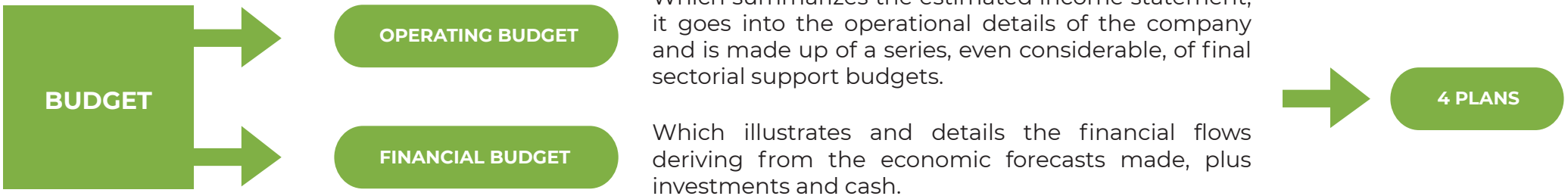


4. BUDGETING AND REPORTING

4.1. Budget activities

Budget must be considered as a necessary tool to manage one's business at the beginning of the year in order to schedule activities and write down the expected figures. While the financial statement aims to check the financial and economical situation at the end of the year, the budget fixes the goals and the strategies that have to be applied to reach them.

The budget is one of the fundamental tools for planning and controlling economic activity

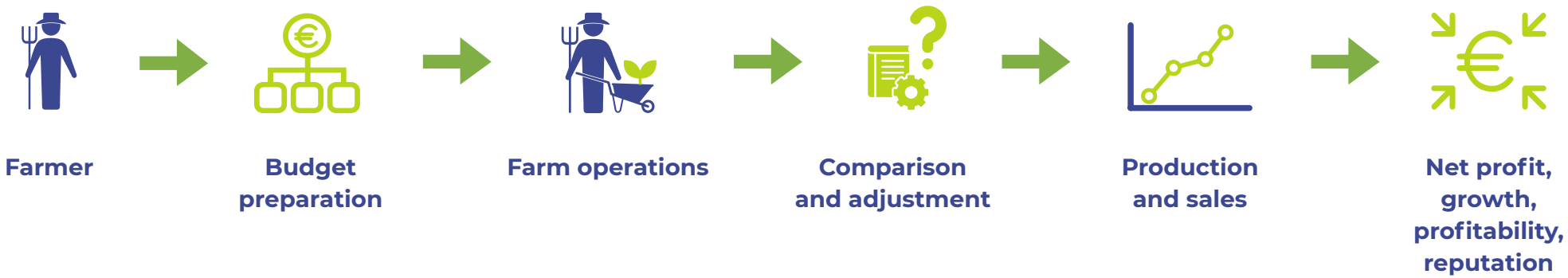


1. **Investment Plan (starting point of the budget)** It is the starting point. It provides the variation of fixed capital to the balance sheet, the amortization to the economic budget, and the resource requirements to the financial budget.
2. **Economic Plan: revenues, costs, margins, profit.** The economic budget is divided into divisional, functional (or operational) budgets and possibly by project / order (which associates a product line with a customer class: product / market matrix).
3. **Asset Plan: fixed assets, current assets, permanent capital, current liabilities etc.** It is made up of a sources-uses table (self-financing from income management, short and long-term debt increases, fixed and working capital divestments); uses: calls for fixed assets, increases in credits and stocks, debt repayments, repayments equity and the cash or treasury budget.
4. **Financial Plan: sources-uses, or needs-coverage, divided into short and long term.** Balance sheet at the end of the financial year, which is obtained by adding the cash flows of the financial budget to the values of the initial balance sheet by increase or decrease.

Obviously the budget preparation is a complex activity and its structure depends on the farm size. Small farms can more easily prepare a budget following the above-mentioned structure. It's important to perform this strategic step necessary for the farm management planning, useful to keep all the beacon at the right point in order to guarantee the final goal: the net profit build-up year by year.

4.2. Reporting activities

It is necessary to carry reporting activities throughout the year to keep under control the actual situation and monitor if any adjustment needs to be made to maintain or implement the running operations as predicted at the beginning of the year. The person in charge of reporting will have a look at budget estimates and reporting checks and see if those figures are aligned to the financial goals planned. Below, a simple graphic of what reporting entails. Overall, reporting helps to adjust the decisions taken at the beginning of the year and is used to operate better, with less cost, better organization, better respect of the environment to maximize the profits.

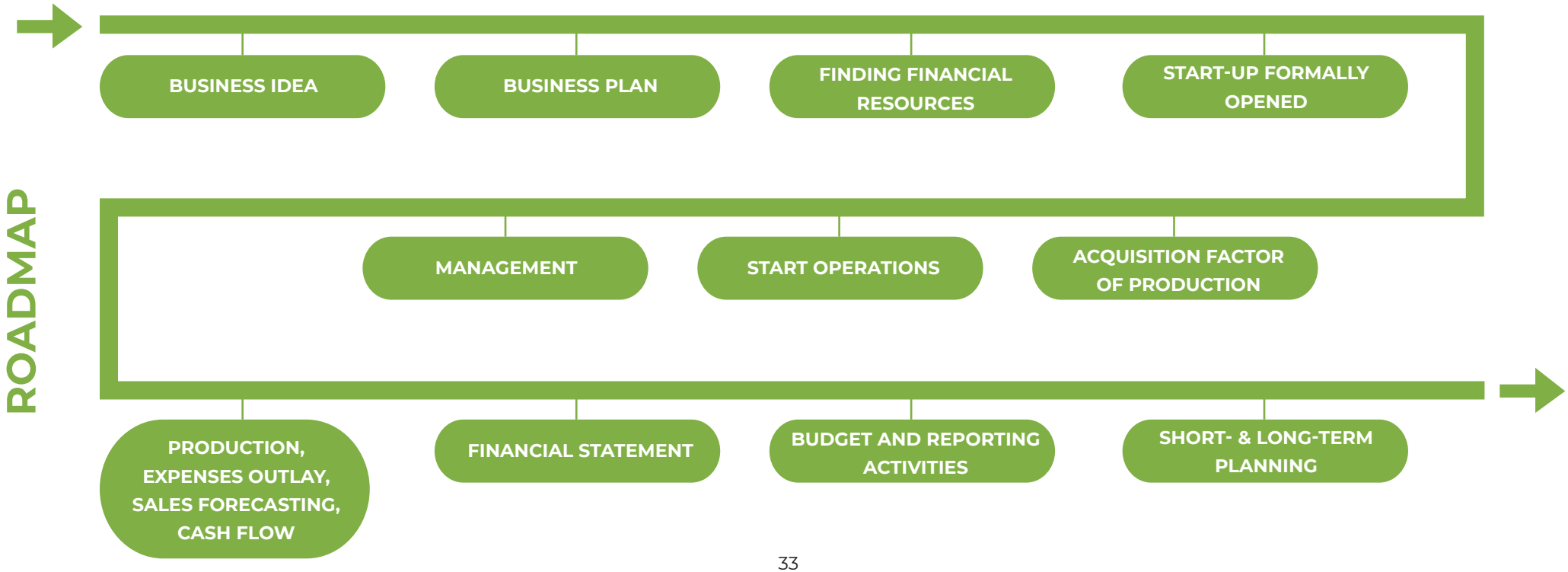


5. FROM THE FINANCIAL TO THE BUSINESS PLAN

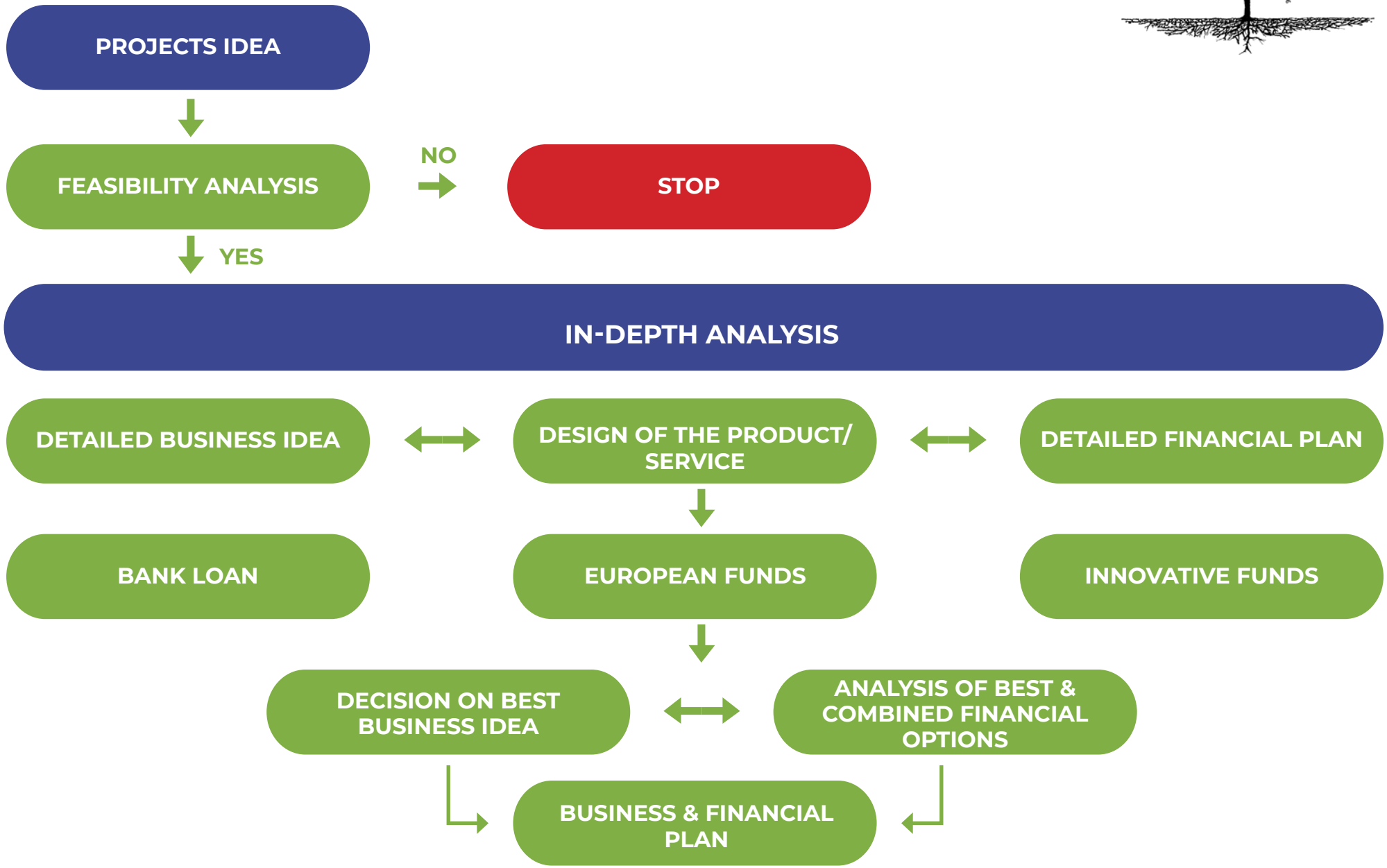
5.1. The business plan

A business plan is a written document that describes, in detail, how a business, usually a start-up, defines its objectives and how it is going about achieving its goals. A business plan lays out a written roadmap for the farm, from marketing, financial, and operational standpoints. Business plans are important documents used to attract investment before a company has established a proven track record. Although they're especially useful for new businesses, every company should have a business plan. Ideally, the plan is reviewed and updated periodically to see if goals have been met or have changed and evolved. Sometimes, a new business plan is created for an established business that has decided to move in a new direction.

A new business plan can be prepared for any new projects the farmer wishes to establish. It takes into consideration the business idea, all the related costs necessary to launch the project, the related sources of financing needed to cover the costs and the profitability of the entire investment with the related timing for economic and financial return.



5.2. Business and financial plan decision tree



CONCLUSIONS

1. This Module is focused on basic knowledge and competences needed to manage business financial aspects, especially related to farm financial planning.

2. The initial test aims to bring the trainee a perspective of management and financial tasks through basic knowledge combined with problem setting and abilities solving.

3. Starting from basic financial principles this Module introduced terms, concepts and key activities to the trainee paving the way to manage a financial and business plan.

4. Types of costs and expenses are identified and briefly described to enable the trainee to set up financial forecasting, budgeting and control activities that can subsequently be tested to the reality of his/her farm.

5. Understanding of cash flow and other terms connected to the skills needed for fixing prices within a farm strategy, competences on ROI calculation, balance statement including profit and loss, up to the more common financial and non-financial performance indicators, budgeting reporting examples and connections between financial and business plan were explored.

6. The final test aims to remind the trainee about the acquired knowledge and use it for self-evaluation.

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