

A Checkup On Your Financial Health

Paul N. Ellinger and Bruce J. Sherrick
Department of Agricultural and Consumer Economics
University of Illinois

Executive Summary

The goal of this session to provide diagnostic tools and information that can be used to measure and monitor the financial health of farm operation. Benchmark information is used to provide a relative performance index for various financial measures. The growing importance of consumer credit scores in agricultural lending is also discussed.

- Shrinking profit margins, increasing capital costs, and the growing complexity of farming provide a strong motivation for the importance of good financial records. Financial statements are an important management tool to assess the performance and direction of a farm business.
- Measures of financial health can be subdivided into five categories: (1) level of debt use (leverage), (2) liquidity, (3) profitability, (4) ability to pay debt, and (5) efficiency.
- Calculating specific ratios in each of these five categories permit farmers to compare to benchmarks and their farm over time. Benchmark data on many of the ratios are provided.
- There are many potential causes of inadequate profitability. The sources of the profitability problems are categorized into asset-, liability-, revenue-, or expense-based. Measures for identifying potential problems in each of these categories are discussed.
- Cash records should be adjusted to account for accrual concepts. Cash basis income is not a good measure of farm profitability.
- Management of machinery costs are an important factor in farm performance. Benchmark data on the level of machinery investment by size of farm are provided.
- Consumer credit scores are being used by lenders at an increasing rate. The factors that determine the consumer score as well as methods to determine the credit score are reviewed.
- An overview of the **FAST** decision tools is provided and specific tools are demonstrated to illustrate the concepts discussed.