Four key mistakes in business planning for dairy farms

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Summary

- The Dairy Expansion service is now in operation over three years and has developed over 400 business plans for new entrants and expanding dairy farms to date around the country.

The Expansion Service, with the help of the local Teagasc Dairy advisors develops a suitable and viable business plan for the client's farm and family. Over this time we have identified some key areas where farmers make mistakes in their farm development and business plans. This article highlights five of these key mistakes.

No. 1: No money in expansion

In any business the expansion phase can be very difficult on cash flow and it's a vulnerable time for the business. Take a suckler herd moving from 50 to 100 cows. There will be an increased replacement rate on farm to allow the herd to build numbers which will reduce sales off farm. There may also be a reduced cull rate that will also reduce farm sales. Invariably there will be capital investment required in growing more grass for the increased stock. Also there may be the need to construct additional housing. All these combined will mean a potential reduced output with increased fixed costs during the expansion phase. There is a time lag before the farm returns to "full production" after the expansion and this needs to be considered in your business plan. The same will happen in an expanding dairy herd as they will have the increased cost of carrying additional heifers and a potential lower output per cows based on having a young herd. Again it will take time after the expansion before the farm will revert to its true potential. So developing a business plan based on no reduction in performance during the expansion phase can lead to a vulnerable plan. There is no money in Expansion, but there should be increased money when expanded if you have developed a good business plan.

No. 2: From here to there

Most farmers considering converting their farm to dairying start the planning phase two years prior to the start-up of the first cow milking. There are a lot of considerations in developing both your physical and financial farm plan. Normally we see when reviewing the plans that there is a good physical plan on how to develop the farm for conversion. So they will know when and where reseeding has to take place for example or the positioning of the new parlour. However, when we review the business plan it normally starts in the year that the parlour starts and does not show the potential cashflows from the farm in the conversion years. This can also lead to a poor business plan as you have ignored the farm operating costs in the years prior to the cows starting to milk. This usually means the farmer over values the stock he has on hand that is available to be reinvested back into the farm. Some of the value of the herd will be required to pay on-going bills. So your Business plan should map the conversion phase right through the early years of your dairy enterprise.

No. 3: Capital budget

An accurate capital budget is essential to develop a farm business plan. While the large ticket items like the parlour and bulk-tank are easily calculated they smaller items are often forgot about. The capital budget should be developed to reflect all investment required on your farm to enable you achieve your expansion plans. Breakdown the capital budget into a number of headings. The headings we use are: Growing grass, Accessing grass, Milking premises, housing and others. Also develop a timeline of when you will need to invest the capital. Often the “small items” can increase the cost of the budget substantially like three phase connection or a new well. Also build in a good contingency fund into your budget. Typically we use 10–15% of the overall capital budget. Most capital projects overrun the budget. Adhere to your capital budget as best you can. The add-ons during the construction can drive the capital required. If the capital budget is too low for the expansion plan it will be not be funded properly. The shortfall then will normally have to be financed from cash flow. This will put increased strain on the cash flow of the business and may result in the farm running up short term debt.

No 4: Overbudgeting

While setting targets and goals for your farm to achieve are an excellent management tool the targets in your business plan should be more realistic. Are plans based on a high milk price viable? Be realistic in your business plan regarding the potential kg Ms Output of your herd. Increasing the milk solids sold per cow will make the plan viable but can it realistically be achieved? The combination of a high milk price on your plan and high milk solids sold can gloss over what may not be a viable plan. Another consideration is to do a sensitivity analysis of your plan. After you have expanded and finishing developing if your plan is not in a position to cope with a low milk price year is that a good plan? The decision to expand your farm and invest into your business should leave your farm in a stronger position after the expansion phase rather than a more vulnerable position. One of the largest costs on any farm is the drawings figure required for the family off the farm. This is an essential piece of information to develop any business plan.

Conclusions

Finally the plan should be discussed with your accountant for any potential tax implications of what you are planning to do. An unexpected tax bill can also put financial strain on the business.