Section 1
Where Am I?

TA A
Avocado

- World, U.S. & Florida Avocado Situation and Outlook
- Evaluating the Financial Viability of the Business
- Inventory of Resources and Talents

University of Florida
Tropical Research and Education Center
Where Am I?

- World, U.S. & Florida Avocado Situation and Outlook
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Avocado is believed to be native to the tropical areas of the Americas. There are three main races of avocado: Mexican, Guatemalan, and West Indian. The fruit is a large berry consisting of a single large seed surrounded by a buttery pulp. Fruit color varies among green, black, red, and purple. Typically, avocados do not ripen until they are picked or fall to the ground. Mature fruit size varies considerably depending upon cultivar and growing conditions. Fruit is popularly eaten fresh, in salads, or used to make guacamole and other dishes. Although it originated in the Americas, the tree is now widely dispersed and can be found in several tropical and subtropical areas.

World production of avocados in 2006 was estimated at 7.24 billion pounds, less than the 7.39 billion pounds recorded in the previous year. Between 1998 and 2006, production grew at an average annual rate of 4.22%, increasing from 5.22 billion pounds in 1998 to the current level. Table 1 shows the world’s top ten avocado producing countries. Together they accounted for about 77% of the world’s production of avocados in 2006.

Mexico is by far the largest producer of avocados, accounting for 34.54% of global production in 2006. The 2006 Mexican crop was estimated at 2.50 billion pounds, about 250 million pounds higher than the previous year. The United States of America is the second largest producer of avocados, recording 545 million pounds in 2006, or 7.52% of world production. Next is Indonesia with a 2006 crop of 528 million pounds, accounting for 7.29% of global production. Other countries in the top ten and their respective shares of world production of avocados in 2006 include Colombia (5.63%), Chile (5.02%), Brazil (5.01%), the Dominican Republic (3.46%), Peru (3.45%), China (2.74%), and Spain (2.50%).

Regarding exports, global exports of avocados reached 1.28 billion pounds in 2006, up 10.79% over the previous year, and were valued at U.S. $849 million. Table 2 shows the
top ten avocado exporting countries. As can be seen in Table 2, Mexico and Chile dominate the export trade with shares of 35.86% and 19.09%, respectively. Next are Spain (8.21%) and the Netherlands (6.52%). Other major exporters include South Africa, Peru, Israel, France, the Dominican Republic, and New Zealand.

World imports of avocados increased from 680 million pounds in 1998 to 1.35 billion pounds in 2006. The United States of America is the number one importer of avocados. In 2006, it imported 425 million pounds, or 31.38% of total avocado imports (Table 3).

In second position is France with imports of 209 million pounds (15.45%), followed by the United Kingdom (9.79%), the Netherlands (7.96%), and Japan (4.73%). Other major importers in the top ten are Spain (4.54%), Canada (3.56%), Colombia (2.88%), Germany (2.62%), and Honduras (1.9%) [FAOSTAT].

While less than 18% of all avocado production is exported, its global market share is expected to increase. Factors influencing the avocado export market include all-around improvements and innovations in post-harvest and shipping technologies, fewer trade barriers, strong global demand, health benefit advertisements, and increased acreage in some countries, particularly Mexico and Chile.
Table 1. World’s top 10 avocado producers, 1998 - 2006 (million pounds)

<table>
<thead>
<tr>
<th>Countries</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>Share of 2006 (%)</th>
</tr>
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<tbody>
<tr>
<td>Mexico</td>
<td>1,933</td>
<td>1,938</td>
<td>2,001</td>
<td>2,073</td>
<td>1,987</td>
<td>1,995</td>
<td>2,176</td>
<td>2,252</td>
<td>2,501</td>
<td>34.54</td>
</tr>
<tr>
<td>Indonesia</td>
<td>289</td>
<td>279</td>
<td>321</td>
<td>312</td>
<td>525</td>
<td>564</td>
<td>489</td>
<td>502</td>
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<td>319</td>
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<td>447</td>
<td>399</td>
<td>467</td>
<td>359</td>
<td>625</td>
<td>545</td>
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<tr>
<td>Colombia</td>
<td>163</td>
<td>349</td>
<td>390</td>
<td>302</td>
<td>319</td>
<td>358</td>
<td>383</td>
<td>410</td>
<td>408</td>
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<tr>
<td>Chile</td>
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<td>181</td>
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<td>243</td>
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<td>309</td>
<td>353</td>
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<td>376</td>
<td>373</td>
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<td>180</td>
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<td>603</td>
<td>482</td>
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<tr>
<td>Peru</td>
<td>148</td>
<td>172</td>
<td>184</td>
<td>206</td>
<td>208</td>
<td>220</td>
<td>239</td>
<td>228</td>
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<td>3.45</td>
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<tr>
<td>China</td>
<td>112</td>
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<td>154</td>
<td>164</td>
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<td>179</td>
<td>185</td>
<td>187</td>
<td>198</td>
<td>2.74</td>
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<td>Spain</td>
<td>163</td>
<td>146</td>
<td>141</td>
<td>165</td>
<td>164</td>
<td>169</td>
<td>168</td>
<td>165</td>
<td>181</td>
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<tr>
<td>World Total</td>
<td>5,223</td>
<td>5,495</td>
<td>5,926</td>
<td>6,267</td>
<td>6,574</td>
<td>7,035</td>
<td>7,005</td>
<td>7,390</td>
<td>7,239</td>
<td>100.00</td>
</tr>
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Source: Food and Agriculture Organization of the United Nations
Table 2. World’s top 10 avocado exporting countries, 1998 - 2006 (million pounds)

<table>
<thead>
<tr>
<th>Countries</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>Share of 2006 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>157</td>
<td>122</td>
<td>197</td>
<td>158</td>
<td>208</td>
<td>274</td>
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<td>482</td>
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<tr>
<td>Chile</td>
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<td>83</td>
<td>124</td>
<td>127</td>
<td>172</td>
<td>210</td>
<td>250</td>
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<td>42</td>
<td>45</td>
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<td>101</td>
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<td>86</td>
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<td>71</td>
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<tr>
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<tr>
<td>New Zealand</td>
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<td>13</td>
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<td>13</td>
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<td>World Total</td>
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<td>917</td>
<td>1,082</td>
<td>1,436</td>
<td>1,281</td>
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Source: Food and Agriculture Organization of the United Nations
### Table 3. World’s top 10 avocado importing countries, 1998 - 2006 (million pounds)

<table>
<thead>
<tr>
<th>Countries</th>
<th>1998</th>
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<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>Share of 2006 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States of America</td>
<td>134</td>
<td>122</td>
<td>173</td>
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<td>60</td>
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<td>7.96</td>
</tr>
<tr>
<td>Japan</td>
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<td>17</td>
<td>31</td>
<td>24</td>
<td>30</td>
<td>53</td>
<td>64</td>
<td>62</td>
<td>64</td>
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<tr>
<td>Spain</td>
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<td>8</td>
<td>11</td>
<td>12</td>
<td>25</td>
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<td>Canada</td>
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<td>35</td>
<td>42</td>
<td>40</td>
<td>48</td>
<td>3.56</td>
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<tr>
<td>Colombia</td>
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<td>18</td>
<td>21</td>
<td>15</td>
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<td>24</td>
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<td>9</td>
<td>25</td>
<td>11</td>
<td>26</td>
<td>1.90</td>
</tr>
<tr>
<td>World Total</td>
<td>678</td>
<td>596</td>
<td>764</td>
<td>714</td>
<td>896</td>
<td>953</td>
<td>1,086</td>
<td>1,467</td>
<td>1,354</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Food and Agriculture Organization of the United Nations
U.S. Production, Imports, and Exports of Avocados

Production

The U.S. production of avocados occurs in three regions: California, Florida, and Hawaii. California is by far the largest producer, accounting for 85.96% of production, on average, followed by Florida with 13.82% and Hawaii with less that 0.25% in the 2007/08 season. Avocados grown in California are mainly of the Hass variety, characterized by “purplish-black skin”. Hass avocados are grown mainly in California’s southern coastal region in San Diego, Riverside, Ventura, and Santa Barbara Counties. Most Florida avocados have green skins and are grown mainly in the Miami-Dade County area.

The United States of America is the second largest avocado producer behind Mexico (Table 1). As can be seen in Figure 1, U.S. avocado production exhibits an erratic pattern, reflecting alternate high- and low-bearing years, which is characteristic of avocado production. In general, however, there has been a downward trend. To illustrate this, 367 million pounds of avocados were produced in the 1999/00 season, followed by 655 million pounds in the 2005/06 season, 293 million pounds in the 2006/07 season, and 398 million pounds in the 2007/08 season. The noticeable drop (53.12%) in U.S. production between 2005/06 and 2007/08, or about U.S. $90 million, was due mainly to adverse weather conditions in the main production areas in California.

Source: National Agricultural Statistics Service, USDA
In the 2007/08 season, U.S avocado production, estimated at U.S. $322 million, was U.S. $58 million higher than the previous year because of increases in avocado production in Florida (96%) and California (30%). Increased domestic production added to record imports (discussed below) could cause a downward pressure on prices.

Exports

The United States of America is not a major exporter of avocados, accounting for a mere 1.13% of total exports in 2006 (FAOSTAT). Figure 2 shows that the volume of U.S. avocado exports since 1996 has trended downwards until 2006 when U.S. exports of avocados grew to 14.50 million pounds. In 2008, U.S. exports of avocados were estimated at 13.3 million pounds and valued at U.S. $10.3 million. Only California avocados (and some from Mexico) are exported/re-exported, mainly to Canada, Japan, and Mexico.

Figure 2. U.S. Total Avocado Exports, 1999 to 2008

Imports

Since the late 1980s, the United States of America has shifted from being a net exporter of avocados to becoming a net importer. Moreover, in 2002, the United States of America overtook France to become the world’s number one importer of avocados (Table 3). Figure 3 shows the trend in U.S. imports of avocados over the period 1999 to 2008. The graph indicates a steep rise in the volume of avocado imports in 2005 and 2007. Between 1999 and 2008, imports increased from 122 million pounds to 694 million pounds, an average annual growth rate of approximately 30%. The largest (by volume) single-year
increase occurred in 2007, with imports increasing by 344 million pounds (from 425 to 769 million pounds). This was due to sizeable increases in the volume of avocados imported from Mexico (discussed below). In 2008, avocado imports were valued at about U.S. $580 million.

The main sources of U.S. imports of avocados are Mexico, Chile, the Dominican Republic, and New Zealand (Figure 4). Most of these imports are the Hass variety coming from Mexico, Chile, and New Zealand. Dominican Republic exports are mainly of the green-skin type similar to those produced in Florida. Mexico and Chile, with shares of 74.49% and 20.53%, respectively, dominate the U.S. avocado import market, accounting for 95.02% of total imports in 2008. As illustrated in Figure 4, before 2004, Chile was the main supplier of avocados to the United States of America, followed by Mexico. However, the situation now has been reversed. In 2008, Mexico increased almost twenty times the amount of avocados it ships to the United States of America, from 26 million pounds in 1999 to 517 million pounds in 2008. This represents big increases by 211 million pounds (247.29%) from the previous year to reach 296 million pounds in 2005 and by 243 million pounds (101.30%) from the previous year to 484 million pounds in 2007. In comparison, imports from Chile increased by 47 million pounds (22.70%) from the previous year to reach 253 million pounds in 2005 and by 89 million pounds (56.62%) from the previous year to 246 million pounds in 2007. Although substantially less than those from Mexico and Chile, avocado imports from the Dominican Republic almost doubled between 1999 and 2008, from 18 million pounds in 1999 to 35 million pounds in 2008.
The main driving force behind the sharp increase in imports of avocados entering the United States of America is the elimination of trade restrictions on imports from Mexico. Before 1993, Mexico was shut out of the U.S. market for phytosanitary reasons. Beginning in 1993, the ban against Mexican agricultural products was gradually lifted until full market access was granted in 2007.

![Figure 4. U.S. Avocado Imports by Countries, 1999 to 2008](chart)

**Source:** Foreign Agricultural Service, USDA

The upward trend in avocado imports is expected to continue due to strong U.S. domestic demand and available supplies. Mexico is expected to increase its avocado production due to increased acreages, better agricultural practices to control pests, and unrestricted harvesting. Chile and the Dominican Republic are increasing their avocado productions to compensate for falling prices and lost market shares to Mexico.

### U.S. Consumption of Avocados

Figure 5 shows that U.S. consumption of avocados has increased considerably within recent times (from 438.3 million pounds in the 1998/99 season to 1,051.1 million pounds in the 2007/08 season). Several factors are responsible for the increased domestic demand for avocados, including year-round availability due to imports, lower avocado prices, a rapidly growing U.S. Hispanic population, health benefit advertisements, and increased disposable income.

A larger portion of the current domestic demand is being satisfied from imports. Figure 6 illustrates the changes in share of domestic consumption (production plus net imports)
due to increased imports over the period of 1998/99 to 2007/08. The share of imports increased from 25.39% in 1998/99 to 62.89% in 2007/08.

Source: Economic Research Service, USDA

Source: Economic Research Service, USDA
The Florida Avocado Industry

Production

The Florida avocado industry consists of about 6,862 bearing acres, 951 growers, and 35 registered avocado handlers and shippers (Census of Agriculture 2007). Of these 6,862 acres, more than 99% are located in southwest Miami-Dade County. In terms of production structure, the avocado industry is comprised of a large number of small producers and a few large producers. As shown in Table 4, 92.53% of avocado farms of less than 15 acres account for 37.73% of total bearing acreage, while 4.63% of farms with 25 acres or more account for 55.29% of total bearing acreage.

Although avocados produced in South Florida look similar due to their "green skin" and are easily distinguishable from the "purplish-black skin" varieties grown in California, they do differ, falling into two main categories: West Indian and Guatemalan. These two categories comprise some 60 major and minor commercial varieties that mature at different times during the season in various weights and sizes. As a consequence, yields per acre vary among producers, depending on the production techniques and varieties grown. As in the case in California, there is a tendency of alternate-year bearing, implying high yields one year and lower yields the next.

Table 4. Structure of the Florida avocado industry 2007

<table>
<thead>
<tr>
<th>Avocado Acres Harvested 2007</th>
<th>Number of Farms</th>
<th>Total Acres Harvested</th>
<th>Average Acres/Farm</th>
<th>Cumulative % of Farms</th>
<th>Cumulative % of Acres</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.1 to 0.9</td>
<td>174</td>
<td>72</td>
<td>0.41</td>
<td>18.30</td>
<td>1.05</td>
</tr>
<tr>
<td>1.0 to 4.9</td>
<td>525</td>
<td>1,157</td>
<td>2.20</td>
<td>73.50</td>
<td>17.91</td>
</tr>
<tr>
<td>5.0 to 14.9</td>
<td>181</td>
<td>1,360</td>
<td>7.51</td>
<td>92.53</td>
<td>37.73</td>
</tr>
<tr>
<td>15.0 to 24.9</td>
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<td>95.37</td>
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<td>25.0 to 49.9</td>
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<td>57.90</td>
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<td>50.0 to 99.9</td>
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<td>653</td>
<td>65.30</td>
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<td>100.0 acres or more</td>
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<tr>
<td>Total</td>
<td>951</td>
<td>6,862</td>
<td>7.22</td>
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</tr>
</tbody>
</table>

Source: Census of Agriculture, National Agricultural Statistics Service, USDA

Figure 7 highlights the trends in volume and value of Florida avocado production over the period 1999/00 to 2007/08. In general, production remained relatively flat until 2002/03 when it increased 34.78% over the previous season. The increase was due to replanting groves with higher-yielding varieties and increasing the planting density. This practice began after the devastation to the industry caused by Hurricane Andrew in 1992. The sharp decline in the 2003/04 crop was due to extreme cold temperatures during the flowering season, which badly affected fruit settings. The avocado industry suffered another major setback due to hurricane damages in 2005. The 2005/06 crop was
estimated at 24 million pounds, a 57.14% decrease over the previous season, and the 2006/07 crop was estimated at 28 million pounds. As can be seen from Figure 7, the 2007/08 crop, was estimated at 55 million pounds, or U.S. $12.1 million. This represents a 96.43% increase over the previous season.

Source: National Agricultural Statistics Service, USDA

**Farm Gate Price**

The bulk (80%) of the avocados produced in Florida is sold outside the state; hence the industry is an important revenue generator for Florida. Federal Marketing Order 915 (in existence since 1954) regulates production practices and harvesting procedures, such as the size and quality of the fruit, packing and shipping containers, and shipping dates. The Order is aimed at increasing grower returns by promoting orderly marketing conditions while ensuring consumer satisfaction. Permits must be obtained by anyone selling over 55 pounds of avocados per day. As a consequence, most of the avocados grown in Florida are sold to the packinghouses.

The avocado marketing season begins in May and ends in February or early March, with the bulk of shipments occurring from July through September. Figure 8 shows the shipping patterns for Florida, Mexico, Chile, the Dominican Republic, and New Zealand. The pattern of shipments reveals that, prior to 2005, the bulk of Florida’s avocados were marketed in a “window of opportunity” that enabled growers to obtain favorable prices because the bulk of the commodity was sold after the peak shipping period for California and before the peak shipping period for Chile. After 2005, this “window of opportunity” eroded because Mexico is being allowed to ship avocados year-round to U.S. markets. As Figure 8 indicates, the quantity of avocados on the market has increased from 85.95 million pounds in 2004 to 537.77 million pounds in 2008. This will no doubt add downward pressure to the prices that Florida growers receive.
Figure 8. Monthly Avocado Shipments, January 2004 - December 2008

Source: Fruit and Vegetable Market News, USDA
Figure 9 shows the actual and inflation-adjusted trends of the prices that avocado growers received over the period 1999/00 to 2007/08. In the 2007/08 season, growers received a price of U.S. $0.22 per pound, only 48.25% of the previous year. As shown in Figure 9, the upward trend in prices becomes more obvious when they are adjusted for inflation.

Price changes seem less responsive to production levels when production decreases than when production increases. For example, in the 2003/04 and 2005/06 seasons, when production decreased by 45.16% and 57.14%, prices increased by 45.32% and 82.17%, respectively, from the previous year (implying that a 1% reduction in quantity resulted in only 1%, and a 1.44% increase in price). On the other hand, in the 2004/05 and 2007/08 seasons, when production increased by 77.61% and 96.43%, prices decreased by 36.14% and 51.75%, respectively, from the previous year (implying that a 1% increase in quantity resulted in 0.56% and 0.54% reduction in price). The implication is that consumers are no longer willing to pay high prices when there is a shortage of Florida avocados, since total supplies remain adequate as a result of imports. The point being made is that growers can no longer expect to make up revenues from higher prices in years where there are significant shortfalls in production.

Source: National Agricultural Statistics Service, USDA
References


Photos by Ian Maguire, Tropical Research and Education Center, University of Florida Homestead, Florida.

Developed by Edward Evans and Sikavas NaLampang, Tropical Research and Education Center, University of Florida, Homestead, Florida.
Evaluating the Financial Viability of the Business

Just as it is important to construct a new building on a strong foundation, it is important to build the economic future of your business on a sound financial base. Evaluating the financial viability of your business will help you understand the financial strengths and weaknesses of your business position. With knowledge of your financial situation, you are in a better position to respond to current economic forces within the industry.

There are three major financial objectives that businesses usually monitor to track their financial performance:

- Solvency, to track changes in the net worth of the business;
- Profitability, to monitor the earnings of the business; and
- Liquidity, to estimate cash flow available for short-term payments.

**Solvency**

Solvency analysis compares the capital (assets) invested in the business with the sources of capital, debt and equity. In almost every business, one of the primary goals is to grow net worth or equity over time. In periods of low profits, a strong equity position helps the business survive and may also provide the borrowing capacity needed to make business adjustments.

The balance sheet is the financial tool used to evaluate solvency. It provides the foundation for all of the remaining financial analysis. It is very difficult to evaluate where you are and what resources you have available for adjusting to economic forces without an accurate balance sheet.

If you do not have a current balance sheet, you may be able to get a copy from your lender. Otherwise, you can build one from scratch. There is a set of financial statement forms at the end of this section that includes a balance sheet format. It is available in PDF format at [http://www.extension.iastate.edu/Publications/FM1824.pdf](http://www.extension.iastate.edu/Publications/FM1824.pdf). Other possible sources include:

- FINPACK Farm Financial Software, available through many local Extension offices
**Asset Valuation**

It is becoming more and more common for agricultural balance sheets to include Cost and Market valuations for capital assets.

- **Cost** – capital assets are valued at their original purchase cost less depreciation. Cost value balance sheets are most useful in evaluating year-to-year progress.
- **Market** – capital assets are valued at their estimated current market value. This is most useful in evaluating the financial soundness of the business and borrowing capacity.

Market value balance sheets are still the standard used by most agricultural lenders. For the purpose of this analysis, it is probably most useful to value assets at their conservative market value net of selling costs.

**Measuring Solvency**

The Debt to Asset Ratio is the most common measure used to evaluate business solvency.

\[
\text{Debt to Asset Ratio} = \left( \frac{\text{Total Liabilities}}{\text{Total Assets}} \right) \times 100
\]

Simple rules of thumb for evaluating solvency (Debt to Asset) position are:

<table>
<thead>
<tr>
<th>Solvency Position</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>Under 30%</td>
</tr>
<tr>
<td>Caution</td>
<td>30 to 60%</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>Over 60%</td>
</tr>
</tbody>
</table>

Businesses that are in a **Strong** solvency position have a firm foundation upon which to build or change their operations. They may be experiencing profitability or cash flow problems because of the current economic situation, but their financial position should open up doors to alternatives and borrowing capacity that allow them to survive and adjust to more profitable strategies.

Businesses whose debt to asset ratio raises the **Caution** flag need to do some serious financial planning to assure, as much as possible, that their net worth position is not going to continue to erode. If so, they need to look at their options. Their lender should still be willing to work with them, but may not be willing to lend enough money to make major changes in facilities or equipment. In the worst case, they may need to consider exiting the business while there is still substantial net worth left.

Businesses in a **Vulnerable** solvency position have limited ability to borrow additional funds. They need to look at options that improve net worth growth without investing more money in the business. Some examples might include using existing facilities more fully and/or improving operating efficiencies. Other options could include adding non-farm income and reducing family living costs.
Profitability

Profitability analysis involves analyzing how much money the business is making. Profitability is measured using an Income Statement. Most non-farm businesses are required to complete an accrual income statement for tax purposes, so it is relatively easy to evaluate their profitability.

Farmers and ranchers, unless they are very large, are not required to do accrual accounting for tax purposes. While cash accounting provides flexibility for tax management, it leaves agricultural producers in a position of evaluating their profitability based on a system whose general purpose is to reduce income. Therefore, for many growers, tax statements do not provide a reliable source of information for evaluating farm business profitability.

Accrual Adjusted Income Statement

An accrual adjusted income statement adjusts the cash income and expenses reported for tax purposes for changes in inventories of crops, growing livestock, and assets that would have been included in taxable income had they been sold during the period covered. It also adjusts for changes on prepaid expenses, accounts payable and other items that would have been recorded as expenses had they been paid.

The set of financial statements included at the end of this section includes an accrual adjusted income statement format. The FINPACK Farm Financial Software, available through many local Extension offices, also includes a tool to calculate accrual net farm income.

Using Schedule F Tax Statements

It may be impossible to complete an accurate accrual adjusted income statement. In that case, the only option may be to use tax information. If so, it is recommended that you use the average net farm income from several years’ Schedule F tax forms. In theory, the average of the net income from three or more years’ taxes will wash out the effects of year-to-year inventory changes. Livestock producers should add the income from sales of raised cull breeding livestock to the Schedule F net income.

The bottom line of the income statement, Net Farm Income, is the amount of money the business contributed during the period for owner withdrawals for family living and taxes. If, over a period of time, net farm income it is not enough to cover owner withdrawals, other sources of income will be needed or net worth will decline.
**Measuring Profitability**

The most common measure of profitability is the Rate of Return on Assets (ROA).

\[
\text{ROA} = \frac{\text{Net Farm Income} + \text{Interest Expense} - \text{Value of Unpaid Labor & Management}}{\text{Total Farm Assets}}
\]

Value of Unpaid Labor and Management is an estimate of the amount of income unpaid farm operators could have earned from off-farm employment.

Rate of Return on Assets can be directly related to interest rates. The goal when borrowing capital is to earn a higher return than the interest rates being paid. Businesses with low debt to asset ratios can operate with a lower ROA because they are paying interest charges on a smaller portion of their assets.

Business profitability can vary a great deal from one period to the next. Managers should take care when basing decisions on results from only one period. With that in mind, some simple rules of thumb for evaluating your Rate of Return on Assets are:

<table>
<thead>
<tr>
<th>Strong</th>
<th>Over 8 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caution</td>
<td>3 to 8 %</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>Under 3 %</td>
</tr>
</tbody>
</table>

A **Strong** ROA indicates that the business is operating efficiently. If there are cash flow problems, it may be that the business is not large enough to support the number of people or families drawing from it. Or it may be that there is too much short-term debt placing undue pressure on cash flows. In that case, maybe debt repayment schedules can be restructured.

If the ROA raises the **Caution** flag, take a closer look at business efficiencies. Are there adjustments that could be made to control costs, improve marketing, or use facilities and equipment more intensively?

For businesses where the ROA analysis comes up **Vulnerable**, managers need to dig deeper to try to figure out why the business was not profitable. It is human nature to blame problems on factors beyond management control, like foreign competition. The management challenge is to position the business so that it can react to those outside forces.

**Liquidity**

Liquidity deals with how much cash the business could convert or generate in the short term, usually one year, to meet financial obligations. Holding inventories of cash and liquid assets is a risk management strategy to cushion the business from short-term financial downturns. Unfortunately, cash flow pressures often prevent businesses from holding liquid assets. And even if they can, it is difficult to invest those liquid assets in
places that yield a high rate of return. So there is often a conflict between liquidity and profitability.

The Cash Flow Statement is the most common tool for analyzing the liquidity of your business. It can be either a summary of sources and uses of cash from the past period or a projection of cash flows for the future. Many agricultural lenders require a cash flow projection as part of any credit application.

The set of financial statements included at the end of this section includes a cash flow statement. Other sources of projected cash flow formats include:

- FINPACK Farm Financial Software, available through many local Extension offices

**Measuring Liquidity**

The most common measure of liquidity is the Current Ratio. It is useful for businesses that have substantial current assets. Businesses with limited current assets have little liquidity, no matter what the current ratio says.

\[
\text{Current Ratio} = \frac{\text{Total Current Assets}}{\text{Total Current Liabilities}}
\]

Simple rules of thumb for evaluating your Current Ratio:

<table>
<thead>
<tr>
<th>Strength</th>
<th>Over 1.75</th>
</tr>
</thead>
<tbody>
<tr>
<td>Caution</td>
<td>1.1 to 1.75</td>
</tr>
<tr>
<td>Vulnerable</td>
<td>Under 1.1</td>
</tr>
</tbody>
</table>

Businesses with a **Strong** Current Ratio have established a healthy risk management cushion for difficult economic times. Their challenge is to make sure they are earning a reasonable return on their liquid assets.

If the Current Ratio raises the **Caution** flag, management needs to monitor cash flows carefully. A low current ratio will not make the business unprofitable, but it might make it difficult to take advantage of opportunities as they arise.

Businesses with a **Vulnerable** Current Ratio are in a precarious position. Businesses don’t usually go out of business because they lose all their net worth; they go out because they can’t pay their bills. Businesses that fall in this category need to take immediate action. First, determine if there is a profitability problem, a solvency problem, or if owner withdrawals are putting too much strain on the business. Maybe adding non-farm income is an option. Operators in this position should work very closely with financial
advisors, creditors and others to craft a plan that will get their operation back on the road to financial security.

**Adding Up the Evidence**

Financial analysis is a diagnostic, but not necessarily a prescriptive process. In other words, it may reveal a problem, but it may not point to a specific solution. The remainder of the resources available through this site will help business managers dig deeper into their operations to look for adjustments and creative options for their individual situations. Producers who understand “Where Am I?” financially are in a much better position to evaluate alternatives for generating more income, controlling costs, and improving their bottom line.

Developed by Dale Nordquist, Center for Farm Financial Management, University of Minnesota.
Statement of Cash Flows

<table>
<thead>
<tr>
<th>Name________________________________</th>
<th>Date___________</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Cash Farm Income and Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Cash Income</td>
<td></td>
</tr>
<tr>
<td>Total Cash Expenses</td>
<td></td>
</tr>
<tr>
<td>Capital Assets</td>
<td></td>
</tr>
<tr>
<td>Sales of Capital Assets</td>
<td></td>
</tr>
<tr>
<td>Purchases and Net Cost of Trades</td>
<td></td>
</tr>
<tr>
<td>Financing</td>
<td></td>
</tr>
<tr>
<td>New Loans Received</td>
<td></td>
</tr>
<tr>
<td>Principal Paid</td>
<td></td>
</tr>
<tr>
<td>Nonfarm</td>
<td></td>
</tr>
<tr>
<td>Nonfarm Income and Receipts</td>
<td></td>
</tr>
<tr>
<td>Nonfarm Expenditures</td>
<td></td>
</tr>
<tr>
<td>Cash on Hand, Farm and Nonfarm</td>
<td></td>
</tr>
<tr>
<td>Beginning of Year</td>
<td></td>
</tr>
<tr>
<td>End of Year</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
</tbody>
</table>

If all cash transactions are included correctly, the totals for the two columns will be equal.
## Balance Sheet

<table>
<thead>
<tr>
<th>FARM ASSETS</th>
<th>Cost Value</th>
<th>Market Value</th>
<th>FARM LIABILITIES</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Checking and Savings Accounts</td>
<td></td>
<td></td>
<td>Accounts payable</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Farm taxes due</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Short-term notes and credit lines</td>
<td></td>
</tr>
<tr>
<td>Crops held for sale or feed</td>
<td></td>
<td></td>
<td>Accrued interest - short</td>
<td></td>
</tr>
<tr>
<td>Invest in growing crops</td>
<td></td>
<td></td>
<td>- intermediate</td>
<td></td>
</tr>
<tr>
<td>Commercial feed on hand</td>
<td></td>
<td></td>
<td>- long-term</td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td></td>
<td></td>
<td>Due in 12 mo. - intermediate</td>
<td></td>
</tr>
<tr>
<td>Market livestock</td>
<td></td>
<td></td>
<td>- long-term</td>
<td></td>
</tr>
<tr>
<td>Supplies on hand</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td><strong>Total Current Assets</strong></td>
<td></td>
<td></td>
<td><strong>Total Current Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Unpaid Patronage Dividends</td>
<td></td>
<td></td>
<td>Notes and contracts, remainder</td>
<td></td>
</tr>
<tr>
<td>Breeding livestock</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Time certificates</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Farm securities</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Machinery and Equipment</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td><strong>Total Intermediate Assets</strong></td>
<td></td>
<td></td>
<td><strong>Total Intermediate Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>Buildings/improvements</td>
<td></td>
<td></td>
<td>Notes and contracts, remainder</td>
<td></td>
</tr>
<tr>
<td>Farmland</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Farm Securities</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td><strong>Total Long-term Assets</strong></td>
<td></td>
<td></td>
<td><strong>Total Long-term Liabilities</strong></td>
<td></td>
</tr>
<tr>
<td>A. Total Farm Assets</td>
<td></td>
<td></td>
<td>B. Total Farm Liabilities</td>
<td></td>
</tr>
</tbody>
</table>

| Current Assets (market) = _________ Current ratio | C. Farm Net Worth, Cost Value (A - B) |
| Current Liabilities                      |              |
| Total Liabilities = _________ Debt to asset ratio | D. Farm Net Worth, Market Value (A - B) |
| Total Assets (market)                    |              |

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Balance Sheet (continued)

<table>
<thead>
<tr>
<th>PERSONAL ASSETS</th>
<th>PERSONAL LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank accounts, stocks, bonds</td>
<td>Credit card, charge accounts</td>
</tr>
<tr>
<td>Automobiles, boats, etc.</td>
<td>Automobile loans</td>
</tr>
<tr>
<td>Household goods, clothing</td>
<td>Other loans, taxes due</td>
</tr>
<tr>
<td>Real estate</td>
<td>Real estate, other long-term loans</td>
</tr>
</tbody>
</table>

E. Total Personal Assets | F. Total Personal Liabilities

G. Total Personal Net Worth (E - F)

H. Total Net Worth, Market Value (D + G)
## Income Statement

<table>
<thead>
<tr>
<th>INCOME</th>
<th>EXPENSES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash income</td>
<td>Cash Expenses</td>
</tr>
<tr>
<td>Sale of livestock bought for resale</td>
<td>Breeding fees</td>
</tr>
<tr>
<td>Sales of livestock, grain, other products</td>
<td>Car and truck expenses</td>
</tr>
<tr>
<td>Patronage dividends</td>
<td>Chemicals</td>
</tr>
<tr>
<td>Agricultural program payments</td>
<td>Conservation expenses</td>
</tr>
<tr>
<td>Crop insurance proceeds</td>
<td>Custom hire</td>
</tr>
<tr>
<td>Custom hire income</td>
<td>Employee benefits</td>
</tr>
<tr>
<td>Other cash income</td>
<td>Feed purchased</td>
</tr>
<tr>
<td>Sales of breeding livestock</td>
<td>Fertilizer and lime</td>
</tr>
</tbody>
</table>

### A. Total Cash Income

<table>
<thead>
<tr>
<th>Income Adjustments</th>
<th>Ending</th>
<th>Beginning</th>
<th>Gasoline, Fuel, Oil</th>
</tr>
</thead>
<tbody>
<tr>
<td>Crops for sale or feed</td>
<td></td>
<td></td>
<td>Insurance</td>
</tr>
<tr>
<td>Livestock held for sale</td>
<td></td>
<td></td>
<td>Interest paid</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td></td>
<td></td>
<td>Labor hired</td>
</tr>
<tr>
<td>Unpaid patronage div.</td>
<td></td>
<td></td>
<td>Pension and profit-share plans</td>
</tr>
<tr>
<td>Breeding livestock</td>
<td></td>
<td></td>
<td>Rent of land, buildings, equipment</td>
</tr>
</tbody>
</table>

#### Subtotal of Adjustments

<table>
<thead>
<tr>
<th>B.</th>
<th>C.</th>
<th>Repairs, maintenance</th>
</tr>
</thead>
</table>

### D. Home Used Production

<table>
<thead>
<tr>
<th>Seeds, plants</th>
<th>Seeds, plants</th>
</tr>
</thead>
</table>

### E. Gross Farm Revenue

<table>
<thead>
<tr>
<th>(A + B - C + D)</th>
<th>Storage, warehousing</th>
</tr>
</thead>
</table>

### F. Net Farm Income From Operations

<table>
<thead>
<tr>
<th>(F - N)</th>
<th>Supplies purchased</th>
</tr>
</thead>
</table>

### G. Capital Gain or Loss

<table>
<thead>
<tr>
<th>Other cash expenses</th>
<th>Other cash expenses</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Livestock purchased</th>
<th>Livestock purchased</th>
</tr>
</thead>
</table>

### I. Total Cash Expenses

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### Income Statement (continued)

<table>
<thead>
<tr>
<th>Expense Adjustments</th>
<th>Beginning</th>
<th>Ending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment in growing crops</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Feed and supplies on hand</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ending</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Farm taxes due</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accrued interest</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal of Adjustments</strong></td>
<td><strong>K.</strong></td>
<td><strong>L.</strong></td>
</tr>
<tr>
<td>M. Depreciation</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>H. Net Farm Income (G + H)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>N. Gross Farm Expenses (J + K - L - M)</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Inventory of Resources and Talents

One of the purposes of TAA Technical Assistance is to help business owners find a profitable future direction for their business. The direction you take your business will depend on several factors, including:

- What you want to do (your goals)
- What is happening within the industry, and
- The package of skills, resources, and talents you and the other stakeholders in your business can pull together to implement a change.

Your resources come in at least two forms: 1) the hard assets and financial resources that are included on your balance sheet and 2) the knowledge, interests, and abilities that you can draw on from your management team. This section will focus on these personal attributes. It will ask a series of questions that are intended not to highlight weaknesses, but rather to help you build on your strengths and avoid the pitfalls of mapping a direction for your business that does not match your skills, likes, or values.

Production and Operations Management

Are your skills best suited to high volume commodity production?

- Do you have a history of producing high yields or rates of production per unit? ______ ______
- Are you a low-cost producer? ______ ______
- Do you stay on top of new technologies? ______ ______
- Do you get things done on time? ______ ______
- Is expansion an option or interest? ______ ______
- Do you gain your competitive advantage by producing more per unit at a lower cost? ______ ______

Or, are your skills best suited to niche market or value added products?

- Are you good at juggling multiple production schedules? ______ ______
- Do you monitor production activities and quickly make adjustments if problems surface? ______ ______
- Do you have a history of producing high-quality products? ______ ______
- Do you gain your competitive advantage by marketing multiple products at a high margin? ______ ______
No matter the type of operation, efficient production is important. But it may be more important for some than for others. For producers of traditional agricultural commodities, the goal is to be the lowest cost producer. If you can keep costs per unit down and produce enough volume, you can generally be successful in commodity production.

For direct marketers, value-added producers, and other non-traditional operations, efficient production is still important. But product quality and efficient marketing may well be more important than producing the highest production rates at the lowest costs. The world is full of stories of companies that have been very successful just because they out-marketed the other guys. Producing these types of products takes a different mindset. You may spend more of your time outside of production activities while managing others. You will spend more time in your office and less time on your tractor. If you can be happy doing these activities and you have skills in those areas, you may want to consider a transition into this type of operation.

**Marketing**

Are your skills best suited to marketing traditional agricultural commodities?

- Would you rather be out in the field or in the production facilities than negotiating with buyers? ______
- Do you feel time on the phone is wasted time? ______
- Do you have the option to contract your production? ______
- Do you negotiate input costs? ______
- Do you lock in a profit when it is offered to you? ______

Or, do you have skills suited to marketing niche market, value added, wholesale, or retail products?

- Do you like to negotiate deals? ______
- Are you good at closing a deal? ______
- Do you know how to estimate the market for a product? ______
- Do you develop good relationships with buyers and sellers? ______
- Do you have skills in advertising and promotion? ______
- Are you good at making pricing decisions? ______
- Do you know who your competitors are? ______
- Do you target your products at a specific market? ______

Is there a market for your product? Most commodity producers have not had experience with estimating market size, target marketing, advertising and promotion, and pricing. These are skills that may be needed if you plan to move into a “niche” market or if your
plans include direct marketing or processing of farm products. Many commodity producers have the ability to move into these areas but they may need to educate themselves on the techniques. There are classes and other resources in community colleges and other institutions in most communities to help you improve these skills.

**People Skills**

Are your skills best suited to managing a sole proprietorship?

- Do you feel a need to be actively involved in all or most production activities?  
- Would you rather be out doing than directing others?  
- Do you feel frustrated training employees?  
- Do you worry about others getting things done right?

Or, do you have the skills needed to manage multiple employees?

- Do you like to work in a team setting?  
- Are you comfortable delegating tasks to others?  
- Are you able to constructively criticize employees?  
- Do you have specific hiring procedures?  
- Do you have specific training procedures for new employees?  
- Are you comfortable with firing employees?  
- Do you get satisfaction out of seeing someone else succeed?  
- Do you like to delegate production tasks to others?  
- Are you good at training others to do production tasks?

Many feel that they have to grow to be competitive in today’s business world, but there are still many very successful small businesses. Moving from a business with few employees to a multiple employee business is one of the biggest challenges for most business managers (inside and outside of agriculture). Those who successfully make the transition tend to be very happy with the change. They find that they can get away with assurance that things are getting done while they are gone. They build managerial capacity in the next generation and they get a great deal of satisfaction out of seeing others grow and be successful. But not everyone has the skills to be a people manager. If you are not comfortable with your skills in this area, there are two options: 1) get help and training in personnel management; or 2) stay small and look for other ways to improve profitability.
## Money Management Skills

### Should you consider hiring accounting and financial services?

- Do you use your records only for tax purposes?  
- Do you let accounting functions slide as long as possible?  
- Does your lender complete your balance sheet for you?  
- Do you place financial reports in your files without examining them?  
- Would you rather do just about anything else but accounting?  
- Do you lack trust in your lenders?  

### Or, do you have the skills to manage the finances of the business?

- Do you know your production costs per unit?  
- Do you like to do your own accounting?  
- Do you read and understand financial reports?  
- Do you develop a financial plan at the beginning of each production or accounting cycle?  
- Do you monitor deviations from your financial plan and make mid-term adjustments to your plans?  
- Do you periodically analyze the financial performance of your business?  
- Do you work well with your lenders?  
- Do you cover risks with adequate insurance and other risk management tools?  
- Do you know your living costs?  
- Do you know your net worth?  

Financial management is an area where many agricultural producers feel least comfortable. Again, there are a lot of resources within the Extension Service and local community and technical colleges to help you improve these skills. This is also an area where you might consider hiring outside help or joining a farm management group if one is available in your area. Hiring accounting and tax services, however, may not provide you with a great deal of management information. You still need to understand the reports and monitor financial performance.
Other Resources

Other resources include the physical assets you own, the other assets you can acquire through lease or other means, and the financial resources that you can access in terms of equity capital and borrowing capacity. If you are considering a major business adjustment, consider how well adapted each of these resources is to your new business plan. Is the business large enough to support you and other stakeholders? Is your land base suited to high yield and high quality production of your selected products? Are production facilities and equipment adequate? Has asset replacement been adequately considered in your financial plans? Is an adequate and well educated labor force available? These are among the questions that you should honestly answer before you commit to investing more in your business operation.

Summary of Strengths and Weaknesses

After considering the resources, talents, and interests of the operation and the management team, it may be helpful to summarize the strengths and weaknesses of the operation. The worksheet on the following page provides a framework for this summary.
# Summary of Resources and Talents

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<th>Strengths</th>
<th>Weaknesses</th>
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Other Publications

Checking Your Farm Business Management Skills, Farm Business Management for the 21st Century, Purdue Extension, West Lafayette, Indiana, by Michael Boehlje, Craig Dobbins, and Alan Miller.


Developed by Dale Nordquist, Center for Farm Financial Management, University of Minnesota.