

Financial management of a farm: the basics of budgeting

By Cobus du Plessis | 4 February 2025 | 3:15 pm

Cobus du Plessis explores the fundamentals of budgeting for farm management, explaining its importance, the different types of budgets, and key concepts like fixed and variable costs.



An enterprise budget is devised on a per-unit basis, for example, per hectare of maize.

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Budgeting is one of the cornerstones of successful farm management and is essential for new and experienced farmers. A budget serves as a financial roadmap, helping a farmer plan, allocate resources, and monitor their economic performance.

A budget is a detailed financial plan that estimates income and expenses over a specific period (usually a year). It outlines the financial expectations and goals of a farm operation, providing a structured approach to managing finances.

Budgets help farmers make informed decisions by forecasting future financial conditions and allowing for adjustments, as necessary.

Importance of budgeting

A budget in farming, as in any other sector, is crucial for the following reasons:



- **Financial planning.** A budget helps a farmer plan their financial activities, anticipate income and expenses, and manage cash flow effectively.
- **Resource allocation.** It enables optimal allocation of resources like land, labour, seeds, fertiliser and equipment to maximise production.
- **Profitability analysis.** By estimating profits, a budget allows the farmer to assess the financial feasibility of different agricultural activities.
- **Risk management.** A budget helps the farmer identify potential financial risks and develop strategies to mitigate them, adapting to unexpected events like weather-related crop damage or market fluctuations.
- **Debt management.** Proper budgeting aids in planning for loan repayments and managing debt effectively to avoid financial difficulties.
- **Investment decisions.** It allows farmers to evaluate the return on investment for expenditures on equipment, infrastructure, or technology.
- **Tax planning.** Accurate budgeting helps optimise tax strategies by estimating income and expenses, minimising tax liabilities, and taking advantage of deductions and credits.
- **Record-keeping.** Budgets encourage detailed financial record-keeping, essential for tracking income and expenses, complying with tax regulations and assessing the farm's financial health.
- **Goal setting.** Budgeting enables the farmer to set specific financial goals, such as increasing yields, expanding operations, or saving for future investments.
- **Sustainability.** It helps the farmer assess the sustainability of their farming practices, identifying opportunities to reduce environmental impacts and improve resource efficiency.

Types of budgets

There are several types of farming-specific budgets. These are:

- 1. Whole-farm budget.** A comprehensive summary of all resources and planned activities on the farm. It includes expected costs, revenues and profitability for the entire operation. This budget is useful for analysing major changes that could affect several enterprises on the farm.
- 2. Enterprise budget.** This focuses on the costs and returns associated with a specific agricultural product, such as maize or livestock. It is constructed on a per-unit basis (for example, per hectare of maize) and helps evaluate the efficiency and profitability of individual enterprises.
- 3. Partial budget.** Partial budgeting is a tool used to evaluate the financial impact of a specific change in a farm's operation. Unlike a whole-farm budget, which covers all aspects of the farm business, a partial budget focuses only on the costs and benefits that change because of a particular decision.

This means it is an important tool for making informed decisions about adjustments or improvements.

- 4. Cash flow budget.** This is critical for managing the liquidity of a farm. Unlike other budgets that provide an overall picture of profitability, a cash flow budget focuses on the timing of cash inflows and outflows. This distinction is crucial because a farm might be profitable on paper but still face cash shortages due to the timing of expenses and revenue.

A cash flow budget helps farmers ensure that they have enough cash on hand to meet short-term obligations, such as payroll, loan repayments and input purchases. This is particularly important in farming, where income from crops or livestock sales may come in seasonal bursts.



A cash flow budget ensures the farmer has enough cash to meet short-term obligations, which is crucial given the seasonal nature of income from the sale of livestock and crops.

By projecting cash flows, farmers can anticipate periods when they might need to borrow money to cover expenses and plan accordingly to secure necessary financing.

Farming is subject to various uncertainties like weather conditions and market prices. A cash flow budget allows farmers to plan for different scenarios and adjust as needed to maintain liquidity.

By comparing monthly inflows and outflows, farmers can identify months where they might face cash shortages and plan accordingly, such as arranging for short-term credit or adjusting expenditures.

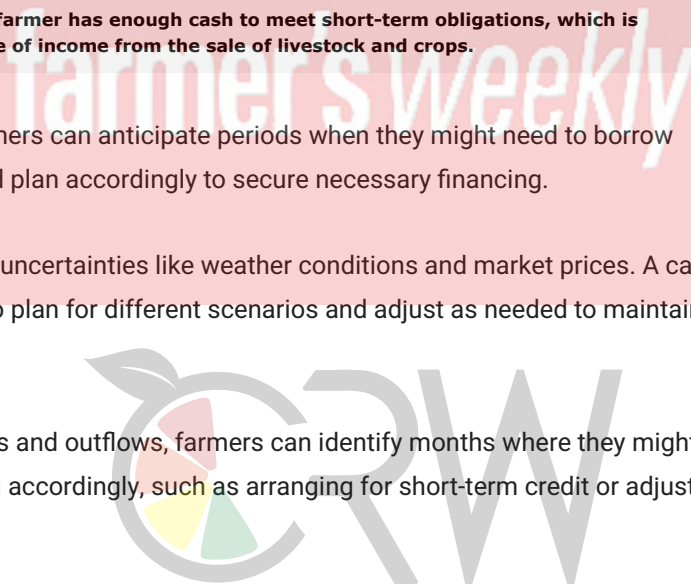
Fixed versus variable costs

Fixed costs are expenses that remain constant, regardless of production levels. Examples include land lease payments, property taxes, insurance and salaries for permanent employees. These costs do not vary with the amount of produce grown or livestock raised.

Variable costs, on the other hand, are expenses that fluctuate with production levels.

Examples include seeds, fertilisers, pesticides, fuel and labour costs for seasonal workers.

These costs can change from one season to the next and can be adjusted during the production process to influence output.



How to create a budget



Follow these nine steps to develop your own farm budget:

- 1. Gather financial records.** Collect financial records from the past year, including income statements, expense records and receipts. This historical data provides a baseline for budgeting.
- 2. Set goals.** Determine short- and long-term goals for your farm. Whether you want to expand, diversify, or maintain your current operations, the budget should align with these objectives.
- 3. List your income.** List all potential sources of income, such as crop and livestock sales, government subsidies and agritourism. Be realistic in your estimations to avoid overestimating your income.
- 4. Categorise your expenses.** Divide your expenses into fixed and variable costs. Fixed costs include your bond or rent, insurance and equipment payments, which remain constant. Variable costs include seeds, fertilisers, labour, and veterinary services, which fluctuate based on production levels and market conditions.
- 5. Create a detailed budget.** Use spreadsheet software like Microsoft Excel to organise your budget into categories like revenue, operating expenses and capital expenses.
- 6. Estimate your income and expenses.** Based on expected yield and market prices, estimate your income and expenses, taking into consideration changing market conditions, production methods and inflation.
- 7. Monitor your cash flow.** Pay attention to your cash flow, ensuring you have sufficient working capital to cover expenses that occur before generating income or unexpected events.
- 8. Review and adjust.** Continuously review your budget throughout the year, comparing actual income and expenses to budgeted amounts. Adjust your budget as needed to reflect changing circumstances.
- 9. Consult professionals.** If needed, consult financial advisers or agricultural economists for insights to make informed financial decisions.

Budgeting is a vital tool for farm management, helping farmers navigate financial challenges, make informed decisions and achieve long-term sustainability.

By understanding the basics of budgeting, distinguishing between different types of budgets and accurately estimating costs and income, farmers can enhance their financial planning and ensure the success of their farming operations.

A well-prepared budget, including comprehensive cash flow and enterprise budgets, equips the farmer with the knowledge to manage their resources efficiently, mitigate risks and optimise profitability.