

CHAPTER THREE

FINANCIAL MANAGEMENT OF A FARM BUSINESS

In organizational studies, resource management refers to the efficient and effective allocation and usage of an organization's resources when and where they are desired. Such resources include financial resources, production resources, inventory, labour resources (human skills), and information technology. Resource management ensures that organizations maintain optimality in the deployment of resources, especially, in today's competitive and changing markets where organizations want to maximize return on investment, and drive efficiencies to sustain the business and support future growth. Financial resources provide a means to an end. Every activity that an organization performs requires a commitment of financial resources. The process of managing financial resources involves establishing clear objectives, developing plans and budgets to predict and monitor the use of financial resources, and the implementation of accountability arrangements. This Unit focuses on the principles related to financial resources management that could be applied to situations in farms, the challenges of financial resources management, while proffering solutions to address those challenges.

3.1.DEFINITION AND CONCEPT OF FINANCIAL MANAGEMENT

Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. The term financial management has been defined as, Financial Management deals with procurement of funds and their effective utilization of an economic resource namely, capital funds in the business. And also, it's an application of managerial principles to the area of financial decision-making. Thus, Financial Management is mainly concerned with the effective funds management in the business. In simple words, Financial Management as practiced by business firms can be called as Business Finance.

The activities of organisations whether business or non-business, have finance as their centrepiece. The role of finance however reflects the objectives of an organisation. Therefore, financial management is a reflection of the nature and objectives of the

organisation. Financial management is thus a very important aspect of finance although it is not easy to separate financial management from the rest of other finance activities.

3.2.FUNCTIONS OF A FINANCIAL MANAGER

The functions of a financial manager have consistently broadened from his traditional role which reflected the descriptive approach to the study of financial management to a more dynamic approach.

1. Anticipation of the Financial Needs of an Organisation

Anticipation of the financial needs of an organisation involves the determination of how much the organisation would need within a certain period to run its activities. This in essence is a forecasting activity. In other words, the financial manager has the responsibility of deciding how much funds his organisation would need within the short-term, medium term and long term periods. The short-term needs for funds are usually determined by considering series of cash inflows and outflows.

2. Acquisition of Financial Resources

Acquisition of financial resources is another important responsibility of the financial manager. This is based on the nature of funds needed by the organisation. The financial manager has to determine the time at which such funds could be acquired in order to make them available to his organisation when it most needs them. Thus, timing of funds acquisition is very important in financial management. Timing can equally help to reduce the cost of borrowing if the financial manager knows when to raise such funds from the market.

The most important thing for the financial manager to do in terms of funds acquisition is to decide on where he is going to acquire such funds. The nature and source of funds will determine the cost of borrowing. Funds could be raised from a bank, a non-bank financial institution or from the capital market. The ability of a financial manager to raise funds from any of the sources would be determined by the size as well as the level of credit worthiness of the business organisation. The financial manager has to make the basic decision of whether funds should come from external or internal sources.

3. Allocation of Financial Resources

Allocation of financial resources is the third important responsibility of the financial manager. Since the objectives of most businesses are profitability and liquidity, the financial manager has to allocate funds to assets that would help in the achievement of these objectives. The allocation of funds is normally done in a way that would minimise or eliminate over investment in fixed assets, or stock piling of inventory. In allocation of funds, the financial manager is normally conscious of maturity transformation in order to guarantee the firm its needed liquidity level.

4. Funds Management

Funds management is highly related to allocation of funds. The financial manager can invest temporary surplus funds in securities to earn interest income for the company. He should know when to invest and when to divest. It is also the responsibility of the financial manager to prepare periodic reports on the finances of the organisation for the information of Management, Board of Directors, shareholders and the general public who may be interested in the affairs of the organisation.

5. Financial Analysis and Interpretation

The financial manager can also undertake the analysis of the historical financial data of the company in order to advise management on appropriate corporate and management strategies to adopt. An appropriate interpretation of financial analysis can always afford him to do this. By his close association with the financial markets, the financial manager is in a position to determine the anticipated influence of fiscal and monetary policies on his company's operations. It is his responsibility to pass informed judgement to management in order to adopt appropriate management strategies which can minimise such effects on the company's operations.

6. Financial Planning and Control

The responsibility of the financial manager includes participation in product pricing. The determination of unit cost of production is done by accounting method and is under the control of the financial manager. Thus, pricing of products also attracts his attention since his objective is

to maximise the difference between revenues and costs. Long-range planning, financial planning and control and budget preparation are very closely related.

3.3.FARM FINANCIAL PLANNING

Meaning and Definition of Planning

Planning is basically a decision-making process in which an organization and its individual members are to take different courses of action over a period of time. It also refers to policy formulation and the establishment of goals. Effective financial resources management involves careful planning. A financial plan is a plan for obtaining and using the money needed to implement an organization's goals. Financial planning has three steps:

- Forecasting both short-term and long-term financial needs;
- Developing budgets to meet these needs;
- Establishing financial control to see how well the company is doing it set out to do.

We shall examine each step and the role these steps play in improving the financial health of an organization.

(1) Forecasting Financial Needs

Forecasting is an important part of any firm's financial plan. A short-term forecast predicts revenues, costs and expenses for a period not exceeding one year. This forecast is the base for most other financial plans, so its accuracy is critical. Part of the short -term forecast may be in the form of a cash flow forecast, which predicts the cash inflows and outflows in future periods, usually months or quarters. The inflows and outflows of cash recorded in the cash flow forecast are based on expected sales revenues and on various costs and expenses incurred and when they fall due. Note that the company's sales forecast estimates the firm's projected sales for a particular period. A business often uses its past financial statements as a basis for projecting expected sales and various costs and expenses.

On the other hand, a long-term forecast is one that predicts revenues, costs, and expenses for a period longer than one year, and sometimes as far as five or ten years into the future. Then, of

what relevance is a long-term forecast? This forecast plays a crucial role in the company's long-term strategic plan. The long-term financial forecast gives top management and operations managers some idea of the income or profit potential possible with different strategic plans. Moreover, long-term projections assist financial managers with the preparation of company budgets.

(2) Budget

Budget refers to the financial plan that sets forth management's expectations for revenues, and on the basis of these expectations, allocates the use of specific resources throughout the company. The budgeting process depends on the accuracy of the company's financial statements –the balance sheet, profit and loss account (income statement), and statement of cash flows. Therefore, financial information from the firm's past is what is used as the basis to project future financial needs.

Most companies prepare yearly budgets from short-term and long-term financial forecasts. It is important that financial managers take forecasting responsibilities seriously since budgeting is clearly tied to forecasting.

(3) Financial Control

Once a company has forecast its short-term and long-term financial needs and established budgets to show how funds will be allocated, financial controls will be established. Financial control is a process in which a firm periodically compares its actual revenues, costs and expenses with its budget. The control procedures help managers identify variances to the financial plan and allow them take corrective action if necessary.

Financial controls also provide feedback to help reveal which accounts, which departments, and which people are varying from the financial plans. Finance managers can judge if such variances may or may not be justified. In either case, managers can make some financial adjustments to the plan when needed.

3.4.STEPS IN THE PROCESS OF FARM FINANCIAL MANAGEMENT

➤ **Objective** : say to take perennial crop enterprise in the area

- **Problem recognition** : No production no marketing problem but say only problem of large capital need
- **Analysis**: Production and consumption based information gathering
- **Decision-making**: Whether to opt for or not. Let him decide to go ahead
- **Action**: He is to implement the plan
- **Accepting the consequences**: If succeeds he should feel happy if receives setback then should try to come out of this tangle.
- **Evaluation**: continuous assessment of changes in agro, socio & economic environment around the farmer.

The degree of success achieved in farm financing management depends upon the following decisions relating to acquisition and use of capital

- Whether to borrow or not to borrow?
- How much to borrow?
- When to borrow?
- From whom to borrow and at what cost?
- When and how best to repay the loans?
- What to use for security?
- What degree of risk should be involved?

3.5.TOOLS OF FARM FINANCIAL MANAGEMENT

3.5.1. Farm Records And Accounts

Definition and scope of farm records

Records are statements of fact or data concerning a specific subject which may be specified in physical, monetary, mathematical or statistical terms. Farm records pertain to information recorded on the day-to-day operation of a particular farm. Farm records can be defined as systematic documentation of all activities taking place in a farm enterprise over a given period of time. It is an act of writing down every activity engaged in on the farm in every production season and at different stages of the production process up to the final disposal of the goods and services to the ultimate consumer.

Farm records are the written records or documents of activities on the farm. Records of farm activities are kept on daily basis. From the daily records, the weekly summaries are prepared and the weekly summary provides information for the monthly and subsequently yearly summaries. All daily activities including performance of crops and livestock, symptoms of diseases observed, farm operations, and other happenings must be recorded promptly and accurately in the farm record book.

Farm record keeping is more than just keeping track of what crop was planted in what field, it is a concept applicable to the entire farm operation. A complete farm record will include all daily activities and transactions and with a proper accounting system it should be possible to have a complete estimate of the profit or loss statement at the end of the year. By keeping a complete farm record on a yearly basis it is possible to have a comparison between years and thereby determine the rate of growth or deterioration of the farm.

Definition and scope of farm Accounts

Farm accounts are the financial records of what the farmer spends or receives on the farm. The systematic way of recording financial business transaction is what is normally referred to as farm accounting. Farm account is usually designed to show two major financial statements. First is the capital position or net worth of the farm- i.e. balance sheet. Secondly, the income and expenditure- i.e. profit or loss in the farm business.

Farm accounting involves maintaining and using records and other information needed to measure the financial performance of the business. A farmer cannot possibly make intelligent decisions regarding the current use of capital unless adequate information regarding the current financial condition and past progress of the operation is at hand. Farm accounts for financial management is concerned with production costs: accounting that is concerned with providing detailed information on the cost of production of farm produce or carrying out an operation in farm business.

3.5.2. The Importance of Keeping Farm Records and Accounts

- 1) ***Calculation of Profit Margin:*** Farm records and accounts involve keeping of all the expenses incurred on the farm and the records of all the income in the operations of the

farm. If the total income is more than the total expenditure on the farm, the result is profit and if the reverse is the case it results into losses.

- 2) ***Progress Report:*** Some of the important records kept on the farm are profit and loss, crop yield and livestock performances. Since the records are kept on yearly basis, the farmers can easily compare the progress made on yearly basis. Through these records, farmers can determine if there is increase in this farm size, livestock population, crop yield, e.t.c. over the years. This will enable him determine the progress he has made over the years.
- 3) ***Easy Access to Credit Facilities:*** One of the major problems facing credit institutions in Nigeria is to determine the appropriate credit suitable to each farmer. Proper records of farm account will eliminate this problem as the record will show the level at which the farmer is operating. Granting appropriate credit will also reduce the problem of credit diversion by farmers.
- 4) ***Determination of Appropriate tax:*** farmers supposed to pay taxes based on the profit realised on their farms. If records and accounts are not properly kept, government will decide to fix any amount which may lead to either over-tax or under-tax payment.
- 5) ***Determination of Insurance Premium:*** With the establishment of National Agricultural Insurance Company, it is now compulsory for any farmer taking agricultural loan to produce insurance cover for his farm business. Just like the taxation of farm business, insurance premium paid by farmer is also based on the volume of farm business. The amount of crop or livestock insurance to be paid is determined from the farm records and accounts kept by farmers. When records are not available, the insurance company can decide to fix any amount they so desired.
- 6) ***Guide in Decision Making:*** A good farm records and accounts will guide farmers in decision making process. A comprehensive record of farm activities will bring out clearly the area of weaknesses and strong points in farm management. A good farm records and accounts will show which enterprises is making progress and which one to be discarded. On the basis of resources allocation, farm records and account can reveal the level of fertilizer used on the farm or the rate of feed consumption by the livestock. This can lead to a decision on whether to reduce or increase the level of resources used on the farm.

- 7) ***For Planning and Budgeting Purposes:*** Farm records and account kept for many years will provide both the farmers and government information for planning purposes. Based on the past records and accounts both farmers and government can prepare accurate budget estimate for the next farming season. Past records and accounts will show clearly the amount spent on the various farm operations and the resources required from these records, the expected revenue can be projected for planning purposes.

3.6.DIFFICULTIES IN FARM ACCOUNTING

The specific and various difficulties in maintaining accounts are:

- i. ***Subsistence Nature of Farming:*** in Nigeria, farming as a business, relatively speaking is a small size operation most of the farmers cannot engage separately trained accountants to help them in the farm accounting and subsistence nature of farming does not produce incentive for keeping the records.
- ii. ***Farm is a Laborious Work:*** Farming requires a lot of physical labour in addition to mental work of management. In the daily routine, the farmer usually gets exhausted in the evening time, and does not feel like keeping and updating records and accounts.
- iii. ***Illiteracy and Lack of Business Awareness:*** The very low level of literacy among the farmers is a hindrance in developing the required level of business awareness on the part of the cultivators and they do not realise the need for records and accounts.
- iv. ***Complicated Nature of Agricultural Business:*** It is a biological activity and is always subject to weather and other natural uncertainties. It therefore requires an accounting system which can handle various complexities involved in the business of farming. Such complicated accounts are difficult to maintain.
- v. ***Inadequate Extension Service:*** In this case, sufficient number of trained specialists in farm management is not available to help farmers maintain accounts of their business.
- vi. ***Non-Availability or Lack of Suitable Farm Record Books:*** Lack of standardized, easy to understand and maintain account books or proforma stands in the way of willingness of the farmers to keep records. To this end, standard

farm record books should be developed and should be simple and easy to understand.

- vii. ***Fear of Taxation:*** Farmers are afraid of taxes. They fear that if they maintain records and accounts and their incomes show up high, some sort of tax may be levied on them.

3.7. TYPES OF FARM RECORDS

There are a number of ways of categorizing farm record and account. However the categories which a farmer adopts depend on the types of information he wants to keep. For our purpose, here, five types of record will be discussed.

1. Inventory Records:

Inventory is the listing of assets owned by the farming business. The farm tools and equipment inventory contains information of the asset such as name, the year of purchase, the cost price, the expected years of life, the annual depreciation and the beginning and end of year values. The common types of farm records are production record and sales record. Farm inventory record contains list of assets owned by the farm. Examples include crop and livestock inventory records. The crop inventory record contains information concerning the quantity and value of crops at the beginning and end of the accounting period; and the livestock inventory record shows the number of each type of livestock owned and their value at the beginning and end of the accounting period.

2. Production Records:

Production records are the records of physical activities on the farm. In crop production, all farm operations involving inputs and outputs from land clearing to the harvesting stage are recorded under the production records. Similarly in livestock production, all operations from the introduction of the new breed up to maturity are recorded here. Production records may be presented under different classes depending on the type of farm enterprise and the choice of farm manager. In crop production we may have separate records for hectares of land under various crops; chemical used in various crops, family and hired labour used, crop yields etc., for livestock production, we identify such classes as quantities of feeds

consumed by the various types of livestock, record of medical treatment, the weight gains of the various livestock, number of eggs collected, amounts of milk produced per animal, number of piglets furrowed per sow, etc., all these records fall into production record.

3. Farm Receipt Records:

A profit oriented farmer should obtain receipts for all items purchased from his farm business and issue receipt for all items sold on the farm and keeps them religiously. In addition, he should properly document all accounts payable to others and receivables by his business. By doing these, he will be able to have an accurate picture of all expenditures and incomes of his farm business at the end of the year. Finally, the farmer should include the value of the farm produce consumed by his household and/or given as gifts as part of the farm income. The naira value of farm produce consumed and/or given to others can be determined by using relevant market prices to value each output.

4. Payroll/Labour Records:

These should contain information such as the category of workers employed, date, work done, number of days worked and wage rate including payment in kind. Other aspect of the labour record which should also be documented is the amount of labour input supplied by members of farm household, categorised into adults and children. Such a record should contain the number, sex and number of days worked by household members during the year. The contributions of family labour (in monetary terms) can be estimated by (a) estimating total man-days of family labour after making necessary adjustments to convert the work done by non-adult and female members of household to adult-equivalents and (b) multiplying total man-days obtained in (a) above by the current wage rate.

5. Farm Operation Records:

Major farm operations on which proper records should be kept include land clearing and preparation, planting, weeding (manual, chemical or mechanical), fertilizer application, and harvesting. The records should show the number of man-days and/or machinery hours employed by each operation as well as the date operations were carried out. Also

necessary for documentation in such records are the types of labour and machine for each operation.

3.8.CHALLENGES OF FINANCIAL RESOURCE MANAGEMENT

Farms, especially in the developing countries, face challenges in the management of financial resources. These challenges can be summarized as follows:

- ✓ There are too few financial resources, which makes its scarcity a vicious cycle.
- ✓ In some cases, farms do not know what financial resources are available.
- ✓ There is lack of skilled and committed manpower, which results from the inability or unwillingness of most farms to hire them. Thus, financial allocation decisions are made by those who lack the knowledge and wisdom to do so.
- ✓ Inability to explore cost-effective approaches to operations.
- ✓ Inadequate monitoring and evaluation of financial performance.
- ✓ Problem of wastages exists.
- ✓ Financial resources are misappropriated by being used for personal gain or outright theft.

3.9.POSSIBLE SOLUTIONS FOR THE CHALLENGES

Solutions to address the challenges can be recommended as follows:

1. Farms should be willing to engage skilled and committed hands as financial managers. Owners of firms and top executives may not know it all.
2. Financial resources should be used to further organizational goals.
3. Financial decisions should be taken from the point of knowledge.
4. If we agree that financial resources management of all the activities concerned with obtaining money and using it effectively, cost-effective approaches to operations should be explored at all times.
5. There should be adequate/appropriate supervision and a periodic auditing of financial records and procedures.