Enterprising Rural Families™

An Online Newsletter December, 2012 Volume VIII, Issue 12

This newsletter is an instrument of the *Enterprising Rural Families: Making It Work* program of University of Wyoming Extension. For further information concerning the Enterprising Rural Families program or on-line course contact *information@eRuralFamilies.org* or go to *http://eRuralFamilies.org/*.

TIP OF THE MONTH:

FUNCTIONS OF MANAGEMENT

Business managers should expect to perform several functions:

- Planning—developing the business purpose, philosophy, goals, and strategies.
- Organizing—establishing a system of roles and relationships to achieve business goals; dividing the work to be done, defining units (e.g., ranches, departments, crews, jobs) responsible for portions of it, and providing a means of coordination among them.
- Staffing—attracting, developing, and retaining people able and willing to perform the jobs as organized.
- Leading—directly influencing people and facilitating their work, generally through interpersonal communications.
- Controlling—Assessing results against objectives, seeing what was actually done compared to what had been planned, and taking corrective action where required.

(Source: *Ag Help Wanted)*

Getting on Track: Understanding Financial Performance

By: John P. Hewlett, UW Farm and Ranch Management Specialist

Rural families today are faced with uncertainty from many directions. Doubts about the national and state economy, stability of rural communities, and increasing volatility in job markets all represent sources of uncertainty for rural business owners. This uncertainty increases the risk involved in managing any type of rural enterprise. The manager of a rural business can reduce at least one source of risk by keeping up-to-date and accurate financial information about the business. A solid system for financial management can help reduce the uncertainty and lower the risk, in addition to leaving the business in a better position to respond to changing conditions.

Financial Information Needed

A complete system of financial management starts with current and accurate financial records. Such records include documentation of both cash and non-cash inflows and outflows for the business. However, records provide little insight into the financial status of the enterprise. In order to gain insights into the financial footing of the business, the manager should prepare accurate and timely financial statements. A statement of cash flows, balance sheets (beginning and ending), an accrual income statement, and statement of changes in owner equity are necessary to correctly assess the financial standing of a business. These statements are prepared from the information provided by the financial records.

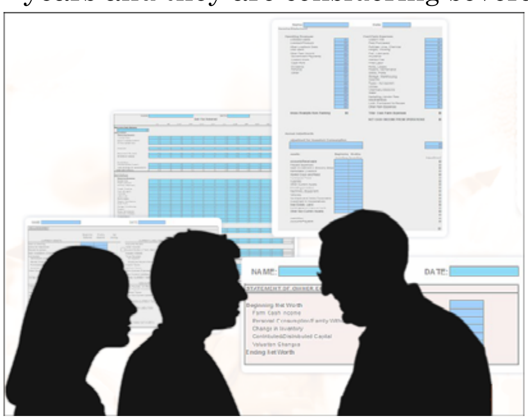
Financial statements are helpful summaries of business financial standing. However, these statements also contain a substantial number of details. The details may make the financial position of the rural business unclear, especially for managers with little experience in interpreting their meaning. To provide a clearer picture of the financial standing of a business or a businesses' financial health, managers can calculate financial ratios or indices.

Managers who routinely evaluate the financial health of their business activities are better prepared to work effectively with lenders and creditors to address changing financial conditions. In the current, uncertain business environment, this could mean the difference between being able to adjust financing plans to changing economic conditions or merely struggling to keep the business afloat.

Online Resources Available

The academic professionals at RightRisk.org have developed an online course called *Getting on Track: Understanding Financial Performance* to help new and smaller rural enterprise managers improve and build upon their abilities to properly evaluate business financial health. Simply log onto RightRisk.org, and click Getting on Track: Analysis in the Products menu. The course is divided into several sections covering topics on all five aspects of financial performance.

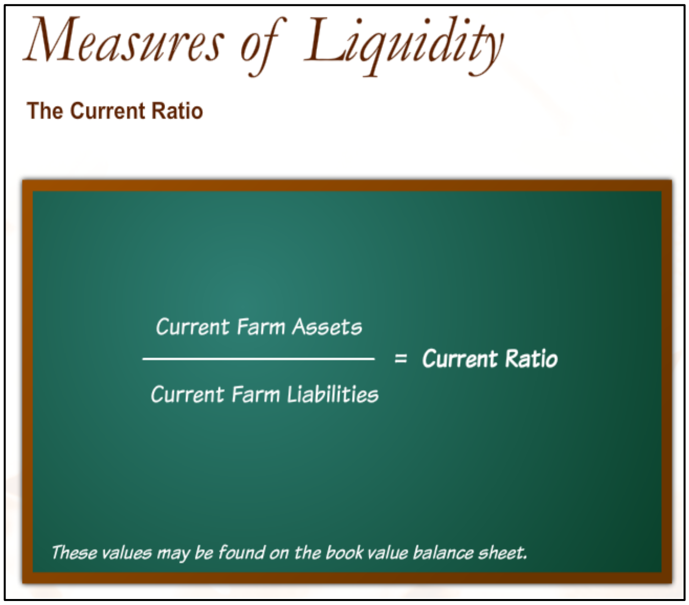
The first section provides an introduction to Jack and Joanie, a young couple who's situation is used to demonstrate the value of evaluating financial performance throughout the course. Jack and Joanie started with a small farm with three ewes and a large flower garden. The business has grown over the years and they are considering several changes to improve the businesses' financial health.



Joanie's dad is a retired bank loan officer. Jack and Joanie consult him for help in developing the financial information needed to keep the business well-managed and healthy into the future. In essence, the course follows Jack and Joanie as they learn to assess the financial health of their business. Conversations between Jack, Joanie and Dad are presented to help students better understand the practical aspects of calculating and interpreting measures of financial performance.

The second section covers the basic concepts of financial analysis and five key areas of financial health. Physical indicators of health are used to assess an individual's state of well-being. Financial indicators are used to evaluate the well-being of a business. These measures include: liquidity, profitability, solvency, financial efficiency, and repayment capacity. It is important to evaluate each area of performance to get an accurate understanding of the overall health of the enterprise.

The next sections of the course cover each of the five key areas of financial performance in detail. Specific information is presented on how each measure of financial performance is calculated, where the particular numbers for calculation may be found, and how to interpret the resulting values. Example information is provided from Jack and Joanie's business and students are challenged to calculate the various measures for the business and interpret the results.



Solvency is a measure of the long run ability of the business to pay all obligations and its ability to withstand adverse business conditions. Specific solvency measures presented in the course include the Debt to Asset Ratio and the Equity to Asset Ratio.

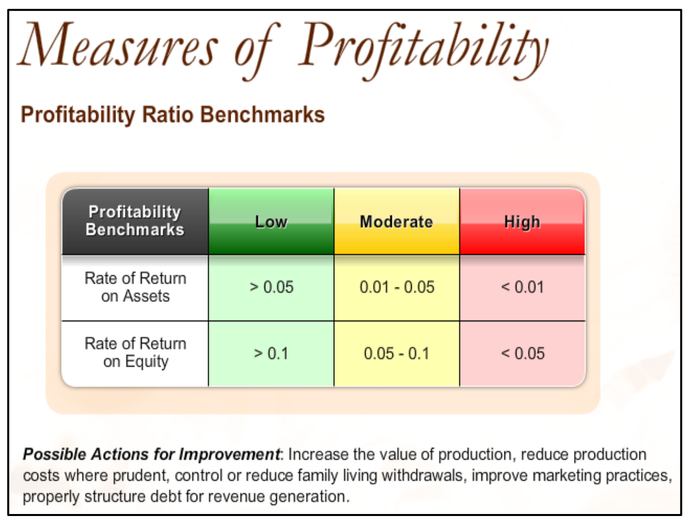
Profitability measures describe the ability of the business to generate more revenues than expenses over a period of time. Specific measures of profitability presented in the course include the Rate of Return on Assets and the Rate of Return on Equity.

Financial efficiency measures indicate whether or not the physical resources (assets, operating inputs, borrowed funds, etc.) of a business are being utilized and combined in a profitable manner. Specific financial efficiency measures presented in the course include the Asset Turnover Ratio, the Operating Expense Ratio, and the Interest Expense Ratio.

Repayment capacity is a measure of the ability of the business to repay term debt from business and non-business income. Specific repayment capacity measures presented in the course include Capital Debt Repayment Capacity, and the Term Debt and Capital Lease Coverage Ratio.

Financial ratios are most valuable when compared to a figure calculated for a previous year or an industry benchmark. Such benchmarks provide guidelines or general rules of thumb related to a specific industry. A green-yellow-red or stop light approach to interpreting the measures is offered in the course to help students understand when a measure represents:

- **GREEN**: area of financial strength or low risk,
- **YELLOW**: where caution should be exercised, or
- **RED**: an area of financial weakness or high risk.



Profitability Benchmarks	Low	Moderate	High
Rate of Return on Assets	> 0.05	0.01 - 0.05	< 0.01
Rate of Return on Equity	> 0.1	0.05 - 0.1	< 0.05

A green light value does not guarantee success, nor does a red light value imply failure. Instead, the stop light approach provides information to the manager about the overall health of the business in a particular area and where additional financial analysis or investigation may be warranted.

The final section of the course discusses trend analysis and interpreting measures of financial performance collected over several years. Opportunities to demonstrate an understanding of this type of analysis is offered with appropriate feedback in the course. How this type of information can act as an early warning system to alert managers to areas of increasing risk is also covered.

Course materials also include additional resources, including: Jack and Joanie's complete financial history and a financial ratio calculator tool. Interactive exercises engage the learner throughout the course to practice evaluating financial performance and interpreting results.

For more information or to access the online course materials, visit the RightRisk web site at RightRisk.org. Click on products and select *Getting on Track: Understanding Financial Performance* from the courses available.

Measures of Financial Performance

Liquidity measures evaluate the ability of the business to meet financial obligations as they come due without disrupting normal operations. Specific liquidity measures presented in the course include the Current Ratio and the Working Capital Ratio.

(Business management and record keeping in family businesses are covered in greater detail in the **Enterprising Rural Families: Making It Work™ on-line course.)**

Keeping organized, up-to-date and accurate records are a key for the success of a rural business owner.