How Profitable Do You Need To Be?

Farm Advisory Service
National Advice Hub
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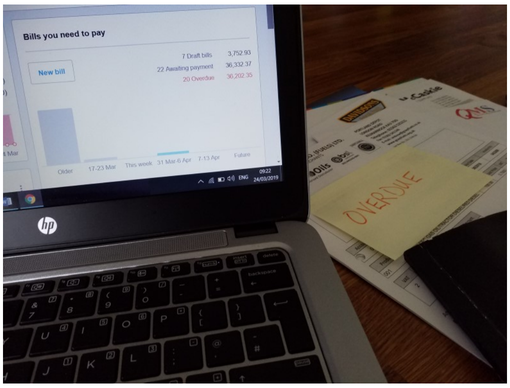
It is important to understand whether your business is viable going forward. Even a business which is profitable may not be sufficiently profitable for your needs.

The business needs to generate sufficient profits to provide the business principals with drawings, repay debt, and have a surplus for reinvestment.

The Profit & Loss account for the business shows the net profit generated but **not** the drawings or capital repayments of loans or finance agreements — only the interest component is considered in the P&L. The profit isn't what's left *after* you've paid the loans and leasing costs: it is the amount from which loan and leasing costs need to come.

Where a business is not sufficiently profitable to provide drawings, repay debt, or fund reinvestment then the normal outcome is that debt increases. This might be obvious, for example if there just isn't quite enough cash in the bank and the overdraft needs to be increased. However, often it isn't so obvious, for instance there isn't sufficient cash to buy a relatively inexpensive piece of equipment outright, so a finance agreement (i.e. a loan) is taken out.



If the business consistently fails to make sufficient profits then over time this debt gradually increases to the point where it becomes difficult to service. **If you are worried that your business is not sufficiently profitable, or that your debt is increasing, then the sooner you act the greater your options.**

Help is available

An agricultural consultant can help you to determine if your business is viable, and advise on the actions you can take.

Support is available to help with the cost via the Integrated Land Management Plan (ILMP) and grant funded specialist advice is also available—this can include advice from your accountant or solicitor. Contact your consultant or the Farm Advisory Service for more information.

RSABI are an excellent source of help. They can provide emotional, practical and financial support to individuals and their families across the agricultural sector including farming, crofting and growing. Contact them on 0300 111 4166

RSABI Supporting People in Scottish Agriculture

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“My drawings aren’t *that* much!?”

Business drawings are often more than people expect or realise. This is because of what is included, not all of it obvious.

Obvious drawings include the cash drawn from the farm account for personal use, or where farm funds are used for an entirely private purchase, for instance when a life assurance premium is paid by the business.

Less obvious is the personal share of many routine bills, such as farmhouse or vehicle running costs.

FINANCED BY

PARTNERS' CAPITAL ACCOUNTS

J Smith				
Brought forward	245,222		255,177	
Add				
Share of net profit	12,235		18,553	
Capital introduced	0		8,000	
	257,457		281,730	
Less				
Drawings	25,123		24,229	
Tax & N I	2,389		3,245	
	27,512		27,474	
		229,945		254,256

These can run into significant amounts and represent the lion’s share of the total ‘drawings’ figure shown on the capital account.

Example:

The invoices for farmhouse electricity are paid in full from the farm account, the total amount paid during the year is £2,000.

The accountant will apportion the cost between business and personal use. The exact split depends on the circumstances, but using 50% as an example: £1,000 is included in the heat & light costs in the accounts, and £1,000 is included in the drawings.

The business therefore needs to make £1,000 of profit in order to pay for the private element of the electricity cost for the year.

An ILMP (integrated Land Management Plan is a flexible process and will include a financial review of the business. See www.fas.scot for more details.

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Some drawings are obvious.

Finance Agreements & Loans

The profit and loss account only shows the interest element of finance or loan repayments.

E.g. in a typical finance agreement for a tractor, the monthly repayment of £600 could comprise £500 capital repayment & £100 interest.

The business therefore needs to make £6,000 of profit (12 x £500) in order to have sufficient cash to make the capital repayments to the loan.

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