Financial Planning for a Farmer Undergoing Organic Conversion

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Introduction

Organic farming involves undergoing a period of conversion in which the land and farmer adjust to organic farming methods. For the farmer, this starts with a change in attitude-you should be convinced that the new system is better than the old one. Are you aware of the changes in production methods, organic regulations and the financial implications of converting to organic farming?

Perspective organic farmers should gather as much information as possible. Visiting neighbouring organic producers and attending some of the Organic Demonstration Open Days to see organic production systems at first hand is essential. Here you can meet with other organic farmers, representatives from the organic certification bodies, the organic unit of the Dept. of Agriculture, Fisheries and Food and the Teagasc Organic Specialist Advisory Team. Regional seminars, websites, educational courses and a range of publications containing up to date advice are a good source of information too.

For farmers, the switch to organic production can represent an excellent opportunity to improve farm profitability. This improvement in profitability is dependent on the following factors:

- Obtaining premium price for produce – produce what the market demands
- Maintaining high levels of productivity
- Minimising inputs and reducing costs
- Maximising REPS 4 and Organic Farming Scheme payments

The conversion period for the change from conventional to organic farming for different farm enterprises is outlined in Table 1.

Table 1 Conversion periods for different organic enterprises

Enterprise	Conversion period required
Livestock production (grass based systems)	2 years
Arable and Horticulture production	2 years
Perennial crops (e.g. strawberries)	3 years

In certain cases the conversion period may be extended or reduced by the organic certification body subject to the approval of the Department of Agriculture, Fisheries and Food. During the conversion period, the farm must be managed to organic standards although produce cannot be certified organic and command a price premium. This can present a financial challenge as there may be a reduction in output and capital investment viz. land, machinery, livestock housing may be required. For this reason the Organic Farming Scheme (OFS) administered by the Dept. of Agriculture, Fisheries and Food offers double the standard rate of organic payment during the conversion period.

Obtaining premium price for produce – produce what the market demands

It is essential to produce products that are in demand and that return a premium price once the conversion period has expired. A number of well established processing outlets exist for organic beef, milk and cereals. Contact should be made with processors and retailers to discuss production plans and to get some commitment from the processor that it is possible to sell this product into the future. Organic products can be sold directly to consumers via country markets, door to door selling or indirectly through speciality shops or bigger retail outlets. Where direct selling is feasible it offers the possibility of a higher margin but there are limitations. All costs including the time and effort required in marketing, distribution and promotion need to be considered.

There is wide agreement amongst marketing agencies that the following premiums would fit market expectations and leave the producer with a reasonable margin:

Meat and Dairy products	20%-25%
Cereals	60%-100%
Vegetables	40%-100%

In recent years this level of price premium has been achieved or surpassed. A variation in price premium is to be expected and on occasions when an organic outlet is unavailable, some produce may have to be sold on conventional markets.

Presently organic animal producers may feed a proportion of their diet from in-conversion sources. This represents an opportunity for in-conversion cereal farmers to obtain a premium price for their grain. Presently prices in the region of €250-€300/tonne may be obtained for in-conversion cereals.

Maintaining high levels of productivity

In order to increase profitability per hectare high levels of output are required. During the conversion period, output reductions may result due to the adoption of a new, less familiar enterprise, the growing of fertility building crops at the expense of cash crops or as a result of actions which could be avoided through improved preparation and planning. In order to minimise these production losses during the conversion period, it is advisable to have good clover content before the conversion period starts or as soon as possible after. For dairy and drystock systems, stocking rates below 1.6 L.U./ha should be sustainable on white clover/ryegrass swards alone but above that red clover swards for silage production are needed. Cereal farmers can achieve yields up to 5 tonnes per hectare but this needs good rotation structure, seedbed preparation and soil fertility management. Horticulture growers depend on rotations but also rely on pest, disease and weed management techniques to maintain productivity levels high.

Minimising inputs and reducing costs

The costs of conversion vary widely according to individual circumstances. Costs may arise from a combination of one or more of the following:

Output reductions: This may be due to changes in agricultural practices (including a possible reduction in stock numbers or a possible conversion-related emphasis on fertility-building legumes at the expense of cash cropping), or as a result of mistakes or inappropriate actions which could be avoided through improved information and planning.

Information and experience gathering: training courses, seminars, conferences, literature.

New investments: e.g. land, machinery, livestock, buildings, manure handling/storage systems and other facilities may be required especially if there is a change in enterprise. Some money can be released from the sale of stock or fixed assets. The organic grant scheme for on and off-farm investments, administered by the Department of Agriculture, Fisheries and Food may also by availed of (see later).

Fixed costs: Extra fixed costs encountered during the conversion period include possible depreciation of conversion related investments and organic certification charges. It is widely assumed that organic farms require considerably more labour than conventional farms. In fact this is only the case for some enterprises, particularly those which require specific additional labour, for example hand-weeding in field vegetables.

Variable costs: The use of artificial fertilizers and sprays can result in a big decrease in variable costs on organic farms. On organic farms, nitrogen input from prohibited artificial fertilizer is replaced by clover. Organic clover can be purchased in the region of €15/kg. White clover sown at a rate of 5 kg/ha can provide ~100kg N/ha at a cost of €75/ha, a small fraction of the cost of artificial nitrogen. Some additional costs may be associated with reseeding grassland, establishing green manures and the purchase of bedding material and organic concentrates for livestock enterprises. Concentrate and straw costs may be mitigated by growing tillage crops on the farm. Livestock farmers who provide organic cattle for the organic meat trade can buy/rear more traditional cattle breeds that are easier to finish without the need for expensive concentrates. Dairy farmers by choosing the “fast track conversion” option can cut costs by feeding cows to full organic standards from six months before the end of conversion onwards i.e. for the first 18 months of the conversion period conventional non-GM feed may be fed.

Lack of access to premium prices: During the conversion period, premium organic prices may not be obtained although produce may be sold into conventional markets. Organic cereal producers may obtain a premium for in-conversion cereals presently in the region of €250 - €300/tonne.

Maximising REPS 4 and the Organic Farming Scheme/Investment Scheme Payments

The Organic Farming Scheme (OFS) administered by the Department of Agriculture, Fisheries and Food operates independently of REPS but the majority of applicants will be in both schemes. The payments are outlined in Table 2. Although the OFS is independent of REPS 4, a farmer in REPS 3 must wait for the end of their scheme term or transform to REPS 4 to be eligible to join the OFS. The OFS offers great flexibility and allows small scale horticulture holdings too small to enter REPS benefit from the scheme. It also allows organic lands to be cropped by another organic operator. It is now possible for an organic crop farmer to grow a crop on another organic livestock farmer's land provided that both are participants of the OFS.

Table 2 Organic Farming Scheme (OFS) payment rates

OFS1 payment rates	**Horticulture Holdings ≤6ha (min. payment 1ha)**	**Holdings > 3ha and <=55ha**	**Area >55ha (less than 55ha other rates apply)**
In-conversion	€283/ha	€212/ha	€30/ha
Full organic status	€142/ha	€106/ha	€15/ha

Source: DAFF 2007

The above payment is in addition to the REPS 4 payments, for example a 40 hectare farm will receive a REPS 4 payment of €8,780 per year and an OFS payment of €8,480 per year for the first two years and in subsequent years a REPS 4 payment of €8,780 per year and an OFS payment of €4, 240 per year.

Terms and conditions of the OFS include minimum production levels for organic farms. To obtain the full scheme entitlement, horticulture-only applicants must crop at least 50% of their land in any given year. For other farmers, a minimum stocking rate of 0.5 L.U/ha is required. Lower stocking rates result in a pro-rata reduction in payment.

OFS applicants also participating in REPS 4 can avail of extra supplementary payments for agri-environmental work carried under REPS 4. Such extra payments may be availed through one of the following options:

- Owned Natura designated land
- LINNET areas (Land Invested in Nature, Natural Eco-Tillage) habitats
- Traditional Rare Breeds
- Traditional Orchards
- Riparian Zones (salmonid, crayfish or pearl mussel sites)

There is an additional option for non-REPS stockless farmers growing green manure during conversion - €240/ha up to a maximum of 40ha for the two years of conversion.

There is also an on-farm and off-farm investment grant scheme administered by the Department of Agriculture, Fisheries and Food which grant aids items at a rate of 40% VAT exclusive for the purchase of new equipment and facilities for the production, preparation, grading, packing and storage and distribution of organic livestock and produce.

Farm Business Planning

Farm business planning involves selecting a particular course of action with the objective of obtaining the greatest satisfaction of the farm's goals. Farmers in practice carry out a certain amount of planning. This can vary from farmer to farmer. Whole farm planning allows you to decide:

-where your business is at currently?
-where your business should be going?
-how are you going to get there?

The farm planning process consists of gathering information, setting goals, preparing the plan and implementing and monitoring the plan.

The Farm Planning Process

Gather and Analyse Information

↓

Setting Goals

↓

Draw up a Farm Plan

↓

Implement the Plan

↓

Control/Modify the Plan

You want to create a farm plan that will allow you to:

1. See the financial performance of your farm over the coming six years, if you remained conventional farming (this is referred to as the Baseline plan).

2. Make a New Farm Scenario to change your farming activities, describing in detail what effects the switch to organic production will have on resources such as land, stock, buildings, machinery etc. The investment (and possible borrowings) requirements must be taken into account at this stage.

3. See the financial consequences if you were to implement the New Scenario over the 6 years (this is referred to as the Scenario).

You can compare the financial implications for the two sets of information to determine if the proposed changes would leave you better off than carrying on as normal (the baseline situation). This will help answer the question, should I go ahead with the change to organic production or not?

There is a Teagasc tool to help with creating these plans called the “Farm Business Planner” program. Practically all the information required can be taken from the Teagasc eProfit Monitor printouts/reports or the farm accounts. The quality of the

information is vital, with the old adage" rubbish in, rubbish out" very relevant. Using a program like the eProfit Monitor or the "Farm Business Planner" will not turn poor information into impressive results.

Farm business planning permits you to make more profits in the long-term by establishing a clear direction and a flexible management framework which can be used to facilitate responses to changed conditions, unplanned events and deviations from plans. In addition a farm plan is a good method of communicating your farm situation to other interested parties such as advisors and lending institutions.

The Teagasc "Farm Business Planner" is a tool available free to all Teagasc clients. Selected pages from a sample "baseline plan" and a sample "organic scenario" for a real 44ha suckler to finish farm on reasonable to good quality land are shown at the end of this paper.

Sample data taken from both scenarios is summarised for both the baseline plan (Table 3) and the organic scenario (Table 4).

Table 3 Financial Data taken from Teagasc Farm Business Planner (2008-2014) for a real 44ha suckler to finish farm (Baseline Plan –stay conventioanl)

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Gross Output (€)	67,790	69565	71,474	69,974	71,474	71,474	71,474
Variable Costs (€)	21,067	23,859	24,593	22,903	23,591	24,298	25,027
Fixed Costs (€)	21,270	20,710	20,276	19,864	19,472	19,096	18,752
Net Profit (€)	25,553	24,995	26,605	27,206	28,412	28,080	27,604
Direct Payments (D.P.) (€)	35,186	35,735	36,494	36, 494	36, 494	36, 494	36, 494
Nett Profit as % of D.P.	73%	70%	73%	75%	78%	77%	76%
Cash Flow (€)	+3,584	+1,849	-1,252	+538	-265	-847	-2,330
Cash Flow Ratio	48%	50%	50%	50%	50%	51%	53%

Note: long-term goals, proposals, loan requirements and price assumptions outlined in the plan at end of paper

Table 4 Financial data taken from Teagasc Farm Business Planner (2008-2014) for a 44ha suckler to finish farm, (Organic Scenario, conversion commences early 2009)

Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Gross Output (€)	67,790	73,843	76,302	76,078	77,578	77,578	77,578
Variable Costs (€)	21,067	24,091	24,732	22,732	23,144	23,569	24,006
Fixed Costs (€)	21,170	21,176	20,756	20,358	19,981	19,620	19,293
Net Profit (€)	25,553	28,576	30,814	32,987	34,453	34,389	34,280
Direct Payments (€)	35, 186	45, 063	45, 822	41, 158	41, 158	41, 158	41, 158
Nett Profit as % of D.P.	73%	63%	67%	80%	84%	84%	83%
Cash Flow	+3,854	+10,567	+5,511	+5,305	+5,195	+3,921	+2,611
Cash Flow Ratio	48%	54%	57%	53%	52%	53%	54%

Note: long-term goals, proposals, loan requirements and price assumptions outlined in the plan at end of paper

Under the organic scenario, the farmer proposes to reduce cow numbers from 2009 onwards, while buying in extra organic weanlings resulting in a marginally lower stocking rate than the baseline plan. In 2014, the projections show the organic scenario with a better net profit (+€6,676) compared to the baseline plan. This is due to a number of factors:

a) *Costs* –although fixed costs are higher in the organic scenario due to extra organic certification fees, variable costs are lower – the savings achieved from no fertilizer costs more than compensated for by the increased costs associated with straw, organic/in-conversion feed, organic clover seed and transport of bought in organic weanlings. Organic feed is projected to cost approx. €500/tonne but is mitigated by the maintenance of an Aberdeen Angus sire in the organic scenario which produces easier to finish stock. In the organic scenario no significant extra on – farm investment is required which also helps to keep fixed costs low.

b) *Production* – although in the organic scenario, stocking rate decreases due to a reduction of cow numbers, throughput of cattle into the market is maintained at similar levels to the baseline plan by the purchase of extra in-conversion/organic

weanlings for a projected similar price to conventional weanlings. Re-seeding with clover maintains the stocking rate at good levels.

c) *Market*- the market for organic beef is considered healthy in the short to medium term. In 2014, projections show the organic scenario with higher receipts from cattle sales (+€5,940) due to the attractive market price for organic beef.

d) *Schemes*- the Organic Framing Scheme is availed of in the organic scenario and results in an increase in direct payments in the organic scenario in 2014 (+€4, 664).

Conclusion

The switch to organic farming may be the biggest farm management decision you ever undertake so careful planning is essential. The vast majority of organic farmers have no regrets once converted. Organic farming can be a profitable option due mainly to lower costs of production, an attractive organic farming scheme and attractive market premiums. However the change requires preparation, an attention to detail and good husbandry skills - a poor conventional farmer may make an even worse organic farmer. From the financial viewpoint, the Teagasc "Farm Business Planner" program will help you in making the decision to convert or not. Like conventional farming, organic farmers should not solely depend on unsustainable schemes and grant aid for future profits. The organic market is a "niche" but growing market and it is important to follow that market.

References

DAFF, 2007 Terms and Conditions of the Organic Farming Scheme 2007 – 2013.