Cost of production

Back to basics

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With a fall in farm income and the autumn budget creating a perfect storm for a challenging financial outlook, *CPM* learns how growers can get a better handle on what they can control.

Charlotte Cunningham

Although farmers are accustomed to riding the lows and highs that come with food production, to say the past few years have been particularly turbulent feels somewhat of an understatement. And now, with what’s been coined a ‘spiteful’ budget, there comes a new element of challenge – alongside official figures reporting a fall in farm income.

Looking in more detail at the latest Farm Business Income figures which were released in November by Defra, it’s arable farmers who appear to have been hit the hardest.

Based on the period March 2023-February 2024, the results indicate:

- In 2023/24, average farm business income was lower for all farm types except for specialist pig farms and specialist poultry farms. The fall in income followed exceptional highs for some farm types in 2022/23.
- For cereal farms, following two years of exceptional highs, farm business income fell by 73% to £39,400. For general cropping farms, average income was 24% lower at £95,300. A combination of lower output prices and yields were a key factor for both farm types.
- The progressive reduction to the BPS was introduced in 2021. In 2023/24 across all farms types the average net payment received was approximately £18,300. This was 21% lower than 2022/23 and accounted for around 40% of farm business income.
- Across all farm types, net income from agri-environment activities increased by an average of 14% to £10,600.

Critical understanding

As growers seek to navigate the changes that lie ahead, having a sound understanding and grip – where possible – on cost of production is vital, says James Webster-Rusk, senior agribusiness analyst at The Andersons Centre. “While inheritance tax changes have garnered the most headlines, there are other elements in the recent budget which for many will have a more immediate impact on cost of production.”

James explains that this includes increases to the National Minimum Wage and National Insurance contributions. “The employment allowance was also increased which will reduce some costs for the smallest employers.”

However, the ‘biggie’ for the coming year is the more aggressive tapering of BPS than expected, he warns. “That’s the one which is really going to pinch cashflow in the most immediate sense. We’re going from what we expected to be a continued steady path of decline towards 2028, to now where we have a hard limit whereby there’s a 76% cap on the first £30,000 – which basically leaves every farmer with a maximum of £7200 worth of BPS. ▶

Andersons’ James Webster-Rusk says it’s the “aggressive tapering of BPS” which is going to pinch cashflow in the most immediate sense.

Changes to inheritance tax, a reduction in subsidies and increased labour costs were among the key announcements affecting farmers in the recent budget.

According to the latest Farm Business Income figures released in November, income on cereal farms fell by 73% to £39,400 (based on the period March 2023-February 2024).

"If I use our model farm example for this, the impact is a £27,000 loss – there or thereabouts – in revenue for next year, before we've even thought about cropping."

So although many now find themselves beholden to a cruel hand of the budget, is there anything farmers can do to put themselves in a better position? Yes, reassures James. "It definitely focuses the mind on ensuring your business is as efficient as possible, and knowing your costs is one of the cornerstones of that."

Getting to grips with cost of production may seem relatively obvious, but keeping up with changing costs is sometimes overlooked in the busy nature of farming – so where's the best place to start? "On paper, cost of production is a relatively simple calculation, but to be really accurate, this should go into a more detailed analysis than just approaching costs on a broad basis.

"Perhaps historically, we've been very focused on producing tax accounts at the end of the year, but it's also worth thinking about bringing in management accounts – and cashflow aspects – into the equation," says James. "Gross margins provide a lot of data, but it's looking at those fixed costs which are really important. That's often where a lot of the efficiencies can be found."

Particularly relevant for arable growers, James says something he often highlights to clients is taking a closer look at machinery costings. "Given recent pricing, I don't think many people are throwing on excess fertiliser or crop protection spend – lots of farmers tend to be very focused on those costs – but I think sometimes the full cost of machinery is slightly overlooked."

Segmentation

In an extreme situation, establishing cost centres for every element of the business will give an accurate picture of where potential efficiencies can be found, he says. "Where this feels a little too complex, start by thinking about poorer performing areas of fields. If these are consistently underperforming and increasing your cost of production, then perhaps it's worth considering an SFI option, for example, so these areas have more potential to earn you money rather than not."

If it all sounds a little daunting, there are tools to help, explains James – pointing out AHDB's Farmbench analysis tool.

Only once growers have an accurate picture of the current cost of production can they begin to look to improve it, if necessary, and James says there are a number of ways to do this. "Even if you're currently sitting in the bottom 50%, it's possible to reach the next level of performance and there are a number of things that will be within the farmer's control.

"This was something we assessed recently in work carried out for AHDB where we relooked at the characteristics of top performers."

Delving into the detail and some of the key comparisons between top and bottom performers were:

- Agricultural costs: total costs are much lower per hectare and per unit of output on top performing farms. However, top performers spend more on fertiliser, seed and crop protection products.
- Contracting: levels of contracting are significantly higher among the top performers. This has become more noticeable since the 2018 report.
- Debt: the two variables related to debt are both highly significant, with higher debt levels amongst the poor performers.
- Agri-environment schemes: bottom performers have more agri-environment income/ha, but the difference isn't statistically significant after matching. The difference is much smaller than when this analysis was carried out in 2018.
- Agricultural diversity: top performers tend to be slightly more specialised, but the difference isn't huge. Poor performers

Budget recap – key changes affecting farmers

The UK Autumn Budget 2024 introduced significant changes for farmers/business owners, impacting everything from taxes and subsidies to investment opportunities.
Key announcements relevant to the agricultural sector include:

● **Inheritance tax**
From April 2026, Agricultural Property Relief and Business Property Relief will be capped at £1M for 100% relief. Assets above this threshold will only receive 50% relief, effectively imposing a 20% tax rate on the remaining value. This will require careful succession planning to manage inheritance tax liabilities, as many farming estates may now be subject to IHT for the first time.

● **Capital gains tax**
CGT rates are increasing with the lower rate rising to 18% and the higher rate to 24%. This change will affect decisions regarding asset sales or transfers, potentially making diversification or restructuring more costly.

● **Subsidy reductions**
Direct payments under BPS are being phased out more quickly, with a significant shift towards ELMs. Payments on the first £30,000 will be cut by 76% emphasising the government's focus on sustainable farming practices, but potentially challenging profitability for smaller farms.

● **Labour costs**
Employer National Insurance contributions will increase to 15% in 2025, with the threshold for payment also falling from £9100 to £5000. Further, the National Living Wage will rise to £12.21/hour. These changes will increase operating costs particularly for farms with larger workforces.

● **Environmental investment**
The government allocated £427M for productivity and innovation in agriculture and £75M for water and flood management projects. These funds aim to enhance resilience against climate change and support long-term productivity.

● **Furnished holiday lettings**
Changes to tax rules for furnished holiday lets, such as removing deductions for financing costs, will impact farms relying on diversified income streams like rural tourism.

have significantly more enterprises from grassland. Top performers have more farming activity from other arable crops (peas, beans, potatoes, etc).
● Wheat price and yield: yield is markedly higher with the top performing farms, and the price difference is also significant after matching.

"That last point about yield and how much you can sell the crop for is particularly important," points out James. "When thinking about a 'good price', on paper something might look favourable based simply on gross margins. However, if you have high machinery costs then it might not actually be such a good deal. So it really is important to factor all of these elements into your calculations.

"To improve prices reached for crops, it's crucial to go back to rotation plans and consider if there are prospects in added value sectors, maybe you're close to a mill with opportunities to get a better premium delivered into the mill.

"Then there's thinking about the market you're supplying. For example, if you're growing spring barley and expecting it to go for malting, do you have a contract in place? We saw last year that market become very quickly oversupplied and where this happens, price is driven down," he says.

James adds that he's an advocate of having a plan when it comes to selling. "Ask yourself, what's your 'get out' price? If you think about when the market is dull or flat – as it is at the moment – then what's the point at which you say, okay, this is where I have to sell something? Essentially, this is the point where you can sell and still make a profit.

"The buoyant pricing we've had during recent years is very fresh in the memory, but unless we experience further global disruption, we're unlikely to see those prices again in the immediate future."

James suggests that making any improvements often requires an element of change, which can in itself feel tricky. "But there are technologies and resources out there to enhance decision-making and take away some of that burden, which is getting more accessible even for smaller farmers. Embracing change can often reduce spend.

"It's difficult at the moment, really difficult," concludes James. "But by keeping an eye on costs and having that focus on attention to detail, farmers can still retain a little control in what's definitely an unsettling time for many." ■

Lower per hectare, higher levels of contracting and less debt are among some of the key traits of top performing businesses, according to work carried out by Andersons for AHDB.