

DEVELOPMENT AND CONSOLIDATION OPPORTUNITIES FOR ROMANIAN FARMS

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***Abstract:** The efficacy of agricultural entities, no matter the form of organisation, largely depends on the managerial capacity doubled by a rigorous administration control. Such a control system is meant to analyse the cause of deviations between forecast and achievements so that these post factum signals lead to correcting the factors that make possible farm evolution. In this paper, the authors point out aspects related to economic efficacy from the perspective of upstream production since they are the only ones able to control profit size (sale price is difficult to control because it is a market variable).*

***Key words:** farms, budgets, agriculture*

INTRODUCTION

An agricultural farm is viable when there is interaction of production factors in economic harmony and it can bring about enough added value for both current needs and its own development.

Effectively administrating an economic unit supposes using the best available resources to reach target-objectives in high profitability ranks first.

To reach the objectives, success depends on a series of factors that need to be put at work:

OBJECTIVES → DECISIONS → RESULTS

In practice, results tend to divert from the forecasts of the entity because of unpredicted factors. This is why, to control the situation, we need a control system able to identify the diversions between forecasts and achievements to make the necessary decisions.

This regulating mechanism through retroaction, feed-back is effective due to procedures that aim at establishing budget forecasts, periodical calculus of costs and results, the calculus and analysis of diversions between forecasts and achievements.

Due to these cost monitoring mechanisms one can ensure control and avoid *sideslips*¹

MATERIALS AND METHODS

The methodology used in the research relied on the theoretical conception in the field, on data collection methods and techniques, on data processing methods and techniques, and on logical processes of analysis and synthesis (building up and systematising theory).

¹ D. Leclere – Comptabilité analytique. Analyse, prévision et contrôle des couts, Ed. Eyrolle, 1992, p.6

RESEARCH RESULTS

1. Budgeting activity and creating value added

A main component of administration control is budgeting: forecasting can establish a profit target and, starting from this, one can estimate and control expenses, and measure and compare results achieved with planned results. Comparing real data with budget data, one can establish diversions, causes that engendered negative or positive diversions and take correction measures.

What are budgets for?

- They ensure more rigorous monitoring off costs by establishing a target profit;
- They help monitoring and adjusting diversions;
- They help establishing and organising payment programmes;
- They keep expenses within normal parameters by following the target.

The performance of a firm is the result of creating economic value. An entity becomes performant when it produces profitability higher than the invested capital under risk and efficacy conditions and in consensus with stakeholders' expectations.

Economic Value Added (EVA)²

According to Peter Drucker's article published by *Harvard Business Review*, "a firm that generates a profit smaller than the resources it uses to produce it does not create wealth, it destroys it."

This concept engendered, in time, theories regarding the finality or goal of creating value added. The *theory of shareholders* advances the idea of creating value to makeshareholders rich, while the *theory of stakeholders* supports the idea that added value as a resource meant to meet the needs of the participants to the firm's "economic life" – suppliers, creditors, clients, and employees.

Another more realistic and equitable vision supports maximising shareholders gains with proper payment for all participants in the firm's economic activity.

In our attempt to increase value added, we need to start from identifying key-factors, establish strategies to fix clear, reachable objectives, adjust diversions, and monitor and evaluate results; conclusions will help optimising the results in consensus with the shareholders will of increasing their wealth.

Increasing value added is, in fact, a concurrence of external factors (suppliers, clients, authorities, State) and internal factors (work environment, staff, management) which, despite their different interests, lead to a common goal – creating value added.

The indicator measuring EVA replaces traditional result indicators EBIT (Earnings Before Interest and Taxes) or EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization), and was successfully embraced by corporate communities due to its analytic perspective.

EVA is determined as follows:

$$\text{EVA} = \text{Net profit} - \text{Equity cost of the firm's capital}$$

This indicator expresses in real terms the profitability of the capital invested after deducing conex costs, the risk taken by the shareholders being compensated by gain. Thus, to create value added, an entity needs to gain enough to cover the cost of financial debt (interests due to creditors) and capital opportunity cost (the dividends shareholders expect).

² This concept appeared in the General Motors corporate system in the 1920s. for a time, it was neglected and then re-introduced in the 1980s by Stern-Stewart&CO, a consultancycompany, as an indicator for the measurement of economic performance.

A positive value of this indicator expresses the creation of wealth for the owner, while a negative value means that the firm loses value even if the profit is positive but not enough to cover debt costs.

EVA can be seen as an indicator for the measurement and control for the firm management.

EVA englobes all heterogeneous aspects of the firm: employees and owners cooperate and positive values allow the firm to develop sustainably.

What was the purpose of this excursus in economic analysis and what is its relevance for agricultural entities?

First, we consider it is an indicator measuring the profitability of an activity, the measure in which, due to the invested capital, it becomes profitable. A forecast of the results, a projection of the result can contribute to making the decision of recurring or not to external sources.

Second, this indicator measures the profitability of the capital invested and results can be compared to forecast ones through diversion analysis leading to decision making in the future. We can analyse the cause and/or cost generators that result in lack of efficacy.

It is, for shareholders, a stimulus in pursuing doing business and an acknowledgement of their managerial capacity.

2. Developing through Diminution and Control of Costs and Dynamic Analysis of the Sale Price

Market economy is the mechanism measuring, determining, and regulating in competitiveness the sale price of goods or services.

The viability of a good/service is assessed through the market prism by meeting two components: *satisfying the clientele* and *the price demanded*, which should be competitive.

Sale price = f (client: price)

Competitive market in which the law is made by demand and offer, provided absolute freedom of prices (State interventionism lost its determining role).

Thus, private entities have no control over the sale price because it is a random variable depending on the matching between demand and offer on the market.

Estimates made when funding a budget can create virtual profits impossible to determine at different times, thus creating the need for positive or negative adjustments depending on market response.

Sale price = product cost + margin can be established mathematically as an optimistic calculus variant, but price volatility on the market can engender estimates that can affect the financial balance of an entity.

Agriculture is an economic branch in which sale price cannot be determined, but can be determinable:

Grain price = f (market)

Sale price is the market (final consumer) response and fluctuations are nothing else but its rebound.

Given these aspects, managerial decision should focus on cost management, on yield increase and on crop productivity, but also on the hope of cashing in an amount that compensates costs already incurred plus a margin/benefit. The manager needs to focus on the cost-benefit analysis, on the controllable component (cost), and not on sale price, which is dictated by the market.

Literature mentions a cost control method – target costing³.

³Target-costing, a managerial approach of costs, a Japanese concept of managing costs.

Grain production is a type of production with a longer cycle, in which costs are mainly made 80% during sowing; therefore, cost management upstream production is the manager's available tool.

How can a manager control cost?

- Through production organisation methods such as *Just-in-time* method;
- Through new technologies, equipment, machines, and tools;
- Through association of technical innovations and managerial practices that encourage the involvement of the firm's members, their initiatives.

The *Just-in-time* method aims at reducing costs along the supply chain, an improvement of the relationship with the suppliers, an improvement of quality and, finally, a reduction of costs per product unit.

Monitoring and controlling costs are the only control instrument of a manager. Sale price is a variable that no entity can control

$$\text{TARGET-COST} = \text{CONCURRENTIAL SALE PRICE (TARGET)} - \text{EXPECTED MARGIN (TARGET)}$$

Managers can control the moment they sell, when there is no signed contract, or when storage capacity or financial situation allow them to store.

Thus, if we deduce from the sale price of a competitive environment established freely by the market the expected margin, we get the price that should not be overrun.

What is the power exercised by the agriculturalist-manager on profit size? He can only determine an estimate price to valorise his crop but he can administrate well the costs incurred at the debut of the production process upstream by diminishing costs. During the production process, he can control costs through better use of human and material resources.

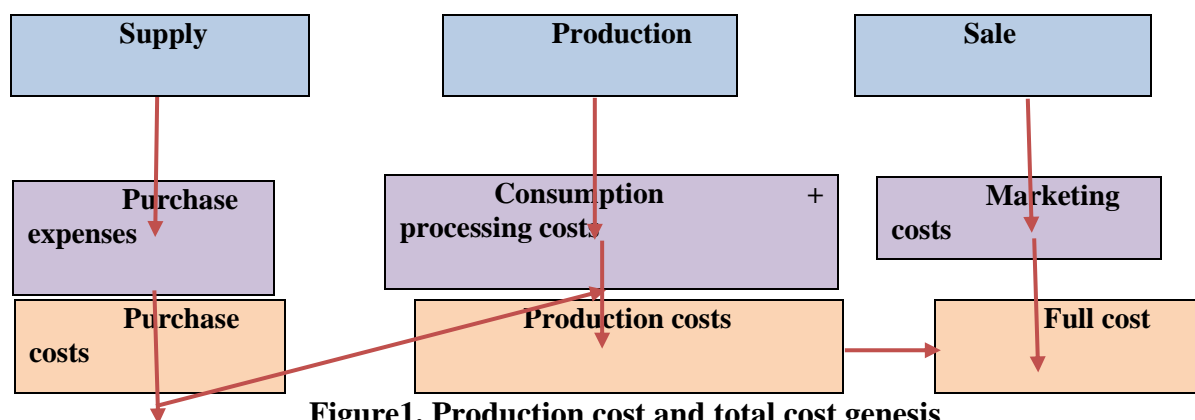


Figure1. Production cost and total cost genesis

$$\text{Profit} = \text{Fiscal value (Qv*Pv)}^4 - \text{Total cost}$$

Production cost, according to Order no. 1826/2003, is formed from the variable production regie + fixed regie allotted rationally by taking into account the level of occupancy of the production capacity.

Thus, productive fixed costs = Fixed costs * level of occupancy of production capacity

Level of occupancy = A_r/A_n = real activity/normal activity

In agriculture, real activity means the crop is not touched until harvesting.

⁴Qv = amount sold; Pv = sale price

If the crops are affected by external factors such as drought, then together with crop damage we need to take into account fixed production costs, fixed production regie and separate them from unproductive fixed costs.

These approaches in administration control result in rational amputation of costs. Lack of productivity cannot be imputed to the clients, because one cannot ask for a sale price that covers all costs or economic inefficacy.

The cost of penury equals lack of gain because of stock rupture and consequent unsatisfied demands.⁵

CONCLUSIONS

Practicing modern, intensive agriculture in Romania can be extremely profitable and attractive if investing material and human resources produces for the investor and shareholders enough profit to be stimulated to continue and develop. To reach this objective, management decision should focus on cost management, increasing profit and crop productivity, and also on the hope of cashing in sums that pay for the expenses already made plus some benefit.

Managers need to focus on the cost-benefit analysis, on controllable components – cost, not sale price – which, in a market economy, is dictated by the market (demand and offer).

A manager can control all costs:

- Through production organisation method, through continuous cost monitoring, through good administration of cash funds;
- Through new technologies, equipment, machines, and tools;
- Through managerial practices that encourage participants to get involved, to take initiatives.

All these management measures are meant to produce value added, economic efficacy, and high quality, and they determine the development and consolidation of the entity.

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⁵Contabilitate și control de gestiune, p. 53

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