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**Agricultural Finance and Small Business Management**

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### Borrower - Lender Playbook: Side-by-Side

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When I was fresh out of graduate school at Cornell University several decades ago, there was an old saying that lending and borrowing is a two-way street that requires good finances, operations management, open communication, and character to follow through with commitments. With that as a backdrop, let's dig deeper into the borrower-lender playbook for resiliency, agility, and nimbleness that will be critical for the challenges and opportunities that lie ahead of us.

#### *Scheduled planning and monitoring*

A major part of a successful playbook is financial planning and monitoring more than once per year in November or December for tax planning. The two-way street of communication requires quarterly or monthly financial statements even for operations that have annual or semi-annual revenue streams. These projected monthly and quarterly cash flow statements compared to actual results are especially useful in inflationary times and now in an era of rising interest rates, particularly for operating lines of credit.

In the past 24 months at our creamery, we have utilized weekly cash flow statements and have monthly online meetings with our lender. The financial statements bring a sense of urgency to our management process and focus our attention on the products, services, and divisions that are generating profits and losses.

After 18 months of utilizing this intense analysis and enterprise budgets, a swing to positive outcomes is being observed. As a result, home delivery and some of our specialty milk and dairy product lines were discontinued. After a thorough analysis, eliminating home delivery and process improvement in some areas of the business has reduced annual labor costs by \$1.5 million. The trucks not used for home delivery were diverted to filling empty store shelves with milk, ice cream, and eggnog. The bottom line has seen a seven-figure improvement! The entire process and the positive outcomes were good motivation for both the management team and the staff.



Another benefit of the weekly cash flows was to determine lost sales. We focused on lost sales as a result of demand exceeding supply or where production and distribution processes did not meet expectations. With nearly \$1 million of lost sales identified, the goal for 2023 is to reduce this number by 70 percent.

With the aforementioned examples, I am sure you can see the power of cash flow budgeting, monitoring, and breaking down the silos of various management areas to improve global communications in the overall business. This type of extreme monitoring can build confidence and communications between the lenders, owners, board members, and amongst employees as well.

### *Communication*

There is an adage that lenders do not like surprises. A classic example is a borrower purchasing a piece of equipment on interest only or signing a contract for a tract of land and then going to the lender with a credit request. On the other side of the street, borrowers do not enjoy surprises either. Some examples include finding out your loan officer does not work here anymore, internal review is going to require more collateral, or more time is needed for a response on the loan request. Open communication channels will improve the borrower-lender relationship and keep both parties informed to better anticipate upcoming changes and needs.

### *Capital expenditure growth plan*

In the borrower-lender playbook, a capital expenditure plan needs to be outlined. First, prioritize your needs versus wants. For example, a green light would be a need, a yellow light is between a want and a need, and a red light would be a want. Examine your equipment lines and depreciation schedules and discuss with your lenders how this will impact cash flows from an operational standpoint and also from a tax standpoint. Wisdom from years of operating a business would be to build a cushion of 25 percent of expenses for unexpected capital expenditures or when Murphy's Law makes an appearance. For lenders, make sure you follow through with the chain of command in the loan process from the relationship manager to credit review. Always ask who the backup is in case someone is promoted, reassigned, or happens to leave the organization.

### *Projections*

Cash flow projections are 80 percent of the business plan. This is because the cash flow links production, expenses, debt service, timing, and operations throughout the year. Rather than the five-year cash flow that was recommended during my undergraduate and graduate school programs, just do a one-year projection and conduct sensitivity analysis on that one year.



A worst-case scenario could be a 10 percent decline in revenue, a 10 percent increase in costs, and now a four percent increase in interest rates. Anything greater would require one to assess working capital to determine if sufficient funds are available, how long they are going to be available, and how long the negative margin is going to occur.

The average case scenario is the most likely scenario with a high probability of occurring, usually above 60 percent. In this case, determine if your debt service coverage ratio is above 125 percent. If not, do you have 25 percent of your expenses as working capital or working capital assets that could be turned to cash within 90 to 120 days? If this test fails, then you must fall back on your equity position, whether that means refinancing or the sale of capital assets.

Finally, analyze the best-case scenario when you hit a home run. This will generally occur about twice in a 10-year cycle for the proactive manager. To stretch ourselves, the creamery has adopted another projection called the “best of the best.” This is a stretch of where we feel we are concerning peer benchmarks to the top 10 percent of the industry for production, operational efficiency, and financial performance. This is becoming a new trend in the agriculture industry that was coined by my good friend Dr. Danny Klinefelter, Professor Emeritus at Texas A&M University. Often, farm management instructors will use the FINBIN database or other state record databases to assist you in benchmarking your operation against the top tier of producers.

### *Character*

In today's world of financial numbers and analytics, sometimes character is overlooked in the borrower-lender relationship. From the borrower's standpoint, are your numbers transparent or do you have hidden liabilities? Do you have your financial statements completed on a timely basis and are you open for review? Have you outlined your plans, aspirations, and expectations for your business and your expectations from the lender?

On the flip side, does your lender hold information in confidence? Are the relationship lenders providing value such as follow through, benchmarking, and explaining the numbers and trends? Do they work with other lenders to provide the best options designed for your situation rather than a generic cookie-cutter type of program? Do they offer educational opportunities and sponsorships and do borrowers attend these programs?

While this list is not all-inclusive, it covers a large part of the playbook that can be implemented in the field. With the economic volatility and transition being experienced in the agriculture industry, a side-by-side borrower-lender playbook can be a great communication tool for the proactive borrower and lender.





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