

David M. Kohl

Professor, Virginia Tech

Agricultural Finance and Small Business Management

This is one of a series of articles written by Dr. David Kohl for the Minnesota State Farm Business Management Education Program.

Vol. #103



What's Driving Your Earnings Engine?

By: Dr. David M. Kohl

The future of agriculture is destined to be one of challenges and opportunities in a disruptive macroeconomic and societal climate. One must step back and strategize on what is driving your earnings engine in your business model.

One of the key strategies will be to focus on managing the controllable variables or the variables that have a high probability of being influenced by your business management. At the opposite end of the spectrum will be to develop a mindset of managing around the uncontrollable variables such as geopolitics, weather, and consumer, institutional, and societal trends. If one develops this approach, you can improve your odds for success and that the earnings engine can provide an economical, sustainable business along with a balanced lifestyle.

In today's economic environment, one must approach the earnings engine with a three-pronged approach. Geopolitics, military action, weather, trade inconsistencies, and the economic health of countries and regions have created extreme price volatility. On the other hand, costs have been impacted by supply chain issues, inflation, shifts in energy policy, and similarly geopolitical and economic health factors. Layer on central banks around the world altering interest rates and money supply which impacts currency valuations. Inconsistent fiscal policy strategies have created disruptions in the engine horsepower to navigate the peaks and valleys along the path towards your next business destination.

What do the owners, managers, and advisory team need to focus on to ensure the earnings engine powers forward? The answer is quite boring! It is to focus and manage the basic fundamentals of production linked to operations, marketing, risk management, and financing in a productive business culture. Attempting to be five percent better than your peers is one component of success.

Priority number one is to develop and utilize a good record-keeping system where someone is in charge. One has to take ownership and be accountable for performance metrics. When



working with businesses in the 1980s farm crisis, the most successful operations had a “Marge in charge.” Marge was the accountant of the machinery dealership from my childhood days in upstate New York. Every dairy farmer knew not to get behind on the bills or attempt to challenge Marge. The owner of the business often credited Marge for the success of his business.

Accountability in tomorrow's business world will require a system of knowing the cost of production and, if multiple enterprises, knowing the metrics for each earnings engine. In the fast-paced three-dimensional economic environment, a price, cost, and interest rate strategy that is executed and consistently monitored is critical. If you were pitching your business on the TV show *Shark Tank*, knowing the breakeven point and the cost of production for your earnings engine when requesting capital is a given. If this financial information is good enough for a TV show, it is a no-brainer for operating and managing your business.

The excuse that I often hear is that I cannot do much with all of the uncertainty. This is where the next step in developing a quarterly or monthly cash flow is a must with financial sensitivity parameters. Include different scenarios for production, price, input costs, and interest rates. This provides the boundaries or the guardrails to keep your business and earnings engine from derailing due to emotional versus objective decision-making. Remember, 80 percent of a business plan is the development of a cash flow with key production, price, and interest rate assumptions. Rest assured, with the uncertainty in today's world, you will need to tweak and refine your strategy just as a conductor will make adjustments as the train journeys to its destination.

Another basic that is often overlooked is to develop your short-term and long-term goals. Short-term goals are to be achieved in less than one year, and long-term business goals have a timeline greater than three years. To provide a balanced lifestyle, it is suggested to document your business, family, and personal milestones. This allows one to maintain focus in a world of clutter, 24/7 cell phones, texting, and media blitzes. On a side note, shut down the technology for at least two hours per day to allow your mind to move to the creative, critical thinking, and problem-solving side.

Next, work with your advisory team. One of the trends of the top managers is that they engage outside expertise. A crop or livestock consultant, lender, farm management instructor, financial advisor, and risk management professional can be very valuable resources. These individuals are the conductors that provide the guidance so the engine can move smoothly to the destination and avoid obstacles and pitfalls.

Whether producing a commodity or a value-added product, a marketing and risk management plan is another example of what the top producers are doing to stay ahead of their peers. The wide ranges of risk, production, and marketing tools can be assembled in a balanced approach



to driving your earnings engine. When executing and monitoring, you are occasionally going to leave some money on the table. The top performers sometimes break even and this can be tough on your ego and emotions. On the other side you may incur losses, but the key is to fail fast and move on down the tracks.

Your business will come to a point that you may be required to move in a different direction as the track is in transition. Start early, maintain constant attention, and realize the journey is not a sprint, it is a marathon. When the wisdom and institutional memory that exists with the past generations is meshed with the energy and thinking of the next generation, you can then move to the next level of your earnings engine. The key is to assess what got you here and where you want to go. Remember, what got you here will not get you there, so be careful!

Finally, an introspective attitude and an “all hands-on deck” approach are very critical. It only takes one individual with an attitude issue to derail the earnings engine. Remember, to build your earnings engine and put the odds of success in your favor, train for attitude and accountability first and aptitude second. The altitude of your business, family, and personal success will often be based on attitude before aptitude.

