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Taking an Economic Punch

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“Everyone has a plan until they get punched in the mouth.” Whether or not you are a fan of the controversial heavyweight boxer, Mike Tyson, his famous quote is valid particularly in the current agricultural industry. From young and beginning producers, to agribusiness people, and specifically grain producers, an economic punch is being felt with different degrees of intensity. What are some of the strategies that one must engage in to navigate the financial white waters that are ahead?

The duration of the economic punch could be short term or long term, depending on a multitude of factors such as global economics, central bank policy in the U.S. and abroad, price of oil, and Mother Nature. A one year downturn will definitely impact repayment ability. Two to three years will impact repayment ability and liquidity. A five- year reset that includes prices similar to 2002 to 2007, with current input costs and expenses will challenge equity on the balance sheet as well.

What should be included when developing a “hunker down” strategy? First, within the next three months, summarize your financials for last year and include a three to five year trend. Schedule a meeting with your farm management instructor, lender, or financial advisor to review your results. Another set of eyes on the books can help examine alternatives and strategies which will be critical moving forward.

Make sure your financial records “talk” to other parts your business. Develop a financial dashboard that is linked to production, cost, and marketing and risk management plans. For grain producers, linking bushels or tons at a projected price in a marketing plan with different cost scenarios and margin scenarios makes the financials come to life. With dairy prices taking a large dip, pounds or hundredweights in the bulk tank per day at various price scenarios with monthly expense controls would equate to various levels of debt coverage, frequently used to monitor repayment ability.

A new term called rolling cash flow that compares projections to actual results on a monthly or quarterly basis could be a very useful tool in a “hunker down" strategy. Some call this variance analysis when projected financials are compared with actual results, including explanations discussing both negative and positive deviations. Strategies for addressing deviations could relate to production, cost efficiencies, or marketing with plans to either continue or change course. In today's agriculture world, with bigger numbers and greater volatility, financial conditions can quickly get out of control so consistent monitoring is critical.

Another area of focus when taking an economic punch will be monitoring living withdrawals and non-farm capital investments. "Average does not live here anymore" would be a great quote concerning living withdrawals. Analysis of farm record systems finds a $50,000 to $80,000 difference between the low third and the high third of family living withdrawals.

A "hunker down" strategy would include contacting your farm management instructor and requesting a personal family living budget template used by the farm record systems. Next, complete the budget and be sure to separate business and family or personal expenses. Commingling expenses is often a sign of financial issues. The true cost of production is also difficult to ascertain when comingling occurs. Include specific expenses in your budget. If miscellaneous expenses amount to more than 10 percent of the total, break this category down into more specific categories. Some producers have found it valuable to set aside a specific dollar amount for family living expenses, and then live within that amount. Finally, be careful of non-farm capital expenditures. Yes, for some of you who have heard me speak, I also call them killer toys. Enjoy yourself, but in moderation.

Next, taking an economic punch may require focus and scaling back. To those who won the cash rent lottery, elimination or renegotiation of rent, shedding marginally productive assets, i.e. land, machinery, equipment, or in some cases nonproductive human assets, may be on the road to recovery. Recently on a trip to Canada I was working with a large farm family. They made a major decision not to farm rented acreage that was marginally productive and located a distance away from the farm. Their focus was to generate more production efficiency from the home base farm and actually take more time to balance business activities with personal and family goals. Remember, in some cases "better is better before bigger is better," or efficiency trumps expansion!

Finally, during times of potential adversity, maintain open communications with your spouse or business partners, lender, farm management instructors, and suppliers. I have seen that a team effort with mini-victories over setbacks can build motivation and momentum for handling economic punches when managing through down economic cycles of the past. In some cases when it is all said and done, your financial management skills will be sharpened, which will position the business to be stronger and more sustainable when favorable economic times return.