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. #94

Business Problems You Want to Have

By: Dr. David M. Kohl

If you operate a farm or ranch business, you reap the benefits along with the challenges and problems. Every business will experience problems, but let's examine some of the good problems you might want to have. These good problems demonstrate that you may be doing something right, but still present you as the owner or manager with a challenge. Let's dig deeper and kickoff 2021 with the "feisty 15" problems that your business might want to have.

1. ***Your business pays a lot of income taxes***

The end of the year can be a challenging time for many that operate small businesses or farm businesses. One good problem to have is that you may have to pay considerable amounts of income tax. This is good news because it demonstrates that net income is strong. Profits are the engine that increases wealth on the balance sheet, if withdrawals and spending are held in check. The challenge is to find the sweet spot between paying taxes versus capital and expense deductions while maintaining cash flow and financial liquidity.

2. ***Your lender wants to loan you money***

If your lender wants to loan you money, this often means your business is profitable and demonstrates cash flow to service debt. This, along with good positions in equity, working capital, character, and other variables used in the lender assessment, can be a good problem to have. The key challenge is to not overextend the business financially and maintain a war chest of working capital greater than 25 percent of expenses and a backup of equity and collateral.

3. ***Growth frustrations***

When engaging with owners and managers at meetings over the years, some have expressed the frustration of not being able to grow fast enough. This sentiment is particularly true with young and beginning farmers and ranchers. The challenge is to stay out of these growth traps.

When budgeting, overestimate your capital and time needs by 25 percent. Maintain a term debt to EBITDA* ratio less than five to one. Use a four-year average for historical results, but stress test financial projections with a 25 percent reduction in EBITDA to see if these changes still keep you within the acceptable range.

A new favorite ratio is to divide net working capital by total debt service. If you are in the growth mode, include any new or proposed debt service. This ratio should be above five to one.

4. ***Everyone wants to work for you***

This is both a problem and a challenge to have. People wanting to work for you usually means that you have a good work culture, which is often spread by word of mouth. A good work culture is like a magnet attracting people, but the challenge is to attract and retain the right people, including family members. Treat productive people well, with a combination of salary, fringe benefits, and other non-monetary attributes. Overcompensation of productive people is often the key. However, compensation is more than just salary and fringe benefits. It includes workplace perks such as flexible scheduling, working with the latest innovations, or working for a business that takes pride in the community. A good book to read concerning this area is *Good to Great* by Jim Collins.

5. ***Excess Cash***

Your business has excess cash in the bank earning a low rate of return. Excess cash is a great problem to have because it is a blocking strategy during times of adversity. At the other end of the spectrum, excess cash creates the opportunity to negotiate cash discounts, have flexibility in marketing plans, or purchase discounted assets in a timely manner. Warren Buffett, the famous billionaire, does not keep cash reserves above $50 billion for no reason!

6. ***The 50 Percent Rule***

The senior generation suddenly wants to exit the business. They have 50 percent of their retirement living needs met by Social Security and investments outside the farm and ranch business. Initially, they were criticized that they could earn more by investing in the farm. However, outside investments provided diversification and flexibility to transfer the business to either the younger generation or the new owners.

7. ***Time on your hands***

The neighbors criticize you because you have time for family and friends. It may appear to some that everything has been handed to you on a silver platter. Organization and focusing on your priorities are key to time management and finding the balance between business, personal, and family life. The rule of working 2,500 hours per year in the business and 500 hours per year for outside activities can provide the parameters for balance. Remember, operating a business, which can require the occasional sprint, is often a marathon. Channeling people's energy is critical for long-term success in business and life.

8. *Your business functions without you*

A real issue for many farms and ranches is allowing their egos to deflate a bit and delegating responsibility and accountability to others. Ask yourself this question: Would the business continue to operate if it required you taking a one-month sabbatical? The old saying in the dairy industry was that, “I have not missed a milking in 15 years.” This was an honor badge from a different era.

9. *Leaving money on the table*

The year 2020 set the progress made on marketing and risk management plans back at least five years. Occasionally, there will be years when events and sudden changes in the market can provide bragging rights to the undisciplined marketer. However, in the long run, following a process and being disciplined is a winning strategy.

10. *Spending time in the office and on the computer*

A criticism I often hear about the younger generation is that they spend too much time on the computer. In today's information age, this might be a good problem to have. In defense of the older generation that often brings up this complaint, a balance between office time and being out on the front lines is usually the optimal strategy.

11. *Paying a facilitator or team of advisors*

A problem your business should have is paying a facilitator or team of advisors who challenges your thinking, whether it is regarding transition or operations. Think of this as an investment in your business. If you do not have a transition plan or operational contingency plan, the winners are often lawyers, tax accountants, or Uncle Sam.

12. *Business stakeholders asking tough questions*

When you are developing a business plan, it is a good problem to have when business stakeholders start asking tough questions about the business. It helps to shed light on various perspectives, which can be incorporated into the business plan. Not asking the tough questions could also eventually lead to lower profits.

*13. **Spending time refining a business plan***

Neighborhood chatter indicates that you spend too much time refining a business plan. Even if you are successful, a business plan can be a great mental map that should be tweaked as game conditions change.

*14. **Too much time at educational seminars and conferences***

Seminars are a good way to stimulate thinking and move ideas and good practices from the back of your mind to the front burner. The key is to identify the best educational events to attend and be sure to apply the lessons learned at these educational events to your business.

*15. **The personal checkbook stays at home***

Like Jeff Foxworthy, the comedian, might say, "You know you are successful when you do not have to bring your personal checkbook to the business board meeting." As a standard practice, a well-managed business that produces cash flow should not require personal funds to continue operations. While a business may occasionally need an injection of personal funds, the challenge is to ensure that this situation is the exception and not the rule.

As you look forward and make plans for the new year, take some time to examine how many of the "feisty 15" problems show up in your business.

**EBITDA is an acronym for Earnings Before Interest, Taxes, Depreciation and Amortization*