MANAGING A CASH FLOW PROBLEM:

SUGGESTIONS FOR GRAIN PRODUCERS

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Managing a Cash Flow Problem: Suggestions for Grain Producers

by

Gayle S. Willett*

With the completion of harvest, grain producers may focus their attention on getting ready for next year. Unfortunately, due to cereal grain prices that are below recent levels, this means some will need to address cash flow problems. The objective of this article is to offer a few suggestions for managing a deteriorating cash flow.

When experiencing a cash flow problem, there is a natural tendency to shorten your planning horizon and focus on making it through the next month or the next year. Management occurs on a crisis-to-crisis basis, with the prevalent attitude being "If I can keep things together for just a little longer, this problem will eventually go away." There is a possibility that current problems are the result of failure to do effective long-range planning and analysis. While admittedly difficult, you may be well advised to occasionally look beyond current problems and focus on long-range planning. Long-term planning may reveal a need to make fundamental changes (for example, utilize alternative marketing tools, expand an enterprise, drop an enterprise, adopt new production practices, etc.), which could improve or stabilize profit and lessen cash flow problem in future production and marketing periods.

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*Extension Economist and Professor, Department of Agricultural Economics, Cooperative Extension, Washington State University.

However, once an appropriate long-range plan is identified, a current cash flow difficulty must be dealt with to insure realization of that plan. The following is a partial list of suggestions for managing a cash flow problem:

1. Prepare an up-to-date and accurate balance sheet. This will tell you the current financial position of the business in terms of the nature and value of assets, liabilities, net worth and the associated ability to withstand risk. Also, insights into business liquidity can be obtained by analyzing debt structure, including the relationship between current assets and current liabilities. Many cash flow management strategies will be based on information provided by the balance sheet.
2. Prepare a monthly (quarterly at a minimum) cash flow projection for the upcoming year. A cash flow budget will identify the size and timing of projected cash deficits. It will also give you insights into the causes of and solutions for the problem. Be sure that you include in the budget your expectations and tentative plans regarding the timing and amounts of production flexibility contract payments, loan deficiency payments, and nonrecourse loans.
3. Work closely with your lender(s). Use standard financial tools (balance sheet, income statement, cash flow statement) to communicate with the lender about your credit needs. These tools can be helpful in demonstrating that the problem is a temporary one and in working out a repayment plan that is acceptable to both you and the lender. Unpaid chemical, repair, or fertilizer bills may pose as serious a threat as your major lender. An unsecured creditor may push for payment and

precipitate a crisis. Consequently, it is important to keep them informed and, if possible, paid up.

4. Examine the possibility of restructuring debt. Cash flow problems may result from improperly structured debt, as well as too much debt. Cash flow can be improved by lengthening the repayment schedule of existing short-term and intermediate-term debt. The ability to restructure existing debt is obviously based on your ability to convince the lender(s) that the current problem is a temporary one. It is also generally dependent upon the presence of equity (collateral) in machinery and/or real estate.

5. Negotiate with your lender to pay interest only on existing term debt. Your position in negotiating an interest only payment is strengthened by the presence of sufficient collateral to cover the unpaid principal.

6. Closely analyze expenditures for capital assets. While there is a tendency to eliminate or decrease investments in machinery, structures, and real estate during a period of financial stress, a highly profitable investment may help resolve a cash flow deficit. However, only a thorough financial analysis will indicate if the investment is profitable, cash flows, and has acceptable risk. Try to negotiate a loan repayment schedule that matches the stream of earnings projected for the capital asset. Fixed interest rates rather than variable rates shift risk from you to the lender. Also, consider leasing, renting or custom hiring machinery. Another possibility is sharing machinery use or ownership with other producers.

7. Partial liquidation of capital assets. If cash flow problems are severe, it may be necessary to sell excess or little-used machinery, or perhaps, land. However, before making this decision, you should give full consideration as to whether this is the best alternative or the only alternative. Of course, the sale of productive assets at distressed prices may only make the problem worse. Also, be aware of income tax consequences.

8. Review your production practices to see if there are adjustments that may result in quick and substantial improvement in profit at little risk. Obviously, the potential for improvement is greatest for those categories of costs representing a significant proportion of total costs. Thus, you will want to focus on soil fertility, pest control, tillage systems, etc.

9. Consider off-farm employment. There may be an opportunity for some members of the family to find work off the farm. While this may be disruptive to family routines, it will probably be acceptable as a short-run alternative. If excess machinery and labor resources are available, performing custom work for other producers may enhance your cash flow. There may also be a need to make the difficult assessment of whether or not the operation is large enough to support the number of people currently associated with the business.

10. Evaluate your living expenses. Focus on items that may be eliminated or postponed without materially lowering your living standard. If these opportunities are not available, lower living standards may have to be temporarily accepted to keep the farm intact.

11. Give financial management a higher priority. Keeping business records, preparing and analyzing financial statements, developing budgets, etc., is a time consuming and, for some people, not an enjoyable task. However, the benefits received from the effective use of these tools are sizable, especially when the business is experiencing financial stress. If you are uncomfortable with financial management, consider hiring a farm finance professional.

12. Aggressively pursue risk management strategies. In this era of widely fluctuating commodity prices and a substantially lower government safety net, effective risk management has become very important. It is especially critical if you are experiencing financial stress and therefore, have little tolerance for downside events. Carefully review your major sources of risk and the various tools you have for controlling those risks. Major sources of risk and the associated leading risk management tools for grain producers likely include the following:

    - Production risk (crop yield/quality variation)
        - Crop insurance (fire and hail, multi-peril)
        - Enterprise diversification
        - Drought/disease/pest resistant varieties and rotations.
    - Market risk (variation in grain prices)
        - Forward contracting
        - Hedging
        - Options on futures
        - Crop revenue insurance

- # Financial risk (variability in returns to equity and cash flow due to financing arrangements).
    - ! Less debt.
    - ! Fixed interest rates on term debt.
    - ! Maintain higher cash and near-cash reserves.
    - ! Substitute crop-share or variable cash rent for fixed cash rent.

It is recognized that the above suggestions represent only a partial list of strategies for managing a cash flow problem; neither are they listed in any order of priority for consideration or use. However, experience suggests that producers who systematically and thoroughly evaluate these strategies and adopt those that fit their situation will substantially increase the odds of staying in business and realizing their long-run goals.