# Dealing With Financial Stress



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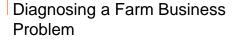
#### **Dealing With Financial Stress**

- Diagnosing a farm business problem
- Short term financial stress
- Longer term financial stress
- Is the farm large enough



### Diagnosing a Farm Business Problem

- Diagnostic Component
  - ☐ Identifying the Problem
    - liquidity
    - solvency
    - profitability
    - financial efficiency
    - repayment capacity



- Diagnostic Component (continued)
  - ☐ Identifying Potential Causes
    - Scale
      - ☐ Fixed costs spread over too few units
      - Labor supply too large





### Diagnosing a Farm Business Problem

- ☐ Identifying Potential Causes (continued)
  - Employment
    - Must fully employ the labor resources
    - ☐ May need to eliminate excess hired labor
    - May need a more appropriate mix between farm and offfarm employment
    - ☐ Add a labor intensive enterprise
    - expand

## Diagnosing a Farm Business Problem

- ☐ Identifying Potential Causes (continued)
  - Efficiency
    - Physical performance
    - ☐ Dictates economic performance (returns over costs)
    - May have a financial efficiency problem (asset turnover, etc.)





### Diagnosing a Farm Business Problem

- ☐ Identifying Potential Causes (continued)
  - Debt-Leverage
    - ☐ Too little debt limits growth
    - ☐ Too much debt accelerates losses
    - Influences profitability through interest costs
    - ☐ Influences liquidity through debt service
    - ☐ Influences solvency when evaluated relative to collateral

### Diagnosing a Farm Business Problem

- Is the problem short term in nature
- Has a longer term shift occurred
- Is the problem external or internal
- Early and accurate assessment of the problem can prevent the need for drastic measures





#### **Short Term Financial Stress**

- Localized drought
- Prices
- Other shortfall in current income
- Rising interest rates
- Poor debt structure
- Drop in collateral values

### Short Term Financial Stress

- Respond by:
  - Managing cash flow
  - Managing Liabilities
  - Managing Assets
- Early signs generally show up in a cash shortfall





#### **Short Term Financial Stress**

- Managing cash flow
  - ☐ Control costs (sharpen pencil)
  - □ Re-negotiate cash rents
  - Reduce capital expenditures (repair rather than replace)
  - □ Reduce family withdrawals
  - □ Rent out un-used facilities excess equipment (custom work)
  - ☐ Increase non-farm income

#### **Short Term Financial Stress**

- Manage Liabilities
  - □ Extend loan terms (buy time)
  - Interest only payments (use only if shortfall is very temporary)
  - ☐ Increase collateral to maintain borrowing, or mortgage another parcel of land
  - □ Reduce debt using off farm sources, or sale of unproductive assets
  - Re-finance at a lower rate



#### **Short Term Financial Stress**

- Manage Assets
  - Liquidate cash and investments
  - Sell inventories
  - Sell capital assets
    - Be aware of tax consequences

#### Longer Term Financial Stress

- The problem is internal
- Strategies to buy time will generally not work. May appear to work in the short run, but problems will re-appear.
- Need to increase profit margins, and asset turnover
- May need to address immediate concerns first (sell assets)





### How Big Does the Business Need to Be

- Internal Dimension
  - □ Low cost economies of scale
  - ☐ Meets operators needs for income
- External Dimension
  - Size permits access to markets, information, technology, etc.



#### Operator Income Needs Analysis

- What is the required level of net income
- What gross income is typically needed to produce this amount of net income
- How much investment will be required to produce this much gross income



#### Operator Income Needs Analysis

- 1. Net income needed to cover family living, equity growth, etc. (\$15,000.00)
- 2. Net income from operations ratio
  - □ Net farm income / gross farm revenues (.12)
- 3. Asset turnover ratio
  - ☐ Gross farm revenues / total farm assets (.16)
- 4. Gross revenue required
  - □ Net income needed (1)/NFIFO (2) (\$120,000.00)
- 5. Assets required to generate gross requirement
  - Required gross (4)/Asset turnover (3) (\$750,000.00)



### Operator Income Needs Analysis – Assume they want to Farm Full Time

- 1. Net income needed to cover family living, equity growth, etc. (\$65,000.00)
- 2. Net income from operations ratio
- □ Net farm income / gross farm revenues (.12)
- 3. Asset turnover ratio
  - ☐ Gross farm revenues / total farm assets (.16)
- 4. Gross revenue required
  - □ Net income needed (1)/NFIFO (2) (\$541,000.00)
- 5. Assets required to generate gross requirement
- Required gross (4)/Asset turnover (3) (\$3,400,000.00)

