

Dealing With Financial Stress



Rodney Jones
Rodney.jones@okstate.edu
405 744 6173



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



Diagnosing a Farm Business Problem

- 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 off-farm 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)

