



## Economic Toolbox

### **Cash Flow Balancing**

Balancing cash to meet the needs of your farm and family can be the most challenging aspect of running your business. When your cash flow is in balance, there is enough of it to pay for operating expenses, debt service, family living and a normal amount of capital investment. When it is out of balance, there never seems to be enough of it and you, your suppliers, your lender or all of the above are unhappy.

Fixing an out of balance cash flow requires some amount of research to determine the exact cause of the imbalance. There are four major areas to look for answers to a cash flow problem in a farm business. These are *operations, capital investment, financing, and family draws*.

*Operations* - Cash flow from operations is the money that should be left over after paying for all your operating expenses from the sale of whatever your farm is producing. Aside from non-farm income, this is, or should be the main source of cash to meet the needs of the family, of principal repayment, and for capital replacement. Most cash flow problems result from insufficient cash flow from operations.

More cash from operations can be obtained from either increasing income or decreasing expenses. "Cost control" is the well worn battle cry for decreasing expenses, and for good reason. What you buy, when you buy and how you buy inputs for your farm business are major control functions of management. Progressive farm managers seek to improve their margins by negotiating early payment discounts, searching out new and better sources of supplies, joining buying groups for getting quantity discounts and continuously questioning the status quo. Cost control should be an ongoing process for everything your farm purchases. However, when management time becomes a premium commodity, the best result on controlling costs is obtained by concentrating on reducing the four largest expenses.

Income is the other side of the cash flow from operations equation. Increasing income can be accomplished by increasing production or increasing price. Production of crops or livestock products is definitely under the control of management. Which crops you produce, how you grow, harvest and store them, where you grow them, and how many acres you grow will have

an impact on the cash you generate for your farm business. For example, management practices that improve yield for the same amount of inputs will increase income. A dairy farm that can increase milk production per cow, reduce calf mortality or lower culling rates with the same amount of feed, labor and overhead expense should also be able to show more cash from operations.

Increasing the price received for crops, livestock and livestock products through improved quality, better marketing strategies or new and better markets are more strategies to use for improving cash flow. Many farmers find it difficult to reach the quality incentives because of the constraints of their hired labor, equipment, management ability or facilities. Acquiring and skills and systems to consistently meet higher quality standards and marketing strategies is another function of your management position.

*Capital Investment* - Sometimes, cash flow problems arise because too much of the operating income is spent on purchasing capital assets such as facilities, equipment or real estate. Beginning an expansion project without your lender, or purchasing a new tractor with your operating line of credit instead of a term note are examples. This type of unbalanced spending can use up cash that should have been used for operating expenses, family living or scheduled debt service. Developing a good budget can help prevent a farm manager from making this mistake.

Once a cash shortage is upon your farm business, it may be possible to sell underutilized capital assets to get through the crisis. Having a woods logged, selling a house lot, liquidating excess livestock or equipment are all methods to help meet the farm's cash needs. However, the sale of capital assets should be done cautiously and to solve a specific problem. It would be unwise to sell assets that limit the ability of the farm to grow and improve operations. Selling real estate, cattle or equipment to meet cash flow problems that are caused by poor profitability, without fixing *that* problem, only bleeds net worth until none is left.

*Financing* - Financing refers to how the business borrows and repays debt. Farm managers with poor spending habits are sometimes put on "short leashes" by their lender, with repayment schedules that use more cash than the business can afford. Farm managers in a hurry to get out of debt put themselves into the same situation by asking for short repayment periods. To improve cash flow, try to get notes amortized over a longer term. In emergency situations, ask your lender for a period of interest-only payments. Under extreme

circumstances, interest and principal can even be deferred, especially with loans through the USDA Farm Service Agency. You may be able to reduce your interest rate by having your lender obtain FSA loan guarantees or apply for the FSA interest-assist program which can pay up to 4 points on interest rates of qualifying loans.

*Family Draws* - Taking more cash from the farm business for family living than it can afford to pay can produce a cash flow imbalance. On most farms, cutting family living expense is one of the first actions taken to provide more cash for the farm business. This can lead to frustration and conflict within the family. At some point the question arises "If the farm can't support the family, why is the family farming?" Some real soul searching is then required to determine if the farm has the capability, resources, energy and attitude to compete in a very harsh economic environment.

Tracking family living expenses closely may surprise many about just how much it does cost to live and raise a family. Budgeting for the family as well as the farm can provide insight into how your limited income can go even further. Apply the same cost control techniques that you use with your business to the family budget.

Finally, off-farm income can and does supplement income provided by the farm business. This income can be enhanced by improving off-farm job skills to make yourself more marketable.

Balancing your farm's cash flow is an on-going process. Cash flow should be thoroughly analyzed at least once a year and monitored on a regular basis throughout the year. Putting goals and budgets into place will give you the ability to control your cash flow, spot problems while they are still small and provide insight into solutions.