Late Summer Observations

Talking with producers, lenders, and agribusinesses from across the country, I have observed several trends that will continue to develop into late summer and fall. Often, a snapshot of other businesses in the industry is helpful as managers assess their own businesses and practices. Let's take a look at some of today's emerging developments.

The full spectrum

The fourth year of the economic reset continues to impact the financial health of businesses across a wide spectrum. The top 40 percent of farms and ranches are making the necessary adjustments to retain profits and cash flow. In some cases, this group is diversifying to include a greater mix of commodities, or off-farm income to keep the business in the black.

Another group which might be called the "tweeners" is utilizing liquidity reserves built during the economic supercycle to maintain the business. Commonly, this group is utilizing equity in land and other assets to restructure the business. This buys some time for adjustments to stabilize the business, and for positive economic cycles to return.

At another end of the spectrum, approximately 30 to 40 percent of farm businesses are experiencing considerable financial distress. This group will attempt to refinance multiple times, and experience a net worth decline on the balance sheet. Additionally, because of the challenge of obtaining refinancing, the result for many in this group will be partial or total liquidation of assets. Of course, this creates selected opportunities for those businesses at the top end of the spectrum that seek growth.

Midwest versus the Coasts

Similar to the economic downturn of the 1980s, the Midwest continues to face the brunt of the economic stress, as compared to the Coastal and Southern agricultural economies. According to recent online and in-class surveys, 50 percent of the agricultural lenders in Coastal regions report that less than 10 percent of their portfolio is exhibiting negative margins. Yet, approximately 60 percent of Midwest agricultural lenders report that 25 to 50 percent of their portfolios are losing money.

From the same surveys, nearly 75 percent of Midwest lenders indicated that over 25 percent of their agricultural portfolio lost equity on the balance sheet. This is in sharp contrast to the reports from Coastal agricultural lenders that reported the same group to be less than 20 percent.

Misdirected Decisions

In discussions with agricultural lenders, farm management instructors, as well as industry consultants, some producers are taking the wrong course to correct their listing economic ships. One of the strategies leading to misdirected decisions is a solitary focus on more production without regard for the cost side of the equation. Additionally, in certain sections of the nation Mother Nature has blessed some with multiple years of ideal growing conditions. This led to record yields and positive profits, but did not force the considerations of cost.

Often in conjunction with those that are production-minded is the hope for an adverse weather event elsewhere in the world to boost prices. Yes, good prices will return. And yes, there will eventually be some world event, weather or otherwise, that will shock prices. However, how much of an increase, at what point in time, and for how long are each important variables to consider.

Another misleading strategy is attempting to grow the business back into profitability. If inefficiencies in the business are causing losses, then a bigger business will only result in bigger losses, if adjustments are not made first. Producers in this situation need to remember one of my favorite phrases, which is “better is better before bigger is better.”

A common practice that may be particularly tempting, but also dangerous is monitoring financials only at end of the year. It is next to impossible to successfully manage a business without a good sense of business financials. Especially when experiencing economic stress, business financials need to reviewed and assessed monthly, quarterly and annually. This is the producer’s chance to stay ahead of problems, and minimize or correct others that already exist.

Personal cuts

A review of some of the farm record data systems shows that producers are reducing family and personal living costs. Compared to the peak of living costs from five to eight years ago, reductions today are in the 10 to 20 percent range. This is very positive. However, even if some cuts have been made, living costs must be tailored to cash flows. This is a place where working with your lender can be extremely helpful. Remember there is no such thing as average family living cost and each situation is unique.

A changing landscape

Some businesses are growing through efficiency, while others have adopted an entrepreneurial approach. Alignment with niche markets, diversifying the operation, and branching out to meet specific consumer demands are all practices that have become commonplace for many of today's producers. Often times, these practices are fueled by the next generation who are using skill sets from jobs and experiences outside of agriculture to capture opportunity in the changing marketplace.

Gen Z

The Millennials, or those 18 to 34 years of age are now entrenched in the workplace, and returning to farms and ranches. But coming up fast is Gen Z, or those born between 1995 and 2012. Next time, we will take a closer look at the ways this generation will influence consumer taste, society in general, and of course, the workplace.

As the economic reset continues, it will be factors like business strategy, cost control, operation efficiencies, and financial monitoring that make a difference in the bottom line. Don't let common traps like trying to produce your way back to profitability derail your proactive efforts for a sustainable, profitable business.

Management Tip:

Analyzing your business performance through schedule F tax records postpones critical questions concerning inventories, accounts payable, receivables, prepaid expenses, and crops growing in the field. Accrual accounting is a not just a good idea, it is a necessity in today's economic cycle.