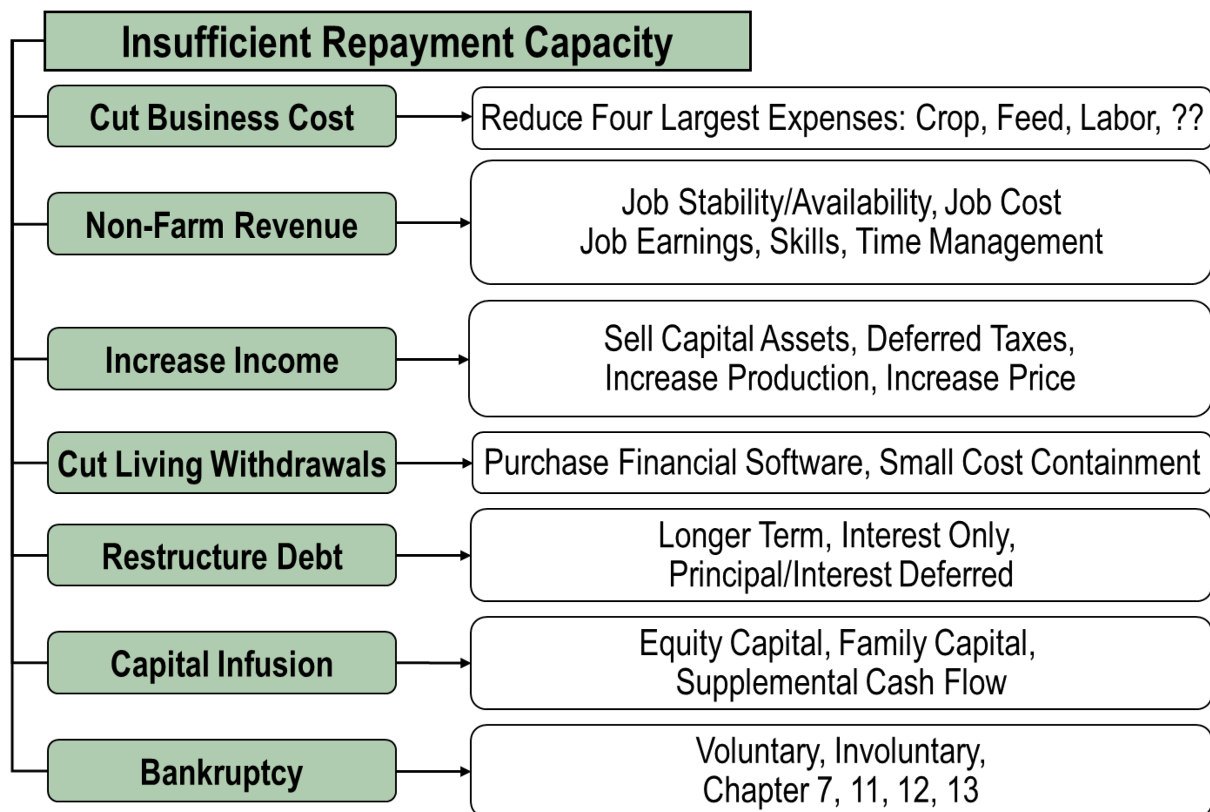
The Troubleshooting Matrix for Lenders and Producers

The agriculture economic reset is now entering its seventh year since the commodity super cycle years from 2007 to 2012. The dairy industry has taken the brunt of this economic punch, followed by grains and hogs, and to a much lesser extent, poultry and beef. An economic environment of low margins and high volatility has resulted in financial and emotional stress. A time-tested tool of the 1980s, called the "troubleshooting matrix," may be *en vogue* now as producers and lenders navigate the economic white waters in the short and long-term.



The troubleshooting matrix was designed and refined as the result of financial stress in the 1980s. This one-page process allows producers and lenders to think through options, similar to a quarterback going through progressions at the line of scrimmage as play conditions change. The troubleshooting matrix requires producers and lenders to explore other alternatives before implementing a refinance or restructure strategy.

First in the troubleshooting matrix is to explore options in **cost control** management without hindering revenues or net margins. Many focus on the big four or five expenses such as crops, feed cost, repairs, and labor. The rule is to attempt to cut these costs by

5 percent. An accurate projected cash flow that is monitored monthly or quarterly with the banker or advisory team can be a good start when controlling costs.

Next, on the revenue side, examine **non-farm revenue**. This was the strategy of choice in the 1980s. However, when farm businesses have more zeros and commas on the financial statements, or larger dollar amounts are involved, often the off-farm earnings make little difference when losses can mount to six or seven figures. Many producers, spouses and partners are seeking off-farm employment for the fringe benefits such as health coverage or possible benefits of a retirement program. If one seeks off-farm employment, be cognizant of the cost of travel and child or adult care. Of course, time management and the assessment of skills that are necessary for the employment to match are critical. Also, consider whether this is a short run or long run option.

Are there any methods to **increase income** without increasing costs or to increase the profit margin? This often includes increasing production and, in some cases, eliminating the least productive land or livestock. The principle of “better is better before bigger is better” or becoming more efficient rather than expanding is a first priority. One producer succinctly called it the “unprofitable cost of farming the road” when referring to the inefficiencies and travel required to farm non-contiguous tracts of land.

Next, to improve income, focus on the marketing and risk management plan. This plan must mesh with cash flow or debt service needs. Often an advisory service is employed to eliminate some of the emotion of marketing crops and livestock. A producer in the Midwest indicated that the advisory service provides coaching, but he still makes the decisions. The bottom line is that he improved his profits by $60,000. Another producer stated that crop insurance has “saved his bacon” over the past six years as he has seen more extremes in weather which appear to be occurring at an increasing rate.

Of course, the troubleshooting matrix option requires one to examine **family living withdrawals**. For the most accurate results, complete a diary of living expenses on a daily or weekly basis to determine where the cash flow leaks are occurring. Once this is done, analyze the data and develop a monthly family living budget. It can be constructed and monitored just like farm cash flow budgets.

Farm family living cost doubled from the go-go years of 2007 to 2012. The premise is the more you make, the more you spend. Another factor contributing to the increase in family living cost has been an increase in the number of generations or people living from the profits of a business. One must make sure that everyone is pulling their weight in the business in this economic climate. Some businesses are experiencing stressed

cash flow due to the high cost of adult care or healthcare, which can amount to $70,000 to $90,000 per year.

In the 1980s and today, many producers will seek a lender-designed solution, such as **refinancing or restructuring** operating losses or negative cash flow on to term debt using land equity with a term of 10 to 20 years. Often, if no change in the mode of operation is made, the losses will result in loss of equity as the business burns through the equity. While the land equity can be a so-called “bridge” over troubled economic waters, it provides a false sense of security. If no changes are made to improve the bottom line, repeated refinancing results in the financial situation going to the “end of the pier,” where the water, or in this case debt service, is getting too deep, resulting in an impossible recovery or drowning in debt.

The other two options when facing insufficient repayment capacity are a **capital infusion** or **bankruptcy**. A capital infusion from an equity partner or family capital could put the business back on its feet, if long-term plans are made for a sustainable recovery. Bankruptcy is also an option in some cases when none of the other options can be implemented.

The troubleshooting matrix acts as a guide to help think through options to improve repayment capacity. The key is to prioritize your strategies and employ a game plan for improvement of the bottom line profits and cash flow. In the case of losses, the preservation of wealth is a high priority.