Managing Your Farm Business during an Economic Downturn

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Crop Agriculture Is Entering A New Era

Prices for corn, soybeans, and wheat have all declined precipitously since the drought induced peaks of 2012. Bumper crops in 2013 and 2014 pushed crop agriculture from a tight supply/demand balance, and record high prices, to a situation where attention is now focused on crop surpluses and declining prices. The result will be a sharp decline in crop farm revenue over the next several years, resulting in very tight operating margins.

Successfully navigating an era of tight margins requires renewed focus on managing every aspect of your business. One of the keys to long-run success in a commodity business is pretty straightforward: be a low-cost producer. And given the downturn in prices for most crops, holding your costs per bushel down will be especially important. Being a low-cost producer is easier said than done, however, since many of us think we are already operating at the lowest possible cost. The first thing to do to change your mindset is, every morning, remind yourself that your number one job is to lower your costs. It’s an everyday job, and if you’re not thinking in these terms already, you should start today!

Many people don't focus their attention on managing the cost side of their business, instead focusing their attention on increasing volume and revenue. But lowering production costs consistently, over a long period of time, can make a big difference. Rarely do big cost reductions come from a single management change. Instead, significant changes in production costs result from a combination of small changes over time that, compounded, makes a big difference. Keep that idea in mind as you read the remainder of this article, which focuses on some key strategies you can follow to help you manage your way through the economic downturn in crop agriculture.

Strategies For Success

1. Protect Your Working Capital

Working capital is the difference between current assets and current liabilities. During the boom times in crop agriculture many crop farms drew down their working capital to purchase assets including machinery, buildings, and land. With strong operating margins, farmers were able to rebuild their working capital in the following year. But now that margins have tightened, that approach will not work. If you have already destroyed your working capital position, you need to think strategically about how to rebuild it. But if you still have a strong working capital position, the first thing to do is protect your existing working capital!

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Protecting working capital will be a challenge for many farms, in part because sellers of farm machinery, buildings, and related equipment will offer what appear to be attractive terms. Sales of new farm machinery are already declining and many dealerships have burdensome used equipment inventories. To market this inventory, dealers will cut prices and offer liberal terms. But you need to remember not to destroy your working capital just to get what appears to be "a good deal".

2. Hold On To Cash and Restructure Debt

Cash provides your first line of defense against financial stress, serving as a buffer. Cash provides you with flexibility to pursue unforeseen opportunities that sometimes arise. And having cash on hand helps mitigate risk.

This is the time to build cash reserves. If you don't have adequate cash reserves, talk to your lender about restructuring your debt. Don't wait until you have a problem, do it now while your financial position is strong.

Restructuring debt will be important because, in recent years, many farms have financed long-term capital purchases with relatively short-term debt. For example, many land purchases over the last decade were made with 10 or 15-year mortgages. That was not a problem with the strong farm incomes we had in recent years, but with much tighter operating margins in the years ahead, it will put a strain on your cash flow and make your farm less resilient to stress.

Now is also the time to restructure debt because long-term interest rates are still near historic lows. Odds favor interest rates moving higher over the next several years so locking in current rates makes sense. If you have any variable rate loans outstanding, convert them to fixed rate loans to take advantage of current interest rates.

When refinancing a land purchase, your focus should be on the repayment terms. With low interest rates available, and prospects for tight operating margins, it makes sense to refinance land purchases for as long as possible, 20 or even 30 years. The lower payments associated with a longer repayment period will make your farm more resilient to stress. So don't hesitate do it now!

3. Increase Your Asset Utilization

Increase the use of your capital assets, which is often referred to as increasing your asset turnover. How? Hold off on purchases of new equipment and try running your existing equipment over more acres. Doing that, and ensuring that field operations are still conducted on a timely basis, might mean running a second shift. Before dismissing that idea as unworkable, consider that few other businesses would make the large capital investments in equipment that we make in agriculture and then leave their equipment sit idle for 7 to 10 hours each day. Although not every farm operation is suited to round-the-clock operation, integration of GPS systems and autosteer into today's machinery makes double-shifting your equipment a much more realistic option than in the past.

Sharing some equipment with another farmer is also a way to more effectively use your assets. For example, you might be able to share a combine with another farmer and spread the cost of that machine over a greater number of acres, which effectively increases your farm's asset turnover.

Leasing equipment, instead of buying it, can also help in some circumstances. If you really need a new or different piece of equipment, you can often lease it with a lower cash commitment than a purchase. This is another way to preserve cash and increase your asset turnover.

4. Buy Right

When many farmers think about increasing their operating margin (the spread between the revenue from selling their output and the cost of the inputs required to produce it), they first think about increasing the price received for the crop(s) they raise. But the first, and most important, marketing decision you make isn't what you sell your product for, it's actually what you pay for your inputs, especially land. If you pay too much for cash rent, or purchase land at too high of a price, you become a high cost producer before you even pull the planter or drill into the field. Focus on buying things right and it will help increase your operating margins year-after-year.

5. Emphasize Better Execution

To be a low-cost producer, you need a systematic way of doing things. Most successful businesses follow a set of Standard Operating Procedures (SOP). And they communicate the SOPs to their staff so they execute it every day on every routine job. Following a SOP ensures that the job is done right, and doing the job right helps reduce costs per bushel. Some farmers resist use of standard operating procedures because of variability in weather, field, or crop conditions. But the reality is that your SOPs should be robust enough that they anticipates changes in conditions and actually encourage members of your team to make the right decision for the conditions at hand. Following SOPs can make your farm more efficient, more timely, and help you achieve your goal of being a low-cost producer.

Position Your Farm for Success

The next several years will be challenging for U.S. crop producers. Lower commodity prices will lead to much tighter operating margins than in recent years. And some farms will struggle to survive because they are not prepared. But if you take steps now to position your farm for this tighter operating margin environment, you will be positioned not only to survive, but actually thrive in the years ahead.

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