Three Ways to Manage Risk in Your Farm Business

By: Michael Boehlje

Most people working in agriculture are in the business of commodity. And in the long run, in a commodity business, there is one absolute key to success. It's pretty straightforward: be a low-cost producer. It can be difficult to make it happen, but necessary, especially in today's volatile financial climate.

How can you protect your farm business and lower your costs during these difficult financial times? It's simple: every morning, you should wake up and think, "My job is to lower my costs." It's an everyday task, and if you're not thinking in these terms already, you should start today.

Many people don't think about how to protect the cost side of their business – they only think about how they can sell more. But just lowering your costs by one-tenth of a cent every day could make a huge difference. If you decide to lower your costs two years from now, you'll be two years behind. Here are some practical ways that you can start lowering your costs today.

Protect your working capital

Historically, when farmers have used working capital (the difference between current assets and current liabilities) to buy assets for their businesses, they have had enough profits the subsequent year to be able to rebuild that capital. But in today's world, it's going to be tough to use that strategy.

If you have already destroyed your working capital position, you need to think strategically about how to rebuild it. The first thing to do? Don't destroy it any further!

Be aware that combine sales are down this year by 10-11 percent. Dealers gave a large amount of used inventory that they don't know what to do with. In the 1990s, one in four machinery dealers went out of business. Their common characteristic? Used equipment.

Be aware that machinery dealers are going to get hurt during this cycle. Therefore, they're going to work very hard to sell to you because they need to unload their inventory. They'll give you prices you've never seen before on used equipment, and you'll think, "I've never been able to buy a combine at such a good deal! I've got to do it!"

It's going to be very enticing, but make sure you don't destroy your working capital just to get a good deal.

Look in interest rates on capital expenditures

Interest rates are only going to go one direction from here: up. Don't play the speculation game on interest rates on your capital expenditure. If you have flexible interest rates, you need to lock them up.

Hold on to your cash and restructure your debt

Cash is your first line of defense against financial stress. It gives you a buffer. If you have an opportunity, it gives you the flexibility to follow that opportunity. It's extremely valuable in risk mitigation.

You need to have better cash reserves. If you don't have those reserves, you should have a conversation today with your lender about restructuring you debt. Don't wait until you've got a financial problem.

Over the past decade, many people have been buying land with 10-year mortgages. It makes no sense at all, but we've been able to do it because we've had such great incomes. Consider extending your payment terms – refinance your land on a 20-year mortgage.

Most lenders' interest rates are fairly close to one another, so the first thing you should negotiate is term of repayment. Make the term as long as you can. You can't get long terms on machinery or equipment, but you can get long terms on land.

If you can lock it in at a low rate, why would you want to repay them quickly? Again, don't wait until you're under financial pressure to do that. Do it now.

Today's difficult financial climate is throwing farmers for a loop, but by being careful with your finances, you can position your farm business for a prosperous future.

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