

David M. Kohl

Professor, Virginia Tech

Agricultural Finance and Small Business Management

This is one of a series of articles written by Dr. David Kohl for the Minnesota State Farm Business Management Education Program.

Vol. #85



Dialogue with the Doctor

By: Dr. David M. Kohl

It is tradition to end our newsletter series with answers to some of the more common questions asked by farm management instructors, producers, lenders, and students. Let's drill down and provide thought and perspective on these themes.

Transition management in a down economic cycle

Farm business management transition can be challenging in the best of economic times. Currently, the agriculture industry is in the midst of a seven-year economic reset with low profit margins and high volatility compounding the financial and emotional components of the business. Generational transfer appears to be accelerating as the senior generation, who may be challenged with economics and technology, appear to be more willing to turn over the reins. A new trend is that up to 20 percent of the vintage farmers and ranchers have no next generation to whom they can transfer the farm. This provides new avenues for those seeking opportunity in the agriculture industry. What are some of the generational transfer elements that need to be addressed in this challenging economic environment?

First, open communications concerning financials is priority number one. Both generations must carefully scrutinize the last three to five years of balance sheets, income statements, and cash flow data to determine debt levels, profitability, and overall cash flow. One observation from the road finds that often there are too many generations or individuals taking withdrawals from the business and putting pressure on cash flow. The amount and duration of these living expenses must be discussed in a candid format.

Next, both generations need to consider a third-party assessment of resources and assets. This would include the quality of land, livestock, machinery, and equipment. A red flag for the junior generation entering the business is rusted, worn-out, and faded assets that need substantial capital investments to remain competitive, particularly early in the process.



An examination of the human resource component of the business is a must. What is the skill base of the owners, managers, and employees? What is the tenure and timeline of the staff, job responsibilities, and accountability?

In these tough economic times, are the different generations willing to make some economic sacrifices such as earning non-farm income and lower living withdrawals to make the transition successful? An old rule of thumb is that the younger generation will have to generate between \$40,000 and \$70,000 of additional net income, or the older generation will have to give up \$40,000 to \$70,000 of net income to succeed.

Of course, in any economic cycle, the good old-fashioned goal setting process for business, family, and personal goals from one to five years is necessary to facilitate open communications.

Exploring a new enterprise

The economic pinch in agriculture has many individuals exploring the profitability of new enterprises. Many are seeking the next big thing or moneymaker, while others are exploring diversification. Over the years, catfish, broccoli, wine, grapes, and organic production have been a few of the avenues. Now, the popular new enterprises are hemp and agri-tourism.

A good business plan with different scenarios for production, market demand, prices, cost, and capital needs is essential. One must analyze and consider whether the new enterprise is consistent with the existing land, equipment, machinery, facilities, and human resources. Are the necessary resources available and the management skills present to carry out the operations? Will the new enterprise be competitive or complementary to existing operations from a time, capital, and resource standpoint?

What is the time to market? It often takes three to five years for a new enterprise to build a brand and become profitable. This can quickly drain working capital and impact overall capital needs. A rule of thumb is to add at least 25 percent more time and money than estimated when exploring a new business. The value-added enterprise must be very responsive to production and marketing shifts. A monthly or quarterly cash flow compared to actual results can be a tool to be responsive to the quickly changing marketplace. A detailed enterprise budget is also useful to test the profitability of the new venture.

Finally, one must have the 3 P's for a positive outcome: passion, people skills, and patience. Passion for your work is required to drive the new venture forward. People skills will be critical, particularly for marketing. Patience and persistence with a focus on marketing and the customer's experience will need to be a priority.



The economically stressed business

I often receive questions regarding economically stressed businesses. In this situation, dusting off the old troubleshooting matrix can be useful in organizing a plan. Many times, the farm will seek to restructure or refinance debt to cure the losses. However, before this strategy is employed, you must first analyze other strategies. How can one reduce costs without hindering revenues? Focusing on the big five expenses can be a start with the goal to reduce the largest expenses by three to five percent.

Next, what can be done to improve revenues? Can you economically obtain higher production? What are the strategies to market your product to improve prices? Cash flow can also be supplemented with off-farm income. This was a popular strategy during the 1980s farm crisis. However, one must examine the job costs, job availability, and fringe benefits. For many producers, the cost of healthcare can be reduced through the utilization of off-farm fringe benefits. Finally, can family living withdrawals be reduced? This often requires a family living budget or diary of weekly or monthly expenses. Often, too many individuals are living off the farm business which can result in operating losses. The resulting bills, open accounts, and other accrued debts may have to be refinanced or restructured.

Quick hitters

What is the best approach to turn a reactive manager into a proactive manager? First, show them how much money they are losing on an accrual basis. Next, calculate their burn rate on core equity. Divide the losses into the remaining equity to illustrate for the reactive manager how many years it will take for the losses to eliminate wealth.

If this gets their attention, map out strategies and tactics to improve the bottom line. Turning around a business requires many small, incremental steps. Progress should be monitored periodically by an advisory team that compares the projected cash flow to actual results.

Young people in agriculture

The future of agriculture is wide open for young people with a desire to make a difference in people's lives. Vocational and technical education and experiences will be in high demand, whether it is crop, livestock, or related industries.

Those who pursue two-year and four-year degrees and other higher education will need a balance of sciences, economics, business, and communication skills. The level of emotional IQ, consisting of listening, writing, speaking, and nonverbal communication skills, will be a differentiator in the workplace culture.

Entrepreneurialism will be a keyword in the agriculture industry that links the consumer to the production of food, fiber, and fuel. An entrepreneurial spirit, ranging from local to global context, will be the key to profitability for a rewarding future.



The decade of the 2020s will see more women in agriculture and the boomerang individual that works outside the industry and then returns. These fresh faces bring innovation and new ideas to agriculture. It will not be one-size-fits-all for successful agricultural endeavors.

This closes another season of the newsletters. The days are getting longer, and the geese are migrating north in anticipation of those long spring and summer days. Remember to surround yourself with a good network of people that are positive and wise. Manage the elements that you can control and manage around those that are uncontrollable. Hopefully, I will see you on the road. Be safe during the planting season

