Economics Commentator
Department of Economics

1-31-2000

Financial Stress Responses

Burton W. Pflueger
South Dakota State University, burton.pflueger@sdstate.edu

ECONOMICS COMMENTATOR

SDSU

South Dakota State University | No. 404 | January 31, 2000

FINANCIAL STRESS RESPONSES[1]

by

Burton W. Pflueger
Extension Economist
Farm Financial Management

The economic situation in agriculture has been debated over the last few months. Some have argued that agriculture is in, on the edge of, or headed to another financial crisis. Others contend that with the emergency governmental aid extended from congress, agriculture is financially healthy even if individual producers face a tight financial situation. Low commodity prices, expanding world production, and now the potential for drought conditions affecting the 2000 cropping year continue to raise concerns about agriculture's financial future.

While the outlook for tight profit margins continues to be a concern for many producers, there are several strategies that producers can use to manage the financial situation for their operations. These management responses can be classified as 1) cash flow management responses, 2) debt management responses, and 3) asset management responses. These types of management responses are examined in this article.

Cash Flow Management Responses

During times when cash flow is stressed, or if cash flow problems are anticipated because of a potential event such as drought, the management response is to examine the operation for opportunities to increase net income by managing costs of operation. A recent study conducted in Kansas found that high profit producers had high levels of production and low costs. The management responses that should be considered include:

a) cost control - stressful situations demand that all input expenditures be examined in terms of how much revenue that input will produce. All cost control strategies need to be reconsidered in times of financial stress;
b) lower rent/lease payments - expenditures to control non-owned assets may be negotiable and a review of these expenditures is warranted in stressful situations. These assets may be of high importance to the operation, but lower or more flexible payment rates may be possible;
c) examine capital spending - during times of financial stress, it is prudent to be more cautious concerning capital expenditures. Examining alternatives to ownership, such as leasing or custom hiring, may be attractive if the cost of these alternatives is lower than ownership costs;
d) asset utilization - assets should be examined to determine if the potential exists to increase income from greater utilization of assets. Leasing storage capacity or building space may be an alternative to increase income. Also, unproductive assets could be liquidated to provide a one-time source of capital.

Debt Management Responses

Debt levels always appear on the list of "problems" with financially stressed operations. Usually debt levels come under examination

[1] This article adapted from "Responding to Financial Stress What are the Options?" by Boehlje, Dobbins, Foster, and Miller, Purdue Economics Report, December 1999.

because in times of financial stress, credit reserves may already be fully utilized.

Different debt management responses include:

a) extension of loan terms - typically, longer debt repayment periods are used to reduce cash flow pressure. However, the debt must still be paid and simply adjusting debt terms does not increase the profitability of most operations. Adjustment of debt repayment terms can be an attractive strategy to allow time to make other adjustments to the operation that will increase profitability;
b) examine carry-over debt - operations that carry-over operating debt from one operating year to the next are not making financial progress. Operating debt levels should be paid from sales receipts of that operating year. If carry-over debt is part of the financial stress problem, re-amortizing that debt to an acceptable payment level and giving attention to cost-cutting, liquidating on productive assets, etc., is advisable;
c) debt payment adjustments - in times of financial stress, it may be possible to negotiate with lenders to establish a period of interest-only payments on existing debt. This is only a temporary situation, but may allow time for the operation to regain the desired levels of profitability;
d) increase credit capacity - several methods can be used to increase credit capacity for an operation. One such strategy is to provide additional collateral against existing debt. While this does not increase profitability, it may relieve the current level of financial stress and provide the lender flexibility to develop other strategies. Additionally, credit capacity can be increased by reducing debt levels. Many operators followed this strategy with the additional governmental assistance received last year. These operations are now in a financially stronger position to face the potential of a low production year.

Asset Management Strategies

Asset management strategies, like many of the strategies previously mentioned, are designed to provide an inflow of cash that can be used to meet current obligations. Most of these strategies, by themselves, may not be long-term solutions, but can provide time to implement strategies that increase the profitability of the operation. Asset management strategies include:

a) liquidating investments and reducing debt - if there is potential that some short-term investments could be sold, that cash can be applied to debt to relieve some financial pressure;
b) inventory management - some inventory may be sold and the proceeds applied to reduce debt. It can be difficult to sell inventory when commodity prices are low, but there is a cost to carrying inventory. Selling inventory can provide cash and reduce costs.
c) sell capital assets - capital assets such as land, machinery, and equipment could be sold to generate cash. However, this strategy needs careful consideration as the long-term viability of the operation could be jeopardized.

Which Strategy?

During times of financial stress it is difficult to give fair consideration to all available alternatives. Successful operations need to maintain cash flow, collateral, and profitability. Successful managers give consideration to the impact on liquidity, solvency, profitability, efficiency and debt repayment when they make their operating decisions. Choosing the right strategy, or combination of strategies, is not always an easy task. The right strategy will depend on the cause of the financial stress.

Financial difficulty can arise from either external or internal factors. These factors can be short-term or long term in nature. Generally, short-term, external factors are the easiest to overcome. These situations could be one year of low production, low prices, or some combination. Returning to normal operating conditions may allow for quick recovery from a stressful situation.

Long-term, internal factors are the hardest to overcome. In these situations, strategies that only buy time will not be effective. Short-term progress may be possible, but the problems will again become evident and solutions may be harder to find. Management strategies that increase revenue, reduce cost, or increase efficiency of input use will not only result in short-term progress, but also will provide long-term benefits of increasing net margins for the operation.

Each situation will be different, and each operator of each farm business will need to develop his own strategy. Taking time to develop management response strategies before the operation is in financial stress is perhaps the best strategy. The earlier a potential problem situation is recognized, the quicker action can be taken to fix the problem. Also the solution to the problem may be easier and less painful to implement the earlier a potential problem is identified.

If readers desire more information on how to respond to financial stress situations, or on how to recognize potential problem situations, they can contact the author. Extension Economists have developed and are implementing the Master Business Manager educational program. Additional information on the Master Business Manager program is available from any of the Extension Economists in the SDSU Economics Department (605-688-4141) or your county Extension Educator.

****

ECONOMICS COMMENTATOR

ECONOMICS DEPARTMENT
South Dakota State University
Box 504
Brookings, SD 57007-0895
Phone (605) 688-4141
Fax (6050 688-6386
E-mail: Penny_Stover@sdstate.edu
400 copies of this newsletter were produced at a cost of less than $100

****

COMMODITY OUTLOOK 2000

SDSU Economics Department
Brookings Inn Convention Center
Brookings, SD
February 24, 2000

Morning Session

9:30 Registration and Coffee

10:00 Introduction and Welcome

10:15 **Livestock Outlook for 2000**
Matthew Diersen, Extension Economist
SDSU Economics Department

10:45 **Sunflower Outlook for 2000**
Larry Kleingartner, Executive Director
National Sunflower Association

11:15 **Corn and Soybean Outlook for 2000**
Roger Krueger, Director of Grain Marketing
SD Wheat Growers Association

12:00 Lunch (on your own)

Afternoon Session

1:00 **Wheat Outlook for 2000**
Randy Englund, Executive Director
South Dakota Wheat Commission

1:45 **Weather Outlook 2000**
Al Bender, SD State Climatologist
South Dakota State University

2:15 **Planning for 2000**
Richard Shane, Economics Department Head
South Dakota State University

There is no registration fee for the Outlook meeting; everyone is welcome!

Contact Persons: Alan May, SDSU Extension Grain Specialist, 605-688-4862
Or Penny Stover, Extension Economics Secretary, 605-688-4855
Fax: 605-688-6386

SOUTH DAKOTA STATE UNIVERSITY
Economics Department
Box 504
Brookings, SD 57007

SDSU

Address Service Requested