

Farm Financial Analysis Series: Managing Farm Finances in Turbulent Times

Farmers and agricultural producers can face many sources of stress, including disease; family issues; psychosocial stresses, such as social isolation and long work hours; physical stresses, such as environmental extremes and chemical exposure; and financial issues. Ways to manage stress include regular doctor visits, eating well, finding time to relax, and actively addressing areas that cause stress when possible.

This publication discusses methods to manage a farm's financial health. It is part of the Farm Financial Analysis Series, which also includes these: [P3713 Balance Sheet](#), [P3710 Cash Flow Statement](#), [P3707 Income Statement](#), and [P3712 Ratios to Measure Farm Financial Health](#). To get a comprehensive view of your farm's financial situation, be sure to use all five publications in the series.

Agriculture, in general, can be a very turbulent industry. Low commodity prices, weather events such as flooding or drought, global trade wars, pandemics, and rising input costs are just a few examples of factors that can stress farm finances. It is essential to understand the various options available for managing your farm's finances so that you are better prepared for these events.

You can determine your farm's financial health by regularly monitoring financial statements—such as a balance sheet, cash flow statement, and income statement—and calculating financial ratios. Ratios that measure financial health include liquidity, solvency, profitability, and efficiency measures. These ratios can be compared to benchmark values to determine if the farm's financial health is strong, stable, or weak. You can then take action to improve weak areas or prevent vulnerable areas from deteriorating. When compared to a benchmark, these ratios can indicate the level of financial stress the farm business is experiencing and identify areas that may benefit from corrective actions. A more detailed discussion of financial ratio analysis with examples can be found in [P3712 Ratios to Measure Farm Financial Health](#).

Agricultural producers are constantly planning for next year's crop, for the next group of cattle going on feed

or pasture, or for production on a newly acquired farm. However, planning for unforeseen stressful situations, such as depressed commodity prices, volatile input prices, or international trade wars, requires contingency planning that elevates production planning. Contingency planning considers how you would adjust your current plans if conditions changed. Having a detailed plan to navigate negative conditions can help mitigate stress if they occur.

Contingency planning begins with understanding the current situation and outlook for key business areas, such as commodity prices for your crops, availability of inputs like seed, fertilizer, feed, and fuel, and availability of labor and custom services. Understanding current and future conditions helps you set expectations for the production planning process and develop annual budgets. Once the production plan and budgets are complete, consider potential "what-if" scenarios that could disrupt the plan, then develop alternative action plans for each disruptive circumstance.

An example of a disruptive circumstance might be if a hired farmhand becomes ill and cannot work for more than a week. In this case, the manager plans to hire Bob Smith, a retired farmer nearby, on a temporary basis until the farmhand can return. This scenario outlines an unexpected situation (farmhand cannot work), a trigger point for action (farmhand is unable to work for more than a week), and an action plan (hire Bob temporarily). Contingency plans should be written and communicated to the rest of the management team, including any family members involved in the business.

This common example scenario illustrates three key parts of contingency plans:

1. Identify a potentially disruptive circumstance.
2. Define a clear trigger point at which action must be taken.
3. Develop an action plan that can be executed when the trigger is reached.

Other disruptive scenarios may be less common and may require more extensive planning. For example, an unexpected drop in revenue due to plunging commodity prices or severe weather conditions may occur. In this scenario, you might need to extend the operating loan into the next production year, increasing the business's total liabilities. This increase in total liabilities raises the farm's debt-to-asset ratio (total farm liabilities divided by total farm assets) to a weak level (greater than 0.6). In this case, the trigger would be the debt-to-asset ratio reaching a weak position. The action plan could include refinancing the carryover debt to a longer term and lower interest rate and selling some seldom-used capital assets to reduce debt.

If the farm business is experiencing financial stress or moving toward it, certain actions can help lessen the impact in the short term. These actions fall into three strategies for improving the financial situation of the farm business:

1. Managing cash flow
2. Managing liabilities
3. Managing assets

Managing Cash Flow

Control costs. Reducing costs is an ongoing challenge for agricultural producers, and it becomes even more critical during financially stressful times. Evaluate all procedures and purchases. Is there a way to make this process cheaper or to use fewer inputs, including time and machine hours? Can you lower the cost of an input by buying in bulk or from a different supplier? Ensure each input generates enough revenue to cover its cost.

Reduce or postpone capital purchases. Capital purchases are generally made only when necessary, but if you can delay the purchase of a new tractor until the financial crisis passes, it may improve cash flow. Consider repairing equipment for another year rather than replacing it. You might also postpone purchasing new technology that will pay off in the long run but would drain cash flow in the short term.

Reduce family withdrawals. Family expenditures can be the hardest to reduce. Consider replacing a weeklong vacation at the beach with a long weekend at a local state park. Postpone purchasing a new family car if possible.

Increase nonfarm income. Consider taking an off-farm job, especially if it's part-time or offers flexible hours, to help get through financially stressful periods.

Renegotiate leases. Approach your landlord with a proposal to reduce the lease payment or shift from a cash lease to a shared lease agreement.

Managing Liabilities

Extend loan terms. Extending loan terms can ease cash flow pressures by lowering loan payments, though it does not reduce interest expenses. This is typically a short-term measure to allow time for fundamental adjustments to the business.

Refinance carryover debt. In times of financial stress, operating loans often cannot be repaid in full within the production year, resulting in carryover debt. Lenders may allow refinancing of the carryover debt into a loan with a longer term that can be paid over several years.

Pay interest only. If the financial stress is temporary, the lender may permit interest-only payments instead of the scheduled interest-plus-principal payment.

Reduce debt. Reducing debt by using external funds can relieve some financial stress. Sources of funds may include off-farm income, gifts or investments from others, or the sale of farm assets.

Refinance. If interest rates have declined, as they often do during general economic downturns, it may be a good time to consider refinancing loans to obtain a lower interest rate or to switch from a variable to a fixed interest rate.

Managing Assets

Liquidate cash and investments to reduce debt. If the farm business has maintained a financial reserve of cash or investments for a “rainy day,” this may be the time to use it to reduce debt.

Sell inventory to reduce debt. If the farm business is holding inventory in hopes of higher prices, consider selling that inventory to reduce debt. Carefully assess projected commodity prices, storage charges, tax implications, and the severity of financial stress caused by current debt levels.

Sell capital assets to reduce debt. Selling assets such as land, machinery, or equipment may be a good strategy to generate funds to reduce debt, especially if the equipment is seldom used. However, selling capital assets may impact your ability to generate revenue in the future.

Summary

Farm businesses can weather financial downturns by relying on their financial resilience. You can strengthen your farm’s financial resilience by establishing strong liquidity and solvency positions and developing contingency plans for financially stressful times. Monitor the farm’s financial ratios for signs of financial stress, and take prompt action when problems arise.

Depending on the area of financial stress, you can improve the farm’s short-term financial situation by managing cash flow, liabilities, and assets. Enhancing financial resilience should be the long-term goal of your farm business.

Publication 3709 (POD-09-24)

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Extension Service of Mississippi State University, cooperating with U.S. Department of Agriculture. Published in furtherance of Acts of Congress, May 8 and June 30, 1914. ANGUS L. CATCHOT JR., Director