



# Ag Business Management

*Informing farm families and ag businesses about management issues.*

## Farm Earnings Improve but Risk Worsens

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2008 was a good year for most farmers. Net farm income is expected to reach a record \$95.7 billion. That's ten percent more than farmers received in 2007. Good yields and prices result in profits to invest. While the temptation is great to buy new equipment, land, or other assets; now may be the time to build working capital. Dr. David Kohl stated recently at the Minnesota Crop Insurance Conference in Mankato, "That farmers make their worst management decisions during good times." Kohl states farmers should be building cash reserves and working capital at this time. Borrowing money now to buy high-priced land might be a poor decision, especially if the turmoil in the financial markets spills over into the farm sector. Currently, we are seeing commodity prices fall while expenses continue to rise. The outlook for next year shows tighter profit margins, reducing funds available to service debt. In fact, at current prices and projected production costs, farmers cannot project a profit for wheat and many other crops in 2009.

Adequate working capital is critical because the amount of capital needed to farm has nearly tripled compared to two years ago. Many bankers are very nervous about the risk exposure farmer's face as they watch farm profit margins decline. Some grain elevators, stung with extensive margin calls, are now requiring non-refundable fees to cover potential interest costs on futures fixed or hedge-to-arrive contracts. Meanwhile suppliers are convincing producers to prepay or pay ahead for their supplies-months in advance. Some bankers find themselves financing their farm customer's old crop, new crop and next crop all within the same year. Prepaying for inputs at record high prices, months in advance, is a tough decision to make. Farmers now must worry about the liquidity and solvency of their input suppliers. Farming today is riskier than at any time in history. So how can farmers manage today's risk?

1. When prepaying inputs, hedge by making future crop sales with one of the marketing tools available. If possible spread risk by buying inputs in increments so, if prices decline, you're not wrong on the whole amount purchased.
2. Know who you are doing business with. When prepaying ask your suppliers for financial statements.

3. Utilize revenue based crop insurance. Buy up to cover higher production costs.
4. Build working capital to meet current and future obligations and to take advantage of opportunities as they arise.
5. Develop and follow a sound marketing plan. If you need help join a Farm Business Management or U of M marketing group.
6. Make sure your lender understands your marketing plan. If you are a do-it-yourself marketer, make sure you have an adequate marketing line of credit to cover margin calls when needed.
7. Invest time educating yourself and your employees to meet new production and management challenges.
8. Communicate with your family, employees, landlords, banker, and others important to the success of your farming operation.
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Farming has always been a risky business. Higher per acre production costs have increased total dollars at risk. Revenue based crop insurance mitigates much of that risk, but at a relatively high cost. Write and follow a pre-harvest marketing plan utilizing technical tools that allow for flexibility during market movement. When practical make grain sales and buy inputs in increments. Take advantage of profitable opportunities when they appear. Combining a revenue based crop insurance policy with a pre-harvest marketing plan is still the best deal in town for managing risk. Plan now for a profitable 2009 and 2010.

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