



Ag Business Management

Informing farm families and ag businesses about management issues.

Farm Decision Making in the Current Economic Climate¹

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Today, I want to talk about plans, ideas, and processes for making decisions on the farm in the current economic climate. Instead of showing you tables and graphs that tell us what we already know—that it is bad, let's look at a short summary of what the future looks like in the short run, say 2-3 years, and then what I see in the long run. Then I'll introduce some ideas for managing a farm during these tough times and preparing for the better times in the future.

In the Short Term

In the short term, we see tight margins and some negative margins for crops and livestock enterprises. What looked like good times just a few months ago has given away to not-so-good and even bleak times today. Product prices have taken a plunge since the summer. We expect to see continuing high volatility in these prices. A few months ago, livestock producers were looking at record high prices for their feed and the resulting tight margins. Now, feed prices have dropped but so have their product prices. Ethanol certainly has a different short term outlook. Ethanol found a ready market due to the blending requirement, but as that blending requirement is met, ethanol will have to compete directly with oil as the fuel of choice. With oil prices low, ethanol prices will be low and thus demand for corn will be lowered.

Input costs have also risen dramatically. Now, we at least see costs slowing in their rise or even dropping. Oil prices and thus fuel costs have dropped considerably, but I expect energy prices to rise in the long run. Fertilizer prices seem to be searching for the direction they should move. Land prices and rents jumped and now seem to have slowed with some reports of rather lower land prices especially from some really high prices. I expect we will continue to see volatility in input costs.

I do not see profit margins improving in the short run; they are more likely to disappear or become negative. Crop prices will be lower than their spring and summer highs, but, on average, crop prices will be higher than they were 2-3 years ago. Milk prices are now essentially half what they were recently. Right now, dairy margins are

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negative for many. Livestock prices may improve depending on how potentially declining production and herd inventories balance with declining demand.

The fragility of the U.S. and world economies will continue to be a concern. Many people have lost jobs; many others are worried about the future. All of us are pulling back in our expenditures. That means decreased demand especially for food eaten away from home and for more expensive food items. With increased pressure on family food budgets, the demand for organic foods will likely not increase at recent high rates.

I see two bright spots for farmers in the current economic situation. First, interest rates are very low, and the Federal Reserve is planning to keep them low. Even though lenders will be asking for more information and setting tighter conditions, farmers in a good financial position with a good business plan will be able to obtain financing for operating and even investment needs.

The other bright point is that the situation is not like what we felt and saw in the early 1980s. Farmers are not leveraged as high as they were in the 1980s. Inflation has been and is quite low. Interest rates are low. While some farmers and families are and will be in financial stress and trouble, we won't see the pervasiveness of financial stress in agriculture as we saw in the 1980s.

In the Long Term

In the long term, I see good prospects for agriculture. Economies will improve; demand for food, fuel and fiber will increase. Future economies will look different than the one we know or knew. Future farms will look different and operate differently, but there will be opportunities. However, prices and costs will be more volatile in the future than they have been.

The "long term" may come sooner than we think for some products, areas, sectors, and people. Beyond current survival, the manager's goal should also be preparing and planning for those future opportunities.

High Attention Management

Before I start into what managers need to be doing and looking for, let me describe about a driving experience I had a few weeks ago. I later realized how well it described the situation for current farm management decisions. We were driving on the interstate highway in a light freezing drizzle. We had tire tracks to follow but in between and on either side of the tracks, packed snow and ice had accumulated. Visibility wasn't bad, but it wasn't great. As long as we drove slower than the speed limit, stayed in the tracks, and passed the really slow cars very cautiously, we were ok. We made good progress with little worry. However, as shown by a few, get too far out of the tracks or go faster than the conditions called for, and you were offered a chance to inspect the ditch closer than you wanted to. I later described the situation to a friend as high attention driving, but not white knuckle driving.

What I experienced driving that day is in many ways how farmers need to manage in the next few years. We'll need good management that pays attention to basics, stays in the safe part of the road, and cautiously prepares to take advantage of opportunities without getting too far out of financial stability. I'd describe this as "high attention

management,” Given our current and expected future conditions, I don’t anticipate “white knuckle management” for most farmers.

Managing in Turbulent Times

In his classic book, *Managing in Turbulent Times*, Peter Drucker said the manager’s first task is survival. This involves managing the fundamentals of finances and productivities. The prudent manager needs to maintain and protect the liquidity and financial strength of the firm. A manager also needs to manage the firm’s productivity, that is, maintain, protect and improve a firm’s capital, physical assets, time, and knowledge. Drucker also argued that “tomorrow is being made today” even though the business was facing tough, turbulent times.

Two of Drucker’s lessons that are very relevant to today are (1) concentrate resources on results and (2) slough off yesterday. For concentrating resources, Drucker says we need to “feed opportunities and starve problems.” That is, we need to spend and invest in those activities that will build tomorrow, that will increase productivity. We need to quit spending good money on activities that are not producing the results we want. For sloughing off yesterday, he said we need to ask this question about what we do: “If we weren’t in this already, would we go into it knowing what we know now?” If the answer is, “No,” start the process of getting out of that aspect of the business. Just because we were successful in the past doing something doesn’t mean we will be successful doing the same thing in the future. My grandfather often said he couldn’t sell the dairy cows because they saved the farm during the Great Depression, but those cows were gone long before we finally closed the “too small herd.” He had kept them about 30 years too long without adapting to changing conditions and requirements.

Another point that Drucker makes that is very relevant for today’s situation is that after growth periods, there are slow periods during which growth shifts to new foundations.

We certainly had a growth period during the last few years or so. Now we are facing that slow period and seeing changes in our economies. Do we spend our energy saving the past and defending our current position? Or, do we need to make changes in our management and in our businesses to be ready for and take advantage of the new foundations of growth?

So, you may rightly ask, how do we know what the new growth foundations will be? Each of us needs to read, listen, and talk with friends and business connections. We also need to get beyond our farm, our close circle to read, talk, and listen to new sources, new views and even opposing views.

Management points for today

In today’s economic climate, Drucker’s point on survival is very appropriate. A manager needs to make decisions and choices that will increase a farm’s probability to survive. Most farms and families are already making these choices: decreasing operating expenses; stopping plans to buy new machinery and trucks; not hiring but working longer; and so on. At the same time, the prudent manager prepares the farm in order to be ready for opportunities. The financial fundamentals of first liquidity and then solvency,

repayment capacity, and profitability need to be monitored. Maintenance of liquidity and managing cash flow management are the primary concerns during tough times for increasing the probability of survival. Liquidity provides the financial reserves to weather unexpected shocks. Managing cash flow provides the better chance to cover necessary expenses and identify unnecessary expenses. If you're using a cash flow basis for tax management and have considerable inventories built, 2009 may likely be the time to sell inventories to meet cash flow needs and thus increase survival even if taxes increase.

Also, hard priorities have to be set and kept so decisions are made on the basis of which actions (1) increase the probability of survival and (2) prepare for future opportunities. Back to Drucker's point on "sloughing off yesterday:" would you restart doing what you're doing now based on what you know now? Are current practices or enterprises helping with survival or not? Are they helping us prepare for the future?

While costs need to be reduced, we also have to keep productive staff and increase efficiencies through changes in production methods. Even though interest rates are low, this may also be the time to defer investments and capital purchases due to uncertainty over the future. Evaluate the need to renegotiate leases. Be ready to walk away when necessary from a lease, a purchase, a dream. Reevaluate the cost of repairing the machinery or equipment instead of buying a new replacement. In terms of cash flow, a repair cost today for 2-3 more years of life from a machine may increase the probability of survival because it lowers the cash flow commitment of a loan for a new machine.

As a reminder in these tough times, set the priority and make the decisions to take care of yourself and your family. I remember a farm article years ago where a divorced farmer asked others to consider the value of a marriage and family versus the value of the farm. He lost both.

Future Management

Change. Be ready for change. And be ready to change yourself and your business. Change the way you approach your business day. Production labor can be hired. Take the time to learn new management skills. That is part of increasing and improving the knowledge assets mentioned by Drucker.

Even though you enjoy driving the tractor or combine, the surviving farm manager will need to spend more time on managing strategy and less time on direct production management. With prices and costs increasing, margins decreasing, and volatility increasing, now is the time to increase risk management skills. Learn the latest tools for obtaining and protecting prices, credit sources, labor management, and so on. Learn how to develop and use scenarios of the future for your management decisions. Head to the coffee shop, not to swap stories, but to have a serious discussion with your neighbors about the future; test your beliefs and theirs, play devil's advocate by taking the opposite position. (But, say, "Let's play devil's advocate," and make it a game so you learn together and stay friends.)

Become a CEO. Future farmers will need to have a much bigger hat, a bigger view of how their farm fits in the world. In short, they will be to be the CEO, not the production manager or even the marketing manager. Marketing managers in general business view selling the product as peddling and that merchandizing the product is a

much more profitable way to spend time. Learn the difference between merchandizing and peddling.

Travel in person or in virtual space looking for new opportunities and new connections. Evaluate the choices for outsourcing what used to be obvious internal functions. Evaluate the value of your time spent on management versus the cost of hired time for unskilled and even skilled activities. Spend more time on risk and financial management and less being production labor. If you don't like financial analysis and financial statement preparation, hire someone to take care of all that. Go in with your neighbor(s) to hire a CFO for the group. Farmers can do a lot of things together and still remain independent businesses. They have done this in the past. Major businesses often set up a joint business to enjoy the benefits of pooling purchases, to obtain better resources than they could afford by themselves. Why can't farmers do the same?

Thank you for spending your time listening to me! I wish you only the best for the future.