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Agricultural Finance and Small Business Management

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Ten Deadly Sins in Finance and Management

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In today's volatile economy with uncertainty around every corner, one slip-up can result in loss of equity and cash flow, setting even the best of managers back for up to a decade. Let's examine some of the more "deadly" sins I have observed when working with lenders, producers, and agribusiness professionals.

Purchasing land using profits, cash flow, and, in some cases, available working capital is very popular today in the red hot land market. It is very common to see the "reverse down payment concept". That is, paying 50 to 75 percent down and financing the remainder. While this strategy is commendable, the downside is that it could lead to cash flow difficulties should Mother Nature, an economic shock, or management hiccup raise its ugly head. Showing discipline by retaining a prudent amount of working capital and cash along with implementing a risk management plan that protects profits is critical. This especially applies to land purchases in which the incremental land investment very seldom pencils out even at 50 to 60 percent of the price paid.

Purchasing machinery and equipment only for tax reasons or without notifying your lender can put you in the economic "dog house." Granted, as a rule of thumb, capital equipment and structure upgrades will generally run 5 to 8 percent of revenue annually. However, Section 179 depreciation expensing and attractive low interest rates can be a double team of possible disaster down the road. Also, be sure to check existing loan covenants to ensure the purchase does not violate any agreements. A balance of capital upgrades, tax management, and communication with the lender is critical in a period when the economic tables can be turned upside down very quickly.

Deferring maintenance on equipment and machinery as well as discontinuing proactive livestock and crop practices can lead to financial disaster in the long run, although it can improve the bottom line in the short run. Sometimes the small costs are cut such as testing, vaccinations, and changing oil filters and belts. It may be tempting to do some of these things, especially for those in the livestock industry who have experienced nearly a decade of volatility, bear markets, and high input costs, but be sure to weigh the long term outcome of short term actions. While optimism sometimes can be a struggle, these actions can set a business back in time and money over the long haul.

Selecting a lender based only on interest rate can have negative repercussions. This is often a curse for younger people who are less loyal to a lender or have not been through an economic down cycle. In my work with ag lenders, two encouraging trends that are high priorities are strict adherence to credit standards, and relationship lending or knowing their customers. Do not get caught in the "low-ball rate trap" only to find when you experience a down cycle or adversity in the business you will be dealing with a back office analyst who only examines the numbers.



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Financing long term assets out of operating loans is another trap. Operating money ideally should be paid down annually or at least every 18 months depending upon your agricultural segment. Operating money is meant for inputs and short term expenses to help manage risk. Mixing financial debt structures can be very dangerous even in the best of times.

“Robbing Peter to pay Paul” which is using one lender’s money to pay down other financial obligations can cause trouble. It is also not a good idea to put one lender against the other in negotiations. In the 1980s, – boy, I’m dating myself – whenever one observed more than five sources of credit on the balance sheet it was a sign of a business headed south. In one situation there were 28 different sources of credit. You should have been there for that workout!

Failing to communicate is another trap. If you have a challenge maintaining open communication with your lender, hiring a third party such as a farm management instructor can be a small investment to make in providing an objective, disciplined road map of recovery. That being said, the lender needs to communicate with you as well. A merger or acquisition by another lender, loss of loan officer, or change in the management team or board needs to be communicated.

Failing to take action is another “deadly” sin that comes to mind. Many hear the message; fewer understand; and even fewer actually take action. It is important to “walk the talk.”

Falling captive to the “undisciplined pursuit of more” can cause a loss of focus. Sometimes, like a defensive back in football, you must hold your position and be ready to pounce when opportunity comes. Planning purchases ahead of time can help you make objective decisions that benefit the business.

Finally, playing the “blame game” takes energy away from finding creative solutions to issues. Uncertain weather, markets, and political and economic states can place you in a “deer in the headlights” mode. Instead of having a laundry list of excuses of why something did not occur, sometimes you must take risk, accept consequences, and be accountable for your actions.



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