Every farm, business and community is unique. How can you adapt to changing local risks and opportunities while also keeping an eye on global trends and the nation’s economy? With nearly 100 local offices and more than 1,200 employees, Farm Credit Mid-America is constantly working to help farmers in Indiana, Ohio, Kentucky and Tennessee leverage the economics of change in their favor. This report shares some of our insights to help you manage your operation and stand strong in today’s competitive, ever-changing marketplace.
IT’S TIME TO ADD A FINANCIAL PLANNER 
TO YOUR TEAM

From large investments to managing and paying employees, farming is a complicated business venture. Any non-farming enterprise with this level of complexity — from Wall Street to Silicon Valley — relies on a team, not a single person, to run it. Many producers know they cannot be a true jack-of-all-trades and they often reach out to other experts for counsel, but some haven’t considered asking for help with financial planning.

One of the most common knowledge gaps farmers have is in finance. With measures like profit margins, liquidity and equity considerations, even the smallest operations have complex financial considerations to weigh. Tried-and-true spreadsheets may not be the most effective way to plan. The truth of the matter is this: No matter the size of your operation or other experts you reach out to, it’s probably time to consult with or hire a financial advisor.

The CFO role

Most farmers are excellent at running day-to-day operations. But from precision technology to animal welfare, it’s nearly impossible to truly master all the skills modern farming demands. Increasingly, producers turn to other professionals to help fill in any gaps in expertise, consulting an agronomist to understand the relationship between soil fertility and yield or a veterinarian for guidance on animal health.

A financial advisor or chief financial officer (CFO) should be the next member of your extended team. The primary role of the CFO is straightforward: manage a business’s finances to ensure the business can meet its goals. In practice, however, the role involves intense attention to detail regarding past and current performance, plus projections for the future. Since an operation’s goals aren’t necessarily all financial, it takes finesse to understand how to plan appropriately.

One of our customers at Farm Credit Mid-America is an Indiana grain producer with more than 5,000 acres. Several years ago, he hired a part-time financial advisor and says it’s one of the best financial decisions he’s made for his farm. He explains, “using a financial advisor allows you to start planning and know what you have. Doing an overall review of your operation is really beneficial. We can tweak and do a lot of little improvements like marketing and machinery costs on our own, but I have to have a view of the big picture. And that’s where the financial advisor comes in.”

When it comes to finances, many farmers look at their end-of-the-year balance sheets and simply ask, “Did I make money or lose money?” Most don’t have the time or background to dig in and develop a deep understanding of why they ended the year above or below breakeven. A CFO can take a neutral view of how your operation is performing and provide recommendations for investments and ways to cut back on expenditures. A good financial advisor can hone in on problem areas and help you plan for goals that are years down the road.

“We look at working capital really closely and understand exactly how much we have on hand,” our customer from Indiana elaborates. “We also do a ratio trend analysis that goes back about 10 years to show how we’re doing. That is incredibly valuable to determine if we should buy equipment or pay down debt. Working with a financial advisor shows us options we otherwise wouldn’t see because we get too caught up in the day-to-day nitty-gritty.”

Hiring a CFO

As you look for your CFO, pay as much attention to soft skills as you do to education and experience. Finding an individual you trust and who works well with your family and team is extremely important. Don’t assume you have to hire someone on a part-time basis. Our customer from Indiana began with a fee-based accountant and gradually transitioned to having a more permanent CFO role within his operation.

Running a modern farm takes a team of well-qualified consultants; be sure to consider working with a financial advisor. Whether you have five acres or 5,000, finding a true financial advisor is an important step toward effective financial management and planning for the future.
“No matter the size of your operation or other experts you reach out to, it’s probably time to consult with or hire a financial advisor.”
STRATEGIES FOR MANAGING FIXED COSTS IN 2017

After several profitable years, the landscape for many producers has shifted. Today, growers are facing a substantial margin squeeze as commodity prices decline and input costs have not dropped as quickly.

While variable costs such as seed, fertilizers and chemicals will eventually moderate, these only account for a portion of farmers’ costs. Fixed costs like labor, equipment and land rent tend to adjust more slowly.

As profit margins shrink and commodity prices go down, operations with high fixed costs could see prolonged periods of losses. Eventually, this can stress working capital and negatively impact operations if not adjusted quickly enough.

So in this time of tight margins and low prices, how can farmers adjust their fixed costs for long-term success? In our work with customers, we’ve identified four fixed costs farmers should focus on to make the biggest impact: equipment, land, labor and family expenses.

1. Find the right equipment balance
In recent profitable years, many farmers have upgraded their equipment. And while that led to increased efficiencies, some farms likely overbought their equipment inventories.

   This is an ideal time for farmers to analyze equipment utilization. Ask yourself: What equipment do I need to have? What is nice to have? And what am I not utilizing fully?

   If a piece of equipment hasn’t been turned on or hooked up in over a year, it probably isn’t crucial to the operation. Liquidating these underutilized assets can help reduce costs.

   However, make sure that equipment sales do not adversely impact the overall efficiency of your operation. The key here is to find the right balance. Aim to have the equipment you need to get the job done efficiently, but don’t be so over-equipped that assets sit idle.

   Renting equipment, hiring custom work or pooling resources with neighbors are other ways to adjust equipment costs.

2. Assess land profitability
Whether rented or owned, every acre is unique. Some will be more profitable than others.

   When looking at land costs, begin with an honest assessment of the profitability of each acre. Review past farm records to determine if rented land is covering at least the variable costs plus the rent payment. This is where keeping good records over time will pay significant dividends down the road. Land that doesn’t generate positive margins can stress an operation.

FOCUS ON THESE FOUR FIXED-COST CATEGORIES TO MAKE THE BIGGEST IMPACT

<table>
<thead>
<tr>
<th>Risk Parameters</th>
<th>Expense as a % of GFI</th>
<th>Low</th>
<th>Moderate</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land costs</td>
<td>principal, interest, rent, taxes</td>
<td>&lt; 30%</td>
<td>30%–35%</td>
<td>&gt; 35%</td>
</tr>
<tr>
<td>Equipment costs</td>
<td>principal, interest, rent</td>
<td>&lt; 8%</td>
<td>8%–12%</td>
<td>&gt; 12%</td>
</tr>
<tr>
<td>Labor costs</td>
<td>family living expenses, hired labor</td>
<td>&lt; 7%</td>
<td>7%–10%</td>
<td>&gt; 10%</td>
</tr>
</tbody>
</table>
While many farmers are looking to include the next generation, it may not be possible for such workers to draw full-time wages from the operation. We’ve seen family members of some customers take an off-farm job to help subsidize what they couldn’t afford to pay out of the farm.

4. Take control of family expenses
As farm profits come down with lower commodity prices, many farm families will need to take a closer look at their living expenses and adapt to living with less income.

One method for controlling the cost of family living expenses is to write yourself a check from the operation every month. Put it in an account that is separate from all operational expenses. This way you can’t overspend, and you’ll have a better idea of how much your family spends every month.

If questions arise when revisiting these approaches, talk with your lender about adjusting your fixed costs. He or she can help you develop a long-term plan and understand the pros and cons of adjusting fixed costs.

Armed with acre-by-acre numbers, you’ll be better prepared to negotiate rental rates with landlords to ensure your operation remains profitable as commodity prices trend lower.

Farmers who own their land should take a similar approach. Selling less profitable or unproductive land can lower fixed costs by reducing the cash flow needed for principal payments and interest expenses.

3. Examine labor expenses
The third area to assess is employee and family labor expenses. It’s an area that can be difficult to trim, but the costs of overpaying for labor or not fully utilizing a workforce can be a drag on farmers’ earnings.

Identifying ways to improve production efficiency is one strategy for adjusting labor costs. For example, precision equipment has allowed farmers to reduce their labor needs while still operating efficiently.

Family labor is another aspect that farmers need to take into consideration. Is the operation making enough income to support the family members working on it? If not, some adjustments may be necessary. These conversations aren’t always easy, but as margins continue to tighten, they are worth pursuing.
SUCCEEDING TOMORROW BUILDS ON PLANNING TODAY

It’s easy to get wrapped up in day-to-day decisions that keep your farm running well. Don’t let those short-term needs distract you from what’s needed for long-term viability and growth. Developing a long-term plan is key to the future success of your operation.

You will always face unpredictable factors, such as weather, markets and crop health. Without a long-term plan, you may find yourself being continually derailed as you react to each factor in the present. Solid financial planning helps you account for those hurdles and minimize their impact. You’re less likely to over- or underreact to the present when your sights are set on the future.

Long-term planning will also help you maximize net farm income, avoid unforeseen taxes and take advantage of new opportunities.

Short-term thinking alone is only part of the solution. Farming demands long-term financial planning.

Developing the plan

Think of your long-term financial plan as a map for your operation. Developing this plan will help your operation meet its goals and be successful in the long-term.

If you’re wondering where to begin, a key first step is forming a team of trusted financial advisers. Your team may include your banker, accountant, attorney, lender, landlords/tenants and other key members of the farming operation.

Your financial team will help you create a long-term plan tailored to your operation. Working with an objective team will neutralize emotion and keep you focused on the profitability, risk-bearing abilities and financial depth of your operation.

To start the process, ask yourself four questions:

• Where am I today?
• Where do I want to be in the future?
• How do I get there?
• Who will get there with me?

While short-term plans focus on the current cycle, such as critical capital purchases and near-term pricing strategies, your long-term plans will address items like tax and risk management strategies, succession planning, and farm policy planning.

Essential components of a sound long-term financial plan include these elements:

• **Shared vision:** Work with key operation owners to outline your future goals. It’s important that everyone agrees on the same vision.

• **Risk-bearing ability:** Outline your operation’s current risks, as well as plans for opportunities and adversity.

• **Contingency planning:** Identify alternative investments or changes in the operation that will help you achieve your long-term goals. Outline factors that may derail your plans and determine how you’ll put the operation back on track if needed.

• **Succession planning:** Decide who will run the operation next. Create a process so this transition will happen as smoothly as possible.

**Avoiding common pitfalls**

Three typical shortfalls can derail the development of a long-term financial plan. Here’s how to identify and avoid them.

• **Prepare to adapt.** Don’t assume that what worked last year will work again this year. Every business cycle is different, so build flexibility into your long-term plan. Be prepared to make short-term adjustments to maximize profits without losing sight of your goals.

• **Regularly evaluate partnerships.** You can’t completely control variable cost such as fuel and fertilizer, but you can evaluate your options and programs to see how you can maximize production while focusing on managing expenses. Review third-party risks, services and costs each year, and make sure each investment is helping you achieve your goals efficiently.

• **Avoid emotion-driven decisions.** Your long-term goals should put profitability, financial depth, risk management and succession planning at the forefront. When making a decision, such as buying land, be sure it’s driven by long-term financial strategy, not by emotion.
Evaluating and reassessing your plan
Markets change and your operation will evolve. While your financial plan should be focused on the long-term, it should be evaluated and updated regularly.

Review your long-term plan annually or when material changes take place in the operation, and take the opportunity to sit down quarterly to ensure that your short-term goals are working in alignment to help you achieve long-term success. Be sure to include operation stakeholders and your financial team in these conversations.

Long-term financial planning is important for your operation, especially in challenging times. Working with a strong financial team, preparing for challenges and opportunities, and planning for future operational needs will set you on the path to success.

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