

PL.6

Planning for Cash and Credit

Cash flow is a dynamic concept that focuses on how the quantity of available cash changes during the year.

Agricultural operations typically require an upfront investment and a period of time to pass before the owner has product available for sale and receives cash from sales of products. This means there is a period of negative cash flow before there is positive cash flow. If the business has enough cash at the beginning of the year to cover the period of negative cash flow, it is self-financed. If it needs help with that gap, it needs access to credit.

Agricultural credit is essential to most operations. It is designed to help a business owner to bridge the gap between when they expend money to grow or raise a product for sale and when they will receive income from a sale. The problem is, it can be hard for an owner to understand if credit is covering a cash flow gap in a profitable operation, or if credit is helping an operation which is not profitable to remain in business. It can be hard for new business owners to distinguish between net income and available cash, but this is an essential skill.

A general rule is that agricultural operations that require a larger up-front investment and a longer waiting period (orchards and vineyards) are more profitable than those with a smaller upfront investment and a shorter growing period (e.g. leafy greens).

- Adding value to a product by transforming it from something that will spoil quickly and therefore must be sold quickly increases the amount of cash and time invested in the product before it is sold. So, adding a value added product to your operation may increase your net income, but it may also increase your cash flow problems.
- Planting peonies on land currently used to grow annual flowers is likely to result in a significant increase in gross sales per acre - but not for a few years. So, adding a high-value crop to your operation may decrease your net income and cash flow for a while before eventually increasing your net income and improving your cash flow.

If you have a business plan that will result in positive cash flow and net income within a year, or over the appropriate payback period, then credit can be a valuable tool to help you through periods in your growing cycle when you are short of cash.

If you use credit to help with cash shortages in an operation that does not have a solid plan for positive cash flow and net income within a year, or over the appropriate payback period, then credit will only worsen your problems.

It can be hard for new business owners to distinguish between net income and available cash, but this is an essential skill.

Cash Flow has four components:

1. From business operations
2. From assets bought or sold
3. From debt taken on or paid
4. From owner’s contributions and withdrawals

Net Income has three components:

1. From operating activities only, also called ‘Gross Profit’
2. After also including administrative and other expenses
3. After also including extraordinary income or expense items such as lawsuit settlements or disaster events

Cash balances change due to:

Increases	Decreases
Payments received for sales made	Payments made for expenses incurred
Loan proceeds received	Payments made for loans owed
Owner’s investments received	Payments made for owner’s draws
Payments received for assets sold	Payments made for assets purchased

Cash is not included in the calculation of Net Income. Net income changes when:

Increases	Decreases
Sales are made - regardless of when cash is received	Expenses are incurred, regardless of when cash payments are made

Assets are sold - regardless of when cash is received	Assets are purchased - regardless of when cash payments are made
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Note the cash flow items not included in net income: Owner's investments or draws, loan proceeds, and loan payments.