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Business cash flow: Navigating high interest rates and inflation

Maintaining trust and open communication with lenders is key to navigating economic roller coasters, along with reduc-

ing unnecessary expenditures and focusing on having sufficient working capital.

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In business, it's been said over and over again that "cash is king." Though a redundant yet catchy phrase, it emphasizes the importance that cash flow plays in sustaining a business. In fact, more businesses fail due to lack of cash flow than for lack of profit. It's the backbone to any successful business but often overlooked.

With farming operations being more expansive than ever and also being historically highly leveraged entities, farmers across the country are facing higher debt service requirements due to the steady increase in interest rates seen over the past couple of years.

Couple that with depressed milk prices and high feed costs (particularly in 2023), historically high labor costs and inflated costs for other operating expenses such as utilities, supplies and repairs, and the cash flow pinch is being felt across the board for dairy operators.

This has forced increased borrowings on variable-rate operating lines of credit, which has increased the cost of doing business, and in many cases, drastically increased the cost of doing business with no corresponding increase (potentially even decrease) in revenues. Some operators are facing the reality of this cash flow crunch with already-tapped-out operating lines of credit.

Below we'll analyze a few things to keep in mind while operating in this business environment of high interest rates and inflation.

1. Focus on cash flow, not net profits

Profits don't pay the bills – cash does. Though profitability is imperative to the long-term health of your business, having access to sufficient working capital is imperative to the short-term ability to keep the doors of the business open.

Preparing monthly or quarterly cash flow projections, and comparing actual results to these projections, provides a more real-time analysis to the business's ability to meet both its short- and long-term commitments.

With rising interest rates, higher debt service requirements and higher costs for day-to-day expenses, banks are becoming increasingly reluctant to lend in the agricultural space and are scrutinizing financial ratios closer than ever.

Sufficient cash flow planning to ensure that debt service requirements and other fiscal obligations are met will help ensure the long-term viability of the business through these uncertain and challenging times.

2. Manage accounts receivable and accounts payable strategically

For dairy farms, managing accounts receivable isn't typically needed when selling to a cooperative. However, for farming, livestock raising and other agricultural businesses, gaining insights into payment behavior and patterns can help in identifying metrics that can help manage and project cash flow. Consider shortening payment terms if longer than 30 days, and consider incentivizing early payments with discounts or charging interest on overdue accounts.

For payables, pay extra attention to the payment terms of your vendors and help preserve cash flow by not paying invoices early unless there is an incentive to do so.

3. Keep an open and clear line of communication with your banker

As mentioned earlier, banks are becoming increasingly reluctant to lend in the agricultural space, with many banks leaving the space entirely. This is due to perceived risks with the volatility of the ecosystem that agricultural entities, particularly dairy farms, operate in. Whether it be the volatility of milk prices, forage or commodity prices, replacement livestock or other operating expenses, many banks have determined that these risks outweigh any potential reward of lending in this space. This has led to fewer alternatives to find financing and has allowed the remaining banks in the space to be more selective in those they offer financing to.

Maintaining strong banking relationships becomes even more critical in a high interest rate and high inflation environment when margins are tight and reliance on working capital from the bank is needed. Open communication into the state of the business, the use of funds borrowed and the projected cash flow to meet debt service requirements will help to ensure the bank continues to partner with you in growing and sustaining your business.

4. Additional consideration for capital expenditures and reducing unnecessary costs

Given the high cost to borrow money in the current environment, careful consideration should be had into any capital expenditures that require the borrowing of funds to complete. Detailed return on investment analysis should drive any decision, and any capital expenditures that won't lead to a high return on investment should be delayed.

Though it sounds obvious, reducing unnecessary costs is critical when margins are tight. This requires extensive review of all spending and minimizing spending that provides minimal benefits to the business. This can also include analyzing inventory levels, analyzing your self-raised replacement animal program or the decision to farm your ground versus leasing it out. These are all areas where significant cash flow is used – whether or not these areas are resulting in business advantages or generating return on investment needs to be analyzed.

The current business climate of high interest rates and ongoing inflation is challenging. It requires business owners to be proactive and strategic with cash management, debt management and requires an overall increased focus on every aspect of the business. The current business climate can also provide a silver lining where these challenges spur businesses to become more efficient and innovative, now and for the future. Focusing and maintaining a positive cash flow position is the first step, and perhaps the most important step, to ensure that your business can weather challenges as they are presented and prosper into the future.

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