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NOTE to editor: This is one in a series of articles produced by University of Wisconsin-Extension agents and specialists to address farming through difficult times. More articles can be found on the Extension Responds website at:
www.uwex.edu/ces/ag/farmingindifficulttimes.html

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Managing Through Difficult Times: What is Your Level of Profitability and Survivability?

Madison, Wis. – The following descriptions can help farm families get a sense for where they fit on a "profitability continuum" and also get a sense for the amount of financial risk their farm business has without requiring them to become economists or accountants according to Tom Kriegl, UW-Extension farm financial analyst.

Farm families can use this approach to understand the price they pay for the choices they make. Those finding themselves below level seven are especially urged to seek more in-depth financial analysis help. The "profitability" levels described below are numbered from one to ten with ten being the most desirable and one being the least desirable.

**Level 10** is where farm income exceeds all farm costs including the opportunity cost of unpaid labor, management and equity capital. Economists call this ***economic profit***. It is rarely achieved.

**Level 9** is where farm income exactly equals all farm costs including the opportunity cost of labor, management, and equity. Economists call this ***normal profit***. Profitability levels below normal profit are not considered profitable by economists.

**Level 8** is below normal profit but high enough for farm income to exceed farm costs, provide a comfortable level of family living and allow some increase in family savings over and above the increase in equity that occurs when loans on assets are paid. However, owners are not fully compensated for all the opportunity cost of their labor, management and equity.

**Level 7** differs from level eight in that there isn't enough farm income to increase family savings over and above farm equity increases that result from normal loan repayment.

**Level 6** differs from level seven in that business expenses cannot be paid while maintaining a satisfactory standard of living unless savings or non-farm income is used.

**Level 5** differs from level six in that business expenses are paid but family living is very restricted even if there is non-farm income. By level five there is little if any savings (other than declining equity) left to fall back on. Equity can provide "staying power" but can be eroded quickly at this and lower levels.

**Level 4** differs from level five in that despite the belt tightening of level five, loans are refinanced to defer principal payments as long as possible so that other bills can be paid. This can accurately be called mortgaging the future (Note, sometimes refinancing occurs at an earlier step)**.** Money for family living is very restricted even if non-farm income is available. In the 1970s and early 1980s, inflating asset values allowed many family farms to regularly borrow more money despite continued low levels of profitability. At this level, options are few and chances of recovery decline rapidly. Owners should seriously consider liquidation to preserve whatever equity may remain to help the owner pursue another career.

**Level 3** differs from level four in that there is not enough money to pay even the restructured principal payments although the family severely restricts personal expenses to pay mounting business expenses. Unpaid bills accumulate. If it hasn't already occurred by now, most of the non-farm income is being used for the farm instead of for the family. Equity is declining very rapidly while debt increases with equal speed. Once again, owners should seriously consider liquidation to preserve whatever equity may remain.

**Level 2** There isn't enough money to pay all current business or other expenses despite non-farm income and loan restructuring. Unpaid bills pile up with ever-increasing speed and liquidation is eminent.

**At Level 1 not only is income less than expense but debts also exceed asset values** and the business ends if it hadn't ended earlier. Many struggling businesses will end during levels 2-4 due to overwhelming financial, emotional and/or physical stress. Salvaging as much equity as possible and transitioning out of farming is often the best strategy PRIOR to reaching this point.

Levels eight to ten should be the goal (especially when entering the farm business) although few farms achieve levels nine or ten. Most farms bounce between levels five, six, seven, and eight from year to year with variations in weather, price, and other factors. But most farms do have a level at which they typically operate more than at any other level. The future in the dairy industry is not bright for anyone who spent much time at level six or lower in 2007 or 2008.

The more one relaxes their standard of profitability below economic profits (Level ten) the greater the risk that is assumed and the easier one falls to the next lowest level. The lower the level of profitability, the faster the business and family can move in the wrong direction.

Below level seven, the likelihood of business success decreases substantially.

Those that find themselves at level six or lower owe it to themselves and their family to seek financial advice soon. Of course, farm families above level six can also benefit from financial advice, and often do.

At level five or lower, improvement is difficult. Transitioning out of farming while maintaining equity may be a more realistic goal for those who are at level five or below.

Many farm families have a number of non-business goals that interfere with maximizing profitability. This isn't necessarily bad, but too often the level of profitability that farm families are willing to accept, places them under great risk, not only of falling short of business goals, but falling short of personal goals of improved family living and security. Financial analysis can help farm families understand the price they pay for the choices they make.

To access more information and/or tools to help analyze your situation, link to the Extension Responds web page at: www.uwex.edu/ces/ag/farmingindifficulttimes.html

For assistance in making these tough decisions, contact your UW-Extension county agent, your Farm Business and Production Management Instructor in the Technical College or the DATCP Farm Center at 1-800-942-2474.

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