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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: Liquidity, Working Capital and the Dairy Cash Crunch

Madison, Wis. – Low milk prices, coupled with relatively high feed costs, are making it difficult for Wisconsin dairy producers to have cash flow. This is not a good situation because dairy producers can only survive in times like these if they are able to get the cash or credit they need to make up the differences between cash inflows and outflows note University of Wisconsin-Extension specialists and agents.

Dairy producers will likely be turning to their lenders for the credit they need to get through the current downturn in the dairy economy. Unfortunately, lenders are not going to be able to automatically grant dairy producers the operating credit they need. The lenders are only going to be able to extend credit to those dairy producers who are likely to pay off their operating loans in a timely manner. Lenders have to get repaid as agreed or they will get into cash flow problems themselves.

Whether producers are able to obtain operating loans depends on the working capital positions of the producers. Working capital, which by definition is the difference between current assets (assets that will be turned into cash within a year) and current liabilities (liabilities that must be paid within a year), is the measure lenders look at to determine whether borrowers are likely to have the ability to pay off operating loans within a year.

A business' access to working capital is largely a function of the business' profitability. The more profitable a business is the more working capital it will potentially have at its disposal. Whether a business retains its working capital depends on its spending habits.

Rather than keeping working capital as a reserve, the manager can instead use working capital to: (1) make down payments on the purchase of big ticket items like machinery and real estate; (2) purchase equipment; or (3) pay ahead on real estate mortgages or other long term debts. All of these actions reduce or deplete a business' working capital holdings. If working capital is drawn down it will not be available when it is needed during periods where businesses are running cash flow deficits.

As a matter of practice, businesses should, when cash flows are plentiful, make sure they accumulate working capital that can be used to obtain short run operating loans necessary for plugging gaps between cash receipts and cash expenditures. This building of working capital should take priority over purchasing assets and/or pre-paying long term debts.

There is a limit to the amount of working capital that should be accumulated. Too much working capital is inadvisable because the returns on working capital are generally low. Thus holding excess amounts of working capital comes at the cost of possible profits.

A reasonable goal for accumulating working capital (which, recall, is the difference between current assets and current liabilities) is an amount equal to half of total current liabilities, which would provide the business with \$1.50 of current assets for every \$1.00 of current liabilities. This should provide the business a reasonable cushion to withstanding short run periods of cash flow deficits.

We are currently in a down-cycle where survival is the primary concern for dairy producers. Farmers who make it through these trying times will have most likely had the working capital needed to bridge the gaps between cash inflows and cash outflows stemming from low milk prices.

When profitable times return, dairy producers should make it a priority to replenish their working capital positions before making additional investments and/or assuming more debt. This simple act of savings will go a long way to ensuring dairy operations are prepared to cope with future down-swings in the dairy economy.

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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