Business Reinvestment

By Jennifer Ifft

Preparing for capital investments

Towards the end of the year, or as opportunity presents itself, many farm operators will consider making capital investments. Decisions on whether or not to purchase land, machinery and equipment are both difficult and important. A wise investment can grow your business and increase profits, while a failed investment could put your entire operation at risk. Ultimately, the decision whether or not to make a particular investment hinges on whether or not it will contribute to profitable operation of your farm business well into the future. Your ability to service debt under an acceptable level of risk is also a primary consideration. Before you sit down at the table with your family, business partners, and/or lenders to develop budgets and discuss these primary considerations, you may want to think about some additional areas.

Choose investments that contribute to long-term profitability.

1) What is your motivation? Are you considering this investment for the right reasons? For any major decision in life, examining your motivation is critical. Even experienced managers may be susceptible to "a good deal that they can't pass up." While interest rates, discounts or other "deals" can play a role in your decisions, the role should be not be primary. Just because a local equipment dealer is offering rock-bottom interest rates, the investment might not be right for your operation. Another factor that shouldn't drive your decision is what your neighbor/friend/relative is doing. While the experience of other farm operators can be an important input into your decision, you need to be certain that this new investment meets the needs of your operation. Examine your motivations before seriously considering a new capital investment. If you're not focused on profitability and the associated risks, it might not be the right time to make a new capital investment.

2) Have you considered all of the alternatives? Before making a yes or no decision on a particular investment, you might be better off considering additional options. There may be both on-farm and off-farm alternatives to the investment you are considering. Custom work may be more cost-effective for your operation than tying up precious working capital in machinery. The same argument applies to the decision to purchase or rent land. Are you considering both new and used machinery? Some profitable operations always buy used machinery, while new may be suitable for certain business models. In addition to alternatives purchases or operating decisions, you should also consider if you would be better off investing off-farm. Your investment may be more profitable and even less risky in various off-farm investments, including stocks, bonds, mutual funds and rental properties. Retirement accounts as a use of capital might also be considered, especially in high income years.

3) Will any new skills be required? While farm operators and managers continually adapt to new technologies and constantly learn new skills, in some cases the indirect costs of a new technology may be too high to justify purchase. In addition to considering the direct costs – the amount to purchase – these indirect costs should be considered before making a capital investment. Will considerable education or training be required for you or your employees? If yes, would it interfere with profitable operation of your farm? For example, a farm going through a complicated ownership transition or hiring a new farm manager over the next year might not want go through a transition to a new milking center at the same time.

4) What maintenance and improvements are needed? While maintenance and capital improvements are normal and should always be expected, the magnitude of associated costs is an additional factor to consider in making your decision. If the equipment or machinery will need servicing, can it be done in a reasonable amount of time at a reasonable cost? If the land you just purchased needs tiling or any other improvements, are the resources and time available sufficient? Maintenance may be especially problematic when you are considering purchasing something that uses old, new and/or uncommon technology. What is the cost, both in terms of dollars and time spent, along with disruption of operations, if a breakdown occurs?

5) Is now the best time to make this decision? While investment decisions will always be difficult and shouldn't be avoided for that reason, you may be in a better position to make the decision next year. Occasionally, events over the next year may put you in a much better position to decide on a particular investment. A general rule of thumb is that the expected changes over the next year would bring substantial changes to your operation and strongly influence your current investment decisions. For example, does the change you made to your reproductive program increase the internal herd growth that you can generate? If so, with more animals, the decision to build a new barn may be easier to make. In such cases, you may be in a much better position to make investment decisions next year.

After examining your motivation; considering the alternatives; taking into account new skills required as well as any costs of improvements and maintenance; and deciding whether or not there is a compelling reason to delay your decision until next year, are you still interested in making a capital investment?

Now the hard work begins! You'll want to be sure that this new investment will contribute to the long-term profitability of your farm. You'll have to make difficult decisions about how much debt to take on, and will want to be comfortable with your ability to make loan payments in good and bad years. For large investments, it's especially important to reflect on your objectives for your farm over both the medium and long-term. For example, is this a period where you need to aggressively grow your operation or do you want to facilitate transition to new ownership in five years? Given the multitude of risks farmers face, it pays to make well-informed decisions about capital investments. ❐

Jennifer Ifft (jifft@cornell.edu) is an assistant professor with the Charles H Dyson School of Applied Economics and Management, Cornell University.

Planning for your future

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7) Sensitivity analysis shows how the financial picture changes for your business with changes to income and expenses. It can help identify which changes have the greatest impact on the profitability of the business. For example, how does the financial picture change with changes in milk price, milk per cow and milk production?

8) Supporting documents are referenced in the body of the business plan and provide more relevant detail. For example, you may want to include past tax returns or positive press clippings about your farm.

9) Summary is a synopsis of the plan and supports the general objective of the plan.

The effort put into the plan now will reap dividends in the future and help turn your dreams into reality.

Resources

Further details on developing a business plan are at:

- www.dyson.cornell.edu, and
- www.NYFarmnet.org.

Information and eligibility to apply for funds to engage the services of a business planning consultant are on the Dairy Acceleration Program webpage at:

- www.prodairy.cals.cornell.edu/dairy-acceleration/. ❐

Caroline Potter (cjh42@cornell.edu) is the Dairy Acceleration Program Coordinator for PRO-DAIRY.