FINANCIAL REORGANIZATION OF THE FARM BUSINESS (Short of Bankruptcy)

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Webster's dictionary lists one definition of reorganization as financial reconstruction of a business concern. For our purposes, a practical definition of reorganization is the question, "What can be done to help the business survive, or if not to survive, then to be dissolved with the least loss?" This paper emphasizes the first part of the question. The last part of the question might involve bankruptcy as a means of dissolving the business.

There are a number of reasons for reorganizing a farm business. One of the most common is that the business has relatively low profitability. Another reason for possible reorganization is insufficient cash flow, even though the business may be making a profit. Later examples will illustrate this situation. A third reason for reorganization is that the business is insolvent. That is to say, if a business can not meet it's financial obligations, it needs reorganization; and, perhaps one of the options at that point is bankruptcy. A fourth reason why a business might be reorganized is because the owner wants to. Perhaps there is little or no hope for improvement under present circumstances and the owner decides that either the business has to be reorganized or it has to be liquidated. Finally, a business may have to be reorganized because the creditors force reorganization or bankruptcy. Reorganization may involve a changing of debt structure, a restructuring of assets, or a liquidation of the business.

Low Profitability

If low profitability is a problem in the business, then an operating statement is an important tool with which to analyze the business. It is important that the operating statement show all cash receipts, expenses, and accrual items such as inventory change and depreciation. Perhaps a word of explanation is in order on the accrual items. Accrual items include inventory changes, including feed crops on hand, and livestock (numbers and value). Depreciation and appreciation of farm land,

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buildings, machinery, and livestock should also be noted. This is not to suggest that the farmer file taxes on an accrual basis. That is a completely different question. An accrual basis operating statement is necessary to value what the business produced during a year. In contrast, a cash basis operating statement, ignoring inventory changes for example, could grossly overstate or understate farm production for the year.

With the operating statement in hand, we want to examine several figures, including returns to equity, labor, and management, in particular, to determine how well the business is doing.

A good source of information on operating statements for farm businesses can be found in the Cornell Farm Business Summaries. These summaries are useful to compare a case farm with similar farm operations for clues as to possible problems. However, for purposes here, let's consider an operating statement summary for John Maydit for 1981 (Table 1).

Table 1. Operating Statement Summary, John Maydit, 1981
(Thousands of Dollars)

Cash Receipts	290	Variable Cash Expenses	160
Inventory Changes	40	Fixed Cash Expenses	50
Total Income	330	Total Cash Expenses	210
Net Cash Income	80		
Depreciation	25		
Farm "Profit"	55		
Less Unpaid Family Labor	10		
Return to Labor, Management and Ownership		85	
Value of Op. Labor ($8/hr)		25	
Return to Capital @ 10%		40	
Labor and Management Income		45	
Rate of Return on Beginning Equity		15*	

*15%: (Excluding Appreciation)

Let me make several points on this operating statement summary. First, if Maydit were using the figures on the operating statement for his income taxes, he would show a farm profit of $55,000. That figure comes from the cash receipts less cash expenses and depreciation. However, note that in this particular year, Maydit increased the value of his inventory by $40,000. That accrual in production value over the course of the year should be included as a part of the returns to the business. So, to obtain a more accurate figure on returns to the business, we add the inventory change to

farm profit, subtract value of unpaid family labor, and get a total return to labor, management and ownership of $85,000. That is a key figure in calculating returns to the farm business, for it includes returns to all of the factors of production owned by the operator after paying for or adjusting for all other expenses. To calculate returns to any of the remaining three components, one must deduct an arbitrary estimated amount for the different contributions. Remember that we have already deducted any unpaid family labor that was not paid for as a cash expense. Maydit had estimated $10,000 for unpaid family labor which could have been spouse's or children's labor. (Incidentally, if we were visiting with Maydit about his operating statement, we should suggest that he pay his family labor in cash as an income tax strategy if not as a human relations suggestion.)

First, we ask Maydit how many hours he put into the farm business, and what he feels his hourly rate should be. (We may need to advise on this figure.) We subtract that amount as an arbitrary labor charge. What is left at this point, $60,000, could be called a return on beginning equity. The figure includes both a return to owned capital and a return to management. If one divides $60,000 by beginning equity of $400,000, a rate of return on equity of 15% is obtained. In this case, we have calculated a rate of return on beginning equity, because we did not have figures for ending equity in the business. A better figure to use, if one has both beginning and ending net worth, would be an average of those two figures.

An alternative calculation is followed to estimate return to labor and management. We start with return to labor, management, and ownership then deduct an arbitrary return to owned capital. In this case, we have used a 10 percent arbitrary return on owner's capital. Since net worth, which is the owner's capital, is $400,000, a 10 percent return on that is $40,000. Subtracting $40,000, we are left with a labor and management return of $45,000.

John Maydit's operation in 1981 was a rather profitable farm business compared to most other New York dairy farms. For example, while figures are not yet available for 1981, the 1980 figures for the Western Plains Region in New York indicate an average labor and management income per operator of about $18,000 in 1980.

The balance sheet, or net worth statement as it is sometimes called, is also useful information for analyzing progress in the farm business. One of the questions often asked by lending institutions is the extent to which net worth changes over time come from earned net worth as opposed to capital appreciation. Consider Table 2, for example, which is a record of John Maydit's net worth change from 1979 to 1981. This summary of net worth change does not have the detail that would be most useful to us in analyzing net worth change over time. It would be better to have numbers of livestock of different types with a value per unit and to have units of feed and supplies on hand. Real estate value should also show actual acreage. In this case, we do have the same acreage from 1979 to 1981. Note that Maydit's net worth increased $18,000 from 1979 to 1981.

Table 2. John Maydit's Record of Net Worth Change
(Thousands of Dollars)

	1979		1980		1981
Assets					
Cash	1		1		1
Livestock	173		154		174
Feed & Supplies	66		65		60
Machinery and Equipment	115		140		135
Real Estate (same acreage)	200		210		230
Total Assets	555		570		600
Liabilities					
Accounts Due	14		4		3
Short Term Loans	19		10		12
Machinery Loans	31		51		35
Real Estate Loans	159		155		150
Total Debt	223		220		200
Net Worth	332		350		400
Net Worth Change		18		50	
Earned Net Worth Change*		8		30	

* If livestock were valued in same dollars!

We can see that $10,000 of that was appreciation in real estate. So the earned net worth change was $8,000 rather than $18,000, assuming that livestock were valued consistently over the period. However, livestock values often change over time depending upon milk prices and dairy farm profitability. One should examine carefully the livestock valuation when estimating earned net worth change.

From 1980 to 1981, Maydit increased his net worth by $50,000, and $30,000 of that change was earned. In short, earned net worth is of interest because it tends to reflect increases in assets over debt that came from plowing earnings back into the business. This is not to say that use of inflation-adjusted real estate values or livestock values are inappropriate. For some purposes, one should use accurate current valuations to estimate net worth. The point here, however, is that lenders are concerned with a farmer's ability to plow earnings back into the business. If the farmer is making a profit, he is able to do that and to get earned net worth increases. If a farmer is losing money, his net worth statement may still show an increase in net worth. However, it is not likely to show an increase in earned net worth.

If low profitability is the difficulty in a farm business situation, then the possible cures need to be tailored to the reason for low profitability.

See Table 3, for example. If low product prices are the basic reason for low profitability, then some of the alternatives include improved marketing, change of enterprises; or if nothing else works, perhaps all that can be done is for the farmer to keep solvent and wait for improvement if that is possible. If the basic problem for low profitability is low volume production, then the operator might consider such things as improved technology, improved genetic capability, better rations to improve livestock production, or change enterprises. Oftentimes, a helpful analysis for spotting low volume or poor production is to look in the Farm Business Summaries to compare with other farms. For example, yields per acre are shown from high to low. If the farm in question had yields that are down on the low end, or milk production per cow that's down on the low end, it suggests that he needs to improve production practices or find out what can be done to increase the return per unit.

Table 3. Solution to Low Profitability Depends on Problem

Problems	Possible "Cures"
Low product prices	Improve marketing. Change enterprises. Keep solvent--Wait for improvement.
Low volume, poor production	Learn improved technology Improve genetic capability Check rations and improve See what others are doing Change enterprises
Costs too high	Change input mix Reduce use of expensive inputs Increase volume to lower unit costs Substitute for costly input

If farm costs are too high, this might suggest changing the input mix, reducing the use of expensive inputs, increasing volumes to lower unit costs, or substituting for costly inputs. Again, it might be useful to see what other farms are doing in terms of costs and returns per unit because that could give clues as to possible answers.

An important final point is that when one finds the probable cause, a budget should be used to be sure the "cure" works for that particular problem. In short, push a pencil to see if that alternative corrects the problem. If not, one may need to look for other alternatives.

Insufficient Cash Flow

If the basic problem of the business is insufficient cash flow rather than low profitability, then it is useful to have both an operating statement and a sources and uses of funds statement. Perhaps the first question is, why is the farm short of cash flow? Is it unprofitable? Or is it profitable but short of cash flow for some other reason? If the problem is profitability, will curing the profitability problem also cure the cash flow problem? And, finally, the question needs to be asked, can the cash flow problem be cured short of liquidation?

Before turning to the operating and cash summary statements, let's first consider briefly the balance sheets for three individuals we will call John Maydit, Joe Bluit, and Jim Cashcrunch. Each of these three has total assets of $600,000. The assets on their balance sheets are identical for January 1, 1981. However, there are some substantial differences on the liabilities side of their balance sheets. Bluit, for example, has substantial accounts due and short term loans, as well as machinery and equipment loans. Bluit's net worth is only $200,000 compared to Maydit's $400,000. Cashcrunch is somewhat in between the two in that there are accounts due of $10,000, short term loans about double those of Maydit, a large volume of machinery and equipment loans, and a somewhat lower real estate debt than either of the other two individuals. Cashcrunch's net worth is $380,000, just $20,000 less than Maydit's.

Table 4. Comparison of Balance Sheets, January 1981
(Thousands of Dollars)

	Maydit	Bluit	Cashcrunch
Cash & Checking	1	1	1
Livestock	174	174	174
Feed & Supplies	60	60	60
Machinery & Equipment	135	135	135
Real Estate	230	230	230
Total Assets	600	600	600
Accounts Due	3	50	10
Short Term Loans	12	120	25
Machinery & Equipment Loans	35	80	100
Real Estate Loans	150	150	85
Total Debt	200	400	220
Net Worth	400	200	380

Let's now compare the three operating statements for 1981. The three farm operations took in almost the same in cash receipts. However, Bluit's cash receipts were $10,000 less than either of the other two, and Bluit's inventory change was downward whereas both of the other two had increases in inventories.

Table 5. Comparison of Three Operating Statement Summaries, 1981 (Thousands of Dollars)

	Maydit	Bluit	Cashcrunch
Cash Receipts	290	280	290
Inventory Change	+40	-10	+40
Total Farm Receipts (Excl. Appreciation)	330	270	330
Variable Cash Expenses	160	155	160
Fixed Cash Expenses	50	75	60
Total Cash Expenses	210	230	220
Net Cash Income	80	50	70
Depreciation	25	35	35
Farm "Profit"	55	15	35
Unpaid Family Labor	10	10	5
Return to Labor, Management, and Ownership	85	-5	70
Imputed Value of Op. Labor ($8/hr)	25	25	25
Rate earned on Beg. Equity	15%	-15%	11.8%
Return to Equity @ 10%	40	20	38
Labor Income	45	-25	32

Cash expenses for the three operations were slightly different. The main difference was that Bluit had $50,000 of interest payments because of his larger debt compared to $25,000 for Maydit and $35,000 for Cashcrunch. Other fixed cash expenses were the same for the three individuals. There was also a slight difference in depreciation among the three. Both Bluit and Cashcrunch had higher depreciation than Maydit. For income tax purposes, the three farm situations varied a great deal in profitability. Cashcrunch had profit $20,000 less than Maydit, and Bluit had profit of $20,000 less than Cashcrunch. The return to labor, management, and ownership was $85,000 for Maydit, $70,000 for Cashcrunch, and -$5,000 for Bluit. The calculations that follow in the table reveal some gross difference between these three operations. The return to labor and management is $45,000 for Maydit, as stated earlier, $32,000 for Cashcrunch, and is -$25,000 for Bluit. The rate earned on beginning equity shows a similar pattern of 15% for Maydit and 11.8% for Cashcrunch. Bluit lost 15% on his beginning equity.

Table 6 summarizes the sources of uses of funds for the three farm operators for 1981. This type of statement shows the sources of cash for the business and family and the uses or outflow for the entire year. It does not include noncash items such as inventory change, depreciation, or appreciation. In other words, this statement shows only the cash flow aspects of a business for the total year. It's often useful to put together a detailed sources and uses of funds statement on a month by month or quarter by quarter basis. Such statements are referred to as cash flow statements. (These detailed statements are particularly useful in projecting the flow in the first year of a business or after a substantial change in a business.)

Table 6. Sources and Uses of Funds Summaries, 1981
(Thousands of Dollars)

	Maydit	Bluit	Cashcrunch
Sources			
Cash Receipts	290	280	290
Sale of Capital Assets	25	10	25
New Loans	15	50	35
Total	330	340	350
Uses			
Cash Expenses (Excl. Interest)	185	180	185
Interest	25	50	35
New Capital Purchases	33	20	45
Principal Repayment	35	60	60
Family Living	30	22	14
Personal Taxes	22	7	11
Total	330	339	350

However, for our purposes, an annual summary of cash flow is quite revealing. Note, for example, that each of the three individuals obtained some funds from sale of capital assets. Also, each obtained some funds from new loans. However, Bluit obtained far more from new loans than either of the other two. Maydit had the smallest need for new loans. Under uses of funds, the big item is cash expense for the farm business. Interest expenses in the table are separated from other cash expenses. Also shown as a use of funds are purchases of new capital items, principal repayment on loans, family living expenses, and personal taxes. In short, all uses of funds are shown except changes in the checking account. If the sources of funds do not total uses of funds (and if all figures are accurate), the difference will be found in the changes in the checkbook balance. For example, Bluit's checkbook balance would have increased by $1,000 from the beginning of the year to the end of the year.

We can see some interesting differences in the sources and uses of funds of these three operations. Bluit is repaying large amounts of debt, but in order to do so, he is simply trading new loans for old loans. His family living expenses are moderate and less than Maydit's, and his personal taxes, because of his financial situation, are relatively low. Personal taxes include state and federal income taxes, social security payments, etc. One interesting question to ask is the extent to which each individual is reducing his debt. Maydit's principal repayment of $35,000 and new loans of $15,000 show a $20,000 reduction in debt. Bluit, on the other hand, reduced his debt by only $10,000, while Cashcrunch reduced his debt by $25,000.

Perhaps for improved perspective on differences in the three operations, it would be useful to calculate some ratios (See Table 7). The ratio of new capital purchases to depreciation gives some insight, though no final conclusion, relative to whether the farm is keeping its capital up to date. Maydit and Cashcrunch are both putting more into capital purchases than their rate of depreciation. Given the rapid inflation in capital items in recent years, it is not clear whether they are making net improvement in capital or are only just keeping it up. However, it is clear that Bluit is not keeping his capital up to date with new capital purchases of only 57% of depreciation. Also, one needs more than just one year's data before drawing conclusions.

Table 7. Some Ratios of Interest

	Maydit	Bluit	Cashcrunch
New Capital Purchases/ Depreciation	1.32	.57	1.29
Family Living & Personal Taxes/Net Cash Inc.	.65	.58	.36
Family Living, Personal Taxes and New Capital Purchases/Return to Labor, Management, and Ownership	.89	9.8	.93
Total Debt/Net Principal Repaid	10	40	9
Debt Service/Cash Receipts	.21	.39	.33

The ratio of family living and personal taxes to net cash income suggests that Cashcrunch is putting somewhat less into family living and taxes than the other two. Another interesting ratio is the family living personal taxes, and new capital purchases in relation to the total return to labor, management, and ownership. When these figures are less than one,

it's highly likely that returns are being plowed back into the business. When the ratio is over one, then the operator is withdrawing funds from the business. For these three individuals, both Maydit and Cashcrunch are within reasonable bounds, but Bluit is using up his farm capital.

The ratio of total debt to net principal repaid is a measure of how many years it would take to repay the entire debt at the rate it's being paid down in this year. Maydit is paying down at a rate of ten years for total repayment. Given his relatively high level of family living expenses, this repayment rate may not be too fast. Cashcrunch is paying at the rate of nine years to repay total debt, but his relatively low level of family living and other evidence of cash flow problems would suggest that his debt repayment rate is too fast. Bluit, on the other hand, shows a problem of farm profitability. His debt is being repaid at a rate that would take 40 years to repay, and even then he is withdrawing funds from the business.

The final ratio of interest is the debt service to total receipts ratio. Maydit is putting about one dollar in five toward debt service. Cashcrunch is putting one dollar in three toward debt service, and Bluit is putting almost two dollars in five toward debt service. Experience suggests that a ratio over .25 typically shows problems in meeting debt service. Bluit, because of his relatively high debt and low profitability, is in deep trouble. Cashcrunch, on the other hand, has a profitable business, but his debt service and cash receipts ratios suggest that restructuring of his debt is needed.

If we were counseling these three farmers given the preceding, what suggestions might we make? For Maydit, probably the only question is whether he should look more carefully at family living expenses and personal tax aspects. Perhaps Maydit needs to give more thought to tax strategies.

Cashcrunch has a profitable operation, but he needs to emphasize ways of reducing the cash flow press of the business. He has a heavy commitment for repayment of machinery and equipment loans and short term loans and a relatively light commitment to repayment of real estate loans. This suggests he might consider shifting machinery and equipment loans or other short term loans to real estate to reduce the press of fast repayment. In many years, this might also lower interest rates. Cashcrunch would also have to face the question of whether he has an inclination to buy "new paint". In other words, does he buy more machinery and equipment than needed, or does he buy new equipment before it is needed? This is hard to know from just one year's data, of course.

To illustrate how restructuring of debt might help Jim Cashcrunch with his cash flow, let's consider the detail in his debt situation and how we might restructure debt. Cashcrunch's debts and commitments as of January 1981 are shown in Table 8. He started the year with $220,000 of debt and a debt service commitment of $35,000 for interest and $60,000 for principal repayment.

Table 8. Jim Cashcrunch Debt Situation, January 1981

Jim Cashcrunch Debt and Commitments, January 1981

Type of Debt	Amount (Thousands)	Int. Rate	Interest (Thousands)	Principal Pmt. Due (Thousands)
Open accounts	10	24%	2.1	10
Operating and short term	25	20%	5.0	20
Machinery loan #1	13	15%	1.9	7
Machinery loan #2	17	16%	2.7	5
Machinery loan #3	30	20%	6.0	6
Machinery loan #4	40	20%	8.0	6
Real estate loan	85	11%	9.3	6
Total	220	15.9%	35.0	60

Jim Cashcrunch Restructured Debt, January 1981

Type of Debt	Amount (Thousands)	Int. Rate	Interest (Thousands)	Principal Pmt. Due (Thousands)
Open accounts	5	24%	2.0	5
Short term	5	20%	4.9	5
Consol. mach. loans[a/]	60	18%	10.6	12
Ref. Real estate loan[b/]	150	11.5%	17.5	-
Total	220	15.8%	35.0	22

a/ Machinery loans 1, 2, and 3 are consolidated into one $60,000 loan to be repaid at rate of $12,000 per year. (5 years)

b/ New real estate debt includes $5,000 from open accounts, $20,000 from operating and short term, and machinery loan #4 for $40,000. No principal payment is due in year of restructuring, but interest on previous commitments is due when refinanced.

Now let's consider how that debt might have been restructured in January 1981. We'll add $65,000 to the real estate loan by paying off machinery loan #4, $20,000 of operating and short term debt, and $5,000 on the open account debt. The refinancing will also include rewriting the $85,000 of real estate debt from before. In restructuring the debt, we'll also have to assume that the interest charges had accrued by the time we refinanced. Therefore, there is no change in the interest due in 1981. However, because of the refinancing of the real estate loan, there will be no real estate payment in 1981, and the total principal due in 1981 will be reduced from $60,000 to $22,000. Cashcrunch now would not need to take out any additional new loans because his debt service requirement would have been reduced from $95,000 to $57,000.

Now note in Table 9 what Cashcrunch's restructured debt situation would look like as of January 1982. The amount of debt would be paid down to $198,000 consisting of just two debts. One is the consolidated machinery debt of $48,000 remaining after the principal payment of $12,000 and the real estate of $150,000. Interest payments in 1982 would be reduced about $9,000 to $25,900 and principal due in 1982 would be reduced to $16,200. This then, represents less than half the debt service commitment in 1982 than if the debt had not been restructured.

Table 9. Jim Cashcrunch Debt Situation, January 1982

Jim Cashcrunch Restructured Debt Commitments for 1982

Type of Debt	Amount (Thousands)	Int. Rate	Interest (Thousands)	Principal Pmt. Due (Thousands)
Open accounts	0	-	-	-
Short term loans	0	-	-	-
Consol. machinery	48	18%	8.6	12
Real estate loan	150	11.5%	17.3	4.2
Total	198	13.1%	25.9	16.2

Total debt service $42.1

Cashcrunch Debt (Without Restructuring) 1982

Type of Debt	Amount (Thousands)	Int. Rate	Interest (Thousands)	Principal Pmt. Due (Thousands)
Open accounts	-	-	-	-
Operating and short term[a/]	10	20%	2.0	10
Machinery loan #1	6	15%	.9	6
Machinery loan #2	12	16%	1.9	6
Machinery loan #3	24	20%	4.8	6
Machinery loan #4	34	20%	6.8	6
Machinery loan #5[a/]	30	20%	6.0	5
Real estate loan	79	11%	8.7	6
Total	195	15.9%	31.1	45

Total debt service $76.1

a/ In order to pay off $60,000 of debt in 1981, it was necessary to borrow $30,000 on purchase of new machinery and to use $5,000 of new operating loans.

An interesting comparison is to look at Cashcrunch's debt and commitments without restructuring of debt in 1982 as shown also in Table 9. Without restructuring, he would have paid the debt down to $195,000 but would still have debt service requirements of about $76,000 consisting of $31,000 of interest and $45,000 of principal due.

In restructuring Cashcrunch's debt, there are several points to be made. Some of the benefit of restructuring comes in the form of a substantially reduced principal commitment per year. Also, there is a reduction in total interest payment because 20 and 24 percent interest rate debts were consolidated into 18 and 11.5 percent debt. Hence, there was a net reduction in interest rate on the amount outstanding.

Finally, a part of the reduced principal comes from refinancing debt to take longer terms for the payment. For example, the various machinery debts he had on January 1981 required repayment commitments of $24,000. One loan had but two years remaining for repayment while another had three years remaining. By consolidating all of the machinery loans into one loan and taking five years to repay, the amount of principal necessary for repayment is reduced from $24,000 to $12,000. This example illustrates how a restructuring of debt can accomplish reductions in both principal payments and interest charges per year.

A final point before leaving this example: Once the restructuring is complete, Cashcrunch has used up his flexibility. If he were then to buy large amounts of additional machinery or other items by unwise use of credit, he could put himself back into the same difficulties as before. The debt restructuring should perhaps also include some counseling to help Cashcrunch understand the nature of the problem and improve his future financial management.

Returning to the third example case, Joe Bluit is a real problem. He is losing money on the business and the press of cash flow is moving him toward some sort of a crisis. There are several suggestions we might offer. First, could family living expenses be cut somewhat? The family living expenses listed on the sources and uses of funds statement do seem high for a business having cash flow problems. One also has to ask the question whether there are possibilities for improved production or possibilities for cutting costs within the business. We simply don't have enough detail in the summaries here to know. We need more detail on Bluit's expenses and production efficiency to compare with other dairy farms in New York State.

Dealing with Bluit's problems may, however, require rather severe actions. One alternative might be to sell some of the assets and pay down his debt. Could some of Bluit's livestock be sold profitably to help pay down debt? Perhaps now would be a good time to cull heavily. Does he have machinery that is not used sufficiently to pay its own way? Would selling some of the machines be a way of reducing debt?

Finally, if there appears to be no reasonable alternatives to save this business, it might be useful for Bluit to consider the question of liquidation to salvage as much net worth as possible before it is all gone.

With cash flow problems, as with low profitability problems, the possible cures depend to some extent on the problem as noted in Table 10. For example, if there is too much short and intermediate term debt, one alternative includes refinancing the debt into longer repayment terms. Be careful here, though, that one does not give up low interest rates for high interest rates in refinancing. Secondly, one might sell some capital assets and pay down the debt. Third, one might buy used machinery rather than new. Fourth, one might simply have to make do with what he has. Still another possibility is to sell seldom used machinery and custom hire the services.

Table 10. Reorganization Cures Depend on Problem

Problems	Possible "Cures"
Farm not profitable	Find cause and correct.
Family living too costly	Reduce family living.
Too much short-term/ intermediate debt	Refinance debt into longer repayment terms-- Be careful of rates. Sell some capital assets and pay down debt. Buy used machinery rather than new. Make do with what you have. Custom hire services. Sell machinery.
Too much debt, too little net worth	Can debt be refinanced to reduce payments or interest rates? Sell capital assets which don't carry their weight. Woodlots? Extra homestead? Sell last parcel purchased. Sell seldom used machinery. Hire service. Sell some of poorer producing livestock. Nonfarm job possible? Spouse vs. operator. Ride with it till interest rates come down and then refinance.
New capital purchases too high	Improve maintenance on old machines. Consider leasing or custom hiring. Budget capital investment decisions carefully.*
Interest costs too high	Don't refinance low cost fixed rate loans-- Lower inventories if possible. Tighten belt. Stick with it till times improve.

* Always sleep on any decision over $5,000.

In a relatively serious situation where the problem is just an overwhelming amount of debt and there is little or no net worth, then the possible cures may also be rather serious. One must first ask whether debt can be refinanced to reduce payments or interest rates. An alternative would be to sell capital assets which don't carry their weight in the business. For example, might there be value of woodlots that don't add to farm production? Might there be an extra homestead on the farm that could be liquidated for some badly needed cash?

Perhaps the farm operation would have to consider selling the last farm parcel purchased (which typically would have the largest debt)--or sell the least productive parcel in the unit (to raise money with the least loss of unit). If the last parcel purchased were close by and one of the earlier parcels purchased was some number of miles away, it might make sense to sell the distant parcel rather than the most recent purchase as the last resort to saving the farm business. One might also consider selling some of the seldom used machinery, mentioned earlier, and hiring the service. Also, ask whether some of the poorer producing livestock should be sold to pay down debt. Still another possibility could be nonfarm jobs for the operators or spouse. If there is no other alternative and the farm has some staying power, perhaps the family could ride out the situation until interest rates come down and then refinance.

For many farm operations, one of the difficulties is that new capital purchases are too high in relation to income. Some of the possible cures for "new paint fever" include improving the maintenance on old machines, leasing, or custom hiring rather than buying one's own machines. It's important when considering a capital purchase decision that the decision be budgeted carefully to be sure it is a paying proposition. Perhaps one useful rule of thumb would be to tell farmers always to sleep on any decision over $5,000 so that some more analysis or thought will be given to such decisions rather than risk questionable purchases on the spur of the moment.

If the situation looks impossible, it is important first to understand why. Is the problem one of unprofitability? Is the problem cash flow, even though the farm is profitable? Or, is the problem insolvency that is beyond possible improvement?

Second, once we understand why, assess the odds for improvement. Such things as weather, interest rates, and prices of farm products are beyond our control. On the other hand, the amount of inputs purchased, the type of enterprises, and the marketing patterns and choices are within our control. It is important to keep perspective, also. There are cycles in prices and economic conditions, and times do change. Sometimes all one can do is to take a conservative stance, ride out the bad times, and try to stick around to take advantage of better times.

Summary

This short report viewed a farm business as assets on the one hand, and debts and net worth as the claims against those assets. The assets usually consist of cash, inventories, livestock, machinery and equipment, and real estate. The claims generally consist of accounts payable, short term debt, intermediate term debt, real estate debt, and net worth, the claim of the owner against the business. The net worth claim, of course, is a residual claim after other claims have been satisfied.

To restructure or reorganize the business can mean a number of things. For one, it could mean shifting asset types to a different emphasis or a different utilization of assets. Secondly, restructure could mean shifting debt to a different make-up--for example, shifting short or intermediate term debt to long term debt. Thirdly, restructure could be to eliminate some of the assets and use the funds to pay down some of the debts.

Fourth, a reorganization could mean liquidating all assets and all debt and converting as much net worth as possible to cash. However, for those few situations where debt is greater than assets, the operator might want to consider bankruptcy, the main advantage of which is that there are no remaining debts after liquidation of the business.