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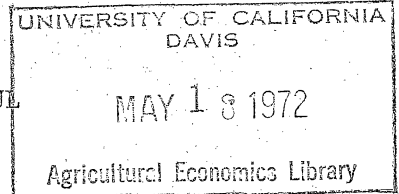
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QUESTIONS CRITICAL TO THE SUCCESSFUL
FINANCIAL MANAGEMENT OF THE FARM
FIRM-STATUS OF OUR RESEARCH
ANSWERS



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Farm financial management principles and techniques have wide application over areas of the country and types of enterprises carried. Definitive studies in this area by researchers in California can have direct and total application for Maine farmers. Farmers with similar goals, assets, and alternatives are likely to rely on the same decision methods. The stage of the life cycle of farms is similar for vast numbers of farms and the problems of farmers in each stage are similar, regardless of the location of the farm or enterprises carried.

Though research is conducted nationwide, the bulk of basic research in financial management is centered at only a few state universities. Farmers and their advisors near those universities have more ready access to published or unpublished research results than potential users outside the state. This is true, not because the information is unobtainable by distant users, but because it is generally not advertised to them and is more difficult and expensive to obtain. 1/ Farmers who live in states where research in financial management is minimal are likely at a disadvantage compared to farmers residing in states where financial management research is emphasized.

Fortunately, the Farm Production Economics Division, ERS, USDA has accepted the challenge of providing "statistical and research intelligence on the financial management practices, problems, and alternatives for farm firms." 2/ In addition to providing

some basic research itself, the Farm Financial Management Group of FPED has taken on a project of summarizing recent publications and current research projects which deal with the financial management of United States farms. The ultimate objective of this project is to provide a means for the communication of financial management research, techniques, and principles to farmers and researchers throughout the United States.

To date, an annotated bibliography [2] of recent publications and current projects has been prepared and is currently in the publication process. This bibliography includes a description of the contents of about 300 recent publications and about 50 current research projects relating to financial management of farm firms. A topic index groups the publications and current projects into subject matter areas within financial management. Also included are lists of teachers of graduate level courses in farm management and agricultural finance in the state universities. This paper, based on the above annotated bibliography, reports the areas of financial management which have generated the most interest in recent years, the areas which appear to have been over-stressed, and areas needing additional research. The paper also suggests a research focus for the future.

The Scope of Farm Financial Management

" Financial management is the managerial process applied to financial resources. It therefore partly overlaps the area generally conceded to farm production management. In general, production management concerns problems of resource organization for agricultural production, while financial management concerns itself with the financial means by which the required resources may be controlled." [1,p.1]

To make the definition and scope of farm financial management more explicit, the following categories of studies are considered to be included in the broad context:

- Financing of productive resources
- Management of capital and credit
- Income tax management
- Financial aspects induced by risk and uncertainty
- Farm corporations and partnerships
- Integration and contract farming
- Growth of the firm
- Intergeneration transfer and estate planning
- Decisionmaking and choice among investment alternatives
- Acquiring investment or operating funds
- Liquidity management
- Goals of farmers

Of course, any attempted boundary about the term farm financial management is hazy at best. Some projects and manuscripts are clearly within its broad scope, some are clearly outside its scope, and a great many others are borderline cases. Those in the last category were of necessity subjected to the biases of the author in their inclusion or exclusion in the annotated bibliography. 3/

Extent of Research in Financial Management

by Subject Area

Table 1 gives an idea of (1) the subject areas which are related to financial management, and (2) the numbers of recent publications and current projects by subject area which are included in the bibliography.

Subject area headings should not be considered as mutually exclusive. A great deal of overlap exists, as should be expected, so that a given study may be listed under one or more subject areas. For instance, many of the "growth" studies also considered "financial strategies" and were listed under both headings.

Some 266 different authors and coauthors were represented in the 294 manuscripts annotated in the bibliography. Practically all manuscripts annotated appeared in the last ten years. In addition, 49 separate current projects were described and involve at least 81 different researchers in the United States. While the bibliography does not pretend to be a complete listing of publications and current projects in the area of farm financial management, it does show to some extent the interest in the topic and indicates the subject areas of greatest concern in recent years.

Most Popular Subject Areas

Table 1 reveals that the following subject areas within farm financial management seem to have been the most popular in recent years: farm corporations, financial strategies, growth of the firm, income tax management, intergeneration transfer and estate planning, investment decisions, and research techniques. In addition, 43 manuscripts and 14 current projects approached farm financial management in a broad or all-inclusive context (See the subject area "General.").

Duplication of Effort

As indicated earlier in this paper, many of the subject areas within financial management have application to farmers regardless of their location and type of enterprise structure. Duplication of effort has been apparent in several subject areas. 4/ Notable in this regard are the studies concerning farm corporations, intergeneration transfer and estate planning, growth strategies, income tax management, and financing practices of lending institutions.

In all states, federal statutes and policies form the basis for farmers' actions regarding farm corporations, intergeneration transfer, and income tax management strategies. One definitive and complete study in each of these areas made available to all farmers may be all that is needed for decisionmaking, regardless of their location and enterprise alternatives. Yet state and federal

institutions conduct research projects and publish manuscripts which add little to information already available.

Once written, the above types of studies do not require updating until federal and state laws are altered or institutions affecting farming change significantly. Other subject areas in farm financial management in which the above concepts apply included accounting, budgeting, and cash flow practices; contractual arrangements for resource acquisition; partnership agreements; characteristics of lenders and borrowers; futures trading strategies; insurance programs; and investment decision techniques. These are areas in which additional descriptive work may be largely duplicatory of past efforts. 5/

Emerging Areas of Research

An area of research which seems to be emerging and gaining interest is the study of the financial management practices of firms at each stage of their life cycle--beginning, expansion, consolidation, and transfer. Traditionally, research has considered these stages individually in isolation from the other stages and almost no effort has been expended in studying the transition of firms from one stage to another. By far the greatest effort has been in studying the beginning and growth stages. What is needed is a decision process for each stage which has later stages in mind so that the utility of a farmer can be maximized over the total life of his firm.

Methods of transferring an estate to the next generation have been adequately expounded but little research has been done in determining "safe" methods of gradually consuming or disinvesting in an estate over the last 10 to 15 years of the expected life of the owner. This area had been alluded to in publications involving intergeneration transfer and estate planning, but we have not noticed a definitive study of workable methods of disinvestment

for farm firms. 6/

The financial management aspects of internalizing the costs of production of agricultural commodities heretofore borne by society, such as environmental pollution, have emerged in recent years. The changes in financial structure of the firm resulting from both the acquisition costs of pollution control devices and the expected increase in annual operating costs should provide fruitful areas of study in financial management.

Organized and coordinated research is needed to determine the financial implications to farmers and supporting institutions of (1) completely mechanized farms in the future, (2) controlling weeds and insects without chemical pesticides, (3) the shifts in resources and products as a result of the development of substitutes for certain agricultural products such as milk, beef, cotton, wool, etc., and in general (4) adaptation of modern agriculture to future conditions of input and product prices.

An interesting area now becoming relevant is the study of the effect on the structure of farms should the farmer satisfy his total loan needs at one lending source. This area becomes doubly interesting when the farmer's loan is based on income earning potential rather than on physical collateral. 7/

The bibliography contains references to the current dialog of needed research in financial management as well as to completed studies and research projects underway.

Concluding Remarks

In summary, let us list six basic questions important in the successful financial management of an individual farm and briefly indicate whether past or current efforts are answering these questions. (1) What are the immediate and ultimate goals of the farm manager? Of all questions listed below, this one is the most important, since if an answer to it is found, then answers to

the remaining questions are immediately obvious. Yet, of all questions listed, this one is characterized by the least emphasis in terms of effort expended and therefore the least useful information obtained. Economists are not trained to fathom the mind of farmers and require the assistance of anthropologists, sociologists, psychologists, and others in this area.

(2) How shall the farm be financed and operated in each stage of its life cycle--establishment, growth, consolidation, and transfer? Research on this question has taken the form of isolating the stages and studying each--hence growth studies, beginning farming studies, intergeneration transfer studies, etc. Little effort has been expended on studying the transition between stages or the life cycle of firms in its entirety.

(3) What organizational structure is most conducive to accomplishing the goals of the firm? Since researchers have had to guess at the goals of the farm operator, they have approached this question by describing the advantages and disadvantages of each conceivable organizational form. Researchers have said to the farmer, in effect, "Here are your choices, pick the one you want." This approach has been effective and the question has been adequately researched, given the level of information on farmers' goals.

(4) What information systems and accounting practices will be required to successfully manage a modern farm? This area has been and continues to be one in which considerable effort is expended. University farm account projects with individual farmers have kept at the forefront in this area.

(5) What criteria should be used in choice among investment alternatives? Again, with farmers' goal structure largely undefined, researchers have had to improvise in this area by assuming the goal of strictly economic profits as the criterion for investment choice. Past and current research, under this assumption, is fairly extensive both within and outside of the agricultural

economics profession.

(6) What sources of capital will be useful in accomplishing the goals of the farm organization? Studies of credit institutions and farmers' debt attitudes are numerous. However, each time conditions change such as institutional innovations and interest rates, the rules of the game change making some of these studies less useful. Research organizations at all levels--U.S. Department of Agriculture, State Universities, lending agencies, and other institutions--tend to keep abreast of this issue.

It is, of course, easy for us to make observations of this type with an annotated bibliography at our fingertips. It points up the need, maybe, for summarizations of this type in additional areas of agricultural research.

Table 1.--Farm financial management research projects, published and in progress, by subject area ^A

Subject area	Published manuscripts:		Current projects	
	Number	% of total	Number	% of total
Accounting practices-----	5	2		
Allotment transfers-----	4	1		
Borrower characteristics-----	11	4	4	8
Budgeting and cash flow-----	10	3	2	4
Computerized farm records-----	3	1		
Contracts-----	2	1		
Land purchase-----	6	2		
Production-----	7	2		
Corporations-----	24	8		
Economies of size-----	6	2		
Farms in the future-----	9	3		
Father-son agreements-----	6	2		
Financial strategies-----	26	9	9	18
Financing resources-----	8	3		
Irrigation-----	3	1	1	2
Land-----	3	1		
Livestock-----	9	3	1	2
Machinery and equipment-----	3	1	3	6
Financing from lending institutions	11	4	1	2
Futures trading-----	3	1		
General-----	43	15	14	29
Goals-----	6	2	1	2
Growth-----	50	17	19	39
Income tax management-----	19	6	1	2
Information systems-----	3	1		
Insurance-----	8	3		
Intergeneration transfer and estate planning-----	19	6	4	8
Investment decisions-----	30	10	2	4
Large-scale farms-----	6	2	2	4
Leasing and custom hiring-----	2	1		
Land-----	9	3	1	2
Livestock-----	2	1		
Machinery and buildings-----	7	2	1	2
Measuring financial success-----	2	1		
Merchant-dealer credit-----	3	1	1	2
Research priorities-----	3	1	1	2
Research techniques-----	22	7	1	2
Risk and uncertainty-----	7	2	1	2
Starting farming-----	4	2	4	8

^ANumbers refer to manuscripts and current projects actually described in the annotated bibliography on farm financial management [2]. Some discretion

was used by the author in deciding which manuscripts and current projects fell into the general category of farm financial management. The subject areas listed were selected as best describing the content of the manuscripts chosen for inclusion in the bibliography. Some manuscripts or current projects are listed under more than one subject area. The category "general" includes manuscripts and current projects which were not specific enough to be included under one of the other subject areas and/or which approached financial management from a broad viewpoint.

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Footnotes

* Agricultural Economist, U.S. Department of Agriculture, Economic Research Service, Farm Production Economics Division, Washington, D.C. The Views expressed are those of the author and do not necessarily represent those of the Economic Research Service or of the U.S. Department of Agriculture.

1/ For instance, county offices seldom carry copies of out-of-state publications even though they may apply and are needed by farmers in the county. Furthermore, publications lists of many land grant universities offer free publications to state residents but require a fee from non-residents for the same publications.

2/ This quote is taken from the functional statements of the Farm Financial Management Group, Agricultural Finance Branch, Farm Production Economics Division, Economic Research Service, dated October 22, 1969.

To continue the quote:

"This includes: Analyses of financial objectives of farm operators, attitudes towards means of achieving those objectives, and how these are changing; analysis of financial management practices common to important groups of farmers, including methods of acquiring access to services of financial and capital resources needed for production; analyses of changing, emerging and potential financial management practices and the implications for resource use and control and for the number and size of farm firms; analyses of the roles of tax policy and other policy variables in financial management; and analyses of risk management strategies."

3/ Since the findings to be reported in this paper are a result of the assembling of an annotated bibliography, it may be useful to explain the approach used in collection of the manuscripts and information involved. The land grant colleges were the basic source of information. Other institutions providing information include the American Bankers Association, certain Federal Reserve Banks, the Farm Foundation, some nonland grant universities, and private firms. The Current Research Information System of the U. S. Department of Agriculture (CRIS) provided some information on current projects, though most of the information used was

from researchers themselves. Letters were written to heads of departments of agricultural economics and leaders of economic research departments of other institutions to obtain publications, lists of publications, and names of researchers interested in farm financial management. Letters were then written to individual researchers requesting manuscripts and descriptions of current research efforts in the area of interest. The response was very good.

4/ Duplication of effort would be justified, in an efficiency-minded society such as ours, if out-of-state extension publications were unavailable to interested users by reason of policy or lack of advertizement. To some extent publications are unavailable for both of these reasons. Hence, the duplication of effort. Other reasons for duplication of effort may be the failure of researchers in conducting thorough literature reviews or failure of the system to disseminate information regarding past and current research efforts. Additional efforts by the Federal Extension Service or Economic Research Service in communicating research efforts of state and federal projects would be useful in this regard.

5/ This does not imply that continued dialog regarding appropriateness of principles and procedures, and suggested applications of some to farming, are not needed. It does imply that continued descriptions and listing of advantages and disadvantages of various financial management practices are largely duplicatory.

6/ However, a notable study in this regard appeared this year by Lee and Brake [3].

7/ Section 1.9 of H.R. 7138, a bill currently before congress, provides concerning Federal Land Banks that"---- credit factors other than the ratio between the amount of the loan and the security value shall be given due consideration." This opens the way for loans being made based on income earning potential. This bill would also allow the FLB to relax the loan limitation of 65% of appraised value of land, provide for varying interest rates, provide loans for rural housing (even to non-farm rural residents), provide loans for farm related services, participate as a second mortgagor on loans, etc.

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3. Lee, W. F. and J. R. Brake, "Conversion of Farm Assets for Retirement Purposes" Research Report 129, Michigan State Univ., Jan. 1971, 12 pp.