MANAGING FINANCES ON PRIVATE LIMITED COMPANY FARMS

by J.E. Peill

Farm Owner, Canada

Since in principal there is little, if any, difference between the financial management of a privately owned farm or private limited company farm, let me first deal with those areas which are common to both, then with some areas which are different.

The basic objective of any business in our society is optimum returns for the different inputs, all of which can be boiled down to dollars and cents. Farming as a way of life, as a hobby, or as a means to keep potential unemployed persons under-employed and in poverty on the land away from the cities, as our governments attempt to do, as political expediency seems to dictate, clearly does not fall under the definition of farming, nor is this method of utilizing potentially scarce land resource likely to produce the needed food which a hungry world requires.

We farmers must, therefore, calculate just as sharply or possibly sharper, as any other business; whether we are incorporated or not, makes, from that standpoint, little difference.

Financial planning is nothing but a logical consequence of short and long-range production planning. Unfortunately, in most cases the freedom of choice is limited by existing production systems, soil or climatic conditions.

I know of few farms which have started without being handicapped by a production system or method already carried out by the predecessor or the present operator himself. As much as the operator may wish to change, practical considerations such as rotation, available skills, available buildings, markets, etc., are limiting factors, even if plenty of funds were available.

In addition to these problems, the farmer is dependent not only on his own meterological climate, and that in other faraway places, but also the political climate in his own and competing production areas. As we all know, both types of climate are fickle, and unpredictable.

Financial planning of a farm operation is, therefore, one of the major challenges, but as mentioned above, really only a logical consequence of a basic farm management plan, which must be objective oriented.

Farms come in many sizes, shapes and combinations, and one can only deal with principles. As any other business, we too, distinguish between short, intermediate and long-range financing, and let me add a fourth one, roll-over financing provisions.

Some of the guidelines which we have evolved and how we try to adhere to them are described in the following:

(1) Simplicity

Any operation must be simple and overseeable. If we cannot see it, at least once a day, we do not want it.

(2) Risk Distribution

(a) From a Production Standpoint:

By using different winter and spring grains we have distributed our growing risks to the point where we have not had a complete failure since we started with this program.

(b) From a Marketing Standpoint:

Winter wheat, and to some extent winter rye, find sometimes a better market in the milling or distilling industry than as feed grains, so we trade, if advantageous. If a lucrative market is not available, these grains go to our hog feed, where we have a second chance on the market place with our pigs. In the case of rye we have added as high as 30% to our finishing ration.

Our hog output consists of weekly shipments; thus we automatically fetch all the highs and all the lows and end up with an average. To date, we have not used the futures market to hedge our hog prices. Up to this point we could not see where it would be of benefit to us.

(3) Workload Distribution

Naturally, a program which alls for seeding in the spring and fall, plus the use of different varieties tends to spread the workload as well.

(4) Optimum Utilization and Preservation of Resources

Land: - With our main rotation of peas, winter wheat, winter rye and corn, we make the best possible use of crop residue from previous crops, minimize the risk of plant disease, maintain soil humus and thus fertility. In fact, over the years our soil tests have shown quite an improvement in soil quality. Since weed control is required for corn and peas and spring grain only, and since in addition these chemicals are supplementary, there is no build-up of any one week species or a herbicide residue problem. The idle time of the fields, without producing crops is shortened, which means less vulnerability to all kinds of erosions, plus best utilization of the growth potential which nature provides.

Labour and Machinery Utilization: - Short of the winter months which we spend in the woods or fixing machinery, the program provides as even a workload as weather permits. The weekly hog shipments provide a fairly steady cash flow, with that portion of the returns which accounts for our own grain inputs, labour, depreciation and sometimes even profit being available to finance the current operating expenses. Our own spring and winter wheat seed grain production provides the bulk of the seed input, and in addition some extra cash during the two planting seasons in our year. Most of our buildings were erected to serve a special purpose; the few old ones have either been torn down or are used as storage, machine shop or hog barns.

(5) Availability, Quality and Cost of Essential Inputs

Any farm program would be vulnerable if it has to depend for the bulk of its inputs on unreliable supplies whose quality sometimes leaves a lot to be desired, at costs which exceed by a wide margin those of own production. For this reason we elected to produce our own feed grains and our own weanling pigs.

(6) Do not Invest Short-Term Monies in Long-Range Projects

So far we have managed to stick to this principal. I hope we can continue.

(7) We Take Advantage of Worthwhile Cash or Pre-Season Discounts

Really nothing but a good management practice, but is is surprising how much money can be saved in the run of a year by paying attention to this matter.

(8) For a Worthwhile Project, and Especially as Long as the Inflationary Trend Continues, Don't Hesitate to Borrow

We watch that we do not overstep our ability to repay, but changes are we repay with a cheaper dollar.

(9) We Are Aware of Tax Provisions

Since this matter is becoming rapidly more complicated every year, we rely on the services of a good accounting firm in our area.

Having applied all these principles and worked for a year, we come up with an audited financial statement which together with any capital development plan is then used to make a Proforma Operating Statement for the following year. The Proforma Operating Statement is broken down to a monthly cash flow which shows us exactly the anticipated needs for cash.

Our annual submission to the bank consists simply of copies of these papers. While we managed to hit the costs fairly close in the past, with the exception of last year, where all predictions were far off, the net income side usually is harder to predict. So far, our banker has understood this, and we never had trouble getting our annual credit needs approved. On the other hand, we have somehow managed to fulfill our commitments, and if we see trouble coming, the bank is the first to know. It must be clear that without the short and long-range detailed farm plan, and of course accurate record keeping, it is not possible to provide such data. We do not use the financing which might be available through various agr-businesses. Firstly, their terms are usually not very attractive; second, we find it best to work all our credit needs through one source, in this case the bank.

For immediate one to five year financing, we have so far only used the Farm Improvement Loan which again comes through the bank, but which is government guaranteed, and carries usually a better interest rate. It does not tie up any collateral other than the item purchased; thus it has no negative effect on our credit worthiness.

Let me say a few words about banking in general. We've all heard it said that banks only lend money to those who really don't need it, and sometimes I'm wondering if there is not a speck of truth in it. The main problem as I see it, is that banks do not accept land as collateral and that existing government lending institutions seldom look at land already being owned by the operator as collateral for additional borrowings. If an additional farm is purchased, however, government lending institutions do not hestitate. It is from the operator's standpoint impractical and follish to tie himself down with short-term loans for long-term investments, and in the process go through all the extra nonsense and book work which borrowing under Section 88 entails. I feel the banks should revamp their thinking to the point where they are prepared to accept medium and longrange mortgages on land as collateral, as is practiced in many other countries of this world.

Our long-range financing is provided mostly by the Nova Scotia Farm Loan Board, and to some extent by previous owners. Roughly, our long-range financing looks as follows:

(a) 65% Director's loan to the company; this also covers the share capital provided by my wife and myself.

(b) 20% Farm Loan Board

(c) 15% - 10 to 20 year mortgages by previous owners.

From this you can see that the best method is still to have enough money of your own in the first place. Without substantial own capital, I would not know where to go for money today. Both our Federal Farm Credit Corporations as well as our Provincial loan boards, change directions as the politicians dictate. Unfortunately, the objective of pleasing as many voters as possible and the objective of maintaining a viable agriculture in the long run do not always coincide.

The private capital market is usually not interested in agriculture, since it cannot see the returns to which it is accustomed. So naturally, an industry which cannot show attractive returns has trouble financing. Using today's input costs, and today's prices, I cannot think of one single agricultural enterprise which would justify the investment on that basis. I contend that to date a good portion of Canada's high living standard has and is still coming directly out of the agriculture of this country.

In our case, we have approximately $100,000 invested per man employed; this includes myself. To operate with less would mean inefficiencies which would threaten our competitive position. Only recently Country Guide reported in a study done in the United States which showed the most efficient corn producer is a one-man operation on 700 acres with an investment of $610,000. $100,000 per man is therefore a rather moderate sum, and a sum which I'm sure will increase substantially over the next few years.

Any other business or industry calculates its depreciation on the anticipated replacement costs, if not for tax purposes then at least when establishing their much debated profit margins. I ask, where is the money coming from to replace today's $10,000 tractor with an equivalent machine 3 years from now for $18,000. What I have mentioned up to now applies really to any farm operation, whether incorporated or not. Let me now deal with the fourth part of financing, which is the area in which the incorporated family farm faces a most formidable problem in the future:

Roll-Over Financing:

The shares of an incorporated farm in this country attract capital gains tax on the death of the owner, while the same type of farm which is not incorporated does not attract capital gains tax at this time if passed on to the children and is farmed by them.

The government has apparently realized that a farm is different and, therefore, allowed unincorporated farms to defer capital gains tax as long as the farm remains in the family. The distinction has clearly been made to avoid a capital gains tax haven in public farming corporations. The disquieting facts are that those family farms who have incorporated have done so at the request and suggestion of government departments and lending institutions. Further, that it has mostly been the progressive farms who have taken that step. They are now trapped since the goal posts were changed during the game. Not only is the heir at an extreme disadvantage against the heir of an unincorporated farm, but continuing inflation will ascertain that the heir either has to accept a debt burden which, if the money is available in the first place, means he has to borrow heavily, a condition under which he cannot farm economically, or he is forced to sell a portion of his farm.

I mentioned under farm planning the importance of having a balanced operation and making the best use of one's resources as a prerequisite for efficient production. Being forced to sell any portion of a farm not only disturbs this delicate balance, but the government standpoint can be compared to cutting off the cow's udder to get the milk. The heir is thus punished far more than the amount of tax. If he is educated enough to farm in the first place, he will likely come to the conclusion that he is much better off to sell out completely and join those people who work a 35-hour week, have automatic raises and full job security. The purchaser of his farm will most likely be a real estate company or public firms like General Foods, etc., which does not die. In either case, it will mean the end of this farm operation, but it means more than that. It also means the breaking of a chain of tradition, for in my opinion, nothing is a stronger bond than that which can be passed from father to son. Seeing the possibility of passing one's lifework on to the children in such a way that they have a chance to continue jeopardized, naturally tend to affect present day planning.

To solve this problem I have no answers, only a few suggestions:

(1) Make farming attractive enough that it provides sufficient income during one's lifetime to keep the operation in tact during roll-over.

(2) Change the present law which would permit presently incorporated family farms to remold themselves back into an unincorporated farm without that being considered a sale which attracts capital gains tax, or use indexing as a tool to discount inflation.

(3) If the government feels entitled to its share not only during one's lifetime but also at one's death, then apply the principal uniformly to all land and real estate holdings, be they private or corporation owned. Provide further that taxes can be paid by way of transferring the land title to the government whereby the present owner has the option of a long-range lease, a lease which preferably should be inheritable. In this way, we would avoid the periodic butchering of viable production units and avoid penalties far in excess of the direct tax bite. We would also avoid rendering useless the work done by other government departments which are helpful in building these production units in the first place. Eventually, the government would end up owning most of the land. If it is prepared to accept the responsibilities that go with it I can see in principal little wrong with that. Whether this country is ready for this and what it might do to the dynamics of our industry is of course another question. Those who are of the opinion that there are plenty of people in the cities willing to take over farming will be sadly surprised. Once used to that kind of life, few people are willing to accept the adversities associated with earning their livelihood on a farm. One only has to look at the migration from farms today and at the average age of the active farmers. Sure, there are some who have a hankering for the land in some sort of a romantic

way. We all know these types; we also know that they are not likely to produce more food than they will need themselves, if indeed that much.

I have dwelled at length on some Federal and Provincial government policies as they affect the financial picture and management of a private limited company farm because I'm concerned - and I not alone in this - that our present attitude towards farming will more and more drive our sons and daughters off the land, and the land is bought up by large international corporations or land speculators, and at the present, as a hedge against inflation not primarily for farm production, which means that land acquires a speculative dollar value which has absolutely nothing to do with its capability to produce food and to provide a living for the farmer.

Thus, highly inflationary increases in land prices not only will prohibit the purchase of additional land for farming out of economic reasons, but if our government continues its policy of taxing our successors at these values without a penny of cash having been realized by the farmer, the consequences are quite obvious.

In short, the private limited company farm in Canada is at present certainly at a disadvantage when it is considered as a means of providing orderly business relationships and financing between members of a family, and to ensure the continued operation of a viable unit upon the present owner's death.

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MANAGING FINANCES ON PRIVATE LIMITED COMPANY FARMS

By R. Levee

Radville, Canada

A question - how many individuals gathered here to-day could tell me which shoe they put on first when they were dressing in the morning? Something that we do every day and yet have difficulty explaining. This is somewhat my problem when trying to explain financial management on my farm. Not to suggest that the task of managing finances is second nature for me, but that as I live and breathe management every day it is somewhat difficult to explain the exact procedure.

Financial management is an integral part of total farm management and in my case, as with most farmers, is the responsibility of one individual. For example, in the case of my farm, you are looking at the production manager, equipment manager, sales manager, personnel manager, tax manager and financial manager all rolled into one. So please forgive me if I tend to approach the subject from a somewhat broader scope than the title would suggest.

First, I would like to tell you a bit about our farm. The farm is located in South-Central Saskatchewan, some thirty-five miles from the U.S.A. border. Forty year average annual precipitation is approximately 15", with a low of 5.98" in 1934 and a high of 22.18" in 1965. The current year is very wet and it looks like we could be setting a new rainfall record.

Our farm is a "straight grain" farm with approximately 3300 acres under cultivation. Normal cropping plans call for 1700 - 2000 acres seeded each year with the balance followed. Crops include hard, utility and durum wheat, barley, flaxseed, and rye. Relative acreages of each crop would vary from year to year depending upon marketing conditions, but a normal balance would be about 70% wheat - 30% coarse grains and flax. Summerfallow crop yields would be in the following range:

Wheat	- 20-30 bus./acre
Barley	- 30-55 bus./acre
Flax	- 10-20 bus./acre

Most of the production is marketed through the elevator system. Variable quantities are marketed each year as pedigreed seed. Approximately 30% of the acreage is devoted to the production of pedigreed seed.

Financial Resources

The availability of capital exerts a significant effect upon financial decisions. To this end I would like to summarize briefly some of the major sources of capital for the Private Limited Company Farm.

CHARTERED BANKS & CREDIT UNIONS provide short and intermediate term credit. Operating loans required for seasonal operating needs are usually established on a demand note basis with the interest rate tied to, and fluctuating with current rates. Intermediate term credit includes loans for a term of up to ten years for the purposes of purchasing equipment, livestock, or making minor improvements. The item purchased is usually offered as security for these loans and interest rates are usually fixed for the term of the loan. Banks and Credit Unions are also a source of mortgage money for land purchased with terms ranging from ten to fifteen years.

RETAIL CREDIT is available through dealers and suppliers and is available for just about any purchase. Term of loan is usually relatively short (1 - 3 years) and interest rates are high. Security is either the item purchased or the crops and livestock that are being produced.

THE FARM CREDIT CORPORATION - A Federal Government Agency, provides long term credit for land purchases or major improvements. Loans are available for a term of up to twenty-nine years with a mortgage offered for security. Interest rates are fixed for the term of the loan and are usually somewhat lower than commercial rates.

MORTGAGE AND TRUST COMPANIES play a minor role in the provision of long term credit. Because of the cyclical nature of the agricultural industry their lending is at a minimum and usually confined to the more productive areas of the province.

EQUITY FINANCING by shareholders can be an important source of capital for the Limited Private Company Farm. In our case, however, as with most other situations that I am familiar, equity financing is usually restricted to "family" members. The use of redeemable shares can provide an excellent vehicle for transferring the family farm from one generation to another.

Problems Facing the Financial Manager

Time will not permit me to summarize all the problems encountered by the financial manager. However, most of the problems we face are caused by the nature of our industry.

Firstly, the Agricultural Industry is a very cyclical industry. In the longer term a decent income can be realized from grain farming, but it is the short term swings that create the problems. Most of this cyclical effect is due to factors over which the manager has little, if any, control. Marketing opportunities and prices for grain result from international conditions and, as we have just recently experienced, can result in the price of wheat going from $1.50/bus. to $5.50/bus. and back to the $4.50 range in a relatively short period of time. For example, in my situation during the period 1970 to 1973 while production remained fairly constant the cash receipts on my farm varied 510%.

Problems that can be directly attributed to the cyclical nature of the industry include:

- difficulty in making regular payments to credit suppliers during a major down cycle.

- credit suppliers become unco-operative during a major down cycle. History has taught that is usually time to invest when the industry is depressed because of the fact that good buys are available. However, because everything is depressed, money is also in tight supply. A competent financial manager must convince his credit suppliers that investments made during this period will be profitable in the long run.

- conversely to the previous point the financial manager must be on guard against over-optimism during a major up cycle. Investments made on the basis of $5.00 wheat might create problems. Good buys become scarce as farmers get the heady feeling that prosperity will last forever.

A second characteristic of the industry which creates problems is the time lag between production and sales. During periods of low sales it is not uncommon to store grain for 2-3 years before being able to sell it. This can create havoc with repayment of operating or short term credit. Monies borrowed in the spring for the purchase of fertilizers, chemicals, and seed might be tied up for an indefinite period. Credit suppliers usually find it very difficult to understand why these short term loans cannot be repaid on time.

<u>Role of Financial Manager</u>

Recognition of problem areas is probably the financial managers first and most important task. Problems require decisions, but before logical decisions can be made the manager must have a crystal clear picture of the problems. Problems can be recognized either before or after the fact. Successful management involves recognizing a majority of problems before they occur.

A comprehensive set of accounts and records will provide much of the information required for early recognition of problem areas. Analysis of records will provide cost data, income trends, debt carrying capacity; and much other invaluable data that is absolutely essential for pinpointing problem areas. Once problem areas are isolated it is the role of the financial manager to plan and budget out various alternative solutions.

A systematic approach to planning will make the task of decision making a lot easier. Formal budgets should be prepared, carefully examining various alternatives. Assumptions should be questioned and all variables should be carefully weighed. Unlikely alternatives should be eliminated. Selection of a course of action is frequently the result of elimination of several unlikely alternatives.

For what it is worth I would like to describe my approach to financial management and decision making. During the winter months records are carefully analysed and scrutinized. Long term goals are carefully scrutinized and changes are made if felt necessary. An annual budget is then prepared setting out plans for the coming season. Partial budgets are used to examine contemplated changes in the annual plan and to eliminate less likely alternatives. An annual cash flow is then prepared setting out the credit requirements for the coming season. Credit needs are separated into short, intermediate and long term categories. Credit suppliers are contacted and plans are discussed. By early spring plans begin to crystalize as the busy season arrives.

Spring, summer and fall are busy seasons and leave little time for pencil farming. Daily financial decisions must be made but, all are related back to the annual plan. Change is the name of the game - prices change, marketing opportunities change, interest rates change, weather is variable, grasshoppers appear, plant diseases occur, and plans must be revised as the season progresses. Careful budgeting will lessen the probability of incorrect decisions being made.

With regards to planning someone once said that even if you are on the right track - you will get run over if you just sit there. This expression points out the dynamic nature of management and illustrates the need for continual planning.

To briefly summarize the role of the financial manager it could perhaps be said that the ABC's of financial management are, Accounts, Budgets and Common Sense.

Accounts and records provide the information so essential to sound planning.

Budgets provide a systematic approach to decision making and;

Common sense is the ingredient that will temper all management decisions with the logic that is so essential for success.

FINANCE FOR PRIVATE LIMITED COMPANY FARMS

By R. Bruce

Midland Bank Limited, U.K.

A Credit Supplier's View

A Limited Company, in U.K. terms of definition, is an association of persons incorporated under the Companies Act 1948, or one such similar earlier Act. As such, it has a legal entity quite apart from its members. The most common type if the Company limited by shares in which the liability of each member is limited to the amount unpaid on the shares held by him. Once his shares are fully paid, he has no further liability.

It is possible, however, to have an "unlimited" company with no restriction upon the extent of the financial responsibility of members for the debts and liabilities of the company.

Companies may be either "private" or "public". The private company has limited powers, these being defined in the Articles of Association, usually as follows:

(1) the right of the individual member to transfer his shares is restricted.

(2) the number of members (excluding employees and former employees) may not be more than fifty, but must be more than two.

(3) no invitation can be issued to the public to subscribe for shares or debentures.

Each company must have a Memorandum of Association which sets out clearly the objects of establishing and operating the corporate body. It is, in fact, the Company's charter, for it also defines any limitations of its powers.

The Articles of Association establish the powers of directors and members and, normally, they contain many rules and regulations governing the internal working and management of the company.

The fact that there are many legal requirements and hence, restrictions upon the formation and operation of a company, make it easier to open a bank account for an individual rather than a company. In the latter case, the Bank requires the following documents for perusal and record purposes:

(1) The Company's Certificate of Incorporation. This is evidence that all the requirements of the Act in respect of Registration have been compiled with.

(2) The Company's Memorandum and Articles of Association. Careful and detailed examination of these is essential.

for they will establish the Company's power to borrow, give guarantees and to charge security. Similarly, the directors' powers, acting as agents of the Company, will be defined and restrictions noted.

(3) A certified copy of the resolution, approved by the Board of Directors, appointing the Bank as the company's bankers (noting that there may be more than one banker).

(4) A mandate covering all banking operations relating to the company's account. This will incorporate the names, and designated offices of those persons authorised to sign cheques, endorse, and accept bills of exchange.

From the banker's point of view, it must be clearly established that the company has power to borrow and to give security for that borrowing. Memoranda occasionally place a limit on the company's borrowing powers and the banker who lends in excess of these figures can be in a highly embarassing situation. If the company repays the loan, it is easy, but where it is unable or unwilling to do so, problems arise.

Another problem may also arise when a loan is made to the company in excess of the director's borrowing powers. To regularise the situation, the banker may ask the directors to call a general meeting with a resolution on the agenda to ratify the excess. Provided that the figure is within any defined limit on the total borrowing of the company, there should be no problem in undertaking this action. If outside this figure, the company could repay the loan if the lender can show that the transaction was within the director's ostensible authority. Failing this, the lender may bring an action against the directors personally for breach of warranty of authority.

The prudent banker, having identified a limiting clause in memorandum, will call for a special resolution to remove it, with a copy being sent to the Registrar of Companies. If such a resolution is excluded by some other clause in the Memorandum, the lending ought to be on a "loan account" basis to prevent excesses over the "limit", Excesses permitted on "current account" will be the responsibility of the banker.

Inevitably, the banker will enquire as to the purpose for which the borrowed money is to be used and he must naturally ensure that this is consistent with the company's objects as defined in the Memorandum.

All of these factors relate to problems which may arise in lending to a limited company. It would not, however, be correct to assume that a bank necessarily prefers to lend to a sole trader. In the event of potential insolvency/bankruptcy, it is easier for the lender to step in under a floating charge on the assets of a limited company than to exercise similar powers under an Agricultural Charge (under the Agricultural Credits Act 1928) on the assets of a sole trader. Although in essence, the actions are identical, the latter course is highly emotive and often leads to severe criticism in the local community. This may be illogical but nonetheless, whilst the individual can be identified, the company structure is impersonal.

When looking at any proposition to lend to a limited company, the lender has to enquire as to the reason for its formation. Was it formed to reduce taxation demands or to safeguard individual investment in a risky project? With liability limited to the extent of the shareholding, it is relatively simple to operate a "high risk" business - a proposal which a prudent banker would wish to avoid unless he was prepared to take a share of the equity and thus improve his returns.

One of the first steps taken by the banker would be to examine the balance sheet to ascertain the issued capital and to look at this relative to the balance of the revenue account and the revenue reserves. If the latter were proportionately very high, the banker might ask the company to capitalise part of the reserves by a shares issue, thus ensuring greater responsibility and financial involvement upon the part of the members. He would obviously wish, in a private company, to see the "active" members, i.e. those closely involved with managing the company's affairs, having the greatest proportion of the shares. The balance sheet would also give him an indication of the balance of the business, having particular regard to the undernoted ratios:

(1) fixed capital to working capital - the higher the ratio, the greater the problems.

(2) current liabilities to current assets - i.e. the ability to meet current requirements. In this context borrowing from a bank must be regarded as a current liability being recallable on demand unless the lending is on a term-loan basis.

(3) current debtors and sundry creditors to sales, i.e. the extent to which credit is given and taken relative to the income of the business.

(4) sales to current assets - to assess whether the company is over-trading.

(5) net assets to overdraft - less than 2:1 calls for close examination.

(6) net profit to tenants capital employed - less than 15% and one is concerned.

Over and above these factors, must be the extent to which provision has been made for taxation liabilities. Special rules govern advance corporation tax and tax incurred on profits not distributed. Advance tax may complicate the cash flow, although this is seldom significant in farming companies. Similarly, in the UK, where one can show that undistributed profits are necessary, either to provide for the maintenance of the business in an inflationary era or to finance reasonable and logical development, taxation is seldom levied although, in theory, it can be.

The trading record over the past, i.e. last three years, is also of great significance, not only to illustrate how well the company has used its available resources, but also to show whether the extent to which the "profit" has been derived by an upward valuation of current assets. Having assured himself that the "best use" principle is satisfied, the lenders would then wish to examine the forward cash flow budget to ascertain the size of peak borrowing and the "swing" of the account. Above all, the potential borrower, in explaining his cash flow forecasts, must be able to justify the assumptions of both income and expenditure. Undue optimism leading to excesses can only kill trust in what should be a continuing trustful relationship over many years.

Obviously the "peak" figure is the key factor unless there be a "bridging" element, i.e. where known expenditure, usually of a capital nature, is linked to known income. This "peak" factor has got to be reasonable in relation to the true capital (i.e. issued capital plus revenue reserves plus directors loans where deferrable with assets valued realistically and not historically) and to the profit earning capacity. All available security would be taken in relation to the company's assets and, depending upon the position, the directors might well be asked for their guarantees and/or for the deposit of collateral security such as a charge upon property, stocks and shares, or insurance policy surrender values. This is just a wish on the part of the bank to be adequately covered, but is a request for the directors to show faith in their own business. Where such security may not be sufficient, recourse could be had to the Government-backed Agricultural Credit Corporation Limited, for a guarantee.

I have laid stress upon the problems of dealing with a company purely because one must realise that it is not quite as straight-forward as some farmers assume. It should not, however, be construed as a suggestions that we prefer lending to sole traders - as far as I am concerned, the corporate structure matters little if the business is sound. Although I quoted many factors related to balance sheet ratios, my main concern is with the cash flow. If the assumed output and the input cost items are acceptable, and if the margin at the end of the period indicates that the business can service and meet reasonable phased repayment dues, then I will back the proposal, subject to the company giving me as much security as it can offer. The terms under which the facilities would be offered - both as to interest rates and repayment arrangements - would be similar to those for the individual borrower.

We must at this stage define more closely our attitude to repayment, particularly in the light of inflationary trends and of the banks' off-stated aims of being short-term lenders. In Midland Bank, we pride ourselves as being the "Farmers' Bank" with a team of qualified practical agriculturalists capable of assessing both the financial and the technical viability of the business. Alone, among U.K. banks, we have stated in our published literature that we recognise that, if we were to insist on reductions without relating them to the stage of development reached in the underlying enterprise or enterprises, we might be denying to our customers just that progress that we should wish to see. This being so, we are prepared to consider continuing or perhaps even increasing those facilities until such time as the customer is farming his holding to near its full potential, provided that (a) in the meantime the farmer is making profits and conserving a proportion in his business, thus steadily increasing his capital, (b) the credit he is using or proposes to use is in reasonable relation to his own stake. We believe that the application of this simple principle is of benefit to the country in that it encourages farmers to make the best use of all their resources. It helps the farmers too, for they are enabled thereby to expand their enterprises and build up their own capital, and it is good for the bank because its farmer customers become more prosperous.

This sentiment applies whether we are dealing with the individual farmer or with the limited company. This is what Farming with the Midland is all about.