# DROUGHT: Cash Flow Planning and Analysis

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# Cash Flow Budgeting, Planning and Analysis

A. Before diving into cash flow discussions with producers, I suggest first reviewing its uses:
   1. Provides the best measure of operational liquidity – the ability to meet financial obligations as the come due without disrupting the continuing operation of the business.
   2. As a projected (pro forma) statement it helps formalize the overall planning process.
   3. Assists in evaluating borrowing needs and repayment plans
   4. Serves as a financial control tool through the monitoring of actual performance versus budget projections.
   5. Formalizes the process of integrating budgets and plans for the various enterprises comprising the business.

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A. Before diving into cash flow discussions with producers, I suggest first reviewing its uses: ( cont.)
   6. Directs attention to the management of cash reserves.
   7. By formulating projection estimates for several alternative outcomes, it provides a practical tool for analyzing the impact of risk (uncertainty).
   8. Helps assess the relationship among production, marketing and financing plans.
   9. By comparing projected cash flows under current operations and modified operations, it can serve as an investment analysis tool.
   10. It does not measure profitability, a business can be going broke and cash flowing just as it can be profitable and unable to cash flow.

# Cash Flow Budgeting, Planning and Analysis

B. The biggest problem for most producers is budgeting accuracy. One study of 300 farm borrowers over a 4-year period found, on average, they overestimated cash receipts by 15 percent and underestimated cash expenditures by 17 percent. As a percent of estimated net cash flow that represented over a 300 percent error. If errors were purely a function of price and quantity variability, receipts should have been underestimated as often as the were overestimated, and the same should have been true for expenditures. The projections were either based on too much optimism, not enough good information or a deliberate attempt to present the best case scenario as the most likely.

Borrowers may be inclined to cast the best light on the situation for their lender; but, they shouldn't be kidding themselves.

## Cash Flow Budgeting, Planning and Analysis

C. Typical producers treat financial planning and analysis as a beginning and end of the year exercise, one for their lender the other for the IRS. Even them most of them see it as a chore rather than an opportunity. The most successful managers spend a great deal of time on planning, monitoring and analyzing performance. By staying on top of things they are much more likely to be prepared for things that could/do happen, and to spot problems and opportunities before it's too late.

## Cash Flow Budgeting, Planning and Analysis

D. In times of stress, it becomes even more important that producers put a lot more emphasis on cash flowing planning and analysis. I'm going to look at 3 best practices that I see many of the top 1 percent of producers employing.

## Cash Flow Budgeting, Planning and Analysis

E. What if scenarios, sensitivity analysis and contingency planning.
   1. Consider what could happen (good and bad) **and** what they would do if it did.
   2. Not limited to most likely, best case and worst case.
      a) Use judgment, historical records/experience and current outlook.
      b) Don't limit themselves to the last few years. They take the concept of "it's a new paradigm" with a heavy dose of skepticism. They tend to be less likely to be caught up in irrational exuberance or irrational fear.

## Cash Flow Budgeting, Planning and Analysis

2. Not limited to most likely, best case and worst case. (cont)
   c) They take both a long term and short term view of planning when considering scenarios.
      – For example, the 4 Ds, what if there was a major disease outbreak, what if we were denied credit, what if we lost a major lease or contract, what if output prices, land prices or yields fell by 50 percent, what if input prices doubled, what if a key employee suddenly left, what if a supplier/buyer went bankrupt……
   d) They consider/evaluate all possible risk mitigation options

# Cash Flow Budgeting, Planning and Analysis

F. Monitoring and Analysis

1. They regularly monitor variances between projected and actual cash flows down to individual line items
   a) This may be monthly or quarterly, depending on the nature of their business, and more often if unusual circumstances arise
   b) Helps identify biases and major areas of risk (variability)
   c) Better able to correct problems, capitalize on opportunities and adjust future plans (heart problems and cancer analogies)

# Cash Flow Budgeting, Planning and Analysis

F. Monitoring and Analysis (cont)

   d) They realize the main difference between the top 10 percent and the rest of the top 25 percent of producers is largely timing, e.g., when they buy, when they sell, when they enter, when they expand, when they cut back and when they reallocate.
   e) Every item in their plan is tied to a set of assumptions, so they can drill down to causes and not be focusing on symptoms.
   f) Monitoring isn't just limited to what has happened, but also to changes in the internal and external environment that may trigger adjusting future expectations and require adjusting the plan for the remainder of the planning period
      – A private business isn't like a government agency whose budget is cast in concrete

# Cash Flow Budgeting, Planning and Analysis

G. Autopsies

1. Debriefings on the results of key decisions, whether things went well or poorly (Blue Angels analogy)
2. Determine why things turned out as they did
   - What was overlooked?
   - What assumptions were wrong?
   - What could/should have been done differently?
   - Were there mid-course adjustments that could/should have been made?
   - Were there risk mitigation tools or contingency plans that could/should have been used/developed?
   - Are there any leading indicators or better information that would help in the future?

# Cash Flow Budgeting, Planning and Analysis

2. Determine why things turned out as they did (cont)
   - If they bought low or sold high were they lucky or did they have a decision process in place that can be used again. If the opposite occurred, were there opportunities missed?
   - Most important, what was learned and what are they going to do in the future, i.e., repeat or change?
3. A great team communication/learning tool and very important part of successor development.
4. Keep notes and written minutes, and develop action plans and assigned responsibilities and timetables. Procrastination is real and memories are short and selective.

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H. Closing

1. Remember, everyone exists in four states of knowledge:
   - What you know you know
   - What you know you don't know
   - What you don't know you don't know
   - What you think you know that just isn't so.
2. Douglas Adams, quote from The Breakthrough Company
   - Human beings, who are almost unique in their ability to learn from the experiences of others, are also remarkable for their disinclination to do so.