Ease your cash flow

In personal and business finance, cash flow is essential to solvency, writes Jeremy Cole.

Cash flow is the money that is moving (flowing) into and out of accounts over time. Having enough 'liquid' cash is vital to ensure that creditors, employees and others can be paid on time. Cash inflows arise from outside finance, operations or investing. Cash outflows result from expenses or investments. The level of cash flow is not necessarily a good measure of performance or profit.

Companies with ample cash 'in hand' are able to invest cash back in the business and so generate more cash and profits. If a person or business has insufficient cash to support these operations, then insolvency occurs and bankruptcy could shortly follow.

Farmers, it is always quoted, are "asset rich and cash poor". But why is this? Obviously it is an expensive game running a farm, with kit costing as much as a house and the cost of input seemingly a function of the wheat price. Many farmers I speak too run on an overdraft, which is expensive to fund and stressful to have hanging over the business, especially in a year like this where crops and production look markedly dodgy.

But there is perhaps a solution, or part solution to this… and it's near to hand. The crops in your barn.

How many farmers store grain for 3, 6 or even 11 months? Those at the longer end of the spectrum I'll discount as they obviously have very good cash flow or other businesses funding farming and making it possible to hold income from one financial year to the next. Most farmers do store grain from harvest to the spring, 6-8 months, most will have an overdraft operating.

The thing about combinable crops now a days, is that they are of high value, 100-300% higher than 10 years ago, so the value of the crops in store is massively higher than they were and the 'Value at risk' (VaR) is much higher too.

VaR is a technique used in business to measure and quantify the level of financial risk within a firm or an investment portfolio over a specific period of time. The risk manager's job, in this case the farmer's, is to ensure that risks are not taken beyond the level at which the firm can absorb the losses from a probable worst outcome.

A 1000t store of wheat now has a value of £200,000, ten years ago that would have been £60,000. This means there is £200,000 worth of cash flow frozen in the shed, waiting and hoping for a capital gain over time.

The cost to store it from August to April must be at least £1/t, so let's say £10-15/t in total. So the wheat market needs to rise by that amount to have made it worth storing. If the market falls, then there is a double whammy of the cost to store and capital loss in value.

So why not just sell the wheat at harvest or by end October? It would release that £200,000, reduce/remove the overdraft, give the farmer an empty shed to use/rent out and remove the worry of looking after an expensive asset.

Worried about the wheat price rising after a sale? Apply a wheat hedge for approx. £10-15/t, and benefit from any market rise, which is the cost of 'self storage' anyway but has the added advantage of not having the downside costs associated with a falling wheat market.

Simple, easy and worry free.

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