READING THE SIGNS OF BANKRUPTCY

BY

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During a crisis such as the one in the grain industry, failing farms reach closing stage without the option to withdraw. Even then, most farms are left to bleed dry rather than die quickly and painlessly, writes Dr Philip Theunissen of Computus Bestuursburo.

A FARM in the midst of financial difficulties does not get sequestrated summarily. Although technically already bankrupt, there is always the excuse of a crop that's due that will pay all the accounts, or some remaining cattle that will be sold to put food on the table. Unlike a failed business concern that gets sold within three months, matters could easily drag on for five years before a failing farm eventually receives the mortal blow.

The current maize crisis will place many farms in this position. The low prices will firstly lead to many farmers being faced with abnormally high levels of overflow debt that, in view of the poor price prospects, will prevent them from planting new summer crops. Simply put, farmers inform their creditors that they do not currently have the funds to pay their accounts, and that the possibility also exists that they will also not be able to pay their debt the coming twelve months.

Profit index

Why are there then still farmers in the midst of this crisis that can still farm successfully and pay all their accounts? That can only be answered when one looks at the definition of a successful farm. A successful farm is one that can, regardless of its size or what is being farmed, still generate sufficient income to pay all inputs (raw materials, capital and labour), while showing a surplus to boot.
This ability can be established by a resource index, measured by the equation:

> RI = GPV/ (GPV – MR) where:
> RI = Resource index,
> GPV = Gross produce value which is the Rand value of the activities for the farm,
> and
> MR = Management return or the return over all costs, including a charge for unpaid labor and owners' equity. The management return can be thought of as pure profit.

If the index is higher than 100%, it means that the farm had more income than expenses and there was also a surplus. An index of under 100% means that the applied resources couldn't be recovered from the income. A successful farm thus has a resource index of more than 100%.

The included graphs illustrate the resource index of 40 eastern Free State farmers as part of Computus' study group. The figures were based on five years' average results from 1 September 1999 to 31 August 2004, therefore it does not include the production year of 2004/2005 with its low maize price.

The figures were sorted from high to low according to the resource index. The highest index was 213% while the lowest was 56%. Five farmers had an index of or below 100%.

Correlations

If there are factors why some farmers are more successful than others, it will emerge when the resource index is compared to, for example, land use or turnover. Figure 1 indicates that there is only a slight relationship between the size of the farm and its success. Farmers that farm on a larger scale are according to the trend line slightly more capable of paying their expenses than smaller-scale farmers, while land ownership versus hiring land has no effect on the resource index.

Turnover size also does not indicate a correlation with the resource index, just like Figure 2 indicates that the composition of produce (livestock versus crops) shows no connection with the success of a farm. It is however true, and rather a result than the cause, that the profitability and solvability of farmers decrease as the resource index decreases (Figure 3). Figure 4 similarly indicates that interest as a percentage of turnover escalates as a farm becomes less successful.

Causes

The physical composition of the farm is in no way a recipe for success or failure. It's rather determined in the manner in which the farm is managed. American agriculture economist Prof Danny Klinefelter mentions a few causes, which can be reinforced by a few additions. Ultimately the ten most important causes why some farmers fail their farms in terms of poor management are as follows:

- **Slackness or lack of discipline:** As managers, some farmers know what they are supposed to do, but are simply too slack and cannot discipline themselves to apply the correct management principles.
- **Timeousness:** Some farmers apply the correct management methods, but always run just a day or a week behind with their activities. Plant a week too late, treat a sick cow a day too late, or fix their grain prices a week too late.
- **Time management:** Some farmers are too busy with unproductive things. Eighty percent of their time goes to 20% less critical activities, while 20% of their time goes toward 80% of the critical activities.
- **Standard of living:** Homes and private cars are unproductive assets and therefore those costs form part of the farmers' management remuneration. The higher the cost, the more pressure on the resource index.
- **Greediness:** As soon as some farmers achieve success with a certain enterprise, they purchase more land to make more money with larger volumes of the same enterprise. The following season the prices or yields are usually not as high, which means that the enterprise cannot justify the new developments.
- **Keeping records:** Farming is being done without proper information. Some farmers think that their farms are generating a lot of money, but proper record-keeping would probably have indicated that self-produced maize is not for free.
- **Lack of judgement:** Management practices are good, but misjudgements are made during calculations being projected on export income.
- **Adaptability:** Some farms aren't sufficiently diversified to adapt to the changing market or climate conditions.
- **Ignorance:** Some farmers do not have sufficient know-how on managing their farms within continuously changing circumstances.
- **Stagnation:** Some farmers get stuck in obsolete management practices of ten years ago and don't realise that new technology and improved practices have been developed since.

Indications

Looming bankruptcy doesn't suddenly overpower farmers during the night while asleep. It does in fact occur in a slow manner while farmers are aware, and the indications are quite noticeable:

- Creditors are continually pressurising and threatening them for payments.
- Their loan balances continue to increase.
- They enter into new debt to pay off existing debt.
- They extend the repayment terms such as a small or no deposit over as long as possible repayment period.
- Repayments are made late and only the minimum required amount is paid.
- Loan repayments are being rescheduled for a later date.
- They cannot pay their VAT.
- They sell loose assets privately for cash to pay private expenses.
- They borrow money from friends or family without making a set repayment arrangement.
- They purposefully makes errors on cheques to win time for a second cheque.
- They have many queries on the accuracy of amounts on account statements or requests for duplicate invoices.
- They say the cheque is in the mail.
- Various rumours are in circulation about their financial position.
- They become aggressive or elusive when talking to about money.
- They refuse to speak to their creditors, are always in meetings, never call back or refer the matter to somebody else such as the accountant or office assistant.

When the farmer feels overwhelmed by debt, a thorough analysis of the financial situation should be done. The question that needs to be answered is if the resource index is above 100%. If not, the farmer should try to increase income, decrease expenses or restructure debt. If that is impossible, assets must be sold or an agreement should be formed with the creditors. If these options do not offer a reasonable chance for financial survival, sequestration is an unavoidable consequence.

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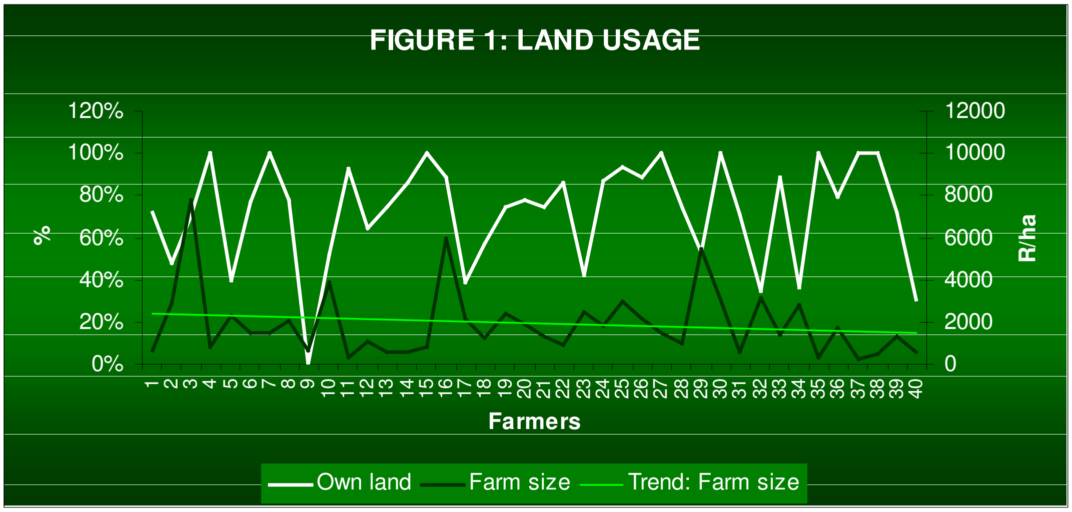
FIGURE 1: LAND USAGE
%
R/ha
Farmers
Own land
Farm size
Trend: Farm size

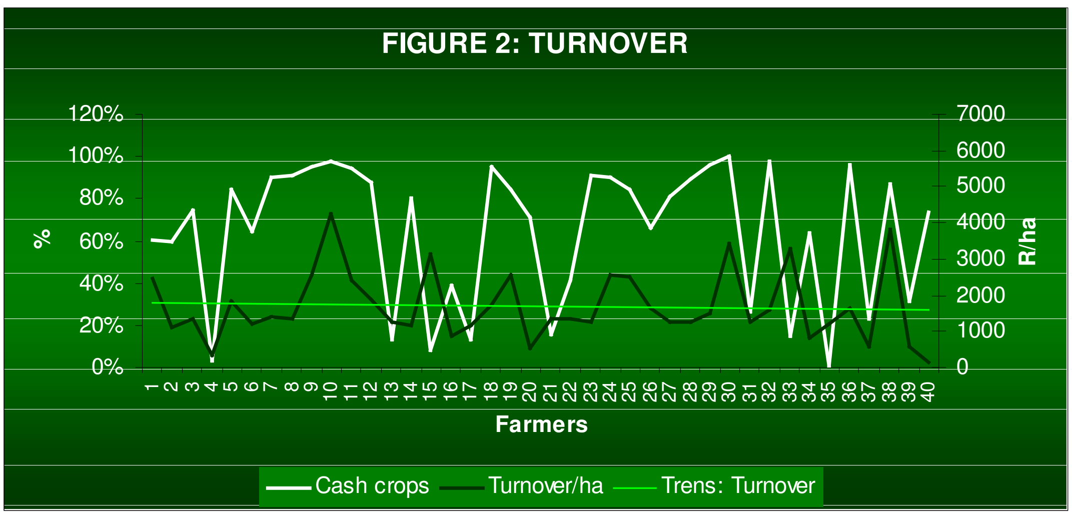
FIGURE 2: TURNOVER
%
R/ha
Farmers
Cash crops
Turnover/ha
Trens: Turnover

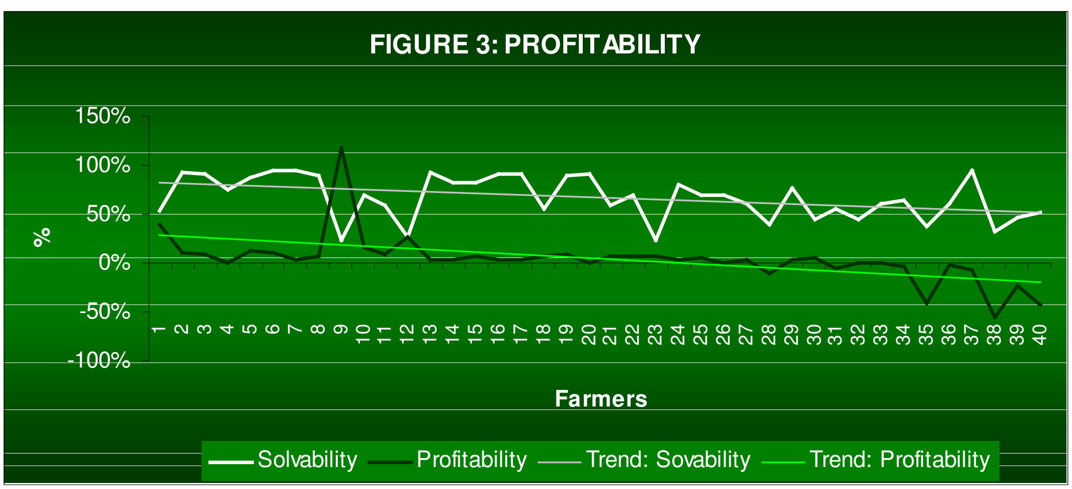
FIGURE 3: PROFITABILITY
%
Farmers
Solvability
Profitability
Trend: Sovability
Trend: Profitability

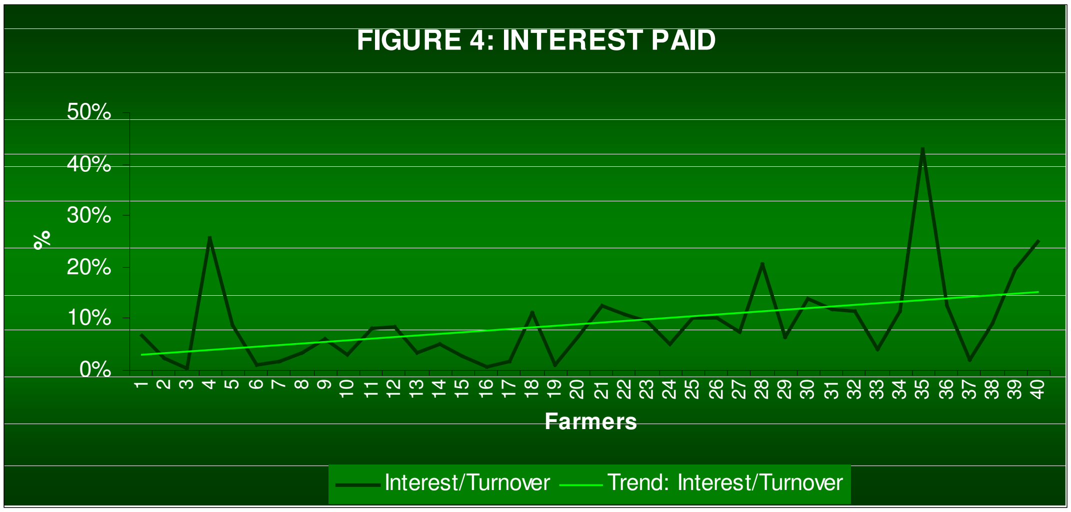
FIGURE 4: INTEREST PAID
50%
40%
30%
20%
10%
0%
%
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40
Farmers
Interest/Turnover
Trend: Interest/Turnover