

## RANCHING FOR PROFIT

# MANAGING CASH FLOW

There are three basic questions we need to think about when it comes to money in our businesses:

1. Is it profitable? (economics)
2. How will I pay for it? (finance)
3. What are the tax consequences?

This is the order in which we should ask the questions. If a venture isn't profitable, the financing should be irrelevant. It doesn't make any sense to finance a losing proposition. If the business is profitable, and we've created adequate cash flow, then we should take steps to minimize taxes. Too often we ask these questions in reverse order and in our efforts to minimize taxes make questionable economic or financial decisions.

Sometimes financial constraints limit economic opportunities. For example, if an investment pays big dividends in several years from now, but doesn't provide short-term cash flow we may find it hard to put food on the table now. But frequently the constraints are self-imposed and result from not recognizing the time value of money or being unwilling to manage cash flow.

Here's an example. A rancher recently told me that he needed to maintain a spring calving herd and a fall calving herd so that he had income twice a year instead of once a year. He acknowledged that it would probably be more profitable to shift to one herd, but said he needed income twice a year to make their loan payment. This isn't a problem of two paychecks versus one. The problem is ignoring the time value of money and failing to manage cash flow.

### ***Time & Money***

Which would you rather have: \$120,000 today, or \$10,000 a month for the next 12 months? Using simple interest at a rate of 10%, the \$120,000 paid today would be worth \$132,000 a year from now. The \$120,000 paid over the next 12 months in equal installments would be worth about \$125,500 at the end of the year. I'll take the money up front please.

### ***Managing Cash Flow***

Managing cash flow begins with creating a cash flow budget that projects income and expenses for the year. At the Ranching for Profit School we teach participants how to construct a cash flow including one income column

<b>Cash Flow</b>				
	<b>Income</b>	<b>Overhead Costs</b>	<b>Direct Costs</b>	<b>Capital Expenses</b>
<b>JANUARY</b> Budget				
Actual				
Difference				
Cumulative Difference				
<b>FEBRUARY</b> Budget				

per enterprise, several columns for overhead costs, several for direct costs, and at least one for capital expenses. We use four rows for each month. The first row is to record the budget for each income and expense item. A good time to prepare the budget is after weaning and preg-checking in the fall. The next row shows the expense for each item that was actually incurred that month. This should be completed as soon as figures are in for that month. The next row simply shows the difference between the budget and the actual expenses for that month and for the year to date.

The cash flow clearly shows periods of cash surpluses and shortages before they occur and can help you determine how to manage through these periods. It will help determine if, when and how to use short-term financing. But the cash flow is more than just a page of income and expense figures. At the *Ranching for Profit School* we refer to the cash flow as *“the minutes of the production meeting, written in dollars and cents.”* The plan communicates precisely what is planned to partners and workers. It shows when you expect sales to occur, and when you anticipate making major purchases. It will also help you determine the tax consequences of your plans well before the taxes are due.

The cash flow plan is more than just a budget. In fact, the greatest value of the cash flow is not the plan itself, but the process of completing it. The thought that goes into assessing various management alternatives is much more important than the sheet of paper (or the computer screen) that holds your projections.

The cash flow is also a monitoring tool. By updating it each month to show the actual movement of cash into and out of the business it will send up a red flag warning as soon as there is a significant deviation between the budget and actual income and expenses. Used this way, the cash flow becomes an essential tool if you are Ranching for Profit.

David Pratt, of Ranch Management Consultants, teaches the Ranching for Profit School. For more information visit <a href="http://www.ranchmanagement.com">www.ranchmanagement.com</a> , or contact him at 707-429-2292 or e-mail: <a href="mailto:pratt@ranchmanagement.com">pratt@ranchmanagement.com</a> .
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