# Debt – your servant or your master?




"We're hoping we can change our mountain of debt into a tourist attraction, and charge a hefty admission."

DEBT is of itself not inherently bad. In fact, most businesses cannot survive and prosper without some level of debt.

Flor-Hanly director Tony Olsen

Agribusinesses, largely due to the cost of land relative to what it may yield, often have significant debt.

Debts well into the millions of dollars are not uncommon.

**Is your debt your servant or your master?**

Most rural debt has come about through either:

- Borrowing funds for business expansion
- Buying out other business partners (normally family)
- Borrowing funds for off farm investments
- Financing cumulative cash flow shortfalls.

**Borrowing funds for business expansion.**

"Today there are three kinds of people: the have's, the have not's, and the have-not-paid-for-what-they-have's." *– Earl Wilson.*

It is very rare that a rural operation would have cash reserves sufficient to fund expansion (unless they are in receipt of a mining settlement).

Typically equity in existing assets is used to support the borrowings required and often the full amount of the new acquisition is borrowed.

It is hoped that by leveraging off the operations existing assets, increased efficiencies and 'economies of scale' will generate increased profits and cashflow sufficient to meet interest and eventually repay the debt.

"Some debts are fun when you are acquiring them, but none are fun when you set about retiring them." *– Ogden Nash.*

Unfortunately in recent years not enough focus was made on the serviceability of the debt being taken on.

Land was being purchased to take advantage of long term capital growth.

This is not in itself a bad wealth creation strategy. However, what goes up can come down (as we have now seen).

> 'Debt is like fire, a bad master but a good servant.'

It is crucial that cash flow is managed to ensure you are always in control.

Relying on increased land values to get you out of trouble and make up for cash losses is a very risky strategy.

You should at the very least be able to cover your interest.

"If you think nobody cares if you're alive, try missing a couple of car payments." *– Earl Wilson.*

**Buying out other business partners**

"I like my players to be married and in debt. That's the way you motivate them." *– Ernie Banks.*

Debt is often used to aid succession. This can put added cashflow stress on an operation.

When considering your options, you need to focus on the cashflow position you will end up in to ensure you will be able to operate comfortably. Often 'emotional attachment' can blur your vision.

A large viable operation with economies of scale may have positive cash flow and be servicing it's debt.

However, when split between family members, each new operation may struggle on their own.

**Borrowing for off-farm investment**

Typically rural operations have large equity tied up in their land.

One strategy is to use this equity to secure finance to buy off-farm investments.

Building up off farm investments is good. However, before you do, consider what cash flow pressure you will add to your operation.

If the cash generated from the investments is not enough to cover interest and repayments then the shortfall will need to be met by your rural operation.

Will this be putting undue stress on it? Don't confuse capital growth as cash income (managed investments typically blur income and capital).

Such negative gearing strategies may be great for high income earners but may not suit primary producers with limited cashflow surpluses.

Instead it may be more appropriate to focus on investments that will pay their own way (positive gearing).

**Financing cashflow shortfalls**

'Debt, n. An ingenious substitute for the chain and whip of the slavedriver.' *– Ambrose Bierce.*

Enter the danger zone!

If you continue to finance cash flow shortfalls with additional borrowings, you are eroding your equity.

Combine this with reducing land values and your equity is reducing at both ends.

You are not in control and are in dangerous territory.

The current drought is putting immediate financial stress on producers.

Cattlemen are selling off cattle prematurely (their source of income in the next couple of years) into a depressed market.

Farmers who have had failed crops have the costs of growing them and maintaining their paddocks ready for the next. You all know the picture.

"The fact is that one of the earliest lessons I learned in business was that balance sheets and income statements are fiction, cash flow is reality." *– Chris Chocola.*

You have no control over the weather and commodity prices.

You can only control what you do.

Whatever position you are in you should be managing your cash flows over both the short and long term to ensure you are in control.

So is your debt your servant or your master? Don't let it become your master.

Act now.

- **This advice is general in nature and readers should seek professional advice regarding their personal circumstances.**