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Financial and Risk Management Database

Improving farm management skills one topic at a time

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Can I Afford This?

Producers often ask this question, but there is not always an easy answer. Unfortunately, the only time the answer is obvious is when the answer is "NO" because the financial situation is so tough there is no other choice. Most times, however, there are several things to consider.

Cash Flow

A cash flow is a good measure of whether you can afford a purchase or not. If there is extra cash remaining after all expenses are paid for the year, you may be able to afford it. Since a cash flow is only a projection, you must be sure that it is made with reasonable estimations. If you can only make the purchase cash flow if you sell your corn for $6.00/bu., it wouldn't be reasonable in 2015. Also, be sure your cash flow contains all expected expenses plus some room for surprises. A cash flow that is too conservative can be just as detrimental to planning as a cash flow to that is not attainable. In either case, making decisions off fabricated information can lead to poor decisions.

Net Worth

For 2015 many crop operations' cash flows have negative projections. Does that mean these operations can't afford to purchase anything? No, not necessarily. Between 2006 and 2014 the farms included in the NFBI averages added over $1.8 million to their net worth. While it would be nice to continue on that pace, it can't be expected. If we see an average of a $150,000 loss over the next two years, the 10 year average net worth increase would still be $1.5 million. Ending a 10 year period with an average net worth increase of $150,000 per year would still be the best ten years on record. If we had a steady growth of net worth instead of spikes and valleys, it would be easier to decide if major purchases could be made.

Choices

Regardless of whether you have a positive cash flow or enough net worth to "burn", each major purchase decision comes with a choice. You may be choosing to use the extra cash flow instead of adding to net worth or you may be choosing to use previously earned net worth to purchase the item. Both choices are okay as long as you know what you're giving up. Even in the past few years when it was easy to cash flow purchases, it wasn't always the best decision to spend the money. Just because a purchase is deductible it is not always a good choice to spend the money and spending the money on family living is not always a bad choice. Each decision to spend money is a choice.

There are often two extreme views on net worth. Some want to spend as much of their net worth as they can before they die and enjoy what they've earned. Others want to save as much

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as they can to be able to pass it onto the next generation; often times sacrificing their own happiness. Many still, find a balance between using their net worth and saving for their children. Your personal preference on this matter will play into the decision of “should I buy” something.

So if the answer to “Can I Afford This?” is yes, then the next question should be “Is this how I want to spend my money?” Whether it is an $80 per month internet TV subscription, a $250,000 tractor or an $800,000 house, there is a choice being made of where your net worth is being spent and where your working capital is being tied up.