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Farm Liquidity – Working Capital to Value of Farm Production

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Last month we looked at Working Capital which is expressed in dollars (current assets less current liabilities) and the current ratio which is a relative term (current assets divided by current liabilities). Both of these liquidity measures indicate that current assets and current liabilities are important. Farming is known to be an industry where it is all too common to be 'cash poor and asset rich'. Knowing the level of one's cash cushion is always prudent. It is frequent that lenders use a measure of liquidity when evaluating the balance sheet of a potential borrower.

In keeping with the idea that Cash is King, lets' look at another of the liquidity ratio's – Working Capital to Value of Farm Production (WC/VFP). Working Capital to Value of Farm Production is a measure of the amount of funds available for use if you sold all current assets and paid all current liabilities. Working Capital to Value of Farm Production 'marries' the balance sheet to the income statement to arrive at a ratio that evaluates one's liquidity position relative to the size of the farming operation. The higher the WC/VFP ratio, the more liquidity the farm operation has to meet obligations. WC/VFP varies by farm type, farm revenue, age of the farm operator, and tenure.

You can easily make this calculation for your own farm. Use your December 31, 2011 Balance Sheet and your Accrual Income Statement for the year ending December 31, 2011. On the Balance Sheet, find your current assets and subtract your current liabilities from the current assets. (Be sure to include the current portion of your deferred income taxes in your current liabilities.) Take that result and divide it by the value of farm production from your Accrual Income Statement. Now you have your answer! Think of WC/VFP in terms of a percentage. If your WC/VFP is 0.60, then you have 60% of the years' revenue in a very liquid position on for your farm. Among other things, this liquidity can provide cash to purchase operating inputs or make capital purchases. In 2011, the median WC/VFP was 0.60 for a group of 2,511 farms in the Illinois FBFM database. For that same group of farms at the 75th percentile, the WC/VFP was 0.98. The value of the ratio can vary throughout the production cycle. It is typical to measure WC/VFP at the same point in the cycle (December 31) to better compare the ratio from year to year.

Table 1. 2011 Working Capital to Value of Farm Production

	Median	75th Percentile
By Farm Type		
Hog	0.48	1.07
Grain	0.61	0.99
Dairy	0.27	0.45
Beef	0.55	1.15
By Age		
30 to 39	0.41	0.71
40 to 49	0.48	0.81
50 to 59	0.58	0.89
60 and over	0.78	1.26
By Tenure		
less than 10%	0.50	0.83
11% to 25%	0.64	0.96
26% to 50%	0.69	1.03
51% to 75%	0.94	1.39
more than 75%	0.90	1.46
By Farm Revenue (in thousands)		
$40 to $250	0.81	1.37
$251 to $500	0.64	1.08
$501 to $750	0.63	0.94
$751 to $1,000	0.60	0.93
more than $1,000	0.51	0.75

- WC/VFP is varies with the age of the farm operator. As age increases, the WC/VFP at the median and the 75th percentile increase as well. (See the table.)
- WC/VFP also tends to increase with the tenure ratio. As one owns' a more substantial portion of the land one farms, the WC/VFP increases as well at both the median and the 75th percentile.
- Farm type also impacts the WC/VFP. Dairy farms tend to carry lower levels of WC/VFP and lower levels of liquidity in general. When compared by farm revenue, the EC/VFP tends to be lower at greater levels of farm revenue.

Click here http://www.farmdoc.illinois.edu/finance/benchmarks.asp to find other financial benchmarks for your farm.

The authors would like to acknowledge that data used in this study comes from the local Farm Business Farm Management (FBFM) Associations across the State of Illinois. Without their cooperation, information as comprehensive and accurate as this would not be available for educational purposes. FBFM, which consists of 5,500 plus farmers and 60 professional field staff, is a not-for-profit organization available to all farm operators in Illinois. FBFM field staff provide on-farm counsel along with recordkeeping, farm financial management, business entity planning and income tax management. For more information, please contact the State FBFM Office located at the University of Illinois Department of Agricultural and Consumer Economics at 217-333-5511 or visit the FBFM website at www.fbfm.org.