The Business Of Farming: Assets & Liabilities – a new view

It is not the situation but what you do about it that determines the future

By S. D. Parsons

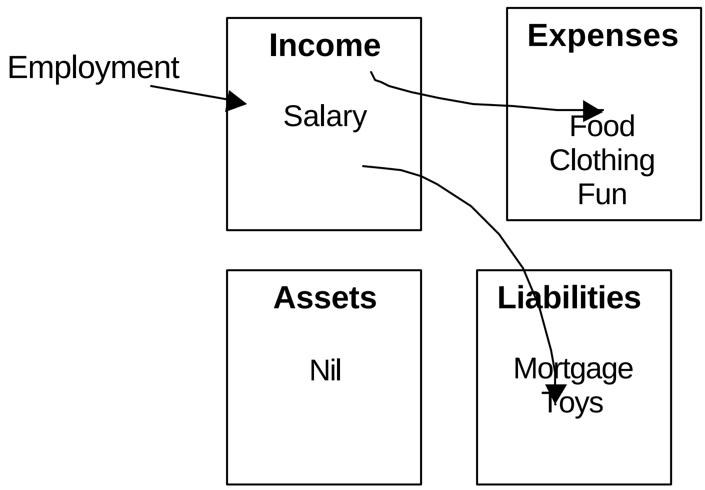
In several past articles I have distinguished between types of assets – those you mean to keep and those you mean to sell. One of the self-imposed reasons farmers in Zimbabwe face financial problems today is because they invested heavily in things they mean to keep. At the time those decisions apparently made good sense, but many had horrendous consequences. For example, one man told me of his decision to build a $3,5 million dam using an off-shore loan at low interest. At the time he thought the two-year moratorium on capital repayment was a godsend, but conditions changed. The loan was repatriated and the interest grew. Today he owes $35 million on that dam and the *daily* interest exceeds $40 000!

Of course we all justify the expenditure on new developments, vehicles, buildings etc because they increase production, reduce drought risk or whatever. But do those investments add significantly to profits and how were they financed? It is one thing to finance those assets out of cash or long term loans with fixed interest rates and an entirely different matter to finance them out of overdraft.

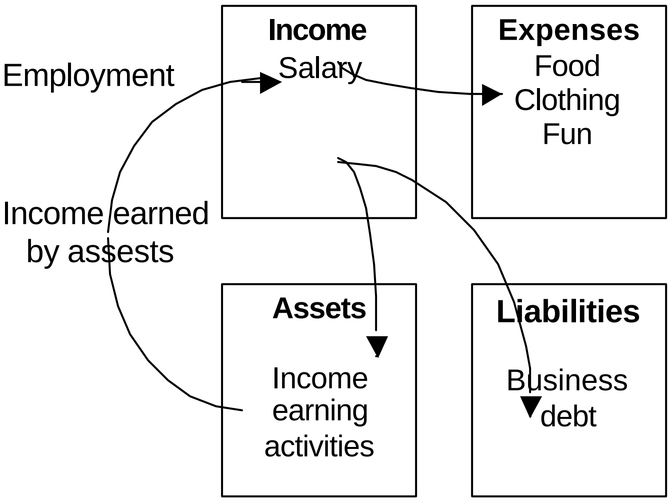
Robert Kiyosaki the senior author of Rich Dad, Poor Dad[1] has an interesting definition of assets and liabilities. He defines Assets as items that earn income. Liabilities on the other hand are items that do not earn an income. I'm sure that definition will stick in the throats of the accountants but it makes a great deal of sense.

By this definition cars, swimming pools, expensive houses, fancy vehicles and the other toys, by which the supposedly affluent middle classes surround themselves, are not assets but *liabilities*! That is a stirring thought that also helps to explain the difference between poor people, middle class earners and the wealthy. In a few simple diagrams he explains that difference. The poor with no capital, and a meagre cash income, live hand to mouth with no opportunity of accumulating wealth. Every penny these people earn goes out immediately on the necessities of life. As we study the balance sheets of the poor it is apparent that even though they have no liabilities they also have no assets.

If we now take a look at the middle classes' financial picture we find:



On the other hand the wealthy portray a very different financial picture:



By investing money in income earning assets the wealthy create business interests that generates more income. The more that is invested in income earning assets the wealthier they become. Another way of putting this is to say that the wealthy earn an income even when they are not working.

The poor are in the unenviable position of having no capital. To survive they are highly dependent upon a constant inflow of actively earned cash. The middle classes may have more income but are also dependent upon a constant stream of actively earned income – if they are not working they are not earning!

But the wealthy are different. Because of previous investments in money earning assets they enjoy a stream of passively earned income. They do not have to be working in order to earn an income. Their investments do it for them. His distinction of self-employed and business owners is also interesting. Whereas the self-employed constantly need to be present to keep the business running business owners can go away for a year and yet have a bigger business when they come back. I believe it would be more sensible to say that business owners are those who need only be involved at the strategic level and do not work <u>in</u> the business.

All of this of course may be a gross over-simplification of the real world, but it does serve to start us on the right track when examining the question of financial risk. The poor are clearly at risk because without any reserves any disruption of their income stream could be disastrous. They are at the mercy of the world. The middle classes are little better off. Though they may have a better income than the poor, and the ostensible trappings of wealth, they too are dependent upon a constant actively earned income. From this we can conclude that a termination, or reduction, of earned income is one of the financial risks that face not only individuals but also businesses. The problem is exacerbated if there are no financial reserves to fall back on.

[1] Rich Dad Poor Dad – what the rich teach their kids about money that the poor and middle class do not! Robert T. Kiyosaki and Sharon L. Lechter

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