



Farm Management

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The Changing Nature of Crop Marketing and Risk Management

We've all heard references to the evolutionary factors affecting agriculture. Undoubtedly, these factors will pose an increasing challenge to successful risk management at the individual farm level. Improved risk management is an opportunity but it is not a choice. However, improving risk management is just part of the solution. Everyone has heard that farming is a way of life. This statement has allowed many people - farmers, lenders, government, and others, to look at and treat agriculture differently from other businesses. We need to encourage everyone to realize that farming must be managed as a business, or it cannot be a way of life.

The message is to really zero in on all elements of the business, including accounting systems, capital structure, production management, and inventory control. Experience has shown that it will be very difficult to help better manage marketing and other risks, if management control around these other issues is not integrated and already in place.

Axioms and Objectives

Let's share a few axioms that are key to successful farm business and crop risk management:

1) A crop marketing program will not be successful in the long term if built solely upon emotional decision making, or speculative price forecasting.

2) A long-term successful marketing program must be based upon financially-informed, balanced, and objective decision making.

3) Objectives of a successful marketing strategy should seek to obtain marketing balance, where profitability, assurance, catastrophic loss insulation and upside opportunity are provided.

Moving toward accepting these concepts is the first, and, perhaps most difficult part of crop marketing. This is because they usually imply significant change, and sometimes move to doing something that is not comfortable. Competitive advantage is gained through education, information, analysis, and gradual introduction of concepts and tools involving the risk management issues, this

process involves an investment in time, and a commitment to improve.

Achieving Marketing Balance

This is not simple. Luckily, Uncle Sam tries to fill the void with acreage controls, deficiency payments, and disaster relief. Also, until recently, the tools were too complicated, or too expensive to provide practical access to profit protection, catastrophe avoidance, and upside opportunity.

To make a point about any real and practical ability to predict price, let's look at historical corn and bean charts.

What do these charts tell us?

1. No repeating pattern of timing of highs or lows.

2. No pattern of degree of highs or lows.

3. No new plateau.

4. Lots of volatility and uncertainty.

None of these characteristics are needed in objective business management.

You can extract only a few general insights from these charts, which speaks to the folly of building a marketing program based solely on price prediction and/or speculative decision making.

1. Try not to sell corn under \$2.40, or beans under \$5.50.

2. Get costs of production under \$2.40 and \$5.50, respectively.

3. Get objective about pricing decisions.

4. Use some means to assure, and insure revenue, as the market

will not provide any guarantees.

5. Usually the market provides an opportunity to lock in profitable values at some time during the marketing cycle.

Unfortunately, there are many out there who wish to convince the farmer that speculative price prediction is marketing. This has led many farmers into the bait and switch cycle of marketing management.

Traditionally, if you chose to price in an attempt to lock in profit, you had very limited flexibility and no opportunity for gain in a rising market. Worse, if you priced, and had production problems, suffering was likely doubled, potentially leading to catastrophic loss. This led to the two primal fears of crop marketing - fear of lack of production and fear of higher prices.

Marketing Strategies

Luckily, just as much of the direct help from the government is going away, marketing tools and strategies are evolving to where the producer has a chance at marketing balance. Tools exist today that offer a reasonable means to lock in profit, insulation from catastrophic loss, and an upside opportunity.

Here are two techniques that producers might use to better manage certain risks, but when combined, can come very close to achieving our objective of balanced marketing:

1. The simple minimum price cash (MPC) grain contract. In its simplest form, in exchange for the delivery of bushels, the buyer guarantees to pay

the farmer a minimum cash price, with upside price opportunity related to the movement of the underlying commodity futures price. If the underlying futures price subsequently rallies, the producer has the right to reprice at the higher level.

2. An additional benefit that is real, but less tangible, is the time provided by this strategy. This time gives the producer the opportunity to maintain price flexibility while crop and market conditions become more clear. Perhaps this will allow for earlier pricing decisions at more favorable values.

One other very important thing the MPC strategy provides is marketing courage. This will help overcome the reluctance to sell, avoid missed opportunity, and overcome the primal marketing fears. You may not find many producers who will confirm this, but a study of price history and actual producer sales confirms that more dollars have been lost by not pricing when favorable values were offered, than by pricing, followed by crop losses or a further price rally (e.g., realization of the primal fears).

The problem with the MPC strategy is that it functions only as a price insurance concept. It does not insure against a production risk, or thus, farm revenue. Limited production at a great price still equals limited revenue. Therefore, from an overall business perspective, we still

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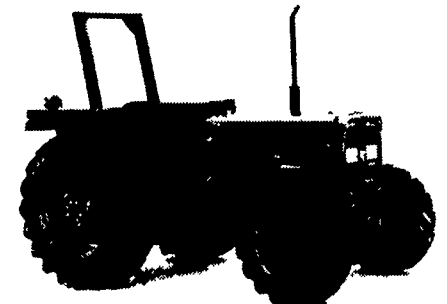
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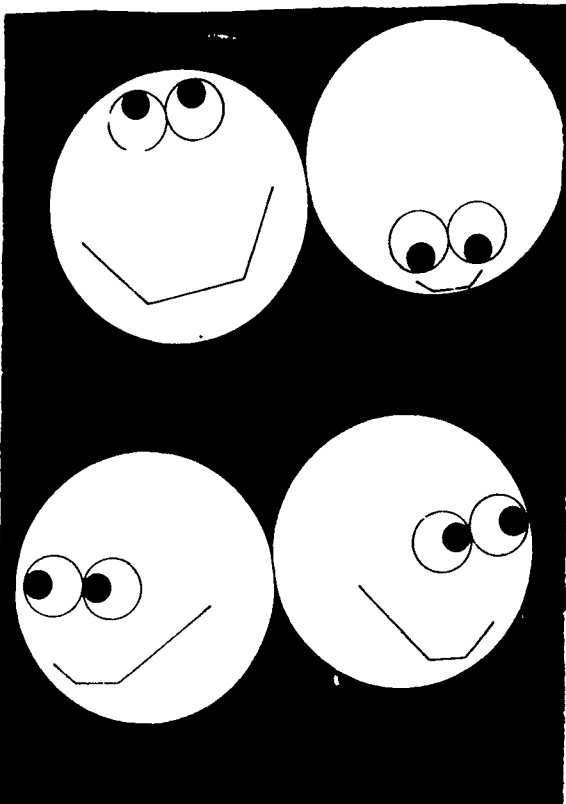
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