Better risk management is the key to lifting farm-gate returns

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AT A GLANCE…

- The Australian Government's White Paper on Agricultural Competitiveness highlights the importance of improving agricultural risk management.
- The Government is to put up $29.9 million over four years for farm insurance advice and risk assessment grants.
- Recent evidence points to the fact that farmers operating without risk solutions do not make the best business decisions.
- Farm managers wanting to develop a farm risk assessment and management plan can apply the value and risk management template described in this article.

STRENGTHENING drought and risk management is one of five priorities underpinning the Australian Government's White Paper on Agricultural Competitiveness released in July 2015.

The Government's new drought and risk management package contain specific initiatives to help build preparedness. These cover:

- Facilitating the uptake of crop insurance and other risk management advice;
- Introducing accelerated depreciation incentives for building on-farm fodder storage assets and water facilities;
- Improving climate forecasting; and
- Making Farm Management Deposits more beneficial and attractive to support good business management.

This third article in my series on Agricultural Risk Management examines why risk management can boost farm-gate returns, and what farmers can do to benefit from the White Paper incentives.

Farmers operating without risk solutions do not make the best farm business decisions

New research from CSIRO highlights how farmers' risk aversion is holding grain productivity back. The July 2015 paper by Marta Monjardino and her colleagues at Waite Campus in Adelaide highlights that farmers in low-rainfall regions – in other words, pretty much all of the Australian wheatbelt – are known to adopt low rates of nitrogen. As a result they are likely to miss out on greater returns from more intense cropping in more favourable production years.

The paper points out that:

Nitrogen is the most limiting nutrient in cereal crop production and is an important requirement in closing the gap between potential and achieved water limited yield. But N fertiliser management in broadacre cereal cropping can be risky for farmers operating in dryland regions because of variability of rainfall and price. Farmers typically respond to this situation by making risk-averse decisions that are neither yield- nor profit-maximising.

Marta's paper indicates a yield gain of more than half a tonne per hectare in moving from current N practice to profit-maximising N practice in several regions, assuming other constraints are well managed. In some areas the yield gain is more.

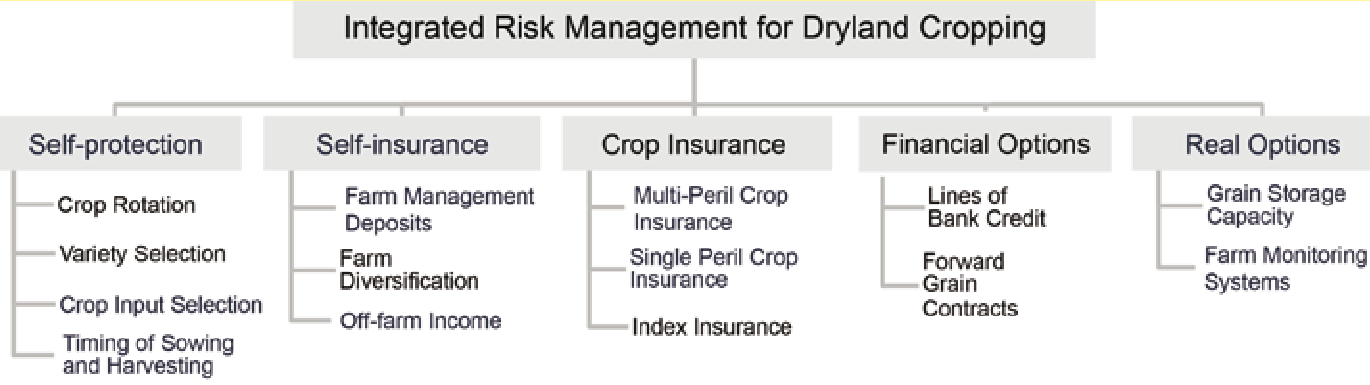
Across Australia's 14 million hectares of wheat fields, let's assume that on half the crop area (seven million hectares), 0.5 tonnes per hectare increase in yield can be achieved. At the farm gate this would create:

- An increase in grower revenue of $735 million per year; and,
- An increase of some $300 million per annum in additional profit (after paying the extra nitrogen costs), or $43 additional profit per hectare.

In contrast, the cost of Multi-Peril Crop Insurance – the key tool to overcome risk-averse decision-making – averaged $21 per hectare in 2014.

Developing a farm risk assessment and management plan can help prepare for natural disasters.

An integrated approach to value and risk management for dryland cropping combines a range of toolsets



Risk management requires an accurate picture of farm financial performance

Not enough farm businesses have a tight grip on farm financials, and fewer still have an understanding of how the business has performed over the past five or 10 years.

A key problem is that financial year reporting at June 30 does not give an accurate picture of grain farm profitability.

What is required is to align season costs with season revenue, by converting June 30 tax returns to production year results, such as April through to March.

How farmers can benefit from the White Paper initiatives

The White Paper explains that farmers will be able to access a grant to help evaluate insurance options and to obtain risk management advice:

Insurance can significantly reduce the financial risk that a farmer faces from production loss… To help farmers select the best insurance product for their needs in this developing market, the Government is providing $29.9 million for farm insurance advice and assessment grants. The Government will partner with State and Territory governments to allow eligible farm businesses to access up to $2500 as a one-off grant based on a dollar-for-dollar matching of funds provided by the farmer.

Integrated approach to value and risk management

From the experience of Strategis Partners, an integrated approach to value and risk management is what farm business managers need (see the chart above).

This approach ensures that the right mix of solutions is selected from the following toolsets:

- Self-protection such as crop rotation, variety selection, timing of planting, crop input management, land management, sowing and harvesting scheduling;
- Self-insurance such as Farm Management Deposits, farm diversification and off-farm income;
- Crop insurance including multi-peril crop insurance, single multi-peril crop insurance and index insurance;
- Financial options including lines of credit and forward grain contracts; and,
- Real option investments that provide flexibility advantages such as grain storage capacity, and farm monitoring systems to detect early signs of changes ahead.

As decision-makers look across this spectrum of risk management options, it is vital to find the right balance between risk prevention and mitigation, and risk transfer measures.

Successful value and risk management is not just about limiting the downside. It requires optimising the use of crop inputs in the face of good seasonal conditions, while taking advantage of higher prices early in the season by forward selling grain.

In conclusion, follow this template when you set about developing a farm risk assessment and management plan. It will ensure that farm returns can be maximised for the level of risk you are prepared to run with.

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THE AGRICULTURAL WHITE PAPER

The Federal Government is committed to five key priorities to achieve better returns at the farm gate:

- A fairer go for farm businesses, to keep families on the farm as the cornerstone of agriculture, by creating a stronger business environment with better regulation, healthier market competition, more competitive supply chains and an improved tax system.
- Building 21st century water, transport and communications infrastructure that supports efficient movement of our produce, access to suppliers and markets, and production growth.
- Strengthening our approach to drought and risk management, including providing the tools to facilitate more effective risk management by farmers and a long-term approach to drought that incorporates provision of enhanced social and community support for farming families and rural communities, and business initiatives for preparedness and in-drought support.
- A smarter approach to farming based on a strong research and development system that underpins future productivity growth; and effective natural resource policy that achieves a cleaner environment as part of a stronger Australia.
- Access to premium markets through the availability of a large number of premium export markets open to our produce and a strong biosecurity system that maintains our favourable plant and animal health status.

The White Paper can be downloaded at <http://agwhitepaper.agriculture.gov.au>