Implications for the Farm Business

With the recent addition of marketing choice for wheat and barley producers, there may also be changes to a farm's risk-return profile. While the new marketing choice system offers some obvious upside opportunities, there may also be some downside farm level consequences.

Price Risk and Volatility

- One possible outcome may be increased price risk and volatility. This will have both positive and negative impacts on net income variability.
- In the past, the Canadian Wheat Board (CWB) has absorbed a considerable amount of flat price risk in their pools by using multiple sales along with futures based instruments.
- The result was a general smoothing of prices that took away some of the high prices as well as some of the low prices.
- In the future, producers that choose not to use pooling strategies in order to capture higher pricing opportunities may be exposed to greater downside risks. Depending on a farm's portfolio of crops and other assets, the resulting downside risk levels may require some alternative management strategies.

Farm Risk Management Strategies

- When a typical farm business is analyzed in the context of the capital markets, it becomes clear that many different strategic decisions can be made to adjust the farm's risk-reward profile to an acceptable level.
- A diversified crop and enterprise structure is one example of a strategic decision alternative.
- Disciplined use of futures and options may also be helpful to some producers in both protecting down-side risk while allowing them to exploit higher pricing opportunities.
- The potential benefits from these more volatile markets can be measured using simulation and traditional option pricing theories which calculate the actual probability of achieving higher target prices resulting from increased volatility.
- The likelihood of observing deeply discounted prices is another measurable feature that may need consideration by some producers. If a farm's financial position cannot survive the possibly of a deeper series of unexpected low prices, alternative business and financial management strategies must be considered.
- Income variability arising from a farm's production and marketing efforts is commonly referred to as 'business risk' while financial risk is simply the business risk magnified by leverage.
- In the case where a farm's business risk management systems do not sufficiently reduce down-side risk, management of the farm's debt becomes an even more critical success factor.
- Another strategy for managing risk starts with a detailed knowledge of the farm's cost of production. Knowing individual crop costs, breakeven price levels, and return sensitivities can give producers the knowledge and confidence to act on their marketing and risk management plans. Designing these plans can help producers capture higher profits while reducing the likelihood of large losses.

Financial Tools

- Alberta Agriculture and Rural Development (ARD) has several tools that can assist producers in assessing their costs and returns.
  - Agri-Profit$ is an ARD program can provide farmers with detailed information on their own operation including unit costing.
  - The ARD Crop Choice$ downloadable software program can also help producers get a handle on their risk by forecasting margin levels and calculating the probability of achieving them.

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  - Crop Choice$ results are presented in easy-to-read tables and graphs including a risk-return trade-off chart.
- Ultimately, successful producers will manage both their upside opportunities and downside risks to build a more competitive and sustainable agriculture industry.