Managing Volatility in Agriculture

Danny Klinefelter
Professor and Extension Economist
Texas AgriLife Extension
And
Texas A&M University

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Too many producers treat input and output pricing as separate issues. Because volatility affects both, the risk of fixing prices on one side of the equation without simultaneously addressing the other can exacerbate problems.

Locking in output prices based on what you think input costs will be or locking in input costs based on what you think output prices will be isn't managing margins, it's speculating

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Most producers focus on minimizing downside risk; but, it's also important to consider the upside opportunities created by volatility.

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A big part of risk management is having the capacity to deal with change. Don’t be so focused on being least cost, that you limit your business’s ability to adapt.

- Management skill sets, capacity and bench strength
- Working capital
- Debt Structure
- Leverage
- Capital debt repayment capacity margin
- Accrual versus cash basis income
- Contracts, e.g., leasing arrangements, cost indexed contracts

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It has been my observation that the biggest difference between the top 10 percent and the rest of the top 25 percent has been timing: when they get in, when they expand, when they cut back and when they get out.

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Two issues are involved. One is have a risk management strategy and tools in place to deal with the things you can't anticipate. The second is learning to recognize and evaluate leading indicators that will help you act before the herd. Success is relative and the future will always belong to those who see the possibilities (problems or opportunities) before they become obvious to the typical producer. As markets have become global, macroeconomic indicators are just as if not more important than microeconomic indicators.

For example:

- Political shifts – not just in the U.S.
- Monetary policies
- Exchange rates – buying and competing countries
- Global weather conditions
- Commodity stocks and carryover: use ratios
- Energy prices

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In addition to the direct affect on your own business, consider how increased volatility may affect your suppliers, buyers, employee/family, and lenders.

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As risk gets priced into or pushed up/down the supply chain, risk management will be increasingly important to the portions of the chain with the least market power.

Examples:

Fertilizer dealers – unpriced inventory, pre-purchase terms

Grain elevators – margin calls

Lenders

- Interest rate risk – ability to match funds, premiums to fix rates
- Do they understand and are they agreeable to and committed to your risk management strategy
- FSA guarantees

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Market volatility has also increased the importance of assessing and finding ways to mitigate counter party risk.

Examples:

Bonded warehouse receipts

Letters of credit

Third party guarantees

Independent verification and financial assessment

Receivable insurance

Key Management Practices

1. What if and sensitivity analysis
2. Monitoring and analysis
3. Decision autopsies
4. Peer advisory groups
5. Pooling arrangements and alliances