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Risk management key to better profits from grain

Doing nothing is a risky business, writes **Jeremy Cole**

Since my last article in April, regarding the value of Sterling and its impact on farmers' single payments, our currency has done just what many people anticipated and appreciated.

Those who hedged and fixed their rate when one Euro was worth 95-90p are now laughing all the way to the bank. A Euro is now worth 85p and falling. Sometimes there are obvious low risk decisions to be taken when the opportunity arises.

This summer has seen traditional dry mornings followed by torrential rain. Recent years have also seen a very volatile grain market - this year during Cereals week, the market plummeted by £12/tonne. That is £120/ha net margin gone on a 10t/ha crop.

It's never easy to sell when the market is at its highest and many people have failed trying. Some hang on too long after a fall, believing the market is "too low to sell" or has "fallen too far".

But there are good reasons to take action in business - when doing nothing threatens to result in a high chance of an adverse effect and when consequences seriously threaten to hurt your margins.

One is risk, the other is uncertainty. Risk is when an outcome is known but there is imperfect knowledge. Uncertainty is when the chances of something happening are unknown.

Risk is a massive subject with thousands of paper written on the subject. It covers operational risk, capital risk, production risk, people risk and what I speak about here with a volatile grain market: price risk and how to manage it.

Price risk in the UK for wheat is straight forward and clear, as there is a well regulated, liquid, established futures market, LIFFE, and a consistent relationship between the futures and ex farm prices.

This enables transparent futures and options to be transacted within the market via recognised hedging processes. This is not available in less developed countries, so we are in a privileged position.

This is why I remain concerned at the lack of market penetration and use of these facilities by the UK farmer. November 09 Options were recently trading at about £10/t for some months now, even with the level of volatility being 30% (18% average, 10% low).

This meant for a £10 premium, today's current price can be underpinned with a minimum price £10 below it, with the possibility, if the market moves £10, of further additional price reward. Many farmers have told me that that is too expensive.

But if Options are deemed as too expensive, presumably it also means that the farmer believes that the Option granter is charging too much and will make a profit when the market fails to move.

If farmers will not take on the risk for under £10 or at £10 as the maximum risk/premium, then there must be another reason for not using this strategy to hedge?

Are farmers not trying to maximise returns by allocating resources efficiently, rejecting classic economic theory? What are your farming goals and ambitions?

With the market at one of its three highs of the trading cycle, what was the real risk of not selling or hedging in case the market fell? It's actually £10, as the market has told you, with no uncertainty at all.

There are no right or wrong answers to this conundrum as all farmers/managers have a different attitude to risk. But decision makers should know their risk profile; adverse, preferring or neutral.

Mind how you cross the road.

Jeremy Cole, Bsc Agri Econ (Reading), runs Agricole – an independent grain brokering and marketing service for farmers. For a weekly grain market report, call 01954 719452 or visit www.agricole.co.uk