Radical ideas needed to meet challenge of low commodity prices

EXPERT VIEW

It's no good telling growers to cut costs - most have already done so, says **Jeremy Cole**.

Tough times require tough decisions. Yet the ongoing slump in grain and oilseed prices – which means most arable farmers are making a loss – has seen repeated calls for growers to "review the situation" and take a close look at their business performance.

Much advice centres on the "same old, same old" need to reduce labour costs, slash power and machinery bills, increase yields, diversify and sell for a higher price. It has been done to death. Most UK growers are already very efficient and have costs pared to the minimum.

It's the law of diminishing returns. When it comes to cost savings, growers are all on the flat part of the diminishing marginal returns curve – and there have been no real advances in cereal yields since the early 1980s when ICI ran their "10-tonne" clubs.

If these lower commodity prices are going to remain for a few years to come, I believe fresh thinking is needed for growers to survive until better times return. It's no good just cutting costs – we need to do something more much more radical.

Virtual farming

Every farmer should have a budget – one or even two years ahead – detailing the minimum price required to grow each crop based on five year average yields. Futures prices for wheat and rape are available a year before drilling, giving plenty of time to assess potential future margins.

If the forward price for the commodity is below the budgeted price/tonne needed during that pre-drilling year, no commodity should be sold forward for that forward harvest year – right up to the latest point of buying seed, fertiliser and harvesting the previous crop.

Come drilling time, if the scenario is the same, no crop should be drilled for that harvest year at all – and obviously nothing sold. In other words, and to be clear, the grower should avoid drilling part or all of that particular crop or field.

There are several margin/tonne spreadsheets generally available that show different margins given different yields and prices. And perhaps in this scenario, Financial Price Risk Management (FPRM) tools could be used to "virtually farm" instead.

On the acreage that there is a negative margin, a grower could simply use a FPRM too called a "call" option – which would benefit the farmer if the market price rises in the future – on the acreage not to be drilled and its predicted tonnage.

> Not many businesses produce an item when they know it will make a loss. So why should a farmer?

At current prices, option premiums are approximately 8-10% (£10/t) of the value of a wheat crop and 6-7% (£15/t) for oilseed rape for 12 months forward cover. A six month option would be cheaper, as with normal household car/house insurance.

If the market rises, the farmer would receive the benefit, as they would have done with growing a physical crop. But in this scenario the would simply "claim on the insurance". So if the market rose £20/t, the farmer could claim £20 minus the £10 premium, to give a net £10/t profit.

This would be a 100% return on the £10 investment. If the market remained the same or fell, the farmer would simply lose the premium £10/t (£90-£125/ha for wheat) and £15/t (£62.50/ha for oilseed).

Yes, there would be a loss, but it would be considerably less the cost and effort of growing, harvesting and storing the crop, to eventually sell it at a price the same or lower than when it was drilled, when the margin was predicted to be negative in the first place.

Not many businesses produce an item when they know the future price makes them a loss, so why should a farmer?

Work with others

Using a contractor – when and as prices are good enough to make a profit – might well make more margin than using your own own kit and labour. Look at your fixed costs. If they don't stack up, don't use the contractor and farm virtually instead.

Individual farms and farmers need to assess the costs associated with each crop grown, and how each one contributes to the cost and revenues of the business. In some cases, however, not growing a crop will increase the overall fixed costs to the business.

Although disposing of labour and machinery is a big step, with prices as they are, it may be that employing men and machines is an expensive luxury. Contractors can often be used more efficiently – and much more flexibly.

Farm sharing agreements and amalgamations ties into the contractor concept. Sharing kit and labour is often advantageous, although it may entail a change of business entity for full benefit. It isn't a new idea but perhaps it is time that more people considered collaboration.

'Greening' crops

With yield-mapping data now widely used on many farms, it is easier to analyse business performance more closely. Lower-yielding field areas can be used to tie into spreadsheets detailing crop margins, pinpointing where higher prices are needed to make growing the crop profitable.

Sometimes it will be more profitable to take advantage of new CAP "greening" measures and grown a different crop on a particular area, rather than cereals or rape. Or it could be left fallow.

This green crop or fallow areas could then be combined with virtual farming FPRM "call" options on tonnes that would have been produced on that marginal land under greening – in case the crop prices increase during the season.

These are just a few ideas that could be incorporated into many farming enterprises. Yes, they are radical, but I believe they need to be fully discussed and modelled. Farmers and the farming industry are adaptable and I have confidence that common sense will prevail.

Other the other hand, failure to adapt will have Darwinian consequences. Just look at the experience of Kodak, which struggled to adapt quickly enough to the advent of digital photography. Or fax machine manufacturers when faced with the advent of email. Don't be a rabbit in the headlights.

› *Dr Jeremy Cole, BSc Agr 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*