

Lessons from the Tough Times to Make Our Business Stronger

Managing volatility in the dairy industry

James Allen, AgFirst

“It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change.”

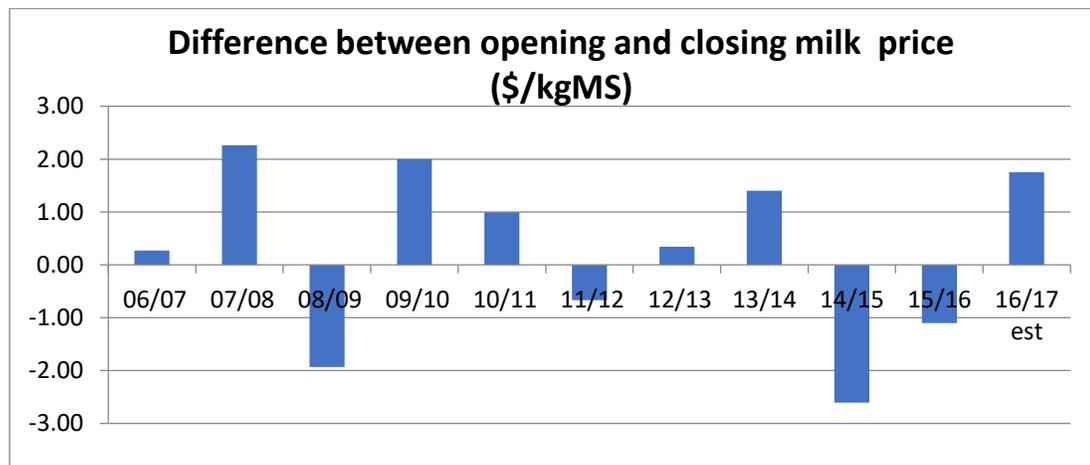
This famous quote from Darwin has never been more true for those involved in our primary sector. The financial turmoil experienced in recent seasons, combined with changing environmental compliance requirements and an impending wave of technology changes mean that constant adaptation to our changing business environment is critical if we want to stay in business.

Lessons Learnt

With luck, we are entering a period of moderate stability with regard to milk pricing, however this cannot be relied upon. Reflecting back over the past few years highlights the number of challenges we have faced, and subsequently the lessons we have learnt.

Payout volatility

We are experiencing milk price volatility that previously was never experienced, and this now must be regarded as part of the business environment we work in. The milk price has ranged from under \$4/kg MS to over \$8/kg MS. Additionally, the interseason milk price based on opening forecast announcement to final pay-out announcement has often varied by more than \$2/kg MS. This highlights the challenges in not only setting accurate cashflow budgets, but also in designing the optimal farm system.



Cost structures

For a variety of reasons cost structures had been steadily increasing on dairy farms, until the 2013/14 season, at which they peaked at \$4.33/kg MS. The average (owner operator) for 2015/16 had farm working expenses of \$3.64/kg MS. While in many cases there have been tough decisions made to reduce farm expenditure, sometimes to below maintenance levels, these changes were necessary for the dairy industry to survive.

Debt levels

In spite of cost reductions and increasing farm efficiency, there have been cash losses sustained over the last two seasons for most farmers. For many this has resulted in an increase in their debt levels. The average level of debt is around \$22/kg MS, an increase of nearly \$2/kg MS in two years.

Pasture growth variability

In the last decade there has been an increase in variability of annual and seasonal pasture growth rate patterns, particularly in the North Island without the benefit of irrigation. This is in line with long-term predictions on the effects of climate change, one of them being increased seasonal variation. The DairyNZ research farm, Scott Farm, has experienced growth rates plus or minus 4 tonnes from the average, i.e. a range of 8 tonnes DM/ha.

Social sustainability

Many farmers significantly reduced either the number of staff on their farm, or simply their level of time off, simply to survive. Now that we have a reprieve in the milk price the lesson is surely how we can structure our farm businesses to avoid potential burnout going forward.

So what does this mean for our farm businesses for the future?

We need to continue to evolve our farm systems. The focus has shifted from a production mentality, to profitability at all costs, to a more balanced approach of sustainable and profitable production. Farm systems for the future need to take into account both environmental sustainability and social sustainability. Social sustainability needs to consider hours worked and working environment conditions, but also increasingly the public perception of farming.

Farm system - Do What You Do Well!

There is considerable evidence to show that the range of farm profit within a farming system (high, medium, low feed inputs) is greater than the range of profitability between systems. In other words, **decide carefully which farm system you are going to run and then run it to the best of your ability.**

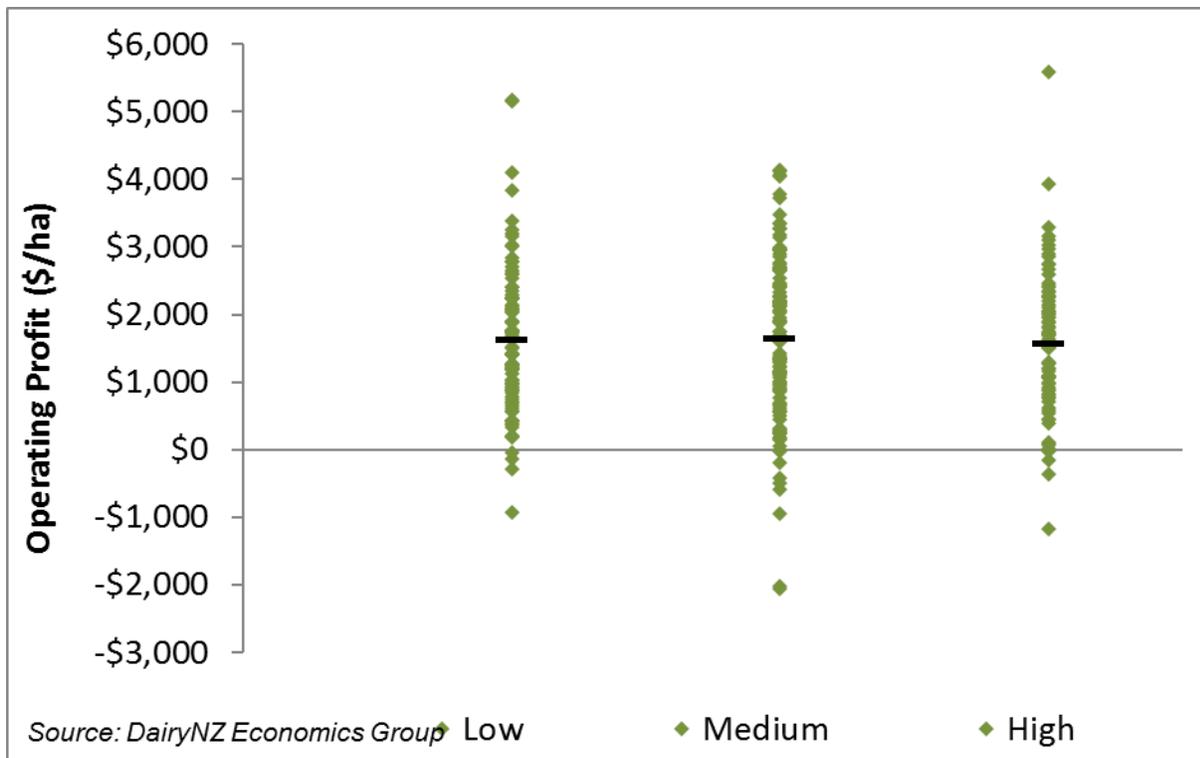


Figure 1. Operating profit variation by farm system (2014/15).

Typically changing farm systems/intensity ad hoc from season to season means that you are making reactive calls which can often end up in poor results. Deciding on which system to run is complex. Seek advice. Consider farm infrastructure, the farm's physical properties, skill sets, workload requirements, and risk factors (e.g. feed price risk, climate, debt).

Feed harvested

Regardless of farm system and farm size or location, a key driver of profitability is the level of pasture harvested and grown. **Ensure pasture harvested is maximised before looking to add in supplementary feed.** The basics of controlling grazing residuals and pasture quality hold true for any farming system. Typical guidelines include grazing residuals of 1500 kg DM/ha, and efficient use off supplements (>80 g MS/kg DM response). For the season aim for an overall feed conversion efficiency of <14:1 kg DM per kg MS.

Expenditure

Set non-negotiable limits e.g. \$3.80/kg MS, or possibly 50% of gross farm income as farm working costs.

Set an agreed policy on the amount of debt you are comfortable with. For most operators, under \$20/kg MS debt provides some flexibility should we encounter another downturn. Such a policy will also help with decision making for future investments.

Don't forget about the below the line expenses. The often-unspoken issues of capital expenditure, tax and drawings impact heavily on cashflow for the season. **There may be temptation to overinvest in capital** in the next few years when prices are good.

Business management

The downturn in milk price forced everyone to refocus on the basics of good business practice i.e. budgeting, business planning, tight financial control. **Don't let bad habits creep in!** Regardless of who you choose, an external person to review your business on an annual (but preferably quarterly) basis will hold you and your business accountable.

Your long term business strategy and your annual plan need to be regularly reviewed to adjust for the aforementioned changes in the business environment. Have you considered how you might prepare for:

- An enforced 50 hour working week?
- Enforced nutrient regulation limits?
- The removal of whole herd dry cow therapy treatment?
- A dairy industry without bobby calves?

Some of the above will occur, others may not. **How will your business adjust?**

Risk

A part of good business management should be understanding your tolerance to risk, but also how you are handling risk in your business. Consider risk in the following four categories:

- business,
- financial,
- environmental,
- strategic.



Assess which risks are most relevant for your business, and those which will have the most impact. Risk can be categorised as follows:

- Risks which **can** be accepted;
- Risks that **should** be accepted (which form an inherent part of the business);
- Risks which **cannot be afforded**; and
- **Unacceptable** risks.

You then have four choices: avoid risk (don't do it), reduce the risk (e.g. safety protocols), transfer the risk (e.g. insurance, hedging), or retain the risk.

Risk management is typically poorly executed in the farming sector. **Include risk management as part of your business planning process.**

Conclusion

The recent decline in milk price had been extremely challenging, and for many farm businesses the lift in price came just in the nick of time. For the vast majority who have made it through, capture these lessons while they are still fresh in your memory, and make the changes to your business now, before the new season diverts your attention.