FARM RISK: THE HUMAN FACTOR

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Every business faces risks, but in scale and variety the farming enterprises faces more than most.

Drought, floods, storms, pests, diseases, the fickle dollar, unpredictable farm gate returns, limited distributors and increasing regulatory demands are all part of the risk that farmers face. Throw in a global recession and the high debt ratios carried by many farmers, applying the phrase “it’s a challenging business” is a classic Kiwi understatement.

Understanding these risks and managing them has been identified as one of the key attributes of New Zealand farmers that make them so successful – and internationally recognised for it.

But what many farmers don’t consider is that their own crucial on-farm role makes them one of the most significant potential risks to the performance of their farm enterprise. Human Capital Risk is defined as the risk of loss arising from the loss of a key person to the enterprise. The implications include impairment to financial performance, the loss of intellectual property and ‘know how’, and the loss of a labour resource. In small to medium private enterprises it can lead to forced windup or forced ‘succession’.

Why are farmers – or farming couples – so critical to the wellbeing of their farms? Simply, because they often are the business. They carry a vast knowledge of the property and stock in their heads – from which paddock can best mange the seasons to stock condition at key times and its impact down the line. They know what works and what doesn’t, and have their plans about where the enterprise is heading. In addition to the skills of management, many are the principal skilled workers on the farm.

If they are badly injured or die prematurely the enterprise loses its core. Farmers, in this regard, top both the workplace fatality and accident statistics year after year. For example, the latest available ACC figures shows there were 31 fatal accidents on farms in the year to June 2009 farmers. During the period from 1st June 2008 and February 2009 farm fatalities made up one third of all workplace accidents.

In a typical year, nearly 300 farmers suffer accidents which prevent them from returning to work for 12 months or longer. And age and experience appear not to provide greater protection – research has shown that the engagement in risky behaviours that lead to injury increase with age in the farming sector.

Focusing on the positive and downplaying the possibility of an accident happening to them have been identified as farmer traits that also increase their susceptibility to risk. Most also under-estimate the losses the farm will suffer as a result of losing core personnel, and the costs of replacing them.

Reduced productivity impacting on farm income and increased farm working expenses can quickly erode the farm surplus and profitability, requiring the farm owners to increase their borrowings (if they can in this environment) or in the worst case be forced into a mortgagee sale.

Take for example the cost of replacement labour, and perhaps a farm supervisor to cover management. This can be a major extra as many farmers do not take 'real' wages. It may also lead to a fall in the quality of farm performance, as the replacement labour and management may not have the intimate knowledge about the farm workings that the injured farmer does.

It may not take long for the financial effect to start impacting on the farm as this simple example shows: a 3500 su sheep farm could easily see a 20% decrease in lambing percentage (loss of $45,000), a 10% check in kill weights ($20,000) and 5% increase in ewe death rate ($25,000). A combined effect of $90,000 - small variations but which cumulatively have the potential to wipe out any farm surplus.

A dairy farm will face different productivity changes but the effect may nonetheless be significant. The loss of a key person on a 600 herd dairy farm may experience a 15% drop in MS production ($218,000),an increased death rate impact($50,000) and a seasonal production loss to a empty rate increase ($145,000) culminating in a total cost of $410,000. And when the farmer is killed it means the loss of a lifetime's store of knowledge about the property, its livestock, its district and networks, and the plans for its future development.

Death and irrecoverable disablement can create other issues for the farming family from how to manage the debt on the farm to avoid a mortgagee sale, through to how to facilitate a succession plan that meets the needs of the surviving farming family and the incoming successors. The average size of a farm enterprise has increased over the past 10 years to an estimated value of between $4M-$10M. This has come about because the farms need to be a much larger enterprise today than 10 years ago to be a viable economic unit.

Debt ratios have also increased over the past 10 years with the average farm debt to equity on farms now at 57.3%.

Various Government agencies cover some of the risks faced by farmers, most significantly ACC, the Earthquake Commission and hospitals. However, their cover is limited and there have been significant cuts to services offered.

Private companies also offer insurance covers for death or disablement of the farmer, but many of these have not been designed around the unique farm environment. The definitions of disablement, the assessment of insurable income and the limitations on the maximum sums assured have meant that many of the insurance solutions put in place for farmers inadequately meet the needs of the farm and the family when things go wrong.

Some special characteristics of farms that need to be recognised when implementing insurance solutions include:

- farmers often manage and work on the farm – they may in fact be the sole permanent worker on a property.
- the farming family live on the farm and ‘off’ the farm- many of their living expenses are intermingled in the farm activities.
- if death or disablement forces them to move off the farm they will incur higher costs of living than when they are on the farm.
- farming is generally seasonal and there are periods where the effect of the loss of the farmer would be more catastrophic than others.
- succession, which is often a priority for the farm needs to be fully understood and provided for in the planning.

Professional advice on insurance solutions designed with to match the needs of the farm and the farming family are essential to ensure that every dollar spent on insurance delivers an effective outcome.

But insurance is only one part of the solution. A holistic farm resilience plan is required, aimed at minimising all risks the business faces to maximise the chance it will withstand the loss of a key individual without significant impairment to financial performance.

The resilience plan requires:

- the documentation of the farm operational, governance and decision-making processes – as a backup to having them in the head of any one person;
- a response plan to allow for the loss of key people;
- decisions on governance, and improving the property’s capital and cash flow;
- plans for trouble-free changes to farm shareholding;
- the estate plan; and
- a suitable insurance plan to cover key individuals, the farm, farm owners and the family.

The implementation of an effective resilience plan will be best achieved through the collaboration of the professional advisers who share a common goal- to support and advise the farming community to build successful, sustainable farms and that are prepared to withstand the shocks that inevitably occur.

References

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