HOW CAN A DAIRY FARMING BUSINESS SURVIVE AND THEN THRIVE IN A VOLATILE WORLD?

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Volatility

Volatility is all about continued ups and downs at unexpected times for unexpected reasons. As New Zealanders are reliant on far away markets, we should continue to expect volatility. It is the world we live in. Things such as the price of crude oil dropping from $120/barrel to $30/barrel, the price of urea dropping from over $900/ton to a $500/ton, the price of milk powder dropping from $5500/ton to $2000 a ton. All of these things and more will just be the new normal.

Volatility also means that things move up too, of course. Over a period of time, volatility actually creates many opportunities. Remember that our inter-connected world links lots of things together so that often a bunch of things can seem to go up or down together. Do we understand why? Do we think of volatility as a good or a bad thing?

The new normal

As humans, we are wired to think things will go back to the way they were, particularly if those were good times. What we have to accept though is that things probably won't go back to the way they were. For example, the fast rising capital value of land that saw dairy farmers being called the new white gold miners. That term isn't used so much these days! We had an inbuilt expectation that no matter what happened, land capital gain over time would sort things out. In actual fact this doesn't happen anymore, and hasn't happened since the time of the GFC. But many of us think it still operates. Land is subject to the same laws of supply and demand as anything else. In many areas it has taken 7-8 years to get back to pre GFC land pricing. Now we are in the middle of a land price decline. Dairy farming hasn't always been about profit but

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now it should be. All other agricultural industries understand this. Recently in the Kiwi Fruit industry for example, land prices collapsed because no one could make any money. In an incredible story, Kiwi fruit farming is now profitable to the point that orchard prices in some areas have risen by a factor of ten, yet even at those new higher orchard values they are still making profits.

The NZ exchange rate stays stubbornly high against all predictions; interest rates are at generational lows. Do we think this will continue, or not?

Averages aren't helpful

All an average does is tell you over a very long period of time what we could expect if average conditions prevail all the time. Given that average conditions never prevail, we never actually experience average. Weather is our best example of volatility, it goes from one thing to another despite the weather forecasters' best efforts. We need to understand this and what its implications are for our business regarding the weather, economic climate, markets, feed prices etc.

A recent example. When interest rates were a little higher recently, many farmers in the South Island had interest bills that were $1.50-$2/kgMS. It was also not uncommon for farmers to have farm working expenses of $4.50-$5.00/kgMS. On average, this meant that interest and farm working expenses were $6-$6.50/kgMS. Given that was the average milk price for some time, then despite the $8.40/kgMS milk price one year, the average farmer was making no money. Hence if you want to be a good dairy farmer, you need to be a lot better than average, top 25% is the goal.

Markets are broken

Part of our new norm is that markets as we used to understand them are generally broken. We have the reserve banks of a number of countries around the world driving policy that actually doesn't make economic sense the way my parents understood economics, i.e., live within your means and don't make promises you can't keep. My economics tells me if my business or job is under threat, I want to reduce debt, save money and cut spending. Yet economists around the world are convinced they can make people do the opposite. Have we factored broken markets into our business plans?

The big picture

Having an understanding of the world that we live in, the countries we export to and import from, countries where our staff come, long term trends, short term trends - what really matters - is important for our business and our jobs, e.g., young people today are in jobs that didn't exist 10 years ago; jobs such as social network marketing and app development.

The concept of being a good farmer, but one who makes no money, makes no sense at all. We need to change the definition of what a good farmer entails. A good farmer is someone who feeds their stock well, looks after their people, enhances the environment, and one who also makes a profit. All four components are what makes a good farmer. Someone who feeds their stock well, but who on average over the years makes no money is a poor farmer, no question.

Flexibility

In our volatile world, given that we are struggling to know what's happening tomorrow, let alone later this month, or next year, or in five years' time, we need to have a lot of flexibility in our businesses. We need the ability to keep capital expenditure to a minimum unless I am very confident of what the capital expenditure will return. I must be prepared to adjust things on farm according to what is happening in the market place. A theoretical example. If I thought there was a chance winter grazing might drop to $5/hd/wk over the next 12 months, and that milk price in the next 12 months might be higher than $5/kgMS, then maybe wintering everything at home on the dairy unit might be something to think about very carefully. Just because everyone is doing it doesn't make it right for you. The question is, why are you doing a certain thing?

Given that every client I work with who has fixed a rate for any length of time since the GFC (that's 8 years now) has always been better off to stay floating, what does that say about our intuitive instinct to fix interest rates? It used to be you fixed rates to reduce risk. Now it seems to be the reverse. Currently, the floating interest rates are acting as a hedge against the milk price. Will that be the same for a while? Who knows, but *you* need to make a call, not your accountant or your bank manager.

Farm management

Most of our traditional sharemilking arrangements do not handle volatility well and this is scary for many of us. However, there are many ways of incentivising those who manage and work on farms. Let's not limit our imagination here and be held back by the conservatism of some of our professional community. There is nothing magical about sharemilking agreements.

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They are just a means to an end. If they are not achieving the end, we need to find another means!

If you are a sharemilker or manager you need to understand that the average dairy farmer has made no money in the last 8 years, despite what you may read in the newspapers. If you can demonstrate to land owners that you know how to make them a profit year in and year out, you will steadily build equity over the years and there will be plenty of opportunities. If you stick to the old ways you may not have a future.

Risk

We need to think about risk differently. The bank will not rescue us, the dairy company will not rescue us, the government will not rescue us when things don't go to plan. Therefore we need to have resilience in our business. How do we achieve that and what does it mean? It means we need to have as few fixed costs in our business as we can and flexibility and some fall-back options.

Who do we listen to?

None of us has all of the answers and all of us get things wrong. However, there are people you should listen to and people you shouldn't. For a start, you need to recognise that you are the only person looking after your business and you need to look after it. All of your business contacts, including all professionals, will have their own agenda to some extent. You need to be very clear with your contacts and what you and your business is all about. You need to understand the difference between a trusted advisor and all other job titles. Just because someone is a lawyer, accountant, or consultant, it doesn't mean they are a trusted advisor. It doesn't mean there is anything wrong with them, but they may not be there to look after your best interests. They probably won't have enough of the picture to determine what your best interests actually are. More than likely, they may be just giving you advice on a certain part of your business the best way they know how.

Your challenge is piecing together all the bits of advice you get in a way that makes sense for your whole business. This may not make sense to any of your neighbouring businesses but you have to be able to kick this around with your spouse and/or trusted advisor.

How do you know you have a trusted advisor?

A trusted advisor generally should listen to you and help you formulate your big picture objectives if they are not initially clear. They should share similar values to you. This only becomes important in the tough times, but then it becomes very important. They should have the strength of their convictions to share an opinion and be able to disagree with you. They should also have a good dousing of common sense and be able to help you see through all the 'white noise'.

Be clear on big picture goals

We now have a plethora of people and groups who say all grass, low cost farming is the way to go. My question is, "Where were all of these people in the last 10 years? What were they saying then, and what will they be saying in the next 10 years? When the milk price recovers, will this message change again? History says it will. My point is that your big picture objectives shouldn't change over things such as milk price and interest rates. Your strategy and how you handle risk may change, but where you are heading shouldn't. Hence if you are able to run farm working expense of $3.50/kgMS or less, why would this ever change, no matter what the milk price rises to?

It may not be all about cost cutting

Sometimes you do have to spend a dollar to make 3 or 4. Also, sometimes saving a dollar can cost you 3 or 4 more. We need the wisdom to judge where that line is. Balance knee jerk reactions with long-term thinking. When making some of our cost cutting decisions, we need to think about the markets and how they might respond and become a studier of human psychology. For example, if you think all of your neighbours are cutting young stock numbers back drastically and aiming to rear very few heifer replacements this year, what do you think may happen in the livestock market in 18 months' time?

Negotiation

Many farmers are poor at negotiation. They either take what is thrown at them or they thump the table, yelling and screaming. However, actually appreciating the counter position in your market, understanding where they are coming from and then working on your long term negotiation strategy are critical parts of negotiation. You also need to be consistent.

For example, you will not get the best rate at your bank unless you consistently make your bank aware that low interest rates are very important to you, that you are aware of what is

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happening in the market place and that you expect to be getting the best rates. You also have to do your bit by maintaining good equity and profitability of course, but that is not sufficient on its own. It just earns you the right to have the conversation. You have to look through the bank techno speak. I consistently come across people in the farming community who are paying floating interest rates under 5% or fixed rates under 6% and think their bank is doing a great job for them, without realising that the best rates around now in the rural community are actually under 4%. This same issue exists in all other markets, e.g., feed and grazing. Yes, there is an average somewhere but there is a very wide range. Where do you want to be in that range? Only you can decide.

Perspective

We all need a wider perspective. I am very passionate about looking after our personal nutrition, exercise regime and interests outside our business. You will feel better about yourself and make better decisions if a) you are well rested, b) your mind is taken completely off your business on a daily basis and c) you spend time with friends and family on a daily basis.

Summary

- Understand and plan for volatility.
- Appreciate there may be new norms that are completely unfamiliar to us.
- Averages can be entirely unhelpful.
- Flexibility is key.
- Develop skills such as negotiation and handling advisers.
- Retain a wide perspective of the world that is bigger than your business.