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Farm Business Guide

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The risk at the top

Of all the skills that today's farmers must breed into the next generation, the most important is knowing when to take a risk

TOM BUTTON, EDITOR / COUNTRY GUIDE

It's too easy to think of risk management in completely negative terms, like worrying whether market prices will fall, interest rates will rise, or your neighbour will sell the land you've been renting at a price you can't afford.

Those are all real risks, of course, and they absolutely must be analyzed and addressed, starting with the tools in John Greig's story on page 6.

But the leader's job of risk management is also a very constructive one. It's about understanding risks in terms of how they can help or hinder you in achieving your goals for your farm and your family.

This is why our lead story, written by Maggie Van Camp, focuses on risk management as a leadership trait. The obvious thing for us would have been to start this risk management supplement with a detailed look at where commodity prices are going, for instance, or what the chances are that the loonie will suddenly jump toward parity.

It seemed to us though that the parallels to crop production are powerful. Writing about commodity prices and exchange rates is like writing about fusarium or weed resistance. These are essential things to know about and manage, but what you really need if you're going to grow a great crop is a great farmer… a person who understands the big picture and uses it to make great decisions.

And what you really need if you want to excel at risk management on the farm is a leader who sees the big picture and makes great decisions to move toward it.

Better yet, it's a person who understands the big picture, makes great decisions, and also involves everyone from family members and employees to input suppliers and bankers in working toward that vision.

Do read Maggie's story. It's crammed with insights.

And when you read it, keep this is mind. We must do a better job of giving today's young farmers and the generation that is coming up at their heels the skills, attitudes and vision they will need to manage farm risks into the future.

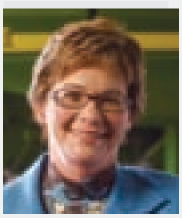
There are many news reports that, as a generation, millennials are far more risk averse than their parents. Maybe those reports are right, maybe they aren't, but I do think it's fair to say that few young farmers today have been tested like their parents' generation.

So read Maggie's story as a sort of checklist. Then ask two questions. How do you score on those traits? And what can you do to help your next generation score even better?

Meanwhile, we'll be busy preparing two more special supplements with RBC this year, on succession planning and financial planning.

And as always, I hope you'll take a minute to let us know: Are we getting it right? I'm at tom.button@fbcpublishing.com.

GWEN PADDOCK
NATIONAL DIRECTOR, AGRICULTURE
ROYAL BANK OF CANADA



At RBC we know that farming is not only a way of life, but also an essential contributor to the Canadian economy, which is why we're proud to partner with farmers to help you deal with present-day challenges — whether that's volatile commodity markets, the fluctuating Canadian dollar, increasing globalization, the need to establish public trust or changing weather patterns.

Running a successful farm business requires specialized knowledge about everything from agronomy to climate change to global markets — not to mention all the latest technology. It also requires you make hay while the sun shines — and prepare how you will mitigate the several risks your businesses can face.

We're pleased to work with *Country Guide* to highlight the importance of risk management and share some strategies you can use with your business. Should you have any questions, the RBC team of industry experts can help you manage risk and grow your business. We look forward to the opportunity to partner with you.

LEAD THE WAY

Great risk managers tend to share leadership strategies that can work on your farm too

BY MAGGIE VAN CAMP, SENIOR EDITOR / COUNTRY GUIDE

Farming means risk. So when the USDA recently tried to sort the different risks that farmers face into different categories, the list they came up with was a long one, with seven distinct categories that threaten today's farms, including risks arising from production, price, casualty (fire, weather and theft), technology failure, relationships, legal/regulatory, and human resources.

Yet strong farm leaders continue to pull their farms through tough economic times. Somehow, they survive political instability, price crashes, disease and pest infestations, and even sweeping social and technological changes.

Sometimes, admittedly, it's dumb luck. But more often, when you look at who's steering the farms that have managed to prosper despite all these risks, you see a group of leaders wielding very similar skills.

In other words, risk management isn't just a process you adopt or a set of questions you ask, important though they are. It's also a leadership attitude, and a leadership strength.

That's why *Country Guide* asked three agricultural leadership veterans — Rob Black, Danny Klinefelter and Gwen Paddock — about the leadership skills that allow some farms to survive and thrive when others stumble and fall.

We wanted to know, what makes a leader resilient?

All three agree that strong leaders score high on identifying, analyzing and prioritizing risks, and on managing them proactively.

Recently retired, Klinefelter co-ordinated and taught TEPAP, the Texas A&M-based business course for farmers.

Paddock during her 32 years in banking and as national manager for agriculture and agribusiness at RBC, has sat at many desks and kitchen tables listening to farmers and talking with them about their farm financials.

Black is chief executive officer of the Rural Ontario Institute, which has built the Advanced Agricultural Leadership Program on the belief that strong leaders model the way, inspire a shared vision, challenge the process, enable others to act, and encourage the heart.

"Resilient leaders," says Black, "do this in spades."

COMMUNICATE AN OVERARCHING GOAL

Resilient leaders see the big picture, says Black. Although they are also immersed in day-to-day work, they keep a wider perspective in front of them, and they tend to think longer term too.

"They have a vision for the future," says Black. "In the hard times, that vision gives them a light at the end of the tunnel to focus on."

As well, since they see the bigger picture, they're more willing to take appropriate risks, i.e. risks that pay off in moving the farm closer to its goal.

Importantly, these leaders find their focus on goals can be motivational, Black adds.

Klinefelter agrees. He finds these leaders discuss specific goals and objectives, they constantly monitor performance, and they use advisers and team members to create a culture of change.

As well, regardless of age, these leaders build a sense of purpose. They talk about the farm's goals, and they involve the whole family, says Klinefelter. "They're able to motivate others to act and to buy in."

THE LIGHT IN THE TUNNEL

There will always be commodity volatility. Weather is unpredictable, global economic conditions change, and "black swan" events occasionally turn our worlds upside down.

"Everyone's going to have stress," says Paddock. "There's risk with farming, that's all there is to it."

At the end of the day, though, it matters if you are prepared for the risks, if you understand exactly how they can impact your farm, and if you have a plan in case of potential problems.

Paddock says she is regularly impressed by the farmers who share their plans about where they want to take their operations. These leaders identify which aspects of their farms require risk management, and they think the issues through, creating actionable plans.

These farmers tend to take a longer-term view, says Paddock. And they allocate resources according to the commodity cycle and their core business strategy, avoiding short-term or knee-jerk capital purchases.

Great risk managers excel at keeping their focus on their most important long-term goals, says Black

Crucially, they also understand that sometimes risk is linked to opportunity, and that they need to manage their overall risk so they will be in a financial position to take advantage of opportunities when they come along.

To be able to do this, they build working capital in the good times, they retain some earnings for when the downturn comes, and they leverage their financial strength then.

"They have a bootstrapped balance sheet," says Paddock.

Strong farm leaders have patience and they understand that sometimes it's just a matter of timing. Also, their plan will focus on two or three concrete changes at a time instead of either having very vague goals or trying to make so many changes that the process gets overwhelmed.

"Resilience is built piece by piece," says Paddock.

Strong leaders also understand that plans must continually evolve, and they must be updated regularly. For example, succession planning can take years to do because of the many tax and personal issues that crop up, plus the changing needs of the people involved.

Through this period, farm leadership must be flexible enough to handle the changes in position but strong enough to keep standing when under stress.

This means a risk mitigation strategy is like the backbone of an overall strategic business plan.

Resilient farms have plans made ahead for things like insurance, business goals and budgets, marketing and succession, Klinefelter adds. "They don't want to be caught scrambling."

COOL UNDER PRESSURE

Resilient leaders not only anticipate change, they drive change and find ways to capitalize on it, says Klinefelter.

In crisis situations, they're better able to see pathways through the problem without getting caught overreacting.

It's like how top athletes are said to see the pace of the game slower so they are able to conceptualize potential plays and opportunities to score.

Says Klinefelter: "Strong leaders rise under pressure, and know how to turn it on at the end of the game."

These leaders tend to think rationally under pressure, when others might be affected by hectic, chaotic situations. "They don't let their emotions rule their thinking," says Klinefelter. "They watch, make adjustments, try new things and know when to get out when things go wrong."

KNOW WHEN TO CALL IT

Resilient leaders learn from their mistakes and know when to get out, says Klinefelter.

They're able to see that sometimes elusive line when it no longer makes sense to try to turn around a situation, or when their ability to lead with impact is overstretched.

In other words, good leadership is also the ability to see when to switch gears and move on to another situation, cause or business. They don't ride it until it dies.

"Today's leaders have to know when to jump in and jump out," says Black. "The issues are complex and there are multiple tasks, so the maximum impact they can make tends to be limited to certain times."

EMBRACE CHANGE AND NEW SKILLS

Strong leaders have a continuous-improvement mentality. Because of this attitude, they're also quick to spot mistakes, and Klinefelter says don't get married to things.

That also enables them to make more objective assessments so they don't quit on something because of a setback. Instead they make their choices based on evidence, not ego, and when things go wrong, they try to figure out what they can learn from the experience.

"They accept that mistakes happen, but they look at it as if every problem has the seeds of a solution in it," says Klinefelter.

Also, they keep important information up to date, which helps them to analyze and mitigate situations. The sooner they know there's a problem, the less of a problem it becomes.

These resilient leaders are constantly making decisions, experimenting and changing instead of stockpiling issues or pushing them aside. So when a change does happen, it's not such a huge deal since they have a system in place.

Over the years Klinefelter has known some particularly resilient farm leaders who looked outside of agriculture for consumer trends, new technology and people. Then they fed those possibilities into their farms.

Similarly, Paddock has noticed some larger farmers in Canada are beginning to reach out to other industries to learn about finances. These clients are looking for more complex financial products available to other commercial business, like commodity derivatives or interest rate swaps, which might be good solutions for their size and scale of business.

Strong leaders are like great athletes, says Klinefelter. They "rise under pressure, and know how to turn it on at the end of the game."

However, whatever the size of the farm, resilience tends to come down to the basics of good production and financial management. Resilient farms connect the numbers to their farm, the people involved, and the future. These farmers know their cost of production and acknowledge that commodity cycles are simply part of the business.

And they also use ratios to monitor and benchmark to help flag any concerns before the alarms start sounding.

"They interpret their financial statements instead of just generating them for their bank," says Paddock.

According to a recent AMI survey, top farmers commit to continuous learning, and Paddock has found that leaders on resilient farms not only make it a priority to participate in peer groups, they make it a priority to learn from them.

CONTINUED ON PAGE 6

CREATE STRONG RELATIONSHIPS

Resilient leaders are big on collaboration, says Black. They work well with others, know where to turn for help, and have strong relationships in place. "These leaders tend to surround themselves with skilled talent," says Black. "Strong leaders know they don't know everything and that they need to rely on others."

These farms excel at finding and retaining employees and they are good at competing with other industries for staff. This is because they have clear performance expectations and explain their vision for the farm, and share that information with their employees.

And good leaders listen carefully. They know that seeing a problem or situation with multiple sets of eyes allows them to consider more opportunities.

This connectivity extends beyond the farm. These farmers are linked to other leaders through business and social interactions and through their church and community. "They're connected to a variety of people, many of whom are also movers and shakers," says Black.

"Good leaders tend to soar with other eagles instead of scratching the ground with the turkeys," agrees Klinefelter.

But that doesn't mean they're arrogant, or that they're always seeking the limelight. "Many leaders view themselves as servants. They like to be in the background, serving others," says Black

This drives positive relationships both personally and professionally. At the end of the two-week trip away during the AALP program, Black tells the group to listen to what happened at home before talking about their exciting trip. Ease into it and share it slowly so it doesn't overshadow the huge commitment it takes from the people back home who kept the farm going.

Nor is this goal-oriented, team-based leadership approach limited to large mega farms with many managers. Recently, Klinefelter has worked with mid-size farms, helping them collaborate among themselves to develop better systems for buying inputs, hiring consultants, and adopting new technology.

But many top U.S. farmers today do have formal relationships with retailers, processors and suppliers. They have contracts for production, and they predetermine prices and production needs. For this to work well, they need strong business relationships with good, transparent communication during the whole growing season. "They believe in transparency with managers, family, and their credit organizations," says Klinefelter.

Resilient farmers should share information — both good and bad — with their banker, says Paddock. We have a tendency to not talk about things when they are going badly, but the sooner you share information, the more options you will have.

"Communicate early," says Paddock. ◣

10 STRATEGIES that reduce farm risk

BY JOHN GREIG, FIELD EDITOR / COUNTRY GUIDE

Markets are more volatile than ever. Land and equipment cost more. The dollars riding on every decision keep getting bigger. And risk management is a crucial skill for today's farm families.

Is your risk management up to scratch? This checklist will help:

1 KNOW HOW MUCH DEBT YOU CAN SERVICE.

Debt servicing is the first risk management area to look at, says James Fehr, a vice-president of commercial services with RBC in Winnipeg.

"Most farms have enough security," Fehr says. "It comes down to their debt servicing. What is their working capital?"

With good financial statements, working capital is a simple calculation. Take current assets and subtract current liabilities.

Using the same number, divide your current assets by current liabilities. This will give you your current ratio. Then track both your working capital and your current ratio over time to monitor your short-term financial health as well as your overall efficiency.

If it sounds complicated, it isn't once you get started.

And it's important too. As land has risen in price, servicing the debt on the land can be challenging, says Stuart Person, director, primary producer agriculture for MNP.

2 CALCULATE YOUR FULL COST OF PRODUCTION.

Making sales at a profit reduces your risk of losing money. But in order to know whether a sale is profitable, you need to know your actual cost of production, says Steve Funk, director of farm income programs with MNP.

"It should include everything, not just input costs," Funk emphasizes. Also included should be capital costs, all interest, rent, even an allowance to pay yourself.

That makes it more time consuming to work out, but it also makes your number much more reliable as a tool for reducing risk.

The number of farmers working our their actual cost of production per commodity is growing, but it still isn't as widespread as it should be.

Funk is clear about his advice. Calculate your cost of production, he says, and make it "fully loaded."

3 DEVELOP A MARKETING PLAN, AND TAKE A RISK MANAGEMENT APPROACH TO CURRENCY AND INPUT PRICING.

Ask your banker, your suppliers and your buyers or marketing advisers about tools and strategies for reducing your exposure to volatile prices.

Many farms are exposed to the Canadian exchange rate, especially since many commodities and high-value inputs like farm machinery are essentially priced in U.S. dollars.

What impact would a sudden change have on your profitability? Potential risk management strategies range from seasonal selling to hedging the dollar through financial institutions.

4 CREATE JOINT VENTURES TO JOINTLY OWN LIVESTOCK OR EQUIPMENT.

Farms have worked together for years to buy more expensive equipment such as sprayers and combines, but there are other areas that can make sense with some creativity. Some farms are pooling all their equipment and then paying that joint venture to work the land. A farmer who has excellent animal husbandry skills may diversify by custom managing some cattle.

As equipment has risen quickly in price, these sorts of joint ventures on equipment make more sense, says Person.

5 USE OFF-FARM INVESTMENT TO BALANCE FARM RISKS.

Off-farm investments can mitigate your exposure to volatile commodity markets. These investments can also be placed so as to balance your overall financial risk, and include anything from equities to real estate.

Off-farm investments can also become useful in your long-term succession planning, Fehr says.

For instance, non-farm assets can provide a secure retirement for the parents, thereby allowing the younger generation the freedom to manage the farm assets for future growth.

6 CREATE AND USE AN ADVISORY GROUP.

Fehr advocates forming an advisory group. This can be a group comprised of your accountant, your lawyer, your lender and your insurance agent, for example, and they could meet once or twice a year to help you formulate an overall plan while also helping ensure that all your key business advisers understand "the whole picture."

Or your group could consist of trusted business advisers who can provide third-party input and advice.

Funk says that peer advisory groups can also help reduce your risk by understanding how similar farms operate. "When you get people like that in a room, that's when you get really good ideas flowing," says Funk.

7 GENERATE HIGHER MARGINS TO LESSEN COMMODITY RISK.

Value adding doesn't have to mean you produce a product and manage the supply chain right to the customer. It can be producing seed, or cleaning seed. It can be moving up the value chain slightly, such as buying trucks to move feed.

Fehr says it can also be doing more of your own feed mixing, citing a dairy farmer who was having a custom TMR made for him, but realized that 20 per cent of his annual net cash flow was being depleted by purchasing prepared feed.

8 USE REVENUE INSURANCE THAT WORKS ON YOUR FARM.

There are several insurance options for managing risk on your farm, says Funk. They include traditional crop insurance and other production insurance products to cover production risks. Other private options now cover whole farm revenue (meaning yield and price coverage), along with price and quality and inputs.

There's also the government AgriStability program. With all those options, it can be challenging to figure out your farm needs. MNP has software that evaluates different options for farmers. The goal is to use programs that work together to fill in the risk gaps on your farm.

Off-farm investments can also become useful in your long-term succession planning

9 CONSIDER ALTERNATE INPUTS WHEN COSTS CLIMB.

If you are stuck on a commodity input with no alternatives, then you have risk when those commodities rise significantly in price. Having an alternative can be an important manager of risk. This is especially important for livestock producers. Work with a nutritionist who can incorporate alternatives, says Fehr.

10 LOCK IN INTEREST RATES AND VARY YOUR TERM LENGTHS.

Farmers are watching interest rates. While there is some potential to use products outside of normal financing to tie lending directly to markets, Fehr says that in most cases, "laddering" investments is a more accessible and applicable strategy.

If you have something like 20 per cent of your debt being renegotiated each year, then you can mitigate some of your interest rate risk, says Fehr. However, this also depends on whether you need flexibility for expansion. If not, then you can lock in for longer term.

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What’s your Next Move?

When high-quality assets become available, time is often a factor. If the price is right, you’ll want to act fast. With your RBC Farm Management Line, you’re always ready to buy inputs, land, technology, whatever you need to grow. Your RBC agriculture banking specialist will set you up so you are ready when you need it, with repayment geared to your farm.

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