8 GRAIN SELLING VERSUS MARKETING

One of the greatest influences on profits is the commodity prices you receive. How can you improve your grain selling skills?

8 GRAIN SELLING VERSUS MARKETING

One of the most important drivers of farm business profit is the price that commodities achieve each season. Farmers need a number of skills to achieve good prices, but are these skills in grain marketing or grain selling? Marketing involves a range of activities whereas selling refers to obtaining a price.

KEY POINTS

- Most grain producers are sellers, not marketers.
- Know your cost of production to determine your target sale price.
- Know your strategies for grain selling.
- Volatility in price is good for grain selling.

8.1 BUSINESS PROFITABILITY

Put simply, the equation for farm profit is:

(Production x Prices) – Costs = Profit

This equation might seem to imply that price received and levels of production have equally important roles in determining profit. In reality, seasonal variability has a greater impact on profits than does price variability. A survey by PlanFarm, a farmer benchmarking service in WA, indicates that production variation accounted for almost all the profit variability in farmer results. Dr Ross Kingwell (Dept. Ag WA) (per com), clarified this difference as 70% of profit impact coming from productivity variations and 30% from price variations, as in recent times there had been a significant increase in price volatility. Management of production clearly has a greater impact than price. However, it is worthwhile for managers to put significant effort into both the sale of grain as well as its production in order to generate reliable profits.

Regardless, farmers often find it easier to focus on production rather than selling. This preference could be the result of recent market deregulation giving rise to more buyers and greater choice in the market, making this aspect of the farming business more complicated and confusing than previously. It could also be that in the recent past, the existence of the Australian Wheat Board (AWB) as a single desk seller provided Australian farmers with well-performing grain pools. All that farmers had to do was deliver to the pool. Or it may be that it is easier to see production happening in the paddock than to 'see' selling happening on the computer or phone. Whatever your preference or history with grain selling, improved grain selling skills can lead to improved business performance. The key is to allocate effort and resources, principally your time, in a balanced way.

8.2 GRAIN MARKETERS OR GRAIN SELLERS

People in the grains industry freely use the phrase 'grain marketing'. This implies the need to use marketing skills to sell grain, which is generally not the case. Marketing implies that you have a product that needs to be packaged in a certain way, promoted to the market and priced in such a way that it will sell. A good example of a product needing marketing in agriculture is stud rams. To be marketed, these products require:

- **Promotion** – Important information about the benefits of the product needs to be advertised to the market to attract buyers. For example, a sheep stud will advertise the benefits of the various traits being bred into its stud rams.
- **Positioning** – This is about where the product sits in the market relative to quality and price. In the stud sheep industry, presenting rams at sheep competitions and gaining prizes greatly assists with reputation building and demonstrating quality.
- **Packaging** – How is the product to be presented and packaged? Again, ram sales are a good example where every effort is made to present the animal. Grooming and supplementary feeding help to present stock in excellent condition.
- **People** – Often 'word of mouth' helps spread the reputation of a product. If you respect someone's opinion and they say how good the product is, then you are more than likely to also purchase that product.
- **Pricing** – The marketer often sets the price for the product and they may have some market power or a very good reputation. For example, a ram from a reputable stud could sell for $5,000/hd, where other studs may only achieve $1,000/hd for their rams.

The marketing of stud rams requires skills that address the aspects listed above. However, when selling a bulk commodity like grain, you do not need to address these wider marketing aspects as the bulk commodity market place is very different.

In selling a bulk commodity with limited ability to differentiate your product, such as grain, fruit, vegetables and minerals, prices are set by both the supply and demand in the market place at a particular point in time. Generally, producers of these bulk commodities can only sell at the price set by the market place. There are few examples where farmers have differentiated their grain to attract a higher price. One good example is Kangaroo Island Pure Grain, which has achieved higher canola prices by exporting to Japan. Being 22km from the mainland by sea allows them to guarantee that their grain contains no genetically modified material and has been grown with minimal chemical input. This helps Kangaroo Island Pure Grain achieve a premium price for their product.

However, the vast majority of Australia's grain has little differentiation for the bulk commodity market, which means farmers have no influence over the market price for their grain. Sellers of bulk commodities are generally price takers. While they do not influence the market, they can search for higher prices on offer (over the season or even during a day) by choosing when to sell, who to sell to and what pricing mechanism to use.

Given this observation, grain producers are **grain sellers**, not grain marketers, and as such require skills in price discovery.

8.3 SKILLS OF A GOOD GRAIN SELLER

Grain market deregulation has caused fundamental change in the grains industry, resulting in a significant increase in the number of ways grain can be sold. There is now a two-year window of opportunity to sell grain via forward selling well before harvest to selling grain well after harvest out of storage. As grain prices do fluctuate widely (refer to Figure 8.1) it provides grain sellers with the potential opportunity of taking advantage of prices when they are high and not selling when prices are low. These decisions are also made depending on the cash flow needs of the business.

What strategies do farmers have to maximise profitability?

With little ability to influence the market price for their product, individual grain producers must look to other strategies to increase their farm business profitability. Consider again the equation for profit:

(Production x Prices) - Expenses = Profit

As producers, farmers can affect their profitability at one of three points: production, cost or price.

As **grain sellers**, what are the crucial skills needed at each of these stages?

'Steve: **'I've lived in the one house all my life – the biggest move I had is from one room to another. I left school at 16 and I've been farming ever since.'**

Lhot: **'I grew up in Manilla, Philippines - about 10 million people. I am a city girl, no farming background at all. I said 'If I have to work here and stay on the farm, I need a computer 'cause I love bookwork. It took me a while - maybe I attended more than 10 grain marketing courses for me to understand what it is about. My principle is, if I don't know, I'll ask questions, and I'll try to learn it myself, so at least I will understand what is going on.'**

Steve: **'For me as a farmer, I'll plan what I've got to grow in the ground and hope to produce something good. And for Lhot, her plan is to market that stuff so we work together well as partners. A lot of farmers they think about growing their crops, but they don't think about marketing.'**

Lhot: **'I'll try to have a combination of marketing options. We use 25% futures and swaps, then 25% of our production will be a physical contract. 25% will be during the harvest and 25% post-harvest.'**

Steve: **'Going down to the silos, you get to talk to other 'cockies' and see what grain's around and see what prices are posted at the silo. I get back to Lhot and say, 'There's a lot of this type of grain around, we'd better sell it.'**

Lhot: **'I review it all the time. When there is something happening, let's say in America, and there's a drought there or an over-supply, or there's something's happening here in Australia, sometimes I review our finances and spreadsheets once or twice a week. It's a risky business, farming. But we pray a lot. Sometimes it also affects the relationship when you have stress and we have to learn to work it out. It's not a perfect marriage or a perfect farm, but I think we have to learn to be supportive of each other.'**

Steve and Lhot Martin,
'Comfromabov', Minlaton, SA

Figure 8.1: Variation in Australian wheat prices over the last decade

Source: www.indexmundi.com

> **'We probably forward sell 50% of our crop and the rest we sell after harvest. I've got a really simple system: if sorghum's below $200, we don't sell anything; if it's $250 we sell some; if it gets to $300 we sell the lot. If the price is no good, we'll probably leave it in silos until we find a good price.'**
>
> Brian Gregg, 'Kolora',
> 'Emerald', Qld

1. Know how much you have to sell

This is one of the major challenges when it comes to selling grain, as farmers can now sell grain up to two years before and one year after harvest - a three-year window for selling. Looking at your property's historic grain production is a good start to estimating production at the beginning of the season. However, actual production is dependent on the area planted and the type of season experienced. There are serious risks involved in selling more grain forward or on futures markets than is actually produced when it is harvested at a later date.

2. Know your cost of grain production

Information about the various types of costs of producing grain, and the different time frames these costs relate to, is valuable information that is specific to each farming business. Refer to section **5.2.6, Cost of Production, Module 2** on how to calculate your cost of production. The cost of producing a tonne of grain is sensitive to seasonal conditions and the total amount of grain produced. A high production season will lead to a low cost of production per tonne, as there are more tonnes over which to spread the fixed and variable costs. The opposite occurs in a poor production season. However, it is important to know the range of your costs of production, so that when sales are made, profits are also being made. Having a 'target price' strategy that has a profit margin built into it enables the business to achieve profits.

Table 8.1: Wheat price deciles (June 2003 – June 2013)

	APW MG Wheat ($/t)
Highest on Record	$420
Decile 9	$352
Decile 8	$309
Decile 7	$292
Decile 6	$256
Decile 5	$230
Decile 4	$212
Decile 3	$191
Decile 2	$170
Decile 1	$156
Lowest on Record	$146
Average	$241

Source: Rural Directions P/L

Table 8.2: Choices for selling grain

Forward selling	• **Physical contracts** – This could be a physical forward sale where a contract for the amount of grain and price are agreed. The grain is then delivered at harvest to fulfil the contract. There is a risk that more production is contracted than is actually produced and so grain is needed to be purchased to fulfil the contract. • **Swaps** – In the grain futures market, either futures contracts or options are used to secure a price well before harvest. Most major banks provide these services and they are called 'swaps'. This type of market instrument works like a form of insurance for prices, as the grain is still delivered to the local authorities. Contact your bank for more information.
At harvest	• **Cash** – Sell grain for cash to brokers at harvest. Payment generally occurs within 30 days of delivery. • **Grain pools** – Sell to an industry grain pool where the pooled grain is sold over a period of time and the average price is returned to the producer. This will have cash flow ramifications, as grain pools take some months before all payments are made.
After harvest	• **Store in the industry silo system** – Deliver the grain to the silo system and sell the grain sometime after harvest. This option for grain storage is generally available for 8 months after delivery. There is a cost for storage. • **Store on farm** – Store the grain on farm in storage infrastructure owned by the farm. This grain can be sold later. There is no time limit for storage, although the responsibility to maintain grain quality rests with the farmer.

Source: P2PAgri Pty Ltd

3. Know the market

It is critically important to be informed about the market and its price movements. Information about up-to-date grain prices is readily available, with numerous electronic services providing timely information. While it is difficult to predict future highs and lows of the market in any selling season, some guide can be gained from historic price movements, as shown by the ASW Wheat Price Deciles in Table 8.1. This table gives an indication of both high and low prices and the deciles provide an understanding of the range of prices over a range of different historical conditions. For example, the Decile 5 price of $230/t means that 50% of the last 10 years ASW wheat prices were below this level, so this price is near average. The Decile 9 price of $352/t means that 90% of the ASW prices in the last ten years were below this price.

The last ten years of market data can be used as a guide to high or low prices in the market. Obviously, it is good to sell when the market is in a high position.

4. Know the various opportunities you have to sell grain

One of the most significant challenges for farmers is to understand the numerous choices they have for the method and timing of selling grain, and select the appropriate choice when the opportunity arises. Table 8.2 provides a broad description of the major choices available, but further research from the grain selling industry is recommended.

As previously stated, farmers can sell wheat and other grains from about 24 months before harvest to 12 months after harvest, which means there are approximately three years of price movements from which to choose grain prices that best suit the desired target prices of the business. The challenge is in having the nerve to balance the price with the ability to deliver and the cost of storage.

5. Know the risks

Price risk management is where the risk of price variations is managed. These are best managed using the range of wheat selling choices available (Table 8.2). However, some of the greatest risks can come from not fully understanding how some of these grain selling choices operate. An example of this was when a large number of farmers started using forward contracts a few years ago. The dry spring greatly reduced their production and they found themselves short of the tonnes needed to fulfil their contracts. At the same time, the grain price rose and so going out at harvest and buying the necessary grain to fulfil their contract shortfall cost them additional money for which they had not budgeted. This cost some grain farmers the significant amount of over $100,000. When they thought they were managing their risk, they actually increased it. Yield risk matters as well as price risk.

Risks associated with grain selling include:

- **Solvency of the buyer** – Solvency means the financial viability of the grain trader or broker you are dealing with. There are always instances of grain brokers going into liquidation leaving farmers with significant losses from unpaid grain payments. To gain some understanding of a grain trader's credit rating, contact your bank or local farmer organisations for information. More information can be found in 'Grain Contracts – Counterparty Risk' (**www.graintrade.org.au/fact_sheets**).

- **Contract risk** – When you enter into a contract at any time, you need to understand your obligation if things go wrong, as a contract is a legal document. This could include issues such as an inability to supply both the quality and quantity of grain due to seasonal challenges. You need to know who is liable for this and if there is any account taken of the season.

Some farmers pay grain selling advisers to assist with their grain selling, as this can be a technical area requiring specific knowledge.

8.4 DEVELOP A GRAIN SELLING PLAN

It is a good idea to have a grain selling plan, to separate the emotion from the logic of making a decision. Some of the strategies available to farmers include:

- **Chase the market and aim to sell at the highest price** – An expert can be hired to assist with keeping an eye on both the current and future markets, and advise when it is best to sell. The challenge here is that even the experts find it difficult to predict market price shifts as these could be due to unpredictable adverse weather conditions such as flood, fire and poor rainfall occurring in other grain producing countries.
- **Sell for cash at harvest only** – All the grain is to be sold at harvest right off the header, as it is only then that the total production is known. Sometimes harvest prices can be good and at other times they are poor. This strategy means you are at the mercy of the market at harvest.
- **Sell to grain pools only** – Traditionally, most farmers have sold to grain pools, especially when the Australian Wheat Board (AWB) had the ability to trade forward grain prices. This form of selling resulted in prices being averaged over a period of time. Grain pools in the current market do not have the old AWB advantage of forward selling, so tend not to perform as well. This form of selling means growers need to be happy that full payment may not be received for some months.
- **Sell 33%:33%:33%** – This is where a third of the crop is sold using forward selling methods, a third is sold for cash at harvest, and a third is stored and sold some time after harvest. This is another form of averaging or hedging, allowing the grower to have control of the timing of grain sales, and to hopefully achieve ‘higher than average’ prices.
- **Sell 50%:50%** – Similar to the method above, except 50% is sold at various times prior to harvest and 50% is stored to be sold at various times after harvest. No cash sales are made at harvest - it is a busy period on the farm and this is the time of the year when most of Australia’s grain gets sold, so prices may not be the best. This is another attempt at achieving results higher than the industry average.
- Any **variation or combination** of the above strategies.

Some questions you may have:

How do I know if the grain broker I use is good at the service they provide?

The answer to this question lies in the quality of service and trust. Also, you need to be clear as to what services you require. For example, this may include regular market updates, personal and clear commentary on what is affecting the market and what is expected in the future, and/or someone who understands the risks of selling and can advise on the best strategies. Once you have this list, a good source of information comes from other farmers’ experiences, so ring around and do your research.

Is using a grain broker worth the investment?

This is a difficult question as it requires you to estimate what grain net income you would have achieved using your own grain selling skills versus what may be achieved using professional advice and then compare the results. The difficulty is that you will not know this before the season and it takes discipline to record what you would have done without the professional as the season unfolds.

Another test is to ask yourself whether you are going to put in the effort needed to study the market throughout the year and to know what each selling choice is offering as the season unfolds. If you are not willing to put in the necessary time, then perhaps professional advice will provide you with additional income to cover its cost.

Is there one marketing plan that stands out better than others?

You would think one particular plan would work best as the international market operates within the seasonal cycles of both the timing of the northern and southern hemispheres harvests. However, this is interrupted by significant world climate events that affect this production cycle. So a plan that is good one year will probably not be the best in the following year. The best marketing plan is to aim to achieve an ‘above average’ price by using marketing information and observing the prices being offered by the range of choices available and comparing this to your costs of production. It is a bit like playing cards, as you know the rules and need to play each season on its merits.

Are there rewards for improving your knowledge of grain selling?

Again, this is difficult to answer but it largely depends on how much time and effort you are willing to put in to understanding all the sell choices, selecting a plan and then having the discipline to implement the plan. Farmers who have put in this effort have reported significantly improved profits, but it depends largely on the desires of each individual farmer.

Action points

- Make a considered decision at the beginning of the season on how you will sell your grain and develop a grain selling plan.
- If you do not have the necessary knowledge, either attend training or hire a professional grain seller.
- Monitor your grain selling performance each season.

Bruce: **'Lachie has a separate business with B-double trucks running on the east coast. They do most of our cartage and it fits into the grain trading and he's got a grain storage facility. We forward sell quite a bit of grain and probably stock as well, and that's part of the deal with the storage facility that Lachie has. We can put a lot of grain away and it goes to specialised destinations when it's required. We mainly sell it for cash flow purposes, but the facility is good enough that the grain can be stored and transacted there and delivered at a later date.'**

Lachie: **'It's a rough land, but half our success is because we're pretty flexible and nimble in adjusting to markets and weather conditions. Times are changing with different share farming arrangements, hybrid lease models etc. For anyone who wants to have a go and knuckle down, it's a world of opportunity really.'**

Bruce and Lachie Wilson,
'Murdeduke',Winchelsea, Victoria