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Developing a Grain Marketing Plan is Critical for Success

A well-thought-out marketing plan will enable you to manage the unpredictability of grain prices and their associated risks. A plan promotes the use of logical, orderly marketing techniques.

This fact sheet describes the five steps you can take to increase the likelihood of making successful marketing decisions.

Five steps to more successful grain marketing:

a) Develop budgets and know your cost of production;
b) Understand seasonal price trends;
c) Know about available pricing tools;
d) Put the plan on paper; and
e) Implement the plan.

1) Develop budgets and know your cost of production

Budgeting is an essential part of business planning, but it is one that is often overlooked. Growers must account for *variable costs* and *fixed costs* to develop accurate costs of production.

- **Variable costs** change with the level of production and include such inputs as seed, fertilizer, pesticides, fuel, labor and land rental costs. Crop insurance and drying costs also are considered variable costs.
- **Fixed costs** are expenses that are not dependent on the level of production, such as machinery, rent and buildings. Using custom rate charges is a quick way to estimate fixed costs, but it often does not reflect true costs. With today's escalating costs of equipment, be sure to take time to calculate your true costs. Remember the acronym DIRTI--**D**epreciation, **I**nterest, **R**epairs, **T**axes and **I**nsurance--which are the most common fixed expenses that should be included in a marketing plan.

Crop budgets are available at www.extension.umd.edu/grainmarketing. There are sample budgets, as well as Excel templates which are updated semi-annually.

Take time to know your true cost of production and set your break-even marketing objective. Also, compute your cost of production with high, average and low yields. Differences in yields dramatically affect the cost of production per bushel.

2) Understand typical seasonal price trends

Knowing price trends will help you market at the most opportune times. Typically, the DEC (December) futures contract for corn is highest in the spring and will gradually decline as harvest approaches. Elevators base their prices on futures contracts.

3) Know about available pricing tools

Any marketing plan is only as good as the information that goes into its development. Limited knowledge of marketing tools will constrain the effectiveness of the plan. Without current information, the plan will be outdated.

Forward contracts, PUT and CALL options, basis, basis variation, hedge contracts, margins, margin calls are essential tools of the marketing plan. Understanding these tools is critical for success. A marketing plan may include all or just a few of the above referenced tools. You need to understand which tools will work with your operation.

4) Put the plan on paper

Writing your marketing plan is an important step. It makes your decisions real and provides a starting point for your marketing actions. It can be in many formats (handwritten, spreadsheets, word documents) but must be recorded. Be sure to share your plan and discuss it with your farm partners.

"Winning the Game" marketing plans, developed by the University of Minnesota (UMN) Center for Farm Financial Management, can serve as a model for developing your marketing plan (see table 1). These UMN outlines include production and marketing information to consider, price objectives, and which pricing tools to use.

When properly done, your plan serves as a road map for the marketing year.

5) Implement the plan

The plan will only be beneficial if followed. Recording and recordkeeping are important to monitor the success of each step. Knowing the position of the plan at all times is essential.

A marketing transaction log serves as an excellent outline to record marketing actions. This scorecard is very simple and can serve as a quick reference to show pricing tools and bushels contracted. Detailed records will enable you to see all sales completed and properly calculate the total crop sales for the year.

Assessing Your Individual Situation Requires Information

A grain marketing plan requires in-depth information on production costs, likely yields, your farm's liquidity and solvency, and your individual preference toward risk. Every farmer's goals and objectives will be different.

As you develop your marketing plan, you should gather as much information as possible:

- Know ending inventories. Actual or predicted ending inventories include important supply (carryover stocks and production) and demand (domestic usage and exports) factors. Pay particular attention to which stocks are free to be sold and which are under government control.

- Subscribe to on-line crop reports. Many technical reports are available on-line, including free services at www.cme.com and www.commodityupdate.com.

  We recommend that you subscribe to a grain charting service and study the charts at least weekly. Bar charts of futures prices will give you a good feel for both short- and long-term price trends in the marketplace.

  The U.S. Department of Agriculture publishes annual national reports on planting intentions, planting progress, weather, and harvesting data. These reports can be found at www.nass.usda.gov/Publications. They can have tremendous influence in the short-term markets. Knowing when these reports are released can be beneficial.

- Consider these important questions. Are ending inventories expected to increase or decrease compared to the previous year? How do predicted ending inventories compare historically over the last 3 to 5 years? Is government policy expected to change the proportion of free stocks significantly? What has happened to prices historically when ending stocks were at similar levels? What are the similarities? What are the differences? Other things equal, tighter ending stocks mean higher predicted prices. Conversely, larger ending stocks result in lower predicted prices.

  What are the short- and long-term trends? Are the markets nearing historic price levels? Are patterns developing which are bound to repeat? What particular trends or patterns have developed? In general, if there is an indication that trends are reversing or are reaching historic price levels (either high or low), then a market reversal is likely.

Many Factors Influence Grain Markets

International factors. Commodity grain prices are influenced by worldwide events. Production in South America and other third-world countries, for example, affect world supply. Buyers have tremendous impact as well. Currency rates and the value of the U.S. dollar greatly influences if and when our customers will buy.

Investment funds. In the early 2000s, investment funds began to seriously study commodity grain markets. Following the financial crisis of 2007-08, investment firms transferred a huge volume of funds into commodities.

At the same time, the Chicago Board of Trade was bought by the Chicago Mercantile Exchange (CME) (www.cmegroup.com). Advancements in technologies have replaced floor traders and spurred a transition in grain trading. Many experts believe these changes are positive for local farmers since trades are made instantly and no one group can stymie trading action.

Large investment funds have formulated investments that require them to have a certain portion of their portfolios in commodity grains, as well as the other commodities such as currencies and energy. As a result, grain markets are influenced by the currency and energy markets. Watching the value of the dollar worldwide and oil prices can help you understand price changes in the commodity grain markets.

Take the Time to Re-evaluate and Modify Your Marketing Plan Periodically

Market conditions may change rapidly in an unexpected direction. If you fail to adjust your marketing plan, it may be too optimistic or pessimistic, or it may contain an inappropriate strategy or one which is impossible to execute.

The appropriate time interval to re-evaluate your marketing plan depends on market conditions. Your plan should be evaluated more frequently in situations, such as:

- before harvest because of the uncertainty associated with predicted production;
- when the market is volatile, rather than stable;
- when weather events occur;
- when the market reflects significant permanent changes in conditions; and
- when there are substantial changes in a producer's individual situation.

Generally, you should review your marketing plan at least once a month and no more than once weekly, unless market conditions or individual situations change. You should know how to manage the information obtained by subscribing to instant market news access available via internet or cell phones.

Be Familiar with Common Marketing Shortfalls to Avoid or Reduce Their Occurrence

Some marketing pitfalls include:

- *Over-reliance on price forecasts.* Some producers make their decisions by considering outlook information as fact. Forecasts are not always right and conditions can change dramatically, even in just a few hours.
- *Trying to pick the top of a market.* Some marketers lose opportunities because they hold out for higher prices. A better objective is to try to sell consistently in the top one-third of the yearly price range.
- *Omitting costs when computing net price.* If you decide to store your grain, for example, make sure you include the interest costs associated with not having the money from the sale of the grain. Omitting these costs will prejudice computation of the net price received, and could result in incorrect decisions.

- *Making all- or-nothing marketing decisions.* Overconfidence in their own or other marketers' predictions often entice farmers to sell nothing or all of their crop. A better strategy is to gradually sell portions of the crop. For example, sell 10 percent now, 10 percent later, and so forth.
- *Becoming overly emotional.* When prices are rising, grain marketers tend to be too optimistic. Conversely, when prices are falling, they tend to be overly pessimistic. Objectivity is preferred.
- *Yielding to personality bias.* Optimistic producers tend to have consistently bullish market outlooks. Pessimistic producers tend to have consistently bearish market outlooks. Individual grain marketer's should examine their natural biases and compensate for them.
- *Failing to communicate.* Grain producers should communicate their marketing plans with lenders and their families. Not communicating with lenders can create financial problems which may result in unwise action. Failing to communicate with families can result in undue stress and create an atmosphere with little support.

References:

Usset, Edward. *Grain Marketing is Simple; It's Just Not Easy*. University of Minnesota Printing Services, 2007.

<u>Table 1: Sample Pre-Harvest Corn Marketing Plan</u>

Chesapeake Farms:

- 800 acres of corn
- Average farm yield: 150 bushels per acre
- Cost of production: $3.50 per bushel (includes variable and fixed costs)
- 2010 expected production: 120,000 bushels

Objective:

- **Buy crop insurance to protect against production risk, and have 70% (84,000 bu) of my insured (APH) corn crop priced by mid-June.**

  - ✓ Price 10% of anticipated corn production at $4.25 (Dec corn) using forward contract/futures hedge/futures fixed contract
  - ✓ Price another 10% at <u>$4.30 or by 3/15</u>, using some form of forward contract
  - ✓ Price another 10% at <u>$4.40 or by 4/01</u>, using some form of forward contract
  - ✓ Price another 10% at <u>$4.50 or by 4/20</u>, using some form of forward contract
  - ✓ Price another 10% at <u>$4.55 or by 5/01</u>, using some form of minimum price contract
  - ✓ Price another 10% at <u>$4.60 or by 5/20</u>, using some form of minimum price contract
  - ✓ Price another 10% at <u>$4.75 or by 6/20</u>, using some form of minimum price contract

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