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Risk Management

Developing a Marketing Plan

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It is essential for an agricultural producer to have a written marketing plan. Developing a good marketing plan will help you identify and quantify costs, set price goals, determine potential price outlook, examine production and price risk, and develop a strategy for marketing your crop.

While producers have traditionally done a good job of producing, they have often neglected marketing. In the past, farm loan programs and deficiency payments allowed producers to neglect or ignore the marketing side of their businesses. Now, with the uncertainty of farm programs and increased volatility in the markets, producers will have the right and the obligation to determine their own financial security. In these more uncertain and risky times, failing to plan may be the same as planning to fail.

Importance of a Written Plan

In any business you must have a set of **goals and objectives.** A marketing plan is a **road map** to work from. It helps identify where you are going and how you are going to get there. Each marketing year has some similarity to previous years, but also some differences. You need that map to help you maintain perspective and stay on course.

The marketing plan should be written down. A plan not written down is only a dream you hope will come true. The plan must also be dynamic. As external market factors change, the marketing plan may need to be adjusted. Having a written plan provides **discipline** and is a good way to **check your logic** or the accuracy of your thought process after the year has ended. By putting the plan in writing and sharing it with your spouse, partners, etc., you will have a reminder that you had committed to follow a specific plan of action (for example, selling a certain percent of the crop pre-harvest if prices reached a certain percent over your cost of production). Writing down both the original plan and the changes you make allows you to analyze your decisions and thought processes later. You will be able to identify what you did correctly; but more importantly, you will see the areas where your analysis, strategies or discipline have room for improvement. This is one of the most critical reasons for having a written plan. You can not fix a mistake until you know what it is, and without a written record, it may be difficult to identify what really went wrong. Once you get the various parts of the plan put together, you can start conducting **what if** or **sensitivity analysis.** Since you know the future is uncertain, you may want to examine different possible price and yield scenarios and see how your strategies perform. You can also use the plan to help you determine what you need to do in the worst case scenario. This is extremely important, because you can not afford to let one big mistake put you out of business.

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Components of a Marketing Plan

Financial Situation and Goals

The first step in preparing a marketing plan is to review your financial situation. A review of the financial health of the operation (financial statements, debt load, non-farm income, etc.) will give you an idea of the amount of risk the operation can bear. In addition to the financial situation, other factors will influence your decision about what to produce, how to produce and market the product, the risk management tools you use, and how much risk you want to accept or avoid. Some of these factors are your goals and objectives, your personal risk preferences, age, etc. In some cases, lender requirements may be an over-riding factor. Many lenders will require producers to have at least some price and/or production risk protection before they will approve a production loan.

Determining What to Produce and Setting Price Goals

The second step is to determine which commodity/commodities to produce, and what price is needed to fulfill your goals. You need to start by determining which crop or livestock enterprises are possible alternatives. The list of alternatives can then be compared by calculating the cost of production and break-even prices. Often we calculate a break-even price to cover only production and harvesting expenses. As one economist put it, "You can go broke breaking even." You need to calculate the price necessary to fulfill your goals. These goals should include gaining enough income to pay your production expenses and debt obligations, provide ample income for cash flow, and possibly contribute capital to operator equity. Additional goals could be sending a child to college or purchasing new machinery.

Sensitivity analysis should be performed at this point to see how much a 5, 10 or 20 percent change in yields will affect break-even prices. Once you have an idea of the price objectives that will meet your costs and needs, you can compare the different crop alternatives to existing forward pricing opportunities and outlook projections to get an idea of which crop might be more profitable or less risky during the coming year. This, of course, needs to be evaluated along with agronomic and crop rotation considerations.

Market Outlook and Expectations

The third component of the marketing plan is to assess the market situation and determine what might happen to prices as you progress through the production and marketing year. While you may not be able to make precise price forecasts into the future, you may be able to get some idea of the probability that the market will offer a price that will meet your objectives some time during your marketing horizon.

Knowing how markets typically act and ways they may change in the future can help in developing a marketing strategy. Most commodity prices are seasonal. Seldom will the highest price for a seasonally produced commodity occur when harvest is in process, but it does occasionally happen in short crop years. Some of the highest prices and best pricing opportunities commonly occur before harvest, such as at planting or pollination time.

How do you expect the market to act this year? Supply and demand for the commodity around the world will dictate where prices go in the long run. Also, keep in mind that the supply/demand situation can be heavily influenced by the political process both in the U.S. and around the world. In the short run, market prices also can be influenced by technical trends, as many traders watch and follow those signals. In your marketing plan, write down those factors that you expect will influence prices. Relevant market factors could include current U.S. and world ending stock levels, projected consumption and exports, growing conditions in the U.S. and around the world, changes in trade policies, economic or currency fluctuations, seasonal or cyclical price tendencies, and price chart formations or other technical indicators. Again, remember that a marketing plan must be dynamic. As conditions change, incorporate the changes into the plan.

With the vast advances in information technology, the various pieces of information that influence market prices are more readily available to the public all the time. This ever increasing amount of information can be overwhelming, so try to maintain perspective and keep the big picture in mind.

Production Risk Tools

The fourth component of the marketing plan is production risk. There are numerous management practices such as irrigation, diversification and dispersion of land holdings that producers can use to help in the struggle against "Mother Nature" and reduce production risk. Beyond the cultural practices, other tools for reducing risk include using the growing list of insurance products. Crop insurance also has its detractors, but insurance providers have responded to the increasing risk by providing more insurance products to cover yield and revenue risk.

The tools for managing production and revenue risk are important not only because they reduce risk due to yield loss, but also because of their interaction with the pricing tools. Used correctly, they allow more flexibility to producers who wish to do more pre-harvest pricing.

Price Risk Tools

The fifth component of the marketing plan is to know what pricing alternatives are available and which ones you feel comfortable using. A word of caution: It is not an alternative to you if you do not know how to use it. Producers have a wide array of pricing tools in their arsenal, yet many are content to sell their commodity at harvest or shortly thereafter. Producers need to explore, learn and use alternatives in the future. A few examples of available tools are forward contracts, hedging with futures and options, minimum price contracts, basis contracts, cooperative pools, harvest time cash sales, and storage.

Each pricing alternative has advantages and disadvantages, and no one alternative is the best year after year. Many producers are reluctant to forward contract because of production uncertainties. Once you have sold, there is risk that prices will move higher. Buying a put option allows the producer to forward price his commodity prior to planting and still have upside price potential, but premiums are sometimes expensive. When you diversify by using several of the alternatives you can spread your sales out, which gives you a much longer marketing horizon over which to look for profitable pricing opportunities.

Price and Date Objectives

In this section of the marketing plan you can begin to combine the information from the previous sections (cash flow needs, costs, price objectives, outlook, production and price risk tools) and start identifying price and date triggers. By what date would you like to have some pre-harvest sales made? What price would you need pre-harvest versus what you would need or accept post-harvest? Are there some seasonal price tendencies that you want to try to take advantage of?

Strategies

Probably the most difficult, yet most important, component of the marketing plan is determining a way to combine all of your information into an overall strategy. This requires discipline and takes into account all the previous information such as the expected production, break-even price, market outlook, etc. You need to have a plan that covers what to do if prices rise, but also what to do if prices decline.

As an example, consider your upcoming wheat crop. You may choose to scale up sales, selling 10 percent increments of expected production at increasingly higher price levels. At what price would the first portion of the crop be sold or hedged? What tool would you choose to price the crop? Would you price only the insured production if it were pre-harvest? What if, by April, prices had climbed to well above your break-even price, the U.S. crop was looking excellent and prices were expected to fall? How much would you have priced using any tool? What will you do if prices decline to your break-even and you have not priced any

of the crop yet? Even if you think prices will go higher, do you need some downside protection?

Evaluate the Plan

Finally, the marketing plan needs to be evaluated both during and after the end of the marketing year. Determine what worked, what did not, and why. Evaluating the plan will help you identify areas that you need to work on. You may need to expand your alternatives by learning more about specific marketing strategies. Having a marketing plan will help take some of the emotion out of marketing, but it takes discipline to execute the plan.

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