Farm Level Management in Dairy: Does Policy Affect?

Terry Betker

Meyers Norris Penny LLP, 500 – 1661 Portage Avenue, Winnipeg, MB R3J 3T7
Email: terry.betker@mnp.ca
Website: http://www.mnp.ca

Take Home Messages

- Policy impacts on dairies directly and indirectly, formally and informally.
- The pace of trade reform and related policy change is very gradual. However, change is underway, evidenced domestically and internationally within the WTO.
- Shifting from day-to-day or operational planning to more formalized strategic planning will provide the best forum to deal with ongoing policy impacts.
- Past success is no guarantee of future success.
- There are numerous strategies that can be used to mitigate the risk that is related to changes in dairy policy.
- "We cannot direct the wind, but we can adjust the sails." Bertha Calloway

Introduction

In discussions with the Organizing Committee, two different topics for my paper and presentation were discussed. Firstly, we considered "Farm Management in Dairies: Setting and Implementing Strategies Related to Policy." Secondly, and chosen, was the topic "Farm Level Management in Dairy: Does Policy Affect?" I think that there is a close correlation between the two topics. In this paper, I will endeavour to put forth discussion relative to both topics because I believe that dairy producers are affected by policy and must set and implement strategies to deal with potential impact related to changes in policy.

At issue is the word 'policy'. Webster's defines 'policy' as: political wisdom (an interesting oxymoron); course of action adopted; prudent procedure (again, interesting!). There is a very broad application of policy as it pertains to dairy production. There are a myriad of policies that impact on dairies, some more so than others and, some directly and some indirectly. And they come from a variety of sources. Policy comes from government – all levels including international, federal, provincial and municipal. It also comes from industry. What about internal farm policies? While most producers probably do not have explicit internal policies, on-farm policies have an impact on management. This paper will not discuss the issue of on-farm policies and their use in management, but suffice it to say that as farms increase in size and complexity, formalizing internal policy becomes more important.

Having stated the above, I think most producers will firstly think of trade and production considerations when asked about the impact of policy on the management of their farms.

This paper will provide an overview discussion on policy and how it impacts on farm management, followed by some discussion on different strategies that are, or should be, considered to deal with potential policy impact. Lastly, it will outline a planning process that producers can use as a blueprint to assist them in managing the impact of policy on their businesses.

I am strongly of the opinion that dairy producers need to formalize strategies to deal with real and/or potential impacts related to policy development and implementation.

▪ Policy

Supply management would seem a relatively simple matter if achieving a balanced market were as straightforward as ensuring that domestic production matched domestic requirements. However, domestic policy can do little to stem over-production in other countries. Prior to the Uruguay Round of Agreement on Agriculture (URAA), Canada maintained a range of measures that placed limits on dairy product imports in order to maintain the stability of its national milk supply management system. These controls changed significantly as a result of the URAA. There was agreement to replace former quantitative import restrictions with tariffs and tariff rate quota. This effectively moved Canada into a much more global marketplace (Canadian Dairy Commission).

The URAA did not affect the ability to restrict domestic raw milk production but it required a shift in border protection from import quotas to tariff rate quotas (TRQs).

Supply management would only be undermined if there are large changes to either level of the over-quota tariff, the minimum level of market access, or the restrictions on domestic raw milk production. If the over-quota tariffs were phased out over time, there would be no competition from imports initially because the tariffs are large. At some time however, the tariff level will reach a point where imports become more competitive resulting in lower milk prices. If the minimum level of market access were increased, the quantity of milk supplied would have to be reduced to maintain producer prices. In the longer term, it may be in the domestic industry's interest to reduce raw milk prices to limit imports. If the domestic production of raw milk were increased, producer prices would decrease as long as production was sold within the country. Since the current mix of prices and production presumably generates an optimal level of aggregate producer income, a reduction of price coupled with an increase in supply would likely reduce aggregate dairy farm incomes.

While Canada has endorsed trade liberalization in those commodities where it has a major export interest, Canada has taken a contradictory position with respect to its supply managed commodities. Canada's commitment to free-trade policies now tends to dominate its protectionist domestic agricultural policies. Recent cases suggest that the dairy industry is relatively sensitive to this policy stance. As over-quota tariffs are reduced and minimum access commitments are increased, the stage is set for further dairy trade liberalization. This is likely to happen slowly since over-quota tariffs are large and the minimum access is a small percentage of domestic consumption (Le Roy).

If tariffs are significantly reduced, an important question to be answered is: What will be the regional impacts resulting from freer trade in dairy products between Canada and the United States?

Qualitative assessments of the likely impacts are quite conflicting. If over-quota tariffs fall so that imported products are competitive with domestic products or if market access is increased dramatically, both producer and retail prices will change. Price changes will vary by region. An economic problem faced by farmers, processors and retailers is how to interpret information embodied in changing prices and to identify the appropriate response to the information. This requires planning. It is important to note that the planning required is not operational (production related); rather it is strategic planning.

Farm size has been increasing rapidly in the U.S., tripling between 1976 and 1998. The increase in Canada during the same period was 120%. This is one of the more common strategies used to deal with policy change and its impact on the dairy sectors in the countries.

The pace of trade reform is very gradual. The EU, U.S., Japan and Canada all have highly protected dairy sectors with influential domestic dairy lobbies. Their appetite for meaningful reform is limited. Pressures will develop for reform of Canadian dairy policy, but these pressures are more likely to come from within Canada than from increased foreign competition (Rude).

There are numerous impacts of domestic policy on the dairy sector in Canada. For example, at the producer level, the current mechanism of quota transfer, ie auction sales, does not encourage increases in efficiency. In fact, any improvement in efficiency generally translates into a production increase, which necessitates the purchase of additional quota. Given the high price of quotas, achieving the profitability threshold for the purchase of additional quotas may be conditional on an increase of 10 or 15% in a producer's efficiency. However, the increase in efficiency is not generally immediate, and this implies that the producer would have to accept short term financial losses while continuing to be uncertain as to whether he could achieve and adequate efficiency threshold for making his investment profitable. A circular conundrum is another excellent reason to develop a long term plan. (Romain)

Agriculture and Agri-Food Canada has announced, and is in the process of implementing, the Agricultural Policy Framework (APF). The APF is designed to brand Canada as a world leader in meeting consumer demands for food quality and safety, innovation and environmentally responsible production. A pillar of the APF includes developing a national program for business risk management that is an integrated approach to stabilization and disaster mitigation. The new program will merge the Net Income Stabilization Act (NISA), the Canadian Farm Income Protection (CFIP) and Crop Insurance programs. Supply managed sectors are not included within the framework of the proposed plan. The APF is a 5 year program. There is no public discussion, within the APF, regarding the potential impact on the dairy sector emanating from potential policy changes in the WTO agreements on agricultural trade. Admittedly, the pace of change in trade is slow, but as it stands today, the dairy producers themselves would bear any negative impact resulting from trade liberalization. (DFC)

▪ Impact of Policy on Farm Management

The impact on farm management is longer term. The challenge facing dairy producers is that decisions made in the short term usually have longer term implications. Alternately, desired longer term impact usually requires that decisions be made in the short term. And remember, maintaining the status quo is still a decision.

So what are the potential impacts? One of the first impacts that comes to mind is how changes in dairy policy impacts on supply and price and therefore on profit. But there are others. Policy change has the potential to impact on:

- the size of dairies
    - Has implications on management skill sets required
- the capital investment required
- risk

- the processing sector
- capital spending decisions
- the availability of capital
- research activity
- individuals and family
  - likelihood of children returning to the farm
  - emigration
  - retirement
- the availability of labour
- environmental requirements
- communities

There are certainly others, and the list does not intend to insinuate any order of relative importance. The impacts will vary from region to region, from farm to farm and in fact, from individual to individual.

Strategies

There are numerous strategies being implemented within the dairy sector. The strategies are both explicit and implicit (formalized and unformalized).

Maintaining the Status Quo.

Maintaining the status quo is a passive decision and can or cannot have implications related to policy. However, it must be understood that, relatively speaking and as the figure suggests, you are going one way or the other. It is important to note that moving forward **does not** necessarily mean getting larger! It does, minimally, mean that your management skill set is advancing.

Growth Continuum

Stagnating ⟵⟶ Improving

You are either going one way or the other!

Primary Producer Skill Line

Producer:	Past	Present	Future
Skill Level:	Contract Producer	General Management	C.E.O.

Expansion

The strategy of expansion can have more than one driver. A son wanting to begin a farming career is a very typical driver of expansion.

Expansion can simply be a function of wanting to increase profit. Supply management can yield a relatively predictable per unit profit and therefore, increasing the number of productive units can increase profit. This can be a subset of a desire to have more disposable income or to accelerate debt repayment. Yet another driver of expansion can be an action stemming from a strategy to expand to offset potential deregulation and possible narrowing margins.

Diversification

a. on-farm (adding another enterprise to the dairy)
b. off-farm

There are different levels of diversification that can be used to manage the risk associated with farming. An example is used to illustrate.

A dairy operation is considering diversifying into a cow-calf enterprise. The concept is that the dairy and cattle sector have different industry risks and influences. In this example, the farmer hopes that if policy changes and negatively impacts on his dairy operation, the cow-calf enterprise will provide financial stability. By diversifying into a cattle enterprise, the farmer has gained a measure of risk management through diversification. However, the farmer is still susceptible to the risks associated with primary production (both dairy and cattle are primary production).

As well, the farmer is susceptible to risks within the ‘farm gate’ with these risks being normally associated with production (eg. crop susceptibility to weather, dairy susceptible to disease and/or feed related problems).

To achieve further risk management through diversification, farmers are investing in community and/or investor enterprises. Again, an example is used to illustrate. A dairy operation invests capital in a local feedlot or hog barn. Risk is mitigated (managed) in three ways:

- The farmer is not the only investor and shares risks with the other investors.
- The operation is large enough to justify hiring production and marketing expertise, of which the farmer probably does not have.
- The operation is outside the farmer's 'farm gate'.

While there is some risk mitigation achieved through this diversification, the business is still primary production and susceptible to external risks (policy, price, market) and internal risks (production and now, as different than the farm diversification example above, human resources … that is, management and labour).

To achieve maximum risk mitigation through diversification, the farmer should consider investing in a business that is not directly or indirectly associated with primary agricultural production. An example would be to invest in a restaurant. Note that there are risks associated with any business. Diversification of investment spreads the risk and thereby mitigates it.

Space limitations do not allow for general discussion on the following strategies:

Exit

- From dairying
- From farming altogether

Relocation

- domestic
- international

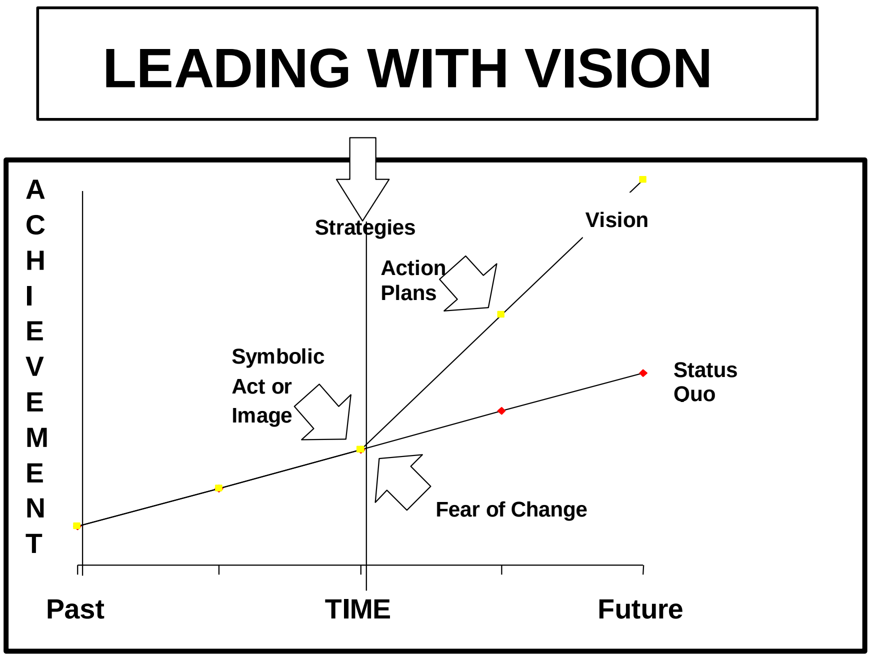
Debt reduction

Business operating models

- shared labour
- shared assets
- joint operating agreements
- partnerships
- farm mergers
- stripping fixed costs

One of challenges in managing a business in the dairy sector is trying to assess and quantify the impact that policy has on the business. This is an important first step that must be taken before any action can be taken.

The following chart depicts planning. The symbolic act or image could easily be synonymous with changes in dairy policy. The key is for the dairy producer and family or partners to assess their current situation and work toward an agreed upon vision for the future. Remember that there is no guarantee that the status quo growth line will show positive results.



▪ What is Strategic Planning

Strategic Planning is an organized process for making decisions which focuses on fundamental issues of management: mission and vision of the farm, major objectives, strategies to achieve objectives, policies and values. Strategic planning consists of issues demanding top management attention. Decisions made have a **long-term impact** on future performance. Decision inputs regularly include factors from the **internal** and **external environments** of the farm business.

Strategic planning involves developing the vision of a business and determining objectives and appropriate strategies for achieving it. Questionnaire

Two important features are associated with the strategic planning process. Firstly, it has a systematic, rational process where strategic decisions are logical outcomes. Secondly, the process is conducted formally with a shared input (all participants), and a tangible output (the plan).

There are a few basic concepts common to all of strategic planning. One emerges from **internal** analysis of the farm business. Simply put, stakeholders should build on strengths in response to the external environment and minimize their vulnerability to threats (possibly policy related).

Perhaps the most significant change to the strategic planning process in recent times has been the dramatic extent to which the **external** environment has come to impact strategy. Accordingly, stakeholders are well advised to identify and capitalize on opportunities and defend against threats in the environment. This is basic to success under the conditions of complexity and rapid change in today's agricultural environments.

As Dr. Peter Drucker has indicated for years, strategic planning deals with what your business *should* be. How should it change to respond to the changing environments? What is important is not today's decision but the **futurity** of today's decisions. Typical time horizons are 3 to 5 years, with trends requiring a longer time perspective.

■ Strategic Planning

- Establishes a clear direction for management and employees to follow
- Defines in measurable terms what is most important for the farm
- Anticipates problems and take steps to eliminate them
- Allocates resources more efficiently
- Establishes a basis for evaluating and analyzing performance of management
- Provides a management framework which can be used to facilitate response to changing conditions, unplanned events, and deviations from plans.

Thinking Strategically

There seems to be great difficulty in motivating farmers to really think strategically. A historical dependence on intuition (gut feel) and past performance extrapolation for their planning decisions is becoming increasingly less satisfactory because of the complexity and unpredictability or the current environment. In other words, the past is no guarantee of the future. To be "Visionary" you must be able to Think Strategically.

Obstacles to Thinking Strategically

- The Important being obscured by the Urgent
    - Problematic in dairy due to significant focus on production
- Fixation of Events (vs. Trends)
- Denial
    - Changes in policy will not impact us
- Avoiding Dissention
- Past Success
    - Changes in policy have not hurt us before
- Pre-occupation with Numbers
- Uncertainty causing Paralysis
    - I do not know what the policy changes will be
- Paradigm Shifts

Concluding Comments

You can meet any challenge, including those associated with changes in policy, if you recognize a shift in the paradigm. Are we ready to *change the rules?* A paradigm is the conventional wisdom about how things have always been done and must continue to be done.

"A long habit of not thinking a thing wrong gives it the superficial appearance of being right."

Experience-based decision-making creates a mental model of how the world works – face it, this is how we have operated for a good many years. After a time we rely on that mental model to such a degree that when new information comes in that goes against the model, we tend to say, "That can't be right – that information is incorrect." We become so deeply trusting and imbedded in our mental models that we fail to see how the world is changing.

Consider these two alternative methods for boiling a live frog. If you drop little Freddie into boiling water, he will hop right out. But if you place him in a pot of cold water and gradually raise the temperature, he will just sit there and boil to death. Freddie, you see, failed to adjust to a shifting paradigm; he ignored a crucial, though gradual, change in his environment.

In the dairy industry, you should ask the rhetorical question, am I waking up and finding it's too late to jump?

"A pessimist sees the difficulty in every opportunity. An optimist sees the opportunity in every difficulty."

Sir Winston Churchill

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▪ Addendum

The absolute most important aspect of strategic planning is implementation. It is a waste of time and money to develop a formal strategy and then not implement it. While the development of the strategy can be challenging, implementation is where it becomes really difficult. Human nature is such that people, including farm business owners/managers, tend to drift into old and well established management patterns and practices. Successful implementation of strategy requires discipline and commitment. Experience in working with producers leads me to believe that external facilitation and/or advice significantly enhances the likelihood of successful implementation.

A structured approach to meetings and plan monitoring works the best. Following are suggestions relative to the types of meetings that should occur and an example agenda. I recommend that a meeting binder be created, with sections specific to the different types of meetings.

Sample Farms Ltd.
Meeting Binder

Types of Meetings

1. Strategic Planning Meetings
    a. Once completed, the strategic plan should be formally reviewed at least annually. Things change and the plan should be updated to account for any agreed upon changes.
    b. Additional people can be invited.
    c. These meetings should occur off-site at a local hotel or corporate boardroom.
    d. These meetings usually take a day or more, depending on the extent of revision.
    e. These meetings should be externally facilitated.

2. Shareholder Meetings
    a. A sample agenda follows. Minutes should be taken and filed in the binder. Agenda items can change as needed.
    b. Additional people can be invited. For example, your accountant or lender.

c. Anyone affected by day-to-day management decisions should be included in the meeting. A daughter-in-law who teaches professionally and is not actively involved in operational decisions should attend. A daughter, who may be a shareholder but is living in Toronto, does not need to attend. She may like to get a copy of the minutes.
d. These meetings should occur monthly, but may be deferred during busy summer months.
e. The meetings should occur where there are no interruptions. Often, these meetings occur off-site at a local hotel or corporate boardroom.
f. These meetings should not necessarily exceed a couple of hours.
g. External facilitation is optional

3. Operational Meetings
   a. An agenda is optional. At the least, discussion should include regular items.
   b. People who have direct involvement in operational decisions should attend.
   c. Notes should be taken and be filed in the binder. These notes can be informal, such as point form.
   d. These meetings should occur weekly, especially during the busy season. Farmers often say they discuss operational issues every day. That should and will happen. However, well run businesses should formalize these meetings.
   e. The meetings should occur in a setting that can limit interruptions.
   f. The meetings should only take an hour.
   g. External facilitation is not required.

4. Ad Hoc Meetings
   a. From time to time, issues arise that require special attention. Ad Hoc meetings should include minutes and should be filed in the binder.

▪ Example of Typical Shareholder / Stakeholder Meeting

SAMPLE FARMS LTD.

Team Meeting

Agenda
January 4, 2003

1. Minutes of the last meeting.

2. General Management
   - 2.1 Operational planning and review
   - 2.2 Conference report
   - 2.3 Other

3. Operations
   - 3.1 Work progress review
   - 3.2 Work to be done – short term
   - 3.3 Work to be done – long term
   - 3.4 Vacation planning
   - 3.5 Staffing and related items

4. Marketing
   - 4.1 Sample Farms Ltd.
   - 4.2 Inventory

5. Financial
   - 5.1 General overview
   - 5.2 Year to date
   - 5.3 Capital budget plan review

6. New business