Grain Margin Risk

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One of my recent research projects has involved applying the principles of enterprise risk management to grain marketing and farm supply cooperatives. ERM involves analyzing all of the “risk buckets” for a firm as well as their capacity to withstand risk and their “risk appetite”. We used data from 10 case study cooperatives to investigate the historic risks for grain marketing and farm supply cooperatives.

Not surprisingly, variation in the volume of grain received was, on average, the largest risk factor. What was surprising is that variation in grain margin was also a major risk factor. For some cooperative grain margin contributes more to overall risk than does grain volume. Grain margin is impacted by numerous factors. Competition can impact the margin that the cooperative can obtain. Almost all cooperatives have hedging policies which are designed to limit the cooperative’s exposure to risk from grain price variation. Despite those programs, a cooperative’s effective margin is impacted by the effectiveness of their hedging and their grain merchandising practices. Cooperatives are also exposed to basis risks on their hedged positions, which in recent years has been substantial. Transportation cost changes can also impact the effective margin received.

A final area creating variation in grain margin is grain grading and shrinkage in both quantity and quality. A cooperative’s effective margin is calculated as the difference from its sales price for all grain less its purchase costs. If a cooperative inaccurately grades grain it runs the risk of receipting a higher quality of grain or underestimating dockage. Those differences will be apparent when the grain is ultimately sold on the basis of an official grade and the difference is absorbed through a reduced grain margin. Some shrinkage always occurs in handling. Excessive shrinkage (weight loss) reduces the effective margin. Quality loss from poor stored grain management creates quality shrinkage which can wreak havoc on the effective margin.

As we approach the wheat harvest season, it’s a good time to consider your grain margin risks. Controlling those risks takes a team effort. Some risks relate to grain merchandizing and hedging while others depend on grading and receiving and stored grain management. Grain margin is just one risk bucket, when you take a close look you can see that there are buckets within the bucket. Just be sure none of your buckets has a hole in it!