Safety net or springboard?

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Could crop multi-peril crop insurance unlock the yield and profit potential in Australia's cropping systems?

Crop insurance is often seen as an expensive safety net, but what if it was really a springboard for growers to capture peak prices and maximise on-farm efficiency?

Andrew Trotter, chief executive of multi-peril crop insurance (MPCI) provider Latevo, has no doubt MPCI can be a springboard to financial security and improved profitability, with the mind-set or perspective of the producer a key factor.

However it is viewed or used, MPCI is customised for each farm business, with the performance of the business determining the level of protection available. The better the manager and the more consistently profitable the business, the higher the level of cover it can access.

The level of cover available is also influenced by the seasonal outlook.

"Latevo is an agricultural specialist and understands issues like the significance of soil moisture levels, for example, so we know we can't offer the same level of cover in a season when there is little soil moisture available at seeding and a forecast for low rainfall as we can in a season like last year's or 2011.

"We have to be just as realistic as the grower, who will target lower yields in a dry season and so have lower input costs and less grain to sell."

Given that Latevo is effectively partnering with the farm businesses it insures, it requires a formal analysis of each farm business's performance over the previous five years.

MPCI cover is customised on the basis of a formal risk assessment based on a five-year history of the business's revenue and is usually designed to cover the full costs of production including input costs, interest, overheads and marketing exposure on forward sales, Mr Trotter said.

"We insure on revenue, rather than yield, with the aim of protecting what it costs to grow and market a crop.

"The aim is to maintain the cash reserves of the business at the level they were before the impact of an insurable peril,

INSURANCE CAN FREE GROWERS TO TARGET MAXIMUM WUE AND FORWARD-SELL GRAIN AT GOOD PRICES.

typically frost, drought or fire, which has the effect of ensuring the season produces at least a break even result so the business starts the following year in the same financial position as it did the current one.

"Latevo's MPCI is really income protection and if we are to be fair and equitable and make an informed decision about the level of cover we can provide, we need to have an accurate picture of how the business is managed."

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Once the business data is analysed and the insurer agrees it can provide cover the focus becomes the level of cover and the cost per hectare to obtain that cover.

The requirement for an 'up front' business analysis had proved an impediment to the uptake of MPCI, Mr Trotter said, although it was no more than financial consultants and banks demand of growers and their businesses and was a relatively simple exercise for businesses with a good 'handle' on their finances.

For those without a clear understanding of their financial position, the requirement to accurately identify their current financial situation can provide valuable financial insights and improve management of the business, whether or not the business decides to pursue MPCI.

"People focus on 'crop', but MPCI is really a farm-based financial product and banks require exactly the same sort of information when making decisions about borrowings and interest rates for growers without arousing the same level of concern or resentment.

"The assessment is all about due diligence. It enables the insurer to understand the risk exposure of the business and provide the best possible level of cover, which means good farm and business management is rewarded with good cover.

"Trying to use a district average significantly disadvantages good growers and unfairly benefits poor ones.

"The aim is to ensure growers have the

funds they need to remain in business and continue farming after a bad season or adverse weather event but the decision to provide cover against those risks needs to be justified by the on-going performance of the farm business."

A pre-insurance business analysis typically costs $5,500; an outlay that now attracts a 50% Federal Government subsidy of up to $2,500.

And the recent Victorian State Budget contains a provision for removal of a 10% stamp duty on agricultural insurance products, which will make crop and other agricultural insurance more affordable for Victorian growers.

The Federal subsidy, designed to encourage growers to explore the use of MPCI to protect their businesses from losses due to natural risks including drought, frost, fire and flood, was announced in March last year by Agriculture Minister Barnaby Joyce.

The Federal scheme, the Managing Farm Risk Program (http://www.agriculture.gov.au/ag-farm-food/drought/assistance/mfrp/guidelines), offers a one-off rebate of up to $2,500 toward the up-front costs of 'advice and assessments to help farmers prepare and apply for a new insurance policy that assists with the management of drought and other production and market risks'.

The insurance cover must be for a peril or climatic event the farm business has not insured against in the previous five years and the rebate is not available for insurance policy premiums.

According to a departmental statement the rebate has been made available because 'insurance can significantly reduce the financial risks farmers face from production loss caused by factors beyond their control'.

"The Australian Government understands that insurance for risks such as adverse weather, drought and fluctuating markets can protect profits and give farmers peace of mind but identifying and choosing suitable insurance can be challenging."

The cost of MPCI varies with the district and the individual farm business but is typically around $15/ha in medium-rainfall districts; less than the cost of a fungicide spray for many growers, Mr Trotter said.

"Growers are understandably very cost-conscious but there is a lot of misinformation about the cost of MPCI and misunderstanding about the product and how it works, so Latevo has developed an 'app' to provide accurate information about what the product actually costs."

ANDREW TROTTER, CHIEF EXECUTIVE OF MULTI-PERIL CROP INSURANCE (MPCI) PROVIDER LATEVO.

"Growers, and their consultants, can download the app and use it to check the likely per-hectare cost to insure against losses due to the natural perils covered by the company. It can also be used to make formal application for insurance.

"It is too late to insure for this season but growers could find it informative to download the app and use it to check indicative costs and do some 'what if' comparisons with and without insurance as the season develops."

Latevo covers crops including cereals, canola, legumes, lupins, linseed and hay and offers a stepped or scaled product with three categories, with category 2, which is generally applicable to 'normal' seasons, the level most often sought by growers, Mr Trotter said.

Category 1 is most relevant to seasons expected to be poor, with category 3 for seasons with very good to exceptional growing conditions.

Growers need to sow in April or May but have little real idea of the likely shape of the season until August or September, so Latevo's Farm Income Protection product has been designed so a grower can apply to upgrade their cover, at an increased premium, if the season looks like being better than initially anticipated, he said.

An upgrade can also be used to mitigate price risk if the grower decides to forward sell at high prices.

Mr Trotter believes MPCI has the potential to unlock the latent potential in Australian agriculture and significantly improve the productivity and profitability of Australian cropping by giving growers the confidence to pursue their water-limited yield potential and higher prices for their grain.

"Australian grain growers have averaged only 52% of the potential water-limited yield over the past 17 years, according to CSIRO data, so there is considerable room for yield improvements by better matching nutrient inputs to the available moisture.

"Companion research suggests that under-investment in crop fertiliser is the largest contributor to the production yield gap.

"Growers tend to be inherently risk-averse and cut back on fertiliser inputs to reduce costs and so the scale of possible losses in case the season 'cuts off' or doesn't 'pan out' for some other reason but these risk-averse behaviours lessen their potential to maximise yields and profits.

"The traditional approaches of delaying seeding until the 'shape' of the season becomes clearer, delaying nutrient application or pest or disease control because of doubts about the season or waiting for rain in a season that starts late all limit yield potential and profitability because they result in crops being sown later than the ideal time and the use of more or more expensive chemicals.

"What has come to be seen as the best way of limiting financial risk in Australia's inherently variable climate is seriously limiting growers' yield and profit.

"MPCI can effectively remove those limitations by freeing up growers to react to the situation in front of them rather than trying to guess what might happen later in the season because growers with the appropriate insurance know the cost of their inputs will be covered if things do go wrong.

"Confidence is a significant factor in production decisions, so knowing production costs are covered frees up growers to change or increase inputs with the aim of increasing yield and production efficiency, even if such decisions might usually be seen as increasing risk.

"If the season fails or the crop doesn't yield as well as expected the insurance will stabilise the business by covering the losses and ensuring the business is able to continue and sow another crop next year."

Improving farm productivity and profitability stands to benefit not only the grower, his family and the farm business, but also the local community and the nation through the tax paid on the extra profit generated, Mr Trotter said.

"The income and revenue foregone from crops not achieving their water-limited yield potential and growers and their marketers not having the confidence to take advantage of good prices when they are available is huge.

"For example, in the 2016 season WA growers harvested 17 million tonnes of wheat instead of the average 12 million or so and most grain was sold at an average of $220/t, although buyers were offering $280/t during the growing season.

"Even selling just the average crop of 12 million tonnes at $280/t instead of $220/t would have generated an extra $720 million income, which would have flowed into local businesses and communities and generated something like an additional $140 million in tax for the federal government.

"Do those sorts of calculations for all Australia's grain-growing regions and the figure is astronomical; something like $2,000 million in farm gate income foregone nation-wide in 2016.

"And that doesn't take into account the potential for better decision making to improve crop water use efficiency.

"I suspect that is one of factors behind the government's decision to cover half the cost of the financial and business analysis that is the first step towards obtaining MPCI. It's in the Federal Government's interest to lift agricultural productivity."

Buying MPCI is cheaper than borrowing money to cover losses in a bad season.

There is much more to achieving maximum water use efficiency and good prices than insuring crops, but the right sort of crop insurance can help the industry move towards that objective by improving grower and business confidence, risk mitigation is a key part of improving decision making, Mr Trotter said.

"For example, when there is soil moisture available, top-dressing nitrogen can increase yield significantly. If every grower had the confidence to target maximum water-limited yield we would be able to push through the national 2t/ha wheat yield average and target the 3t/ha mark.

"Without insurance growers almost invariably take a 'safety first', 'tighten the belt' approach because they focus on the risk rather than the potential.

"That is understandable because they have had to cover the risk themselves and over-exposure could have cost them their business, but access to MPCI changes that because the insurance covers their input and other production costs.

"They still need to understand and manage production and other risks, but the access to insurance significantly changes the situation by reducing the financial impact on the business if there is a problem.

"And growers with adequate insurance know they can invest more in growing the best possible crop and target the best possible prices because if things go wrong the insurance will cover the cost of those inputs.

"Ironically, that means insurance can have the greatest benefit in years where there are no pay outs because knowing insurance will cover their input costs if the season turns bad or crop is damaged or lost due to frost or hail gives growers the confidence to increase inputs such as nitrogen fertiliser to target maximum water use efficiency and yield and forward-sell grain at good prices ahead of harvest."

"Latevo supports growers to sell up to their projected yield each season at the best possible price, whenever that might be available," Mr Trotter said.

"Things changed when the wheat industry was deregulated and many growers have continued to struggle with the need to take more responsibility for their grain marketing.

"Being able to insure against loss of

MORE THAN ONE OPTION

Latevo was the first of the current generation of companies offering multi-peril crop insurance (MPCI) in Australia but there are now also two others.

One of those is PrimeGuard, which is owned by Allianz, the company that underwrote Latevo's Australian product for its first three years, and is being marketed by Primacy Underwriting Management.

The other is Sure Season, which is underwritten by Lloyds of London.

While they all present as MPCI each product has clear distinguishing characteristics that make it distinct from its competitors.

income opens the way for growers, or their grain marketers, to pursue good prices whenever they become available, including before seeding and during the growing season.

"Businesses need to understand the marketing tools available and make good grain marketing decisions, but with adequate MPCI they can forward sell grain with confidence because if the season falters or fails they know their input costs will be covered and they will be able to buy out any contract they are not able to fill.

"In this context MPCI works like a 'trailing stop' in the market because it limits potential losses to a manageable level. If there is a failure the grower gets a cheque in hand in February so he can sow in May.

"It's a very cost-effective way of managing market risk.

"To use a farming analogy, running a farm business without MPCI is like seeding with a 20-foot combine instead of 40-foot air seeder, despite air seeders being readily available.

"At present only a few managers are using this new risk-management tool, but just as happened with the shift from combines to air seeders, I expect that to change quite quickly as more growers realise the benefits it brings and start to look at the cost in the context of their overall input costs.

"A per-hectare cost of $15 or so might seem a lot but for most businesses the cost of MPCI works out at around 3% of cropping income, which is not a great deal when you look at the impact of insurance on yield and profit potential from improved grower confidence and decision making and how the business is viewed by banks and other financiers.

"Growers have had their bank reduce their interest rate on borrowings because they mitigated their production risk with Latevo's Farm Income Protection program. One grower had his interest bill reduced by more than the cost of the insurance, which also gave him the confidence to forward-sell lentils at the top of the market so he got a double benefit.

"Even without that sort of up-front benefit, buying MPCI is cheaper than borrowing money to cover losses in a bad season because there is no interest cost associated with the payout."