

Canadian Beef Breeds Council
Private Sector Risk Management Partnership
Purebred Risk Assessment Project

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Project History

The Canadian Beef Breeds Council Purebred Risk Assessment (PBRA) Project was initiated in 2005 under the Private Sector Risk Management Partnerships (PSRMP), a program of Agriculture and Agri-Food Canada and part of the Agricultural Policy Framework—Business Risk Management.

PBRA Project Outcome Statement

Based on perils/risks identified, establish a base-line of related industry innovative 'Risk Management' practices, solutions and tools will be developed for producers to adopt, thus helping to secure the ongoing economic viability, profitability and growth of the purebred beef cattle sector in Canada.

*Risk includes any aspects/items/issues that have the potential to prevent the growth, advancement or success of purebred beef sector

PBRA Risk Identification

Overview

This project is driven by the need of the CBBC to address its member-producers' risk management needs, by helping member-producers and their respective associations better understand their business environments, the risk management challenges they face and the tools currently available to address them.

A key element in addressing member-producers needs is the identification and characterization of

the current circumstances that purebred member-producers are facing in reference to trade, animal health, producer demographics, environment, business management practises and genetics.

'Risk Identification' was seen as the first step collection of this information. This phase included: surveys of purebred producers and the commercial cattle sector, focus groups with diverse industry stakeholders, analysis of sector communications, followed by further characterization and analysis of seven identified 'key' risk areas.

Producers and association surveys were conducted over a 6 month period and risk information was gathered through a number of methods including:

- a telephone survey of 500 commercial producers;
- a written survey circulated to 7,000 purebred producers;
- a review of communication tools and processes; and
- 15 national facilitated industry focus group sessions.

The focus groups included representatives for cow-calf producers, feeders, auction markets, packers, geneticists, veterinarians, exporters, federal and provincial governments, industry organizations, purebred producers, academics, exhibitors, and nutritionists.

Overview of findings

Research indicated that the purebred beef cattle

sector in Canada is a decentralized group of individual breed associations and producers that operate without generally agreed upon and supported goals and objectives. The sector does not have a common understanding of, or agreement on the key risks it faces, the value that their product adds to the beef industry as a whole, or the appropriate strategies that are required to achieve success, or the mechanism to collect pertinent industry data other than breed specific information—to demonstrate the relevance and value of the sector. These issues are created and to a certain degree compounded by the fact that there is weak strategic communication amongst, and a lack of coordination between, industry players.

In particular, findings identified the following regarding the purebred beef cattle industry:

- **Profitability and growth prospects are low.** The 2003 BSE outbreak and continued restrictions on export of livestock over 30 months of age had profound impacts on the purebred beef industry due to the significant dependence on exports. In addition, the increased value of the Canadian dollar compared to the US dollar will reduce purebred trade; the significant increase in domestic feed inputs and reduction in commercial cow herds will reduce sector profitability. Note: BSE has had impact on all aspects of the beef industry.
- **Lack of industry cohesiveness, coordination, and commercial focus.** The Canadian purebred beef industry is comprised of a large number of different breeds. There is a wide geographic distribution of producers. The business motivation of producers also varies from profit, to tradition, and to lifestyle.
- **Structural weaknesses.** The industry's economic structure is very segregated with

respect to scale, size, and management/marketing capabilities. On one end the industry has relatively few, very large, sophisticated, market focused, and largely successful purebred operations. On the other end of the spectrum, there are a large number of very small operations, mainly part-time farms, with a limited number of cattle in which the owner operator has another, possibly well-paying professional career. In the middle there are a large number of intermediate scale operators that are working towards becoming full time successful purebred livestock breeders. The producers often have to depend on off-farm income, have difficulty in accessing capital, are often older and struggling with succession planning, and have intermediate management and marketing skills. In a sense, the industry is tri-modal. This implies the purebred population is divided into three almost distinct but overlapping farm groups.

- **Risk Management Program Gaps.** Much of the livestock industry, and the purebred beef industry in particular, do not qualify for, or benefit from many of the government sponsored assistance programs. Some examples include AAFC's Advance Payments Programs, Price Pooling, and Crop Insurance (now production insurance) programs. In addition, other programs such as the Canadian Agricultural Income Stabilization (CAIS) program have not been well suited for the industry. Other examples include the various feeder livestock guaranteed programs, which have been quite successful for beef feeder cattle in various provinces.
- **Production orientation.** The industry, with some exceptions is based on production more than on marketing and value added output. Producer orientation is with respect to breed

branding, often with limited linkages to end user consumer branding (a major exception to this is the Angus breed branding programs). Producers judge and compare themselves to showings at sales and exhibitions, more than to ability to maximize productivity, sales and profits.

- **General lack of a transparent and open market system for the sale of breeding stock.** It is recognized that there are sales of breeding stock at a wide number of public sales across the country. However, the majority of breeding stock sales is between individual producers, and conducted on a private treaty basis. At the same time there are concerns that some of the consignment and production sales are “artificial” or impacted by breeders traditionally buying and selling from each other. There is not the same level of market pricing and market liquidity that is evident in most other livestock markets in Canada.
- **General level of management, particularly with respect to marketing and financial management.** As indicated in the risk surveys, the industry is generally weak in areas of marketing and financial management. Many producers do not have a business plan, or succession plan. The industry does not have access to, or use, forward risk management tools such as futures marketing, hedging, and forward contracting
- **Inability to capture and market the progeny and genetic value of the breeding stock in the market place.** There is an awareness of, but not global acceptance of using tools such as Expected Progeny Differences (EPDs) to develop and create added value of breeding stock. It is recognized that there are limitations of such tools for creating breeding stock value.

The limitations are from EPDs themselves, the ability to keep records, and management capability. This underpins the concern within the industry that the true value of purebred breeding stock is not adequately recognized in the marketplace, and particularly with lenders.

- **Access to capital, both debt and equity.** A major concern expressed in consultations is that the industry has suffered from a lack of access to capital for a considerable time. During the 1970’s and 1980’s, it appears that the industry had better access to capital than it currently has. This lack of capital has impeded the ability of the sector to renew itself and limited intergenerational transfer and new entrants. The lack of access to capital has been the result of poor return on investment, low liquidity in the sector and limited supply of debt instruments.
- **High capital to sales or profit ratio.** The industry has, more than almost all other agricultural enterprises, had a very significant investment in land and breeding stock. The annual gross and/or net income generated is modest relatively to this level of capital investment, a factor that limits the appetite of traditional lenders.
- **Tax barriers.** One major tax regulation which impacts on the purebred beef industry more than most other sectors, is the fact that industry must follow the mandatory inventory adjustment (MIA) which disallows the purchase cost of breeding stock to be considered an operating expense. The cost of the animal must be treated as a capital asset and added to the balance sheet, versus the income statement. This prevents the business being able to reduce taxable income, and potentially pass these losses on to other investors who may have a use for such expenses against their higher taxable

income. In addition, the restricted farm loss provisions under the Income Tax Act provides a barrier to firms who wish to offset these losses against non-farm income, or transfer these losses to third party individuals.

- **High level of financial and economic risk.** Many of these factors contribute to the perception and in most cases the reality that the industry has a high level of financial risk. The debt to asset leverage ratio is high, the turnover ratio of sales to assets is generally low, and the level of management capability is modest.

These factors, many of which are inter-related and co-dependant, contribute to, and impose barriers to the industry managing its risks and in having the capability to grow and innovate.

The major gaps and needs as seen by most of the people in the consultation process, and noted by consultants engaged in this phase of the project, included:

- The beef breeds industry does not have access to many of the programs that are available to the grains and oilseed and other sectors.
- The purebred industry does not have access to the type of support currently available to cow calf and cattle feeders across Canada.
- Industry has strong support of its customer base with 94% approval rating
- There is recognized to be two major types of concerns that need to be addressed within the industry: 1) income and risk management, and 2) access to capital.
- The management capacity is limited and needs

to be improved with respect to marketing, financial and business risk management.

- The capital financing system for the industry needs to be restructured, modernized, to allow for the injection of fresh capital, and to facilitate the intergenerational transfer of management and ownership, and to support growth and modernization.
- The core asset value of the industry, the value added of the breeding genetics, and animal progeny characteristics, needs to be standardized, quality certified, branded, and capitalized upon in the domestic and international markets.
- A purebred beef market based information system is lacking and needs to be established inclusive of genetics, cost of production, and sales and pricing information.
- The industry needs to develop risk management tools (forward marketing tools, insurance and income/production stabilization mechanisms) to underwrite the long-term financial stability of the industry.
- The industry has a gap with respect to the capacity to utilize existing tax laws (MIA provisions), and is currently exempt from the utilization of other investment tax instruments such as flow through shares, which have been utilized by oil and gas, and mining exploration firms for many years.
- Purebred is generally not the primary source of income for the producers
- Raising and marketing of purebred genetics is life style choice for majority of breeder

- Thus, the industry is not growing, partially due to the carryover effects of BSE, but also due to the limited capacity to revitalize itself, attract new entrants (replacing the near retirement generation), and to effectively brand itself.

In the second stage 7 key risk areas received additional research, examination and analysis to determine producers' perils/risk impact, needs and benefits were:

- Value Proposition/Sector Relevance
- Flow of Genetic Information through the Beef Value Chain
- Product Pricing and Financial Services
- Framework for Purebred Sector Business Model and Sharing of Resources
- Inventory and Analysis of Producer Training Products and Services
- International Trade
- Communications and Messaging of Key Risk Activities

Overview

Research findings through Work Plan 1 and Amendment to Work Plan 1 have highlighted for CBBC the opportunity to collaborate with key industry stakeholders to develop risk mitigation strategies and tools for the purebred beef cattle sector. CBBC is committed to working with others to develop strategic business models and multi-faceted initiatives to strengthen the sector (including purebred producers' business practices and sector viability) with 'results focused' activities in a variety of areas. Several of the risk mitigation strategy and tool development actions will occur with CBBC's involvement and collaboration with private sector groups. Other efforts will be directed toward strengthening the value and 'fit' of government programs to provide the maximum benefit to purebred producers while helping support the effectiveness of these programs.

Areas of CBBC PBRA project proposed for development of Risk Mitigation strategies, solutions and tools.

Financial Products and Services

As a major issue identified by industry representatives was access to capital—firstly equity capital, and to a lesser extent debt capital. The industry has for many years faced an issue of being unable to adequately attract investment. This has had direct consequences with respect to insufficient capital for growth, and to intergenerational transfer or other transfer of ownership.

The CBBC's objective within this area of risk mitigation was to lead collaborative (public/private) development—including consulting with financial institutions and/or government policy decision makers, on new products and services to assist current and new and future purebred producers to access to sources of capital and sector investment instruments, tools and products. New and revised investment products, new loan options or a portfolio of loans may be developed with the input of purebred producers and designed to better meet their needs and mitigate business risks.

Potential product offerings to be developed include:

- Growing the business loan
- Transition loans for breeders wishing to disperse their purebred herd
- Herd-builder loans
- Start up loans:
- Purebred Industry Equity Investment Funds

Insurance Products and Services

CBBC's objective within this area of risk mitigation is to lead collaborative exploration and potential:

- Potentially full mortality coverage with animal registration
- Producer and association liability coverage to

- include off farm coverage at sales and shows
- Directors & Officers coverage for the executive and board members of the various breed associations
- Errors & Omission Insurance for breed associations and producers
- Bundling of farm property insurance with other perils coverage for the purebred industry
- Business interruption insurance
- Off-farm transportation insurance

Cost of Production

CBBC’s objective here is to design a comprehensive production tool for purebred producers to analyze production and marketing costs, cost management and control, and benchmarking within the sector.

Product Pricing

Through consultations with the major beef breeds associations and industry, design and implement a confidential system and database by which price, sales, production costs, performance and other information is established for use by the industry, the financial community and others.

Efforts will include the evaluation of possible market price discovery, pricing mechanisms, and valuation models to drive the development of a model to benchmark the value of the industry for purposes of risk management and facilitating access to financing.

Flow of Information through the Beef Value Chain

Producing the best cattle and the best beef is impeded by lack information and/or access to it throughout the beef value chain. Given this, the project is committed to leading collaborative efforts that will enhance the flow and utilization of

financial and genetic information including data regarding performance, maternal, economic, and carcass traits; DNA markers; cost of production and purebred sales. The interest in Flow of Genetic Information has dramatically increased recently with the introduction and interest in DNA trait markers.

The CBBC is not considering or recommending the establishment of a new data collection entity. Instead, through the strengthening of relationships—existing collection groups and industry stakeholders be supported and encouraged by CBBC to enhance data collection and data access with partnerships that support better utilization of data. Gaps in data availability and access do exist and CBBC’s role is best utilized in supporting and encouraging the enhancement and expansion of data collection by appropriate groups, and by supporting more effective sharing and use of data throughout the beef value chain. These relationships also enhance sector value and relevance.

Strategic communications will continue to play a key role in the effective dissemination of information and strengthen sector perception by its customer base including the consumers. Breed beef branded programs are effective way of building strong customer loyalty amongst consumers. The second phase of the project has been very effective in getting the sector to drill down to the key baseline needs and focus on these in the near term going forward.

The research, exploration and collaborative discussions led by CBBC in the PBRA project have provided CBBC’s board and their breed association membership with significant insight into perils/risks in the purebred beef cattle sector. Each of the stages of the project have helped formulate a clearer vision of how the sector can collaboratively and in partnership with the beef industry enable the

development and promotion, and future utilization, of effective, meaningful business risk mitigation strategies and tools.

The Canadian Beef Breeds Council has identified ‘financial business risk’ and ‘flow and access to information’ as fundamental and priority key operational risk needs, in the near term, to assist with better management decisions and raise the economic bar for the Canadian beef industry. This phase of the project will develop the necessary tools and solutions to help producers address these identified risks. The risk of limited purebred cow-calf and feedlot focus will also be resolved as producers will be incorporating operational management program data that was sourced from the commercial sector including the packers. Including value chain information will greatly enhance the market value of purebred genetics and enhance producers’ return on investment. This will truly provide a win-win opportunity for the beef industry in Canada and particularly as it provides beef producers with a competitive advantage both domestically and internationally.

The overriding goal of the project is to, through the adoption of these tools by purebred beef producers: enhance the long term economic viability, profitability, and growth of the Canadian purebred beef sector. By incorporating improved access to capital and industry information, and better understanding of business risk mitigation practices this insures the increased sustainability of this valued sector and the value added genetics they provide for domestic and international beef producers.

Developing business risk solutions and tools:

This next phase which is just underway on the extensive and broad information, knowledge and perils/risks gathered in the earlier research and analysis. The primary objective going forward is to

develop and provide producer user friendly tools to address these key financial risk areas.

Anticipated solutions include greater access to capital, developing and implementing a national data bank collection mechanism, and data repository that will provide management information that can support the economic viability of purebred beef producers. This information will be available to producers to identify superior economic traits thereby aiding production and business decisions that reduce producers’ risk and supports increased farm level profitability as well as sector/industry-wide growth, relevance, and viability.

Elements of the data collection/flow will include, but will not be limited to pedigree, performance traits, production and animal health records, predisposition to disease, carcass traits, DNA/genomic traits, sale/price information (both private treaty and public), animal identification, etc.

This data collection system will also support the establishment of a parallel system model for product pricing analysis and a national selling price reporting to establish transparent market value and market validation. This integrated system will provide storage and access to historical purebred animal health, operational, statistical data necessary for developing coverage and premiums for sector specific insurance products. Data analysis/data interpretation will be conducted, within industry guidelines, by members, producers and other stakeholders.