



7 Secrets of Effective Farmers

Webinar Series: Risk Management

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August 6, 2020



Risk Management



Risk Management

- Events like the COVID-19 pandemic reinforce the need for businesses to develop a comprehensive risk management plan to address all 5 major categories of agricultural risk.
- Some risks are:
 - Known risks
 - Unknown risks (black swan events)

What are we trying to accomplish with risk management?

- Prepare for multiple uncertain outcomes by reducing or mitigating the likelihood of and adverse outcome.
- Every businesses risks are different.
- Can we remove all risk? **NO!**

“Risk is what makes it possible to make a profit. If there was no risk, there would be no return to the ability to successfully manage it.” - ERME



The COVID-19 pandemic has affected multiple aspects of managing risk – highlighted in red are some obvious examples of the impact of COVID-19 on agricultural production.

9 STEPS IN RISK MANAGEMENT PLANNING

1. Identify Risks

Types of Agricultural Risk

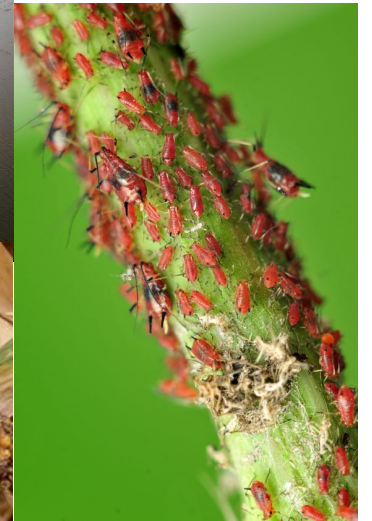
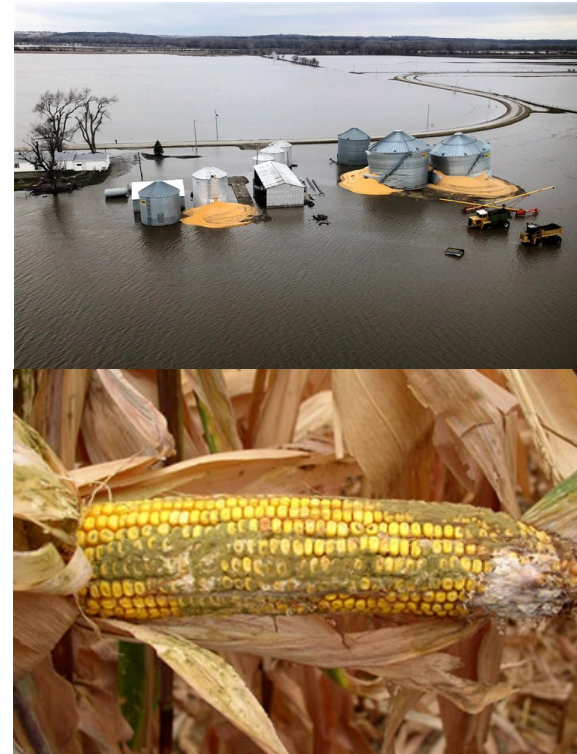
1. Production
2. Marketing
3. Financial
4. Legal
5. Human

<http://extensionrme.org/pubs/IntroductionToRiskManagement.pdf>



Production Risk

- Any production activity, input, or process that can result in a range of outcomes.
- Examples of production risk
 - Weather
 - Climate changes
 - Pests
 - Diseases
 - Technological obsolescence
 - Input quality
 - Theft
 - **Loss of labor supply**



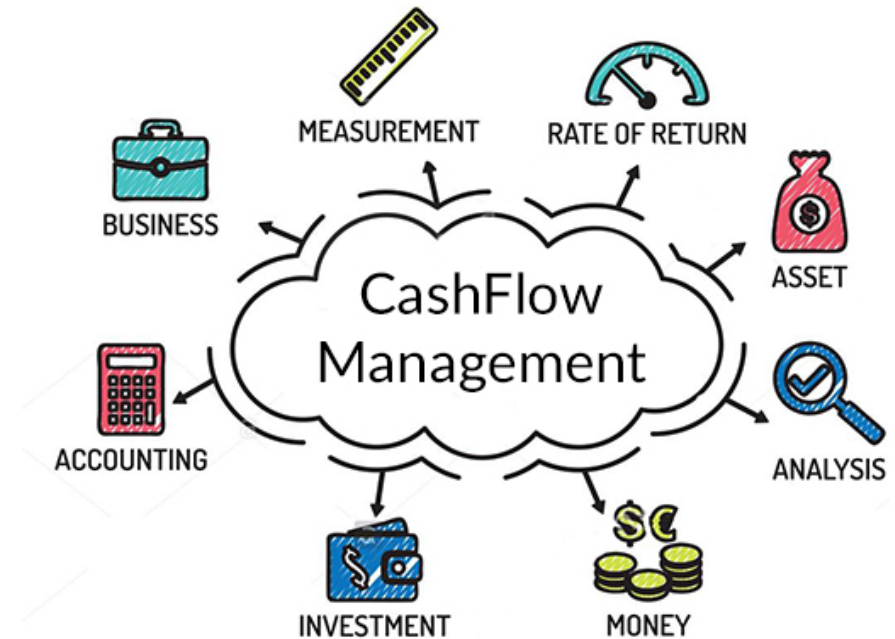
Marketing Risk



- Market related activity or event that leads to the variability of input/output prices.
 - Global/national weather.
 - Government action (tariffs, new regulation, etc.)
 - Market access.
 - **Logistical disruptions.**

Financial Risk

- Factors that threaten the financial health of the business.
 - The cost and availability of capital.
 - The ability to meet cash flow needs in a timely manner.
 - The ability to maintain and grow equity.
 - **The ability to absorb short-term or long-term financial shocks.**



Legal Risk

There can be legal implications for many farmer decisions that interact with other types of risk.

- Repayment terms for credit
- Pesticide application
- Marketing contracts
- **Employee rules and regulations**
- Inheritance laws

5 categories of legal risk

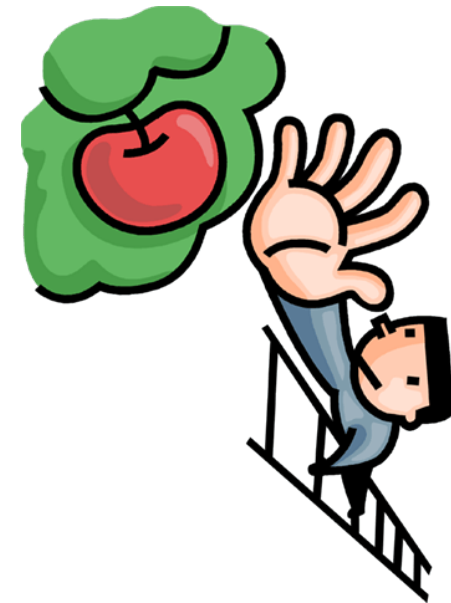
1. Contractual agreements
2. Business organization
3. Laws and regulations
4. Tort (one person causes damage, injury, or harm to another person) liability
5. Public policy and attitudes

Human Risk

Human risk management is the ability to keep all people who are involved in the business safe, satisfied, and productive.

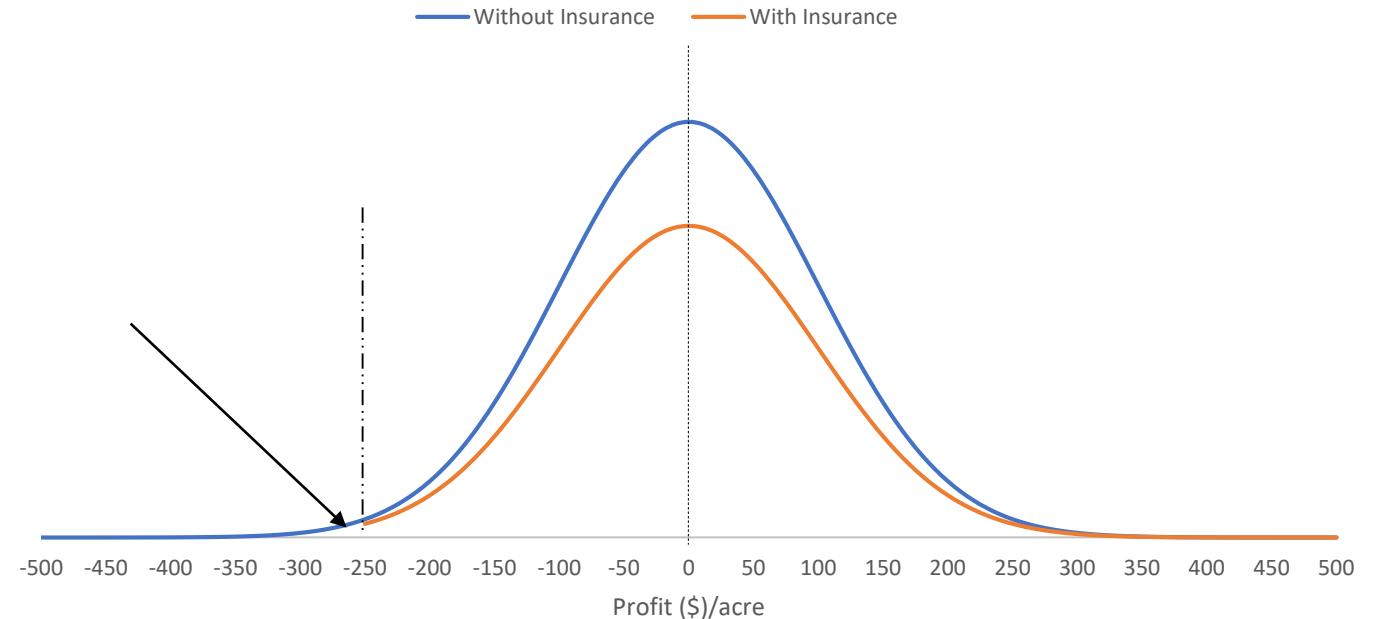
Types of human risk

1. **Human health and well-being**
2. Family and business relationships
3. Employee management
4. Transition planning



2. Measuring Risk

- Probability of outcomes.
 - Objectively measured
 - Subjectively estimated
- What are the range of outcomes (high – low; most likely).
- Shape of distribution?
- Importance of record keeping and data analysis.



3. Assess Risk Bearing Capacity

- Ability to withstand the outcome.
 - Financial loss from a decision (liquidity and solvency)
- Cash flow obligations.
 - Time and magnitude
 - Greater portion of cash inflow or outflow = lower risk tolerance?
- Records and data!

4. Evaluate Risk Tolerance

- Risk Averse
 - Cautious avoids risk = low risk + lower reward
- Risk Neutral
 - Refers to a mindset where an individual is indifferent to risk.
- Risk Preferring
 - Enjoy risk as challenging and exciting and look for the chance to take risks for the potential for higher rewards

5. Establish Risk Management Goals

- Goals are specific, measurable, attainable, **challenging but realistic, time specific**, written, and performance based.
- Goals should focus on factors/decisions that one has the most control over.
 - Internal vs. external factors.
- Goals should:
 - Reflect the values, interests, resources, and capabilities of the business;
 - Provide a basis for all business and family decisions;
 - Set priorities for the allocation of resources; and,
 - Measure progress.

6. Risk Management Tools

- Identify the tools that are available to mitigate specific types of risk:
 - Location, commodity, size, and resource specific
- Identify your understanding and willingness to use the tools.
- Some tools reduce risk (herbicides, irrigation) some offset risk on third parties (crop insurance, contracts).

7. Professional Assistance

- Actively seek out professionals that can assist with managing identified areas of risk .
- Professional advice will vary based on operation size, commodities, and location.
- Examples: Ag lenders, insurance agents, Extension, consultants, lawyers, accountants, other producers, etc.

8. Make a Decision and Implement the Plan

- Construct a written plan and implement it!
 - Write down the plan (develop steps).
 - Set timeline.
 - Determine how to track progress and measure outcomes.
 - Start small and build the plan over time.



9. Evaluate Results

- Have a mechanism to collect results.
- Compare actual with anticipated results.
- Make adjustments for future decision cycles.



Managing Production Risk

- Growers have three choices in dealing successfully with production risks:
 - Control or minimize risk
 - Ex irrigation to minimize the impact of drought
 - Reduce variability
 - Ex. Diversification to reduce income variability
 - Transfer risk
 - Ex. Crop insurance – pay a premium to move some yield /revenue risk.

PRODUCTION RISK MANAGEMENT CHECKLIST

- What are your major sources of crop and livestock production risk?
- Are the knowledge and management capabilities available to diversify or add another enterprise?
- Is there a strong level of commitment to diversify?
- What are the income and risk relationships between a prospective new enterprise and existing enterprises?
- Will the new enterprise provide effective diversification?
- What are the implications of a crop loss on the ability to meet debt obligations and cash flow needs?

PRODUCTION RISK MANAGEMENT CHECKLIST

- Which crop insurance product(s) and coverage offer the best protection for the coverage needed?
- Which coverage will best complement the marketing plan?
- Are there no cost or low cost practices that can be implemented to control or minimize risk?
- Is contracting a viable method of transferring risk?
- What are the legal conditions and implications of contracting?
- What are the economic benefits and risks of adopting new technologies?

Managing Marketing Risk

- Write a marketing plan.
- A marketing plan sets specific actions to be taken and the steps needed to accomplish the business goals. It requires:
 - an understanding of the alternatives and the tools the business wishes to use;
 - analysis of the alternatives; and
 - the discipline to follow through.

Components of Marketing Decisions

- When to price or sell
- Where to price or sell
- What form, grade, or quality to sell
- How to price
- What services to use
- When and how to deliver

Marketing Risk Management Checklist

- Is the marketing plan feasible and does it fit the producers' risk preferences?
- Is the marketing plan coordinated with the financial plan to ensure farm income meets cash flow needs?
- Is the marketing plan coordinated with the crop insurance plan?
- Based on historical yield records, what are the expected yields and what are the production costs and breakeven prices for those yields?

Marketing Risk Management Checklist

- Does the producer's lender understand the marketing plan and will the lender provide the needed financial support to carry it out?
- What are the costs, returns and associated risks alternative strategies?
- Where can the producers get the professional help that they are most comfortable with and will provide assistance that is consistent with the situation, goals and risk management philosophy?
- How can producers best upgrade their marketing knowledge and skills?

Managing Financial Risk

- Financial statements
 - Balance Sheet, Income Statement, Cash Flow
- Financial Performance Measures
 - Liquidity, Solvency, Profitability, Repayment Capacity
- Basic components of financial risk
 - Cost and availability of capital, meet cash flow needs in a timely manner, **ability to absorb short term financial shocks**, maintaining and growing equity

FINANCIAL RISK MANAGEMENT CHECKLIST

- Are the financial records in place that are needed to monitor the financial position of the business and the financial risks it faces?
- What have been the financial trends of the business?
- How do the key financial ratios compare to the guidelines and to those of similar operations?
- What is the relationship with lenders and how can that be enhanced to lower the interest rate charged?

FINANCIAL RISK MANAGEMENT CHECKLIST

- What are the cash flow needs of the business for operating inputs, machinery, personnel, land costs, debt payments, taxes, living costs and farm overhead?
- How can profit margins be protected?
- Have family living expenses followed projections?
- Have “what if ” scenarios been conducted to evaluate the financial impacts of uncontrollable events?

Managing Legal Risk

- Contractual arrangements
- Business organization
- Laws and regulations
- Liability
- Public policy and attitudes

LEGAL RISK MANAGEMENT CHECKLIST

- Are property and liability insurance policies adequate?
- Have all new acquisitions been added to insurance coverage?
- Are contracts in place to specify the performance and remuneration for all parties?
- Is care taken to ensure that all parties have sufficient knowledge to make informed decisions?
- Do contracts include terms and remedies in the event of default?
- Are farm activities in compliance with local, state, and federal laws and regulations?
- Do owners and managers stay current on changes in laws and regulations?
- Do owners and managers stay current on trends in consumer attitudes and preferences?

Managing Human Risk

- **Health and safety**

- Structure work assignments and schedules consistent with skill level and physical limitations.
- Include safety precautions in all aspects of training.
- Allow sufficient time for physical and mental rest.
- Utilize proper machine guarding and maintain equipment to manufacturers' recommendations.
- Follow instructions exactly when using chemicals.
- Always use protective equipment (seat belts, safety gear, goggles, gloves, boots, etc.).
- Purchase health, life and disability insurance policies.

Managing Human Risk

- Provide training for back-up support within the farm business in areas such as record keeping, financial analysis, market planning, and production management.
- Practice open, honest, and effective communication.
- Establish family rules and policies to guide family members in their personal business and family relationships.
- Seek legal counsel regarding financial and tax implications before people exit the business due to death, illness, divorce, retirement, alternative employment opportunities, and estranged relationships.

Succession Planning

- Establish transition goals to guide decision making through the process.
- Consider who else should be involved to make decisions about transition planning.
- Consider both the process and outcome when determining what is fair and equitable for the distribution of property.
- Prepare an estate plan.
- Plan for any legal, tax, or other consequences that may arise as a result of the decisions.

HUMAN RISK MANAGEMENT CHECKLIST

- Has an overall farm safety and health plan been prepared and shared with family members, business partners and employees?
- Is farm safety included in all training opportunities?
- Have back-up support training, how-to manuals, and contingency plans been developed to prepare for unexpected absences or when human resources are unable to produce?

HUMAN RISK MANAGEMENT CHECKLIST

- Have communication forums and conflict resolution processes been established to manage the family component of the farm business?
- Have employee management procedures been developed and incorporated into the management plan?
- Has a transition plan been prepared and is it current?

Summary

- Start small and build the plan over time
 - Identify risks
 - Develop a plan
 - Implement the plan
 - Measure the results
 - Improve the plan for the next time period
- **Data and record keeping is one of the most important assets in managing risk.**
- **“You can not manage what you can not measure” – Dr. Clark Garland**



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