AGRIBUSINESS
RISK AND RISK MANAGEMENT STRATEGIES

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Sources of Risk: Overview

- Five sources of risk and risk strategies to improve outcomes
  - Production
  - Marketing
  - Financial
  - Legal
  - Human Resource
Sources of Risk: Overview

- **Topic 1** - Production Risk and Production Risk Management Tools
- Topic 2 - Marketing Risk
- Topic 3 - Financial Risk
- Topic 4 - Legal Risk
- Topic 5 - Human Resource Risk
Sources of Risk: Topic 1 – Production Risk

- Know that production risk is a variation in production level
- Agricultural production implies an expected outcome or yield
- Variation in expected outcome affects your ability to achieve expected financial goals
Sources of Risk: Topic 1 — Production Risk

- Sources of Crop Production Risk
  - Weather
  - Insect damage and weed competition
  - Diseases
  - Interaction with new technology

- Sources of Livestock Production Risk
  - Weather and the environment
  - Disease effects in producing calves or finishing
    - Predators (coyotes, wolves, mountain lions)
    - Interaction with new technology
Sources of Risk: Topic 1 — Production Risk Management Tools

- Enterprise diversification
- Try different production practices or practice enterprise diversification by
  - Growing different crops
  - Trying combinations of crops and livestock
  - Identifying different end points in the same production process
  - Growing different types of the same crop
Thinking of starting a new enterprise?

The answers to these questions can help you discover any limiting resources you might encounter:

- What knowledge and management skills do I need?
- What are the added labor needs?
- Where are the markets?
- What do your answers tell you?
Crop Insurance

Consider using crop insurance as a tool to transfer your yield or price risk to others.

Crop insurance works the same way as car insurance, the greater the coverage, the greater the premium.
Sources of Risk: Topic 1 – Production Risk Management Tools

- The answers to these questions can help you determine if you’re getting the most out of your insurance dollar
  - What are the costs?
  - Which type offers the best protection?
  - How much coverage do I need for adequate cash flow?
  - Which insurance product will best complement my marketing plan?
  - What do your answers tell you?
Sources of Risk: Topic 1 – Production
Risk Management Tools

- Contract production
- Be prepared to commit to deliver a specific quality and quantity of product
- You must meet the contract specifications
- Manage the contracted risk with crop insurance and sound management practices
Sources of Risk: Topic 1 — Production
Risk Management Tools

- The answers to these questions can help you determine if contract production is a solution for you
  - What benefits will a production contract provide?
  - What flexibility will I give up?
  - Do I understand the terms of the contract or should I seek legal advice?
  - What do your answers tell you?
Sources of Risk: Topic 1 — Production
Risk Management Tools

- New Technology
  - Some of the technological advances in agriculture that have improved the producer’s success rate
    - Planting improvements
    - Crop production chemicals
    - Harvesting equipment
  - Benefits of using new technology include
    - Lower production costs
    - Improved environmental quality
    - Higher quality product
Sources of Risk: Topic 1 – Production
Risk Management Tools

- New technology benefits for livestock producers include
  - Advances in disease control
  - Improved feed supplements
  - Better management practices
Sources of Risk: Topic 1 – Production Risk Management Tools

- Once again, knowing the answers to these questions can help you determine if using new technology is a useful production tool for you
  - What is the economic benefit of adopting a new technology?
  - Does the adoption of a new technology reduce my risk?
  - Is crop insurance a better risk than adopting a new technology?
  - What do your answers tell you?
Sources of Risk: Topic Overview

- Topic 1 - Production Risk
- **Topic 2 - Marketing Risk Marketing and Risk Management Tools**
- Topic 3 - Financial Risk
- Topic 4 - Legal Risk
- Topic 5 - Human Resource Risk
Sources of Risk: Topic 2 - Marketing Risk

- Marketing risk involves
  - Price and market uncertainty
  - Input costs
  - Outside forces
Sources of Risk: Topic 2 - Marketing

Risk

- Outside forces that affect prices and market risk are
  - Weather
  - Actions of US and foreign governments
  - Farm programs
  - Regulations
  - Embargoes
  - Trade tariffs
Personal considerations for handling marketing risk include:

- Know your risk comfort level
- Improve your current marketing skills and learn new skills
- Develop an integrated management approach
- Develop a marketing plan
Sources of Risk: Topic 2 - Marketing

Ways you can handle marketing risk

- Reduce risk by avoiding higher-risk ventures
- Shift risk to others
- Maintain flexibility
Reduce risk and avoid higher-risk ventures by:

- Knowing current market information
- Using key business partners
- Spreading out sales
- Using contract production
- Creating and following your business plan
Sources of Risk: Topic 2 - Marketing
Risk Management Tools

- Shift risk to others by
  - Using contracts (cash, forward, deferred)
  - Participating in futures and option markets
  - Pooling
  - Joining cooperatives
  - Sharing leases
  - Timing or modifying the type of sale
  - Purchasing crop insurance
Sources of Risk: Topic 2 - Marketing
Risk Management Tools

- Maintain flexibility by
  - Timing sales and/or purchase of outputs/inputs
  - Placement where and from whom your sales/purchases are made
  - Different forms of sales and input purchase
Sources of Risk: Overview

- Topic 1 - Production Risk
- Topic 2 - Marketing Risk
- **Topic 3 - Financial Risk and Financial Risk Management Tools**
- Topic 4 - Legal Risk
- Topic 5 - Human Resource Risk
Sources of Risk: Topic 3 - Financial Risk

- Financial risk develops from regular business activity
  - Cost and availability of debt capital
  - Ability to meet cash flow needs
  - Capability of generating additional equity

![Figure 1.8: Major stock market price indexes, January 2004–February 2005 (1 January 2004 = 100)](image)

Note: Morgan Stanley Capital International (MSCI) is a capitalization-weighted index that monitors performance of stocks from Asia-Pacific, excluding Japan. Sources: Datastream, downloaded 1 March 2005; Bloomberg, downloaded 1 March 2005.
Sources of Risk: Topic 3 - Financial Risk

- Other financial risk can be attributed to
  - Poor planning
  - Failure to maintain control of the operation
  - Lack of financial understanding
Sources of Risk: Topic 3 - Financial Risk

- **Cost and availability of debt capital**
  - Money or capital that comes from sources outside the operation, such as bank loans

- **Work with your lender to create a solid relationship and reduce your financial risk when**
  - There’s an increase in interest rates or interest expenses from variable rate loans
  - You need to borrow and access credit to maintain flexibility
Sources of Risk: Topic 3 - Financial Risk

- Ability to meet cash flow needs
- Typical financial obligations include
  - Production expenses
  - Debt payment
  - Property taxes
  - Insurance
  - Family living expenses
- Address with cash flow “planning” and budgeting
Your ability to increase owner equity in your operation is an indication of basic business profitability.

If you notice a downward-trend in your owner equity over time, you are seeing a lack of profitability in the business.
Sources of Risk: Topic 3 - Financial Risk

- Keep or increase your profitability by
  - Maintaining effective and up-to-date records
  - Implementing a professional financial plan
Sources of Risk: Topic 3 - Managing Financial Risk

- Manage your financial risk by
  - Determining your acceptable risk levels
  - Putting controls and tracking mechanisms in place to maintain your acceptable risk level
Sources of Risk: Topic 3 - Managing Financial Risk

- Other ways to manage your financial risk are
  - Budgeting cash inflows and outflows
  - Maintaining accurate and up-to-date financial records
  - Conducting a basic financial analysis
  - Developing annual financial statements
Sources of Risk: Overview

- Topic 1 - Production Risk
- Topic 2 - Marketing Risk
- Topic 3 - Financial Risk
- Topic 4 - Legal Risk
- Topic 5 - Human Resource Risk
Sources of Risk: Topic 4 - Legal Risk

- Legal risks include
  - Business structure
  - Contracts
  - Tort liability
  - Statutory compliance
Sources of Risk: Topic 4 - Legal Risk

- Business structure has many forms
  - Corporations
  - Limited partnership
  - Limited-liability companies
  - Partnership
  - Sole proprietorship
  - Trusts

- They all have an effect on
  - Income and property taxes
  - Estate planning and transfers
Contractual agreements are part of the day-to-day management of most agricultural businesses.

The five types of contracts that can affect your legal risk are:
- Financial agreements
- Leases or crop-share arrangements
- Federal program agreements
- Insurance instruments
- Labor
Tort and tort liability law is primarily concerned with compensation to someone injured or damaged by a wrongful act or omission.
Sources of Risk: Topic 4 - Legal Risk

- Tort liability includes acts of
  - Negligence or intentionally caused damage related to
    - Farm injury
    - Farm discharges
  - Non-disclosure of known farmstead hazards
  - Consult a legal professional to ensure you have adequate protection against this type of legal risk
Sources of Risk: Topic 4 - Legal Risk

- Statutory compliance is defined as meeting regulations imposed by government agencies on your operation.
- Statutory compliance risks arise from the failure to follow regulations governing the operation of your business.
You need to know that statutory compliance involves:

- Tax reporting and payment
- Wage and worker safety
- Nondiscrimination
- Pesticide/herbicide use regulations
- Federal program compliance
- Failure to comply can result in severe fines or other penalties
Sources of Risk: Topic 4 - Legal Risk: Managing Legal Risk

- You can manage your legal risk better by
  - Obtaining professional assistance
  - Purchasing additional liability insurance
  - Contacting an attorney
  - Hiring an accountant or CPSA
  - Understanding the legal risks
Sources of Risk: Overview

- Topic 1 - Production Risk
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Sources of Risk: Topic 5 - Human Resource Risk

- Human resource risks may arise when business activities require working with other people. These would include but are not limited to personnel issues, such as
  - Hiring and/or firing employees
  - Injury, illness, or death
  - Changing personal or operation objectives
  - Marital status
Sources of Risk: Topic 5 - Human Resource Risk

- Labor risks you should become familiar with include:
  - Work that is not done, is done poorly, or not on time
  - High indirect labor costs can be incurred
  - Potential conflict with employees
  - Laws and regulations
    - Worker safety regulations/OSHA requirements
Sources of Risk: Topic 5 - Managing Human Resource Risk

- You can reduce human resource risk by effectively training your employees
  - Training should be ongoing to encourage motivation and skills development to maintain peak efficiency
  - Consider shifting some jobs to contract or custom labor
    - May provide a lower cost alternative
    - Specific tasks can be assigned to contract workers
    - May outsource human resource administration
Sources of Risk: Topic 5 - Managing Human Resource Risk

- You can further reduce human resource risk by monitoring your operation’s hiring practices

- Always
  - Check personnel qualifications
  - Follow the hiring laws for your state

- Also have plans for
  - Personnel transitions
  - Estate transfer
QUESTIONS/COMMENTS

Thank you.........