



R I G H T R I S K N E W S

Managing Risk in a Small Agricultural-based Business

Are you the owner of an agricultural business? Do you sometimes feel left out of the conversations about managing risk in agriculture because they focus on crop insurance and commodity marketing tools that do not apply to your situation? The *SRMP Small Business Edition* was specifically designed to help non-commercial and lifestyle operations create and customize a personal risk management plan.

Agricultural producers face more risk than most business owners. Whatever your agricultural business, no matter how large or small your operation, you are affected by market uncertainties, changing operating costs, and unforeseeable events that affect production and other aspects of the business. Whether your operation survives or thrives depends on how well you anticipate these changes and plan for and manage risk.

Strategic Risk Management

There is no right or wrong answer when it comes to the level of risk you are comfortable with for your business. One of the most important aspects of a good risk management strategy is understanding the level of risk that works for you and your business operation. The *SRMP Small Business Edition*, available for free in electronic booklet form at RightRisk.org, walks readers through the ten-step Strategic Risk Management Process (SRMP) using a case study operation of a small vineyard operated by a couple of recently retired school teachers.

The SRMP is divided into three main parts: strategic, tactical, and operational. These three phases lead the business owner through a systematic, sequential planning process by dividing the three phases into ten operational steps. Because risk management requires continuous evaluation and adjustment, the three management phases and the ten steps are combined into a circular flow diagram. The message being business owners are never done managing risk. They must learn to modify their actions as information and conditions change. A good risk management plan involves continuous monitoring and evaluation to keep the business on track for success.

Step 1: Determining your financial health (strategic)

Most small business owners embrace hard work and find satisfaction in producing a good product and/or service. However, it is also important to invest the time to ensure you have a financially sound business. Financial health refers to the well-being of the business as measured by financial analysis. A good financial analysis should look at five areas of the business: liquidity, solvency, repayment capacity, profitability, and financial efficiency. Information in the four basic financial statements – balance sheet, cash flow statement, income statement, and statement of owner equity - can provide all the information you need to analyze your financial health. It may take some time to become proficient at this step but it provides an important foundation for understanding how your business is operating financially and for making good business management decisions.

Strategic Risk Management Process



How Much Risk is Right for You?

An Example Weather Risk



Step 2: Finding Your Ability and Preference to Tolerate Risk (strategic)

Some people seek out risk, others avoid it. Most people are somewhere in between. Realizing that risk is part of doing business, they know that working too hard to avoid it will lead to low returns on their investment. However, they are not willing to take on too much risk in an effort to get rich quick. The SRMP Small Business Edition provides some examples of risk-return tradeoffs along with a risk tolerance quiz to help business owners assess their own tolerance for risk. The quiz is also available online at <http://risknavigatorsrm.com/toolbox/Risk%20Preference%20Tools/default.aspx>. In a business with multiple owners or decision makers, it is important to be aware and respectful of everyone's tolerance for risk.

Step 3: Goal Setting for Strategic Risk Management (strategic)

Having clear, well-defined goals provides focus for precious time, energy and effort. In small family owned agricultural businesses, this is an extremely important factor in achieving a high quality of life. Too often the temptation to complete the next task can lead to eighty-hour work weeks, poor family relationships and complicated rather than quality daily experiences. The SRMP Small Business Edition provides readers with an example goal setting process for the White's Vineyard case farm to provide guidance on how to do this important step for their operation and increase opportunities for success.

Step 4: Determine Risk Sources (tactical)

The tactical phase is designed to evaluate various alternatives for reaching the goals determined in step 3 and to develop a plan to achieve them. The first step in this phase is to determine potential risks that may threaten successful achievement of one's goals. Risks can come from a number of sources but generally fall into one of five categories for agricultural operations: production risk, market or price risk, financial risk, institutional risk, or human resource risk. It is important to not only list the potential risks but also understand how much of an affect they may have on your business and your ability to influence or manage the risk. The SRMP Small Business Edition provides a complete example of the White's Vineyards completing this step and arriving at two high priority risks to address.

Step 5: Identify Risk Management Alternatives (tactical)

Once risks are identified and prioritized, alternative management actions need to be considered. There are four basic options for addressing risk: avoid it, transfer it, reduce it, or assume it. Avoiding risk comes with the forfeiture of potential rewards. It may make sense in some cases where the risks are just too high or management alternatives are inadequate. Likewise, assuming risk may make sense if the management alternatives are inadequate but the risks are deemed acceptable given the potential rewards. Many people transfer risk using insurance and contracting tools. Others seek to reduce the risk by taking action(s) that either reduce the likelihood of bad outcomes or the impact if they occur. For many small agricultural businesses, market price is an important risk to address. This is especially true for high value crops or products that are not well addressed by existing insurance and commodity marketing tools. In the SRMP Small Business Edition case study, the owners of White's Vineyards identified developing good relationships with potential buyers and possibly entering into contract price agreements as a good risk management alternative.

Step 6: Determine the Likelihood of Risk Outcomes (tactical)

In Step 6, estimated likelihoods of various risk outcomes are determined. Step 6 is often initiated before identification of

Example Strategic Goal Worksheet from the SRMP Small Business Edition

MISSION STATEMENT FOR WHITE'S VINEYARDS:

To fulfill our lifelong dream of developing a profitable specialty crop business during my retirement, where we will produce the highest quality grapes in western Colorado.

WHITE'S VINEYARDS STRATEGIC GOAL WORKSHEET

Goal Statement: <i>Produce high-quality grapes that can be sold for wine making within five years. That is, drink wine from our own grapes within five years!</i>			
Deadline for Goal Attainment: <i>Fall 2012</i>			
----- Goal Costs/ Resources Required: -----			
Natural Resources + Own 6 acres of 3-year-old vineyards + Weather and soils conducive for grape growing (particularly for Riesling)	Human Resources (Available, rather than hours worked) + Husband- 20 hrs. + Wife- 40 hrs. + Adult children available for back-up help- 10 hrs. week	Financial Resources + Cash purchase of 6 acres of vineyards, using retirement savings (no mortgage!) + No debt and able to borrow for equipment	Capital Resources + Adequate senior water rights + Four-wheel drive pick-up truck
Associated Tactical Objectives:			
<i>Tactical Objective 1-1: To beat the county average yield and price for wine grapes within 5 years.</i>			
<i>Tactical Objective 1-2: Within 5 years, establish supply contracts with two local wineries for wine grapes.</i>			
<i>Tactical Objective 1-3: Recover investment costs, except for land, after 5 years and position vineyards to be able to purchase 2-3 more acres for vineyards in year 6.</i>			
Associated Operational Plans: (for Tactical Objective 1-3 only)			
<i>Operational Plan 1-1.1: Consult with grape and wine experts to establish an annual growing and production schedule. Monitor progress quarterly and annually to meet targeted production schedule. Re-evaluate schedule each year.</i>			
<i>Operational Plan 1-1.2: Purchase used tractor trailer at the end of the year, if annual production goals are attained.</i>			
<i>Operational Plans 1-1.3 and 1-2.1: Develop a demand for the product by inviting select local wine producers to annual holiday season open house to view operation and sample the product.</i>			



Strategic Risk Management

risk management alternatives and is presented that way in the SRMP Small Business Edition. In the case study, the White's estimated the likelihood of various market prices for their grape production. Using this information, the business owners could better understand the potential impact of price uncertainties. This motivated the identification of entering into a contract agreement as a potential risk management action. Steps 4-6 may require iteration to fully identify and prioritize risks and possible ways to address them.

Step 7: Ranking Your Management Alternatives (tactical)

After gaining an understanding of your tolerance for risk (Steps 1 and 2), your goals (Step 3), the risks you face (Steps 4 and 6), and your management alternatives (Step 5), it is time to determine the best course of action. Many small businesses have limited resources available to implement new management alternatives. It is important to align the prioritization of your management alternatives with the prioritization of the risk(s) you determine are most important to address. It may be necessary to seek outside help to implement some management alternatives that address the most important risks. An example would be paying a marketing expert to help develop a marketing plan. Regardless of current capacity to implement, developing a list of high priority risks and alternatives to address them positions the business for continuous improvement in managing risk.

Step 8: Implementation (operational)

The operational phase is where the strategic and tactical work performed in the previous phases is put into action. The most important influences on implementation are resource flow management and communication. Resource flow management is making sure the proper quantity and quality of resources are available at the appropriate time and place to implement the plans developed in the tactical phase. Coordination of this outcome requires good communication. Small agricultural operations sometimes fall victim to miscommunication because of false assumptions. Developing a culture of free flowing information to avoid this pitfall is one of the highest yielding investments a business owner can make.

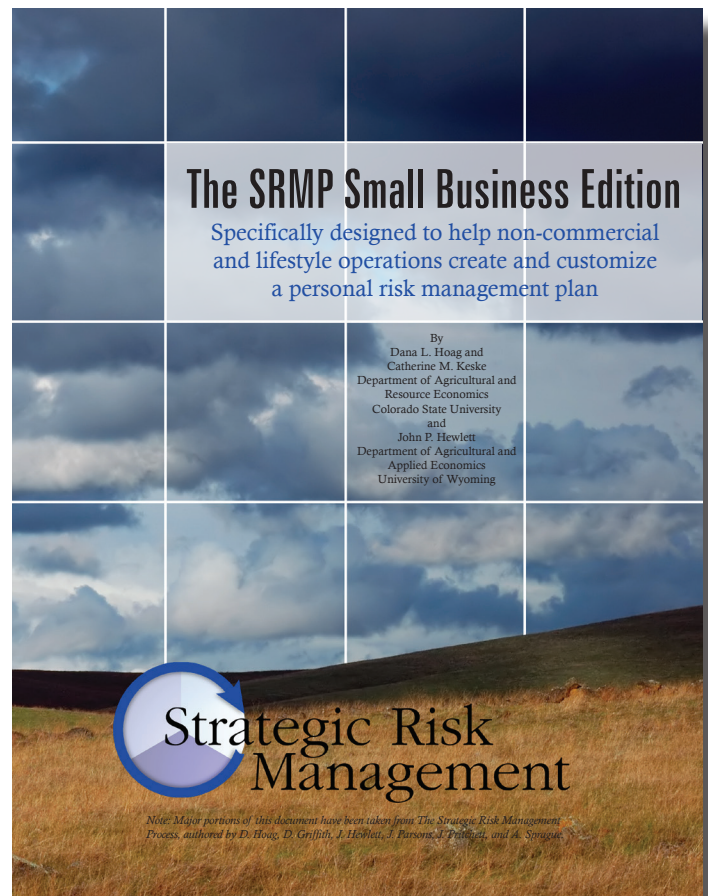
Step 9: Monitor and Adjust (operational)

Monitoring can provide information on how well the implementation is going and whether plans should be adjusted. Even the best management plans often need adjustments. Weather events, slower than expected progress and market changes all require consistent monitoring and adjustments to make sure current plans match up with current conditions.

Step 10: Replan (operational)

Re-planning closes out one decision-making cycle, such as a production year, and sets the course for continuously managing risk by cycling back through the SRMP. Mid-year adjustments may also be considered part of re-planning but typically re-planning considers changes that drastically alter the business, such as a large real estate purchase or a more involved inclusion of the next generation.

The best way to manage risk is to have a good process for managing risk. The SRMP Small Business Edition provides operators of small agricultural businesses with a process they can use to successfully navigate the risk and uncertainties of their business environment. For more information, visit www.RightRisk.org and explore available resources on Strategic Risk Management under the Products menu item.



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NEWS RELEASE - JANUARY 19 | RIGHTRISK

Federal Reserve Beige Book Summary on the Ag Sector

OVERALL economic activity was relatively unchanged since the previous report. Five Districts reported slight or modest increases in overall activity, six noted no change or slight declines, and one cited a significant decline . . .

For more see: RightRisk.org/News



	<p>January 3 Social Media Post <i>Problem Work Situations via Ag Help Wanted</i></p>		<p>January 19 Social Media Post <i>Risk Management Profiles RightRisk</i></p>
	<p>January 5 Social Media Post <i>Ag Help Wanted: Guidelines for Managing Agricultural Labor</i></p>		<p>January 24 Social Media Post <i>Taxes for Agricultural Enterprises</i></p>
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