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RightRisk™

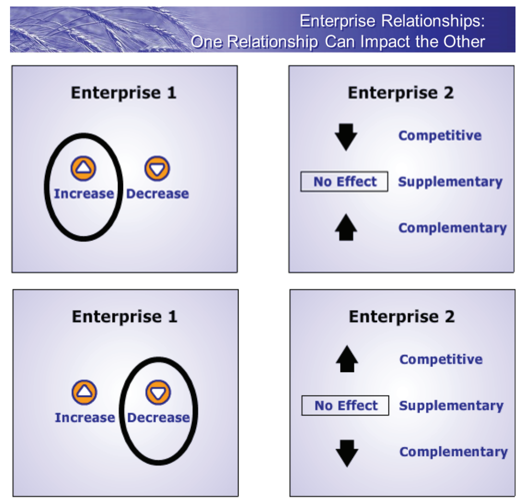
RightRisk News

Enterprise Mix: What Should I Grow?

How Much Risk is Right for You?

Many farms and ranches across the U.S. have resources that would allow for more than just one crop, one type of livestock, or even a combination of a variety of crops and livestock. If you were just getting started in agriculture, you might easily ask the question, "What do I grow?"

Often operations are managed with an eye to the past; working from the crop or livestock enterprise mix that has worked well in the past to build the business into the future. The RightRisk online, self-paced learning module covering Enterprise Feasibility offers several important concepts to help better understand the issues. Let's begin at the beginning to consider what options exist.



First, an enterprise is an activity that generates one or more saleable products. Agricultural enterprises, such as cow/calf, wheat and hay produce marketable products measured in pounds of beef, bushels of wheat, and tons of hay.

A common goal of many agricultural businesses is to use limited resources such as land, labor, and capital to produce one or more enterprises to generate profits. To single out a segment of the farm business for analysis as a separate enterprise, it is necessary to isolate the revenues and expenses (both direct costs and contributions to overhead costs) associated with that activity for consideration on a stand-alone basis.

For accounting purposes, each enterprise is considered a separate profit center within a farm. Enterprise accounting includes receipts and expenses that are directly related to the specific enterprise. These enterprise accounts are an important source of information for determining which enterprises are profitable and those enterprises that should receive further analysis or be reduced or eliminated. In addition, each enterprise has its own, unique risks to consider.

Another important aspect to consider is the relationships enterprises can have with each other. They may be competitive, supplementary or complementary. Two enterprises are competitive when an increase in one enterprise results in a decrease in the other. They are competing for the same resources and inputs at the same time. Enterprises are supplementary if an increase in one does not affect the other. Finally, complementary enterprises occur when an increase in one enterprise causes an increase in the production of the other. For example, a legume that fixes nitrogen in the soil might increase the yield of next year's crop in the rotation.

Enterprise Activities

Looked at in a broad context, enterprises are the activities that farms or ranches are involved in that use the available resources to produce one or more products. Those products are sold to generate the revenue stream for the operation.

Most farm/ranch owners and operators are involved with these enterprises to achieve their goals. Although for some, ownership is a goal in itself, others are also looking to earn a return on their investment in the capital of the operation. With this understanding of how goals drive many of the choices, it should not be surprising that operators with access to similar resources make different choices about what enterprises to engage in.

Each farm/ranch manager has a unique tolerance for risk. As a result, some are more willing to consider enterprise activities that may include a higher level of risk, whereas others may avoid those types of enterprise with worries about the possible losses involved. The RightRisk online, self-learning module entitled Enterprise Risk Analysis walks through many of the risk considerations when comparing enterprises.

Five distinct sources of agricultural enterprise risk
- Market risk
- Production risk
- Institutional risk
- Human risk
- Financial risk

Enterprise Risk

Enterprise risk management is focused at the enterprise level and the changes that management are able to make in the allocation of resources, the timing of enterprise activities, or the priority given to the enterprise. Management must decide, to the extent possible, which enterprise activity, process, function, project, product, or service in terms of time and location is in order to ensure the best chance of success for the risk management strategy selected.

One significant aspect of enterprise risk analysis is how management defines success for the enterprise. Some managers are content to simply sell all their production within the current operating year. Others look for synergies across all enterprises in their operation. Still others take a more long-term or strategic view and consider how success for one enterprise today can contribute to the success of another down the road or to the success of the entire operation.

Enterprise risk pertains to the variability or uncertainty that arises at the enterprise level of management. Here we are focused on the implications of decisions made for a single enterprise or commodity, rather than the whole farm or ranch. Many, if not most, day-to-day management decisions are about the details of enterprise management. These cover a broad range of choices from timing of production activities, to the quantity of inputs used, to the choice of approach to follow.

Identify Risk Sources

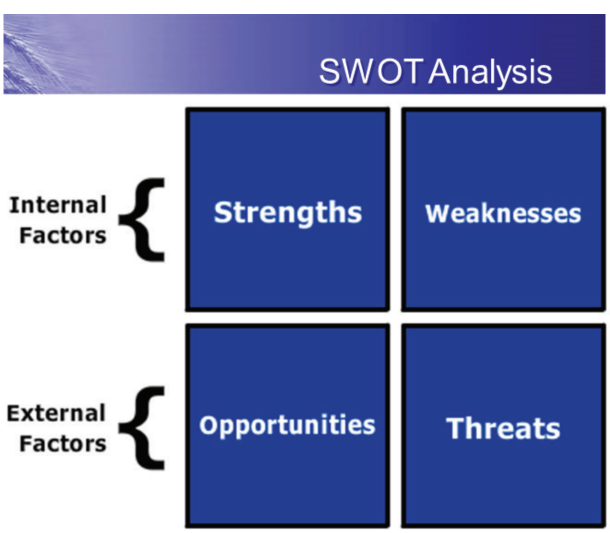
Enterprise risk likely originates from one or more of the five sources of risk. It may be helpful to consider those sources and how they relate to enterprise uncertainty.

Enterprise Production Risk - uncontrollable variation in enterprise output or output quality due to factors such as weather, pests or disease. Many, if not most, enterprise-level decisions are focused on managing this source of risk. The timing of cultural practices such as vaccinations, pasture rotation, crop cultivations, applications of crop amendments, pesticides, herbicides or other inputs are all enterprise-level production decisions.

Enterprise Marketing or Price Risk - prices of inputs or outputs that change after you commit to a plan of action. Clearly, changes in price can bring about a change in the net income for an enterprise. This could include the price received for the commodity being produced due to changes in market conditions, changes in the quantity or quality of the commodity delivered, or changes in other factors such as transportation costs, dockage, or delivery charges associated with marketing the commodity. Changes in the prices paid for production inputs will also result in variability in net income for the enterprise.

Enterprise Institutional Risks - rules, regulations and policies that effect profitability through increased costs, reduced returns, or both. Certain enterprises are more vulnerable to institutional risk than others are. Commodities produced for direct-sale or direct-delivery to consumers face a much higher standard for quality and visual appeal than those that do not. On the other hand, commodities produced, even by traditional methods, face increasing regulation and changes in local policies across much of agriculture.

Enterprise Human Risk – variability in enterprise production due to inconsistencies in character, health or behavior of the people involved. Most obviously, this points first to any labor resources that are involved in the production of the commodity. Irregular performance or following an approach that produces inconsistent results creates enterprise human risk.



Enterprise Financial Risk - risk associated with borrowing outside capital to make the enterprise function. Not all enterprises require outside capital; those that do represent higher levels of this type of risk. In addition, enterprises that require higher levels of operating inputs result in products that sell more directly to consumers, or have higher prices, and generally have higher enterprise financial risk.

The purpose of enterprise risk management is to ensure that the farm/ranch has an appropriate response to the risks facing the enterprise. Any risk management strategies adopted should help avoid ineffective and inefficient responses to risk that can prevent reasonable activities or distort resource allocation.

Comparing Enterprises

One way to compare enterprises you may be considering is to complete a SWOT Analysis to evaluate existing or new enterprise – Strengths, Weaknesses, Opportunities and Threats. Strengths and weaknesses evaluate the internal factors that affect the success of an enterprise. Opportunities and threats evaluate the external factors that affect the success of an enterprise. The Enterprise Feasibility module digs into this idea further.

Another basis for comparing enterprise activities is on their profit margin and contribution to overall farm profitability. The risk analytics tool Enterprise Risk Analyzer from RightRisk allows the user to complete this type of evaluation to gain an overall understanding of how enterprises are currently performing. The tool also allows for a very detailed analysis of enterprise performance.

		Probability (Likelihood)		
		Low	Medium	High
Impact (Consequence)	High	0	2	1
	Medium	3	1	1
	Low	4	2	2

Enterprise Risk Analysis

After developing net return estimates by allocating all farm/ranch expenses and revenue to appropriate enterprises, breakeven analysis is possible on both a price- and yield-basis using risk-estimates provided by the user. Breakeven data are presented in both tabular, as well as graphical form using probability density functions.

With an accurate and completely-allocated set of farm/ranch expenses and revenue in hand, the manager is in a good position to evaluate: 1) How profitable each enterprise activity is on its own merit, 2) How profitable one enterprise activity is compared to others, and 3) What are the largest expense categories for each enterprise. This information is extremely helpful when identifying adjustments to enterprises activities with the goal of improving either enterprise profitability or the profitability of entire farm/ranch. It is important to remember that the profitability of any farm or ranch in total arises from the ability of each enterprise activity to employ resources in such a way as to earn a greater return from those activities than the accumulated expenses of production.

In addition to this mission-critical management information, the manager armed with such enterprise cost and return information may begin to accurately assess breakeven prices and yields for each enterprise activity. This provides the active manager with the detailed understanding required to make mid-year corrections to marketing plans, as well as production strategies.

Finally, the Enterprise Risk Analyzer tool enhances the manager's understanding of how those breakeven prices and yields are likely to vary over time. Using the risk-estimates provided by the user as most likely, minimum, and maximum estimated yields and prices for each enterprise, allows the tool to provide tabular and graphical information for the probability of breaking even over a range of values.

Clearly the selection of which enterprise or combination of enterprise activities hinges on many, diverse considerations. Answers to the questions about what resources the manager has to work with, what the risk preferences of the people involved are, as well as what financial performance might be expected should all be considered. A SWOT analysis may help to pull answers to these questions and other differences together into a framework that can help guide the owner/manager through the selection process.

Resources:

Enterprise Risk Analysis. An eBook to accompany the online RightRisk education module: Enterprise Risk Analysis. Hewlett, J.P., J. Parsons, J. Tranel, and B. Taylor. August 2017. RightRisk.org

Enterprise Risk Analyzer - Tool. An online risk analytics tool. Hewlett, J.P., Dr. Jay Parsons, and Dr. Stuart Nakamoto. September 2012. RightRisk.org

Enterprise Risk Analyzer - Technical Guide. A guide providing insights into the use and application of the Enterprise Risk Analyzer tool. Hewlett, J.P., Dr. Jay Parsons, and Dr. Stuart Nakamoto. September 2012. RightRisk.org

Feasibility of Alternative Rural Enterprises. An online, self-paced learning module covering the concepts of enterprise feasibility. Sharp, R., J.P. Hewlett, and J.E. Tranel. September 2006. RightRisk.org

~ Other RightRisk News ~

News Release - November 20 | RightRisk

AG CREDIT: Credit Conditions Soften with Farm Economy

Agricultural credit conditions in the Tenth District softened during the third quarter. Farm income and loan repayment rates were lower than a year ago for the second quarter in a row. The moderation was more pronounced in areas most impacted by drought, but more tempered in areas most concentrated in cattle production . . .

For more see: RightRisk.org\News

Highlighted Publications: *Risk Concepts*

Our Risk Concepts series consists of 7 bulletins covering various forms of partnerships, limited liability companies, corporations, as well as sole proprietorships. Each of the 6 most common forms of business ownership are compared across 6 characteristics of greatest importance to most farm and ranch families.

Selection between these alternatives has broad implications for how management decisions are made, the liability individuals may have when things go wrong, tax implications and level of taxation for owners, how to accommodate new owners or family members, implications for sustaining operations into the future, transfer of ownership, and ease of dissolution. The Risk Concepts summary chart can help.

To access the publications see: **RightRisk.org\RiskConcepts**.

November 2 | Social Media Post
Ag Help Wanted: Guidelines for Managing Agricultural Labor

November 7 | Social Media Post
¿Cuáles son los reglamentos Estado Unidenses para el trabajo de menores en agricultura?

November 9 | Social Media Post
Evaluating Lease Agreements via RightRisk Analytics

November 14 | Social Media Post
Lasting Legacy Course #1

November 16 | Social Media Post
Courses in Risk Management | RightRisk

November 21 | Social Media Post
Job Descriptions Why Waste the Time?

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How much risk is right for you and your operation?