

Risk Management for Agricultural Producers



It's a whole new ballgame...

- Risk Management is a whole new ballgame. It means confidence in a changing world.

By learning about and using these tools, U.S. farmers and ranchers can build the confidence they need to deal with:

- the risks of the future
- the opportunities of the future

Changes:

- Changing governmental role
- Outside forces
- Risk connections

You are not competing by yourself. You have a whole team of professional players prepared to help you win.

- Grain elevator operators
- Commodity brokers
- Crop Insurance agents
- Loan officers
- Extension educators
- Commodity organizations
- Cooperatives
- Lawyers
- Accountants
- People in the local USDA offices

Understanding Goals

- Recognizing and acting on *opportunities* as well as trying to *minimize losses* can help shape agreement on fundamental risk management.



Benefits of Goal Setting:

- Reflects your values, interests, resources and capabilities.
- Provides a basis for your decisions and a focal point for everyone involved.
- Establishes priorities for the allocating of scarce resources.
- Provides a means for measuring progress.

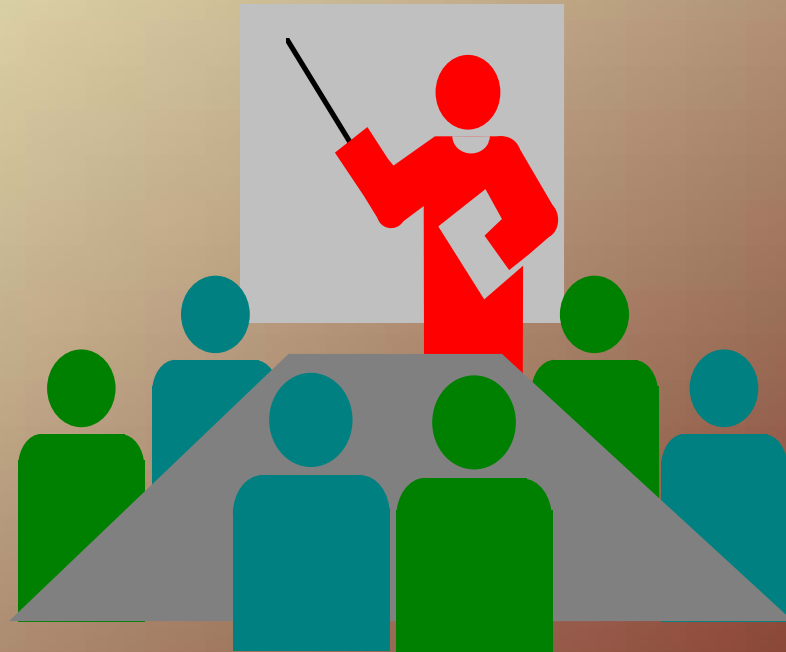
Goal Setting: *Ask yourself....*

- Are my goals written, reasonable and measurable?
- Are my goals attainable in my lifetime?
- Have I shared my goals with everyone involved in the business and have they shared their goals with me?

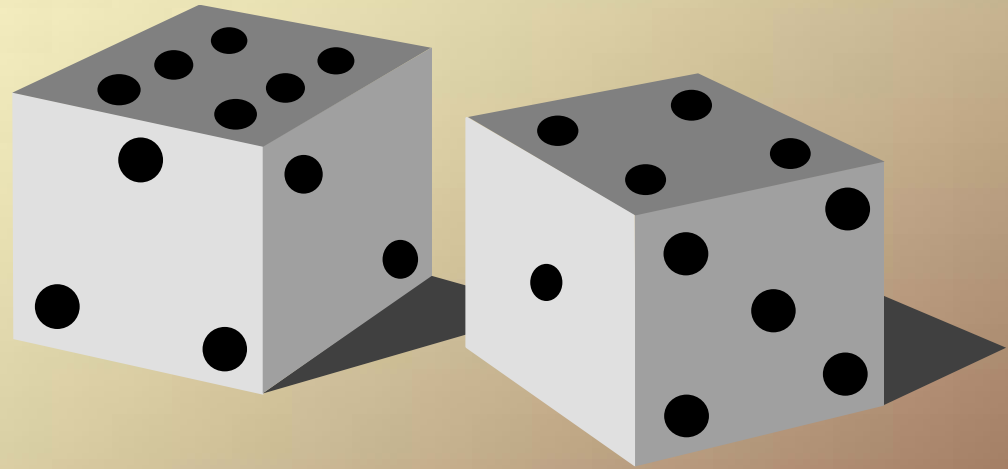


Handling Risks

1. RETAIN
2. SHIFT
3. REDUCE
4. SELF-INSURE
5. AVOID



RETAIN



- For example, holding an unpriced commodity, with no protection from downside risk.

SHIFT

- A contractual arrangement where someone else takes on some of the chance of a negative occurrence happening in exchange for a premium.
- The more risk you shift, the higher the cost.

REDUCE

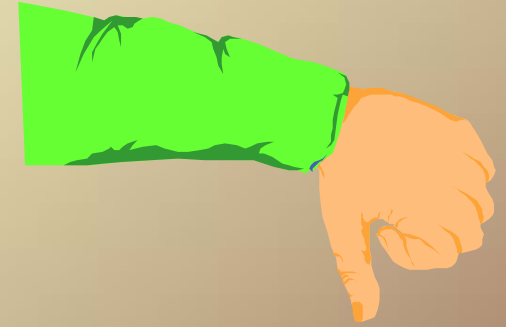
- Keeping fences in good condition to prevent livestock on the highways.
- Implementing a marketing plan that locks in some level of guaranteed return.

SELF-INSURE



- Emergency reserves funded from previous years' profits.

AVOID



- Not selecting a particular enterprise.
- Not pushing either end of planting windows.
- Not increasing your debt to asset ration beyond your comfort level.

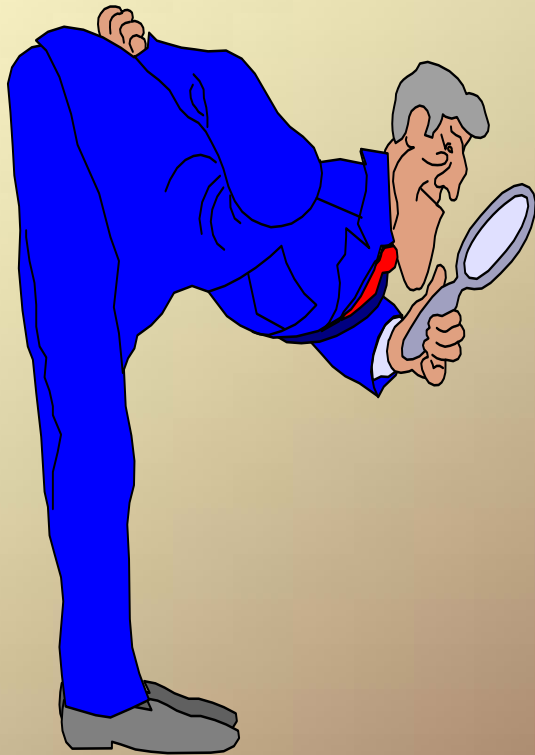
Benefits of Identifying Your Risk Tolerance and Assessing Your Risks

- Allows you to identify and exclude those alternatives which expose you to unacceptable risks
- Helps guide providers of risk management services to the best options for you.
- Ensure that your insurance dollars will be spent wisely
- Increases the likelihood that you will select the best combination of risk management strategies.

Ask Yourself, Have I...

- *Identified my style of managing risk?*
- *Communicated my style to the professionals who provide me with risk managing services?*
- *Looked at my goals in terms of the risks which can keep me from attaining those goals?*
- *Identified which risks am I comfortable retaining/managing with my own resources?*
- *Had an insurance check-up for health, life-casualty, disability, long term care, Medicare/Medicaid and crop insurance?*
- *Established a confident relationship with the professionals who can help me assess my business risk exposure?*

WE HAVE IDENTIFIED
5 MAIN SOURCES OF
RISK:



- **PRODUCTION**
- **MARKETING**
- **FINANCE**
- **LEGAL**
- **HUMAN RESOURCES**

UNDERSTANDING PRODUCTION RISKS



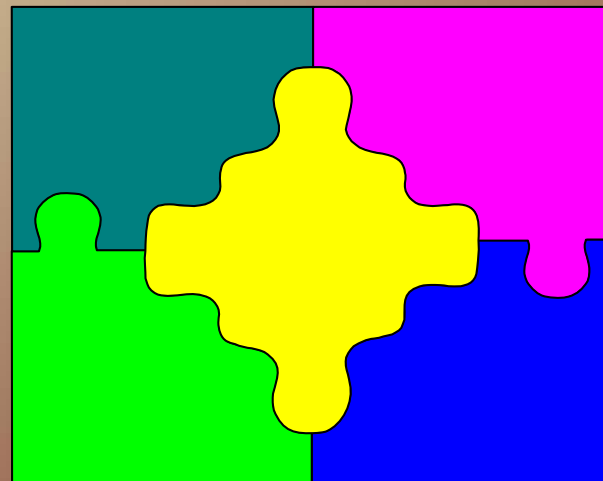
Production Risks Divisions

- Enterprise Diversification
- Crop Insurance
- Evaluation New Technologies



Enterprise Diversification

Combining dissimilar production processes.



Enterprise Diversification:

Ask yourself.....

- What knowledge and management capabilities are needed for the extra enterprise? Are they readily available? Do I have a serious commitment to a new enterprise?
- Which additional capital investments would I need to diversify?
- What are the added labor needs of a new enterprise?

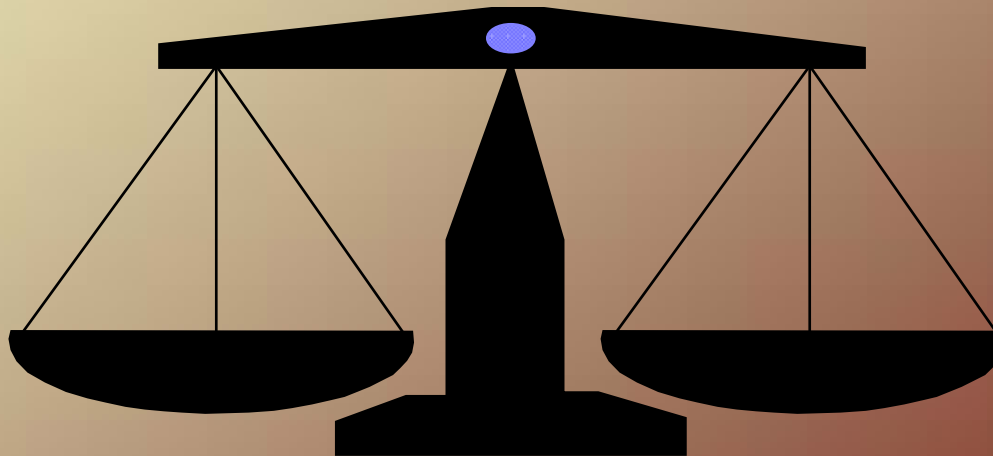
Enterprise Diversification:

Ask yourself....

- Where are new markets?
- What are the income relationships between this enterprise and the existing enterprises?
- Will the newsletter provide effective diversification.

Crop Insurance

Protects against losses but also offers the opportunity for more consistent gains.



Types of Crop Insurance:

- Multiple Peril Crop Insurance
- Crop Revenue Coverage
- Group Risk Protection
- Income Protection (IP)
- Revenue Assurance (RA)
- Crop/Hail Insurance



Crop Insurance:

- Available only through crop insurance agents.
- Currently available on over 60 crops.

Crop Insurance: *Ask yourself...*

- What amount of coverage is needed in terms of cash flow needs?
- Which crop insurance product will best compliment my marketing plan?
- What are the implications of a crop loss on my ability to meet my debt obligations?
- What are the major sources of production risk and what type of coverage is needed?
- What are the costs of the various types of coverage and which offers the best protection for the level of coverage needed?

Evaluating New Technologies

For example....

Genetically altered seeds

Precision farming



Evaluating New Technologies: *Benefits*

- Lower input costs
- Environmental quality
- Higher crop yields due to improved pest control
- More cost-effective use of crop inputs

Evaluating New Technologies:

Ask yourself.....

- What economic tradeoffs between more aggressive pest control and minimal control?
- Are pest management strategies consistent with my management philosophy about environmental quality?
- Will more intensive monitoring of pests be an economical strategy?

Production Risks Overall:

- What is the economic benefit for adopting new technology?
- Does the adoption of new technology reduce my risk?
- Would it be more profitable to manage risk by purchasing seed that is resistant to a specific pest or by diversifying production over several crops?
- Would it be a better risk strategy to simply buy crop insurance, regardless of the specific factor that might cause a reduction in yield reduction, than to buy seed that is resistant to a specific pest?

UNDERSTANDING MARKETING RISKS



Marketing Risks

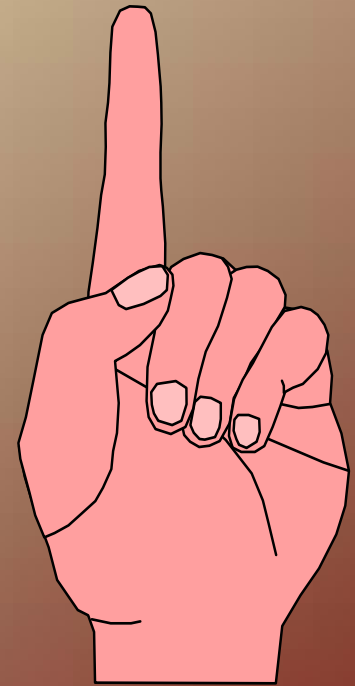
- Marketing is the part of business that transforms production activities into financial success.
- Unanticipated forces can lead to dramatic changes in crop and livestock prices.
- When these forces are understood, they become important considerations for the skilled marketer.
- To be successful, you should take an informed and balanced approach to making marketing decisions.

Marketing Risks

- **Personal Considerations in Marketing:** Marketing agricultural products involves information, objectivity, attitude and skill.
- **Developing a Marketing Plan:** An accurate understanding of production costs is a critical part of a sound marketing plan....for you and for professionals who work with you.
- **Marketing Plan Discipline:** A marketing plan is of little value if actual decisions deviate from the plan.

Three Personal Factors to Consider:

- Know what level of risk you are comfortable with.
- Be willing to increase the number of skills in your marketing toolbox.
- Develop an integrated management approach to your business.



Personal Considerations:

Ask yourself...

- Am I financially able to “shoot for the top price” and withstand the potential downside consequences of missing it?
- Should I receive professional marketing services?

Personal Considerations cont.

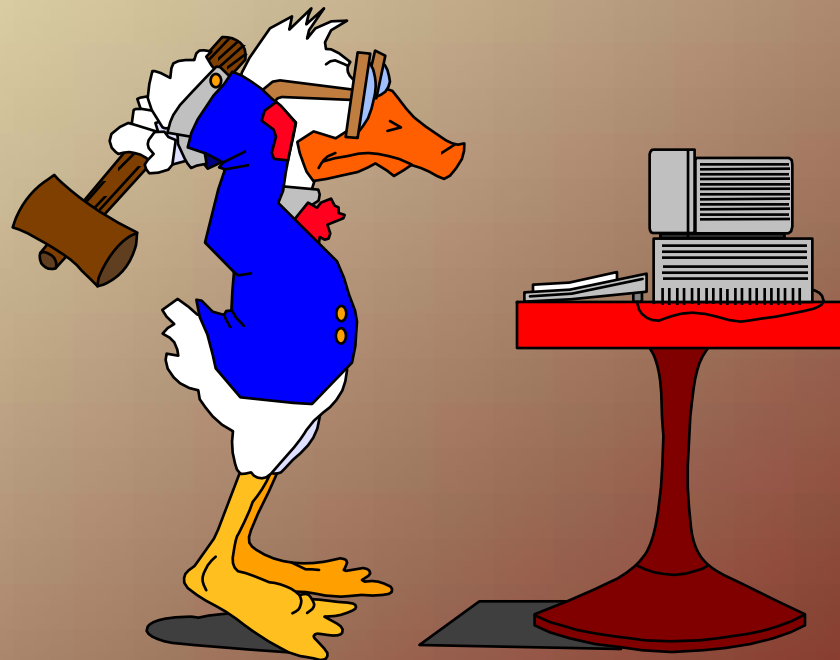
- Will my lender understand my plan and help me achieve my goals?
- What are the potential costs and returns associated with alternative strategies?

Develop a Marketing Plan:

- Goals and objectives of the business should drive the marketing plan.
- Understand production costs. A break-even price should serve as a well understood reference price, even though it is not usually the pricing objective.
- An analysis of supply and demand is important in developing targets for your marketing plan.
- Know long-term average prices.
- Consider cash flow requirements (family living needs).
- What works for your neighbor may not be what will work for you.

Marketing Plan Discipline :

- Emotions
- Science
- Discipline
- Analysis



Marketing Risks: *Ask yourself*

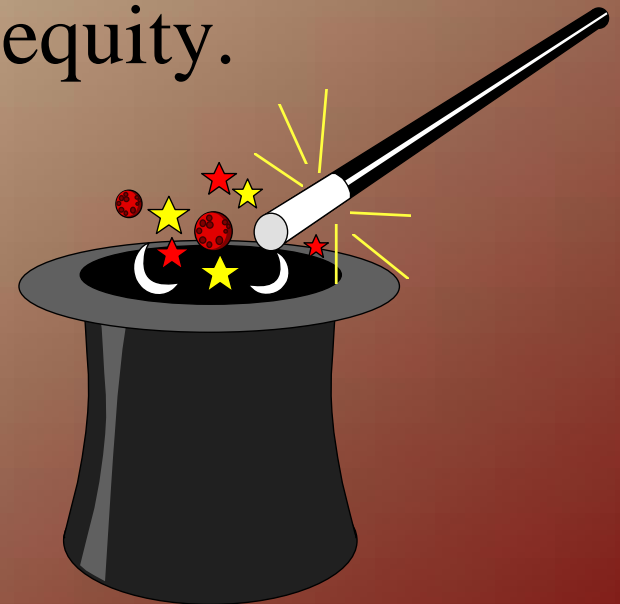
- Does my marketing plan cover the entire calendar or crop year?
- Have I checked my marketing plan against my financial plan to make sure that income from marketing covers cash flow needs?
- Are all your crop and livestock enterprises covered in my plan?
- Have I calculated production costs and estimated my yield to determine my breakeven price?

UNDERSTANDING FINANCIAL RISKS



Financial Risk: Three Basic Components...

- Cost and availability of debt capital
- Ability to meet cash flow needs in a timely manner
- Ability to maintain and grow equity.

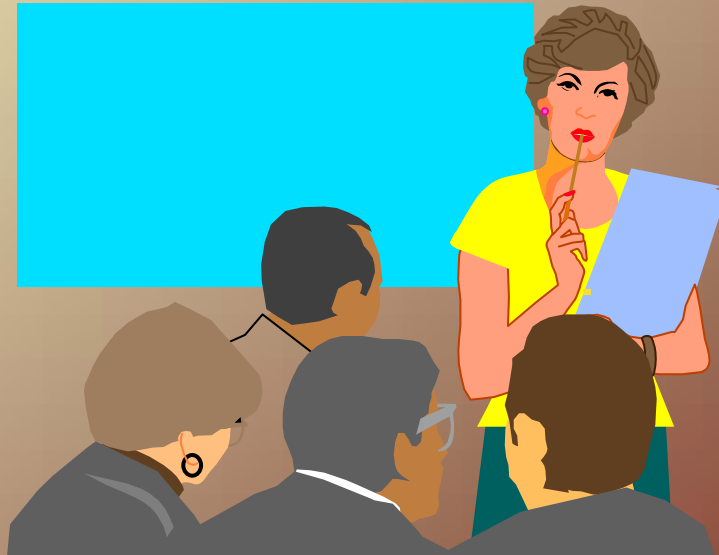


Types of Financial Risk

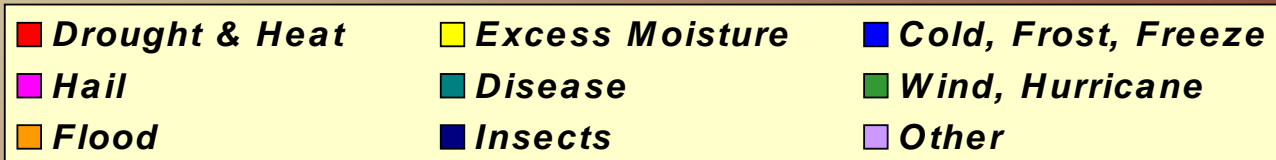
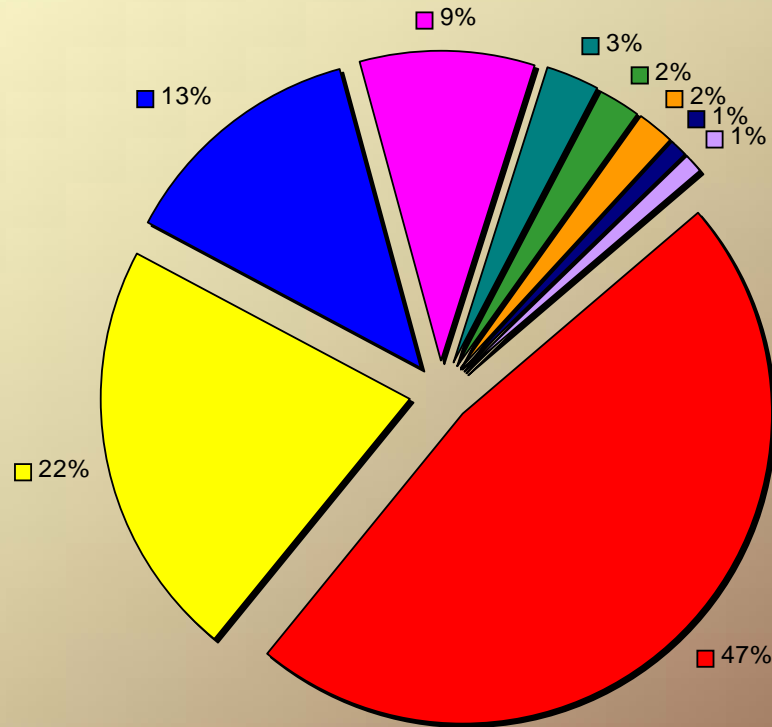
- Farm Records and Financial Analysis
- Interest Rate Risk
- Liquidity and Meeting Cash Flow Requirements
- Insurance
- Family Living Costs
- Legal Issues and Security

Farm Records and Financial Analysis:

Financial risk management is not achieved directly by maintaining comprehensive records.



Causes of Crop Loss



For business history and
financial performance
measures, use....

- Balance sheets
- Income statements
- Projected and Actual cash flows



For overall financial performance, use.....

- Debt-to-asset ratio
- Debt-to-equity ratio
- Asset turnover

Financial Records and

Analysis:

Ask yourself.....

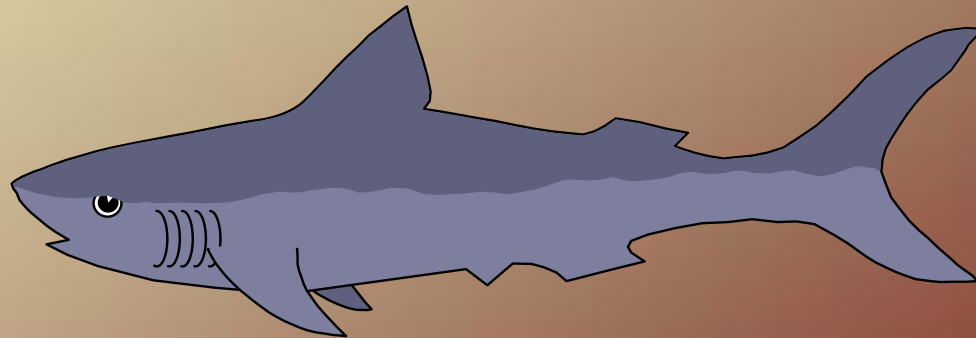
- What are my short-term and long-term goals? How do they affect my financial planning?
- Was documented historical information used in my financial projections? Was it accurate?
- Which records do I need to monitor the financial status of my operation?

Financial Records cont...

- Which records do I need to document my borrowing requests?
- Which farm record and financial analysis packages might help me?
- What have been the trends in my business's key performance indicator's?
- How do the ratios for my operation compare to those of similar operations?

Interest Rate Risk

- Interest rates are mostly out of your control.
- However, you can sometimes influence your interest rate by lowering your debt-to-asset ratio.



Interest Rate Risk: *Ask*

yourself...

- What is the most effective way to monitor general financial conditions and changes in interest rates?
- What are the alternative sources of financing and their terms and conditions?
- What can I do to reduce a lender's risk exposure and thereby ensure that I pay the lowest possible interest rate?
- Do I completely understand the terms and conditions of my borrowing arrangements, including the calculation of interest?

Liquidity and Meeting Cash Flow Requirements

- Ensuring the farm's ability to survive shortfalls in net income relative to various cash obligations.
- Can facilitate contingency plans for production disasters or poor market conditions.

**Improving liquidity to ensure
adequate cash flows can
include:**

- Reducing family living expenditures
- Using resources efficiently
- Leasing assets
- Utilizing appropriate insurance programs

Liquidity and Meeting Cash Flow Needs: *Ask yourself....*

- What alternative sources of income are available to me?
- What are some ways of reducing cash expenses?
- What are my tax obligations?
- What types of personal and property insurance do I need?

Liquidity and Meeting Cash Flow Needs cont...

- What are my cash flow requirements for operating inputs, machinery, personnel, land costs, debt payments and farm overhead?
- What are the cash flow implications of a crop failure or low market prices?
- What is an effective contingency plan for meeting cash flow needs after a crop failure or a period of low prices?

Insurance

There is a lot more to risk management than buying insurance. But insurance can complement many other risk management tools.



Benefits of Insurance Planning:

- An annual insurance review should assure proper coverage and protections.
- Just because many insurance policies are automatically renewed is no reason to neglect an annual examination of your insurance needs.

Life Insurance: *Ask yourself....*

- Have I compared costs and benefits of different types of policies?
- Is my list of beneficiaries up-to-date?
- Is low-cost borrowing power “hidden” in a long-held life insurance policy?
- Do I need to include an investment program in my life insurance policy (whole life), or is pure life insurance (term) sufficient?

Family Living Costs

- Careful scrutiny of your living costs should be an integral part of annual cash flow planning.
- Off-farm employment can be a risk management strategy.

Family Living Costs: Ask yourself....

- Have family expenses followed projections?
- What alternative enterprises or employment opportunities are available?
- Are all living expenses included in cash flow projections?

Legal Issues and Security

- Important legal issues are involved in borrowing.
- The legal language incorporated into loan contracts can be intimidating and puzzling.
- Security and repayment capacity are essential to the lender.
 - Liens, credit life insurance and crop insurance- coupled with a sound marketing plan- can help to make a loan more secure in the eyes of the lender.

Legal Issues and Security:

Ask yourself....

- Are certain contracts beneficial to me?
- Do I understand all the implications of a contract before I sign.
- When do I need to consult an attorney in regard to contracts?

UNDERSTANDING LEGAL ISSUES



LEGAL ISSUES ASSOCIATED WITH AGRICULTURE

- Structural Issues
- Contractual Agreements
- Tort Liability
- Statutory Compliance

Structural Issues

- The first legal issue that many family farms encounter is the nature in which the business is to be operated.
 - *Sole proprietor*
 - *Partnerships*
 - *Limited Partnerships*
 - *Limited-Liability Companies / Corporations*
 - *Trust Arrangements*

Structural Issues cont....

- Income and property tax consequences at the local, State and Federal level vary significantly, depending upon the legal entity chosen.
- Estate planning consideration may arise in the course of making structural decisions.

Contract Arrangements

- A contract is any agreement (written or verbal) where the parties exchange mutual promises in return for some sort of consideration or benefit.
- Financial arrangements (promissory notes or mortgages)
 - Lease
 - Crop share arrangements
- A contract specifies what constitutes events of default and the remedies of the various parties in the event of a death

Contracts cont....

“Statutes of Fraud” - requires certain types of agreements to be in writing before they can be enforced.

- Sales of real estate
- Agreements which cannot performed within 1 year

Contracts cont....

**When contracts are unclear,
the courts will employ two
types of for breach of contract:**

- **Specific Performance**
- **Damages**

Contracts cont....

Specific Performance-

The breaching party is ordered to remedy the default and fulfill the contract.

Contracts cont...

If the specific performance is not possible or reasonable, damages are awarded to compensate the party not in breach.

Statutory Obligations

- Tax reporting and pay obligations
- Wage / hour / safety requirements
- Compliance with nondiscrimination statutes
- Termination of employees
- Use of pesticides and herbicides
- Participation in certain farm programs

Tort Liability

- Arises from the negligent or intentional infliction of damage to a person or property
 - Injuries on the farm
 - Wrongful discharge
 - “Toxic Tort”- adjacent landowners, public groups or other assert liability for damage to air and water quality on account of agricultural activity.

Environmental Liability

- The new pollution policies that are available contain unique characteristics that are unfamiliar to farmers.
- Liability insurance affords no protection from criminal penalties assessed against a farmer by a regulatory agency.
- Accurate records should be kept on the applications of herbicides, pesticides and fertilizers.

Legal Issues: *Ask yourself..*

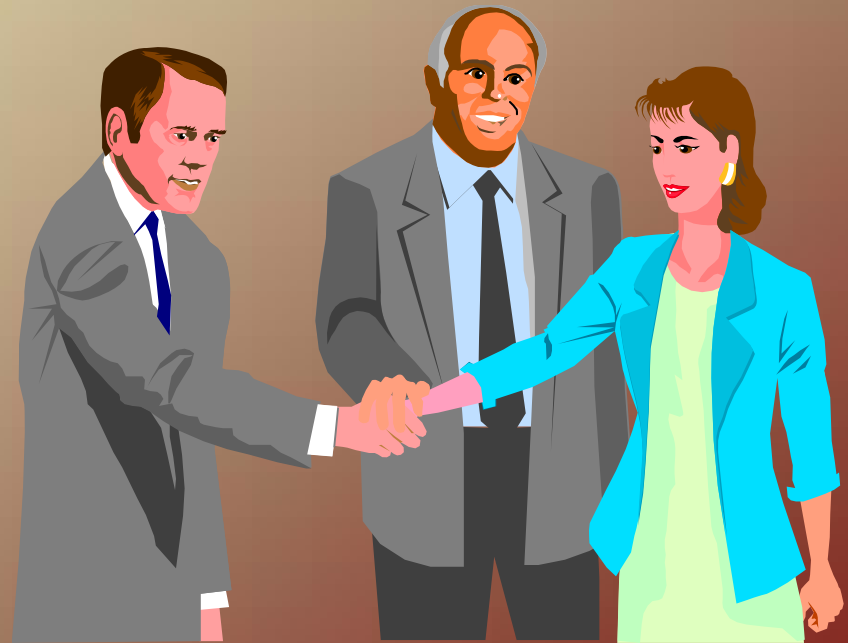
- Have I reviewed my property and liability insurance policies? Do they exclude areas that concern me, such as pollution or livestock?
- Am I covered in community service activities?
- What about leased buildings or equipment?
- Are my recent acquisitions covered, such as computers or antiques?
- Do I need to perform an environmental audit?
Am I aware of and do I follow environmental record keeping requirements?

UNDERSTANDING HUMAN RESOURCES ISSUES



Issues in Human Resources:

- Managing People
- Estate planning



Managing People

- Involving everyone, family and outside employees, in the planning process can create a sense of group ownership of the goals of the organization.
- Formalizing planning and management can improve safety performance and reduce legal risks arising from employee relationships

Human resources is best viewed as a process:

- Job Analysis / Job Descriptions
- Hiring
- Orientation and Training
- Employer /Employee Interaction
- Performance Appraisal
- Compensation
- Discipline

Benefits of Formal Planning and Management Systems:

- Helps everyone focus on the right priorities
- Allows the business to function during the illness or absence of a key person
- Gives employees a better opportunity to plan their own lives

Formal Planning: *Ask yourself....*

- Does everyone understand our plans and decision making structure?
- Does everyone feel that they have a chance to contribute to the planning process?
- Do I understand the goals of other family members and employees?
- Do we have regularly scheduled time for reviewing goals and performance?
- Does everyone understand what they have to do to be successful within the organization.

Estate Planning

- The process of planning for the the final disposition of your life's work.
- Estate planning is as much for them as it is for your peace of mind.
- Anyone with business or personal assets and with responsibility for children or parents should have an estate plan.

Benefits of Estate Planning:

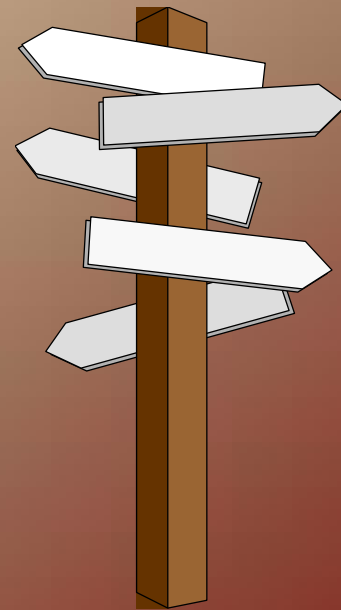
- A reduction in estate tax liability, where there is sufficient wealth to exceed the legal life time limit, thereby preserving more assets for your family.
- Peace of mind for you and your family.
- A distribution of assets which is according to your wishes.
- An assurance that your business will continue with the least amount of disruption.

Estate Planning: *Ask* *yourself....*

- Do I have a will? When did I last review it?
- Have I sought professional help to guide me through this process?
- Can I find important documents such as wills, titles to property, banking and investment records? Is it possible for others to find them as well?
- Have I explored combinations of ownership, trusts, disposition by will, and lifetime gifting as a means to transition assets to the next generation?

CONCLUSION:

A broad array of established risk management tools are there, ready to be used.





Armed with good information and good skills, U.S. farmers and ranchers will be able to face their new risk environment with confidence.

*Thank you and Good
Luck!*

