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## Risk management in 2012: what does it really mean?

by Kelvin Leibold, extension farm management specialist, 641-648-4850, kleibold@iastate.edu

We put a lot of focus on the topic of “Risk Management” and reducing risk in agriculture but it is often not well defined. Risk management in agriculture is often thought to encompass five general areas. These areas include production risk, marketing Risk, financial risk, legal risk and human risk. As we head towards the start of a new production cycle, it is prudent that every business review the potential impact of these different risks and what strategies are being used to manage them. Risks are rarely eliminated; the exposure to the risks may just be shifted to another party.

### Production risk

The area of risk that most businesses are familiar with is production risk. The government has done a lot to provide tools to manage yield risk through the subsidization of crop insurance. Production risk includes many other areas such as land base and rental rates. A question you may have to answer is, how will you deal with landlords that die or increasingly higher rental rates? Knowing the answer now can help manage the risk later. Maintaining a land base at a reasonable cost is becoming a greater challenge as more land is owned by out-of-state landlords.

Corn hybrid selection is a good example of how production risk management has increased. Do you manage rootworms with insecticides or biotechnology? How does “green snap” impact the crop insurance I buy? How does “dry down” of various hybrids impact my corn drying costs? The decision on which hybrid you plant impacts several other areas.

Another area of production risk that is getting more attention is the area of machinery costs. Producers seem to be more interested in looking at machinery sharing arrangements. This is driven by the high cost of machinery as well as the new tech-

nology that is available. Iowa farmers tend to have higher fixed costs with machinery due to the short length of our growing season. Along with fixed machinery costs, there are operating costs such as fuel and repairs. With higher costs for fuel this summer, it will be an expense many are concerned about. To keep operating costs down, expenses may need to be cut in some areas to make up for the higher fuel prices.

Other areas of production risk might include specialty crops, livestock production, and grain drying, handling and storage. With the unusual winter we have had we are noticing an increase in both grain spoilage and insect damage. Weekly monitoring of grain quality and temperature along with aeration will help reduce the risk of grain losses.

### Marketing risk

This leads us into the next area of risk to review and that is marketing risk. Again the government has done a lot to help us manage price risk under the current Farm Bill. We have revenue crop insurance and items such as Loan Deficiency Payments or Marketing Loans are still available though not currently viable with current market prices. The highly subsidized crop insurance products offer a wide array of choices that can make finding the right one time consuming. In addition, marketing has become more difficult as we face significant volatility and potentially very wide swings in prices.

Marketing will continue to be a major factor in the overall profitability of farms. A key starting point is to know what your break-even costs are and look for opportunities to market above those costs. If your break-evens are so high that you have little opportunity to market at a profit it indicates that you have to reanalyze and find what options there are for you. *Decision Tools and Information File,*

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A1-20, **Estimated Costs of Crop Production** are available from the Ag Decision Maker website can help you find your breakeven price for different crop rotations.

**Financial risk**

Financial risk ties back into marketing risk. The areas of financial risk include strategic planning, business planning, financing, credit analysis, record keeping, retirement planning and estate planning to name a few. To begin managing financial risk, start by looking at the trends in your net worth statement. A *Decision Tool* is available to help you in analyzing your net worth statement at: [www.extension.iastate.edu/agdm/wholefarm/xls/c3-21networthanalysis.xls](http://www.extension.iastate.edu/agdm/wholefarm/xls/c3-21networthanalysis.xls).

Look at several years of operating profits to see what the trend looks like. How is your “working capital” changing over time and in what direction? This will help you get started looking at some of the strategic planning that every firm needs to set aside time to do. What changes are occurring in the industry and how will they impact you? Think about the changes that you may need to make to keep up with technology and similar operations to remain competitive. *Information File C1-10, Iowa Farm Costs and Returns*, includes data from the Iowa Farm Business Association and can serve as a bench mark to compare your financial analysis.

**Legal risk**

Another area of risk to review is legal risk. This topic ties in with various points of the other areas. Many contracts are signed without the individual obtaining any legal review of the document. In grain marketing, grain is often sold over the phone without even a signature. Misunderstandings can often be avoided down the road by having a written lease contract that has been reviewed by a legal expert, see *Information File C2-01, Improving Your Farm Lease Contract*. All the various insurance policies such as life, disability, long term care, medical, liability and property, should also be reviewed. Having good legal expertise is imperative when planning and executing an estate plan.

For more on **estate planning**, visit [www.extension.iastate.edu/agdm/wdbusiness.html#evaluating](http://www.extension.iastate.edu/agdm/wdbusiness.html#evaluating). Taking a little extra time now could save you time and money in the future.

**Human risk**

The area of human risk in agriculture is often overlooked, but gaining attention with the increased use of hired labor. How would the operation be impacted if you were injured or disabled? How would the labor and management of the operation be handled? Is the rest of the family knowledgeable about the operation? Do you use hired help? Do you provide training and help in learning new skills? Are you complying with all of the legal requirements? Planning ahead can make dealing with an illness or injury much easier on the individuals and the business that is affected. Find resources on hiring and managing farm labor at: [www.extension.iastate.edu/agdm/wdcostsreturns.html#labor](http://www.extension.iastate.edu/agdm/wdcostsreturns.html#labor).

I have touched on just a few of the many issues related to risk management. Many of these are tied together. Hopefully you will spend some time thinking about how these risks impact your business and what you can do to reduce your risk. For more in-depth information visit the following websites.

**Ag Decision Maker** [www.extension.iastate.edu/agdm/](http://www.extension.iastate.edu/agdm/) has a multitude of resources for farm and business management decisions, including current outlook, historic prices, lease information, as well as information on beginning the Estate Planning process.

**Ag Risk Library**, [www.agrisk.umn.edu/Library/Topics.aspx?LIB=AR](http://www.agrisk.umn.edu/Library/Topics.aspx?LIB=AR), at the University of Minnesota has hundreds of articles from Universities across the U.S. organized by the five risk management areas.

**Agricultural Marketing Resource Center**, [www.agmrc.org/](http://www.agmrc.org/), also has a lot of information on alternative crop resources and business risk management.

Updates, continued from page 1

**Internet Updates**

The following information files and tools have been added or updated on [www.extension.iastate.edu/agdm](http://www.extension.iastate.edu/agdm).

**Farmland Value Survey (Realtors Land Institute)** -- C2-75 (2 pages)

**Estate Planning Attorneys: Finding One Who Can Work For You** -- C4-61 (3 pages)

**Current Profitability**

The following tools have been updated on [www.extension.iastate.edu/agdm/info/outlook.html](http://www.extension.iastate.edu/agdm/info/outlook.html).

**Corn Profitability** -- A1-85

**Soybean Profitability** -- A1-86

**Season Average Price Calculator** -- A2-15

**Ethanol Profitability** -- D1-10

**Biodiesel Profitability** -- D1-15

**Returns for Farrow-to-Finish** -- B1-30

**Returns for Weaned Pigs** -- B1-33

**Returns for Steer Calves** -- B1-35

**Returns for Yearling Steers** -- B1-35

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