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Risk management: What does it really mean?

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A lot of discussion is given to the topic of “Risk Management” but it is usually 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 end of another production cycle and the start of a new, 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 technology 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 fall, 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. Grain storage losses can be significant as we saw at several commercial elevators.

**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 2002 Farm Bill. We have revenue crop insurance and Loan Deficiency Payments or Marketing Loans to help manage low prices. However, marketing has become more difficult as we now are trying to pick both the high and the low price to maximize revenue. In addition the highly subsidized crop insurance products offer a wide array of choices that can make finding the right one time consuming.

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 that are available from the AgDM web site can help you find your break even 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. This spreadsheet is available at: [http://www.extension.iastate.edu/agdm/wholefarm/xls/c3-20networth.xls](http://www.extension.iastate.edu/agdm/wholefarm/xls/c3-20networth.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.

**Legal risk**

Another area of risk to review is legal risk. This ties in with some 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 be avoided down the road by having a written lease contract that has been reviewed by a legal expert. All the various insurance policies such as life, disability, long term care, medical, liability, and property, should also be reviewed. Taking a little extra time now could save you time and money in the future. In the near future, legal issues regarding the environment will be coming to the forefront; especially for livestock producers.
Human risk
The area of human risk is often overlooked in agriculture. 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.

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. If you would like more in-depth information visit the following web sites. The Ag Risk Library http://www.agrisk.umn.edu/Library/Topics.asp?CMD=Count&LIB=Main at the University of Minnesota has hundreds of articles on these topics. The Agricultural Marketing Resource Center http://www.agmrc.org/ also has a lot of information on business risk management.

New short form cash rent lease available
by James Jensen, Iowa State University Extension Farm & Business Management Specialist, jensenjh@iastate.edu

Recent Iowa State University data reveals what we know we have been seeing for years...leasing relationships are changing. Leasing agreements are moving from crop-share arrangements between the tenant and landowner to cash rent agreements. There are many reasons for the change which include both advantages and disadvantages for the tenant and the landowner. The move to cash rents has been gradual over the years but at an increased rate recently. To help accommodate this change, Iowa State University Extension has created a new “short form” cash rent lease form that it hopes will encourage leasing participants to have a written lease. Iowa State University Survey data suggests that only 56% of leases in Iowa are committed to writing and less than that are reviewed every year. Leasing property is a legal relationship that often involves large sums of money changing hands. Written leases that are updated yearly are a good way to make sure that the agreements are business-like and up to date. The agreements should be stored and labeled in such a manner that relatives or business partners can find them if the need develops. The new form is ISU Publication Number FM 1874 and can be obtained at any ISU Extension Office or an interactive form is available on the AgDM web site at http://www.extension.iastate.edu/agdm/wholefarm/pdf/c2-16.pdf.

The following discussion touches on some of the advantages and disadvantages to landowners and tenants when using a cash rent rather than a crop share lease.

Tenant advantages to cash rent leases:
• The tenant does not need to keep production from each landlord separate and can comingle the grain from various landowners into one storage bin.
• The tenant does not need to check with every landowner when making production related decisions including FSA programs. This reduces the time it takes to make decisions and act.

Tenant disadvantages to cash rent leases:
• The tenant has more risk exposure than with a crop share lease situation.
• Operating cash needs are increased.