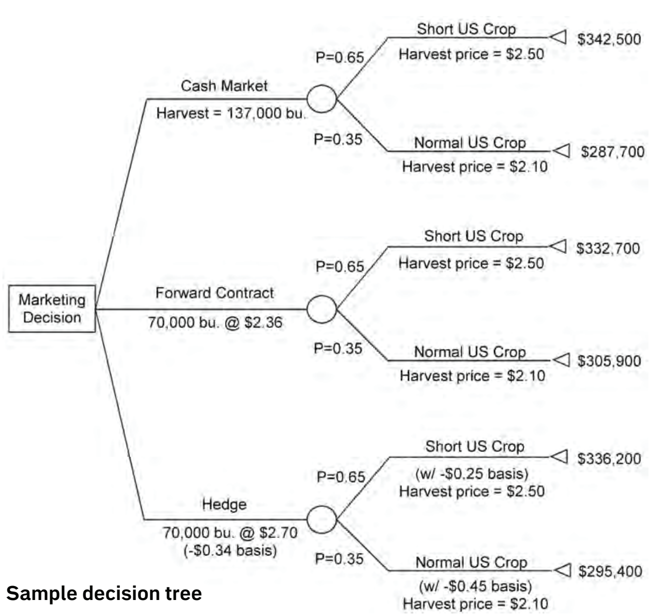
Getting Started In Ag: Evaluating Risk and Building Strategies

Those involved in production agriculture quickly learn how much everything revolves around risk. Risk can take many forms. The weather can easily end a production season at a moment's notice. Prices for the commodities produced can drop unexpectedly. Input prices can go up, employees can be difficult, and seemingly a million other things can go wrong that are out of your control.

It is, therefore, extremely important to understand risk at some basic level. Producers essentially have two choices when considering risk: they can ignore it and accept the consequences or they can manage it. Risk management is developing one or more strategies that increase the likelihood of positive outcomes and/or reduce the consequences of negative outcomes.

DECISION TREES

Developing a risk strategy involves defining the series of decisions that will be or could be made as new information is collected and the strategy unfolds. This process can be outlined as a decision tree or flow diagram. A decision tree is formed by identifying the main decision and the relevant courses of action, based on the events and associated outcomes that are expected as part of each decision. This process can be as simple or complicated as desired; the main advantage to drafting a decision tree is that it forces the decision maker to think through the important elements like possible chance events, decision points, outcomes, and timing.



Sample decision tree

FOR MORE INFORMATION

Evaluating Risk Strategies includes links to the course e-book, as well as a companion presentation and webinar recording. The course is one of the many risk management resources available from RightRisk.org. These resources cover a wide range of topics including estate planning, financial management, management succession planning, crop insurance programs, and instruction for RightRisk.org tools.

Nearly any production or marketing decision can have a decision tree built to describe it. Begin by first naming the decision to be made, then describe potential outcomes. Between each set of possible outcomes is a point where a decision is made. For example, if event A happens, then decision A is the choice that leads to event A. It is important to include potential probabilities for each outcome, where possible, as well as the expected results. The more detail included in the form of prices, probabilities, or outcomes the better prepared the decision maker will be to understand and include risk in any resulting decisions.

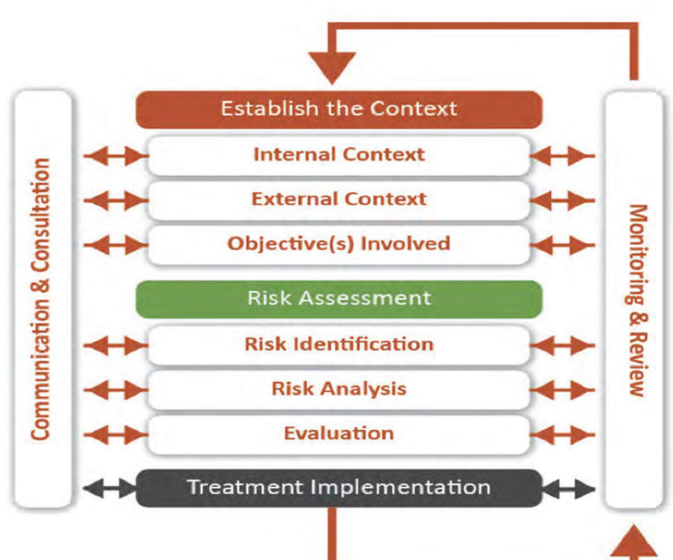
ONLINE COURSE

A particularly useful resource is Evaluating Risk Strategies (ERS); a comprehensive online module designed by the academic professionals at RightRisk.org offering producers a chance to learn how to identify and properly manage risk. It is important to remember the only thing certain in life is uncertainty. The course outlines five main sources of risk in agriculture: marketing, production, financial, institutional, and human resource risk.

Marketing and price risk refer to the uncertainty of prices for inputs, such as seed and fertilizer, and outputs like crops or livestock. Production risk includes all the uncontrollable variables in the production process; temperature, rainfall, weed density, crop health, etc. Financial risks result from borrowing outside capital. Institutional risks arise from government rules, regulations, and policies, as well as factors in the general and global economy. Finally, human resource risk comes from the human element involved in the business; hired employees, family members, multiple decision makers, etc.

RISK MANAGEMENT PROCESS

Risk management planning can be described as a circular, three-step process: The first step is to establish context, both internal and external, along with objectives or risk criteria. The second step involves risk assessment, including risk identification and analysis. The last step is implementation. One of the most important aspect of this process is that it allows for evaluation and review of everything involved from the risk to any strategies developed to address it.



The risk management process

The **Wyoming GrowinG Internship Program** is accepting applications from hosts and interns interested to participate in 2022. The deadline is Feb. 28, 2022. The online application forms are available under the Hosts or Interns tabs at: GrowinG-WY.org.

STRATEGIES FOR RISK MANAGEMENT

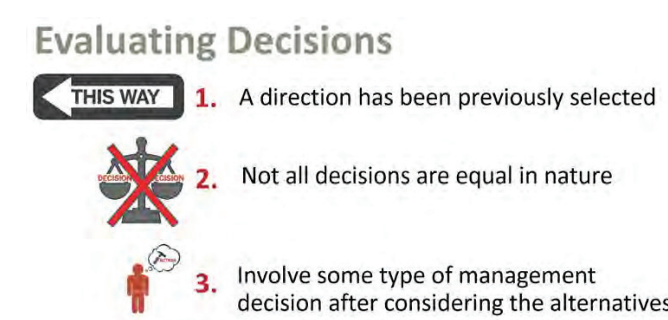
The first step in formulating a risk management strategy is to prepare a concise set of goals and objectives. The goals should indicate the direction of your business and they should help with process of describing what resources are needed to achieve them. Subsequent risk management planning should include the specific steps and a timeline for reaching the goals and objectives set. The ERS course offers four general risk management strategies typical in agriculture: avoid risk, transfer risk, control risk, or accept risk.

Remember the goal is to manage risk to a level management is comfortable with, not attempt to reduce risk to zero. An example might be to pursue strategies that improve expected returns, rather than reduce the variation in outcomes through diversification or increasing cash reserves.

EVALUATION OF STRATEGIES

Successful managers will continually evaluate risk management strategies and decisions to properly gauge their effectiveness, as well as make sure they align with the goals of the organization. Strategic decisions tend to be longer term in nature and larger in scope. Different aspects of these decisions are discussed, including understanding the difference between a decision and strategy.

Measuring progress and accomplishments by quantifying the variation in outcomes is a key part of evaluating a strategy. The overall success or failure of the business can be judged once these areas have been addressed. The manger should also try to account for all aspects of the strategy involved (resources, timing, goals met) when evaluating overall effectiveness. This type of evaluation should be completed at least annually to allow the manager the chance to stay one step ahead of any changes and even more often where change is occurring more rapidly.



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