RISK MANAGEMENT PROFILES

Risk Management Strategies for Specialty Crop Producers in Alaska

Barb and Sue are partners in a flower and vegetable business near Homer, Alaska. Barb recently attended several workshops and webinars looking at identifying and managing the risks associated with their specialty crop business.

During one of their regular management meetings, Barb suggested that they take some time to discuss risk management in their business.

Sue understood that there were risks associated with their business, but she was a little confused on how they might manage them.

Barb explained they first must identify the major risks associated with their business. Then, they could develop strategies to either reduce the negative impacts associated with the risks or reduce the odds of them occurring.

Barb suggested that they follow a six-step process for managing their risks presented at one of the workshops. Barb outlined the process on a white board.

Step 1:
List and classify our risks

- Production risks – factors that affect the quantity and quality of commodities produced.
- Market risks – uncertainty about the prices producers receive for their products or prices they pay for inputs.
- Financial risks – factors affecting the financial health and stability of the farm such as rising interest rates, loans being called by lenders, and restricted availability of credit.

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- Legal or institutional risks – uncertainty surrounding government actions, tax laws, regulations, and other institutional and legal impacts. Human risks – factors such as accidents, illness, death, divorce and other risks associated with the people involved with the business.

Step 2:
Measure (and prioritize) the importance of our risks

- Low Probability/Low Impact – Lowest Risk
- High Probability/High Impact – Highest Risk
- What can we do about the risk?
  - Highest Risk/Highest Influence – Highest Priority
  - Lowest Risk/Lowest Influence – Lowest Priority

Step 3:
Consider our ability or capacity to bear risk

- Liquidity – the ability of the business to meet cash flow needs or obligations.
- Solvency – the ability of a business to withstand adversity and continue in business.

Step 4:
Consider our risk preferences

- Risk averse or risk avoiders -
  - Cautious individuals.
  - Prefer less risky sources of income/investment.
  - Willing to sacrifice some income to reduce the probability of low incomes or losses.

- Risk preferring or risk takers
  - More adventuresome individuals.
  - Prefer more risky business alternatives.
  - Willing to accept some probability of lower income or losses for the opportunity of higher income.
- Risk neutral -
  - Individuals between risk averse and risk preferring.
  - Choose the decision with the highest expected return.
  - Not concerned with the specifics about extreme highs or extreme lows.

Step 5:
Describe our risk goals

- Use clear statements of where you want to be after a period of time (short-term, intermediate term, and long-term).
- Goals should be SMART (Specific, Measurable, Achievable, Relevant, and Time-related).
- Identify the required actions to achieve our goals.

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Step 6:
Identify risk management tools and strategies to help manage priority risks

- Identify risk management tools such as diversification, insurance, contract agreements, etc. that are available to address our high priority risks.
- Consider whether we want to reduce the risk, transfer it, or increase our capacity to bear it.
- Identify risks we want to completely avoid and risks we are willing to accept.

After considerable discussion Barb and Sue identified four, high-priority risks. Their two highest priority risks are disease and untimely frost that can affect production of peony stems and vegetable produce. The next highest priority threat is market risk associated with market prices for their products and inputs. And the final high-priority risk they identified is human risk related to the impact on the business if something (death, illness, injury, etc.) would happen to either one of them or to a key employee.

Once these risks were identified and prioritized, Barb and Sue spent some time with their financial records to assess their ability to bear the potential impact any one of these risks might bring to their business. While they both felt the business was in good financial shape, they acknowledged that they were still a relatively small business with little room or capacity to bear a large financial setback.

In this same discussion, they shared with each other their personal preferences about risk taking. They decided that, while they were both risk takers for owning the type of business they do, they each preferred to avoid or mitigate any risk that could potentially put them out of business.

With this in mind, they decided to clearly describe their risk management goals and begin brainstorming and listing risk management strategies and tools to help them to achieve those goals and mitigate each of their high-priority risks.

Barb and Sue's Risk Management Goals:

1. Reduce production risk so they have at least a 90 percent probability of achieving 50 percent of normal (5 year rolling average) overall production value each year.
2. Reduce market price risk so that a total collapse in the cash market price for any one of their products does not decrease overall annual cash revenue more than 30 percent.
3. Reduce human risk so that the absence of any one person for a period of up to 45-days could be absorbed without a significant impact on operations.

Barb and Sue's Brainstorming Session: Production Risk

Strategy: transfer risk

1. Tool: crop insurance
   - Whole Farm Revenue Protection
     - Provides qualified producers protection from losses in revenues based on historical average revenues and expenses.
     - Expands options for specialty crop, organic and diversified crop producers, allowing them to insure all the crops at once instead of one commodity at a time.
   - Non-insured Crop Disaster Assistance Program (NAP coverage)
     - Provides catastrophic coverage in case of major production losses.
     - Provides financial assistance to producers of non-insurable crops when low yields, loss of inventory or prevented planting occurs due to natural disasters.
     - Can provide a level of revenue protection for eligible commodities under buy-up coverage.

Strategy: reduce risk impact

1. Tool: diversify enterprises
   - Spread the downside production risk over more than one enterprise to reduce the impact of complete crop failure in any one enterprise.

2. Tool: dispersing production geographically
   - Reduction of production risk by producing in different geographic locations.

Market Risk

Strategy: transfer risk

1. Tool: crop insurance
   - Whole Farm Revenue Protection

- NAP buy-up coverage with Direct Market Price Option

2. Tool: forward pricing
   - Forward contracts with buyers and input suppliers

Strategy: reduce risk impact

1. Tool: diversifying enterprises
   - Spread the downside market risk over more than one enterprise to reduce the impact of declining market prices for any one enterprise.

Human Risk

Strategy: increase capacity to bear risk

1. Tool: cross-training in business operations and management with each other and employees.

2. Tool: develop a succession plan for transition of ownership in case of a human tragedy.

Barb and Sue decided to further investigate the strategies and tools before committing to anything, following the brainstorming session. They wanted to be clear about the resources required for each alternative and to define an implementation plan including roles and responsibilities.

Barb and Sue each felt good about their initial attempt to start managing the high-priority risks in their business operation. They both feel committed to finalizing and implementing a plan of action in the coming weeks.

As times goes on they will monitor the effectiveness of their plan. In addition, they plan to make adjustments as necessary by reevaluating their strategies on a regular basis.

Additional Resources:

RightRisk Courses
http://RightRisk.org > Courses

RightRisk Risk Analysis Tools
http://RightRisk.org > Resources

USDA Risk Management Agency
http://www.rma.usda.gov

USDA Farm Service Agency
http://www.fsa.usda.gov