Risk Management Update:
Risk Tolerance and Organizational Goal Setting

Oregon farmers and ranchers have witnessed dramatic changes in agricultural practices over the years. However, one thing never changes – farming is a risky business.

Today's most successful producers utilize a deliberate and knowledgeable approach to risk management as a vital part of their operating strategy. At a minimum, producers must understand and consider the potential impacts of the five primary sources of agricultural risk:

- Production risk;
- Market (price) risk;
- Financial risk;
- Legal risk; and,
- Human risk.

Ideally, producers should develop a strategic risk management plan to address each of these risk categories within the context of an operation's high-level organizational goals. Further, organizational goals and strategic risk management plans should be (largely) based on the operator's tolerance for risk.

<u>Risk Tolerance</u>
A producer's risk tolerance is reflected in the ways the producer chooses to manage risks. An improved understanding of risk concepts and risk management options may cause a producer to change organizational goals and/or management styles to more closely reflect the producer's risk tolerance.

In general, risks can be handled through some combination of five approaches:

- Retaining risk, such as holding an un-priced commodity;
- Shifting risk, such as using forward contracting or crop insurance;
- Reducing risk, such as hedging to lock in some guaranteed price level;
- Self-insuring against risk, such as using reserves funded from prior years' profits; and,
- Avoiding risk, such as exiting a particular enterprise or maintaining a conservative debt-to-asset ratio.

Any risk must be evaluated for its frequency of occurrence and its possible negative consequences. As a general rule, formal insurance strategies (e.g., disability insurance, health insurance, crop insurance, and life insurance) are available for risks with 1) low occurrences and 2) severe negative consequences.

Producers who assess and understand their personal and organizational risk tolerance will be more effective in establishing and achieving organizational goals. Further, this understanding will help producers to more easily identify and exclude alternatives that create unacceptable risk exposure. Finally, a clear view of risk tolerances and organizational goals will help a producer to choose risk management services and insurance products that best align with his or her overall risk management strategies.

Benefits of Goal Setting

The individuals involved in a family farming or ranching operation must share some common goals. After all, no family business can be successful if it does not help in some way to fulfill the individual dreams of everyone involved. Many times, the hardest thing about setting risk management goals is reconciling different views about risk. Recognizing and acting on opportunities, as well as trying to minimize losses, can help shape agreement on basic risk management goals.

An operation's goals should reflect the values, interests, resources, and capabilities shared among the owners and their family members. Organizational goals also provide a basis for decisions, and well-understood goals allow every individual in the organization to set realistic personal goals. Realistic and attainable goals are a means for measuring progress and can establish priorities for the allocation of resources. For example, should farm income be used to pay down debt, invest in more land, or pay for college?

Many producers are reluctant to engage in formal goal setting activities. In some cases, these producers wish to avoid the conflicts that could arise during the discussions among partners and/or family members. Nevertheless, producers who work through the goal-setting process nearly always view the effort as a valuable use of time. These producers benefit from the common understanding and clear objectives that result from an honest examination of risk tolerances and organizational goals.

The RMA website (www.RMA.USDA.gov) provides many online information resources and training tools to help producers better understand and manage risk and take advantage of existing and emerging crop insurance programs:

- Crop Insurance Agent Locator: http://www.rma.usda.gov/tools/agent.html
- Cost Estimator: http://ewebapp.rma.usda.gov/apps/costestimator/
- Farm Risk Planning: http://farm-risk-plans.usda.gov/
- Risk Management Checklist: http://rma.usda.gov/pubs/2011/risk_management_checklist.pdf

Even more producer-oriented tools are available at http://www.rma.usda.gov/tools/.

Custom Ag Solutions (CAS) works with producer organizations, such as the Oregon Sheep Growers Association, to reach farmers and ranchers with information about risk management and Federal Crop Insurance Programs administered by the USDA's Risk Management Agency (RMA). CAS' efforts are made possible by a USDA/RMA partnership with RightRisk, LLC (RightRisk.org). USDA, RMA, RR-LLC, and CAS are equal opportunity providers.

RightRisk www.RightRisk.org
CAS Custom Ag Solutions