



# Getting Started in Ag: Risk Management for Smaller Ag Operations

Unstable input and commodity prices, weather, and pests are just a few of the risks faced by managers of agricultural businesses of all sizes. Current problems such as high inflation, rising interest rates and supply chain disruptions can further amplify these risks. Smaller operations may have less capital at stake and lower risk exposure than larger operations; however, smaller firms present their own, unique set of risk-related challenges. Often, smaller businesses have even less room for error.

## STRATEGIC RISK MANAGEMENT PROCESS (SRMP)

The Strategic Risk Management Process Small Business Edition (SRMP-SBE) is tailored to smaller, non-commercial and lifestyle-type operations. The SRMP-SBE model proposes three main phases for risk management: strategic, tactical and operational. The diagram is circular to suggest that risk management planning should be an ongoing process; conditions on the ground change, and the plan should be adjusted accordingly.

Visit <https://bit.ly/risk-mgmt-process> for resources designed to guide users through each step of the process, presented alongside an in-depth example developed for a specialty crop operation.

## STEP 1: DETERMINE YOUR FINANCIAL HEALTH

The first step is to know the operation's complete financial position. The idea is to identify any financial issues before they become too big to address down the road; proper financial analysis should provide a clear picture of which parts of the business are in good shape and which parts need attention. This is achieved by constructing basic financial statements that can help

monitor business liquidity, solvency, repayment capacity, profitability and financial efficiency. The four statements crucial to this step are the cash flow statement, balance sheet, income statement (accrual-adjusted) and statement of owner equity.

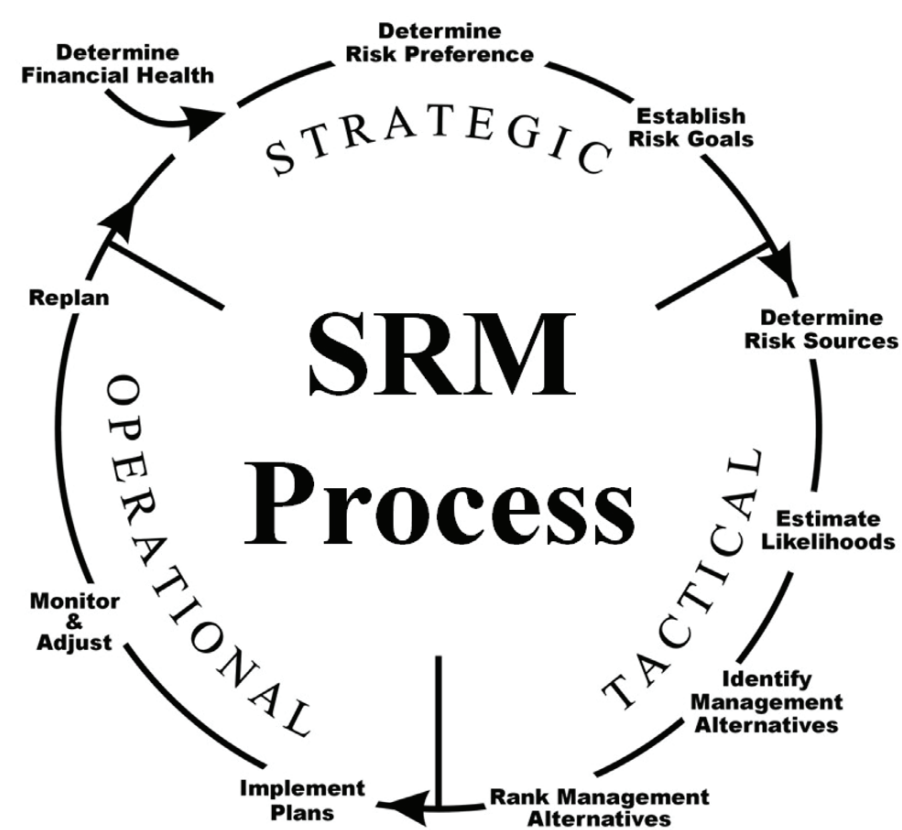
## STEP 2: DETERMINE RISK TOLERANCE

Risk tolerance is the level of risk a person is willing accept in order to achieve a particular goal. Some business owners seek to avoid as much risk as possible, while others seem to actively seek it out. Finding your risk tolerance

helps set the tone for strategies to manage the risks facing your business. The SRMP Small Business Edition offers a worksheet to help you determine your personal risk tolerance.

## STEP 3: SET RISK MANAGEMENT GOALS

Strategic goals, tactical objectives and operational plans provide a road map for guiding the business forward, particularly with regard to risk. Outlining clear, achievable short-term objectives that are tied to longer-term goals can help focus energy



Strategic risk management process.

and resources, especially in a smaller scale business. The example worksheet illustrates the approach and resources needed to achieve those goals.

## STEP 4: DESCRIBE SOURCES OF RISK

Agricultural risk is often grouped into five categories: production, price, financial, institutional and human resource risk. To successfully manage risk, it is necessary to both identify and prioritize the sources of risk that pose threats to your business. The SRMP-SBE approach outlines steps to address each significant area of risk. This approach entails ranking each source of risk on a scale based on potential impacts to the business, followed by ranking each risk factor by how much the business owner can influence it.

## STEP 5: ESTIMATE LIKELIHOOD OF OUTCOMES

Estimating how likely a risk outcome might be can help managers focus attention where it has the greatest effect. For example, if you are certain a negative outcome is highly likely to occur, you will probably avoid taking the risk. The SRMP-SBE supplies a method that draws from historical data or your own estimates to assess how likely future risks might be.

Understanding the probability of a certain risk can help you decide just how much of that risk you are willing to assume.

## STEPS 6 AND 7: IDENTIFY AND RANK MANAGEMENT ALTERNATIVES

The four basic strategies for risk management are avoid, transfer, assume and reduce. Each business manager has a different perspective on risk. As a result, some strategies are more appealing than others. While generally there is a positive correlation between risk and return, where each manager falls on the spectrum depends on their risk tolerance. In other words, being totally risk averse will leave money on the table, whereas taking too much risk may cost the business money as well.

Potential risk management strategies should be evaluated based on how well they move the business toward its goals, their demands for resources, and how well they match your risk tolerance. Strategies that provide better results at a lower cost rank higher. This stage in the process involves combining the tactical steps outlined earlier with the strategic steps to set the best course of action for the business.

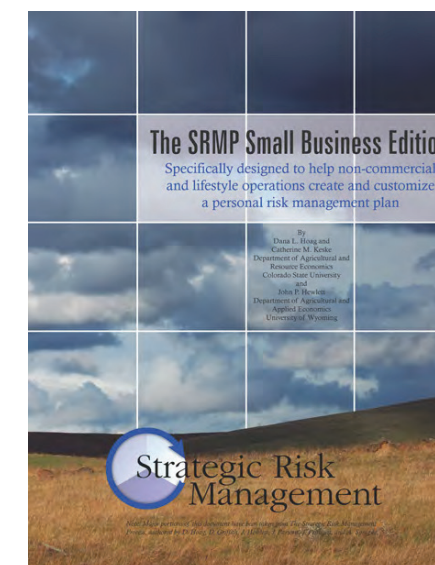
## STEPS 8, 9 AND 10: IMPLEMENT, MONITOR/ADJUST, AND RE-PLAN

This is the operational phase of the process and puts risk management plans into action. Implementation of the management plan includes resource management—making sure the correct resources (land, labor, capital) are available to properly put the management plan in motion. Monitoring and adjusting are closely tied to the implementation step, as available resources change from year to year (or within the year). Along the way, the manager must monitor resource performance and make necessary mid-course adjustments. With the aid of the SRMP model, these adjustments are much easier to make and are more responsive. This adaptive approach also allows managers to consider possible changes in the overall business strategy. Changes to the management plan may not be necessary each year, but occasionally operators should reflect on how well business resources are performing, if progress toward goals is appropriate and even whether those goals are still correctly described.

The 10-step SRMP process helps users identify, plan for and manage risk. Copies of the SRMP Small Business Edition are available for download at [RightRisk.org](http://RightRisk.org) (select Strategic Risk Management under the Products tab). There is no right or wrong answer when it comes to risk strategies; rather, the goal is to help identify and understand what level of risk works best for you and your business.

MISSION STATEMENT FOR WHITE'S VINEYARDS: <i>To fulfill our lifelong dream of developing a profitable specialty crop business during my retirement, where we will produce the highest quality grapes in western Colorado.</i>			
WHITE'S VINEYARDS STRATEGIC GOAL WORKSHEET			
Goal Statement: <i>Produce high-quality grapes that can be sold for wine making within five years. That is, drink wine from our own grapes within five years!</i>			
Deadline for Goal Attainment: <i>Fall 2012</i>			
----- Goal Costs/ Resources Required: -----			
Natural Resources <i>+ Own 6 acres of 3-year-old vineyards</i>  <i>+ Weather and soils conducive for grape growing (particularly for Riesling)</i>	Human Resources (Available, rather than hours worked) <i>+ Husband- 20 hrs.</i>  <i>+ Wife- 40 hrs.</i> <i>+ Adult children available for back-up help- 10 hrs. week</i>	Financial Resources <i>+ Cash purchase of 6 acres of vineyards, using retirement savings (no mortgage!)</i>  <i>+ No debt and able to borrow for equipment</i>	Capital Resources <i>+ Adequate senior water rights</i>  <i>+ Four-wheel drive pick-up truck</i>
Associated Tactical Objectives:			
<i>Tactical Objective 1-1: To beat the county average yield and price for wine grapes within 5 years.</i>			
<i>Tactical Objective 1-2: Within 5 years, establish supply contracts with two local wineries for wine grapes.</i>			
<i>Tactical Objective 1-3: Recover investment costs, except for land, after 5 years and position vineyards to be able to purchase 2-3 more acres for vineyards in year 6.</i>			
Associated Operational Plans: (for Tactical Objective 1-3 only)			
<i>Operational Plan 1-1.1: Consult with grape and wine experts to establish an annual growing and production schedule. Monitor progress quarterly and annually to meet targeted production schedule. Re-evaluate schedule each year.</i>			
<i>Operational Plan 1-1.2: Purchase used tractor trailer at the end of the year, if annual production goals are attained.</i>			
<i>Operational Plans 1-1.3 and 1-2.1: Develop a demand for the product by inviting select local wine producers to annual holiday season open house to view operation and sample the product.</i>			

Example of a strategic goal worksheet.



The Strategic Risk Management Process (SRMP) Small Business Edition is available online at <https://bit.ly/risk-mgmt-process>.