



## Being Prepared to Manage Risk

by, **Dr. Laurence M. Crane, NCIS**

---

"Be Prepared!" That's good advice for Boy Scouts and farmers. In fact, one of the most difficult tasks farmers face is being prepared for unknown events. Being prepared means not only avoiding and/or minimizing negative events, but being able to take advantage of positive events. This is the essence of risk management; being prepared to successfully respond to unforeseen negative and positive events.

There has been a lot written about the new risk environment farmers face as a result of the changes in the government farm program. The end result is that farmers now have both the freedom to succeed and the freedom to fail. With the responsibility to manage risk placed squarely back on each individual farmer, the need for successful planning is critical. A major crop loss without insurance would not only be a crop disaster, but the likely end of the farm because the federal government is no longer in the business of handing out disaster payments. A favorable swing in crop price, without a marketing plan to take advantage of this swing will be more than a missed opportunity, it will be a major reduction in farm business profit because profit margins will be narrower. Those who master the necessary business management skills will likely succeed, and those who don't will likely fail. Management is the key.

The opportunities for professionals who have direct contact with farm producers should be obvious. Crop insurance agents who understand basic farm management principles can help farmers be prepared for the future by demonstrating the numerous ways crop insurance meets their risk management needs. Any service a crop insurance agent can provide to a farmer that enables the farmer to be a better manager and make correct decisions, by definition, is going to succeed.

There are four general steps for a farmer to follow in determining risk management preparedness. These steps can be stated as questions. Obviously, the answers will vary from farm to farm but the questions need to be answered and understood. In fact, an understanding of the answers to these questions will enable a farmer to respond correctly to changes as they occur.

### ***1) What is the risk bearing capacity of my farm?***

To adequately answer this question it is necessary to define what risk is, where it comes from, and what the impacts are. Also critical to answering this question is a complete understanding of the farm business in all aspects. Farmers who maintain current and complete records covering all aspects of the production, financing and marketing functions of their farm business have an advantage in answering this question. For those who don't maintain adequate records, extension educators can provide regional budgets that can be used as crude proxies for actual farm production records. Detailed historic farm records are fundamental to documenting risk bearing capacity.

One approach to answering this question is to do so for each of the functional areas of the farm. Most farm management textbooks, at a minimum, identify (1) production, (2) marketing, (3) financing, and (4) policy as four functional areas to consider for assessing risk bearing capacity.

## ***2) How much risk is my farm currently bearing?***

This question is easy to answer once the first question is answered. In fact it is not possible to answer this question without having the same information needed before, namely, comprehensive production, marketing, and financial records at the enterprise level. Determining the degree of risk exposure is critical to preparing a risk management plan. Understanding the sources and degree of risks enables a farmer to tailor a plan to accomplish necessary goals. The answer to this question will go a long way to determining what specific insurance coverages are needed.

One of the most difficult management decisions for a farmer to make is how to respond to an event that is not clearly negative. Choosing between two events that both appear positive is not easy or simple. Understanding and being able to document what the risk capacity and current risk exposures are make it more likely that correct decisions will be made. Though feelings and emotion can be an important part of the decision process, they are subjective. There is no substitute for being able to make a critical analysis based on historical data and objective facts.

## ***3) How much risk do I want to bear?***

This question is subjective and consequently more difficult than the first two for some farmers to answer. Frequently, the answer is not the same for all of the owners/managers of the farm. It is not uncommon for husband and wife to differ greatly on what level of risk they want to bear. The more partners involved in the farm, the more possible conflicts. Because this is a subjective question there are no right or wrong answers. There are some definite danger zones, however; like when desire to bear risk exceeds the risk bearing capacity of the farm.

The economic reason individuals desire to bear risk is because of the risk-return tradeoff. Recall, the opportunity for risk is also the opportunity for profit (or loss). Problematically, more often than not the opportunity for loss is greater than the opportunity for profit. Often the consequences of a significant loss are fatal to poorly capitalized or inefficient farm businesses. Moreover, it is often the case that these farm managers are also willing to accept more risk than their fragile operations can safely bear. Having the ability and knowledge to be able to answer question (1) makes it possible to better answer this critical question.

## ***4) What risk management changes do I need to make?***

This is the most important question. In fact, it can't be answered without first answering the other questions. Conversely, when the other questions are adequately answered, the answer to this question appears rather straightforward.

Management is the secret to being prepared because preparing for the future is not a one-time event, it is a continuous process, just as record-keeping is a process and not just an event. One goal of answering these questions is for farmers to thoroughly understand the risk aspect of their business so that they, at any time, can determine how a current decision will impact the long-term health and success of their farm as a business.

---

**Where to go from here:**

- [Back to NCIS Home Page](#)
  - [About NCIS](#)
  - [Technical Support](#)
  - [Other Links](#)
  - [NCIS Publications](#)
  - [Site Evaluation](#)
- 

**Any questions about this website, please contact the [webmaster](#) at NCIS.  
© 1999 National Crop Insurance Services  
Last updated: September 13, 1999.**