



Painting the Risk Management Landscape

ASSESS YOUR MANAGEMENT SKILLS AND FINANCIAL STRENGTH

RECENT SURVEYS by *Farm Futures* questioned farmers on a number of topics ranging from their knowledge of pricing tools to their farm's financial strength. The survey produced some illuminating findings, several of which are summarized below in Table 1. Almost 70 percent of those surveyed manage risks through farm program payments, which will end in the year 2002.

According to *Farm Futures*, few farmers appear to be putting it all together and actively trying to control the risks on their farms through a coordinated plan. Though the number of producers with written marketing plans has increased, this practice has been adopted by just one in seven farmers, according to *Farm Futures* research. And, as Table 2 shows, few farmers appear to be using analytical tools like ratios and accrual accounting although many of which are now computerized.

The advent of many new risk management tools has made farming even more challenging. Moreover, many different private sector companies offer a piece of the risk management puzzle, but there is no one-stop shopping outlet available when it comes to risk management.

Marketing Skills

A *Farm Futures* marketing skills test confirmed the assumption that farmers who scored higher were also more likely to have achieved above-average profitability, as measured by return on equity, over the last five years. It was also encouraging to see that between 85 percent and 95 percent correctly answered questions relating to essential topics such as basis.

Moreover, between 68 percent and 83 percent correctly defined options terms such as a put, a call, a strike price, and a premium (see Table 3). When similar questions were asked in

1989, 45 percent answered correctly. And, while only about a quarter use options, this figure has doubled since 1989.

TABLE 1
Risk Management Practices
(% using technique a lot)

69%	Used government farm program
39%	Diversified operation by raising crops and livestock
39%	Varied maturity dates of seeds
35%	Used contract inputs to lock in a good price
30%	Bought crop insurance
25%	Used crop-share land rents
20%	Kept a credit line open to take advantage of attractive prices on inputs
16%	Used multi-year leases
13%	Irrigated
10%	Shared expenses with landlord
8%	Refinanced loans to take advantage of lower interest rates
6%	Hired custom operators to improve timeliness of crop operations
6%	Hired custom operator to reduce machinery expense
3%	Diversified by raising crops not normally grown in the area
3%	Leased equipment rather than bought
2%	Rented equipment rather than bought

SOURCE: FARM FUTURES



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As encouraging as these findings are, research also shows that for many farmers the educational process is only beginning. Only 6 percent of those surveyed scored an A on the marketing test, answering 18 or more of the 20 questions correctly. And 60 percent of the respondents received a score of 70 percent or less.

In addition, another recent survey demonstrated that risk management means more than managing price risk. When farmers were surveyed on other practices, few (just 5 percent or so) qualified as first-rate risk managers, using a wide spectrum of financial, production and marketing tools to control their overall level of risk while achieving outstanding returns.

One of the most troubling aspects of this survey research was that some 20 percent of today’s full-time farmers are vulnerable, burdened by debt and without adequate cash-flow and profitability. Indeed, a majority, some 55 percent, had substantial levels of debt but had not yet adopted the risk management skills needed to ensure their farm’s survival.

TABLE 2
Financial Risk Management Tools
(% using tool)

55%	Cash-flow statements
46%	Computerized financial records
24%	Financial ratios
19%	Accrual accounting

SOURCE: FARM FUTURES

TABLE 3
Knowledge of Options Terms
(% correctly identifying a term)

	Aug. 1989	Sept. 1996	% Increase
Strike price	44%	79%	+35%
Put	41%	68%	+27%
Call	42%	68%	+26%
Premium	45%	83%	+38%

SOURCE: FARM FUTURES

Research indicates that educational efforts need to extend beyond one-dimensional approaches to risk management, which address strictly marketing fundamentals or crop insurance. Instead, farmers need to understand all components of risk and be able to put together comprehensive risk management plans. By using this knowledge, farmers can indeed improve their profitability and prosper in this new era of free-market agriculture.

How does your farm rate? We’ve included two short quizzes to help you gain some perspective. First, measure your knowledge and use of risk management tools. Then, rate your farm’s financial strength. You may be surprised.