**Farming is Risky Business**

Every business and every person faces risks each day, but, really, *What is Risk*? People have different attitudes about risk. Some will wager a week’s pay at a casino, while others will hide their money under a mattress. A person’s aversion to risk is a key factor in the extent to which they will try to manage their risks. In general terms, people often think of risk as the chance of something bad happening. “Bad” and “chance” are two key elements of risk. In financial terms, risk is the possibility of financial loss.

*Risk Management*, in a business context, is about reducing the *cost* of risk, which includes the cost of *managing* risk. Business, including farming, is about making profits or gains. Farmers need money to make a living for themselves and their families. To make a living, farmers must take risks, investing $200,000 or more worth of seed, fertilizer, and herbicides and hoping for rain - but not too much rain. Farming is risky; one doesn’t know what the outcome will be when the crop is planted (the “chance” element), as all or a portion of the crop could be lost (the “bad” element). Because farmers are willing to take this risk, our nation has a plentiful food supply.

**Don't Risk a Lot for a Little**

The first key concept of risk management can be expressed by the old saying, “nothing ventured, nothing gained.” Risk management involves asking the question, “Is the risk appropriate for the return?” Is the farmer venturing too much for too little gain, (i.e., will the farmer make enough profit to reasonably justify the risk?) The word “reasonable” is key. Usually, as people take greater risks, they seek a higher return on their investments. Banks, for example, charge higher interest rates to customers who they believe are less likely to pay back a loan.  Remember, the more risk you take, the greater the reward you should expect.  In short, "Don't Risk a Lot for a Little."

**Don't Risk More than You Can Afford to Lose**

Few people think it would be wise for retirees to invest their life’s savings in a technology stock. If they lose, there is no opportunity to make back the loss. Who hasn’t seen movies of the gambler who loses, but just needs that last “score” to get even? It never seems to work out for this person. No matter how good the odds, sometimes bad things still happen. No one should invest more than they can afford to lose, unless they want a drastic change in their lifestyle, because sometimes they’ll lose. Ruin is the result of losing more than you can afford. Unfortunately, to support a family by farming, some farmers must face the possibility of ruin each year. Crop insurance helps reduce the chance of ruin by reducing the maximum amount of money a producer can lose. Still, in today’s economic climate, ruin is a real issue for farmers.

**Know the Odds**

A coin toss is a 50-50 proposition. A roll of a die is a 1-in-6 event. What are the chances that this year will bring a drought? And, if it does, how much revenue will be lost? No one knows precisely, but estimates can be made based on historical data, and these estimates can be invaluable in making an investment decision. The USDA's Risk Management Agency (RMA) develops tools to help farmers estimate the chances of profit or loss. The odds may be in a farmer’s favor, but sometimes they still lose. That is why avoiding ruin is important—it allows a farmer to keep farming. A loss doesn’t put them out of business.

It is very important to realize that the odds of making a profit or of ruin change every year, and a losing year can make the odds of either outcome much worse the next year. “Losing years” must be paid for by borrowing or by using equity built up in good years. The greater the debt or the less equity a farmer has, the harder it will be for the farmer to pay the bills if another loss occurs. Thus, it is very important that farmers understand their true financial situation, including not only preparing cash flow projections, but also preparing a balance sheet and income statement. Remember, a farmer can have a positive cash flow and still lose money.

**In Conclusion**

For risk management to be effective, a farming operation must have a reasonable expectation of making a profit (assuming financial returns are important). Risk management cannot make a business that is fundamentally not profitable, profitable. Today's most effective farm managers keep careful records that facilitate effective use of available risk management strategies designed to keep expected financial returns in line with the risks. Done well, risk management can help protect a farmer’s hard-earned money from the risks associated with farming.  RMA’s mission is to encourage farmers to proactively manage their risks. Farming is risky, more so than many other businesses. For taking these risks—and feeding the world—some farmers earn a good return on their investment. Others do not. By practicing risk management, farmers can gain greater control over their risks, financial returns, and solvency.

*The content for this article was adapted from "Risk and Risk Management", a Risk Management Agency Fact Sheet. AgRAEIS works with producer organizations, such as the Kentucky FFA Association, to reach beginning producers with information about risk management and Federal Crop Insurance Programs administered by the USDA’s Risk Management Agency (RMA).  Many Kentucky FFA members have participated in AgRAEIS’ workshops held across the state. AgRAEIS’ efforts are made possible by a USDA/RMA partnership. For more information about RMA and its programs, please visit* [*www.RMA.USDA.gov*](http://www.RMA.USDA.gov)*.*

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