

Managing Risk

HOW RISK TOLERANT ARE YOU?

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The risk environment for farmers is changing. Many factors contribute to today's especially risky situation. These include increasing globalization of markets and industrialization of agriculture; variability of prices and yields; changes in technology; legal and social concerns; and the human factor itself. Higher risks means that farmers need new risk management tools.

However, individuals are unique, and so are their personal and financial circumstances. Farmers need to adopt risk management strategies that are in accordance with their own risk attitudes, preferences, and business and family conditions. Understanding how risk tolerant you and your business are can help you assemble the best combination of tools from the risk management tool bag.

We have all probably made statements like: "If I'd known this was going to happen, I would have done it differently." Unfortunately, the consequences of a decision are not generally known when the decision is made. When evaluating risky situations, you need to look at:

- The probability that an unfavorable event may occur;
- The probability of adverse consequences should the unfavorable event occur; and
- Should the adverse consequences occur, how significant would the disruptions be to you, your family and the business – how risk tolerant are you?

This will help you evaluate your options and decide which action to take. Taking no action could also be an option. But it should be a conscious decision you make after assessing the options, not the result of your lack of knowledge about the situation.

The following checklists are designed to help you evaluate your own attitudes toward risk and assess the probabilities of various unfavorable situations. Answering these questions will help you determine your level of risk tolerance, in specific areas and overall, which will aid your decision-making in a risky environment.

Evaluate Your Risk Attitude

Knowledge of your basic attitude towards risk can be helpful in understanding your feelings in certain situations, and why you make particular decisions. Which of the following descriptions fits you best?

- **Risk Avoider** - You are a very cautious risk taker. You stay prepared for the worst, and you dislike taking any chances. Your operation tends to be stable, but you lose out on opportunities that would involve going out on a limb.
- **Risk Calculator** - You believe that one must take some chances to get ahead. Before making a decision or taking action, you gather information and analyze the odds. You try to be realistic, to recognize the risks and them to acceptable levels. Sometimes you over-analyze.
- **Risk Adventurer** - You feel risks are challenging and exciting, and you often look for the chance to take risks. You enjoy the excitement of risk taking, and sometimes you need to be reminded to keep the stakes to a reasonable level.
- **Risk Daredevil** – You're a risk daredevil if you take unnecessary chances, plunging right in (or staying put) with your eyes closed to risk. Although you might sometimes get lucky, Daredevils commonly fail when they ignore the facts or refuse to take any precautions.

Your risk attitude influences how you think about risks, but it doesn't protect you from risk. In other words, just feeling like a risk adventurer doesn't give you any magical mechanism for coping with a bad year. There may also be other people involved, like family members, who do not share your feelings about risk. So you need other criteria for choosing your farm's risk management strategies.

To take a more detailed risk attitude quiz, [click here](#).

Evaluate Expectations and Probabilities

When determining how risk tolerant you are, it is important to take into account your expectations about the future of your personal and family situation. In addition, you should assess the probabilities of various unfavorable circumstances that would affect prices, costs, yields, and a number of other factors. However, be cautioned that when evaluating probabilities and expectations for the future, most people tend to have selective memories. The recent past tends to be weighted more heavily than events occurring some time ago. Moreover, if circumstances have changed, the past may provide very little basis for future expectations. The following sets of questions will help you determine your overall risk tolerance.

1. Assess Your Personal and Family Situation

- | | | | |
|--|--------------|--------------|-----------------|
| What is your age? | 1) <30 yrs | 2) 30-50 yrs | 3) >50 yrs |
| What is your health? | 1) Excellent | 2) Average | 3) Poor |
| How many people are you financially responsible for? | 1) one | 2) two-three | 3) four or more |

Do you expect an event in the near future that will significantly change your family's financial situation, such as college, housing, new child, or retirement?

- 1) Expect less financial pressure
- 2) Expect minimal change
- 3) Expect more financial pressure

2. Assess Your Tolerance to Production Risks

Yield variability	1) Low	2) Average	3) High
Probability of damaging weather during the growing season	1) Low	2) Average	3) High
Microclimate or geographic diversification	1) High	2) Average	3) Low
Product diversification	1) High	2) Average	3) Low
Production practices diversification	1) High	2) Average	3) Low
Your horticultural (or agricultural) production skills	1) High	2) Average	3) Low
Flexibility to change to different crops and/or production practices	1) High	2) Average	3) Low

3. Assess Your Tolerance to Marketing Risks

Price variability	1) Low	2) Average	3) High
Access to market information	1) High	2) Average	3) Low
Marketing diversification (number of marketing channels)	1) High	2) Average	3) Low
Flexibility to change marketing practices	1) High	2) Average	3) Low

4. Assess Your Tolerance to Financial Risks

Probability of having sufficient cash from the business to cover operating costs, personal withdrawals, and principal on term debt each year	1) High	2) Average	3) Low
How is the business growing or developing? (Acquiring assets, making investments)	1) Gradual development	2) Rapid development	3) No development
Your costs of production compared to others in the industry	1) Lower	2) Average	3) Higher

Your farm's financial health (debt/ equity ratio, cash flow, solvency & liquidity position) **1) Excellent 2) Average 3) Poor**

Level of your farm's financial reserves **1) High 2) Average 3) Low**

Family's off-farm income **1) Significant 2) Minor 3) None**

Personal or family financial reserves **1) High 2) Average 3) Low**

Level of insurance against business loss **1) High 2) Average 3) Low**

Level of investment diversification, farm and off-farm investments **1) High 2) Average 3) Low**

For a more detailed financial risk assessment, [click here](#).

5. Assess Your Management Skills

Risk management knowledge **1) High 2) Average 3) Low**

Farm business management skills **1) High 2) Average 3) Low**

People management skills **1) High 2) Average 3) Low**

For a more detailed management skills assessment, [click here](#).

So, How Risk Tolerant Are You?

For each question in the four checklists above, give yourself one point for every answer **(1)**, two points for every answer **(2)**, and three points for every answer **(3)**. Add them up. A score of 56 would be right about in the middle of the pack. The higher your score, the less risk tolerant you are, and the more attention you should pay to developing risk management strategies to protect you, your family and your business.

Without a doubt, farm business decision-making is a complex process, and risk management adds to this complexity. In developing a comprehensive risk management plan, you need to consider not only the five basic sources of agricultural risk (production, marketing, financial, legal/environmental, and people); you need to understand your level of risk tolerance in those areas, your unique family and personal situation, and your attitudes towards risk.

For more information all aspects of risk management, [click here](#).