

## News from Cornell's Small Farms Program

Topic: Risk Management for Small Farms  
Release Date: For immediate release, January 20, 2003  
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### Don't Break a Leg: Managing Risk on Your Small Farm

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Farming is a risky business, so what else is new? Too much rain, too little rain, a pest problem here, a tractor problem there... farming is all about risk and uncertainty whether your farm is big or small. Thank goodness farming is full of rewards too, for you, for your family and your community. In this article we want to introduce the idea of risk management and look at some of the particular challenges and opportunities that small-scale farmers have in managing risk.

#### Types of Agricultural Risk

It's helpful to think in terms of five basic types of agricultural risk:

- **Production risk** includes weather, pests, equipment breakdowns, and anything else that directly affects the quantity and quality of your production. If you've been farming for long, you probably understand your production risks quite well!
- **Marketing risk** results from uncertainty in the market for your product, for example uncertainty about the price you will receive, or loss of a market you were expecting to sell to. Unless you regularly spend time keeping up to date with the market for your products, you may not understand your marketing risks very well at this point.
- **Financial risk** relates to your ability to pay the farm's cash obligations in a timely manner (liquidity) and protect or grow your equity (solvency.) Obviously, this is closely tied to production and marketing risk. Financial risk also includes the risk of inflation and changes in interest rates.
- **Legal risk** refers to the possibility of being sued, fined or otherwise penalized for violating a law or regulatory standard. "Tort liability" is the risk of being sued by a customer, worker or visitor, for example if there is an accident due to improper safety procedures on the farm. Product liability reflects the risk that your product may cause harm to others. For example, if you fail to withhold milk from cows treated with antibiotics, you may have to buy an entire truckload of contaminated milk. Legal risk also includes your liability for environmental problems that might result from your farming practices.
- **People risk** (also called "human resources risk") includes the four D's—death, divorce, disability and disagreement. Because a small farm is highly reliant upon the operator and family for its workforce, these incidents can have a huge impact on the viability of the business. The impacts of death and divorce are obvious. A disability, even short term, leaves the farm without a vital member of the team. The convalescing farmer needs the security of knowing the business can continue while he or she fully recovers. And family businesses are particularly vulnerable to the impacts of serious disagreements. The break

up of a family farm partnership can have both financial and personal consequences that are felt for a long time.

### **What is “risk management”?**

Risk management is not just buying insurance. Risk management is everything you do to understand and deal proactively with risks. There are two primary aspects of risk management.

The first is anticipating that an unfavorable event may happen and acting to reduce the chances that it will happen. Examples include keeping all equipment in good working order, staying healthy and happy by eating a proper diet, quitting cigarettes, taking time for relaxation, and keeping a sense of balance between the business and family life. All of these practices help you avoid costly mistakes and accidents.

The second aspect of risk management is contingency planning -- taking actions ahead of time to reduce the negative consequences if something bad happens. For example, having an emergency plan in place with your neighbors can keep the farm running more smoothly in case you have an injury. And having some form of health and disability insurance can keep a medical problem from becoming a financial disaster for the farm.

### **Special concerns of small farms**

Although every small farm is unique, many share the following characteristics, which will affect the kinds of risk management strategies that are appropriate:

- **Limited workforce.** Most small farms rely almost entirely on family members for labor and management. With so few people doing so much, a disability, disagreement, divorce, or death in the family can easily mean the end of the farm business. Even without such a catastrophe, fatigue and stress add to your risks.
- **Limited time to study and make decisions.** With everyone so busy, it can be hard to find time to keep good records, follow the market, study all those risk management options out there and make the best decisions.
- **Limited financial resources.** You may have a limited financial cushion to fall back on in an emergency, and a limited line of credit. These factors increase your overall financial risk. And sometimes purchases that would reduce your risk have to be put off until you can afford them.
- **Difficulty transferring the farm.** Transfer of the business often involves a period of time when more than one family is involved in running the business. During this time, generating adequate revenue to fairly compensate each party can be a challenge when one of the key goals of the farm is to remain small enough to be able to rely entirely on family labor to run the operation. The exiting party often has planned upon revenue from the sale of farm assets to fund their retirement. With today's thin agricultural margins, the goals of transferring the farm and using revenue from the sale of farm assets to fund retirement are often in conflict.
- **Lack of health, disability and long-term care insurance.** The escalating costs of health and disability coverage means that many small farms are going without. Long-term care is also a concern. Nursing homes are very expensive and many farm families find they have to care for their elders at home in order to preserve the farm assets for future generations. The time required for conscientious elder care can be a real drain on the farm business.

- **Older equipment and facilities** carry additional risks, including safety risks. If equipment is not kept in excellent repair, breakdowns are more frequent. Old wiring and overloaded circuits increases the risk of fire. The risk of collapse of a barn under heavy snow load increases with age, poor design or damage from everyday operations. This also puts stored equipment or housed livestock at risk.

### **Risk management priorities for small farms**

Given these concerns, how can you make sense of all the risk management information and options out there? The following is a list of suggested priorities for the family with limited time and resources to put into risk management. These are the bare essentials. If you have more time and resources available, we recommend that you spend some time reading and attending meetings about risk management tools and strategies.

- **Minimize safety risks.** Remember that nothing is more important than safety. Take the time to do things right, wear protective gear, store hazardous chemicals like milk equipment cleaning chemicals, fuel and pesticides where children can't get into them. Maintain equipment regularly. Adopt a stress management plan.

Teach the kids about safety and assign them to age appropriate tasks. Children are often anxious to show their responsibility by trying to tackle jobs that require more physical or mental abilities than they have developed. Adults should closely supervise visiting non-farm children because they are unfamiliar with the everyday dangers associated with farm equipment and livestock.

- **Use good agricultural practices.** Another basic risk management strategy is simply using good agricultural practices, such as IPM, nutrient management planning, rotational grazing, and careful herd health management. These practices can reduce costs and increase efficiency in the use of pesticides, fertilizer and other inputs, since you only apply materials when and in the amounts necessary for optimum production.

Always be careful to minimize spray drift, and to store and dispose of toxic materials properly. You may need to document pesticide and fertilizer applications. These practices not only limit your legal risk from environmental mishaps, they can reduce costs and improve profitability, thus reducing your financial risk. And they can improve neighbor relations as well.

- **Support your neighbors.** A strong network of good neighbors is the best safety net a farm family can have. Sharing labor, equipment and knowledge can reduce your costs and increase satisfaction with the farming lifestyle. Make-emergency plans with neighbors in case-any one of you gets sick or disabled. Write down procedures so someone else can step in and keep things going if you suddenly become unavailable. Write down which cows need to have milk withheld, or crops that cannot be harvested until a certain date in a visible place a family member or neighbor can check. Consider creating a study group to learn about other risk management strategies.
- **Property and liability insurance.** Carefully review your farm owner's insurance policy to make sure that you are covered for events such as collapse of a barn roof, barn fire, or injury to a visitor. Many policies don't adequately cover these events. If yours doesn't, increase your liability limits or purchase additional "riders" to cover them. Make sure your animals and/or stored crops are covered. Remember that if you have a farm market the potential for tort liability increases dramatically, and you need special "riders" to cover the increase risk.

Insurance costs and company structures change frequently. It's important to make certain you are spending your insurance dollars wisely by getting quotes from a number of insurance sources every two or three years. This process also gives you the opportunity to get a "second opinion" on your coverage needs when you review them with different agents.

- **Health and disability insurance.** Health insurance is an important part of addressing your human resource risks. Unfortunately, the high cost of health insurance means it is often one of the first expenses cut. However, there are ways to reduce your insurance bill. Many organizations offer group insurance at reduced rates, more than offsetting the cost of membership. Great places to check are your milk cooperative, Farm Bureau, and county Chamber of Commerce.

New York State offers several important programs for limited income residents, including Child Health Plus, Family Health Plus, Healthy NY, and EPIC (Elderly Pharmaceutical Insurance Coverage Program). Contact information for these programs is listed at the end of this article. There are also several insurance agencies that offer health insurance targeted to the farm community, and you may also explore the more traditional resources of health insurance (like Blue Cross, Aetna, etc). A perusal of your local farm publications will help you to identify options.

The Social Security system offers basic disability insurance benefits to those who qualify and pay into the system. Many operators of small farms don't pay into the system because they don't generate enough farm income. However, depending on your specific circumstances, the "Farm Optional Method" for Social Security coverage *may* allow you to earn some disability coverage even if your net farm income is negative. It may also allow you to receive the Earned Income Credit, which may offset some of the increased self-employment tax. However, it's important to talk to a tax advisor to find out whether the Farm Optional Method will provide any disability insurance in your particular situation.

- **Attention to business management.** One of the best ways to manage financial risk is to analyze, in writing, the impact of decisions on the financial performance of the farm before implementing a new practice or making a capital purchase. In order to do this kind of analysis, you need to keep good production and financial records. The "Cornell Farm Account Book" or "Cornell Farm Business Record" offer easy-to-use formats for keeping financial records. It's also important to file all your receipts in an organized manner. Being able to quickly retrieve a receipt for a part gone bad sure helps reduce the stress of the moment when a breakdown occurs.
- **Basic crop insurance.** We suggest that, at a minimum, growers should purchase "Catastrophic Coverage" (CAT) for eligible crops, and "Non-Insured Crop Disaster Assistance" (NAP) for crops that cannot be insured under CAT. Although these programs don't offer a high degree of protection, they do help in case of serious crop failures, they are very affordable, and they make you eligible for assistance in the event of disasters, such as the widespread drought such as we have experienced in the Northeast in recent years. Additional crop insurance beyond CAT or NAP may be worth the additional cost to you, but it takes time to figure out these costs and benefits. If you don't have that time, at least get CAT or NAP coverage.
- **Make use of free assistance.** Most small farms can't afford consultants. Fortunately lots of information and help is available for free including your local Cornell Cooperative Extension office, county health department, office of the aging, USDA Natural Resource Conservation Service and Farm Service Agency, and many others. One of the best resources for help is NY FarmNet (1-800-547-Farm), which offers free, confidential counseling on a wide range of business, financial, family and personal concerns.

## **Additional Resources on Risk Management**

### **General Risk Management Information**

Cornell's Horticultural Business Management and Marketing Program Risk Management Website offers many online resources relating to all five types of agricultural risk:

<http://hortmgt.aem.cornell.edu>

### **Farm Safety**

Cornell's Ag Health & Safety Program offers resources, training and publications about all aspects of farm safety. 607-255-5492. <http://web.vet.cornell.edu/Public/CUAgri/>

### **Stress Management**

NY FarmNet offers free, confidential assistance with business, personal and family issues. Toll-free: 1-800-547-Farm

### **Business Management**

*Cornell Farm Account Book*. Available for \$6.95 from the Cornell Educational Resources Program, 607-255-8122 or <http://cerp.cornell.edu>.

### **Health and Disability Insurance**

New York State Health Department: [www.health.state.ny.us](http://www.health.state.ny.us)

Child Health Plus: 1-800-698-4KIDS

Family Health Plus: 1-800-698-4543 or 1-877-9FHPLUS

Healthy NY: 1-866-HEALTHY NY, 1-866-432-5849) [www.ins.state.ny.us/healthny.htm](http://www.ins.state.ny.us/healthny.htm)

EPIC (Elderly Pharmaceutical Insurance Coverage Program) 1-800-332-3742

### **Social Security -- Farm Optional Method**

*Income Tax Management and Reporting for Small Businesses and Farms*.

C. Cuykendall and G. Bouchard Oct 2002. Cornell University Applied Economics and Management Extension Bulletin 2002-17. Cost is \$15. To order call Charles Cuykendall at 607-255-2130.

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In cooperation with:

NY FarmNet

Cornell ProDairy Program

Cornell Horticultural Business Management & Marketing Program

Cornell Program on Dairy Marketing and Policy

Northeast Regional Center for Risk Management Education