

Many Types of Risk

- Production risk
- Market (price) risk
- Financial risk
- Legal risk
- Human risk

Die horse, reckon this'll be the end.

- Together these make up business risk

Risk Management Objectives

- Ensure survivability of business
 - Reduce risk to manageable levels
- Other goals may be important as well
- Cost effective
 - Cost of doing business
- Must meet changing needs over time
 - Reevaluate periodically and adjust as needed

Risk Management Tools

- Business Structure
- Management
 - Animal health management
 - Financial management
 - Cash marketing/timing
- Production/Marketing Flexibility
 - Feed/forage/water reserves
 - Retained ownership
- Insurance
 - Many forms
- Offsetting risk tools
 - Futures and options

What is Risk?

- Risk versus uncertainty
- Risk is a measurement of the impact of adverse outcomes
 - Risk = (probability of an event) x (consequences of the event)
 - Usually measured in monetary terms
- Risk management means the ability to reduce the probability of the event or to reduce the consequences of the event

Reducing the Probability of Adverse Outcomes

- Examples:
 - Vaccinations reduce the probability of disease outbreak
 - Forward contracting sales reduce the risk of price decreases
 - Safety equipment reduces the likelihood of injury

Reducing the Impact of Adverse Outcomes

- Examples:
 - Feed and water reserves to reduce the impact of drought
 - Using insurance to protect against losses
 - Hedging prices to reduce the impact of adverse price changes
 - Using multiple hay piles to reduce the impact of fire

Production Risk

- Adverse weather, disease/pest outbreaks that reduce production and revenue
- Usually addressed through management
 - Optimal feed/water reserves
 - Animal health program/biosecurity

Market (Price) Risk

- Prices (values) may decrease in the time lag between production decision and sales
- Input price volatility
- Can be managed by a variety of tools:
 - Timing of sales/purchases
 - Forward pricing products
 - Offsetting risk tools
 - Futures and options
 - Revenue insurance

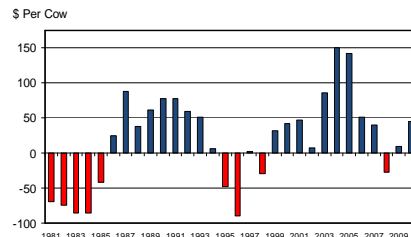
Financial Risk

- Interest rates
- Leverage
 - Cash flow (liquidity)
- Solvency
 - Loss of equity
- Financial risk is often determined by the impact of production and market risk

Risk Interactions

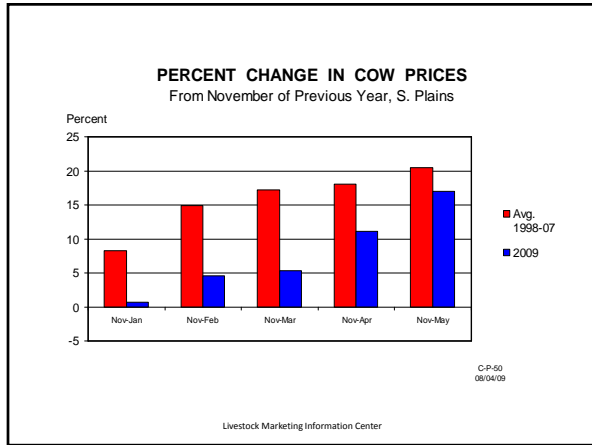
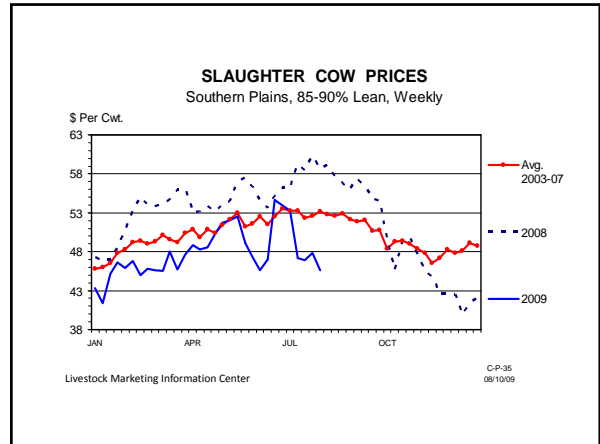
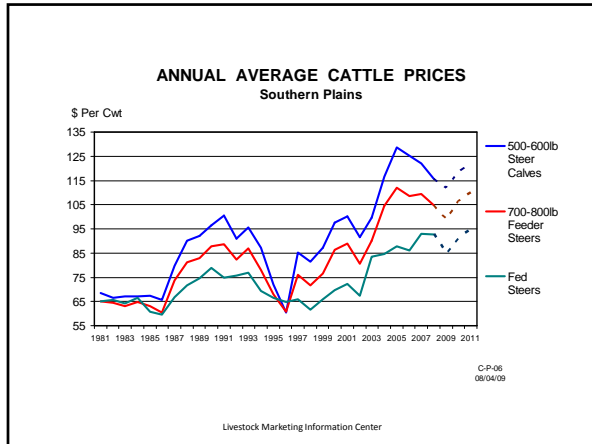
- Production and market risk
 - Forward contracting
- Production/market risk and financial risk
- Diversity of activities and tools
 - Comprehensive risk assessment and plan

ESTIMATED AVERAGE COW CALF RETURNS
Returns Over Cash Cost (Includes Pasture Rent), Annual



C-P-66
08/04/09

Livestock Marketing Information Center



Risk Management Considerations

- Optimal level of risk (Benefits versus costs)
 - Business (including lender)
 - Personal
 - Family
- Balanced approach to risk
 - Needed coverage (changes over time)
 - Appropriate application of tools
 - Avoid excess or redundant coverage
- Risk and profit potential are often positively related
 - Eliminating risk is not the goal
 - Maximize profits with an acceptable level of risk

