



## **RISK AND AGRIBUSINESS: INSIGHTS FROM THE RISK DOCTOR**

By Suzanne Deutsch, January 2011

### **Part 1: Understanding risk management**

<http://www.farmcentre.com/News/TodaysStory/Article.aspx?id=ef1dedd3-e04e-462f-b49b-983b17a554af>

Farmland values are skyrocketing; it's outperformed most other investments in recent years and investors are now eager to become landowners. At a time when people are concerned about the world's food supply, it's become a tangible, strategic asset. Rising land prices are great if you want to sell, but it makes it harder for new or expanding farmers to buy land. Paying higher prices means making bigger payments. If anything goes wrong, or if a disaster happens, profit margins can be squeezed or disappear entirely. Not only will risk management play a greater role than ever in decision making on whether to buy additional land; it is now one of the essential management skills required to operate a successful business.

Understanding your attitude towards risk can help improve your risk management effectiveness, says Dr David Hillson. Hillson, also known as "The Risk Doctor" was a featured speaker at the CFBMC's 2007 Managing Excellence in Agriculture conference in Kelowna, BC. His presentation at the conference dealt with the psychological factors that drive your judgment and your behavior; he talked about the importance of putting words to an intuitive thought process or "gut feeling".

Hillson defines risk as uncertainty that matters –he says this phrase is key to understanding what is a risk and what isn't. He says that everyone is subject to biases or things that affect their judgment. These can either increase or decrease their sensitivity to risks. Some people are risk seekers and others are risk averse, while some are somewhere in between. Which group anyone falls into is determined by a whole set of psychological and situational factors. Hillson says it's worthwhile for managers to take the time to analyze what their motivators are. If they don't they won't be able to account for them to avoid making a flawed decision based on biased or flawed judgment.

"Someone who's very cautious, because they've been burned a couple of times with financial investments, are likely to be overprotective and miss some investment, development or marketing opportunities," says Hillson. "What they need to do is examine their bias, look at it in the cold light of day and say, okay well it did happen before, but realistically is it going to happen again? Is the situation exactly the same as the previous time and even if it is the same, now that I know about it, can I do something different?"

Not only is it important to understand your own biases or judgment; it's also important to understand how other people we work with in our business feel about risk. If everyone making decisions is too cautious, it could bring the operation to a standstill. On the other hand, if everyone is over adventurous they could drive the business off a cliff. Either extreme can be dangerous (although a certain amount of both caution and innovation are both important), so you have to be able to recognize if you tend to fall into one of those categories and correct for them where necessary.

## Real risk management

Some people think that we need to manage “real risks” as distinct from “imaginary risks”. But all risks are imaginary if risk is defined as an event that might or might not happen in the future. Many people only think of risk management as a process to deal with standard issues, such as changes in pricing, losing staff, interest rates going up and so on. However, Hillson says, if these are standard issues, then as a manager, you should have standard responses in place to deal with it.

“The real risk management occurs when the non-standard things, ones that you wouldn’t normally think of, crop up,” he says. “You’ll need to think outside of the box for these, looking for unexpected and uncertain things that have a credible probability and a significant impact; otherwise it isn’t a real risk.” He suggests looking for things that are unusual, and that are not part of your normal experience. Weather for example wouldn’t qualify if you are a farmer, he says, because all farmers deal with the weather. It’s inherent to farming.

The end of supply management would qualify as a risk for dairy and poultry producers who depend on tariff protection to keep imports from countries with lower cost of production. A drop in quota value alone would put many in severe financial straits.

Another example would be a sudden spike in gasoline prices that would discourage customers from driving to your farm store.

Hillson suggests only listing events that would have a significant impact for your operation to keep your list manageable. You shouldn’t worry about uncertainty as remote as Russia invading Canada, or about things that have a chance of happening but don’t really matter.

## Part two: Risk management and planning

<http://www.farmcentre.com/News/TodaysStory/Article.aspx?id=ad28ad58-19d0-441b-a9bd-4f3be1cc632b>

Most Canadian farmers are bracing for a wet spring in 2011 and wet soils are for the most part, cold soils. Plants take longer to emerge under such conditions, this allows more time for them to be infected by root rots. No one has done research on which varieties can handle flood-like conditions since the Prairies are more likely to be affected by heat, drought and frost than wet and saturated conditions. As a result, planning crop rotations and other decisions affecting your operation will no doubt be very daunting.

Using risk management tools can be helpful to analyze what happened last year in order to make sure it won’t colour your decision making process for the upcoming year. Dr David Hillson’s seven-step risk process can help you examine how you should respond when you are faced with an uncertain situation. This will hopefully give you a clearer picture of what you and your business are hoping to accomplish.

### The seven steps

Hillson explains the traditional view of risk is negative but it doesn’t have to be. Risk can be both an opportunity and a threat. It all depends on how you view it. This is why risk-seekers minimize threats by saying: it’s nothing to worry about and are optimistic about opportunities “that are too good to miss”. Meanwhile, risk-averse individuals are likely to assess the same situation in a totally different way. Their guiding principles are: “better safe than sorry.”

Here’s how the process to maximize positive events and minimize negative threats works.

1. **Set objectives.** The first step of the risk management process is clearly answering questions such as: What am I trying to do? What are my objectives and goals? Where am I headed, what do I want to happen? Hillson says clarifying your investment strategy, your rate of return, your marketing position, and figuring out what kind of product you want to produce should be your priority. These are the things that are at risk, that matter, and that can affect your objectives.

2. **Identify risk.** The second question is what could affect me in achieving those objectives? What are the uncertainties that could affect me in a good or adverse way, that can help, or hinder?
3. **Qualitative risk assessment:** Of all the potential risks you've identified, which ones matter most? By identifying which are the most important, you are able to assess and prioritize which ones are more critical to the success of your operation.
4. **Quantitative risk analysis:** By using a computer-based model of your business situation and adding the elements of risk you've identified, it's possible to come up with a range of different outcomes reflecting the overall effect of risk on your business.
5. **Risk response planning:** Once you have identified which risks are the most important, you can tackle the fifth question which is: What am I going to do about it? Risk response planning is about selecting appropriate response strategies in order to minimize and avoid threats while maximizing and exploiting opportunities.
6. **Implementation:** The implementation stage is about taking the planned actions and monitoring their effectiveness.
7. **Review:** Risk management is cyclical process. It must be adjusted as the business faces new risks and as the environment or family situation evolves. It is also a "work in progress". Take the time to ask yourself questions such as :
  - What's changed? What have I learned from doing what I said I would do?
  - Did the bad risks go away and the good risks happen, or not?
  - What will I do differently next time?

Thinking about these answers will give you the opportunity to refine and improve your risk management effectiveness.

Dr David Hillson is a well-respected international consultant and trainer, author, and speaker on the topic of risk management. For more information, or to sign up to receive his free electronic newsletter, visit: <http://www.risk-doctor.com/>.