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## Managing an Agricultural Business in a Risky Environment

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# CORNHUSKER ECONOMICS

UNIVERSITY OF  
**Nebraska**  
Lincoln

February 8, 2006

University of Nebraska–Lincoln Extension

Institute of Agriculture & Natural Resources  
Department of Agricultural Economics  
<http://agecon.unl.edu/pub/cornhusker.htm>

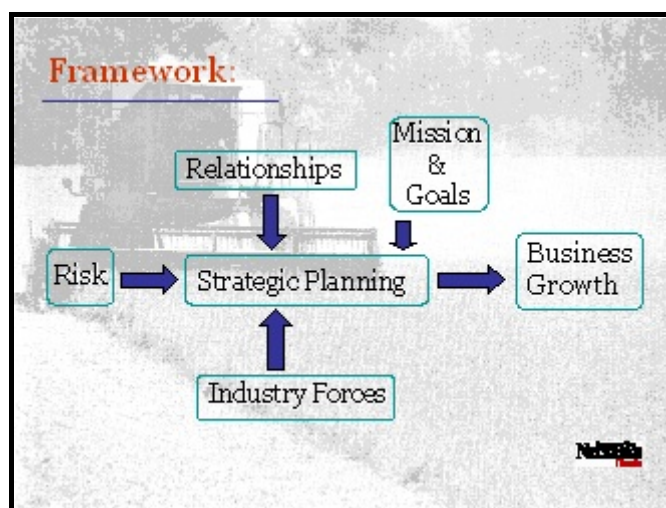
## Managing an Agricultural Business in a Risky Environment

Market Report	Yr Ago	4 Wks Ago	2/3/06
<b><u>Livestock and Products,</u></b>			
<b><u>Weekly Average</u></b>			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight . . . . .	\$89.05	\$92.66	\$90.87
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb . . . .	127.06	140.88	140.31
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb . . . .	106.29	118.08	113.18
Choice Boxed Beef, 600-750 lb. Carcass . . . . .	142.69	155.58	151.25
Western Corn Belt Base Hog Price Carcass, Negotiated . . . . .	68.73	57.56	51.48
Feeder Pigs, National Direct 45 lbs, FOB . . . . .	80.76	72.50	60.55
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean . . . . .	72.37	65.31	57.57
Slaughter Lambs, Ch. & Pr., 90-160 lbs., Shorn, Midwest . . . . .	109.50	81.00	78.13
National Carcass Lamb Cutout, FOB . . . . .	257.94	236.02	218.06
<b><u>Crops,</u></b>			
<b><u>Daily Spot Prices</u></b>			
Wheat, No. 1, H.W. Imperial, bu . . . . .	3.22	*	3.76
Corn, No. 2, Yellow Omaha, bu . . . . .	1.75	1.90	1.98
Soybeans, No. 1, Yellow Omaha, bu . . . . .	5.00	5.73	5.56
Grain Sorghum, No. 2, Yellow Columbus, cwt . . . . .	2.41	2.96	3.13
Oats, No. 2, Heavy Minneapolis, MN, bu . . . . .	1.85	2.15	2.16
<b><u>Hay</u></b>			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton . . . . .	115.00	130.00	130.00
Alfalfa, Large Rounds, Good Platte Valley, ton . . . . .	62.50	65.00	65.00
Grass Hay, Large Rounds, Good Northeast Nebraska, ton . . . . .	57.50	52.50	52.50

\* No market.

**What is Risk?** Risk is a possible adverse event that has the potential to interfere with a business entity's financial stability or its ability to achieve its mission. Risk can also have a positive outcome. Strategic planning is the process of selecting the plan that will overcome the possible negative impact and convert risks into opportunities.

Traditionally, the universe of risk has included the five major areas of risk: production, marketing, financial, human resources and legal. This is still a logical and effective way of identifying the risks a business may face. A more contemporary way of specifying risks and selecting appropriate risk management strategies is to first describe the operating environment



that the business is in and the forces that are impacting it. Legal and government policy issues and human interactions are still part of that set of forces. Other

forces include supplier structure, buyer power and preferences, substitutes, competition and emerging technology.

### Industry Forces

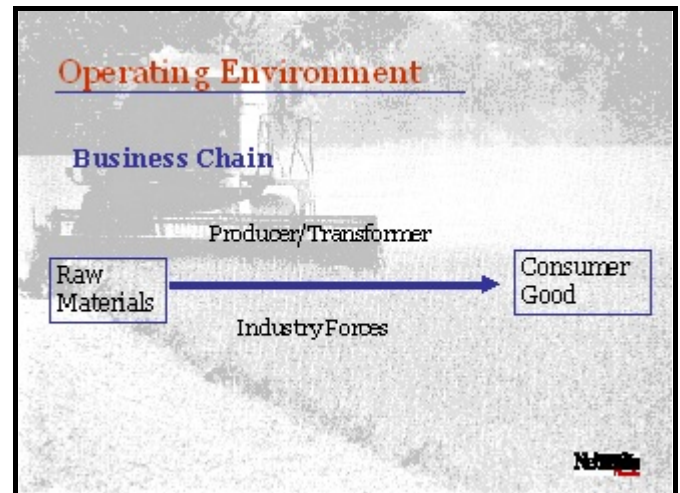
1. **Supplier Power:** the bargaining power of the sources of inputs. The factors which impact strategies include the concentration of suppliers, the availability of substitute input and/or suppliers and the impact on costs.
2. **Buyer Power:** the bargaining power of customers. It may include processors and final consumers. The force factors include the volume purchased and leverage of the customer, the market information available and the availability of substitute products.
3. **Substitutes:** the availability of alternative products at lower prices, or the providing of better performance or that which is more attractive to consumers. The impacts of substitutes for a business include the cost to switch production processes, the price of the new output compared to the cost and the trendiness of the alternative product.
4. **Competition:** the competing force of existing or new producers. This includes both domestic and foreign competition. The factors which determine the impact of competition include the economies of size, the specific cost advantage competitors have and the entry costs to become a new or expanded producer.
5. **Technology:** the impact of technology on production processes and on the demand for the products. The force factors include the expected lifespan of the technology, the ease of adoption and the impact on the production and marketing chain. Electronic identification of livestock is a current example.
6. **Change Agents:** a general category of agents that force change. Government policies and regulations are the classic example.

These six forces also create **relationship risks**. For example, creating and maintaining good relationships between the business and the suppliers is one of the keys to success. Relationship risks also occur between family members, with business partners, employees, lenders, property owners and other producers.

**The mission statement** typically may not be considered part of risk management, but it defines the

strategic direction of the business. It sets the tone for strategic planning and initiates the planning process. It also explains the values and uniqueness of the business, which are a critical part of risk management.

A business operator is part of a chain that involves taking raw materials and transforming them into a final or consumer good. There are many interactions involved in that chain and many opportunities for adverse events to arise. Defining that operating environment and how all the players interact is a critical step in identifying risks and specifying a risk management plan that will meet the needs of the business.



Once the business or operating environment is defined, the process of managing risk can begin. First, identify the key risks to the business – the risks that have the greatest possibility to disrupt the business; assess the chance or likelihood of occurrence; evaluate the consequences; and, finally, select an action. The action may involve retaining the risk, transferring it to other entities, selecting a strategy that reduces it or, avoiding the risk. The business framework and operating environment help put it all into perspective and decide on priorities, including where the risks are that can be turned into opportunities.

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