



Risk Management Guide

Securing the future you want



Managing risk in your operation

Every farm operator has a different tolerance for risk. Depending on your age, the stage of your operation, or your family situation, risks and tolerance can change.

What if you wrote down all the unexpected things that could cause you to not meet your financial targets? Would it be a long list or a short list? Changes can involve cash flow, fluctuating interest rates, weather, commodity prices, trade channels, input costs, or unprecedented events like the completely unexpected COVID-19 pandemic.

Identifying the risks you face is the first step in being prepared to mitigate them - do you know your risks and what options are available to you to reduce your exposure?

Consider the questions below and if you're not able to confidently answer each, we invite you to use our Risk Management Guide to help you identify your risks and understand some strategies to help address them in your operation.

Questions:

1. Do you know what your top risks might be?
2. If one of these risks were to happen, do you know what the impacts would be and how you would manage them?
3. Do you feel you are:
 - a. Risk-averse?
 - b. A risk taker?
 - c. Risk neutral?
4. Do you have a process, plan or the skills in place to deal with risks?

Explore our Risk Management Guide now to help minimize the risks to your operation.

Risk management:

Working towards securing the future you want

Agriculture is not without risk. As a producer, you know the list of risks that come with running a successful operation is as long as it is complex. There are the obvious risks with issues like adverse weather, weeds, pests and fluctuating markets. But there's also risk in technology adoption, government policies and human resources. It can be as overwhelming as it is difficult to navigate.

Managing through the risks to a positive outcome for your farm business means being deliberate in the decisions you make – even if that decision is to maintain the status quo. It's a matter of actively managing the risks you face in order to make the most of the opportunities in front of you while minimizing the downside potential.

Why go through the effort of evaluating your risk management approach when you've been operating successfully for years? Fair question. The fact is, farming is getting more complex every year, with escalating land and capital costs, increased input costs and more adverse weather events. Add to that the never-ending stream of new, expensive technology and the challenges of staffing your operation with great people and you can see the risks are growing along with the stakes. **In today's farming environment, risk management is an essential activity to ensure the long-term economic success of your operation.**

In this guide, we will help you to actively manage the risks in your operation by covering three important facets of risk management:

1. Identifying your risk appetite
2. Identifying the risks in your operation
3. Strategies and tools to manage risks

We invite you to take the time to do a thoughtful evaluation of each of these three areas of risk management. Actively exploring these topics can help you get to a stronger position to weather any unexpected events and to capitalize on future opportunities that support your business goals.

Let's start.

Identifying your risk appetite

You wouldn't go to a steak house if you were a vegetarian. The same thing goes for your appetite for risk. For example, if you know you're not comfortable taking chances on things that aren't proven, then you'll want to avoid taking risks on brand new technologies. So, a good place to start your risk management journey is by identifying your risk appetite level.

There are three general levels of risk tolerance. Have a read through each and decide where you stand. Knowing your approach to risk and the levels of risk you are willing to tolerate, will help you manage risk accordingly.



Aggressive

Managing Risk in your Operation

Moderate

You're relatively less risk-tolerant when compared to aggressive risk takers, but still willing to take on some risk to have a chance at a competitive return. You know that you must take chances to get ahead, but not unreasonable ones. You are more methodical in gathering information and analyzing the probability of a positive outcome.

Conservative

Caution guides your decision making. You prefer less risky sources of income and dislike taking unnecessary risks that could result in lower or loss of income. Even if that means earning lower income in the process. Your operation tends to be stable, but you do miss out on opportunities that would involve unnecessary risk.

Which category do you fall into? Understanding your appetite for risk allows you to align your planning and practices to your tolerance level. Going forward, keep this top of mind as you make decisions that will allow you to sleep at night.

Another thing to keep in mind around risk appetite is that your family members and employees likely have different attitudes about risk. Knowing this and talking about it will mitigate some of the human risks in your operation (like stress and misunderstandings).



Identifying the risks in your operation

Armed with an awareness of your appetite towards risk, the challenge now is to identify the risks you face in order to decide how to manage that risk to an acceptable level. **Here are five primary examples of risks faced by farmers with a range of specific risks under each category.**

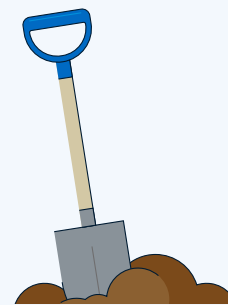
These five categories should provide you a starting point to consider the specific risks in each area for your operation. Think through each category looking for risks that will face your operation in the short term or as you plan for your long-term growth.

Production risks

Production risks relate to events that directly affect quality or output levels, or anything that negatively changes your expected yield.

Major sources of production risk include:

- Weather (drought, flood, freezes, hail, wind, excessive rainfall or heat)
- Disease and/or pests
- Production management (planting, harvesting, food safety)
- Equipment malfunction or breakage

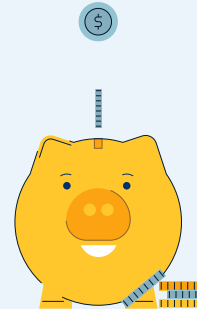


Market risks

Market risks come from uncertainty about costs, prices, and demand for your product. This includes the possibility of losing the market for your product, as well as lower sales or prices from increased competition.

Major sources of market risk include:

- Price risk
- Loss of market access from buyer or processor closures (temporary and long-term)
- Loss of market share/advantage due to competition
- Changing consumer preferences

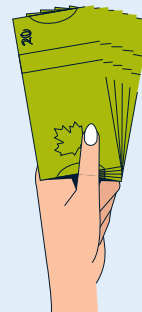


Financial risks

Financial risks relate to issues like generating lower than expected profit, the cost of debt, cash flow needs to meet unexpected obligations and losing equity in the farm.

Major sources of financial risk include:

- Production and price risks
- Inaccurate estimates of cash flow demands
- Inflationary pressures
- Increased costs on key inputs
- Changes in interest and exchange rates

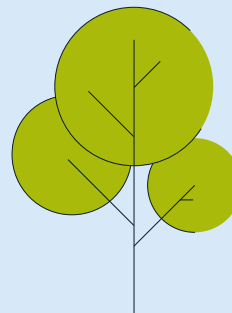


Legal and environmental risks

These risks are connected to your business agreements and contracts. When we fall short of these obligations it can carry a high cost. Also included here is the risk that comes from possible civil suits as a result of causing injury to another person or property due to negligence. There is also risk related to environmental liability and regulations.

Major sources of legal and environmental risks include:

- Business structure, which can impact taxes, estate planning and succession
- Bankruptcy and foreclosure
- Contractual arrangements
- Tort liability (being sued)
- Statutory obligations (regulations, including environmental)



Human Resource risks

Finally, there are risks related to Human Resource management. For farm operations, this often is associated with individuals and their relationships to each other. The risk includes family, farm employees and customers and is captured in the four D's: disagreement, divorce, death, or disability. The impacts of these can be a large risk to a farm operation.

Major sources of Human Resource risk include:

- Illness and health issues
- High stress
- Poor communication and people-management practices
- Safety (chemicals, structures, machinery, etc.)



Risk management starts with identifying the most important risks in front of you. Take the time to think through risks under each category and the likelihood of that risk occurring and creating an unfavourable outcome. Identifying risks will allow you to take possible steps to mitigate or accept the risk.

It's worth noting that identifying risks can sometimes be difficult when looking at your own operation. It can be productive to involve outside support to fully evaluate all the risks faced by your farm to ensure you didn't miss a critical area.



Strategies and tools to help manage risk

It's been said that if farming was easy, everyone would be doing it. But the truth is, today's producers face a very turbulent business climate. There are constant changes in regulations, interest rates, technology and competition, making it critical for you to be able to anticipate risks and create multiple, flexible strategies.

Four main risk management strategies

As you assess, identify and begin planning to manage the risks to your operation, you will likely use a combination of all of these four strategies in addressing your identified risks.

1. Avoid the risk

Avoidance is looking at the structure of the operation and your approach to production so you can steer clear of certain types of risk.

2. Reduce the risk

Reduction is the process of lowering the risks associated with operations and production, reducing the likelihood of a negative outcome as much as possible.

3. Assume or Retain the risk

Assumption or Retention is about retaining or accepting risks that would normally have been borne by some other party, or that you're aware of but decide the risk fits with your risk appetite. The objective of assuming this increased risk is to maintain control or enhance overall profitability.

4. Transfer or Share the risk

Transfers of risk occur when you lower your risk by shifting it to someone else, often for a specified price. Common examples of this type of shift include futures and options contracts and crop, fire and hail insurance.

The right strategy to use will depend on a number of factors including your risk appetite, the potential economic impact, the type of risk you are mitigating and more.

To assist you in considering the right strategy to deal with a specific risk, below are a number of tools and approaches you could use to Avoid, Reduce, Assume or Transfer the risk for each of the five main risk categories we introduced earlier.

Tools to manage **production** risks include:

- Diversify by planting different crop varieties and exploring new crops to introduce into rotation
- Expand production through more intensive growing practices or by planting more acreage
- Invest in new production technologies
- Purchase crop insurance if available to stabilize income during times of loss
- Consider site selection - use fields less susceptible to frost or pests and rotate crops
- Maintain equipment and keep facilities in good working condition
- Incorporate strong bio-security processes and routines for livestock

Tools to manage **market** risks include:

- Develop a marketing plan that relates to your farm business plan and includes realistic sales forecasts and target prices
- Increase direct marketing efforts to capture a higher price
- Market through multiple channels or outlets to reduce reliance on a single market
- Leverage hedging and other derivatives such as options, swaps and forward contracts to manage swings in variable elements such as commodity prices, foreign exchange and interest rates
- Enter into sales or price contracts with buyers
- Spread harvest and sales over the season by scheduling planting and considering storage
- Perform regular market and customer research and analysis to understand needs and preferences
- Price your products correctly for your markets and your efforts
- Consider value-added ventures



Tools to manage **financial** risks include:

- Develop a strategic business plan
- Monitor financial ratios and enterprise benchmarks
- Control key farm expenses - consider other suppliers and alternative inputs
- Understand your Cost of Production, so you know your break-even point and how much to sell and when
- Conduct a trend analysis to assess change in farm profits and owner's equity over time
- Consider leasing and rental options rather than purchasing machinery, equipment or land
- Evaluate the possibility of expansion
- Control or defer unnecessary family and household expenditures
- Find off-farm employment for a family member, preferably a job with benefits such as health insurance, group life insurance, and a retirement program
- Use non-farm investments to diversify your asset portfolio
- Work closely with your advisors to ensure you know and understand your numbers, you're keeping good records and have support for good decision making

Tools to manage legal and environmental risks include:

- Review farm insurance policies and carry sufficient coverages
- Evaluate your business legal structure – understand the merits of incorporating vs. being a sole proprietorship
- Understand business contracts and agreements - ask questions if you are unsure
- Develop good relationships with neighbours and address their concerns
- Use good agricultural practices to limit environmental risk
- Know and follow provincial and federal regulations related to your farming operation

Tools to manage Human Resource risks:

- Develop and practice good “people skills” with family members, as well as employees
- Evaluate alternative sources of labour
- Provide adequate training for employees - formalized programs may help your safety record and improve operational performance
- Communicate frequently with employees and family members
- Recognize and reward good performance
- Review wills, trusts, and powers of attorney
- Initiate estate transfer and business succession planning
- Consider health and life insurance needs

These tools and approaches are not a complete list of alternatives for you to Avoid, Reduce, Assume or Transfer your risks. They are meant to give you examples of some approaches to managing the risks you identify with your operation. Each approach you take should align with your risk appetite and ultimately bring your farm's risk down to a level that ensures the economic outcome you're working towards.

How RBC can help

Where are you in managing the risk for your farm? You might be operating with a risk mitigation framework in place. You could be working through your risk appetite and identifying your risks and how to tackle them for the first time in a formal way. Your risk management journey could be at any stage.

As you work towards mitigating the risk in your operation, you can count on the expertise of RBC® to help you.

Assessing your current business. RBC has agriculture account managers with many years of experience. We've worked with thousands of farm and ranch businesses across Canada. By analyzing your farm in detail, and bringing our broad industry experience to bear, we can help you accurately assess the financial and business status of your operation.

Identifying opportunities and risks. As you look ahead to where you want to go, our agriculture account managers can work with you and other banking partners to help identify associated risks and provide solutions to manage these risks. We can work with you to weave your risk management strategies and your personal, family and business goals together – all into one, comprehensive plan.

Financial products and services. RBC offers a full range of solutions for farm businesses of all shapes and sizes, including credit products, leasing, cash management and trade services. The RBC Group Advantage™ program can even help your employees with their own financial planning. RBC has the people, products and services to help you achieve both your farm or ranch business and personal goals.

We invite you to continue the conversation with your RBC agriculture account manager or find the manager nearest to you by visiting rbc.com/agriculture

What's your next move? We're ready to help.

Talk to an RBC agriculture account manager



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