Managing Farm and Farm Household Financial Risk

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The purpose of this session was to highlight the links between farm and farm household financial risk, show how to manage that risk, and spotlight a highly successful Extension program. There is a need to manage financial risk, both from the farm business and farm household perspectives, and recognize how the two intersect. This has always been important when farm and family funds are comingled, and becomes a higher priority as off-farm income becomes more common.

Leading scholars in agricultural economics and consumer economics highlighted applied research on financial risk, focusing on concepts such as tolerance and mitigation, and outlined implications for educational outreach. An Extension educator showed how to integrate farm and farm household financial management education, using a specific program, Annie's Project, as an example. Participants also learned why integrating financial risk management education for the farm and farm household is gaining attention by farming and ranching communities, Extension, USDA, and Congress. For more information, see http://www.extension.iastate.edu/annie/AAEAACCI.ppt.

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Farm Business Perspective: Paul N. Ellinger

What are the relationships among family living expenses, nonfarm income, farm income, off-farm investments and leverage? This panelist used a unique farm data set to illustrate the linkages of financial risk, consumption patterns and farm/nonfarm income. The average family farm in Illinois earned, on average, approximately $101,000 of farm income and $28,000 of nonfarm income from 2003 to 2007. The farm and nonfarm income received over this five-year period is over $75,000 higher than the previous five-year period indicating a significant amount of volatility in farm household earnings. Farm family households spent approximately $59,000 annually on family living costs over the 2003 to 2007 period. Family consumption was statistically and positively related to the level of farm and nonfarm income, leverage of the farm, farm wealth, family size and age.

Low proportional investment in financial and retirement assets indicate a lack of diversification for farm households. Only 5.4% farm assets reside in retirement accounts, while farm households only invest 3.4% in marketable securities. This lack of diversification is more pronounced as farms take on additional debt. Hence, these more leveraged farms have increased financial risks and also incur increased investment risk due to a lack of investment diversification. The segment closed with an outline of some potential farm and family financial risk decision tools that could be used in financial management education.

Household Perspective: John E. Grable

What are the factors that influence a person's decision to engage in a financial risk-taking behavior? This panelist reviewed important findings from the literature related to personal and consumer financial risk tolerance and assessment. It was determined that financial risk tolerance refers to a person's willingness to engage in a risky behavior in which the outcomes are unknown. Although similar to the concepts of risk preference, risk perception, and risk capacity, it was concluded that risk tolerance – as a description of a person's willingness to take risk – plays an important role in shaping many consumer decisions. Risk tolerance, within a financial framework, takes on a particularly useful role in explaining investment behavior.

Several questions emerged from the discussion specifically related to farm and ranch family risk tolerance. For example, is the amount of risk tolerance exhibited by farmers and ranchers different than the general population? If yes, might risk tolerance differences be based on federal price supports and/or a perception of control or lack of control over production output? The general consensus was that ample opportunities exist for agricultural economists and personal financial planning researchers to work together to explore differences and similarities in risk tolerance among rural and urban populations.

How Separate Are Farm and Family Finances? Lessons from Annie's Project: Tim Eggers

If family financial risk is recognized and validated as an issue, then it can be addressed as a farm business risk to be managed. In Annie's Project, participants learn ways to manage family finances as a valid farm business "expense" instead of treating family living as a residual. Annie's Project is designed to empower farm women to manage information systems used in critical decision making processes and to build local networks. The target audience is farm women with a passion for business and involvement. Following face-to-face learning, usually in about 18 contact hours, participants are more confident about financial decision-making both with the farm business and the household, more involved in the farm business and community, have a better understanding of the farm business, and are better able to handle diverse personalities in farming. For more information, go to http://www.extension.iastate.edu/annie.

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