Volume 10, Issue 7 July 2022

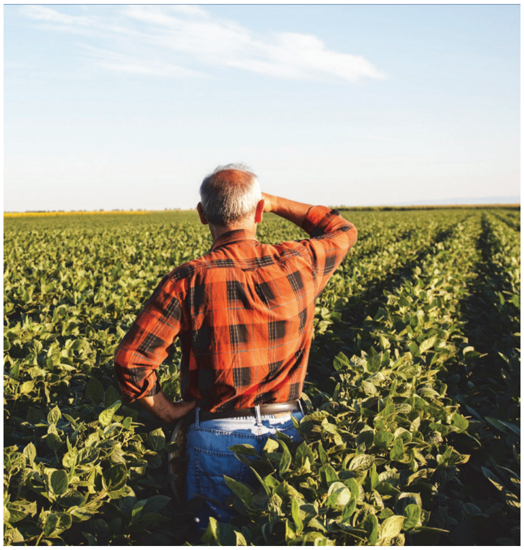
RightRisk™

RightRisk News

How Much Risk is Right for You?

Managing for an Uncertain Future

Risk is generally understood to mean future events for which the outcomes are unknown or uncertain. However, it is important to note that not all aspects of the unknown future are created equal. We might describe risk as a case where the unknown future matters; if the outcomes did not matter there would be no risk. In such cases, the consequences make a difference to those who are making the decisions or may be affected. Risk does not always imply a negative or bad outcome. Uncertain future events may result in good, bad or neutral outcomes. The probabilities or the likelihood of one or more outcomes may also be unknown.



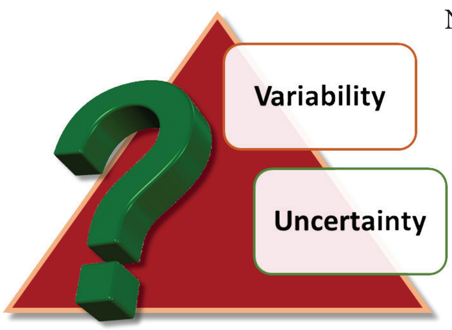
Almost nothing is certain and, instead, uncertainty should be expected. The unknown future should be thought of as the normal or usual situation we encounter when considering how events might turn out. This future can be and is influenced by a number of factors. For our purposes, it may help to break these factors into three broad categories… risk, attitudes and human factors.

Variability (risk) vs. Uncertainty (indeterminability)

Future events are unknown to us due to two, separate and distinct factors. The first of these is variability. Variability is what most managers have in mind when referring to risk. Variability means alternative or different outcomes in the future due to the effects of chance. As a result, this type of change or variation in results cannot be reduced by further study or by any type of measurement.

The second factor of the unknown future is uncertainty. Uncertainty refers to our lack of knowledge about the future. It may even represent our uncertainty about the meaning of current events and what it may imply for future outcomes. Uncertainty can sometimes be reduced by further study or measurement. In such cases, a manager becomes more aware about the outcomes that are possible or are better able to estimate the likelihood of a set of outcomes through research on the underlying system.

Uncertainty may also represent the subjective nature of the individual making the evaluation. The perceptions of the decision maker about what outcomes are possible, as well as how likely those events are may or may not be accurate. For this reason, some refer to uncertainty as indeterminability or ambiguity. Some aspects of uncertainty are unknowable and, as a result, unmanageable.

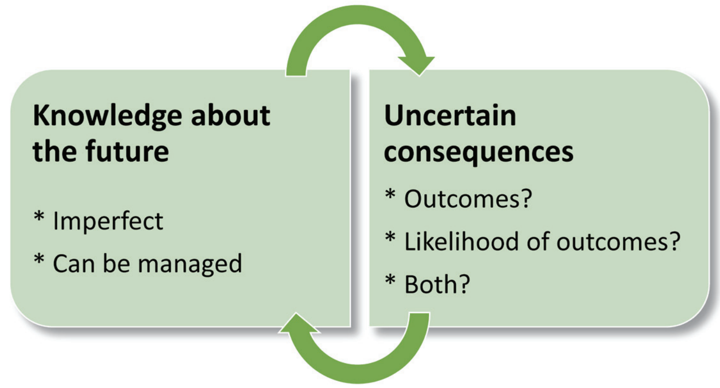


Risk And Threat

Not all unknown future events are created equal. The unknown future may include good, bad, or neutral outcomes. In addition, the likelihood of one or more of the outcomes may also be unknown. Risk management is really about selecting between alternative management strategies, where negative consequences are possible.

It is also possible that future events do not represent a substantial threat to the business. The consequences may not be great enough and/or the likelihood may not be high enough to require a management response. Stated in another way, not all risk must be managed.

Threats to the business should be taken into account and management strategies developed where the risk is greater. This occurs when objectives become more uncertain where the consequences of a bad or negative outcome become:



1. Larger in potential effect – Management may decide that the potentially negative consequences would be substantial enough to threaten the future viability of the business if they occur. Even where the business might be able to continue operations, expectations for future profitability may be so low that carrying on might not be justified.
2. Less known, less knowable – Even with a reasonable investment of time and effort, it is not possible to know about all the outcomes of every management decision. In cases where the choices are less clear or the alternatives less well understood, the chances of a substantial threat increase.
3. Negative consequences become more frequent – The manager may decide, after fully evaluating the alternatives available, that a strategy which includes the possibility of negative outcomes with a high likelihood is the best choice. In such cases, a strategy for managing the risk should be carefully considered, as well as the potential cost.

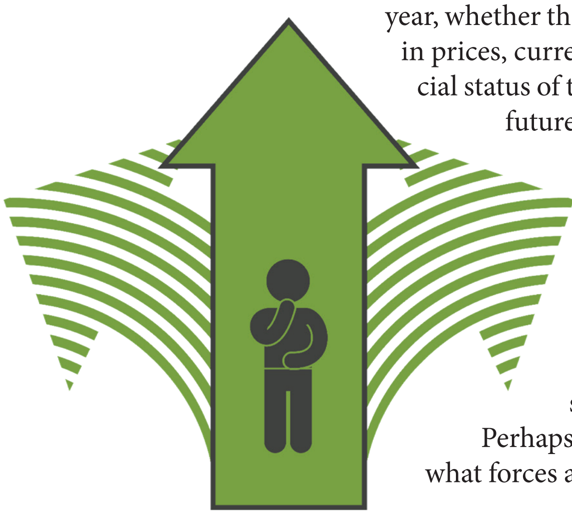
Challenges to Managing Risk

There are numerous challenges to managing risk. These can range from not understanding the threat, to not recognizing the possible consequences, to not realizing what management options are available. Other factors may include one or more human-elements.

Attitudes - Risk attitude may be thought of as a chosen response to variability and uncertainty. They may be influenced by changes in perceptions about a set of alternatives, by gaining new information, or through a shift in emotions. Attitudes, even about risk and uncertainty, may change over time. In addition, human factors may lead to differences in response to risk between people, individuals and groups. These alternative viewpoints often have to do with both the source of variability and attitude. One person considering the same set of risk alternatives and expressing the same risk attitude may choose one option, while another may make a vastly different choice. Personal preferences, past experience, and other human factors influence our choices in many ways.

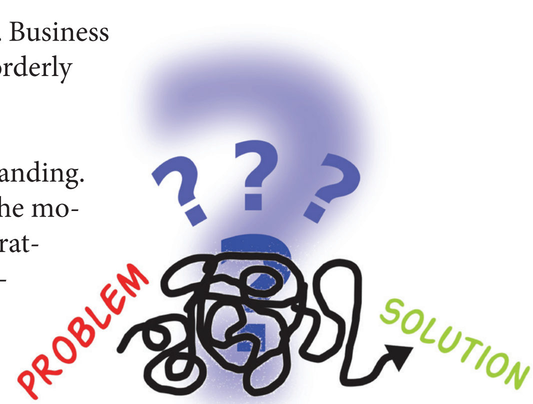
It is also important to note that risk attitudes are neither right nor wrong. Different individuals can have well-reasoned arguments for the alternative choices they make, even when those choices vary over time. That does not mean, however, that the consequences of those choices will be the same each time, nor that they are good choices, even if the outcomes are consistently positive. Although the thinking is somewhat counter to our natural way of responding to variability and uncertainty, we should note that the quality of a risk management strategy should be judged based on the information available at the time the strategy is selected and not solely on the final results.

Situational Responses - Attitudes about risk, especially those we may face in the future, are often situational. That is, our attitudes vary or may change depending on several factors. Factors could include the time of day, the stage of the production year, whether the commodity marketing approach used last year coincided with an upswing in prices, current forecasts for next year's weather, the manager's stage of life, or the financial status of the business. In addition, they may vary based on our perceptions about the future, rather than today's facts.



Attitudes Can be Modified - Recognition that attitudes about risk and uncertainty can be modified flows naturally from our understanding that those attitudes can change depending on the situation. It is easy enough to see that we may adjust our approach as we receive new information about changes in our current environment. However, we likely would resist the notion that we might be influenced by information intended to steer our perceptions about the future in one direction or another.

Perhaps it is more important to recognize that, as we work to better understand what forces and factors influence our attitudes about variability and uncertainty, we can simultaneously learn to manage our responses to those same forces and factors. Business management, in the face of an unknown future, can follow a disciplined and orderly response, rather than a reaction to fears and perceptions.



Emotion and Risk Behavior - Attitudes are shaped by perception and understanding. They are also shaped by emotions. Our feelings, moods, and temperament at the moment all influence our outlook and chosen response. When considering our strategy for managing variability and uncertainty in the future, we do well to acknowledge that we not only can be, but likely are influenced by our emotions.

Emotional intelligence is a term becoming more common place and is used to describe an enhanced awareness of the role of emotions in making choices. Emotional literacy, stems from that understanding, and is used to describe a person who is able to recognize different emotions, understand that emotion may influence their reasoning, can accurately and appropriately express those emotions, as well as deal with those emotions when considering their choice of action.

Good Errors vs. Bad Errors - It has been said that humans only learn by making mistakes but do not learn much from success. Often the goodness or badness of a situation and our fear of those two alternatives when considering the future cause us to act or react without even consciously thinking about it. Good errors are mistakes that need to be made through trial and error, modeling, or even learning from other's mistakes. Decision makers can learn from such an approach, not only to refine their capacity to weigh alternatives, but also to make selections. Bad errors, on the other hand, are mistakes in judgment or perception of a situation. Bad errors do not lead to learning or to refinement of the decision maker's capacity to function better in the future.

One example of a bad error is judging the quality or correctness of a risk management strategy on how things turn out. This is particularly true where a strategy was neither carefully thought through nor put down on paper for later reference. Instead, such strategies are often formed in the head of the decision maker as only one of many available alternatives and only generally given preference over the others. As the future unfolds, the strategy may even adjust to facts and events as they become known. As the decision maker looks back, perhaps at the end of the year, they judge their strategy as good, since it led them to where they are, rather than recognizing that they never actually developed a strategy and did not make management decisions that caused a strategy to be implemented.

Separating Variability And Uncertainty

One of the biggest hurdles to good risk decision making is the separation of variability and uncertainty. Insights into the correct approach for evaluating the alternatives available can be gained where the manager is able to sort the unknown future into variability (due to chance) and uncertainty (due to a lack of knowledge about the future).

Collecting more information or further study may offer new ideas where uncertainty is the bigger issue. In addition, seeking the advice of an outside expert may reveal additional options that were not previously understood. Finally, where the uncertainty has a greater relationship to the decision maker's beliefs or biases about the future, these too can be modified through additional information.

Deeper insights and further information on this topic can be obtained by accessing the online module *Understanding Risk in Agriculture* and associate eBook at: **RightRisk.org/Courses**.

~ Other RightRisk News ~


RightRisk
Federal Reserve Beige Book: Summary on the Ag Sector
How Much Risk is Right for You?

News Release - June 3 | RightRisk

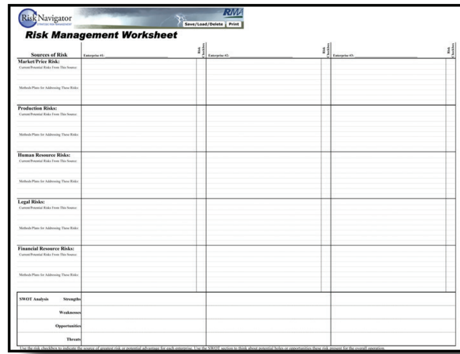
Federal Reserve Beige Book Summary on the Ag Sector

All twelve Federal Reserve Districts have reported continued economic growth since the prior Beige Book period, with a majority indicating slight or modest growth; four Districts indicated moderate growth. Four Districts explicitly noted that the pace of growth had slowed since the prior period. . . .

For more see: RightRisk.org\News

Highlighted Tool: *Risk Management Worksheet*

The *Risk Management Worksheet* provides a tool for contingency planning and monitoring risk over time. Each source of risk is considered on an enterprise-by-enterprise basis, challenging management to consider the potential risk exposure each enterprise represents to the business and various methods and plans for addressing those risks. A risk checkbox column provides a place to note priority risks and/or enterprise advantages.



To access the Risk *Management Worksheet* see:
RightRisk.org/Analytics > Risk Navigator Toolbox

June 2 | Social Media Post
What Are Risk Controls?

June 7 | Social Media Post
Understanding Financial Performance

June 9 | Social Media Post
Ag Help Wanted: Guidelines for Managing Agricultural Labor

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Risk Concepts: Limited Liability Company

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Risk Scenario Planning with RightRisk Analytics

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How much risk is right for you and your operation?

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