RISK MANAGEMENT IN COTTON GINNING OPERATIONS

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In the past, handling risk was simple. Management would simply purchase insurance to provide protection from loss. The escalating cost of risk and the reduction in the number of insurance companies willing to take those risks forces us to change. Economics demands the use of analytical methods to identify, analyze, and reduce business risks. Risk Management is one of the best tools available to accomplish this task, providing the ginner with the best tools to minimize financial loss while efficiently and effectively spending his insurance dollars.

The techniques of risk management grow out of the insurance industry and have been in use for a number of years. Risk Management can be defined as the best use of money, materials, and manpower to protect financial interest.

There are four steps to a Risk Management Program:

- Identify and Evaluate Risk
- Select Action to Manage Risk
- Implement Action Plan
- Monitor Results

The Risk Management evaluation is a time-consuming project; however, it is the foundation of a successful Risk Management Program. The first step in the evaluation is to become totally familiar with the business operations. This should include financial as well as operational conditions. In addition, knowledge of raw material suppliers, outside service providers, and end product users is needed.

Risk must be identified, analyzed for frequency and severity, and then evaluated to review all past losses and estimate potential losses. Construction of flow charts are helpful in this process. For each box in the flow chart, a list of risks associated with that area of activity is compiled. The following example shows a basic flow chart for cotton ginning.

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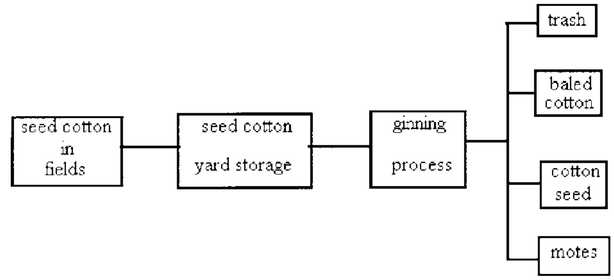

Losses will generally fall into one of the following categories: property losses, income losses, legal liability losses, personnel losses. Once the loss potential has been identified, the following questions should be asked:

- What is the probability that loss will occur?
- Will the severity potential be high or low?

The use of a logic table can aid in making decisions. The risk is assigned a numerical rating for frequency and severity. This scale, whether 1 to 4 or 1 to 10, will allow the risk to be prioritized and categorized. As a general rule, the following actions apply:

- Low frequency and high severity-- ***transfer the risk***
- Low frequency and low severity-- ***retain the risk***
- High frequency and high severity-- ***avoid the risk***
- High frequency and low severity-- ***reduce the risk***

The following is an example of a logic table used to evaluate seed cotton in the field.

Exposure	Frequency	Severity	Notes
Physical damage to seed cotton due to:			
Fire	4	8	transfer with high deductible
Wind	1	9	transfer
Flood	0	9	retain

You must then decide for each area of risk what action to take to best manage it in a cost-effective way. The options are avoidance, reduction, transfer, and retention-- which are the essence of risk management.

Avoidance is always the first choice in approaching any risk. The question, is this something we really need to be doing, should be asked.

Reduction of risk usually involves implementing controls that eliminate or reduce the chance of loss, or reduce the severity. A good safety plan is key with these risks.

Transfer of risk involves transferring the risk to another party who can better handle it. It is important that all efforts to control risk be employed before transfer of risk is used as an option. Transfer of risk usually involves a contractual agreement with the party assuming the risk. Insurance companies fall into this category, as well as independent contractors, suppliers, tenants, etc. Anytime non-insurance transfer is used, the following needs to be considered:

- Is a hold-harmless agreement needed?
- What limits of insurance will be required?

If the risk transfer is to be an insurance transfer, the questions of deductibles and limits of insurance need to be addressed. A common question is how much deductible should be considered. The following can used as a rough guide:

.5% annual income		_________
.1% net worth	+	_________
3.0% liquid assets	+	_________
total deductible		_________

Retention of risk is a management decision to retain the risk in-house. There a few basic rules that should be followed. Don’t risk a lot for a little... Know the odds... Don’t risk what you can’t afford to lose. In other words, use the logic table to evaluate the risk!

To summarize, the basics of risk management are:

- Understand you business and the risk associated with it.
- Document where past losses have occurred, how often, and what their financial impact was.
- Understand what your are buying when insurance is used for risk transfer. Know what is covered and what is not. Understand factors that control the insurance rates.
- Be aware that changes in your business operations and new lines of business require risk to be evaluated.
- Have a contingency action plan in case a severe loss occurs.
- Recognize that the financial health of your company can depend on how well you handle risk.