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CULTIVATING HEALTHY COMMUNITIES

Risk Sharing Implications for Today's CSA Farm

FBFS002—2/13 Mark Cannella, Farm Business Management Specialist, UVM Extension, 617 Comstock Rd, Suite 5, Berlin, VT 05602

Every year we see a new twist on the way a Community Supported Agriculture (CSA) farm offers products to consumers. Sometimes I am impressed by the creativity of the arrangement; at other times I get concerned that the model is changing so much that it should not be called CSA. Regardless of the day, however, a clear understanding of the Risk-Sharing component of the business is essential to business managers and your customers. This becomes more critical as we observe more severe weather events causing production delays or losses on farms. Farmers should understand what risks are or "are not" being hedged by the CSA arrangement and in turn, clearly communicate this to customers, members, subscribers….whatever the correct term is these days.

Community Supported Agriculture (CSA) is a partnership between consumers and farmers. Consumers contract with farmers before the growing season begins for a share of the upcoming harvest. In its original format, both farmer and consumers agree to share the risks and rewards of growing food in their local climate. Farmers generally receive all or most payment in advance. In the original definition of CSA, risk was spread between both parties. Both the upside and the downside. If the farm had a bad tomato season, consumers got less while the farmer still got paid for trying to grow the tomatoes. Don't forget the upside….when there was a flush of tomatoes the consumers were expecting to get extra for fall canning. This upside benefit to the consumers was the compensation for their willingness to commit to the farm and pre-pay cash in advance.

So where are we now? Here are some variations on the model where the risk-sharing should be evaluated and clearly communicated.

- Declining Balance Subscription: members pay $400 up front and receive "store" credit at the farm. Each week they shop they work down on the balance to reach $0.
- Add-Ons (on farm): members pay up front for a base share and then have the option to purchase add-ons at an additional cost. Add-ons may include: Pick-your-own access or meat product options.
- Meat CSA: applying the pre-pay concept for future quantities of chicken, pork or beef.
- Multi-Farm CSA: members pay in advance and a farmer manages to supply a portion from their own production while using a portion of member payments to buy-in product from other farms.
- Multi-Outlet Farms: many farms maintain a CSA, but they also serve other direct marketing outlets (farmers markets) and wholesale accounts too. So if they have a bumper crop of tomato will they compensate members (the upside) or will they wholesale the surplus for more cash income?

What questions are important to ask?

Let's remember that in some regions CSA farmers are targeting a new segment of shoppers. In many places, the market has been saturated for traditional 18 week vegetable CSA's where members pick up directly at the farm. As a new segment of buyers are recruited for CSA-style products these people may or may not be aware of any risk-sharing expectations. These are important questions the farm must answer:

- Are we sharing risk or just looking to get pre-payments from customers to smooth out spring cash flow?
- Do your customers/members know the answer?

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Risk Management 101 says there are four types of risk in agriculture: production risk, market risk, institutional risk and human risk. Production risk relates to impact on yields and productivity for the items you produce. Market risk relates to the changing marketplace; fluctuation in the cost of inputs and the pay price for your outputs. Institutional risk embodies the consequences of policy and regulations on the business. Human risk deals with the impact of relationships, health and employee situations. It can be argued that the CSA set-up can be used to mediate all 4 types of risk, but for now, we will focus on production risk and market risk.

Market Risk:

By receiving a pre-payment for goods to be sold the producer has mediated the down-side risk of price changes in the marketplace. This also means that the producer has given up any upside potential from increasing prices over the production cycle.

The farm has in no way managed the market risk of changes in input prices. A great example of this is poultry farms that collected pre-payments for whole chickens based on prices set in winter/spring of 2008. Corn prices rose over $2.00 per bushel from January to June in some areas ($4.50/bu to over $6.50). Feed prices went up, retail poultry prices went up but pre-paid farmers had a tough time covering costs.

For CSA, the loss of customers may be considered market risk for the next year. It may also come in the form of customers wanting to pay less next year due to dissatisfaction this year. Pre-payments prevent some farms from having to access operating loans early in the season. If your operating loan is subject to an unpredictable interest rate change over 3-4 months, then pre-payments from customers to reduce loan exposure does reduce risk. Realistically, however, most managers can have a set interest rate (the market price for credit) on their line of credit. The time frame of the loan is so short that any volatility in rates cannot result in significant consequences. The CSA can help you avoid the loan but you have not necessarily mediated any market risk here.

Production Risk:

By receiving pre-payments the farmer has mediated the risk from loss of a certain crop if the risk-sharing element is fully conveyed to customers. Hail storms hit early summer crops of chard or a fall flood eliminates storage crops. If the customer is sharing the risk, they realize that they have paid the farm to try to grow an abundance of crops but some may never make it to harvest. The farmer has insured against crop failure by taking a non-refundable payment in advance. On the upside, the customer may get a higher volume of other crops to make up for losses or even exceed the market value of the price they paid. Many farms have built in a specified "discount from retail" value where they calculate to deliver $480 worth of retail value but the CSA share costs $400.

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Price Adjustments:
Livestock producers should consider if they have enough information to set firm product prices in advance or if they need a mechanism to change prices closer to date the meat or poultry product is received by the customer. Identify your most significant costs of production and determine if your number one, two or three greatest expenses are subject to change. If your cost could shift a lot during the production cycle you may want to take steps to lock-in input prices through negotiations with your vendors or retain the right to adjust prices with your customers.

Winter CSA Dilemma:
This happened all over VT in 2011. Farmers had invested in growing winter storage crops for CSA shares that would offered from November-March. The CSA shares usually get sold or pre-payments begin in September of that year. Flooding in late August rendered crops unfit for consumption just about 2 weeks before farms were going to start receiving winter CSA payments. We can see the risk management problem here. There is no production risk management if the farmer is investing in the production of the crops before the CSA members have invested in that winter share.

Innovations to the CSA model in recent years have made tremendous improvements to the variety of products and relationships available to potential CSA members. With these changes, however, farmers need to re-assess if they are getting the same risk management and risk-sharing out of the relationship that the original CSA model provided. Consider what type of risk sharing you want to establish with your membership and then take advantage of all the advances web and digital communication to send your message out and promote the unique CSA experience offered at your farm.

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