

# United grain grower case

Business, Risk Management



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Case Risk Management United Grain Grower Case Risk Management

PREFACE United Green Growers (UGG) is a company who provides commercial services to farmers in Canada and markets agricultural products worldwide. UGG tried to distinguish itself from competitors by creating products with brand names and by providing on-going services to customers. During the latter part of the 1990s, some UGG's managers started to question the desirability of managing pure risk and financial risk separately. UGG started by forming a risk management committee, consisting of the CEO, CFO, risk manager, treasurer, compliance manager (for commodity trading), and manager of corporate audit services. This committee, along with a number of UGG employees, then met with a representative from Willis (risk management consultant) for a brainstorming session to identify the firm's major risks. This process identified 47 exposure areas, from which six were chosen for further investigation and quantification. The six risks were: 1. Environmental liability 2. The effect of weather on grain volume 3. Counterparty risk (suppliers or customers not fulfilling contracts) 4. Credit risk 5. Commodity risk and basis risk 6. Inventory Risk (damage to products in inventory) The analysis conducted by Willis Risk Solutions led to the conclusion that, of the six risks originally identified, UGG's main source of unmanaged risk was from the weather. According to Willis research if weather risk removed, UGG's profit would have been more stable: Having quantified their exposure to weather risk,

UGG had to decide what to do about it. They explored several options: 1.

Retention \* Advantage: \* No cost associated with shifting it to someone else.

\* Disadvantages: \* Higher loan interest rate. \* UGG need to hold extra equity capital as a cushion against unexpected low cash flows. \* Suppliers and customers could not rely on for service and high quality products due to

unstable cash flow 2. Weather derivatives \* Advantage: \* Zero loss if

contract structure could perfectly cover all the risks \* Disadvantages: \*

Difficult contract structure. \* UGG would have to obtain price quotes in a marketplace that had relatively few participants. 3. The insurance contracts

idea \* Advantage: \* Easy contract structure \* Disadvantages: \* Moral hazard problem \* Only cover shipments risk SOLUTIONS Our group prefer to choose

insurance contract idea because of these following reasons: \* It cover the

main effect of weather problem \* Easy contract structure \* It has a wide

market place/it's already proven \* Insurance cost should be lower than

weather derivatives due to easy contract structure