



Managing for Today's Cattle Market and Beyond

Marketing Alternatives That Can Be Considered In Your Business Plan Today

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Often times the production process takes so much effort that the marketing of the product becomes just a sale after weaning or coming off pasture. As such, producers often seem to get in a marketing rut. It isn't until market prices drop that serious consideration is given to marketing alternatives. This article, and the next, will discuss the alternatives you can use right now to manage your price risk and perhaps meet your goals. The purpose of this article is to present some of the marketing alternatives available to you right now, and the next article entitled, "Comparing Your Marketing Opportunities" discusses the advantages and disadvantages of these alternatives.

Alternatives

Price at Delivery - Auction

Price at delivery is a primary marketing method used by producers selling livestock. This type of market alternative basically just requires the producer deliver the product to the market location whenever the producer is ready to sell. The timing of the marketing decision is often linked to production operations such as harvest or weaning. In general, the producer delivers whatever quantity of product he/she wishes to sell and accepts the price dictated by the market. The producer usually has the option to accept or not accept the price offered. However, if the offer is refused, additional costs may be incurred due to transportation, interest, etc. while exploring other alternatives or wait-

ing for a better price. Selling cattle at the local auction is an example of this alternative.

The major costs of marketing at an auction are commission and yardage. Lesser deductions may be made for such items as insurance, feed, state inspection, state fees, National Livestock and Meat Board checkoff, and brand inspection. A considerable variation exists nationally among auctions in the determination of commission charges. Some auctions assess commission on a per-head basis, others on a percentage of the proceeds, and some on a combination of the two. Other costs which must be considered by producers are shrinkage and transportation which are incurred prior to the livestock entering the auction ring.

Forward Contracts Forward Pricing

It is possible to obtain a forward price contract for some types of livestock. Many livestock buyers will contract to purchase a given amount of these commodities at a set price for delivery in a later month. Contract sales remove price uncertainty but do not allow selling at a higher price if prices rise later in the year.

Even with a contract there are risks of non-performance or misinterpretation. These risks can be minimized by carefully reviewing terms of the contract and credibility of the buyer. Both buyer and seller need to understand all terms of the contract before signing the

agreement. If you still have questions, it might be wise to have an attorney familiar with contract law review the agreement.

Cattle Contracts

Direct sales of beef cattle can reduce transportation and handling problems, actual shrink (usually there is some pencil shrink though), and commission and yardage costs compared to selling cattle at an auction. In general, the buyer contracts for a certain quantity of cattle, weighing within a certain range, to be taken possession of at some future point in time for an agreed upon price.

While the majority of cattle buyers are honest, previous experience indicates that some take advantage of unsuspecting sellers. Most problems involve non-payment for livestock. Many times the cattle are taken from the state of origin, making it difficult to repossess or to receive payment. In the past a verbal commitment and a handshake from a buyer you knew were sufficient. However, today's livestock seller should exercise more caution to ensure an equitable transaction is accomplished. Each year situations develop where some livestock producers are faced with non-payment when selling their cattle direct to buyers. The risk of non-payment, non-performance, or loss of title when selling direct to livestock buyers can be minimized by following a few guidelines.

It is a good practice to check out the legitimacy of the buyer. First determine the license status of the buyer or the dealer the buyer works for. Buyers who are employed by brokers and dealers generally buy under the dealer's license and must be individually bondable. Dealers or brokers applying for licensure must identify all buyers and must provide evidence that each buyer has been registered with a bonding agency. Each buyer is issued a buying card. Sellers should inspect the buying card and note the number and expiration date if there is any question the legitimacy of a buyer who claims to be operating under the authority of someone else's license.

To receive a license, the dealer must meet certain criteria and post a performance bond. Individual states will have different requirements as to the type and amount of state department bonds. A \$10,000 bond through the Packers and Stockyards Administration is usually also acceptable. The relatively low bond does not provide much protection to the seller, but it does ensure some minimal financial standards have been met. These rules and regulations vary from state to state, and can be determined for your state through your state Department of Agriculture. You might also ask for some financial references such as the buyer's

banker. The financial reference can verify if the buyer does in fact have an account with the institution, and perhaps the reference might offer an opinion as to the legitimacy of the buyer as a business person.

The bill of sale can be useful to protect the seller's title to the livestock until payment is received. By retaining the bill of sale, the seller retains title to the livestock. Buyers have an understandable desire to receive the bill of sale at delivery because it is proof of purchase. It is possible to modify the bill of sale to include provisions to retain possession of title until payment is made.

By designating the document as a bill of sale and contract, it becomes more useful for both buyer and seller since it summarizes not only the sale transaction, but also the provisions of the sale. This can be extremely useful in the event the seller must later repossess and prove ownership, origin, or title to the livestock, or must initiate litigation against the buyer. It also is useful when establishing a claim on livestock which have been resold one or more times after the original sale.

Between states, the bill of sale requirements may vary. You may want to check with your state authorities concerning what information is and can be specified in the bill of sale.

Another consideration concerning direct sales of livestock is method of payment. Currently, a wire transfer is the payment method recommended by some financial institutions. If the seller withholds title until the transfer is confirmed, a wire transfer is virtually foolproof and practically eliminates payment risk for the seller. However, even the limited time lag may hinder its usefulness. Other methods that have a relatively low risk are cashier's check, certified check, or a letter of credit. The letter of credit is especially useful for recurring transactions. A cashier's check is good for out-of-state or unfamiliar buyers, but is not convenient for buyers. A certified check may not be convenient for buyers either because it is usually pre-drawn in a specific amount.

Other specifications or factors to be considered are any weight, sex and quality standards specified by the buyer. Usually the buyer has looked at your cattle and has drawn conclusions concerning quality, but since the cattle are to be delivered at some future point in time some of the expectations concerning weight and so on may need to be specified in the contract. Also, the provisions for any price premiums or discounts based on those specifications should be spelled out in the contract. For example, what happens if the cattle are expected to average 500 pounds upon weigh-

ing? If the cattle are heavier, the buyer may discount the price. The price discount or slide should be specified in the contract.

Transportation and shrinkage costs must also be considered when entering into a forward contract for livestock. Where are the cattle to be weighed and when? If they are to be weighed off your place, how much will transportation and shrinkage cost you? Additionally, a pencil shrink is often specified. What are the weighing specifications? For example, if the buyer asks for an overnight dry stand before weighing the cattle plus a pencil shrink, the buyer is discounting your cattle significantly through loss of payweight. Additionally, be sure who accepts liability concerning death loss on the truck. Normally it should be the trucking firm, but if there is any doubt, specify it in the contract.

These considerations can minimize potential risks livestock producers face concerning non-payment, non-performance, loss of title and unfair marketing costs when selling direct to livestock buyers. Be sure to verify the qualifications and financial adequacy of prospective buyers, insist on acceptable payment methods, retain title to the livestock until final payment has cleared the financial institution, and don't accept unfair practices which dock your payweight heavily.

Video Auctions

Video auctions have gained wider acceptance as a method for marketing cattle. This method entails producing a videotape of the animals being sold. Then, after buyers have received written description of the cattle, an auction is held. The sale is conducted with buyers assembled in a room looking at TV monitors and/or beamed by satellite to other buyers who bid by telephone. Completed sales become cash forward contracts since all cattle are sold for future delivery.

Detailed Description of Video Cattle Auction

The following discussion comes from "Current and New Beef Marketing Technology (Electronic)" (reference in the appendix).

For illustrative purposes this section will use the Superior Livestock Auction. this does not endorse this auction, but uses it as an example of how a video auction works and its requirements. These will vary some among auctions. Video auction cattle presentations consist of two components—the video or visual component and the sale catalog or written component. A \$2.00/head videotaping fee is included in the sale commission unless the seller rejects the bid, in which case the seller forfeits the taping fee. The taping is done by one of Superior Livestock Auctions's (SLA) regional

representatives. Thus, the integrity of the video auction is heavily dependent on the integrity of its regional representatives. Sales catalog descriptions are prepared by the video auction company and the seller when the cattle are videotaped.

Videotapes of about two minutes in duration are shown while an auctioneer solicits bids. Buyers must register in advance of the sale and undergo a credit check in order to participate. Buyers may bid either in person or by telephone from any location where the satellite transmission can be received.

The video auction representative oversees delivery. Although the video auction representative is responsible for ensuring contract compliance by both buyer and seller, buyers are permitted to be present at delivery.

Each video auction has its own set of terms. A buyer must register with the Auction prior to the sale, and be issued a buyer's number. Only qualified, pre-registered buyers with issued numbers are allowed to bid in the sale ring.

Hedging with Futures

When a producer plans to sell a commodity, he/she can use a short hedge to lock in a price and protect against price decreases. It is important to remember that if you plan to sell the commodity in the future, you need to sell in the futures market when you take your initial position. Otherwise you will not be locking in a future sale price for your commodity. A producer can also use the futures market to lock in a future purchase price of a commodity such as feed. In this case, you plan to buy the commodity in the future, and thus, you need to buy a futures contract when you take your initial position. This is called a long hedge. Another article entitled "Futures Markets - Basic" discusses using the futures market in more detail in this publication, but it is important to remember this is an important forward pricing tool which can be used to lock in a future sale price or a future purchase price of a commodity.

Using Agricultural Options

An option contract is simply an agreement which allows the purchaser the opportunity, but not the obligation, to buy or sell a futures contract at a specified price. Since buyers of options have the "option" but not the "obligation" to exercise their right to buy or sell futures contracts at a specified price (referred to as the strike price), they are called "options."

An option is like an insurance policy. Just as a producer may purchase the right from an insurance agency to collect on a policy in case of a disaster, he or she may purchase the right to buy or sell a com-

modity (through a futures contract) at the strike price in case of a disastrous price move. As in the case of an insurance policy against fire, the producer must pay a premium to insure against commodity price declines or increases. A producer could collect on the option if the price moves in an unfavorable direction.

There are two types of options. They are the "PUT" option and the "CALL" option. The put option is purchased by the producer who wants to insure against price declines. The put option insures a minimum selling price for the option buyer who has a commodity to sell. The put option gives the option buyer the right to sell a particular futures contract at a specified price. The call option gives the option buyer the right to buy a particular futures contract at a specified price. The options then can be used to set a minimum selling price (put) or maximum purchase price (call) for a commodity at future point in time. How this tool can be used will be explained in more detail in an article entitled "Commodity Options As Price Insurance For Cattlemen" in this series.

The advantage of using a put option is that you can protect yourself against falling prices, but you are not locked into a price if prices rise. That is because you have the option, but not the obligation to exercise the option into a futures position. The advantage of using a call option is that you can protect yourself against rising prices when purchasing a commodity, but you are not locked into a price if prices fall. For this right but not obligation to be in the futures market, you pay what is called a premium.

All of these alternatives are available to you today. They can be used to help you manage your price risk and perhaps improve your chances of meeting your business goals. In comparing your marketing opportunities it is important to consider transportation costs, shrink, market charges or fees, marketing services available, methods of selling available, competitiveness of the market you are considering, price risk and marketing or pricing goals. If you take the time to get out of a marketing rut, you can compare these alternatives and shop for good pricing opportunities rather than waiting until weaning or coming off pasture to make a sale. Just take a little time to develop a marketing plan.

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