Cattle Feeders' Marketing and Pricing Practices

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Fed cattle marketing and pricing have changed dramatically over the last decade. Grid pricing has increased in importance while cash marketing of fed cattle has decreased. Numerous strategic alliances have evolved while marketing fed cattle without a marketing agreement or part of an alliance has declined. These and other changes have created opportunities for some and frustrations for others. One result has been increased interest to seek Congressional intervention to resolve potential marketing problems.

The authors conducted a survey of cattle feeders in four southern plains and corn belt states (Texas, Kansas, Nebraska, and Iowa) in 2002.[1] Two specific objectives were to determine marketing and pricing practices of cattle feeders, and to solicit feedlot managers' perceptions regarding various aspects of the marketing environment they face and policy proposals. This fact sheet summarizes selected aspects of the survey results. A complete reporting can be found in Schroeder et al. 2002a.

Response Profile

Total questionnaires mailed numbered 1,501. Completed questionnaires numbered 316, for a 21.1% response rate. The number of questionnaires mailed for each primary state, along with the response number and response rate was: Texas – 150 mailed, 48 returned, 32.4%; Kansas – 131 mailed, 50 returned, 38.2%; Nebraska – 250 mailed, 66 returned, 26.6%; and Iowa – 970 mailed, 152 returned, 15.7%.

[1] Assistance from the, Texas Cattle Feeders Association, Kansas Livestock Association, Nebraska Cattlemen, and the Iowa Quality Beef Supply Network is gratefully acknowledged.

Responses by feedlot size varied by state, since Iowa and Nebraska have many more smaller feedlots than do Kansas and Texas. For all respondents, the distribution of responses by feedlot size was: less than 5,000 head capacity, 53.8%; 5,000-19,999 head, 17.8%; 20,000-49,999 head, 11.5%; 50,000-99,999 head, 10.5%; and more than 100,000 head, 6.4%. For some questions, responses were weighted by feedlot size to get a weighted average response.

Pricing Practices and Motives

Feedlot managers were asked to identify how cattle marketed from their feedlot were priced in 1996, 2001, and what they anticipated in 2006. This was intended to provide a profile of recent, current, and future pricing practices so as to identify changes or trends over time.

In 1996, 97% of the respondents used the cash market to market at least some fed cattle. By 2006, that percentage was expected to decline to 70%. For grid pricing, 23% used grid pricing for some fed cattle marketed in 1996 and the percentage was expected to increase to 88% by 2006.

Figure 1 shows the same distinct trend away from pricing fed cattle on a live weight, cash market basis to grid pricing for the weighted average marketings by respondent feedlots. Grid pricing typically consists of a base carcass weight price in conjunction with a price grid or matrix of carcass premiums and discounts for carcass attributes (see http://posuextra.com in the Marketing and Outlook section for information on grid pricing). Weighted average marketings priced on a live weight basis accounted for 66% in 1996 but fell to 38% in 2001 and was expected to decline further, to 22% by 2006. Carcass weight pricing, sometimes called in the meat or in the beef pricing, declined less dramatically, from 16% in 1996 to an expected 11% in 2006. Grid pricing clearly is replacing live weight, cash market pricing. Weighted average marketings priced on a grid accounted for 16% in 1996, increased to 45% in 2001, and was expected to increase again, to 62% by 2006. Feedlot managers indicated very little use or expected use of fixed price or basis contracts.

Why have feedlot managers switched pricing methods? With live weight and carcass weight pricing, each animal in the sale lot receives the same price regardless of quality. With grid pricing, each animal is priced individually based on its

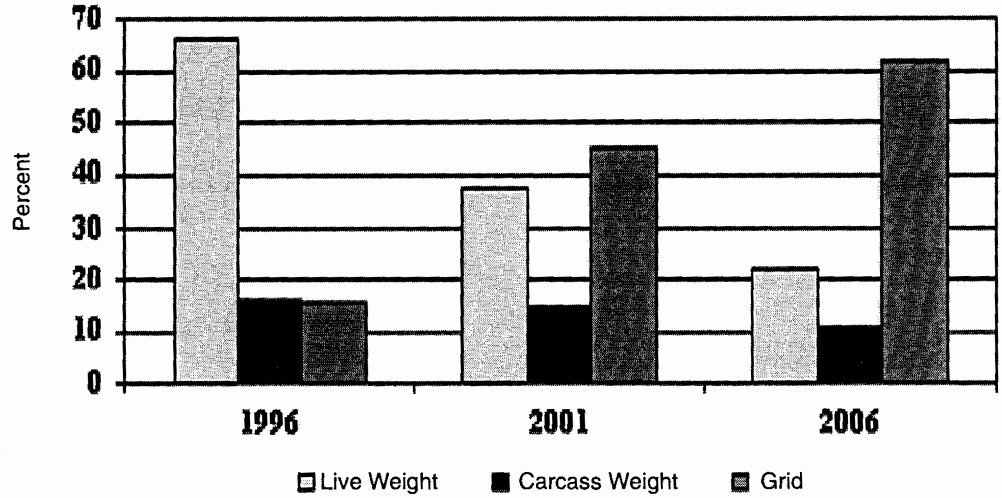

Figure 1. Percent of Weighted Average Marketings by Pricing Method.

carcass attributes. Thus, economists would argue grid pricing is more accurate. Cattle feeders are paid for the quality of fed cattle marketed. This means better quality cattle do not subsidize lower quality cattle as is the case with live weight or carcass weight pricing.

Feedlot managers were asked for their level of agreement regarding several possible motives for using grid pricing. The three most important reasons were to obtain carcass premiums associated with higher quality grade and higher yielding animals, to access carcass data from packers on fed cattle marketed, and to obtain a higher base price. Notably, perhaps, respondent feedlot managers indicated their lowest ranking motive to switch to grid pricing was being pressured to do so by packers.

The most common method of determining the base price varies with grid pricing. However, feedlot managers confirmed the belief that the most common method has been and will continue to be a formula price tied to the cash market. This occurs in two ways, either tying the base price to a market price quote for a particular cash market (such as the Western Kansas direct trade) or to tie the base price to the buyer's plant average price for a preceding week. Most economists dislike either of these formula pricing methods. A major reason is that packers have an incentive to keep cash market prices low for two reasons. First, it is in their best interest to pay lower prices for fed cattle and reduce procurement costs. Second, it also means their formula prices for cattle purchased on a grid will be low, again contributing to lower overall procurement costs for cattle.

Other alternatives are available but are not frequently used according to cattle feeders. Alternatives include negotiating the base price with packers, tying the formula base price to a futures market quote, or tying the formula base price to the wholesale boxed beef price (Schroeder et al. 2002b). Feedlot respondents indicated some small movement to these alternatives from 1996 to 2001 with an interest in increasing their use by 2006. However, they still expect the weighted average percentage of base prices tied to the cash market to be 35% in 2006, the same percentage as they reported using in 2001.

Marketing Practices and Motives

As with pricing methods, feedlot managers were asked to identify how fed cattle were marketed from their feedlot in 1996, 2001, and what they anticipated in 2006. This, too, was intended to provide a profile of recent, current, and future marketing practices so as to identify changes or trends over time.

Just as with pricing methods, there has been a sharp change in how fed cattle are marketed. Using marketing agreements and contracts, participating in an alliance, or being part of a cooperative has increased while marketing fed cattle without some type of agreement or contract has declined.

Just 30% of the respondents had used some type of marketing agreement either outside of an alliance or in conjunction with an alliance in 1996. By 2001, that percentage increased to 64% and was expected to increase to 74% by 2006.

In 1996, marketing fed cattle without some sort of marketing agreement or contract accounted for 78% of weighted average marketings by respondent feedlots (Figure 2). That percentage dropped to 48% by 2001 and is expected to decline to 35% by 2006. Marketing agreements and contracts that are not part of an alliance, cooperative, or similar marketing program increased from 14% in 1996 to 25% by 2001, and is expected to remain at about that level in 2006 (26%). A larger increase was reported for alliance or cooperative related marketings. Weighted average marketings for this marketing method in 1996 were 8%, increasing to 27% by 2001, and expected to increase to 39% by 2006. Thus, by 2006, more fed cattle are expected to be marketed under some type of agreement as part of an alliance or cooperative than without any marketing agreement or contract.

Two of the three most important reasons for the shift in marketing method were the same as for the switch to grid pricing. Those are to obtain carcass premiums associated with higher quality grading and higher yielding carcasses and to access carcass data. This response by feedlot managers is not surprising, since most marketing agreements, alliances, and cooperatives use grid pricing. The third most important motive was to guarantee having a buyer for the fed cattle when they

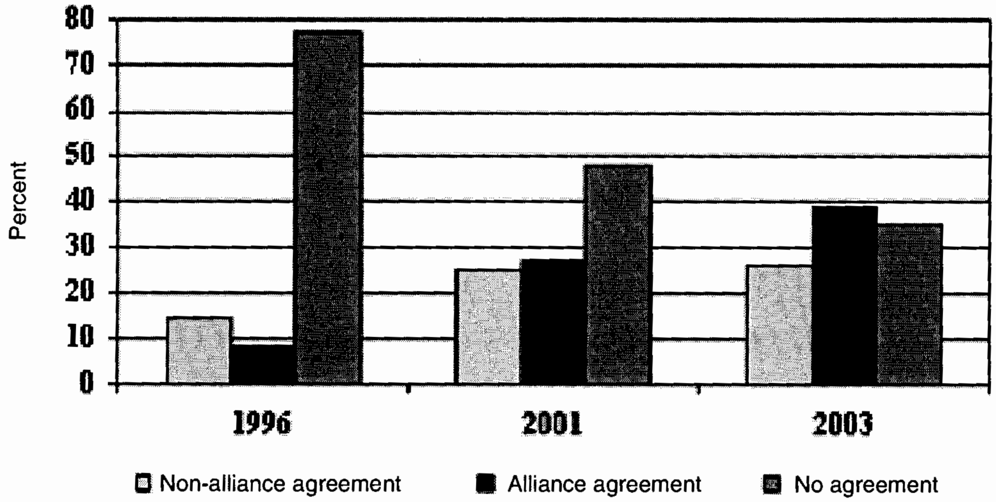

Figure 2. Percent of Weighted Average Marketings by Marketing Method.

are ready for market. This motive no doubt relates to feedlot manager concerns regarding concentration in meatpacking and captive supply use by packers. Again, feedlot managers indicated the least important reason for changing marketing methods was pressure by packers to enter into an agreement.

Perceptions of the Marketing Environment

Feedlot managers were asked to rate their degree of agreement or disagreement on several statements related to the market environment in which they find themselves when marketing fed cattle. The agreement-to-disagreement scale was a 9-point scale with one extreme being strongly disagree and the other strongly agree. A rating of 5 indicated an uncertain perception or no opinion. Here, results are reported for three categories: those indicating any degree of disagreement (slight to strong), those indicating an uncertain perception or no opinion, and those indicating any degree of agreement (slight to strong).

The trend toward grid pricing and away from cash market trades presents a concern to many. As indicated above, the most common formula for determining the base price in grids ties the base price to the cash market. Therefore, declining cash market trades results in a thinning of the reference market for the base price formula. Economic theory does not provide a clear indication of how thin a reference market can be for it to remain representative. Therefore, we really do not know "how thin is thin."

Feedlot managers were asked their opinion regarding whether or not reduced trading in the cash market would be harmful to the industry. Of respondents, 69% agreed that it would (Figure 3). The remaining feedlot managers were about evenly split between those disagreeing (16%) and those with no opinion (15%).

Many producers and feedlot managers are concerned about packer concentration and captive supplies (see http://www.osuextra.com in the Marketing and Outlook section for information on structural changes in cattle feeding and meatpacking and on concentration and captive supplies). Simply the use of captive supplies reduces the proportion of cash market trading, contributing to the thin market problem just discussed. The bigger concern, however, is with packers using captive supplies to leverage their cash market bids lower. Research indicates use of captive supplies has a negative but relatively small effect on cash market prices. When asked, feedlot managers overwhelmingly agreed that packers bid lower for cash market cattle when they have cattle contracted, one form of captive supplies (Figure 4). Among respondents, 86% agreed with the perceived negative effect captive supplies have on fed cattle prices. Of the remaining managers, 5% had no opinion and 9% disagreed regarding the negative or harmful impact.

Thinning of the cash market becomes less of an issue if another means is used to determine the base price in grids. Feedlot managers were asked their preferences for determining base prices. Respondents indicated negotiated base prices were preferred to formula prices (Figure 5). Of the respondents, 57% agreed that negotiated prices should be how the base price is determined. Another 29% had no opinion and the remaining 14% disagreed.

Among respondents, 77% agreed formula base prices should be tied to the wholesale boxed beef or retail market (Figure 5). This alternative is preferred by many economists if the base price is going to be determined by formula, rather than tying the base price to the cash market. Packers have a natural incentive to push wholesale prices as high as possible, since that is a key factor in their sales revenue. Of remaining respondents, 17% had no opinion and 6% disagreed.

Perceptions of Policy Proposals and Potential Solutions

As with perceptions of the marketing environment, feedlot managers were asked to rate their degree of agreement or disagreement on several potential or recently enacted policies. The agreement-to-disagreement scale here, too, was a 9-point

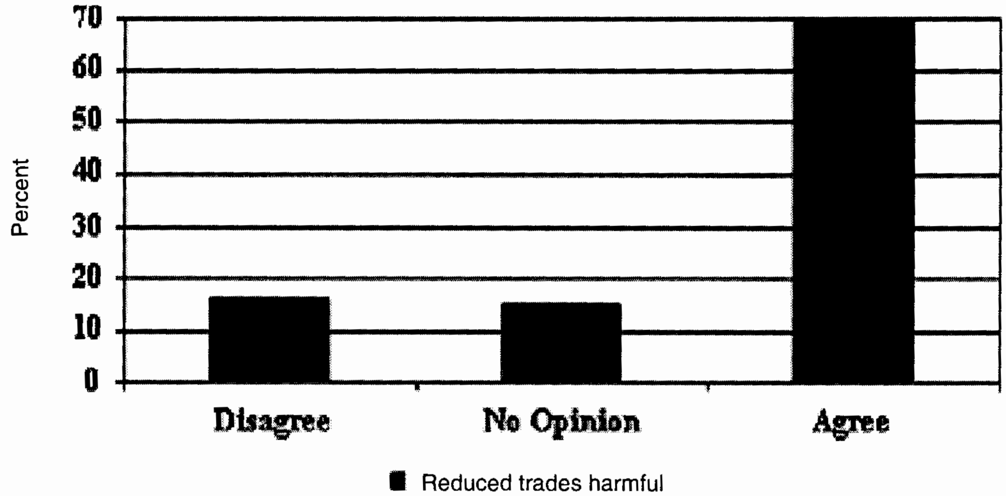

Figure 3. Will Reduced Trading in the Cash Market be Harmful to the Industry?

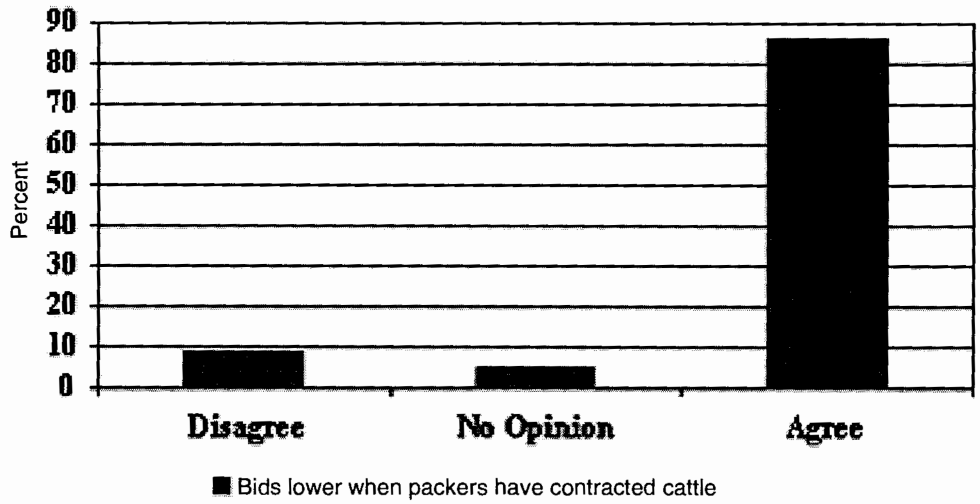

Figure 4. Do Captive Supplies Reduce Cash Market Prices?

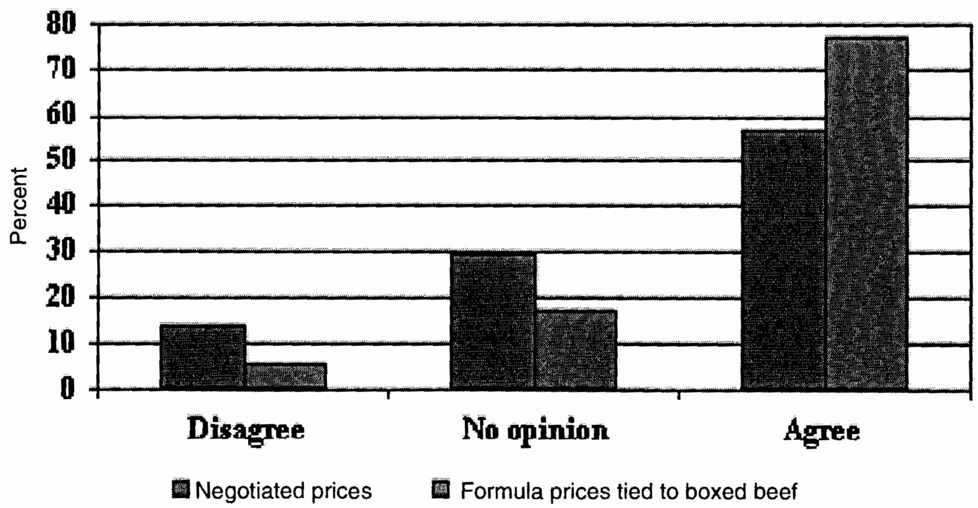

Figure 5. Preferred Base Prices in Grids.

scale with one extreme being strongly disagree and the other strongly agree. Results again are reported for three categories: those indicating any degree of disagreement (slight to strong), those indicating an uncertain or no opinion perception, and those indicating any degree of agreement (slight to strong).

Feedlot managers were asked about two alternatives related to the high level of concentration in the packing industry and in food retailing. Two potential solutions are to break up the larger packers and retailers into several smaller ones, or to provide incentives to form new, producer-owned packers. Breaking up the larger packers and retailers did not receive strong support (Figure 6). Responses were almost evenly split between those agreeing (33%) that breaking up these firms would benefit the industry, those disagreeing (36%) with that view, and those with no opinion (30%).

Organizing more producer-owned packers received much stronger support (Figure 6). Of respondents, 59% agreed that more producer-owned packers would benefit the industry, while 18% disagreed and another 24% had no opinion.

Proposals to deal with the captive supply issue include limiting packer ownership of livestock and limiting contracting between packers and feeders (Purcell and Koontz). If contracting is restricted between packers and feeders, should it be restricted between packers and retailers? These policy alternatives were posed to feedlot managers. Figure 7 shows strongest support for limiting ownership and feeding of livestock by packers. Of the respondents, 64% agreed with this policy alternative. Another 21% disagreed and 14% had no opinion. Responses to this question varied more by state where the feedlot was located than for other questions. Feedlot managers in Iowa agreed more strongly with this alternative than did respondents from Texas and Kansas. Further analysis indicated that feedlot size was the determining factor. Smaller feedlots favored a ban on ownership and feeding of livestock by packers than did larger feedlots.

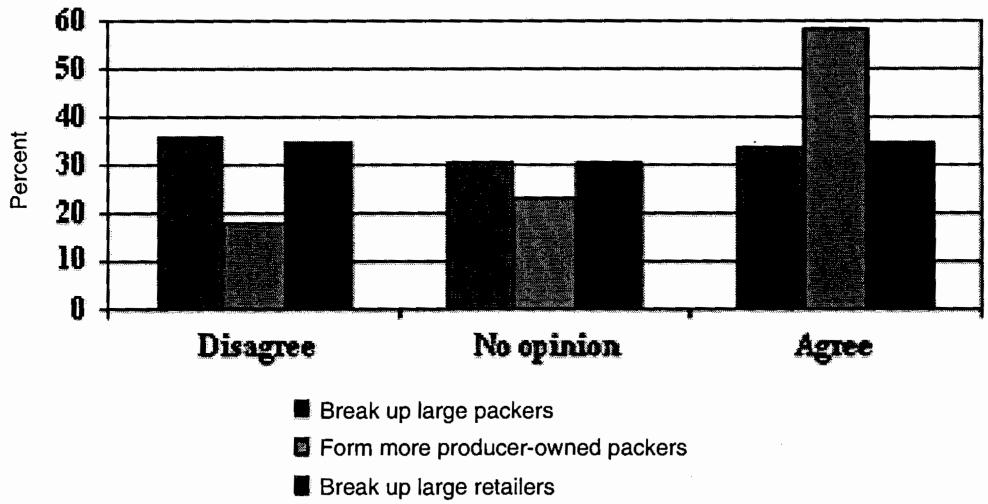

Figure 6. Break Up Large Packers and Retailers, and Organize New Packers?

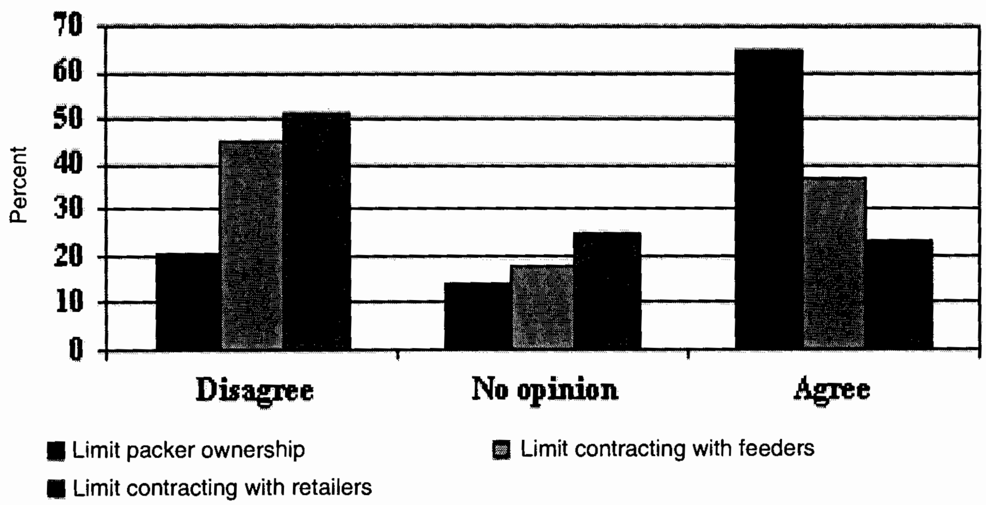

Figure 7. Limit Packer Ownership and Contracting?

Limiting contracting between packers and feeders had less support (Figure 7). Among feedlot managers, 37% agreed that packers should not be permitted to contract or form marketing agreements with cattle feeders. However, 45% disagreed and 18% expressed no opinion.

The support for restricting contracting between packers and retailers was even less (Figure 7). Just 23% favored not permitting packers from forming contracts and marketing agreements with retailers. On this, 52% disagreed and 25% had no opinion.

Because of several expressed concerns surrounding price discovery, the Livestock Mandatory Reporting Act was passed in 1999 and implemented in 2001. That legislation marked a significant change in market policy in the livestock industry. Typically, the livestock industry had not sought governmental or non-market solutions to their actual or perceived marketing problems. The mandatory price reporting legislation contains a sunset clause, meaning the enabling legislation must be re-assessed and renewed or the U.S. Department of Agriculture reverts to voluntary price reporting. Thus, feedlot managers were asked their opinion of the effectiveness of mandatory price reporting after having experienced it for nearly a year (Purcell and Koontz). The response was clear. Mandatory price reporting has not been the boon it was thought to be by some. Of respondent feedlot managers, 79% agreed the benefits to date were less than expected. Only 7% disagreed and another 14% registered no opinion (Figure 8).

Similarly, 50% disagreed that mandatory price reporting was benefiting the industry, while 28% agreed and 22% had no opinion. Over 50% of respondents generally agreed with several other aspects of mandatory price reporting. They indicated mandatory price reporting provided less cash market information than with voluntary reporting. Mandatory price reporting did not enhance their ability to negotiate cash prices with packers, to negotiate base prices and formulas with packers, or to negotiate grid premiums and discounts with packers. Mandatory price reporting resulted in no improvement in the timeliness or frequency of price information for decision making. The survey response shows clearly that expectations regarding mandatory price reporting were considerably higher than the benefits realized. As a result, feedlot managers indicated an increased likelihood of using private information sources in lieu of or in addition to mandatory price reports.

Summary and Conclusions

Feedlot pricing and marketing practices have changed dramatically and will continue changing. Some changes are a response to failures and inefficiencies in the marketplace and an effort to make improvements. However, regardless of the reasons, these changes carry additional implications for the beef industry's future.

The survey reported on here was intended to document changing pricing and marketing practices and to determine perceptions of cattle feedlot managers regarding resulting market conditions, alternative marketing policies, and a retrospective view of one recent market policy change. While insightful for what was revealed, results forewarn of rocky times ahead. The trends toward grid pricing, formula pricing to the cash market, and increased use of marketing agreements, including those in conjunction with alliances and cooperatives, also contribute toward conditions that many respondents deem undesirable. These include captive supplies and thin markets, among others. Thus, there will continue to be pressure for non-market, governmental solutions. As the response regarding packer ownership of livestock indicated, these may cause sharp divisions in the industry based on size, location, or type of livestock enterprise. Some governmental intervention may be necessary, but as this survey indicated, not all government mandates will necessarily improve the situations they were expected to correct. Thus, each policy alternative must be assessed independently on its own merit.

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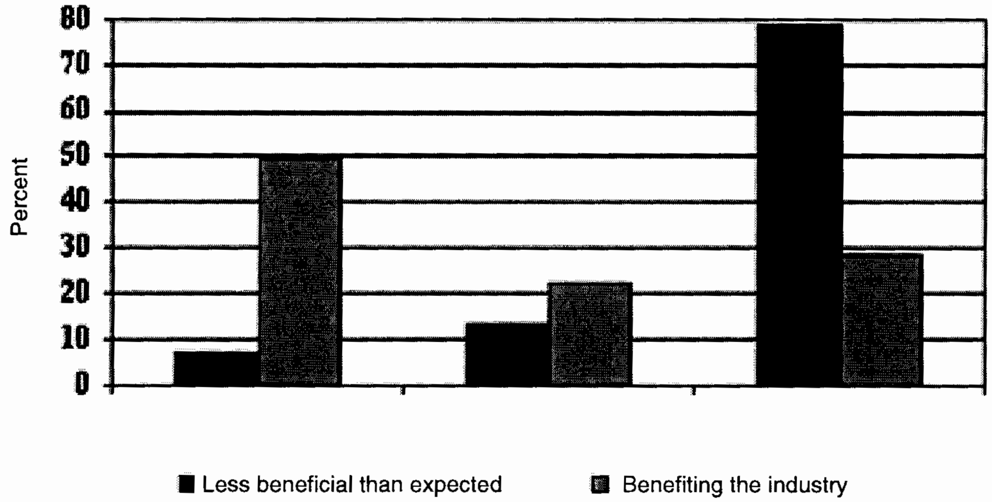

Figure 8. Mandatory Price Reporting: Expectations vs. Reality?

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- It provides practical, problem-oriented education for people of all ages. It is designated to take the knowledge of the university to those persons who do not or cannot participate in the formal classroom instruction of the university.
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