MOTIVATION FACTORS FOR BEEF PROCESSOR-PRODUCER LINKAGES

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Summary

A survey was conducted of the 15 largest beef processors to identify the mix of procurement practices being used and to understand reasons motivating recent processor-producer linkages. Processors are shifting away from cash-market live, fed-cattle trade, which represents only 36% of cattle procured by survey respondents in 1999. Processor-owned cattle feeding represents only approximately 5%, where it has been for more than a decade. Various other forms of pricing such as carcass weight, grid, and formula represented the largest portion of purchases at 49%. Processors indicated the two most important reasons they get involved in contracts and marketing agreements with producers is to secure higher and more consistent quality cattle. Assuring food safety was also a motivation for linking more closely with cattle producers. In the future, processors felt these motivational factors would increase in importance. As cattle feeders explore grid pricing and alliance opportunities, it is important they understand why processors desire to enter into contracts and marketing agreements.

(Key Words: Beef Processors, Contracts, Marketing Agreements, Cattle Marketing.)

Introduction

The U.S. beef industry is undergoing marked transitions in the way livestock and meat products are marketed and the way price discovery occurs. The once dominant negotiated cash markets are shifting to long-term contracts and marketing agreements. The purpose of this study was to determine current marketing and pricing methods being used by beef processors. The current and expected mix of pricing methods for fed cattle were estimated by the processors. In addition, major motivating factors for changing beef processor-producer linkages were assessed.

Results of this study will contribute to a better understanding of the important coordination mechanisms that affect market efficiency and performance in these industries. This study will also offer insights into the changing industry organization that will be useful in strategic planning by industry members. The complexities of mandatory livestock- and meat-price reporting (from recent federal legislation) will become more clear as the variety of methods employed in the marketing system are documented. Finally, the information from these surveys should be useful in assessing issues raised in court cases alleging illegalities associated with "captive supplies" in the beef industry, and proposed legislation to eliminate processor vertical integration and long-term contracts with livestock producers.

Procedures

During April 2000 the largest 15 beef processing firms were surveyed to determine current procurement practices and to discern processor perceptions on why the beef value chain has moved to more formal agreements.

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Survey responses were received from 11 of the 15 packing firms, representing 72% of cattle slaughtered. The processors were telephoned, asked to participate in the study, and were faxed a survey form.

Results and Discussion

Processors are shifting away from live cattle cash market purchases to more long-term contractual and/or value-based grid purchases. However, negotiated cash market pricing arrangements still remain dominant. Only 5% of cattle slaughtered by survey respondents were owned by them and either fed in their own lots or other feedlots. This represents little change over the last 15 years. In 1999, survey respondents reported 36% of cattle were purchased on the cash market on a live weight basis, and 29% on a carcass weight or grid (carcass merit) basis (Table 1). Thus, approximately two-thirds of cattle slaughtered were cash market acquisitions.

Long term (more than 14 days) formula-priced contracts linked to the cash market accounted for 20 percent of 1999 purchases. "Cash market" included live cattle or wholesale beef prices reported by USDA, processor cattle purchase cost averages, retail beef prices, or futures market prices. Four percent of cattle purchased were via short-term contract arrangements based on the Chicago Mercantile Exchange (basis contracts, or fixed price based on futures-market prices, with deliveries typically several months in the future). Three percent of the cattle were acquired under risk and profit-sharing, market contract arrangements with cattle feeders, but not owned by processors while in the feedlot.

Cash market purchases by processor buyers are based on their expectations of likely carcass quality. However, a large number of cattle feeders sell all of their pens, perhaps with several owners, at the same live or carcass price, allowing little distinction for quality on a lot-by-lot, or carcass-by-carcass basis. Cash market purchases based on carcass merit are increasing in the cash and contract markets. In 1999, at least 35% of cattle purchased on contract or in the cash market were priced based on carcass merit but some processors did not break that out in their responses. Most cattle fed by processors were also transferred to their processing operations based on carcass merit.

Processors were queried regarding the importance of specific reasons they and cattle producers enter into contracts and marketing agreements. The two most important reasons cited by processors were to "secure higher quality cattle," and to "secure more consistent quality cattle" (Table 2). Both of these responses had an average score of 4.0, with 1 being *not important* to 5 being *very important*. These were also expected to be most important (and even more important at 4.2) in 2004. Improving risk management, reducing plant operating costs by maximizing slaughter plant capacity utilization, and assuring food safety were the next most important reasons (average scores of 2.8 to 3.0 in 1999). All three of these items also are expected to become more important, with 2004 ratings for food safety at 3.7 and plant operating efficiency at 3.5. The low importance (average score of 1.8) attached to the assertion that contracts enabled processors to purchase cattle for a lower price may be because contracts and agreements do not enable processors to lower prices paid for cattle, as shown in recent USDA-sponsored studies. Securing adequate cattle quality and quantity are the primary factors motivating beef processor use of contracts and marketing agreements with cattle producers.

Processors perceived that producers' primary incentives to enter into contracts and marketing agreements were to secure a quality premium and obtain a higher price for cattle (Table 3). Processors felt that, in the next five years, producers would benefit from marketing agreements primarily for these reasons, as well as to obtain detailed carcass data.

Table 1. Percentage of Cattle Procured via Various Methods, 1999

Procurement Method	Percent
Cash-market purchases on live weight basis	36
Cash-market purchases on a carcass-weight or grid basis	29
Formula-priced contract purchases based on a reported live cash market, reported dressed price, plant average price, CME cattle futures price, quoted boxed beef ,or retail-beef price	20
Processor-fed cattle	5
Fixed-price or basis-contract purchases based on CME futures	4
Risk-sharing contract purchases	3
Other purchases	4
Total	100

Table 2. Processor Survey Responses Regarding Importance of Contract and Marketing Agreement Incentives to Beef Processors[a]

Importance to Processors	1999 Average	2004 Expected Average
Reduce plant operating costs due to improved slaughter plant capacity utilization	2.9	3.5
Secure higher quality cattle	4.0	4.2
Secure more consistent quality of cattle	4.0	4.2
Assure food safety	3.0	3.7
Improve long-run price-risk management	2.8	3.1
Improve week-to-week supply/price management	2.2	2.9
Reduce costs of searching for cattle to procure	2.3	2.4
Able to purchase cattle for lower price	1.8	1.8

[a]Scale: 1 = not important, 5 = very important.

Table 3. Processor Survey Responses Regarding Importance of Contract and Marketing Agreement Incentives to Cattle Producers[a]

Importance for Producers	1999 Average	2004 Expected Average
Secure a buyer for cattle	2.6	2.8
Secure a quality premium/discount	4.0	4.0
Reduce price risk	3.3	3.3
Reduce costs of searching for a cattle buyer	2.4	2.8
Able to sell cattle for higher price	3.8	3.8
Easy to get loans	3.1	3.4
Provide detailed carcass data	3.4	3.6

[a]Scale: 1 = not important, 5 = very important.