

Selecting the Best Market Alternative

By V. James Rhodes

What shall I do? Shall I sell my cattle to the packer buyer who has just made an offer or send them tomorrow to an auction market? Shall I sell my hogs today at the local buying station or wait another week? Would it be profitable to erect a roadside market for selling my apples and peaches? Shall I sign a contract to produce so many acres of green beans or shall I put that land in soybeans this season? Shall I contract some of my expected wheat crop before harvest, or sell it all at harvest to my local co-op?

Those questions suggest the nature of market alternatives for farmers. Alternatives involve outlets or buyers. Also important are the various conditions of sale. Some of these conditions can be classified by type of market outlet such as an auction, buying station, feedlot sale, or roadside stand. Other market alternatives involve the market options provided. These market options include the time relationships of sale, delivery and pricing; schedule of premiums and discounts, and other factors.

What criteria do farmers consider when selecting their best market alternatives? Highest net returns is likely to be at the top of the list. Net returns are the take-home pay after all marketing expenses (transportation, commissions, time spent

in selling, pricing, and delivery) are deducted. Clearly, net returns are more important than gross price.

Other criteria are also important in choosing the best market alternative. A national sample of hog producers recently mentioned the following characteristics of a preferred market outlet (not listed in rank order): Top price. Proximity. Competitive bids. Daily market with price established early in day. Adequate demand (can take any quantity offered and also can take nonstandard sizes and qualities along with the typical sizes and qualities). Honesty in weights, grades and condemnations. Friendly personnel who are willing to handle fairly any mistakes or misunderstandings. An appropriate set of premiums and discounts for quality and size (farmers vary greatly as to what they consider "appropriate"). Variety of options for timing and pricing and selling. Conditions of delivery (is there congestion at the docks or 3 inches of manure to wade?).

Reworded slightly, this list could apply to producers of many farm commodities. The relative importance of market characteristics will vary among farm commodities and even among producers of a particular commodity. Hence the best market outlet for one producer may not be the best for another.

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Haul 400 Miles or Quit

The market characteristics of proximity and competitive buyers have been growing more important in recent years. A declining number of processors and of other outlets for many commodities means that markets are fewer and farther away. Transportation costs for many commodities can rapidly erode net returns. No farmer wants to haul hogs or sugar beets or vegetables 400 miles to market. Numerous producers in various areas have been faced with the unpalatable alternatives of haul that far or quit production. But growers in the Red River Valley banded together to buy the American Crystal Sugar Company when it threatened to close the only beet factories in the area.

Vegetable growers in California have rather regularly been forming cooperatives to buy processing plants that are being closed by the large processors. Recently a packing plant in New Mexico was purchased by a group of West Texas hog producers who had no other major market outlet within 400 miles. In other commodities and in other areas, the same story is repeated of producers banding together to preserve a market outlet. Usually, their organization becomes a cooperative, although it is sometimes an investor-owned firm (IOF).

A farm cooperative is a special kind of business firm owned and operated by an association of farmer-members for their mutual benefit. When organized as a corporation, a co-op has the usual corporate attributes of unlimited life, limited liability, and freedom to contract as an artificial person. A cooperative differs in significant ways from the ordinary IOF. A cooperative's member-patrons (customers) control it via democratic voting

procedures. Operation is at cost with the savings refunded to members in proportion to their volume of business with the co-op. A cooperative may have capital stock, as in an IOF, but the stock-owners do not have voting control of the co-op nor do they receive more than limited returns.

Cooperatives may provide bargaining and/or marketing services to their members. A bargaining cooperative, in fruits and vegetables for processing or specialty crops or milk, represents its members in working out marketing agreements on terms of sale with individual processors. Capital requirements are small because a strictly bargaining co-op is not involved in the physical functions of marketing. Bargaining, as a way of discovering price and other terms of the transaction, is particularly useful when commitments are needed before planting time as to what is grown and who will process it. Likewise the highly perishable characteristics of fluid milk have made cooperative bargaining a useful way of reducing market uncertainty and transaction costs. Market access and adequate demand are necessary characteristics of milk markets.

A marketing cooperative requires significant capital to finance the inventories and the physical facilities essential to buying, assembling, storing, processing and shipping agricultural commodities. To understand why farmers will commit scarce time and capital to cooperatives, we need to look at the reasons that farmers consider co-ops a potentially useful market alternative.

Assured Market Outlet

Farmers value co-ops as an assured market outlet. While that value is ab-

solute when there are no other accessible outlets, co-ops are still important as a competitive yardstick when few other outlets exist. Sometimes, concentration of ownership in a particular region may greatly limit rivalry among IOF buyers. Farmers may also expect the co-op to achieve some marketing channel leadership and even market power in its dealings with processors or retailers. For example, cooperatives in grapes, walnuts, almonds, oranges, and cranberries have expanded markets through channel leadership and market development. Perceiving themselves as weak price-takers facing positions of concentrated market power, many farmers believe they can strengthen their market position through a bargaining co-op or an aggressive marketing co-op.

Why do farmers often feel more assurance of a continuing market outlet with a co-op? Because a co-op is tied to its farmer-members and their interests in a way that an IOF is not. The IOF, responsible to its owners, is expected to quit processing soybeans or sugar beets or tomatoes if its capital will yield more return elsewhere. The co-op owned by beet growers has a specific purpose — beet processing. No thought is given to switching its capital into flour milling or oil drilling. The co-op must meet market competition, of course. If a co-op simply cannot compete in beet processing, for example, it eventually must close its doors. Thus market outlet assurance can never be absolute, but generally a co-op provides more assurance to farmers than an IOF does.

Farmers value co-ops as an assured market outlet. Workers in this Haines City (Fla.) Citrus Growers Association packing plant examine every orange and reject those that do not make U.S. Grade No. 1. Losers go to the juice plant.



Like most other things, cooperatives have been growing larger. Several have sales that rank them in Fortune's list of the 500 largest industrial corporations. A recent U.S. Department of Agriculture tabulation reports that U.S. co-ops in 1979 marketed farm commodities worth nearly \$42 billion. In value terms, about 28 percent of all farm commodities at the first handler level were marketed by co-ops. The co-op share was much higher in dairy, 68 percent, but was quite low in certain areas including livestock, 10 percent.

Uses of Contracts. Contracts are becoming a more important part of market alternatives. While buyers often have been more aggressive than producers in seeking contracts, many producers have found contracts useful. Producers use contracts to fix a price they like or to reduce risk. Producers may use a contract to assure market access or to participate in pooling. In a few markets such as broilers, market access is impossible without contracts. In some cases producers without marketing contracts find credit very difficult to obtain for producing that commodity.

Contracts vary in nomenclature around the country. One classification distinguishes between marketing and production contracts. A marketing contract is a simple forward sale of a growing crop or growing livestock or an existing inventory. The marketing contract provides for later delivery and may fix price or provide for pricing later. A production contract provides for a commodity to be

produced and involves the "buyer" in the production process in terms of providing specifications and inputs. Broilers are the prime example of production contracting although some turkeys and eggs, a few hogs, and some vegetables for processing are also included. There is generally a different sharing of risks and returns in production contracts than in marketing contracts. From the general perspective of this chapter, both kinds of contracts are considered as market options.

Time Options — Another important market characteristic is the set of options provided for the timing of sale and delivery. Selling, establishing a price, and delivery of possession are separate acts that may or may not be consummated



Farmers selling their wares at a farmers market is an example of simultaneous Sell-Price-Deliver. This farmers market in Washington, D.C., attracts farmers from several neighboring States and is sponsored by the Cooperative Extension Service.

simultaneously. As farmers search for new ways to manage market price risks and to time sales for high returns, they are testing options that frequently involve a separation in time of pricing, selling, and delivery.

The traditional, simultaneous sell-price-deliver (SPD) time spectrum is still likely the most used market option. Sale of livestock in an auction or terminal market, or sale for cash of grain delivered to an elevator, are examples of simultaneous SPD. Other examples include farmers selling their wares at roadside markets, or producers selling cotton for cash at the gin.

A rather similar option is to sell and price

simultaneously with delivery later. The "later" may vary from the next day to several months. Delivery usually occurs at harvest or when the livestock are ready for market. This SP—D option includes various production and marketing contracts in which price is fixed at the time of contracting. Examples include not only the commodities produced on production contracts described earlier, but also marketing contracts for hogs, cattle and various crops. Generally producers are most interested in fixing prices through marketing contracts when they have pessimistic price expectations. This very general use for many commodities of an option separating SP from delivery indicates its perceived usefulness to farmers and/or buyers.



William E. Carrigan

A third time option is to sell at delivery with price set later. Ordinarily price is set according to a formula. The simplest case of SD—P is perhaps grade and yield selling of livestock, in which a specific set of prices for various quality characteristics is agreed upon with the actual characteristics (and hence prices) determined later during processing. The pricing delay is necessary to the postslaughter measurement of quality. A more striking example is grain or soybeans sold to an elevator on a deferred pricing plan, in which the seller eventually picks the day for pricing and price is determined by formula. The formula may relate price to the current offer price of the elevator or the price of a nearby futures contract. In the grain example, the producer gains time to achieve what he or she hopes to be a better price. One disadvantage is the producer has given over possession of the commodity without payment and thus depends for some period on the buyer's financial solvency.

A fourth time option is to sell now with both delivery and pricing postponed until later. A major example of S—DP is dairy producers who contract to market all milk for the coming year to their co-op, or to an IOF, with prices determined later through some process such as co-op bargaining.

Pros and Cons of Pools

Pooling is another example. To pool is to allow your commodity to be sold along with that of other producers by a cooperative or other pooling firm. Generally

most agreements to pool are made pre-harvest. The eventual price received by the pooling producer is determined by the average net pool receipts for the qualities sold by that producer. An expert pool manager may be able to secure a better pool price than many farmers would obtain on their own. However, the farmer has to wait a year for part of the final payment and has to yield the selling decisions to the pool manager. Pooling is common in rice and milk markets, and is used a bit in soybeans, wheat, and some other crops.



When soybeans are sold to an elevator on a deferred pricing plan, the seller eventually picks the day for pricing and the price is determined by formula. Here soybeans are delivered to a Missouri elevator.

One of the biggest changes in use of market outlets for a big ticket commodity has been the decline of terminal markets for livestock. At the beginning of this century they were the dominant method of livestock marketing. It isn't clear that the terminals will survive until century's end. Much the same decline occurred earlier for the "produce" markets (fruits, vegetables, poultry, and eggs). As open, public markets, the terminals were widely praised for their pricing efficiency. Even yet, the easily gathered prices at terminal livestock markets are dissemi-

nated quickly as important market news.

The terminals' decline stems from two weaknesses. Terminals are operationally inefficient because they generally have higher transportation and transfer costs than direct shipment from seller to buyer. Terminals generally lack SPD flexibility; their operations are geared to simultaneous sale, delivery, and pricing. Farmers rather generally prefer to have the sale closed before delivery, because they retain no negotiating power once delivery has been made to the terminal.



Auctions are the most viable element of the open, physical-assembly markets. In livestock, auctions offer outlets for the smaller producers and for odd lots, breeding stock, etc., of the larger producers. Auctions are also important for feeder livestock. In these instances where some off-farm physical assembly is necessary, the auctions are not operationally inefficient. Auctions are also the way that tobacco is sold. Otherwise, auctions are seldom used as market alternatives by farmers.

Electronic Markets

The appeal of the electronic commodity markets (ECM) is that they combine pricing efficiency of the old terminals with the operational efficiencies of direct seller-buyer shipment. Moreover, an ECM tends to enlarge the market for farmers because more distant buyers can compete when transaction costs are lower. Thus some price enhancement can be expected from the development of an ECM provided that volume is sufficient to keep market costs low. USDA has financed experimental operation of computerized ECMs in slaughter hog and feeder cattle marketing. Sizable volumes of lambs and cotton are being marketed on computerized ECMs. Large quantities of feeder pigs are being marketed by tel-auction, a simpler version of ECM.

The attractiveness to farmers of selling the commodity while on-farm was commented on previously. In fact, most market alternatives do involve that characteristic. The main exceptions would be auctions, terminals, and such actions as the shipment of hogs to a packer or a packer buying point with no prior packer commitments to purchase.

The larger the producer the more likely

that he or she sells through individual negotiation, or what is often called private treaty. On the buying side, the larger the potential purchase the more attractive to buyers and thus the more buyer competition. On the selling side, the larger the potential sales, the more effort that a seller can devote to obtaining market information and to becoming a skilled seller. The full range of SPD flexibility is readily available, of course, to individual negotiators. Hence, individual negotiation of either cash or contractual transactions is used frequently for numerous commodities including livestock, poultry, eggs, fresh fruits and vegetables, cotton, grains and oilseeds.

Direct marketing of farmers to consumers is a specialized and growing market alternative. While not important in the aggregate for all farm commodities, direct marketing — roadside markets, U-pick operations, and farmers' markets in cities — is very important to some farmers, especially those in the Northeast. The major sales are in fruits, vegetables, melons, floral and nursery products.

Let's return to the general theme. How do farmers select their best market alternatives? Sometimes there is little choice — so little that farmers develop co-ops or even roadside markets to obtain market access. Sometimes there may be a confusing plethora of market options. Generally, however, farmers do have several options as to timing and several competing buyers. Thus, they may array alternative outlets and options in terms of the market characteristics they deem important in order to make their choice or choices.