



Managing for Today's Cattle Market and Beyond

Cooperation in Cattle Marketing

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One strategy producers can use for possibly adding value to cattle is to cooperate with other market participants. This cooperation may be with other producers (horizontal cooperation) or with firms at different points in the marketing channel (vertical cooperation).¹ The latter occurs when feedlot operators and meat packers cooperate. Cooperation is generally motivated when a situation or conditions exist which require producers and/or cattle processing or feeding firms to combine resources to solve a mutual economic problem(s).

Formal cooperation may include contracts between market participants or the formation of marketing/processing cooperatives or marketing associations. Joint marketing is an important method of cooperation for cattle producers and often takes the form of packaging cattle in pools for sale. Packaging means cattle are merchandized by putting them together in groups with particular characteristics which meet the needs of particular buyers. One focus of this paper is on joint marketing with an emphasis on pooling.

The current cattle price crisis and large margins between retail and farm level prices for cattle during the last two years have increased interest of some cattle producers in integrating into processing and/or other marketing activities along the marketing channel. A discussion of considerations that must be accounted for when contemplating integrating into other marketing activities besides production also is

presented here.

Why Consider Joint Marketing?

Most cattle operations in the United States are relatively small. For example, in the 1992 Census of Agriculture it was reported that farms with cattle have fewer than 41 head of beef cows, on the average. This suggests that the average cow/calf operator, after accounting for weaning percentage and held replacement heifers, probably has fewer than 30 calves to sell each year. With so few calves to sell, packaging cattle into lots that are optimum sized and are uniform by sex and weight is virtually impossible for the majority of cow/calf operators at least on an individual basis.

Different research projects conducted at Utah State University and Kansas State University have found that the number of cattle in a lot influences the price buyers are willing to pay for them.² In the KSU study it was found that the optimum size for a lot of feeder cattle sold through a regular ring auction was 50-55 head. In the USU study it was found that the optimum lot size for cattle sold through a video auction was approximately 240 head. Cattle are sold in larger sized lots, on the average, at video auctions as a service to buyers. In video auctions buyers often have difficulty pooling lots for shipment. This is unlike a ring auction where buyers can pool the lots they buy on a given day. The larger lots sold at video

auctions also are a way to more efficiently match the supply of cattle on a given day with demand, especially for feedlots. In the USU study it was reported, based on interviews with cattle buyers, that feedlot operators prefer cattle lots large enough to fill at least one pen (typically between 100-250 head depending on the size of the feedlot). Buying lots large enough to fill feedlot pens isolates health problems that could occur if lots are mixed. It also reduces the logistical problems associated with purchasing cattle numbers to fit pen sizes.

Creating uniform lots by weight and sex also can improve the price buyers are willing to pay for the cattle. Another study conducted at USU concluded that buyers at a video auction paid approximately \$1.70/cwt. more for uniform lots of cattle than they did for lots which were not sorted by sex and weight. This means that a 500 lb. calf sold in a uniform lot would receive \$8.50/head more than a similar animal sold in a nonuniform lot. Cattle of the same weight and sex can go directly into feedlot pens and receive the same feed ration. Consequently, buyers often are willing to pay more for uniform lots than nonuniform lots because the need to sort the cattle after delivery is reduced or eliminated.

Organizing a Cattle Pool

Since most cattle producers do not have enough cattle to effectively package their cattle, they may consider pools as an alternative. Organizing a cattle pool takes interest and commitment on the part of producers who are involved. These are elements found in all successful pools. One of the best things a group of producers interested in starting a pool can do is to examine what other successful pools have done as a starting point for developing their own pool.

Facilities where cattle can be unloaded, weighed, sorted, pooled, and loaded for shipment are a basic requirement for this type of joint marketing. It may be that these types of facilities are not already available. If so, the group may consider building and paying for such facilities by charging a fee to those using the facility.³

The successful operation of a pool depends much on the good will that exists between its members as well as the economic incentives which exist for pooling. The group must establish rules regarding how decisions will be made relating to how cattle will be handled, sorted, and included or excluded from the a pool. Some producers may be unhappy if they believe their cattle are superior to other members of

the pool. Concerns also will arise when cattle are “sent home” because they do not meet specifications to be included in the pool. Successful pools establish firm rules for operating the pool. While causing concerns at first, these rules improve cooperation among pool members after members recognize, accept, and respect the rules since they know they will be enforced. If producers do not like the rules of the pool they can attempt to change the rules through the channels established by the group or they can simply choose not to participate in the pool.

One calf pool in Utah operates in basically the following fashion:

1. Producers who are members of the pool indicate the number of steer and heifer calves they will provide to the pool that year. This becomes a marketing agreement between the pool and the producer.⁴
2. The calves are prepriced through a video auction using videos and descriptions of “representative” calves. The calves normally are sold in six pools--three for steers and three for heifers, based on different weights. For example, the three steer pools may have average weights of 450 lbs., 525 lbs., and 575 lbs. The pools normally range in size from 150 to 250 head. Prepricing through a video auction eliminates the need to gather the cattle to obtain bids. Producers also know the day delivery will take place and the price they will receive before the cattle come off the range.
3. On the day of delivery, producers are responsible to bring their calves to the unloading/loading facilities. After unloading, the calves are brand inspected, sorted for different pools, the sorted groups for each producer are weighed, and then are placed into their respective pools. Records are maintained on the number and weights of cattle for each producer in each pool. After the pool is completed, the cattle are loaded and shipped.
4. The pool is paid by the video auction company and the pool issues a check to each producer based on the total weight they contributed to each calf pool.

Producers in this pool believe that pooling has been a very successful method for them to increase the price they receive for their calves. No members of the pool have more than 200 mother cows and some of the producers have fewer than 10 calves to contribute to

the overall pool.

Pooling offers both challenges and opportunities. As stated before, participants must be willing to abide by the rules established for the pool. For example, only cattle meeting pool specifications for breed, weight, sex, or other specific characteristics will be accepted. Producers also must be willing to accept the pool price for their cattle and agree with the marketing methods used by the pool. If a producer cannot abide by these restrictions, they should not participate in the pool.

Processing Cooperatives

Low cattle prices have caused some producers to consider integrating into processing⁵ or other activities along the marketing channel. This is motivated by what they see as a relatively large farm to retail price spread. Some of these producers are considering forming cooperatives to build processing facilities and compete directly with the large meat packers. Some may seek out niche markets where competition may be less keen.

A cooperative is a special type of corporation which allows agricultural producers to pool their resources and also seek other types of investment as a means to gather enough capital, in this case, to build beef processing facilities. Cooperatives are designed to allow producers to make joint marketing decisions. Cooperatives have been very successful in improving farmers' incomes⁶ in some agricultural industries.

When considering forming a cooperative, producers need to ask themselves some important questions such as: 1) Is the current market noncompetitive? 2) Will we be able to raise sufficient capital to compete in this market? 3) Can we as producers supply the processing facilities with enough commodity at a competitive price to operate the facilities efficiently? 4) Will there be sufficient profits in this industry over the period of our investment to justify entering the industry? 5) Is there a strong enough commitment among producers to make the necessary investment in terms of money and commodity during the investment period (say 10-20 years) to justify the cooperative?

The first question relating to competitive markets is a basic one. Economic theory says that when a market is competitive, over a period of time no profits above a normal rate of return on assets will be made by firms in the industry. The beef packing industry is one of the most often studied industries in the United States. Even with all the research which has

been conducted relating to the industry, there is still no clear evidence that the beef packing is not competitive. At the least there is no evidence to suggest beef packers exploit cattle producers or the public in a big way. This suggests that market entrants competing directly against large beef packers will likely be facing a basically competitive market and should not expect returns that are abnormally high.

Ward reports that considerable economies of size exist in beef packing. Those plants with the lowest production costs are slaughtering approximately 1 million head per year. This conclusion is supported by the dramatic decrease in the number of small packing plants in the United States during the last 15 years. The implication is that large amounts of money will be needed to be competitive in this business and that the amount of capital required may preclude producers from integrating into processing.

Obtaining the numbers of cattle required to keep a modern processing facility efficient is a difficult task due to cyclical, seasonal, and competitive influences. The larger the number of cattle needed, the larger the geographic area that will be served by the cooperative, and the more producers that will be needed to participate. This suggests that plants should be located near areas where large numbers of cattle exist. This would likely place a cooperative in direct competition with large packers already in high density cattle areas. Locating in low density cattle areas would increase transportation costs.

How profitable will a cooperative be? To be successful, a cooperative must either compete with large existing packers on a cost basis, which means it must be as large and have just as good a marketing network as large packers, or it must find markets where large packers are unwilling to compete on a cost basis (niche markets). This might be accomplished by offering superior customer service or developing a product which is somehow different than regular beef products. The beef market still is driven largely by costs. Consequently, differences in the costs of production between a cooperative and a large beef packer still should not be extremely large.

Finally, cattle producers normally are more willing to cooperate with each other during bad times than they are during good times. A cooperative will require a high degree of commitment from its members for a number of years to assure an adequate supply of cattle to keep the plant operating efficiently. This could probably best be accomplished by requiring an upfront investment from members of the cooperative and also requiring them to sign a

marketing agreement with the cooperative.

Processing cooperatives are not a common phenomenon in the cattle industry. When considering forming a cooperative, particular care should be given to the ability to increase the income of cattle producers over the long run. The long-term commitment of the potential members also should be considered carefully. Producers considering a cooperative should contact their extension livestock marketing specialist to examine these and other issues relating to the formation of cooperatives.

References

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¹ Formal cooperation between packers and feedlots is referred to by different terms. They are sometimes called strategic alliances or captive supplies. These topics are discussed elsewhere in these materials and will not be discussed in this fact sheet.

² For example, the KSU study found that optimum sized lot of cattle received between \$4/cwt. - \$6/cwt. more than cattle that were sold in single head lots at Kansas auctions during 1986 and 1987.

³ Some groups have sought and received aid from private citizens and/or local governments to build such facilities in the form of donated property, use of machinery, donated labor and materials (especially

from members of the group), etc.

⁴ Most of these producers are on similar breeding programs and calve at approximately the same time.

⁵ The term "processing" is used in the sense of a combination of packing and fabrication (i.e., boxed beef) as is done by the large beef packing companies.

⁶ For example, a number of marketing cooperatives in the fruit industry have been very successful (e.g., Sunkist and Ocean Spray). Some livestock cooperatives also have been very successful especially in dairy and poultry (e.g., American Milk Producers Inc. and Goldkist).