Business Management In Agriculture

A Marketing Strategy For Livestock

A joint project of the Cooperative Extension Service, Farm Credit and Chicago Mercantile Exchange
A Marketing Strategy for Livestock

- calculating production costs
- evaluating price objectives
- consequences
- six-step strategy
- determining price objectives
- net price level and price risk
- reevaluation
A Good Marketing Plan

1. Focuses on realistic goals
2. Compares pricing alternatives
3. Appraises odds of meeting goals
4. Assesses levels of risk
5. Identifies price decision model
6. Encourages periodic evaluation
Marketing Questions Faced by Livestock Producers

1. Price level to market?
2. When to price?
3. Where to market?
4. What to market?
Marketing Rule:

If the price difference between point A and point B is equal to or greater than the shipping cost, then ship to A.
Marketing Rule:

If the price difference between weights B and A is equal to or more than the cost of producing weight B versus A, then put on more weight.
Pricing Questions Are Related To:

1. Production schedule/volume
2. Financial condition, goals and needs
3. Attitude of producer
4. Economic conditions of market
A specific pricing plan has:

- Specific goals that can serve as criteria for judgement
- A pricing mechanism which triggers action when goals are reached.
Pricing Decision Model

Financial Criteria Weights

Outlook Criteria Weights

Technical Criteria Weights

Decision Rules -- Triggers Action
Examples of Cash Flow Needs

- Keep operation afloat
- Plus debt repayment
- Plus min. family living
- plus higher family living
- Plus operation expansion
Examples of Cash Needs

- Keep operation afloat: $28,750
- Debt repayment: 30,000
- Minimum family living: 31,250
- High level family living: 32,500
- Expansion of operation: 33,750
Examples of Cash Flow Needs

- Keep operation afloat  $46/CWT
  Plus:
- Debt retirement  48/CWT
- Minimum family living  50/CWT
- High level family living  52/CWT
- Expansion of operation  54/CWT
  250 hogs at 250 pounds -- 625/CWT
Livestock Marketing
Alternatives Are:

1. Forward Contract
2. Futures Contract
3. Cash Market
Bounds for Making Decisions

Step 1
Determining Today's Prices:

- Forward contract: $50
- Futures contract: $52
Bounds for Making Decisions

Step 2
Estimating Basis:

- Widest possible: $2.50
- Narrowest possible: 1.50
- Most likely: 2.00
### Bounds for Making Decisions

**Step 3**

Estimating Net Hedge Return:

<table>
<thead>
<tr>
<th></th>
<th>WIDE</th>
<th>NARROW</th>
<th>LIKELY</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FUTURES</strong></td>
<td>$52.00</td>
<td>$52.00</td>
<td>$52.00</td>
</tr>
<tr>
<td>- BASIS</td>
<td>2.50</td>
<td>1.50</td>
<td>2.00</td>
</tr>
<tr>
<td><strong>NET</strong></td>
<td>49.50</td>
<td>50.50</td>
<td>50.00</td>
</tr>
</tbody>
</table>
Bounds for Making Decisions

Step 4
Estimating Delivery Cash Price:

- Highest possible: $53.50
- Lowest possible: 48.50
- Most likely: 49.75
Bounds for Making Decisions:

Step 5

Summary for Probability (Risk)

($53.50)
Step 5

Forward Contract Price

Futures Prices

Expected Cash Prices

Risk in Price Ranges

No Risk

$50.00

Mod. Risk

$49.50 to $50.50

High Risk

$48.50 to $53.50
## Probabilities of Min. Price Levels From Various Markets

<table>
<thead>
<tr>
<th>Threshold Levels</th>
<th>Cash Market</th>
<th>Probability Forward Contract</th>
<th>Futures Hedge</th>
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<tbody>
<tr>
<td>Cwt</td>
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<td>Percent</td>
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<tr>
<td>$46</td>
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<td>48</td>
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<tr>
<td>54</td>
<td>60</td>
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</table>
Pricing Decision Model

- **Financial Criteria Weights**
- **Outlook Criteria Weights**
- **Technical Criteria Weights**

Decision Rules - Triggers Action
Examples of Pricing Model Criteria and Weight Comparisons

Current Contract Prices Versus:

A. Financial needs of the enterprise (Threshold Price)
B. Outlook prices
C. Signals from tech. analysis
## Example Criteria and Weights

A. Current Contract Price vs. Financial Need

<table>
<thead>
<tr>
<th>WGT</th>
<th>Contract Price Is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Much below (5%) threshold</td>
</tr>
<tr>
<td>2</td>
<td>Some below (5%) threshold</td>
</tr>
<tr>
<td>3</td>
<td>Equal to threshold</td>
</tr>
<tr>
<td>4</td>
<td>Mod. over (2-3%) threshold</td>
</tr>
<tr>
<td>5</td>
<td>Well over (5%) threshold</td>
</tr>
</tbody>
</table>
## Example Criteria and Weights

### B. Current Contract Price vs. Outlook

<table>
<thead>
<tr>
<th>WGT</th>
<th>Contract Price Is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Much below outlook price</td>
</tr>
<tr>
<td>2</td>
<td>Mod below outlook price</td>
</tr>
<tr>
<td>3</td>
<td>About equal to outlook</td>
</tr>
<tr>
<td>4</td>
<td>Mod above outlook price</td>
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</table>
Example Criteria and Weights

C. Current Contract Price vs. Technical Signals

<table>
<thead>
<tr>
<th>WGT</th>
<th>Contract Price Is:</th>
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<tbody>
<tr>
<td>1</td>
<td>Short term uptrend</td>
</tr>
<tr>
<td>2</td>
<td>Sideways trend</td>
</tr>
<tr>
<td>3</td>
<td>Short term downtrend</td>
</tr>
<tr>
<td>OPTIONS</td>
<td>CRITERIA</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>-------------</td>
</tr>
<tr>
<td>A Only</td>
<td>A Only</td>
</tr>
<tr>
<td>A &amp; B</td>
<td>A &amp; B</td>
</tr>
<tr>
<td>A, B &amp; C</td>
<td>A, B &amp; C</td>
</tr>
<tr>
<td>Aggregate Sum-Wgts</td>
<td></td>
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<tr>
<td>No Forward Pricing</td>
<td>1-2</td>
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<tr>
<td>Price Some Production</td>
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<tr>
<td>Scale Up Amt. To Be Priced</td>
<td>4</td>
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<tr>
<td>Price Remain. of Production</td>
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<tr>
<td></td>
<td>2-5</td>
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<tr>
<td></td>
<td>6</td>
</tr>
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<td></td>
<td>9-10</td>
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<td></td>
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<td>11-12</td>
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