April 10, 2000

Contracting - Economic Viability, Risks, and Management

Program Implementation Experience (PIE)
April 4 and 5, 2000

Producers are lured to contract production with the expectation of larger profits or less price risk. Contracting can be in the form of production contracts, for which a producer agrees to deliver a specified quantity of good at an agreed upon date for a specific price. Contracting can also be in the form of a marketing contract in the form of delivery to deliver a specified quantity or in the form of a value-enhanced premium for certain quality characteristics. Contracting occurs in livestock, grain, and oilseeds.

Many Missouri cow-calf producers are interested in retaining ownership, whereby one retained ownership alternative is for the cow-calf producer to own the animals until processing. During August 1999 in Kansas, where many Missouri cow-calf producers opting to retain ownership feed-out their animals, nearly 80% of the live cattle marketed to packing plants were through some type of contractual agreement (see figure below for historical trend). According to a study by Grimes and Meyer nearly 75% of market weight hogs are marketed through a contractual agreement with a processor. Low hog prices during the past year have forced many Missouri hog producers to discontinue independent hog production and either contract finish pigs or raise segregated early weaned (SEW or 10 lb.) pigs whereby they have a contract with another party to deliver these pigs. A study by Lawrence, Grimes, and Hayenga found 40% of pigs are finished through some type of production contract.

For grains and oilseeds, over 40% of producers enter into some type of marketing contract that locks in a future price. For corn, current estimates have 10% of U.S. production under some type of value-enhanced contract (see figure below for production areas). This U.S. percentage has increased from 1% 5 years ago to 10% today. For four types of value-enhanced soybean, U.S. acreage under contract increased from no acres in 1996 to over 200,000 acres planted in 1999. Missouri's commercial livestock industry will allow Missouri producers to have numerous opportunities to contract produce grains to feed livestock.

As contracting evolves, producers will require more information on the changes in management accompanying contracting, the economics of contract production, and the legal issues surrounding contract production. Several hog producers lost hundreds of thousands of dollars in 1998-99 due to misunderstanding contractual agreements, and many crop farmers are enticed to contract produce grain for the $0.20/bushel premium only to later learn that variety selection, storage/segregation, and moral hazard costs may offset this premium.

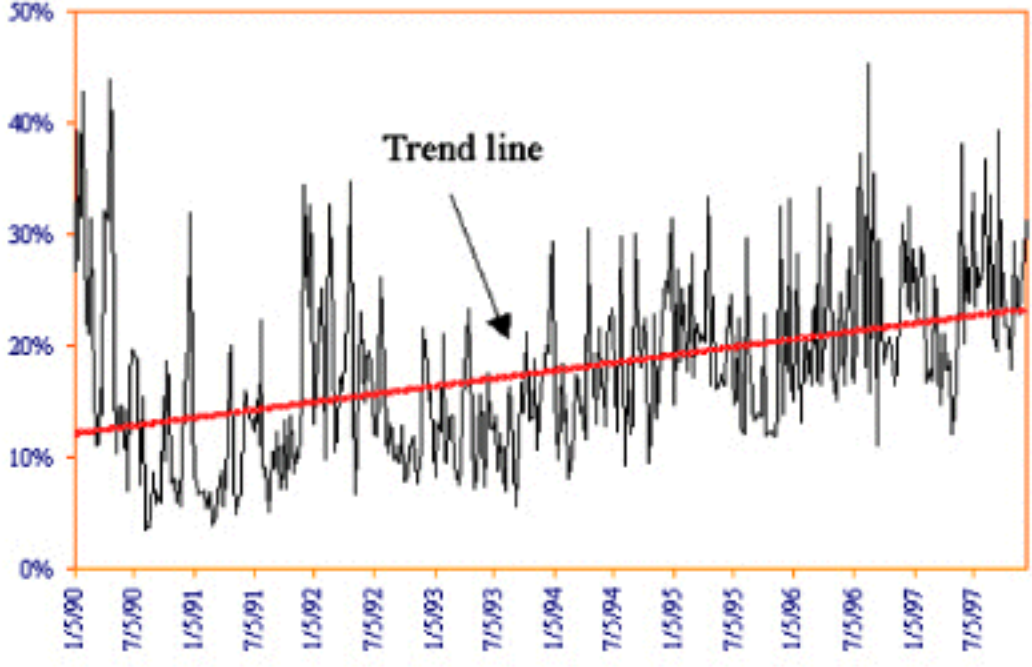
Specialty Corn Production Regions (1997)

Specialty Corn

Kansas Cattle

[AgEBB] - [Farm Management] - [Agricultural Contracting]

Percentage of Kansas Cattle sold under Contract (1990-1998)




High Oil
Endosperm/Food Grade
White
High Amylose
Waxy