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### Abstract
Interviews were conducted with cattle feeders, beef packers, and others involved in the beef industry to discern their concerns about fed-cattle price discovery. Three issues predominated. First was the need to better identify beef quality, ideally by objective means. Quality often, but not always, referred to tenderness and the "eating experience"? of consumers. Second was the need for greater pricing accuracy, signaling a desire for less average pricing and more value-based pricing. The need for improved market information was the third issue identified.



### Keywords
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# PRICE DISCOVERY ISSUES FOR FED CATTLE

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## Summary

Interviews were conducted with cattle feeders, beef packers, and others involved in the beef industry to discern their concerns about fed-cattle price discovery. Three issues predominated. First was the need to better identify beef quality, ideally by objective means. Quality often, but not always, referred to tenderness and the "eating experience" of consumers. Second was the need for greater pricing accuracy, signaling a desire for less average pricing and more value-based pricing. The need for improved market information was the third issue identified.

(Key Words: Fed Cattle Price, Price Discovery.)

## Introduction

Price discovery is the process of buyers and sellers arriving at transaction prices. Several factors, including issues related to value-based marketing, market information, and pricing methods, have caused price discovery concerns for cattle producers and others. This research was initiated to examine price discovery issues in the beef industry.

## Experimental Procedures

Most of our information for this study came from a series of personal and telephone interviews with persons associated with selected cattle feeding, beef packing, and related industry firms and organizations. These interviews were conducted during October 1996 through February 1997. They included discussions with five of the largest beef packing firms and eight of the 25 largest cattle feeding operations (located primarily in the midwest and plains regions), as well as numerous others in the industry.

## Results and Discussion

Many differences were identified *among* packers and *among* feeders during our interviews as well as *between* packers and feeders. Some packers and feeders thought price discovery was not really a problem or issue. Others thought it was a major problem. Six price discovery issues surfaced frequently.

*(1) More accurate, less subjective measurements of beef quality are needed.* Participants generally agreed that third party quality grading was essential. However, larger packers felt that they could quickly adjust to elimination of federal quality grading. There was consensus that mechanized, objective, quality grading would be preferable to the current, subjective, quality-grading system.

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Several cattle feeders and packers indicated that a large market exists for lower-quality, cheaper, beef products. The issue is that these lower quality beef products need to be accurately identified and targeted to the appropriate markets. Concurrently, animals producing these lower quality cuts should receive lower prices.

Many also voiced considerable concern regarding predictability of red meat yields. Yields of boxed beef from the same quality and yield grade of carcasses vary considerably, and current technology does not accurately estimate that yield. Technological developments, such as video imaging, seem to hold considerable promise in this regard in the near future. Adoption of improved technology in this area would make it possible to reward high yielding carcasses and penalize low yielding carcasses.

(2) *Price premiums and discounts for fed cattle do not adequately reflect cattle value*. Cattle feeders with small operations located in areas with access to high quality, more uniform cattle had strong sentiments regarding this issue. They felt that for prices to reflect value differences, cattle must be marketed on a grade and yield, dressed-weight basis. However, large custom cattle feeders tend to be less concerned about selling cattle on averages. Large operations that feed large numbers of their own cattle varied in their opinion on this issue, depending upon their management strategy. Cattle feeders striving to be low-cost operators were more willing to sell cattle on averages than those attempting to target their cattle to specific markets.

Most beef packers interviewed felt that buying cattle on averages was detrimental to the industry. All packers indicated a willingness to buy cattle based on quality. Buying cattle based on dressed weight seemed to be more prevalent than buying on grade and yield. Packers felt fewer cattle would be traded on a live basis (i.e., on averages) over time, but it would be slow to happen because of some cattle feeders' resistance to change.

*(3) Inadequate market information inhibits efficient price discovery.* Almost every cattle feeder interviewed, many of the beef packers, and even retailers indicated a need for increased and more reliable market information. An issue not addressed was the willingness to pay for more or better information. Different individuals and firms stressed different needs.

Cattle feeders felt that more information was needed on short-run, week-to-week, supply and demand conditions. In particular, they wanted more information regarding the volume of formula and contract cattle being delivered to packers. Many industry participants across different sectors indicated a need for better price reporting for wholesale boxed beef products. They felt current price reports did not represent boxed beef trades, primarily because of the low volume of trades reported, especially for close-trimmed products. Recommendations included using less-than-truckload prices to increase the volume of trade reported and greater efforts to capture more of the total boxed beef trade in price reports.

Inadequate retail price reporting was identified as a problem area by several individuals. Concerns included the need for volume-weighted retail prices to reflect actual trade rather than just published prices, and a desire that retail specials be better reflected in price reports. Improved knowledge of retail prices would provide a better indication of beef demand.

*(4) Risks of live cattle futures basis is excessive.* Some cattle feeders felt that the

risk of the live cattle futures market basis (basis is cash price minus futures market price) has become excessive, since contract specification changes were implemented with the June 1995 contract. They indicated problems with the delivery process for the live cattle contract, especially for cattle that do not meet contract specifications. These participants advocated cash settlement of live cattle futures.

Concerns regarding live cattle futures tended to be regional. Cattle feeders in the northern states generally were less concerned about basis risk than cattle feeders located in Texas and Kansas. This may be partly due to differences in quality distributions of cattle fed in northern versus southern states. Several individuals indicated that cattle fed in the north may fit quality specifications of futures contract more closely.

(5) *Formula pricing arrangements adversely affect cash fed cattle markets.* Cattle feeders who do not participate in formula marketing agreements had strong sentiments against such agreements. This was true regardless of size of the feedlot operation. They voiced considerable concern that existence of formula pricing arrangements made it difficult for them to discern fed-cattle supply and demand on a week-to-week basis. As a result, this contributed to panic selling of fed cattle by feeders who have limited access to this information. Some of these feeders expressed a need for weekly information regarding how many cattle each packing plant had scheduled for delivery under formula. Some feeders indicated that when formula deliveries were at high levels, certain packers did not bid for cattle in the cash market, and they felt that this depressed live prices.

Cattle feeders involved in formula marketing agreements generally had much different perspectives. Feeders marketing via formulas indicated that formula pricing taught them the advantages of sorting cattle, including sorting several times prior to marketing. They indicated that formula prices better reflect true value and eliminate pricing on averages. In addition, they felt that pricing fed cattle on formulas helped them improve their purchasing strategies for feeder cattle. Some participants in formulas voiced concerns that if only better quality cattle are sold on formula, and the formula price is based on live cattle cash trade, then poor quality cattle will establish the base price for high quality cattle.

*(6) Group marketing of fed cattle may offer solutions to some price discovery problems.* Smaller cattle feeders, especially those not located in strategic locations relative to several competing packing plants, felt that group marketing efforts could reduce some of the problems associated with fed-cattle price discovery. Some perceived that one potential benefit of joint marketing was to countervail the market power of large packers. Generally, large feeding operations had less enthusiasm for group marketing. Many felt that group marketing efforts would fail, because nothing would bind participants to the group and benefits might not be as large as some organizers perceive.

Packers tended to be less excited about group marketing efforts. They noted that group marketing would not solve problems associated with pricing on averages. They voiced concern that cattle producers need to be cautious about getting tied into group marketing efforts that promise big returns by branding beef products and owning them all the way to retail. They cautioned that considerable capital, infrastructure, and marketing expertise will be needed to develop and sustain this kind of effort.