PROJECTING FED CATTLE PRICE DISCOVERY OVER THE NEXT DECADE

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Summary

Interviews were conducted with cattle feeders, beef packers, and others involved in the beef industry to project how fed cattle prices will be discovered in the next decade. Respondents generally indicated that economics will determine beef's market share in 2010, how important public grades and grading will be, and whether consumer brands for fresh beef will become common. Economics also will determine how much influence alliances will have, whether most cattle will be marketed by some value-based pricing system, and what changes will occur in market information and futures markets.

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

Introduction

Price discovery is the process of buyers and sellers arriving at transaction prices. Several factors have caused price discovery to become a major concern to cattle producers and others in the past few years. This research was initiated to project how fed cattle price discovery will evolve over the next decade.

Experimental Procedures

Most 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 largest 25 cattle feeding operations.

Results and Discussion

Improved price discovery and vertical coordination in the beef industry are essential for beef to maintain market share into the future. Market prices need to better signal buyer preferences from the consumer level all the way to cow-calf producers. One theme that pervades all change in the beef sector is that the industry desperately needs to produce products perceived to possess greater value to consumers. Value means the product must be priced competitively, must be convenient, and must provide a consistently desirable eating experience for consumers. These attributes, though simple conceptually, have proven immensely difficult for the beef industry to manage. A myriad of beef products and product qualities are produced, and the target markets represent such a diverse set of consumer demands that there is no simple solution to the industry's struggle for

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market share. This diversity of beef products and array of target markets suggest that the industry and beef products are likely to become progressively more segmented. In order for beef product segmentation at the consumer level to succeed, segmentation will increase at all levels of the cattle and beef production chain as each level strives to become more customer-focused.

The following significant forces will influence price discovery and vertical market coordination in the beef industry over the next decade.

1. Technology to *improve* our ability to identify and sort beef products according to varying quality and value attributes will be developed and adopted commercially by processors. Several such technologies are already being developed, including beef tenderness tests, video imaging, and product identification tracking. Technology will create quantitative and/or mechanical quality determination procedures, reducing subjective assessment of meat quality. This is a necessary step toward better identifying and paying for quality attributes of fed cattle.

2. Federal beef quality grades are likely to be less important in 10 years. Many different means will be adopted to measure and describe beef quality differences, depending upon the targeted consumer. Because standardized quality grades are not likely to adequately measure all the different needs of consumers, standardized grades will have less general value. However, in transition, federal quality grades are *valuable* to the industry and should be *maintained*. Though the current grading system does not adequately describe beef tenderness and the eating experience consumers can expect, it does provide consumers with some information regarding beef quality.

3. Our ability to predict meat quality from visual inspection of live cattle will not improve much over the next decade. Thus, live cattle price differentials will not adequately reflect cattle and beef value differences. This will lead to more fed cattle being sold on a dressed weight, carcass quality, and yield grade basis.

4. Formula and grid-based pricing will become more common in procurement of fed cattle by packers. Pricing methods that more accurately reflect value differences will replace systems not based on product value. Grids may continue to have a variety of base prices and a range of premiums and discounts. Collecting and reporting of grid prices by the USDA will continue to be important.

5. More cattle will be produced under alliances that directly link cow-calf producers all the way to retail and food service outlets. Alliances provide opportunities for clearer price signals and encourage producers to produce beef products targeted to specific consumers. However, only a relatively small portion of the industry will find alliances profitable. They involve considerable risk, coordination, infrastructure, and control, and generally offer only modest opportunities for additional profit. Alliances will not replace the predominant pricing methods for fed cattle, but information exchanged in alliances will supplement price signals in the market place. Alliances also may contribute to better understanding between feeders and packers and a reduction in the disruptive adversarial relationship that plagues the beef industry.

6. Beef price discovery will shift toward the wholesale level and away from the live market. More fed cattle will be sold on a dressed weight, carcass quality, and yield grade basis with greater use of price grids and increased alliances. This suggests a greater need for

improved price reporting by USDA for boxed beef and by-products.

7. Producer group marketing and closed cooperative efforts will increase, but they will not represent a significant portion of the fed cattle market. The most probable beneficiaries of producer group marketing activities will be small and mid-sized operations. Group efforts may offer significant opportunities for information sharing and capturing of volume premiums associated with grouping cattle for large processors.

8. An increased share of beef will be marketed by brand name. Some alliances may introduce branded products, as may some producer groups. Certified programs will continue to market branded products. Many restaurants will differentiate themselves by the beef they sell, with their name serving as the brand. Some packers may brand beef products, and more retailer product branding could occur. Large beef processors will not brand much beef until profitability of doing so is clear. Successful beef product branding requires control over the type of cattle procured, careful beef quality measurement and sorting, extensive coordination between product merchandisers and commodity procurement, and national brand promotion programs. More intensive management and control are costly, and a packer whose comparative advantage is large volume, low-cost processing sees little benefit to the increase in costs and risks associated with large-scale branding.

9. Asymmetry of market information is a characteristic of the beef industry and was considered a problem by cattle feeders. The USDA has been very responsive to industry demands by developing new information and reports. Even more information is needed especially regarding boxed beef prices, especially closely trimmed boxed beef; export prices; hide and offal values; andshort-run captive supplies. If industry participants do not cooperate and provide the requested information, mandatory reporting may be the inevitable policy solution. The need for more market information regarding captive supplies is *not* an indictment against this marketing method or against packer concentration. It simply represents a need to balance information when these marketing alternatives are prevalent.

10. The live cattle futures contract will see increased pressure to move to a dressed weight specification. Overwhelming evidence suggests that live cattle cash trade will decline and dressed weight pricing will increase in the future. Carcass weight pricing likely will become the predominant fed cattle pricing method in 10 years, though a significant percentage of fed cattle will still be priced on a live weight basis. In addition, the dressed beef contract likely will be cash-settled because of the inherent difficulties in delivering dressed beef. Developing a cash-settled dressed beef contract will require improved reporting on boxed beef and carcass prices by the USDA.

11. Negotiating terms of trade will increase. Larger operations, group efforts by producers, producer cooperative ventures, alliances, and product branding all require more negotiation of terms of trade than have previous marketing methods. Beef product specifications, base prices, formulas for premiums and discounts, volume needs, and control and verification of production practices, all targeted on specific consumer demands, will increase the need for, and benefits of, negotiations among market participants. Increased negotiations require better market information, technology to more accurately measure product specifications, increased knowledge of how to control product quality, and more coordination among stages of the marketing and production system.