Strategic Alliances--How Will They Impact the Market?

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Trading cattle has always been characterized as a "bid-and-ask" process. This process typically leads to the packer controlling the price ultimately paid for a group of cattle. This price is given on the average of the pen and does not reward cattle that have superior carcass merit, nor does it discount those cattle that have inferior carcass merit. Because of this situation, the advent of value-based marketing systems has received a great deal of attention. While the industry has been slow in implementing this type of value-based system, there are many breed alliances and branded beef co-ops which are moving forward in this arena. The question remains: How will strategic alliances and a value-based system affect the market and the price the rancher receives?

Currently, there are approximately 25 strategic alliance groups in the market. These groups range from breed associations (Angus, Gelbvieh, Hereford, Limousin, Red Angus and Salers) to feed companies (Cenex/Land o' Lakes, Farmland Industries, Hi Pro, Moormon's and Purina Mills, Inc) to feedlots (Decatur County Feed Yard, Inc; Hitch Enterprises, Inc; and ConAgra Cattle Feeding Co.) to branded beef groups (B3R Country Meats, Inc; Coleman Natural Products, Inc; Laura's Lean Beef Company; and Premium Gold Angus Beef, Inc.) to cooperative groups (Beef Works, Decatur Beef Alliance, Maverick Ranch Association, Northern Plains Premium Beef, Precision Beef Alliance, Western Beef Alliance U.S. and Premium Beef, Ltd). These organizations all try to increase the value of the animal by "integrated cooperation" across the segments of the industry and(or) through the use of a value-based formula and grids.

Typically we can break the alliances into two groups: (1) Alliances that focus on "integrated cooperation" and (2) marketing alliances that help producers market their cattle into niche markets so that producers get rewarded for superior carcass traits and(or) management styles.

Integrated cooperation alliances are typically referred to as retained ownership programs. Such alliances help producers capture more income by allowing them to retain ownership of their cattle through all or part of the industry segments. Many of these alliances require that cattle be preconditioned using certain vaccination programs and(or) feeding programs before shipping. The increased profit potential in these alliances arises from two strategies. The first is that producers can capture the entire value of their calf crops-- through the feeding phase–where, typically, this profit would otherwise be passed on to the feedlot operators. The second strategy for potential profit increase is to insure that cattle are handled correctly throughout the process, thereby reducing losses due to death and sickness.

Marketing alliances help producers capture increased returns by rewarding cattle producers for specific carcass traits. These cattle are typically marketed on a formula and grid system. Cattle then receive premiums and or discounts based on carcass traits. It is important to understand how these formulas are derived and how the premiums and discounts affect your overall profit potential.

The use of formulas and grids is subject to many different variables. Typically, a formula is based on carcass weight, quality grade, and yield grade. Carcass weight usually ranges from 550 to 950 lb. Discounts as high as $25.00 can be placed on carcasses outside of this weight range. Some alliances want choice or prime carcasses, while others place a premium on leaner carcasses which are higher-yielding in lean beef markets. Discounts for yield can be very high, with one alliance discounting $25.00 per head for a yield grade 5 carcass; whereas another alliance awards a premium of $45.00 for a yield grade 1 carcass. In addition, premiums for items such as a 50% black hide, not using implants and(or) antibiotics, and high feeding levels of vitamin E are awarded by some alliances.

Producers should be cautious when looking at marketing through strategic alliances. It is critical that producers understand how their formulas are derived. A key component to the formula is how the base price is established. The base price is determined many different ways. Often alliances use an average price reported by USDA, while others utilize a local or regional average to set the base. This is a critical part of the pricing mechanism and producers need to understand how the base price is calculated. Premiums and discounts for quality grade are also factored into the formula. A producer should know how his cattle typically grade when slaughtered. It is a good practice to get an average group of cattle from the ranch and feed them so that you know what alliance your cattle will fit into. The key to using alliances is to market your genetics as they relate to carcass quality.

The use of strategic alliances is the first step to a true value-based marketing system. The use of strategic alliances will impact the beef market in the future. The degree to which this impact will be felt is difficult to determine at this time, given the relative infancy of these alliances. It is important to understand that very few cattle go through these types of marketing alliances today; however, it is positive that more and more cattle are being placed in these alliances.

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