

## Chapter 6. Value-Added Marketing Opportunities

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### Objectives

- Provide information on value-added marketing opportunities.
- Discuss four alternatives that fit with recent beef industry trends.

Producers need to be alert for opportunities to add value to their cattle and calves. This chapter discusses four alternatives that fit with recent trends in the beef industry. Those alternatives include preconditioning calves, cooperative marketing programs, retained ownership via custom feeding, and participating in strategic alliances. These can be independent alternatives or one may overlap with each other.

Each value-added alternative has pros and cons for an individual cattle producer. The overriding economic criterion for evaluating each alternative is relatively simple in concept but not as simple in reality. Does an alternative opportunity add more value to a producer's cattle than the added costs required for the value-added alternative?

### INDUSTRY TRENDS UNDERLYING ALTERNATIVES CHOSEN

The cattle industry, like most of production agriculture, has seen increasingly tight margins for commodity production. Questions abound regarding how to move from a commodity sector to a value-added product sector. In processing and retailing, value-added typically occurs by developing processed, branded products. Developing branded products in the production sector of agriculture does not exist per se on a widespread scale for any one, average size producer. There are opportunities to establish a positive reputation with buyers, so the emphasis for producers should be on identifying what they can do individually or collectively that adds value for the buyer at the next production or processing stage.

For stocker operators, one of the most important factors affecting profits is calf health. Similarly, cattle feeders increasingly recognize the value of cattle health on profits. For these reasons, increased attention has focused on preconditioning calves to increase animal health and strengthen immune systems. Figure 6.1 shows the percentage of preconditioned lots sold at Superior Livestock Video Auctions has been increasing.

More importantly, the benefits of preconditioning are recognized by buyers. Figure 6.2 shows price premiums paid by buyers for preconditioned calves has increased over time.

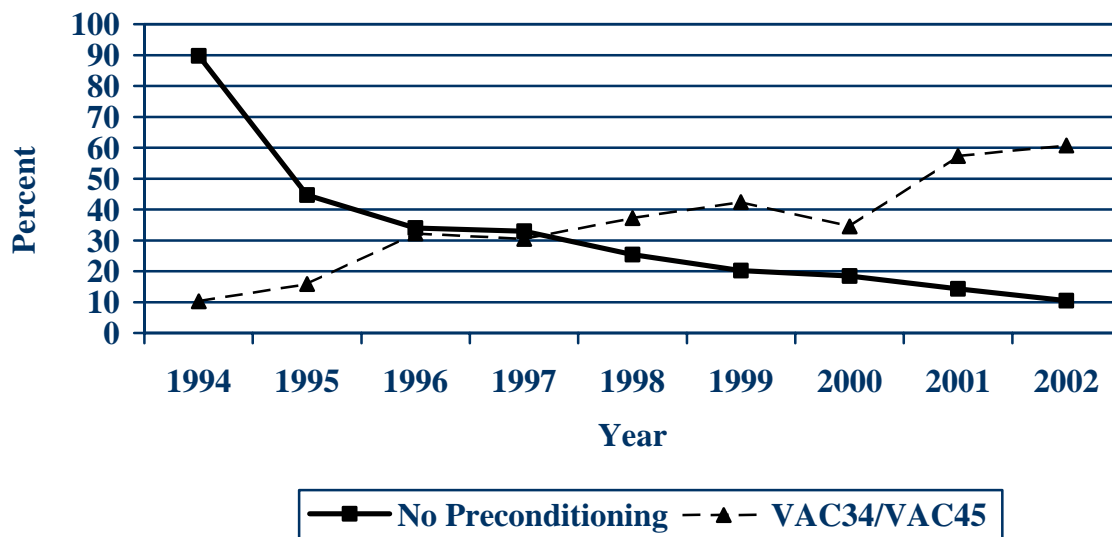


Figure 6.1 – Preconditioning growth (VAC34/45 programs) at Superior Livestock Auctions.

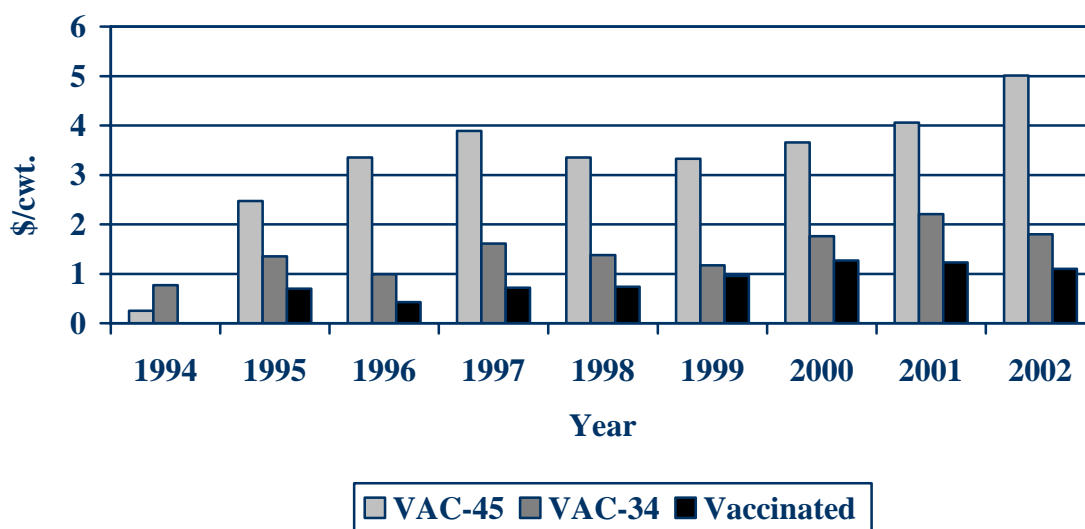


Figure 6.2 – Preconditioning price premiums paid by buyers at Superior Livestock Auctions.

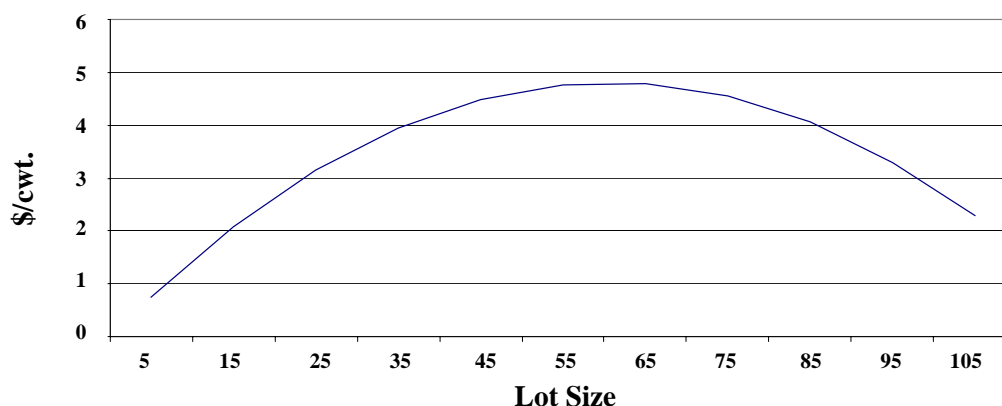


Figure 6.3 – Effect of lot size on prices paid by buyers at the Joplin Regional Stockyards, December 2000.

The average size cow herd in Oklahoma is about 40 head. Many smaller cow-calf producers are at a comparative disadvantage in one or more ways. Most cannot market large lots of uniform calves. Research over many years, including recent research at OSU indicates that higher prices were paid for larger sale lots up to about 55 to 60 head at the Joplin Regional Stockyards (Figure 6.3). The upper size is much larger than most cow herd owners in Oklahoma can market.

Many producers in Oklahoma are not sure how to upgrade their cow herd genetics and make management changes to increase uniformity of their calves in terms of weight, frame, muscling, sex, horned or polled, etc. One alternative for small groups of producers in some states is to form a

cooperative marketing organization. These have varying objectives. Some are designed to upgrade cow herd genetics, some to pool calves into larger, more uniform lots, some to purchase inputs collectively. This is an alternative tried by a few producers in Oklahoma and is of interest to others.

Custom feeding of owned calves, like preconditioning, is not a new alternative. However, with the advent of grid pricing, custom feeding is one method of increasing the assurance of getting feedlot performance data and carcass data on calves produced. This information in turn can assist cow herd owners in making improvements in genetics and management of the calves raised. Cattle feeding extends the ownership period for the producer. Producers must recognize this component of custom feeding adds significant risk but

it may also increase the possibility of being paid for assuming the added risk.

Figure 6.4 shows how strategic alliances have increased in recent years. The volume of cattle marketed through those alliances is increasing. These programs are often attempts to better understand buyers' needs and determine what can be done to improve coordination and meet those demands. One of the key reasons cattle feeders state for joining alliances is to access carcass data. Again, part of this demand for carcass data comes from cow herd owners wanting to improve their cow herds and produce calves that have a better chance of meeting consumers' demands. Participating in an alliance program of some type may be a desirable alternative for some cow herd owners.

Improved coordination can occur in several ways and trends in the industry suggest some possible alternatives that cow herd owners might consider. Note that some producers may be satisfied with the marketing program they have currently and some (or all) of these alternatives may not appeal to them. The alternatives discussed here are targeted to those producers who are interested in exploring alternatives to their current marketing program.

## PRECONDITIONING CALVES

There are several preconditioning programs with varying names and management requirements. One program familiar to many in Oklahoma is the Oklahoma Quality Beef Network (OQBN) program sponsored by the Oklahoma Cattlemen's Association. It is a process verification and certification program and similar to the VAC-45

program, which is a process verification program recommended by Texas A&M University. Both require a 45-day post-weaning phase, a specified animal health program, dehorning, castration of bull calves, and bunk feeding. The purpose of preconditioning programs is to reduce stress from shipping calves at weaning, improve the immune system, and thereby enhance performance in post-weaning production phases (stocker, feeding, and carcass levels).

## Preconditioning Price Effects

Research in Oklahoma and other states indicates how important certain traits are to prices paid by buyers. Several feeder cattle traits that affect price are in turn affected by preconditioning. Those are discussed briefly here.

### Weight

Preconditioning calves results in marketing heavier animals compared with marketing calves at weaning. Producers sell more pounds after preconditioning, but the weight effect alone means producers can expect lower prices for preconditioned calves. Some of this lower expected price may be offset by the seasonal price component associated with most preconditioning programs. Therefore, instead of selling calves at weaning in October, for example, calves would be marketed 45 days later, in November or December. The typical seasonal price pattern for feeder calves in Oklahoma involves a higher price in November through December than in October. Thus, preconditioning may enable cow-calf producers to capitalize on the normal seasonal price pattern for feeder calves.

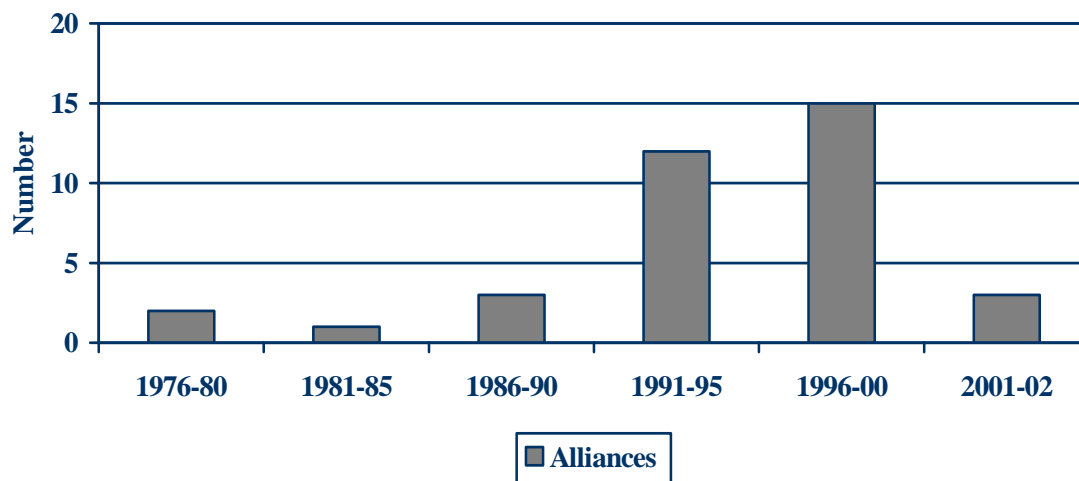


Figure 6.4 – Alliances listed in *Beef* magazine by year organized.

### **Sex**

Most preconditioning programs require castrating bull calves. Therefore, producers can expect higher prices for steer calves than for bull calves and thus higher prices for the castration requirement in preconditioning programs.

### **Horns**

Dehorning has received increased attention because the 1995 Beef Quality Audit found a significant increase in carcass bruise damage compared with the 1991 Beef Quality Audit. Most preconditioning programs require dehorning calves. Therefore, to the extent producers market preconditioned, dehorned calves instead of horned calves, higher prices can be expected from the dehorning requirement in preconditioning programs.

### **Condition**

Condition can affect feeder cattle prices positively or negatively. Thin calves may be discounted, especially if there is evidence of thinness being related to poor health or muscling. However, if associated with poor nutrition, thin calves may receive a price premium because buyers expect compensatory gains after improving the nutritional level. Fleishy calves are usually discounted, a recognition by buyers that no compensatory gains are likely. However in some cases, fleishy calves are preferred as long as the degree of fleishiness is slight or moderate and is associated with health or thriftiness of the animals. Preconditioned calves that receive or are provided a high degree of nutrition may appear fleishy. Thus, in some cases, preconditioned calves may be discounted due to their fleishy condition. However, some buyers may associate slight or moderate fleishiness with higher nutrition and health and may pay a price premium for preconditioned calves.

### **Health**

Preconditioned calves are expected to be healthier, less stressed, and have a stronger immune system than calves sold at weaning. Therefore, cow-calf producers should expect a price premium for preconditioned calves, simply due to improved health of the animals.

### **Uniformity**

Production and feeding efficiency increases for uniform lots of cattle. Not all preconditioning programs include sorting as part of their protocol. In cases where they do, producers can expect a price premium for more uniform sale lots of calves.

### **Value of Preconditioning**

Managers of Texas Cattle Feeders Association's (TCFA) member feedlots estimated the value of preconditioning to be \$5.25/cwt on average. Data in Figure 6.2 shows buyers are increasing the premium paid for preconditioned calves. Premiums for sale lots of calves following a VAC-45 program reached their highest annual average (\$5.01/cwt) in 2002.

In an OSU study, data were analyzed from the Joplin Regional Stockyards in Joplin, Missouri. The livestock market sponsored three, consecutive-day sales in December 2000, two preconditioned calf sales, and one regular feeder cattle sale. The premium price for the preconditioning program with a single protocol was \$3.36/cwt compared with the regular weekly auction. Estimates of price premiums from the OQBN fall sales in 2001 and 2002 averaged \$3.11/cwt.

### **Evaluating Preconditioning**

Preconditioning has several positive benefits but also requires additional time and cost. Producers must assess the added gains against the added costs. Table 6.1 on page 55 is a spreadsheet example of that process designed for the OQBN preconditioning protocol. It would be applicable to similar VAC-45 programs and could be modified for other preconditioning protocols. Revenue from marketing calves at weaning is compared with marketing calves after a 45-day preconditioning program. Cells with Xs in the spreadsheet can be changed to fit each producers' situation or to explore the sensitivity of results to changes in selected items. This example was intended to show only a slight positive gain for preconditioning. However, under many circumstances, (such as lower average daily gains, less seasonal price increase, less premium for OQBN calves, higher costs, etc.) results would be less favorable. On the contrary, these same factors in reverse (such as higher average daily gains, more seasonal price increase, more premium for OQBN calves, lower costs, etc.) would result in more favorable results. Producers must be careful to enter realistic values for their specific case.

Some resources for those interested in preconditioning can be found at the following sites:  
<http://osuextra.okstate.edu/topical/economics/mktingout.shtml>  
<http://osuextra.okstate.edu/dept/ansi/>

**Table 6.1 – Sample preconditioning comparison for Oklahoma Quality Beef Network protocol.**

<b>Traditional management alternative</b>		Default entries
Ranch (marketing) weight (lb)	500	xxx
Shrink (%)	4	4
Sale weight (lb)	480	xxx
Price (\$/cwt)	95.00	xxx
Gross revenue (\$/head)	456.00	xxx
<b>OQBN management alternative</b>		
Weaning weight (lb)	500	xxx
Days from weaning to marketing	45	45
ADG (lb/day)	1.5	1.5
Ranch (marketing) weight (lb)	568	xxx
Shrink (%)	2	2
Sale weight (lb)	556	xxx
Weaning day price (\$/cwt) from traditional alternative	95.00	xxx
Price change from weaning to marketing (\$/cwt)	1.00	1.00
Price slide for heavier weight (\$/cwt)	7.00	7.00
Price discount for increased flesh (\$/cwt)	0.00	0.00
OQBN premium (\$/cwt)	3.50	3.50
Final price (\$/cwt)	92.50	xxx
Gross revenue (\$/head)	514.44	xxx
<b>OQBN management costs (\$/head)</b>		
Interest rate (%)	8.0	8.0
Cattle interest	5.07	xxx
Health supplies and medicine	8.00	8.00
Death loss (%)	0.5	0.5
Death loss (\$/head)	2.57	xxx
Labor and equipment	6.00	6.00
Feed, hay, and pasture	35.00	35.00
Additional marketing costs (tags, commission, etc.)	5.00	5.00
Total cost	56.65	xxx
<b>Traditional and OQBN comparison</b>		
Traditional gross revenue	456.00	xxx
Network gross revenue	514.44	xxx
Increased revenue	58.44	xxx
Less OQBN costs	56.65	xxx
Net return from OQBN program	1.79	xxx

Source: R.K. Avent, C.E. Ward, and D.L. Lalman.

## COOPERATIVE MARKETING PROGRAMS

Cooperative marketing programs can be very diverse. They are cooperative in the sense of producers working together toward a common goal or mutual objectives. But they need not be organized legally as a cooperative form of business. Three specific objectives of such programs are (1) add value to calves through improved cow herd genetics;

(2) add value to calves by increasing uniformity of calves and marketing in larger sale lots, and (3) lower production costs by cooperatively purchasing inputs.

## People Issues

Perhaps nothing is more important in considering a cooperative marketing program than ensuring participants who agree to work together are on the same page. Participants must understand and agree to the objectives of the program. They all must understand that each person must adhere to the requirements in order to participate. Any cooperative effort can be undermined by one person not doing what is expected of them. Commitment to the program is essential.

Another essential ingredient is leadership. One person or a small group will have to assume the leadership role in organizing potential participants, accumulating information, planning and conducting meetings, etc.

Producers are encouraged to write clearly and specifically the objectives and requirements of each cooperator-producer. Undoubtedly at some future time, there will be a challenge or question about someone's involvement. Having everything in writing will help avoid selective listening and miscommunication.

## Genetic Improvement

An effort in northeast Oklahoma a few years ago had as one of its goals to improve the genetics of several cow herd owners. This paralleled what is being done in other states as well. Together, producers purchase or lease bulls with similar attributes or artificially inseminate cows with semen from bulls with similar attributes. This may involve a common breed or breeds and a set of criteria such as breeding and carcass EPDs (Expected Progeny Differences). Typically, producers determine a set of common management practices, such as beginning and ending breeding dates to shorten and target the calving period, for example, 60 days in length.

Then progeny from the commonly-selected genetic base are typically marketed at the same time. Marketing programs can vary. The program may be designed such that producers can retain heifers for their cow herd and only market bull calves. Producers may choose to market calves independently or advertise and market them as a group through a local livestock market or directly to buyers. Most important is the objective of the group.

Much also may depend on the number of animals, location of the producers, etc.

### **Larger, Uniform Sale Lots**

A second common objective of a cooperative marketing program is to market more uniform calves in larger lots. This can be done independently of using common genetics and management, but is also a logical extension of the genetic improvement objective. Having similar genetics and having cows calve in a predetermined period (based on the predetermined breeding period) are means of moving toward more uniform sale lots. Producers typically also have a common set of management practices to follow after calving. These often follow the preconditioning protocol as indicated in a program such as the OQBN. This, too, increases the uniformity of calves marketed in terms of weaning date, nutrition program, vaccination program, castration, dehorning, etc.

Actual marketing of these calves may differ according to the objectives of the cooperative group. Calves may be marketed by each producer independently, marketed at a predetermined livestock market on a set date, marketed in commingled lots at a specified market, and on a set date marketed directly to buyers or retained for a stocker or feeder program.

### **Cooperative Purchasing of Inputs**

While this chapter's focus is on adding value, some producer cooperatives are formed to also purchase production inputs cooperatively. They determine the needs of producers in the group, determine appropriate specifications, solicit bids, and purchase from the chosen bidder. The decision may not be based on the low bid, but may consider reliability and reputation of the bidders as well. The group must determine the criteria on which they will base group purchases.

This type of cooperative program may be independent of improving genetics and value-added marketing or may be an additional objective. Groups have found that local suppliers are often unwilling to bid or are unhappy when they are not the chosen bidder. However, they quickly learn that to win the cooperative group's business, they must be competitive both in price and service.

## **Evaluating a Group Marketing Program**

Forming a group of producers with clearly defined, common objectives does not occur overnight or easily. If producers have a starting date in mind, they must start planning several months in advance. Such an effort takes time, numerous planning meetings, some research or use of outside resources, and some risk taking. Experienced groups that have been operating for some time often are willing to share their experiences. Some have websites and will communicate quickly and efficiently via email and the Internet. Experienced groups can be especially helpful in identifying pitfalls an interested group might avoid. However, each group effort is different and each may have its own unique problems and pitfalls.

Some resources for those interested in cooperative marketing can be found at the following sites:

<http://osuextra.okstate.edu/topical/economics/mktingout.shtml>

<http://www.ohioprobeef.com/>

<http://agebb.missouri.edu/commag/beef/premierbeef/index.htm>

<http://www.extension.iastate.edu/newsrel/2000/may00/may0011.html>

<http://www.animal.ufl.edu/extension/beef/documents/short01/Anderson.htm>

## **RETAINING OWNERSHIP THROUGH CUSTOM FEEDING**

Retained ownership through cattle feeding is indeed risky and not for everyone. That represents one of the major disadvantages. Advantages include knowing how cattle perform in the feedyard. Marketing fed cattle on a grid also provides information on how the cattle perform in carcass form. And one desirable feature of grid pricing is that better carcasses do not subsidize poorer carcasses. Each carcass is essentially priced individually rather than all cattle in the pen receiving the same price.

### **Questions to Ask**

Producers interested in custom feeding are encouraged to ask several questions before determining where to feed or with whom to feed cattle. Here are a few:

- Does this feedlot typically handle these kind of calves (weaned, bawling, preconditioned, off wheat or grass, etc.)?



- Will the feedlot manager provide examples of closeout sheets for similar kinds of cattle?
- Will the feedlot manager provide names of other customers to contact?
- What receiving practices are followed and what rations are fed?
- What pen sizes do they have?
- How are feed and services priced? How do these compare with other lots? How often are cattle owners billed?
- Will feedlots provide financing? Risk management services? Insurance?
- Who determines when fed cattle are marketed? To which packer? By which pricing method?
- Does the feedlot sort fed cattle before marketing them?

## Financing and Risk Management Considerations

Producers need to contact their lenders before entering into a custom feeding arrangement. Similarly, it is wise to contact a futures market broker and assess risk management alternatives. This might be advisable even if the feedlot provides such services. Three-way agreements have worked well for some producers. These involve communication between the lender, broker, and cattle owner. Margin and brokerage fees can be billed directly to the lender and can be included in the loan agreement so as to not cause stress during the hedging period for the producer.

## Evaluating a Custom Feeding Opportunity

Producers should do some budgeting and risk assessment before entering into a custom feeding arrangement. Table 6.2 is a spreadsheet example of a custom feeding budget to compute the fed cattle breakeven price. Shaded cells in the spreadsheet can be changed to fit each producers' situation or to explore the sensitivity of results to changes in selected items. Realistic values need to be used. It is advisable to use less optimistic values for selected variables than you think will be experienced to see the sensitivity of the breakeven price to those variables. Some variables to consider changing, perhaps one at a time, include days on feed, fed cattle price, death loss, veterinary costs, conversion, and ration cost.

Some resources for those interested in custom feeding and marketing fed cattle can be found at the following sites:

<http://osuextra.okstate.edu/topical/economics/mktingout.shtml>

<http://osuextra.okstate.edu/dept/ansi/>

**Table 6.2 – Sample custom feeding budget.**

Feeder cattle cost		Default entries
Number of head	80	xxx
Purchase weight (lb)	700	xxx
Shrink (%)	5.0	5.0
Delivered weight (lb)	665	xxx
Purchase price (\$/cwt)	90.50	xxx
Delivered price \$/cwt	95.26	xxx
Freight rate (\$/mile)	2.00	2.00
Miles	300	xxx
Freight (\$/head)	7.50	xxx
<b>On-feed costs</b>		
Estimated days on feed	140	xxx
Estimated sale weight (lb)	1120	xxx
Estimated gain (lb)	455	xxx
Estimated average daily gain	3.25	xxx
Estimated price (\$/cwt)	80.00	xxx
Interest rate (%)	8.0	8.0
Interest on cattle (\$/head)	19.44	xxx
Death loss (%)	0.75	0.75
Death loss (\$/head)	6.72	xxx
Veterinary costs	15.00	15.00
Estimated conversion (lb feed/lb gain)	6.0	6.0
Pounds fed	2730	xxx
Ration cost (\$/cwt)	7.50	7.50
Estimated feed cost (\$/head)	204.75	xxx
Yardage cost (\$/head/day)	0.05	0.05
Interest rate (%)	8.0	8.0
Interest on operating capital (\$/head)	6.96	xxx
<b>Cost of risk management</b>		
Futures contract commission (\$)	70.00	70.00
Futures contract commission (\$/head)	0.88	xxx
Interest rate (%)	8.0	8.0
Margin call for 60 days (\$)	2000	2000
Interest on margin call (500 points)	26.30	xxx
<b>Summary</b>		
Total feeder purchase cost (\$/head)	641.00	xxx
Total operating cost (\$/head)	280.09	xxx
Total cost (\$/head)	921.09	xxx
<b>Breakeven price (\$/cwt)</b>	<b>82.24</b>	<b>xxx</b>

## PARTICIPATING IN A STRATEGIC ALLIANCE

Strategic alliances as used here are broadly defined. Some alliances prefer referring to themselves as a cooperative, partnership, marketing program, or some other term. Here, they are all categorized as strategic alliances. Strategic alliances in the beef industry typically enable producer participants to fundamentally maintain their independence for most production decisions. But they share information to more effectively price products and improve coordination among the vertical production-marketing stages.

Participation in an alliance may be done independently of the alternatives discussed thus far. However, each of the above alternatives may also be part of an alliance. For example, 11 alliances in the most recent list compiled by *Beef* magazine require participants to precondition calves. Nearly all alliances have a targeted set of carcass characteristics. Increased uniformity may enable producers to more easily meet the target. Stated differently, increased uniformity decreases those carcasses that do not meet the criteria and which might be discounted or disallowed for the alliance program. Five alliances require truckload lots of cattle. Thus, a value-added program that enables marketing larger sale lots may better fit one of these types of alliances. Fourteen alliances have formal ties with one or more feedlots where producers can custom feed cattle. Thus, the above alternatives are not by themselves necessarily required to participate in an alliance. But each alternative may make participation easier.

### Information Needed

Producers need specific information regarding alliances in which they are considering joining. First, producers need to have a solid understanding of the quality of their production. Will production be compatible with what the alliance wants, or will substantial capital investments and changes be required to adhere to their requirements? Here are a few questions to ask:

- What are the objectives of the alliance? Does its objectives mesh with the operations objectives?
- Is there a required minimum number of head?
- What is the per head fee and/or capital commitment? What benefits does that include?
- What are the management requirements? Genetics? Preconditioning? Use of implants?

- Which feeders, packers, and retailers are part of the alliance?
- Does the alliance have its own brand? Are cattle in the alliance targeted toward specific retail brands?
- How much have past participants benefited from the alliance?

### Evidence of Economic Benefits

The *Beef* survey asked participating alliance programs to indicate the returns to participants in terms of the premium received. For 15 respondents, the range in premiums was \$10 to \$60/head over some average cash market value. Nine reported premiums were between \$20 and \$30/head. Thus, the economic advantages to participate in some alliance programs appear to be substantial. Recognize, however, that some alliances did not report their average premium. And averages mean some producers were above and some below the average. Not all producers will benefit from an alliance program initially, and this represents a risk to first-time participants. Ideally over time, the information feedback will allow producers to improve production and management practices so they can participate in the gains alliances offer others.

Some resources for those interested in strategic alliances can be found at the following sites:

<http://osuextra.okstate.edu/topical/economics/mktingout.shtml>

[http://beef-mag.com/mag/beef\\_taking\\_control/index.htm](http://beef-mag.com/mag/beef_taking_control/index.htm)

### CONCLUSION

Often cow herd owners feel as though there are no opportunities for them to add value to calves. There are no costless alternatives, but alternatives do exist. The purpose of this chapter was to discuss a few alternatives. It should be repeated that none of these may appeal to those producers who are satisfied with marketing calves as they have in the past. Others may be looking for alternatives to consider and may or may not find the alternatives discussed here attractive. In either case, producers need to recognize both the potential advantages and known risks associated with each alternative.

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