



G.R.A.I.N.S.

(Grain marketing Research And INnovative Strategies)

Volume 9 - Number 2
October - December, 2004

G.R.A.I.N.S. is a quarterly publication offered by Ohio State University Extension. Its goal is to provide updated research and strategies for the progressive marketer. Those parties interested in receiving this publication via Email may subscribe to G.R.A.I.N.S. by following these steps: Send an E-mail message to listserver@ag.osu.edu with the two line message:

subscribe grains
quit

Subscribers are encouraged to reprint any articles in G.R.A.I.N.S. with appropriate recognition of source and authors.

To unsubscribe to the list send an e-mail to listserver@ag.osu.edu with the two line message:

unsubscribe grains
quit

OSU Embraces human diversity and is committed to ensuring that all educational programs conducted by Ohio State University Extension are available to clientele on a nondiscriminatory basis without regard to race, color, age, gender, identity or expression, disability, religion, sexual orientation, national origin or veteran status.

Keith L. Smith, Associate Vice President for Agricultural Administration and Director. OSU Extension TDD No. (800) 589-8292 (OH only) or (614) 282-1868.

Edited by Barry Ward, Extension Agent, ANR, Champaign County

In This Issue.....

- ? Crop Farmers' Use of Market Advisory Services
- ? China: Will They or Won't They?

? Rethinking the Soybeans-to-Corn Price Ratio: Is It Still a Good Indicator for Planting Decisions?

Crop Farmers' Use of Market Advisory Services,

by Olga Isengildina, (Visiting Scholar, Dept. of Ag. and Consumer Economics, University of IL at Urbana-Champaign) Joost M.E. Pennings (Assoc. Professor, Dept. of Ag. and Consumer Economics, University of IL at Urbana-Champaign), Scott H. Irwin, (Professor of Ag. Marketing, Dept. of Ag. and Consumer Economics, University of Illinois, at Urbana-Champaign) and Darrel L. Good (Professor, Dept. of Ag. and Consumer Economics, University of IL at Urbana-Champaign)

Farmers place a high value on market advisory services (MAS) as a source of price risk management information and advice. For example, in a rating of 17 risk management information sources, Patrick and Ullerich report that MAS are outranked only by farm records and computerized information services. Schroeder et al. find that a sample of Kansas farmers rank MAS as the number one source of information for developing price expectations. Davis and Patrick report that marketing consultants have the largest impact on the use of forward pricing by soybean producers. Norvell and Lattz find that marketing consultants tie for first place (with accountants), in a list of seven, as likely to be most important to Illinois farmers in the future. The rating of importance of MAS

among participants at Purdue Top Farmer Workshops has steadily increased from fifth in 1997 to fourth in 1999 to third in 2001 (Patrick).

Surveys also report that a growing number of farmers subscribe to market advisory services. Among the participants at Purdue's Top Farmer Workshop, the share of subscribers grew from 53% in 1997 to 62% in 2001. Davis and Patrick report that 39% of farmers in Mississippi and 49% of farmers in Indiana used marketing consultants or subscribed to market information services in 1999. Along with the increased use of market advisory services for management decisions, farmers are willing to spend increasing amounts of money to receive this advice. Among Purdue's Top Farmer Workshop participants, annual expenses on marketing advice moved from the fourth highest expense for consultants to the second highest from 1991 to 2001, growing in absolute terms from \$755 to \$3455. The majority of respondents that used marketing consultants in Coble et al's survey indicated that they spend \$1,000 or more on marketing advice in 1998. It appears that the increasing importance of MAS in the decision making process of farmers is part of an overall trend towards firm reliance on external consultants in operational capacities, as pointed out by some researchers (e.g., Henderson; Venkatesan).

Previous studies have focused primarily on the pricing performance of MAS in corn, soybeans and wheat (e.g., Martines-Filho, Good and Irwin; Irwin, Martines-Filho, and Good). A key assumption in these evaluations is that a representative farmer follows the recommendations exactly as provided by the advisory services. Limited evidence is available on how farmers actually use the marketing recommendations provided by advisory services. Pennings et al (2004, 2005) examine factors that determine the impact of MAS on farmers' marketing decisions. They argue that perceived MAS performance, the way in which MAS recommendations are delivered, and the match between a particular MAS and an individual farmer's marketing philosophy are important factors explaining the impact of MAS recommendations. Other studies have evaluated MAS as sources of consulting advice and information (e.g., Ortmann, et al; Jones, Battle,

and Schnitkey). These studies have found that the use of consulting advice may be affected by the operator's age, farm size, farm ownership, education and risk aversion, among other factors. Ortmann, et al revealed that farmers rate their marketing management skills lower than their other management skills. They also found that marketing sources of information were ranked lower than other sources of information, which may indicate that the needs of farmers are not being met in this area. These findings emphasize the need to investigate further the nature of MAS use.

The purpose of this study is to provide new and more comprehensive evidence about crop farmers' use of MAS. More specifically, in this study we (1) identify the levels of MAS use by US commercial farmers, (2) differentiate farmers who use MAS, (3) describe farmer valuation of MAS relative to other sources of marketing information and their selection of particular MAS, (4) demonstrate changes in MAS use under different market conditions, (5) describe the nature of MAS use, and (6) discuss the impact of MAS use on producer marketing behavior. These issues are examined based on the results of a survey of commercial agricultural producers conducted in January/February 2000. The study is concluded by providing practical implications of the survey findings for advisory services, farmers, extension programs and research.

Farmers in the US continue to identify price and income risk as one of their greatest management challenges. Numerous surveys show that farmers place a high value on market advisory services (MAS) as a source of price risk management information and advice. While the pricing performance of MAS has been examined in detail, there is limited evidence about how farmers actually use these services. This study sought to examine the nature of farmers' use of advisory services based on the results of a survey of US crop producers. The survey questioned 3,990 farmers in the Midwest, Great Plains, and Southeast and provided 1,285 complete responses for the purposes of this study. The sample of survey respondents appears representative of large-scale commercial farmers in the US.

The survey revealed that about 82% of the respondents used MAS. Users of MAS cannot be differentiated from non-users, based on demographic characteristics, such as age and farm size. However, MAS users tend to be significantly more risk seeking than non-users. The use of a specific MAS appears to be closely correlated with farmer familiarity with the MAS. Farmers value both aggressive and conservative MAS, which suggests the match between the marketing philosophy of a farmer and MAS may play a key role in MAS choice. These findings imply that a MAS may be able to expand its customer base if it makes more producers aware of its services, and its marketing style, in particular. The biggest potential for the new customer base is among more risk-seeking producers that may be in greater need of marketing advice.

Stability of customer base may be an important issue for MAS. Respondents to this survey reported that they switched MAS on average about once every three years. This finding implies that MAS must find a new pool of subscribers about every three years, and therefore, their marketing efforts are extremely important. Additionally, farmers reported moderate levels of satisfaction with MAS use overall. These findings are consistent with conclusions by Ortmann et al. that producers' needs for marketing information are not being fully met. Therefore, MAS (as well as other sources of marketing information) may need to invest in further research to identify these specific needs.

Stability of MAS use also may be affected by market conditions. A simple experiment included in the survey indicated that farmers differed in their likelihood of subscribing to MAS in different market conditions. Three groups of farmers were identified that revealed (A) decreasing, (B) increasing, and (C) constant probability of subscribing to MAS relative to crop price levels. Thus, in order to increase stability of use in different market conditions, MAS should concentrate their efforts on the first two groups. It appears that the first group (A) may be most interested in risk-reducing characteristics of MAS, and therefore, this group should be presented with recommendations targeted at reducing producers' risk exposure. The

second group (B) seems to be very sensitive to the cost of MAS. Hence, some price-discriminating strategies may make MAS more attractive for these farmers.

This survey showed that farmers use MAS for various reasons. Most often MAS are used for marketing information, market analysis, and to keep up with markets. Advisory services are more often used in an attempt to receive an above-average price than to reduce price and income risk. Most farmers use MAS recommendations as background information, compare it with other sources and do not follow MAS advice precisely. Only 11% of farmers allow the specific pricing recommendations of MAS closely. Based on this information, it appears that MAS may benefit from providing more differentiated products, some concentrated on general marketing information, some focused on specific pricing recommendations. Such product differentiation may allow MAS to better meet the needs of farmers. In view of our findings regarding the importance of the match between MAS and farmers' marketing philosophies, it is critical that these new products be clearly identified.

The results of this study may be used by producers to compare their use of MAS with that of other users and to form expectations for MAS use. The survey revealed the importance of a good match between the marketing philosophy of a farmer and a MAS in farmers' selection of MAS. Therefore, farmers should carefully consider the marketing style of a particular service while making their choice of a MAS. A better "fit" between farmers and MAS may result in higher satisfaction levels and lower switching rates. Only 28% of MAS users reported that they have never switched MAS. The other 72% of MAS users may be chasing "the hot advisor." Such behavior may result in substantial switching costs. Similar behavior on part of mutual fund investors has been shown to be quite costly in terms of realized performance (e.g., McDonald). Additionally, previous studies of MAS performance (e.g., Irwin, Martines-Filho, and Good) show that past performance is not indicative of future performance. This emphasizes the importance of selecting a MAS based on its marketing style rather

than past performance.

The insights about the nature of MAS use by U.S. crop farmers presented in this study also have interesting implications for extension program development. University extension services received a very moderate ranking as a source of marketing information by survey respondents, which suggests that information the extension service provides to large commercial farmers is not, in general, highly-valued. Two findings of this study are particularly curious in this context: (1) MAS users are more risk-seeking than non-users and may have a greater need for marketing advice because they are involved in more sophisticated marketing strategies; and (2) farmers appear more interested in the price-enhancing characteristics of MAS rather than in their risk-reducing features. These findings contribute evidence to the ongoing debate in the agricultural economics literature about the relevance of risk-management education and research. Numerous arguments have been made that risk reduction is not of primary interest to farmers (Christensen and Wimberley), that risk only matters when a producer is in a tight financial situation or is contemplating a major change in farm operations (Patrick and De Vuyst), or that producers' primary concern is how to use the information in order to make money (Anderson and Mapp). On one hand, these arguments emphasize the need for educational programs that incorporate information on price-enhancement opportunities from various marketing strategies and help producers better understand marketing information. This can be accomplished in part by incorporating more outlook information into extension programs. On the other hand, these findings indicate the importance of educating farmers about market efficiency concepts, which challenge their focus on price enhancement (e.g., Zulauf and Irwin).

Results of this study clearly show that advisory services are highly influential with marketing decisions of large commercial farmers. If this group of farmers is deemed an important target of extension programs, then advisory services may provide an effective way to reach this audience. One approach would be to involve MAS in the design, and potentially, even

delivery of extension programs. Another approach would be to create "train-the-trainer" type programs focused on MAS staff directly. This approach has proven quite successful with other groups, such as agricultural lenders.

The results of this study also have important research implications. This study demonstrated that MAS have a substantial impact on producer pricing decisions. Therefore, MAS use should be included in future studies of producer marketing behavior. In fact, some recent studies (e.g., Katchova and Miranda) already consider MAS use as a part of farmers' decision process regarding the use of marketing contracts. Additionally, previous studies of MAS performance (Irwin, Martines-Filho, and Good) are based on the assumption that farmers exactly follow the marketing recommendations provided by services. The conclusions strictly refer to the 11% of producers that follow MAS recommendations closely. Research is needed that examines the relationship between the degree of implementation of MAS advice and subsequent pricing performance. This study also emphasized the importance of the match between farmers' and MAS marketing styles in farmers' use of MAS. However, objective information about advisory service marketing style is quite difficult for farmers to obtain. Thus, there is a need to investigate marketing styles of various MAS in order to determine style categories based on objective quantitative factors. Such information may be used by farmers to improve their choice of MAS.

To view the entire article, go to the website: www.farmdoc.uiuc.edu/agmas/index.html

China: Will They or Won't They? By Daryll E. Ray. Institute of Agriculture, University of Tennessee, and Director of UT's Ag. Policy Analysis Center

One of the perennial unanswered questions in agricultural trade is, "What are China's intentions?" Will China become a major importer of grains and seeds or will it seek to continue its record of relative agriculture self-sufficiency? This question has generated additional consideration since China's

accession to the World Trade Organization and the anticipated opening of its markets to world trade.

A June 1, 2004, the Guardian Unlimited headline proclaims “Lula seals deal to feed China’s cities with Brazilian soy in return for infrastructure investment.” The article notes that Brazilian president, Luiz Inacio Lula da Silva, and a delegation of more than 450 political and business leaders met with Chinese officials to ink a number of trade deals designed to benefit both countries. While the details of the negotiations were not spelled out, it is clear that Brazil intends to pay for Chinese infrastructure investments with exports of iron ore, uranium and soybeans.

On the same day, I read a report in “Doane’s Agricultural Report” giving highlights of the 2004 World Agricultural Forum. One of the highlights focused on China and what was reported as its changed definition of agricultural self-sufficiency. In the past, China’s goal of self-sufficiency has focused on domestically producing all of the food it consumes. The new definition defines self-sufficiency as the “combination of domestic production and export earnings from high-value fruit and vegetable production.” It has been argued that China, with its low labor costs, would be better off concentrating its efforts in labor intensive crops like fruits and vegetables, importing land extensive crops like grains and seeds.

Both of these news items are consistent with the stories and largely unrealized projections we have seen since at least the time of the adoption of the 1996 Farm Bill. For nearly ten years, these projections have shown ever-increasing imports by China. In the past, the rationale was not adjustment shifts brought about by WTO, but the need for imported grains to feed animals to provide a growing middle class with meat.

On the other hand, in May, the USDA revised its estimate for China’s corn stocks for the second time in less than four years. Once again, the level of grain stocks was increased to account for China’s continued corn exports. Without the revision, China would have been exporting corn that USDA estimates said it didn’t have.

While I was thinking about these issues, I learned

about some research being conducted by Yu Zhang, one of our graduate students here at the University of Tennessee. She found a 2003 survey of the attitudes of Chinese consumers toward the issue of self-sufficiency (Food Security Module China). Almost every Chinese believes in food security that is based on self-sufficiency. Zero percent of the urban respondents said they wanted China to rely on food imports. Similarly, only 3.3% of rural residents indicated that they would be comfortable relying on imports. Zhang said that food self-sufficiency is deeply imbedded in Chinese culture going back centuries, if not a millennium or more.

The feelings of Chinese consumers are reflected in the comments that Zhou Ming Chen, Chairman of the China National Cereals, Oils and Foodstuffs Import and Export Corp., made a presentation on February 17, 2004 in Washington D.C. In that address, he said “China attaches great importance to agricultural development and increasing the income of farmers. It is inconceivable that a country of 1.3 billion people will rely on others to feed themselves.”

This commitment to self-sufficiency was fleshed out with China’s launch of a new agricultural policy at the beginning of 2004. This “Number One Central Government Document” comes 18 years after the last number one agricultural policy. The policy commits significant funds to increasing farmers’ income and living standards and ensuring food security. The document calls for increased agricultural research, increased mechanization of Chinese agriculture, support of rural incomes, the availability of capital and credit in rural areas, and policies to support grain production and processing.

Only time will tell whether China will live up to the expectations of those anticipating agricultural prosperity based on large exports to China or continue its centuries-long commitment to agricultural self-sufficiency.

Rethinking the Soybeans-to-Corn Price Ratio: Is It Still a Good Indicator for Planting Decision, by

William Lin and Peter A. Riley Agricultural Economists, Market and Trade Economics Division, Economic Research Service. Taken from Feed Yearbook/FDS-1998/April 1998

Analysts have long used the soybeans-to-corn price ratio as an indicator to determine whether there would be an acreage switch from corn to soybeans, or vice versa. If producers expect the soybeans-to-corn price ratio to exceed the breakeven price ratio (BEPR), there would be a tendency to switch from corn to soybean plantings. Conversely, if the expected soybeans-to-corn price ratio is below the BEPR, the reverse would be true. The BEPR is the ratio of expected soybeans-to-corn prices which equates the expected net returns of producing corn and soybeans, given trend yields of corn and soybeans, the expected price of corn, the variable costs of corn and soybean production, the expected program payments, and other program expenses.

The soybeans-to-corn price ratio is a simple measure of relative returns for corn and soybeans. When producers expect the price ratio to exceed the BEPR, it suggests that expected net returns for soybeans are greater than those for corn. In contrast, the opposite is true. However, producers do not simply look at the price of soybeans versus the price of corn in deciding what to plant. Other than crop rotation concerns and restraints, the use of the soybeans-to-corn price ratio assumes that the market prices for corn and soybeans accurately reflect their relative net returns. This may be a heroic assumption in the current climate.

This article examines the ratio in terms of its role in explaining the switch between corn and soybean plantings in historical context and the evolution of the soybeans-to-corn breakeven price ratio. In addition, this article points out deficiencies of the ratio as an indicator for planting decisions, particularly after the enactment of the 1996 farm legislation.

Given more planting flexibility, States outside of the main Corn Belt have accounted for much of the change in corn and soybean acreage in the last 2 years. The soybeans-to-corn price ratio presents a less complete picture of crop choices than in the past

as (1) corn and soybean production continues to expand to the Central and Northern Plains region and, to a lesser extent, the Delta and Southeast regions over the last 2 years, and (2) plantings became more flexible under the 1996 Act. Analysis of other indicators, such as the soybeans-to-cotton price ratio and the corn-to-cotton price ratio for the Delta and Southeast, becomes necessary to more fully capture the competition for cropland use among major field crops. In addition, due to planting flexibility and a faster yield gain in soybean production since the early 1990's the BEPR, which used to be around 2.6 at the national level in the early 1990's hovers around 2.5 for this year, offering producers greater incentives to switch from corn to soybean plantings.

Due to greater planting flexibility, corn and soybean plantings future years are likely to be increasing affected by factors other than the soybeans-to-corn price ratio. In the Great Plains region, these other factors could include the soybeans-to-wheat price ratio and the corn-to-wheat price ratio. In the Delta and Southeast regions, these price relationships include the soybeans-to-cotton price ratio, the corn-to-cotton price ratio, and the soybeans-to-wheat price ratio. In the spring wheat areas, the soybeans-to-wheat price ratio could be relevant to forecasting soybean acreage in future years. Much of the other price relationships need further investigation before the exact relationships are established.

Sincerely,

Extension Educator,
Agriculture & Natural Resources