

Master Marketer Newsletter
Volume 1, Issue 9, December 2000

Master Marketer Highlights

Uvalde Master Marketer Program in the Fall

The Uvalde Master Marketer program concluded on November 9 with the graduation of 32 Master Marketers. Given the evaluations and comments received from the graduates, the classroom portion of the Uvalde program was very successful. Jose Pena, district economist at Uvalde, said that he and the county agents would be working with the Master Marketer graduates to get additional marketing clubs started.

Abilene/Vernon in January and February 2001

Registration for both the Abilene and Vernon Master Marketer programs are going well. There are still spots remaining for interested producers. If you know of someone that might be interested, please have them contact Stan Bevers (940-552-9941) for the program in Vernon which starts on January 16, 2001, or Jason Johnson (915-653-4576) for the program in Abilene which begins January 17, 2001. There will be one-day long leveling workshops held in both Vernon and Abilene before the Master Marketer sessions begin. Anyone needing a refresher course, or wanting to get up-to-speed before the programs start should attend one of the workshops. Stan and Jason can provide you with the dates and locations for these programs if you give them a call.

Ag Lender's Program

Work is continuing on the lender program. The team is talking with potential speakers and developing advertisements. The plan is to offer a two session, five-day fee-

based course once a year in June. The location for the program is tentatively scheduled to rotate between Amarillo and San Antonio. The current plan is to offer the first course in Amarillo on June 12-14 and June 27-28 of 2001.

Cotton Funding to Support Master Marketer Program

Beginning in 2001, Cotton will be joining Corn and Wheat along with Texas Farm Bureau and Houston Livestock Show to provide statewide support for the Master Marketer program.

Marketing, Crop Insurance and Risk Management

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Marketing

Today there is quite a hullabaloo in U.S. agriculture circles in regards to improving producers' planning and marketing skills. This topic, however, is not new to Ag. Economists. It was an important issue back in the late 1960s when, as an undergraduate at A&M, I heard it discussed at length in marketing classes. It is evident in the early literature that market development and marketing was a cornerstone to the evolution of Agricultural Economics as a separate discipline.

The Chicago Board of Trade has been around for more than 150 years. Agricultural commodity futures trading has, for the most part, been the domain of commercial interests - the wholesale marketers. The standardized futures contract tied to the clearing mechanism has created the liquidity that commercial interests need in order to lay off price risk. Evolving out of this arrangement has been the following formula:

Price = Futures +/- Basis

- Price is the local cash value of the commodity.
- Futures is the value of the commodity traded on the exchange.
- Basis is the difference between the cash and futures price at any given point in time.

Producers are price takers and tend to sell in their local market as a means of creating the price they receive. Interestingly, the components that make up the local cash price (futures & basis) can be traded separately and summed to create the price received. A rather common phenomenon is that as futures rise the basis falls and as the futures

price falls the basis gains in value. Local cash prices do not keep pace with the futures, either up or down. The commercial trade has long recognized this relationship and most commodity wholesale trade is conducted around a basis contract with the futures price being somewhat incidental. Since futures and basis often move in opposite directions, the probability that on any give day, a producer can capture the maximum combination of futures and basis by selling the cash commodity is low.

The Farm Act of 1996 changed the formula for U.S. producers by adding the loan deficiency payment (LDP) as a means of clearing the market and still supporting producers' prices at a predetermined level. The pricing formula faced by producers changed to:

**Price = Futures +/- Basis + LDP
where (LDP > 0)**

Prior to the LDP, the market price and the price received by the producer were one in the same. The LDP is a rather sophisticated pricing tool that acts as a hedge for the producer (en lieu of futures) as long as it has not been taken. The likelihood of a producer selling his crop locally, collecting the LDP on the same day, and realizing the year's maximum value of the formula price is zero. At any given futures price, when basis is weak, the LDP is high, and local cash price is low, an offsetting situation.

Today there are a growing number of marketing advisors who work with producers in an attempt to better the producers' economic outcome. Advice is given on how to make the pricing formula work. Futures, basis and LDPs are dealt with as separate and distinct parts of the whole. The prudent use of available marketing tools has proven to both decrease price risk, and at the same time increase the price received.

Crop Insurance

Crop insurance has become a key component of U.S. farm policy in the support of farm revenue. I believe that the revenue type policy (e.g. CRC) is the best concept since the advent of the marketing loan in dealing with

producers' revenue risk. By guaranteeing revenue versus only quantity produced at a fixed price (MPCI), the producer has a very valuable tool in the management of his revenue risk.

A concern among farmers is that if one goes out and forward sells a portion of expected production, the risk of a buy-back in the event of a crop failure is tremendous. Thus producers have been reluctant to "lock in favorable prices" prior to having the crop (asset) in hand.

Prudent use of a CRC policy can minimize this concern. If a producer forward contracts a portion of his crop and then has a crop failure with rising prices, he is protected against the loss of the buy-back. However, this assumes the basis for the crop doesn't increase over what it was at the time of the forward contract. Since the risk of crop failure in Texas is rather high, the use of futures instead of forward sales is preferable.

From an asset basis there is an additional pricing formula which today's producers can use if a CRC type crop insurance policy is taken:

Price = Futures
(where harvest price > base price)

This formula only holds if there is an insurable loss. The quantity this price is applied to in order to derive revenue is defined by the percentage election of the applicable actual production history (APH).

Risk Management

The two pricing formulas, price received and CRC price, have one thing in common - the futures price. In the price received formula, futures price is both explicit and implicit; the LDP is a function of the futures price. The insurance price is defined via the base price, harvest price, and the indemnity clauses.

While conventional wisdom for protecting revenue has been either to forward contract or buy puts, the potential basis risk of a forward contract may be great and the cost of a put may mean leaving a good bit of money on the table. The combination of futures and a CRC type insurance

policy creates a unique financial instrument, which if used properly, allows producers to better manage revenue risk. The percentage election of the APH in a CRC type policy is an asset just like having the commodity in storage.

Producers have the difficult task of setting the price via the revenue formula. The fear of being wrong in a pricing decision weighs heavily on producers' minds and usually means that the price actually received is less than could have been obtained by having had a plan. Positions can be built which provide for both at-the-money price floors with upward price flexibility but requires complex futures and options strategies. These strategies may act like futures in the short run, thus requiring margin money, but mature over time into pure options. Having a complete understanding of the tools needed to react to varying market conditions should be the goal of every businessman.

Risk management for today's producer revolves around the world of futures and options. Clearly the managing of price level is tied to the futures/options markets, but when combined with revenue crop insurance, risk is redefined. I use the concept of marketing to mean the avenue elected to physically exchange title for cash; basis. Risk profiles can be altered at anytime to better fit the changing marketplace; marketing is normally a onetime affair and does not take place until the asset in-hand is the crop produced.

A Revenue Operating Plan is one that separates and treats the pricing formula as parts; risk management and marketing. The price deriving formula is rather simply defined; its maximization may not be.

Inside the TAEX System *Profiling the Master Marketer Graduate*

Those Master Marketers that have graduated more than two years ago have had the pleasure of completing a two-year post Master Marketer survey. Some of the results of those surveys are summarized here. We have received 143 responses from the 1997 Lubbock program, 1997 Wharton, 1998 Vernon and 1998 Waco.

Prior to attending the Master Marketer program, 42 percent said they had a marketing plan while 91 percent reported having a marketing plan after completing the program. Only 3 percent had a "written" marketing plan before while 32 percent now have a written marketing plan. Thirty percent shared the plan with others prior to the course while 70 percent shared it after the course. Eighty-seven percent of the respondents reported that since the program, they sought further education on marketing tools, strategies or market information. The overall rating of the Master Marketer program was 6.49, with 1 being poor and 7 being excellent.

The average age of the respondents was 45 years old. They had been a principal farm operator for an average of 20 years. Forty-six percent of the farm business structures are sole proprietorship, 32 percent are partnerships, 15 percent corporations and four percent for both estates and trusts. Ninety-nine percent of the respondents hold at least a high school degree, while 61 percent had at least a bachelor's degree. Twelve percent had either an advanced or professional degree.

While the majority of their time is spent on production (as well it should be), respondents reported that prior to the course they spent 7.6 percent of their time on marketing. Following the course that has increased to 14.0 percent of their time.

The Master Marketer team offers a sincere thanks to all of those who completed the survey (and to those that will be receiving the survey in the future and completing those). This type of information is invaluable.

Texas Risk Management Education Program Update

Newsletter Survey Results

We appreciate those of you who completed and returned the newsletter evaluation survey that was included with the June 2000 newsletter. Thirty-four survey responses were received from Master Marketer graduates (8% of all graduates) while fifteen survey responses were received from extension personnel which represents 5% of extension faculty who receive the newsletter. The survey asked readers to rate, on a scale of 1 (poor) to 5 (excellent), the overall newsletter and each section of the newsletter. The average of the ratings by Master Marketer graduates and Extension faculty are summarized below:

	<u>MM*</u>	<u>TAEX*</u>
Overall	4.77	3.93
Highlights	4.80	4.00
Guest Column	4.80	3.80
Inside TAEX	4.40	3.73
Risk Management		
Education Program	4.47	3.93
Web Site	4.61	4.27

* MM = Master Marketer responses, TAEX = extension faculty responses

Master Marketer graduates, on average, rated the newsletter higher than did Extension faculty. Eight of the Master Marketer respondents and six of the Extension faculty provided comments with their survey response. The comments ranged from complete satisfaction, interest in specific marketing alternatives under current market conditions, more crop insurance, more producer testimonials, and marketing consultant reviews just to name a few. We have developed a brief report of the evaluation and will attempt to improve the newsletter based on feedback received from you. Thanks again for your input!

Choice Web Site

The Web site of USDA's Risk Management Agency (RMA) is

www.rma.usda.gov. RMA was created in 1996 by Congress to administer the Federal Crop Insurance Corporation's programs and provide other risk management tools. Some of the featured links on the website are the Agent Locator, Crop Weather and Tools and Calculators. There is also a link to the National Ag Risk Library at the University of Minnesota where producers can search the database for a variety of risk management topics, including price and financial risk.