Mapping the Route to Better Prices: Developing a Marketing Plan

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Agricultural producers often live up to their name. They are very good producers, but they often lack skills to be good marketers. Marketing and market planning to secure the best price for hogs sold and inputs purchased with an acceptable level of risk are an important part of management. Many of the exciting advancements in technology and opportunities for improvement are in production, but most pork operations can also benefit from improved marketing. However, unlike production efficiency, market prices are largely beyond the control of the manager. What is under the manager's control is how he or she chooses to deal with market prices and price risk that the firm faces. Developing a marketing plan forces the manager to address the marketing questions that are crucial to the firm.

Market planning should incorporate several aspects of marketing: what and how much is being produced, when will it be marketed, where will it be sold, how will it be priced, etc. These factors impact the business plan through the cashflow, ability to withstand risk, and price relative to cost of production. In this light lenders are taking a critical look at the marketing section of a business plan. They often want to see a clearly defined, well thought-out marketing plan that demonstrates a respect to the importance of factors external to the firm—the market. Even though prices for hogs and inputs are similar for all producers, the way in which individuals plan for and manage during different price scenarios sets them apart from their colleagues.

Although some aspects of marketing are viewed as more artful than scientific, marketing decisions can be managed. The first step to managed marketing is developing the marketing plan. A written plan makes implementation easier and is an important communication tool for use within the firm as well as with external audiences such as lenders. While the written marketing plan itself is important, the process of developing the plan is also crucial and should be viewed as an investment in the business. Marketing plans are unique to the individual operation because they incorporate the constraints and opportunities of the firm in addition to the financial and personal characteristics of the manager. As a result, marketing plans are custom tailored—not "one-size-fits-all." In spite of this individuality, marketing plans can be developed around a general outline. This paper will examine key components of developing and implementing a marketing plan for pork producers and provide an example that producers may use in their operation.

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Managing Market Risk

Because market prices are the greatest source of profit risk, risk management is often incorporated into a marketing plan. Market prices for hogs and feed vary greatly over time and even within a production cycle (breeding to slaughter). Futures, options, and forward contracts are tools available to manage price risk. If these tools are to be beneficial to the operation, producers must be educated in the use and application of such tools, and they should be incorporated into the marketing plan— not used as a last-ditch effort to avoid a market crash.

Producers must understand and quantify risk before they can manage it. Although pork producers face a variety of risks (financial, political, business, and/or production), a marketing plan deals primarily with price risk. Price risk originates from two sources—futures price variation and basis variation. The futures market represents the general price level determined by supply and demand information in the market. Basis risk is due to changes in the local market relative to the general market level. Futures price risk can be offset by hedging with a futures contract or an option contract. Basis risk is caused by local market condition and cannot be eliminated without a specific basis contract or a forward contract that sets a specific cash price. In general, basis risk is smaller than futures price risk.

There are also two types of risk. The risk of "sinking the ship," and the risk of "missing the boat." While these risks are not high-tech, quantifiable price levels, they demonstrate that each producer has a different level of risk that makes him uncomfortable. "Sinking the ship" risk is a price that must be avoided. For a highly leveraged producer, it may be the price at which he fails to make the farm payment. To a more established producer, it may be the price that doesn't cover the feed bill. To a third producer, it may be the price at which he doesn't make $20 per head. "Missing the boat" is the lost opportunity of higher prices if the producer chooses to hedge, but the price moves higher. Many producers worry more about missing the boat than sinking the ship. They are more concerned about missing out on a possibly higher price than what happens if they pass up locking in a moderate profit. Research has shown that a low-risk strategy of locking in everything is also a low-return strategy. Higher risks are often needed to achieve higher returns. High-risk strategies often mean disastrous results for a producer with a ship that may easily be sunk. Therefore, a balancing act between risk and return becomes important and a marketing plan helps producers strike that balance.

Mapping Out a Marketing Plan

A marketing plan has often been compared to a road map for the business. It should identify your present location, your destination, and the route you plan to travel. The map should also describe the terrain and possible alternative routes to reach your destination if some roads are out or you missed a turn. The driver and/or navigator using the map will also have to know something about the capabilities of the vehicle he or she is driving. Road signs are needed to determine when to take another route or change lanes. And just as with

a road map, it may be better if both partners of a husband-wife firm develop and use the marketing plan. The marketing plan is more useful if developed before a lot of time is wasted driving around in circles.

"You are here."

The first step in developing a marketing plan is to describe your current operation. The business plan is typically used for this purpose and the marketing plan will be one section in the business plan. Characteristics of the operation important to the marketing plan may include:

- Annual marketings: number (market hogs, feeder pigs, breeding herd), weight, timing of sales
- Input purchases: feed needs, when and how much
- Quality of hogs: genetics, lean (average and distribution), weight distribution (sort)
- Cost of production: direct and total costs
- Alternative market outlets: name, distance, transportation costs
- Marketing philosophy: sell on tight schedule, shop for best price, standing order
- Attitude toward price risks and knowledge of risk management tools

Where are you going?

Once you have determined where you are now, you must determine where you want to go. What are your goals? Goals are long-term general targets that you hope to achieve for your business, and they should be consistent with the long-run success of the business. Goals should be achievable and measurable. Once they are consistently met, they should be revised upward. For example, the goal may be to receive a barrow and gilt net selling price that is ten percent higher than the state average for the year. The goal is measurable because it can be compared to the reported state average price. It is also achievable through selling leaner-than-average hogs, better sorting, plant delivery, using futures and options, or joining a marketing network. The goal is also long-term because any one load of hogs may sell for less (fast-growing barrows tend to be fatter, non-uniform pigs are discounted, sort loss may be high with AIAO finishing). Depending on where you start, the goal may need to be lowered until it is met. Other goals may be to achieve an annual average corn and soybean meal price that is less than the annual average price, or to increase average market weight of pigs to 250 pounds and reduce sort loss to less than $0.30/cwt.

Goals should be set carefully to ensure that they are really what you want to achieve (Is your final destination Death Valley, or do you simply want to visit it?). For example, is selling half of your barrows over 56 percent the goal if they are cost-probative to produce in your facilities? Goals may change over time, but they should not be so fluid that they are ignored. The number of marketing goals listed at one time should be limited and, when possible, be consistent. It is much easier to visit Denver, Las Vegas, and the Grand Canyon on one trip than Seattle, Miami, and Boston.

How will you get there?

After identifying marketing goals that are consistent with your business goals, a plan must be developed to achieve them. This is where the map becomes important. You are currently in Boston and your goal is to reach Dallas. What roads do you take? These short-term navigations directed at the long-term goal are "marketing objectives." Like goals, objectives should be realistic, measurable, and achievable. Objectives have a shorter term focus, and incorporate current production and market conditions and projections specific to a particular set of hogs or inputs. For example, what are the objectives for June-September corn needs or October hog marketings? You should be able to quantify how much corn you will need during those months and how many hogs you will sell in October. You will also have information about market conditions, futures market prices, and outlook. From this information you can choose a route that will move you closer to your destination or at least reduce the amount of backtracking.

In addition to long-term goals relating to growth and profitability, objectives must also meet short-term cash flow needs consistent with current market and financial conditions. For example, hedging an October price that covers cash costs and assures enough income to cover a loan payment due that month may be a good short-run decision, even though it does not comply with your goal of hedging only if a $15/cwt. profit or greater is offered.

Like a road map, objectives should also be detailed. They may refer to a marketing year, but should also be broken down to specific time and/or product within that period. Objectives should have some basis. Cost of production and profit targets provide tangible benchmarks on which to base objectives. This approach also offers an increasing series of price objectives: direct cost, total cost, total cost plus $2/cwt. profit, total cost plus $4/cwt. profit, etc. Managers should also identify risk objectives for a particular time period or group. These objectives may state the acceptable probability of failing to achieve a particular price objective to avoid sinking the ship. For example, I want to be 90 percent sure that direct costs are covered and 40 percent sure that total cost are returned. I also don't want to miss the boat. I will stay unhedged unless I can hedge $12/cwt. profit; then I will hedge 75 percent of my production. I won't miss the boat going up, but I don't want the ship I'm on to sink.

When are we going to eat?

In our travel analogy, we have identified a final destination and the roads that we will take to get there, but what about the details? Beyond objectives, the marketing plan should provide decision triggers, and actions to take once the trigger is hit. You may decide to travel until noon and then start looking for a name-brand restaurant. When that happens, you will stop to eat. Given your price and risk objectives, the marketing plan may call for selling a futures contract on half of October's production if its price—adjusted for basis—falls below total cost. The price objectives based upon cost of production identify the futures price that would trigger the risk objective. The marketing plan identified the action necessary to meet the objective, in this case—hedge half the hogs in the futures market.

A marketing plan should be flexible enough to react to changing market conditions. However, without triggers, specific actions to implement, and contingency plans, a marketing plan is of little value. Contingency plans evaluate possible scenarios and develop a set of triggers and action plans for each scenario. That is not to say that you have to have a plan for every possible twist and turn in the market, but suggests that once you implement a plan, you should consider how you will react to new information that will affect prices. In my example, I hedged half of my hogs at breakeven. What about the other half? What if, weeks later, a new Hogs & Pigs Report was bullish for the market? A contingency plan can help route marketings around an unexpected detour.

Stop and check the map.

Travelers are often distracted, miss a turn, and get off track. Managers can also get distracted with the other things they have to think about (hogs, crops, family, employees). While they may listen to the markets daily, do managers understand what the current cash or futures prices mean to their operation? In the middle of planting season, hog futures move up the limit one day and you realize that they have increased $5/cwt. over the last week. Should you sell or wait? How much? Futures or options? A written marketing plan provides a quick reference of rational thinking in a fast moving market. The objective, triggers, and actions guide the manager back on track to reach the desired destination.

Keep a log of marketing decisions, current conditions, and what marketing decisions are made. This includes not only futures and options decisions, but also cash marketing decisions. Keep a record of hog sales by marketing and by group of hogs, such as sort loss, lean premium, and dressing percent. The amount of information collected can become overwhelming if not properly managed, but detailed information on a large number of hogs and possibly different packers is needed to make truly logical marketing decisions.

Which route next time?

Marketing plans should be evaluated to determine if the objectives were met and if the results were consistent with the long-run marketing goals. Also, learn from your mistakes and your successes to determine what you would change next time. When evaluating a marketing plan or marketing decisions, it is important to evaluate the results against your objectives—not against perfect hindsight. Often, marketing decisions that met the objectives of the manager at the time they were made are compared to prices they "could have had." If the only measure of a marketing decision is whether it hit the top of the market, you will be disappointed. Judge the decisions against the written objectives and the information available at the time the decision was made; then work to improve marketing decisions in the future.

Tools to manage marketings and price risk.

Futures, options, forward contracts, and long-term marketing agreements are all tools which help managers make better marketing decisions. Each tool has different strengths and weaknesses and it is doubtful that the same tool is right for every manager every time. What is universal is that managers must fully understand the tool that they are using. Education is ***essential***. Sources of information and education include the extension service, Chicago

Mercantile Exchange, and reputable brokerage firms. Experience is also an important teacher, but the tuition can be expensive unless one is cautious. Marketing clubs are producer networks that have been very successful classrooms where producers learn together by doing. The ten or so members of the club jointly take a market position. Each individual has enough money in the market to pay attention, but not enough to have a serious financial consequence if the market moves against the group.

Summary

Marketing is an important part of profitable pork production, but it has often been ignored because it was considered to be out of the producer's control. While individual producers cannot change hog or input prices, they can alter the impact changing prices have on their operation. The first step in effective marketing is to define it in the context of your operation by setting goals and objectives to achieve those goals. The components of cost of production and profit targets serve as a basis for price objectives. Cash flow, financial strength, past market performance, and personal preference can be used to identify risk objectives. Regardless of the amount of planning, implementation of the plan will determine its success or failure. Implementation requires clearly identified triggers and the appropriate action required when the trigger is hit. Finally, marketing decisions need to be monitored and evaluated against the stated objectives, rather than against perfect hindsight. By monitoring market conditions and decisions and realistically evaluating their marketing plan, managers can sharpen their marketing skills to better navigate their operation to greater profits.

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OBJECTIVE BASED MARKETING PLAN

Date________________

Commodity description ____

Number of animals	________	Futures contract	________
Placement date	________	Current quotation	________
Placement weight	________	Expected basis	________
Expected sell date	________	Expected price	________
Expected sell weight	________		
Price Objectives			
Direct costs		1. Profit objective	________
Feed cost	________	2. Profit objective	________
Non-feed variable cost	________	3. Profit objective	________
Overhead costs			
Facilities	________	Bonus ____________	________
Family withdrawal	________		
Management fee	________		
Total costs	________		

Risk objectives: The acceptable probability of failing to achieve a price objective.

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____
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Decision rules: Trigger prices and actions

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____

Forward pricing decisions: (futures, options, contracts)

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____
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Evaluation (attach killsheets or summary of each load):

Number sold	________	Average price	________
Average weight	________	Actual cost	________
Sort loss	________	Return $/cwt	________
Lean premium	________		

Objectives met: ____
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____
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Comments: ____
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