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## Beef Alliance Economics 101.02

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In the last installment, I discussed the basic reasons behind vertical coordination and beef cattle marketing alliances. In this issue, I will discuss the types of alliances found in the beef industry, the pros and cons, and the importance of understanding these differences before making a decision to participate.

As discussed in May, alliances attempt to capture and create additional value and higher returns to participating producers. All marketing alliances be categorized into three distinct groups; co-operatives (generally as a closed co-op), brand licencing organizations, and specialty product marketers.

Closed co-operatives are producer owned entities that tend to provide the highest opportunity for additional returns. However, the high returns come at a price. In a closed co-operative, the producer must either buy a part of the company in the form of stock shares, or lease excess shares from another producer. The shares come with certain rights and obligations. The biggest obligation is to market a cattle for each share owned (or leased). Failure to meet the obligation results in a penalty fee. This is how the co-operative regulates and controls the number of cattle that flow through the program. The closed co-operative uses a market based grid as do most all alliances at this time. Many use a combined grid of yield and quality grades. In addition to the premiums and discounts provided on the grid, closed co-operatives pay dividends to shareholders, and some have additional bonuses paid to the producers who marketed their cattle through the program. Value is created through a co-operative marketed brand which consumers can easily identify.

Brand licencing programs are often breed based requiring cattle to meet a defined genetic template. They create value by centering the program around a branded product that conveys to the consumer a given quality standard. The licencing organization certifies a herd, and producers must use certified bulls to produce calves on their certified cow herd. The organization then will handle the marketing of the beef produced. Generally, the arrangements will have cattle sold on a quality or yield type grid with a few that will use a combined grid. Licencing programs tend to be rather loose contractual arrangements with the only obligation being the certification. Thus, producers can choose to sell all or none of their certified cattle through the marketing program. Cattle that do not meet the certification can not be marketed through the program, generally making this type of program costly to enter for those whose herd does not meet the requirements.

Specialty product marketers are not entirely different in concept than the brand licencing programs. However, the structure is somewhat different. Again, value is added by brand identification, but in many cases, these arrangements attempt to create a niche market for their product. This is the source of the specialty product term used in describing them. In some cases, these programs will have breed restrictions, but most often, they have certain production requirements that stipulate what can and can not be done to the cattle in order to qualify them for the program. These stipulations can be as simple as limiting the timing of antibiotics or as restrictive as to limiting what feeds can be fed and how the veterinary program must be structured. These programs will often use a yield based grid for their payout scheme. However, some use a quality based grid. Many will have a screening process to further limit the cattle in the program. Such screenings may use a quality grid to eliminate certain grades that do not meet the desired characteristics of the program. Some programs use more technologically advanced methods to screen carcasses for inclusion or exclusion in the program.

While profitability may be increased by alliance participation, income risk, or income variability, also increases. This effect is generally a result of the uncertainty of carcass performance. With the addition of the price grid, the producer becomes exposed to an additional variation in production. This variation had previously been nearly entirely bourne by the packer. By agreeing to take on this production risk, producers are also expecting a higher return which is considered an economically sound decision.

The key in determining the best alliance for you is your herd's genetic make up and how well it matches the grid used by the alliance. A clear understanding of your goals and how well the alliance will help achieve those goals is critical. Lastly, you should be aware of the limitations and restrictions an alliance may put on your production process and be comfortable with those limitations. When compared to the contract production in poultry and swine, cattle alliances allow producers to maintain a great deal of autonomy.

In the next, and final, installment, see how producers with small herd are finding ways to participate in various programs, including the use of traditional marketing channels to make it practical.