Managing for Today's Cattle Market and Beyond

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The New Beef Industry: What Will It Mean To Feeder Cattle Producers?

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Forces Changing the Beef Industry

One can rarely pick up a livestock magazine or a cattle-related article without reading some reference to how the beef industry is changing. This of course is not a new message. We live in a changing world, and the beef industry must continually change to meet the ever-changing demands of the marketplace. What is new, is the magnitude of the potential changes and their impacts on the way feeder cattle producers do business. The potential impacts of the looming changes in the cattle industry are large because the market is moving toward selling differentiated products rather than a commodity. This would represent a huge fundamental change in how feeder cattle are produced and marketed since product quality control would start at the ranch level.

The Forces of Change

Producers and academics both expressed concerns regarding the impacts of shrinking demand and structural change in cattle markets during the 1980s and 1990s (Purcell 1989; Bastian et al. 1996; Mintert et al. 1996; Barkema et. al. 2001). As demand declined the beef industry lost market share at the retail counter to poultry. The result was that smaller, higher cost processors were forced out of business, the beef processing industry consolidated, and processor concentration increased. The 1990s also saw significant consolidation in the food retailing business when the market share for the four largest food retail firms doubled from 17% to 34% (Barkema et al. 2001).

Many of these structural changes were a result of changing (declining) consumer demand which forced beef processors to increase cost efficiency to remain competitive with other meat products. One of the reasons the demand for beef was declining during the last two decades of the 20th century was a lack of convenient, easy to prepare beef products. Today's consumers continue to prefer more convenience-based products that require short cooking times and have consistent quality. In the beef industry, cost efficient firms are usually those that survive over time. A need for different types of beef products coupled with technological innovations are setting the stage for the transformation of the beef industry from marketing just a commodity to a market environment driven by product proliferation and differentiation.

This new market environment is continuing to evolve and we can expect that increasing pressure will be placed on processors and cattle producers to produce beef products that meet the needs of the changing market. One potential benefit of consolidation in the beef industry is that fewer firms are in the market and this contributes to a higher probability that those firms will require coordination along the marketing chain. Efforts to increase coordination along the marketing chain may result in products that are better at addressing consumer needs than beef products have done in the past. Vertical coordination means firms can forward contract, draft marketing agreements, and manage supplies without necessarily owning other firms up or down the marketing chain. Declining U. S. cattle numbers, increased price uncertainty, consumer demand for more consistency in beef products, and pressure to reduce transaction costs associated with purchasing and storing beef supplies have each provided an incentive for vertical coordination among firms in the beef industry.

When firms coordinate their efforts they can select a target retail market and begin to demand cattle that meet the specifications for products that will be sold in the targeted market. This in turn means cattle buyers will begin to purchase and price cattle based on the characteristics of the beef produced by the animals that closely match the product needs of the targeted market rather than basing purchase decisions on cattle types or breeds. Feeder cattle producers will be required to provide documentation on how their cattle have been treated, fed, medicated, their expected performance in the feedlot, and finally how the characteristics the meat from their cattle match the specifications of the targeted market. This is in fact the essence of value-based marketing.

The move to value-based marketing is made feasible throughout the supply chain via electronic technology. Electronic ear tags that store information about individual animals regarding origin, feeding and health programs, and animal performance, along with handheld computers and portable ear tag readers are being used by many alliances and firms (Reisland 2001). This technology makes feeder cattle a differentiable product for cattle buyers and sellers, and it gives firms selling beef products the information they need to insure feeder cattle will deliver the meat characteristics they advertise.

Beef and Cattle Marketing Changes

The transformation from commodity marketing to differentiated beef product marketing is occurring rapidly. More than 40 marketing alliances have come into existence in the last six years (Peck 2001). Cattle-Fax estimates that 15 percent of the cattle in the U.S. are now marketed through some type of alliance or integrated program, and more than 50 percent of fed cattle are marketed using a contract, grid, or formula price (Peck 2001).

Grid-pricing techniques, alliances, producer-led cooperatives and increased branding of beef products are all indicators of the beef sector's current evolution (Barkema et al. 2001; Gordon 2001; Lusk 2001; Roybal 2001). Grid-pricing techniques attempt to provide incentives to cattle feeders that produce a type of carcass the packer is trying to market. Alliances and producer-led cooperatives are moving toward supply chain management and capturing consumer market share. Companies branding beef products are using labels and packaging to communicate to targeted consumers that their product has desirable characteristics. All of these changes require tighter coordination in the supply chain with a goal of providing a consistent set of beef product characteristics to consumers (Ishmael 2001).

Why are these changes more likely to meet consumer needs? Most consumers are not aware of or do not understand information being conveyed about product quality via USDA grades for beef marketed in traditional ways (Cox et al. 1990). Characteristics such as convenience, tenderness, and food safety are important to consumers (Barkema et al. 2001; Lusk et al. 1999). These characteristics are easier to communicate to consumers using a brand name than using traditional Styrofoam-tray-wrapped, generic, meat products.

How are alliances or vertically coordinated firms making sure branded products deliver the characteristics they promise? One example of how an alliance can deliver a consistent quality, branded beef product is found in Future Beef Operations plan (FBO). Regardless of the success of FBO the model they proposed illustrates how coordination could occur within an alliance. FBO's proposed partners include five packing plants, 100 genetic seed stock suppliers, 1,000 cow-calf producers, 20 to 25 stocker cattle producers and five feedlot partners (Roybal 2001). FBO will collect and share performance and value data among its partners on all program cattle, and the cattle will be individually tracked and source identified. The goal of FBO's program is for cattle to meet the following carcass specifications: 1) carcass weight range of 650 to 800 pounds; 2) ribeye area of 11.5 to 16 square inches; 3) 63.5 percent dressing percentage followed by a hot fat trim yield of 92 percent; 4) quality grade of mid-Select or marbling of Slight 30; and 5) no more than 3 percent outliers (Roybal 2001). Partners will receive economic incentives to provide program cattle meeting specifications. FBO also will implement multi-site electrical stimulation and new aging technology to guarantee tenderness (Roybal, 2001). Moreover, FBO is planning to supply 1,700 Safeway stores in North America with its beef products. Thus, FBO's overall plan is to coordinate genetics, production and processing coupled with cutting edge technologies to deliver consistent, high quality beef products tailored to a major chain of retail stores. The goals of many other alliances or coordinated firms will likely mimic FBO's concept with varying degrees of success for other target markets. To achieve their goals, alliances will need to focus on communication among partners, have strong quality specifications and procedures, provide incentives to hit alliance targets, and provide risk management tools and profit sharing to its partners (Peck 2001).

What Will This New Differentiated Product Orientation Mean to Feeder Cattle Producers?

In the future, feeder cattle producers will be asked to provide information relating to the characteristics of the beef they produce. Buyers will penalize feeder cattle producers that do not have performance data, carcass merit data, and/or health program histories for their cattle. At a minimum this means that feeder cattle producers may need to participate in an alliance. In any case, they will need to gather and communicate information to buyers about the specific characteristics of the beef they produce or face market penalties in the future.

It is probable that feeder cattle producers will need to make serious choices about who they are going to sell their cattle to and closely manage their production accordingly. The marketing alternatives they will face in the future include opportunities with alliances, marketing agreements or forward contracts with buyers for vertically coordinated firms, joining a new generation cooperative targeting its own market set by producer members, and niche marketing. Marketing the traditional way may mean that producers are relegated to the lowest-priced markets since their cattle may be seen as generic beef that doesn't have verifiable characteristics. Once a marketing alternative is chosen, feeder cattle producers will need to tailor their production to the quality specifications desired, record required data, and continually monitor potential production practices and/or markets that will improve ranch profits.

The new beef industry will likely involve a significant change in the way feeder cattle producers will conduct business. For some the loss in independence will be a negative, but the new beef industry may mean a chance at increased profits and reduced income variability. The incentives for producers to evaluate results of their management and marketing choices at the retail counter will increase. Ultimately, the beef sector may enjoy stronger demand and market share after the transition from a commodity-based market to a differentiated product market. Like all change, this will mean opportunities for some and painful adjustment for others. The key to success will be continuous market assessment and managing resources to produce the appropriate product at the least cost.

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