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## The Hog Industry: Can the Little Guy Compete?; Crop Market Alternatives


Gene E. Murra

*South Dakota State University*

Dick Shane

*South Dakota State University*, richard.shane@sdstate.edu

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# ECONOMICS COMMENTATOR

SOUTH DAKOTA STATE UNIVERSITY

No. 356 November 30, 1995



## THE HOG INDUSTRY: CAN THE LITTLE GUY COMPETE?

by

*Gene E. Murra  
Extension Livestock  
Marketing Specialist*

"Times they are a changing" and "The small-scale producer faces many new challenges". Those statements certainly apply to the hog industry, both in the U.S. and in South Dakota. Many examples of those changes could be cited, including the entrance and growth of large scale producers, a reduction of hog numbers in South Dakota and the intended purchase of Morrell's in Sioux Falls by Smithfield.

When one says "large-scale" in the hog industry, the comment is an understatement. According to a recent issue of *Successful Farming*, Murphy Farms now has 225,000 sows. Others with over 100,000 sows include Carroll's and Tyson. *Successful Farming* identified 44 farms with over 10,000 sows. In 1994, there were only 31 firms in that category. By far, the largest growth in any state in the hog industry has been in North Carolina, now second in total inventory to Iowa.

South Dakota's inventory has decreased drastically in the last year. On September 1, 1994, there were a total of 1.61 million hogs and pigs and 240,000 head in the breeding herd in South Dakota. On September 1, 1995, those numbers were only 1.36 million hogs and pigs and 190,000 head in the breeding herd, or roughly a 20 percent decline. In many cases, it has been small-scale producers who have dropped out of the industry in South Dakota. Some may have believed they no longer had a place in the changing industry described above.

*(Continued on page 2)*



## CROP MARKET ALTERNATIVES

by

*Dick Shane  
Extension Grain  
Marketing Specialist*

The USDA Supply and Demand Report, released Thursday morning, Nov. 9, 1995, was bullish feed grains and neutral soybeans and wheat. Early futures market price reaction was positive but quickly turned lower as market bears began to sell the fact in their "buy the rumor, sell the fact" marketing strategy.

### Corn

U.S. corn production is estimated at 7.373 billion bushels, down from the trade pre-report average guess of 7.45 billion bushels. U.S. corn yield was lowered to 113.7 bushels per acre compared to 115.5 in the USDA October report. Very low test weights were blamed for a large part of this yield reduction.

Producers will most likely get opportunities to add to their step-up sales plans on winter and spring price rallies. This pricing strategy allows the seller to keep averaging higher as opposed to most years when producers' price averages lower after initial summer pre-harvest pricing. These rallies may only be to the top of a trading range that seems to be forming.

Storage pencils out for some corn producers who are still facing abnormally wide basis at their local delivery market. The current price level gives an opportunity to buy an out-of-the-money put option to protect the price downside in stored grain in case of exceptionally good growing weather in the southern hemisphere this winter and in the United States this coming spring. For producers with high interest rate operating loans and

*(Continued on page 3)*

Recently, Smithfield announced intentions to purchase John Morrell's, including the plant in Sioux Falls. This announcement adds some uncertainty to the future of the small-scale, family farm type of hog producer in South Dakota. Smithfield is somewhat representative of many of the large-scale firms in the hog industry--vertically integrated with extensive use of contracting. Questions related to "if and when those practices will be used in South Dakota" and "if so, the impact this will have on South Dakota producers" are raised.

One of the basic questions related to all of the above is "Is there a place for the smaller-scale family farm type of producer in the future, whether that be in South Dakota or elsewhere"? The answers might not always be pleasant for everyone. The recently released Swine Enterprise Records and Analysis Program from the University of Nebraska may provide some direction.

### Difference between the "Best" and "Worst"

The table below speaks volumes. "Top" producers use less feed per pound of pork produced. They produce more pigs per sow per year and they made a profit, even during a period (July 1994--June 1995) when it was tough to make a profit. Those producers can compete (more on that later). In general, the number of sows was not a major factor affecting profit levels.

### Summary of Nebraska Swine Enterprise Program

	Worst ¼	Average	High ¼	"The Best"
Feed fed per cwt. of pork produced	385	373	360	346
Pigs weaned per female per year	16.1	17.6	18.6	23.4
Total cost per cwt. of pork produced	\$44.50	\$39.69	\$36.37	\$32.23
Profit per female per year	-\$243.48	-\$30.87	\$147.84	\$363.15
Profit per crate per year	-\$1179.64	-\$191.36	\$606.94	\$1431.69
Rate of return on capital	-12.42%	3.5%	17.3%	44.3%

There also are producers who "shouldn't be producing pork", especially if profit is a major issue. And, given their past performance, they probably won't

be there long. Anyone "losing 12.42% on their investment" will be out of business in a few years.

In summary comments in the release from Nebraska, Larry Bitney includes the following (these comments are copied from the report but not necessarily in the same order as included in the report):

1. Performance standards that were above average a few short years ago may now be average, or even below average. If you stand still, the "pack" will run over you and move on into the distance.
2. I know of no agricultural production enterprise that is more responsive to management.
3. While the adoption of new technologies has enabled some producers to become more efficient, we have (within our records program) examples of producers who are matching the production efficiencies of the "big boys" and using conventional technology.
4. I'm not recommending that you ignore the new technologies, but am merely pointing out what a difference management can make.
5. Increasing the intensity of management is not an easy process. It may involve changing the mind-set that you, your family, and your employees have toward pork production.
6. Keeping records, analyzing them, and using them to make management decisions has never been more important.
7. If you plan to retire from pork production in 3-5 years, maintaining the same pace or making investments with a short payback period may be feasible. But, if you and your family would like to continue to make all or a significant part of your income from pork production, you should be developing a strategic plan to increase your competitive position.

The above statements, either alone or in total, say "the management minded, efficient producer can compete. Records are critical. Change may be required. It may not be easy, but 'was farming ever easy'".



*(Crop Market ... cont'd. from p.1)*

poor on farm storage facilities or commercial storage, selling corn now and reowning through purchase of call options is often the best alternative. Still others prefer taking the good current prices by selling cash and pricing 1996 crop corn on spring weather rallies should they occur. This last strategy could result in a very good two year average price.

Producers should evaluate several pricing opportunities for 1996 crop corn. One alternative is to sell July futures and roll this hedge to December futures sometime this spring or summer (roll means buy back July and sell Dec futures). This procedure will allow the user to add to the harvest time price by gaining on the current 50¢ per bushel spread between July and December futures. Of course, this is not guaranteed but probable. Another alternative is a hedge-to-arrive or no-basis established contract which allows the user to gain on basis improvement between today's new crop 1996 bid and the bid at harvest time. Synthetic puts and fences also are worth evaluating. The bottom line is for the producer to use alternatives with which he/she is comfortable.

### Soybeans and Wheat

U.S. soybean and wheat supply and demand estimates by USDA for November were very close to their October estimates. World stock estimates were lowered slightly for soybeans due to small adjustments in China and the U.S. and were raised 40 million bushels for wheat due to production increases in India, Australia and Canada. Price action as a result of this report has been mixed. Strong positive or negative market movers have not occurred and prices continue to move sideways in a trading range.

As a result, normal seasonal price patterns and current basis levels narrowly support storing soybeans and selling some more wheat. Aggressive sellers will want to consider pricing some 1996 crop at this time. Soybean futures for November 1996 are currently over \$6.80 per bushel and offer \$6.00 per bushel local prices with several marketing alternatives. Six dollars is a good target price to start your 1996 soybean marketing plan. The percentage sold at this price, of course, depends on your individual cost and debt structure.

The objective of pricing say 10 to 30 percent of expected 1996 soybean production at this time is to get some priced in case of a good crop in South America and good spring weather in North America, which would

cause prices to decline. If the opposite occurs, use step-up marketing to sell more of your expected production and increase average price for the season. This marketing strategy allows for a profitable season average price but does not allow selling all of your production or expected production at the peak for the year.

Of course, no one hits the peak except in "lucky" circumstances. One can always look back and say I should have waited. But, what we usually wait for is lower prices. History tells us, we do not price at the peak because we can't identify the season peak until after the season is over. "Waiting for the peak" is not good risk management.

Current wheat prices are among the highest received over the past 15-20 years. Consequently, producers should evaluate not only adding to 1995 crop sales, but also multi-year rolling hedge opportunities. Be sure you are aware of potential margin needs with this strategy and make arrangements for margin money if the need should arise.

Pricing 1996 production using May futures or a May hedge-to-arrive at the elevator and later rolling the contract to harvest time is another alternative to evaluate now (be sure the elevator hedge-to-arrive has a roll provision). The use of put options and new crop 1996 futures at least offers some downside price protection if the 1996 world wheat crop is very good.

### Conclusions

The keys to using the pricing strategies discussed here are to be familiar with the pros and cons of each alternative, to use the alternatives that fit your profit and risk situation the best, to write them into your marketing plan and to execute your marketing plan when pricing triggers are hit. Above all, do not get in a strategy you do not understand or makes you very uncomfortable.

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## **ECONOMICS COMMENTATOR**

EDITOR: Donald C. Taylor

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ECONOMICS DEPARTMENT

South Dakota State University

Box 504A

Brookings, SD 57007-0895

Phone: (605) 688-4141

Fax: (605) 688-6386

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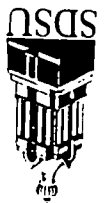
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Economics Department  
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