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Strategic Alliances: Advantages and Challenges...Or What Does It Take To Turn a Marketing Concept Into a Business Practice?

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INTRODUCTION

The beef industry has just lost $300 per calf weaned. Industry analysts have rumored that 40% of the beef producers are currently broke and but just don’t know it yet. Bankers tell their clients that they only have two ways to keep out of debt—cut costs, and/or make more money. Simply keeping from spending—doesn’t contribute much to refilling the coffers and satisfying cash flow—therefore cowmen are left with few alternatives. Since we can’t get more for them—we have to figure a way to get more out of them.

The first strategic alliance study challenged traditions of "blending", "averaging", and selling "live". In the four short years since its completion, the study has spawned mini-alliance projects in half the states, with several major alliance projects developed within breed associations, feedyard "networks", and seedstock based alliances such as the Western Beef Alliance in Montana.

ECONOMIC MYTH BUSTING

The greatest revelations coming out of the original alliance study was the amount of variability occurring within a set of assumed "uniform" calves off the same ranch. The ranges within physical traits such as feedyard gain, backfat deposition, muscle, and grade validated the retail and food service complaints about the inconsistencies they found in commodity boxed product.

Simultaneously with the outcome of the alliance project was academia’s findings in certain correlated traits. It was discovered that external fat and intramuscular fat (marbling), are not correlated. Then the most sacred myth was attacked: marbling and tenderness. They also were found to be poorly correlated.

NEW ANSWERS TO OLD QUESTIONS

Fear is the greatest motivator. Today’s cowman has to cash flow his operation—yet keep the balance of production, feedlot efficiency, and final carcass quality. Before he can optimize his operation he needs to know his available options—or production "menu".

The producer needs to know how the system works. Market segmentation prevents cowmen from learning market dynamics—from the "buyer" that keeps secrets and never shares
data, to the feedyard who is only concerned with collecting yardage and feeding corn.

**WHY DO FEEDYARDS "BLEND" CATTLE?**

Blending allows purchase of "cheap" cattle--light muscled mature imports and "stretched" grass cattle--to be blended with enough quality muscled, reputation "black hided" (bait) cattle. These high plains "corn hotels" are in the business of adding value to com--not cattle. Their game plan: buy cheap--hedge feed and cattle by using the "board". Mixed lots are fed 110-140 days (yearlings), sold live: no consequence for "quality".

**WHY HAVE PACKERS BOUGHT ON "YIELD"--Dressing Percent?**

Until recently most of the retail beef was sold as "commodity", with up to 1" external fat allowed. The retailer felt it was economically feasible to trim off that much fat if he could buy the commodity beef cheaper. He also bought the "myth" that he had to have fat to get quality. The packer buyer based his commissions on % of dress--which included tremendous amounts of waste backfat and the internal KPH and seam fat which all increased dressing percent.

Almost everyone won! The meatcutters stayed busy trimming the fat; the retailer felt he was getting quality; the feedyard sold and financed corn; the commodities broker hedged on "fixed" time on feed; the banker had a reliable "window" for interest income; the fat cattle buyer only had to pick out a "quonset top" animal with enough cod and brisket fat; the packer sold the fat in the "box" to the retailer as commodity beef--and the producer back on the ranch sold "soggy--toppy--mellow--soft feelin'" calves (black preferably) for two to five cents more than his neighbor.

**WHAT CHANGED THIS PREDICTABLE, "AVERAGE" MARKET?**

Almost everyone won...but not the consumer. FAT suddenly became the enemy! Complaints to the retailer about excess fat forced him to throw away any fat he couldn’t blend into his burger products. Universities contributed to "value awareness" with the CARDS program sponsored by checkoff dollars pointing out the waste of backfat, seamfat, excess bone, and lightly muscled cattle. The retailer found out there was a difference! Starting about five years ago the trend to buying "trimmed" beef now has 40% of the retailers opting to buy labeled "trimmed" beef in the box.

These enlightened retailers learned that, not only were they subsidizing the "corn hotels", but they were also getting an extremely variable product with wide ranges of fat, bone, toughness, marbling, meat texture, flavor, juiciness, and portion sizes.

**WHY HASN'T THE MARKET BECOME 100% "TRIMMED" BEEF?**

The meatcutters have a say--they don’t want to lose their jobs. Education also plays a part. The INNOVATORS bought into the idea--but many meat managers in the smaller retail stores simply don’t want to change, or they think the higher price for trimmed beef isn’t worth it.
However, we are now seeing in the larger chains, managers taking over meat departments without any prior meat experience--they are very cost/margin conscious!

Also, we are seeing large chains such as COSTCO, WALMART, PRICE CLUB--and other EDLP "every day low price" retailers who don’t have meatcutter "unions" applying pressure. These stores are talking "case ready" with the "meat" employees simply placing pre-packaged portions in the matches. The transition to close trim will progress, but at a slower rate than it has the past four years.

**HOW WILL PRODUCERS BE AFFECTED BY THE CHANGE TO "CLOSE TRIM"?**

Most packer buyers have recently switched from a "reward" based on buying by yield or dressing%, to a profit and loss incentive commission that rewards them for the true profitability their purchases bring to the packing plant. The plant keeps track, then rewards them for quality grade, yield grade, absence of fat, and absence of outliers such as overweights, underweights, dark cutters, etc.

Fat cattle buyers will become "finished" cattle buyers trained to identify "harvest-ready cattle" that come from reputation programs within reputation lots. They will still want to buy "on the average" -- stealing the good ones to subsidize their mistakes--made because they still can’t identify accurately the value of genetics and management in the finished steer.

**WHEN WILL I GET PAID MORE FOR MY QUALITY GENETICS?**

If "Quality" means more measured value--and not just "mythical hype"

You will get paid one of THREE ways:

A: INDIRECTLY [calf or yearling sale]--least risky, least profitable--by a calf buyer, sale barn, or satellite market program buying for a feedyard who sells to a packer buyer competing with other packer buyers who now have to pay more for cattle with profitable traits--because their commissions are based on economic accountability. Price is based on ME futures. NO DATA RETURNED.

B: DIRECTLY [retained ownership] more risky, more profit potential -- retaining ownership in a feedyard who sells to the same buyer mentioned above. Price is based on daily or weekly CME quote. OCCASIONAL DATA RETURNED.

C: DIRECTLY [Alliance/Network--source verified] most risky, most profit potential --it requires producer to take all risk, but shares profitability from retailer for "source verified" product with unique product claims. This program identifies problems and returns data allowing you to improve your genetics and management by retaining ownership through the kill--paid
directly by the packer for measured value of each individual carcass.

COMPREHENSIVE DATA RETURNED.

Quality cannot be valued until its measured --and since you can’t manage averages-- only individuals--the producer can never get paid until he sells individual cattle instead of averaged cattle. Blending is like feedlot socialism. The meatballs subsidize the greaseballs, the tender subsidize the tough, the efficient subsidize the inefficient.

WHY DO THE "CORN HOTELS" FIGHT "VALUE BASED" MARKETING?

Feedyard "BLENDING" is very profitable. One high plains feeder boldly declared that he did indeed add value to corn--that his interest in breed types only extended to their efficiency--since the buyers had to buy the entire "show list" at once--regardless of the makeup or "mix" in the pen.

He also acknowledged that each 30,000 head yard nets $1 million per year with minimum risk because he has a good share of "investor" cattle in the lots. He also makes money on the financing, and attached "grass" programs, (the feedyard’s own way of establishing "captive supply"--along with a "captive supply" of feed). Producers will hear such feeders turning up the rhetoric about the evils of "value based" marketing.

Value based purchasing requires the packer buyers to mentally "sort" the cattle they observe in this "mongrelized" blend of cattle that include over-aged imports and proven "tough" genetics that can easily end up as a "choice" steak in the same box as a tender calf-fed.

HOW DOES FEEDYARD BLENDING DISCOURAGE QUALITY DIFFERENTIATION?

Producers who are never rewarded for quality will lose incentive to seek identification of profitable traits to breed and manage for.

YOU CANNOT MANAGE AN AVERAGE--and since it is the variation that most affects bottom-line profitability, you must learn to identify, then eliminate the unprofitable "boarders" from your program. This is only accomplished through individual identification in a marketing program that tracks profitability and applies economic rewards and penalties to physical traits. There is no other way short of educated guessing!

ITS A 60/40 DEAL....

Genetics contributes 40% and management controls provide 60% of the economic outcome of a carcass.

Muscle is established at conception. The use of implants can enhance muscle mass.

Bone is established at conception...but can change ratios with age.
Marbling traits have been reported as high as 60% heritable. These traits seem to be affected by stress, weather, and most recently, improper use of certain powerful implants. If the "blended" lots that sell LIVE--and those that sell "DRESSED", have no accountability for quality grade, they will continue to abuse drugs that inhibit the development of marbling--at the expense of beef’s credibility to the retailer.

**POINT:** October, 1995 should be experiencing a $4-5 choice/select spread. It has been as high as $15!

*Who sets choice/select spread?* The retailer.

*Why?* Accurate or not...it is his way of identifying "value".

*Should the producer be concerned?* Yes--the less "choice" the less confidence the retailer and food service industry has in the quality of beef.

**WHERE DOES THE CONSUMER FIT INTO THE COWMAN’S PROFIT PICTURE?**

The consumer purchases pork and poultry as "survival food", and perceives beef as "treat" food. Therefore he demands a good eating experience. Because of quality differences, both observed and perceived, beef can be "product differentiated" at the counter as GOOD, BETTER, BEST.

Product differentiation is established through market research and development--a procedure that’s been underutilized in the beef business--because of the difficulty in "sorting" from the cooler with a product that’s mixed up in the "blended" feedyard. If we expect to price the beef in the counter with special claims for consistency, taste, etc., we have to verify the "source" by presorting at the ranch--and even further back--from genetic development.

**HOW CAN WE IMPROVE ON THE CURRENT RETAIL MARKET SYSTEM TO MAKE MORE MONEY--A PROFIT THAT PRODUCERS AND FEEDERS COULD SHARE IN?**

Today’s retailers sell 60% of their beef at a loss! Why? Because tradition has established a pattern of selling high the first three days of the week--then using beef as a "loss leader" on the weekend to attract consumers to buy "bargain beef", and fill their carts with additional full priced items.

The proven "elite" beef could be established as "branded" and never discounted. Truly a "treat meat", this product would pass back added values from superior "eating trait genetics".

"Network" producers, feeders, and packers can establish similar goals and disciplines as they focus on genetics and management disciplines with sufficient consistency and eating qualities that truly reflect "added value" by producing cattle with the following criteria:

**Youthful cattle** (A maturity)

**Adequate muscling**, (with ribeyes that "fit")

**Adequate marbling** (average select to average choice)

**Absence of "identifiable", tough genetics.**
Adequate aging of the beef (at least two weeks from kill to counter)

Utilization of Vitamin E (improved shelf life)

By developing an identifiable "consistent" quality beef product, the retailer can showcase the "good stuff" as the best meat--much as Purdue Chicken and Jimmy Dean Pork. Today very few beef products outside of Certified Angus Beef are commanding the respect due a product that doesn’t have to be discounted. Quality beef should keep its price--because it has proven value!

This superior product is out there now--it just hasn’t been identified--the packer can’t get it out of a "blended" yard, and the retailer can’t get it out of a "blended" box. Therefore the producer can’t get paid--and his "quality" genetics gets lost in the "mix".

**HOW CAN ALLIANCES PROVE THE CLAIMS OF THE "ELITE MEAT"?**

Alliances are the first step in "source verification". They provide the enrollment tool required by a properly established PQC (partial quality control) program as mandated by USDA when certain quality and management claims are made to the retailer and consumer, particularly when labeling of such claims is made on a box or package.

Once the claims are made--they are subject to audit by USDA. Therefore, only provable claims are filed, thus keeping the credibility of the beef marketing program.

**HOW MUCH PROFIT CAN BE RETURNED TO THE PRODUCER?**

The "formula" pricing of the cattle is established through a "grid" pricing mechanism that attaches an economic value to a physical trait. For example, if the proven average of fat trimmed to 1/8" is 8.5%, then the producer that brings cattle in that measure only 6% fat beats the average by 2.5%. Each % represents $12 of waste fat. The producer just made $30 on that individual. If that individual graded choice, and the choice/select spread is $10, then he makes an additional $28 on a 700 pound carcass.

This $58 price only applies to this individual animal. Each carcass is identified and paid for separately. Other values are also applied, making it possible for some individual carcasses to bring up to $130/head.

However, since risk is involved--some carcasses also lose. One animal lost $213. The "trim" 15%--which came from an injection site the size of a bowling ball that had to be cut out of the round.

Market timing also plays a role. We shipped one load of 12 month old steers 1200 miles from Idaho to Greeley, CO. The local packer in Utah was taking off up to 4% "trim" in the name of ZERO TOLERANCE. Since hot fat trim takes off ALL the fat to 1/8", and the producer gets PAID for the difference, the process more than paid for the additional freight.
These February-March 94 steers had been weaned at 140 days, (mid August) fed 200 days on a 85% barley ration (barley that had been frozen and couldn’t be utilized for commercial sale), to a finished live weight of 1060#, and harvested in early March of 1995.

They sold on a $73 market (which fell to a predicted $68 three weeks later), thus returning $55/head simply with market timing. They trimmed at 6% fat returning $30/head and still graded 55% choice with no standards or dark cutters. Hot fat trimmed cattle can’t be yield graded, but the equivalent estimate of muscle scoring plus fat trim estimated them at 90% yield grade one and two. Under the Texas A&M "window of palatability" (average select to average choice), 85% of the load would have fit.

Obviously, the cattle could have been fed longer. The cost of gain would have been far under the market price--justifying more time on feed. However, we learned that our genetics has tremendous "MARKET LATITUDE", or the ability to finish early WITH ADEQUATE GRADING QUALITIES, yet stay in the feedyard if necessary WITHOUT SUBSTANTIAL FAT DEPOSITION.

The participating ranch, using our bulls, also identified seven cows within the 43 head load that obviously had poor muscling or fat deposition problems. For our part, we identified through this kill group and others, one bull with inadequate feedyard gain, and one bull that’s a "home run" for quality grade and absence of back and seam fat.

Western Beef Alliance processed over 4,000 head during the 1995 market season through Monfort and Bradley Ranch Beef (B3R) in Texas. The average profit--above live market price was nearly $22/head for a total of nearly $88,000. One producer in Wyoming processed over 800 head with a $28 profit, plus a $32/head feeding profit.

One set of 94 heifers, from a ranch in Idaho using our genetics, received a "premium" of $54/head over the live market price the day of kill. These were out of the same bulls from the other ranch in Idaho that killed at Monfort in Greeley, Colorado. We found the same results--one bull had inadequate feedyard gain (the same bull), and the other bull produced similar overall superior results.

Through ultrasound selection we’ve culled off the outliers that showed no visible evidence of grade. In the process, we’ve raised the level of "grade" in both our replacements and bulls. This evidence substantiated our investment in the selection process. The 94 heifers fed 210 days graded 97% choice and 3% prime at 14 months.

The Wyoming producer didn’t individually identify his cows--therefore, he couldn’t identify the cow that made him $120 on her calf. He also couldn’t identify the cow that produced the calf that lost him $40. He plans to identify his 4,000 cows next year!

The Idaho producer is already planning his matings and culling procedures for next year based on his individual data. He knows just which bulls to put with his cows that need more muscle, and where he’s going to use our bulls proven to have superior "grading" traits.
WHAT IS THE "DOWNSIDE" TO ALLIANCE PARTICIPATION?

Whenever reward is greatest--risk is involved. Several producers made little if any profit the first year. They learned. After finding their cattle had too much fat and too little muscle, they now can "tune up" their program to fit tomorrow’s markets.

Most producers are comfortable with the fact that they learned in 1995--giving them a "leg up" on a system that will increasingly favor cattle with "more taste & less waste". They learned quickly about the "myths" of fat, marbling, tenderness, and breed "religion".

WHY IS THE BANKER’S INVOLVEMENT ESSENTIAL?

Like most procedures that challenge traditions, new ideas are hard to "sell" to bankers. The banker is critical to this program because the producer can’t capture his genetic profits, costs of preconditioning, feedyard profits, and additional management and "program/enrollment" fees, unless he owns the animal THROUGH the kill.

To enroll the banker’s support, the cowman must "learn" his risks, and perhaps only participate with a portion of his production the first year. However, if he puts off the decision to participate, or if he outright sells his calves, he may not get returned data that would support taking the risk the following year.

Like many decisions during adverse economic times, he has to ask himself, "What if I don’t learn this year...what will next year bring?"

There is no totally safe ground--the producer must take the risk to get the reward--but then that’s the American way, isn’t it?