



finish-out hogs. The contractor's objective when entering into a directed feeding contract is to increase feed sales and secure a reliable feed outlet.

The contractor provides the feed and some management assistance and typically directs the feeding program. The contracting firm will often purchase the feeder pigs, in which case profits from the sale of the hogs are shared as discussed below, or it will help the producer obtain financing to purchase the pigs. The producer agrees to purchase all feed and related services from the contractor and is responsible for all costs of production. The producer receives all proceeds for the sale of the hogs minus any outstanding balance owed to the contractor.

### **Option 3**

In a **profit sharing contract**, the producer and contracting firm divide the profit in proportion to the share of the inputs provided by each party.

Typically, the producer provides the facilities, labor, utilities, and insurance for his/her portion of the profit. The contracting firm normally purchases the pigs and is responsible for all feed, the veterinary services, transportation, and marketing expenses. Over the duration of the contract, the contractor's costs are charged to an account. This account balance is then subtracted from the sale proceeds to determine the profit. The contracting firm will often use its own feed and provide management assistance.

The producer is normally guaranteed a minimum amount per head as long as death loss is below a set percentage. For instance, depending on contract terms, the producer may receive \$5/head if death loss is 3 percent or less and \$3/head if death loss is over 5 percent. The producer receives this payment regardless of whether a profit is made. The contractor's return depends upon the profit made on the sale of the hogs and the gain received from the markup on feed, pigs, and supplies provided.

## **Feeder pig production contracts**

Feeder pig production contracts come in several forms.

### **Option 1**

The producer provides everything but the breeding stock and bids what he is willing to produce a feeder pig for, based on production criteria such as pigs weaned per litter, etc., with discounts and bonuses based on a target level. Most of the production risk is retained by the producer.

### **Option 2**

A contractor provides breeding stock, feed, management assistance, and supervision, and pays the feeder pig producer a flat fee for each pig. This fee varies according to pig weight and current production costs. In this option most of the risk falls on the person providing breeding stock, feed, and management.

### **Option 3**

The contractor provides breeding stock, feed, facilities, and veterinary costs. The producer provides labor, utilities, maintenance, and manure handling. A fee for each pig produced and a monthly fee for each sow and boar maintained is paid to the manager. This option fits owners who no longer want to be actively involved in production, but have a good manager with limited cash willing to take over the operation.

### **Option 4**

A shared revenue program with revenues divided in proportion to inputs provided. One example would be where the producer supplying facilities, veterinary care, utilities, labor, and insurance would receive a negotiated percentage of gross sales in return for his/her share of production costs for each pig sold. The feed dealer would receive a certain percentage based on his/her share of the total inputs. The remaining percentage would go to the breeding stock supplier and the management firm that supplies computerized records and consultations. Negotiated percentage shares should be based on inputs provided and risks borne by each participant.

## **Farrow-to-finish contracts**

While base-payment plus bonus contracts are offered in some regions, many farrow-to-finish contracts are

on a percentage basis to reflect the relative inputs supplied by each person or firm.

### **Option 1**

The producer supplies facilities, labor, veterinary care, utilities, and insurance for an appropriate percentage of gross sales based on input costs. The feed retailer supplies feed, standard feed medications, and receives a predetermined percentage of returns. The capital partner and breeding stock supplier get another percentage. The management firm receives a percentage for supplying computerized records services and management consultation.

### **Option 2**

The current hog inventory is purchased outright by a limited partnership and it will supply sow replacements. The producer supplies facilities, labor, utilities, veterinary costs, repairs, and manure disposal. The feed retailer provides feed and standard feed medications. A management agency supplies production and marketing guidance. Each of the contract participants receives a percentage of the proceeds when hogs are marketed. The remaining percentage is split between the limited partnership and the general partner for managing the partnership.

### **Option 3**

The contractor provides breeding stock, feed and a prescribed system of management. The producer provides facilities, labor, utilities, insurance and disposal of manure. The producer receives fees per head or per pound of hog marketed plus possibly additional compensation for farrowing and feeding efficiency.

## **Breeding stock leasing**

The popularity of breeding stock leases has declined in recent years and are presently seldom used. Many contractors were dissatisfied with the care of the breeding herd and sometimes were unable to collect their payments from producers.

One lease arrangement involves a payment-in-kind for the use of the breeding stock. This lease is particularly attractive to producers with limited capital but ample feed, facilities and labor to pro-

duce hogs. The producer pays all production costs and pays the breeding stock owner, for example, one market weight hog per litter.

## **Characteristics of a good contract**

Production contracts need to be evaluated with special care. When considering contract production, contractors and producers need to evaluate each contract on its own merit. Each party should look for a contract that best fits their operation and management capabilities. Both parties must know their cost of production to make an informed decision. Simply signing a contract will not necessarily improve efficiency or insure a profit. For example, it is doubtful producers will receive a bonus for feed efficiency better than 2.9 if they have been only achieving 3.5 on their own.

## **Scrutinize proposed examples**

Carefully scrutinize the examples that are used to demonstrate cash flow or producer returns. Unless otherwise stated these are only examples and not guarantees. Producers should consider the impact on cash flow and debt repayment if payments are less than projected. Is there a guarantee of contract length if new facilities or other major capital expenditures are required to obtain the contract? Most contracts guarantee a stated number of turns (group of hogs) or are in force for a stated length of time. Few, if any, guarantee the number of hogs that will be put through the facility in a set time, say one year. Facilities that sit idle during an unprofitable period in the hog cycle may profit the contractor, but disrupt the producer's debt repayment schedule.

## **Consider the other's financial strength**

Before considering the details of a contract, one should first consider the reputation and financial stability of the company or individual with whom the contract is to be made. For instance: How long has the company been in business? What has been the company's financial success? How long has the company offered contracts? Do other producers in the area have contracts with the company? Does the company fulfill the terms of its contracts?

Because little can be done after the fact to correct the problem, both parties should be encouraged to gather

financial information about the other. This may be best handled on a document separate from the production contract. Problems and risks can arise for both the owner and the feeder due to financial failure of the other. Remember that:

- Except for the right to remove the hogs, the hog owner is an unsecured creditor of the feeder. The owner has little chance in recovering losses resulting from excessive death loss.
- The feeder has a statutory lien on the hogs, but this lien is subject to all prior liens of record. This means that the owner's secured creditors can remove the hogs without paying the grower. Once the hogs are removed, the grower has an unsecured claim for his contract damages which is probably uncollectible.
- It is possible for the grower to receive first lien on the hogs if the owner and his creditors are willing to give the grower a lien subordination.

#### **Minimum contract provisions**

- The contract must be in written form and must be clear and concise.
- The contract should clearly define the rights and responsibilities of both parties involved.
- The contract should also contain the following: number of pigs involved, names of both parties, duration of the contract, method and timing of payment, and definition of who shall supply certain inputs.
- A contract should be thoroughly read and understood before it is signed. Enlisting the advice of a lawyer, farm management specialist, or business consultant is helpful and often essential when evaluating contracts.
- The contract should contain an arbitration clause. Such a clause removes any disputes from the court system. The contract should also define how the arbitrators are chosen.
- Complete records of inventories, deaths, purchases, and sales should be maintained and open to both parties.

#### **Other provisions**

Other possible contract provisions would include:

- The right of the owner to inspect pigs any time.
- Designation of responsibility for purchasing and marketing
- A procedure for refusing delivery of unhealthy or poor quality pigs
- The basis for compensation of feed and non-feed costs
- Acceptable weight ranges for incoming feeder pigs and outgoing market hogs
- A procedure to use if failure of payment arises
- The means and timing of communication by producer to owner when a death loss occurs
- Who assumes the risk of death loss
- The extent of the producer's responsibility for care of the pigs and record keeping
- Designation of who will provide insurance and how much coverage
- The brand and quality of feed and supplement that is required if any, and who is responsible for ration formulation
- How and when the contract may be terminated by either party

#### **Summary**

The key to feeding or producing hogs under contract is finding the type of contract that will allow each individual to profit most from their skills, resources, and ability to bear risk associated with hog production. This strength may be record keeping, producing with a low mortality rate, or an ability to maximize herd feed efficiency. Whatever the case, producers should make certain that the contract will reward them appropriately for what they do best.

Once the best contract type has been found, the written contract itself should be carefully read and understood. The responsibilities of both parties should be clearly spelled out and understood as should procedures for dealing with possible disputes. While a well written contract is essential to successful contract production, it is also important that both parties are professional and willing to work out any problems that arise. A contract can never be so complete that every possible problem is anticipated. Individuals interested in contract production should check laws regarding contracting in their state.