Risk Management Practices: Small- to Medium- Size Swine Producers

Ag Decision Maker

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The pork industry represents a significant portion (greater than 25 percent) of Iowa's agricultural sector. Proportionately, Iowa represents one-third of U.S. hog production cash receipts.

Volatility in the pork industry continues from both production, societal, and marketing risks. Managing these risks is an important step to achieving long-term financial viability in the industry. Production risks include herd health and performance. Serious financial consequences occur with high death loss, usually from a disease outbreak, but could be a feed mis-formulation, contamination or other quality problem. Social risks become real on the farm if there is a failure from:

1. welfare audit
2. unsafe work conditions that cause injury
3. food safety mistake like an antibiotic residual
4. odor complaints or an environmental mishap that results in a fine.

This fact sheet focuses on the marketing risks component for the small- to medium-size independent swine producer in Iowa. On December 13, 2017 the United States Department of Agriculture announced more transparent swine industry pricing protocols (www.ams.usda.gov/content/usda-market-news-expands-livestock-mandatory-reporting-swine-report). The USDA terminology definitions are now associated with the mandatory USDA reporting regulations (www.ecfr.gov/cgi-bin/text-idx?SID=776d5666e8abcdaf592b8aa682bd18a0&node=pt7.3.59&rgn=div5). Operation risk management generally improves by understanding both these developments, and its impact when identifying and assessing market risks.

Because market prices (and resulting margins, i.e. market risk) will vary by *type* of production, it is generally recommended that most swine producers develop a **marketing plan**. A clear understanding of swine marketing terminology can aid in the initial development of a marketing plan, (www.ecfr.gov/cgi-bin/text-idx?SID=776d5666e8abcdaf592b8aa682bd18a0&node=pt7.3.59&rgn=div5#sp7.3.59.c).

Well-done marketing plans (note: even open market cash sales is a plan) include a discussion of:

1. ***Price Protection*** **–** locking in a price floor, even when at a small loss, can protect the operation from larger losses if prices fall. Some level of price protection should be considered in case of market collapse from an export disruption (foreign animal disease), an economic downturn, currency value, or trade tariff, etc. A few pennies per pig to protect some of the cost to produce a pig could be a wise risk management decision in the event of the unthinkable.
2. ***Profit Goals*** **–** specific profit level goals help with decision-making. Forward pricing when positive margins are available is an example of risk management, and the plan would lock in a percentage of the pigs at a profit. What percentage of pigs to lock in at what profit level is part of the marketing plan process.

Further information on **risk management practices for small- to medium- size swine producers** can be viewed in the accompanying video, https://vimeo.com/279546476

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Resources to help include:

- Ag Decision Maker (www.extension.iastate.edu/agdm)
- ISU Livestock Crush Margin App (www.ipic.iastate.edu/software.html)
- Penn State University Extension (https://extension.psu.edu/swine-production).

3. ***Managing Risk*** - professionals are available to assist with managing marketing risk. A team of risk management specialists, potentially including a marketing specialist, tax specialist, farm management specialist, or packer can enhance risk management. Finding individuals you can trust for help developing your risk management plan is important.

Marketing plan decisions can help guide other decision in the pork production process. The final return on investment or enterprise breakeven analysis can guide the *type* of production decision. Using average cost of production is risky, because of the wide variation in production costs between operations. Developing an individual breakeven analysis that is unique to the operation is important. *Niche market* operations typically have a set price or margin contract, but would still have cost of production, performance standards, and health risks to consider. *Niche market* floor premiums or price floors are also typically needed to mitigate these unique operating risks.

Knowing production costs is vital to developing a marketing plan. **Livestock Enterprise Budgets for Iowa** (www.extension.iastate.edu/agdm/livestock/pdf/b1-21.pdf) is a resource for a producer to complete a needed breakeven analysis and inform decision-making. Estimated monthly returns ($/head) for farrow-to-finish Iowa operations can provide averages to compare with an enterprise budget (www.extension.iastate.edu/agdm/livestock/pdf/b1-31.pdf). Actual historical hog prices can help in assessing potential returns (www.extension.iastate.edu/agdm/livestock/pdf/b2-10.pdf).

Once you know your costs and you have a plan for marketing, you are ready to manage risk. The next step is understanding the available tools, and deciding which tool to use. For example, depending on the situation, a producer can choose among price contracts (vs. open market), hedges, options, or price insurance, etc.

Finally, your agricultural lender is often a partner in the risk management process and will want to discuss the swine marketing plan early in the process. A sound marketing plan will tend to improve this discussion. The best chance of a successful outcome will be when this business relationship is fostered long before production begins in the barn.

For more on this topic, view the accompanying video at: https://vimeo.com/279546476. Also see the complete series on Risk Management Practices, www.extension.iastate.edu/agdm/wdother.html.

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