

**Motivations, Attitudes, Satisfaction, and Future Plans
of Iowa Contract Hog Producers**

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Contract hog production involves an agreement between two or more parties. The agreement divides responsibilities for supplying resources such as capital, labor and management. While contracting is not a new concept to U.S. agriculture, hog contracting represents a growing segment of the national hog production industry. The farm crisis of the 1980's created an environment advantageous to expansion of contract production. For individuals faced with poor livestock returns, debt problems and equity erosion, contracting provided a method to overcome the financial difficulties and remain in operation (Christian et al.).

This paper will focus on the motivations for growers to participate in contract hog production. Also examined will be independent producers' reasons for not contracting, the satisfaction of growers with contracting, and the future output plans of contract production participants. Iowa results will be compared to other regions of the United States whenever possible.

Information for the report was obtained from a national survey conducted in early 1989. The survey was conducted at the University of Missouri, encompassing medium and large producers (marketing at least 500 hogs/pigs per year) in all 50 states. A breakdown of the states by region of the United States is provided in Appendix A.

"Growers", also known as contractees, are individuals who enter into agreements to care for contractor-owned hogs in their facilities and are compensated for their labor, facilities, or inputs they provide to production. "Contractors" refers to individuals or business entities that place their breeding stock or pigs in growers' facilities for the production of hogs. In some areas of the report, an added distinction is made between size of contractors: "large contractors" that produce more than 50,000 hogs and "small contractors" producing lesser amounts. Independents refers to hog producers who are not involved in contract production (Rhodes et al). Further definitions are provided in Appendix B.

*This report is based on the Iowa results of a national survey in 1989 conducted by V. James Rhodes and financed by the University of Missouri Department of Agricultural Economics, the National Pork Producers Council, and Pork 89. Financing for analysis of the Iowa results was provided in part by the Iowa Pork Producers Association.

Growers typically provide the care of animals in their own facilities using feed furnished by the contractor who also provides and owns the animals. Growers are compensated by various methods, usually by payments on a per head basis. The contract payment provides for downward price protection for the grower, but moderates the ability to take advantage of big gains during strong market conditions and limits the grower's management control (Christian et al). In the short term, the grower transfers market price risk to the contractor. However, while these market price risks are transferred, it must be realized that the longer term financial risks of facilities ownership are tempered by the contract terms and length.

Growers' Motivations for Contracting

Growers were asked to provide their reasons for contract production. The primary reason was financial. Forty-eight percent of Iowa growers reported financial considerations: lack of finances to be independent (38 percent), better and/or more steady income (8 percent), and better cash flow (2 percent) (Figure 1). Other reasons were reduced market risk (22 percent) and simpler than trying to play the market (11 percent). When compared to reasons as reported by all respondents, Iowa growers had more financial and similar market risk pressures. Iowa grower respondents were similar to the North Central grower respondents. Lack of finances to be independent was listed by 37 percent (38 percent Iowa) of the North Central respondents (Figure 2). For East Coast respondents lowering market risk was more important than lack of finances for entering a contractual arrangement. Marketing alternatives are dramatically fewer on the East Coast than in Iowa. This can potentially lead to uncertainty about market availability and greater market price risks. East Coast respondents were more interested in shared returns than the more variable returns through receiving established market hog prices.

Of the Iowa growers, 94 percent were once independent producers. This was significantly higher than the national average of 79 percent. This percentage dropped to 47 percent in the South Atlantic region and 31 percent for the South Central, areas which have seen the development of more large, corporate-type contractual operations.

When growers were asked if they would like to become independent, 50 percent of the Iowa growers reported yes; 24 percent said they were currently marketing some hogs on their own. However, when asked if they thought they would be independent in the next three years, only 38 percent replied affirmatively. Iowa growers were more optimistic about becoming independent than the rest of the nation which reported 23 percent expecting independence. This difference may be related to the well-known independence of Iowa farmers (Rhodes 1990-1). When the financial picture develops to the point where growers can become independent and provide their own financing etc., tradeoffs to enhance income potential over time will need to be weighed against increased risks of market price and income fluctuations. Some have decided they prefer the more assured stable income of a grower to the higher and more risky income of an independent producer.

Figure 1. Reasons Why Growers Contract

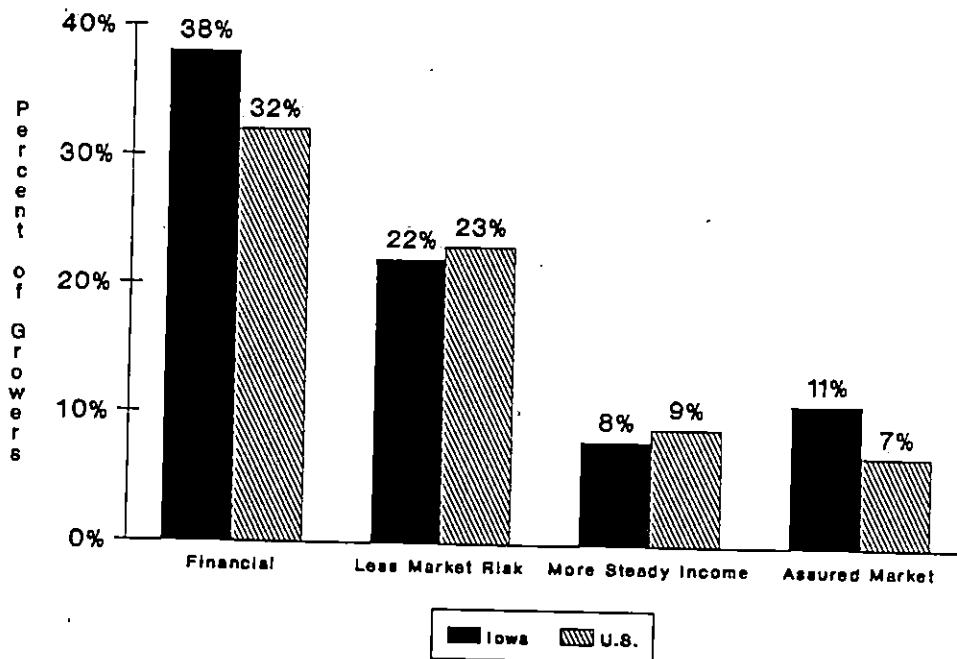
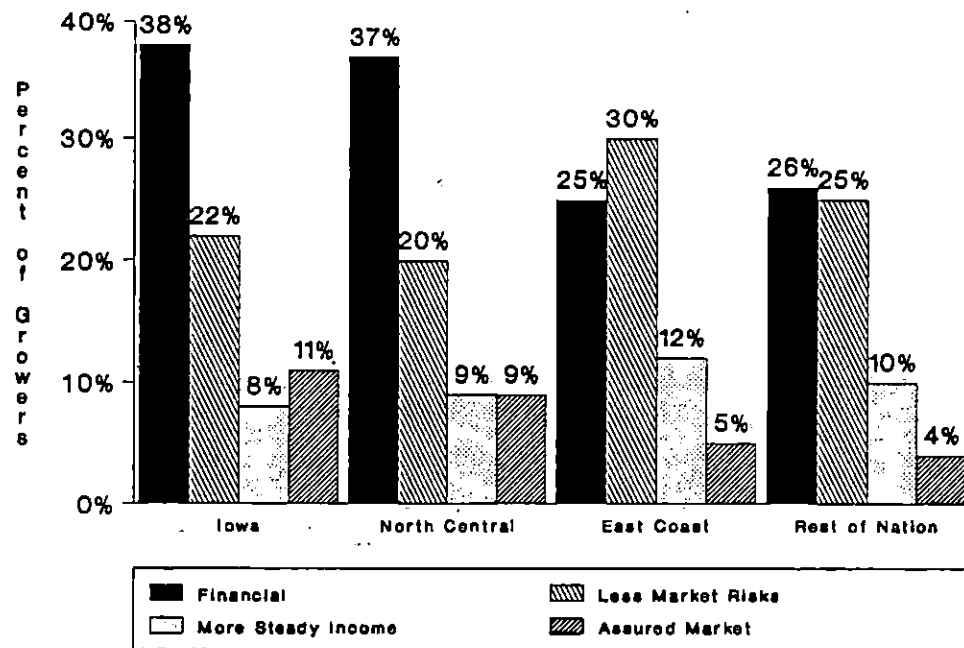


Figure 2. Reasons Why Growers Contract (by Region)



Independents' Responses

In general, Iowa's independent producers were not actively looking for contract production alternatives. Only one percent of Iowa independent producers were currently considering contracting and 15 percent said they might consider it. National averages were similar with percentages of one and 20 for those who were considering or might consider contracting (Figure 3 and Figure 4). A larger percentage of East Coast respondents (24%) indicated they might consider it while a smaller percentage (42%) indicated they would not consider it under any situation.

Iowa independents were asked why they opposed contracting: 31 percent cited that they wanted their independence, 20 percent were fundamentally opposed to contracting as bad, and 16 percent felt that it paid poorly (Figure 5). This followed closely the response of independent producers across the nation (Figure 6). Attitudes on contracting have likely changed from when the survey was completed. It is likely viewed more favorably as a method of entering the pork production industry. It may be the only alternative for someone short on investment funds. It is also becoming more widely viewed as one of a number of ways of expanding the farming operation. It is an option within the farm's portfolio of investments and is viewed as such.

Figure 3. Independents' Willingness to Become Contractors

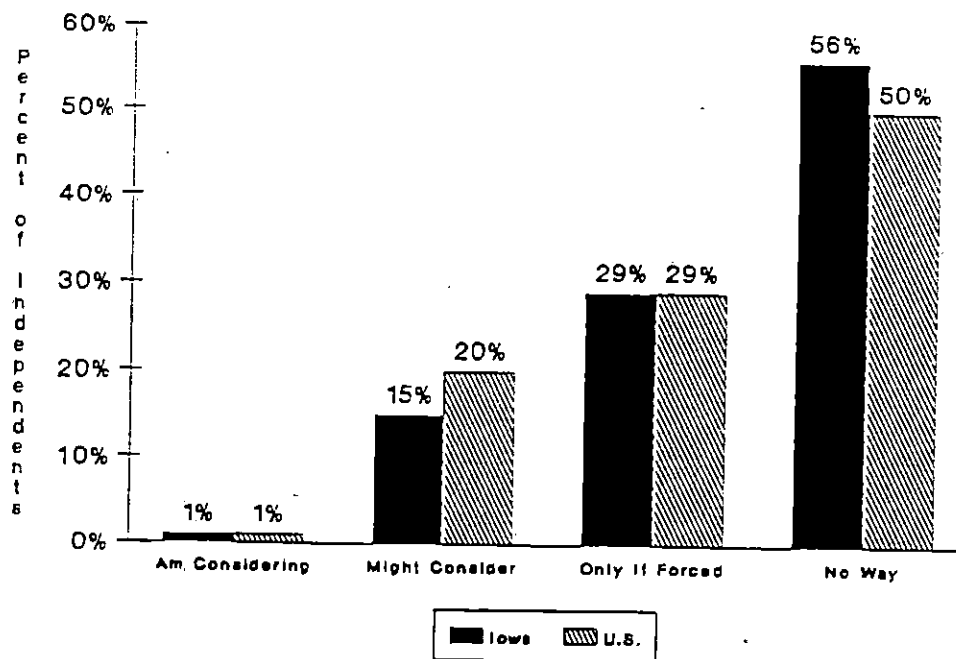


Figure 4. Independents' Willingness to Become Contractors (by Region)

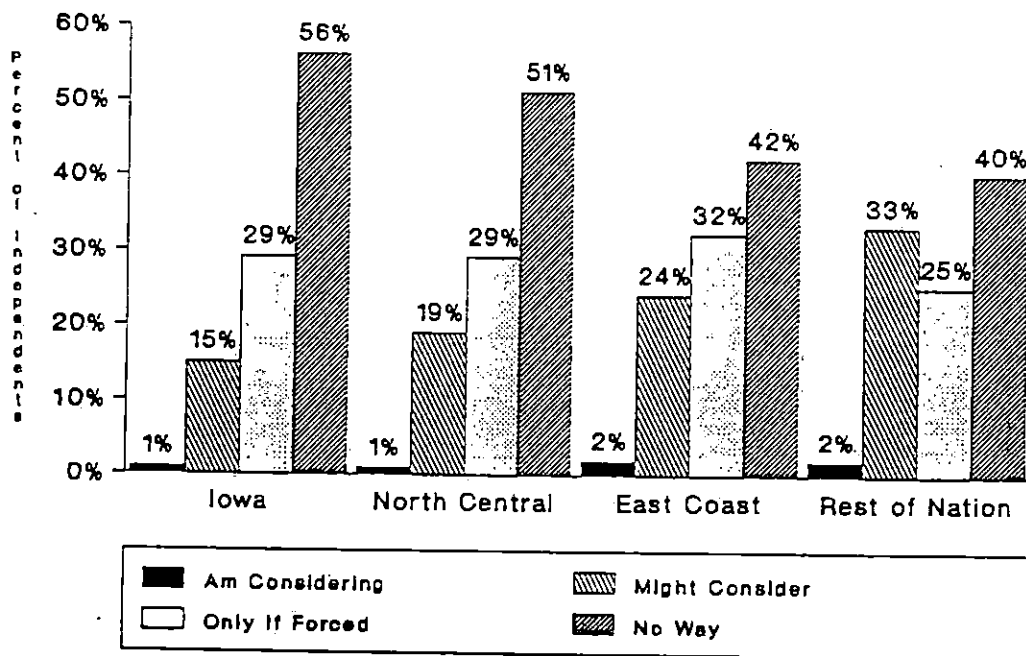


Figure 5. Independents' Reasons for Not Contracting

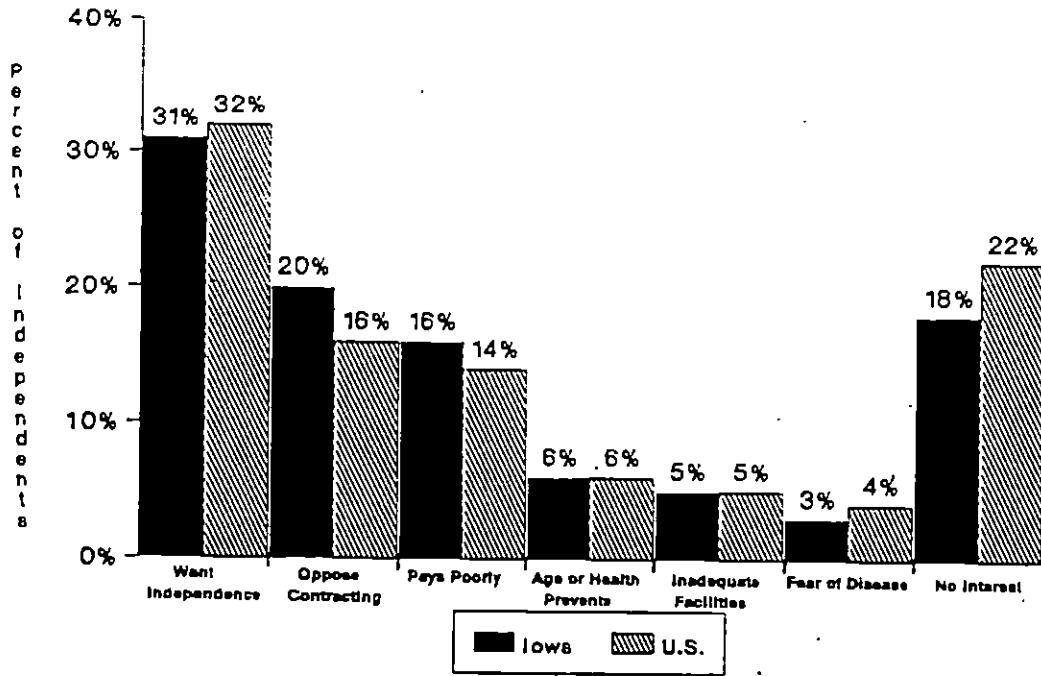
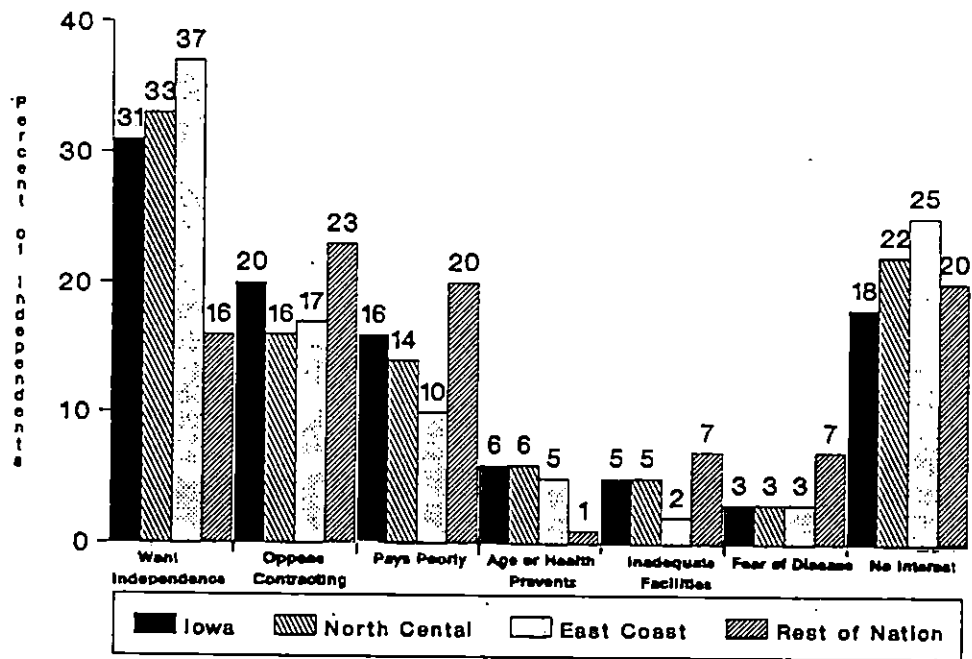


Figure 6. Independent's Opposition to Contracting (by Region)

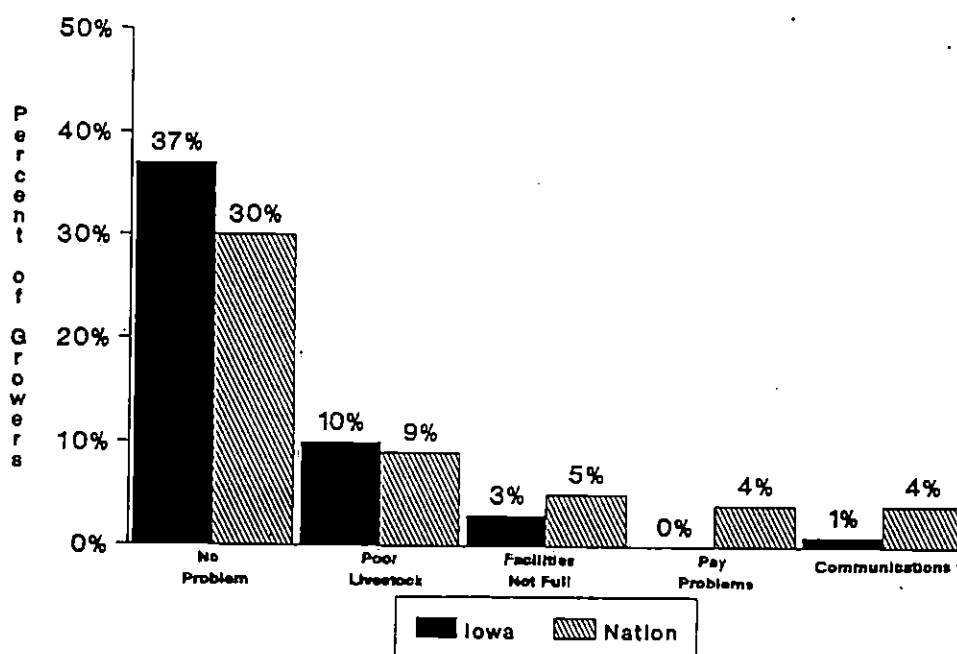


Attitudes and Satisfaction

Iowa contractors and growers mirrored the national average in satisfaction with each other's performance. On a scale of 1 to 6 (1=lowest satisfaction, 6=highest satisfaction), contractors (pig owners) reported a satisfaction rating of 4, while growers reported an average satisfaction level of 4.7. Growers, on average, were satisfied with the contractual arrangement.

Growers were given an opportunity to list what problems they had experienced with their contractors. Only four percent of the Iowa growers reported that they worried a lot about losing their contract while 75 percent said they did not worry at all. Nationally, two percent of growers worried a lot about losing the contract and 78 percent did not worry at all. Thirty-seven percent of the respondents reported they didn't have any problems while 15 percent reported problems; the most common being poor quality livestock. Other complaints included communication hassles, the lack of facilities being kept full, insufficient or slow payments, and that the contractor did not provide adequate medicines or veterinarian services (Figure 7). Reported problems were relatively constant across grower size. Communication hassles tended to increase as a problem as grower size increased. Poor livestock was a larger problem for the smaller growers.

Figure 7. Problems Reported by Growers (Iowa and U.S.)



It is interesting to note that 47 percent of Iowa growers did not respond to the question of problems faced with their contractors. Non-response was large for all areas. Whether these growers had no problems or if they worried about possible retaliation is not known. However, responses were confidential and respondents were informed that they were confidential. Inclusion of this large proportion of nonresponding producers could significantly change the stated percentages.

Plans for 1992

Seventeen percent of Iowa contractors reported they are likely to reduce their level of hog production by 1992 (Figure 8). This compared to 13 percent in the East Coast region and in the Eastern portion of the North Central region, and only nine percent for the rest of the nation (Figure 9). Of the Iowa contractors, 36 percent plan to expand production by 1992. This compares to 48 percent of the contractors in the East North Central area, and 42 percent in the East Coast region. A smaller percent of Iowa contractors were aggressively pursuing expansion. Moreover, in the West North Central region (includes Iowa) a larger percentage (10%) of contractors intended to exit contract hog production.

Figure 8. Iowa Contractors Output Plans by 1992

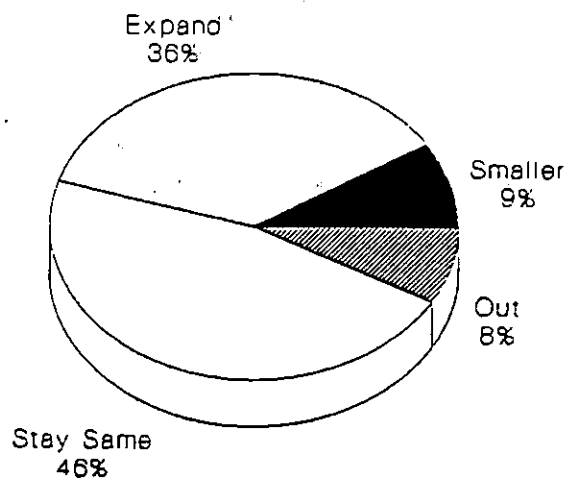
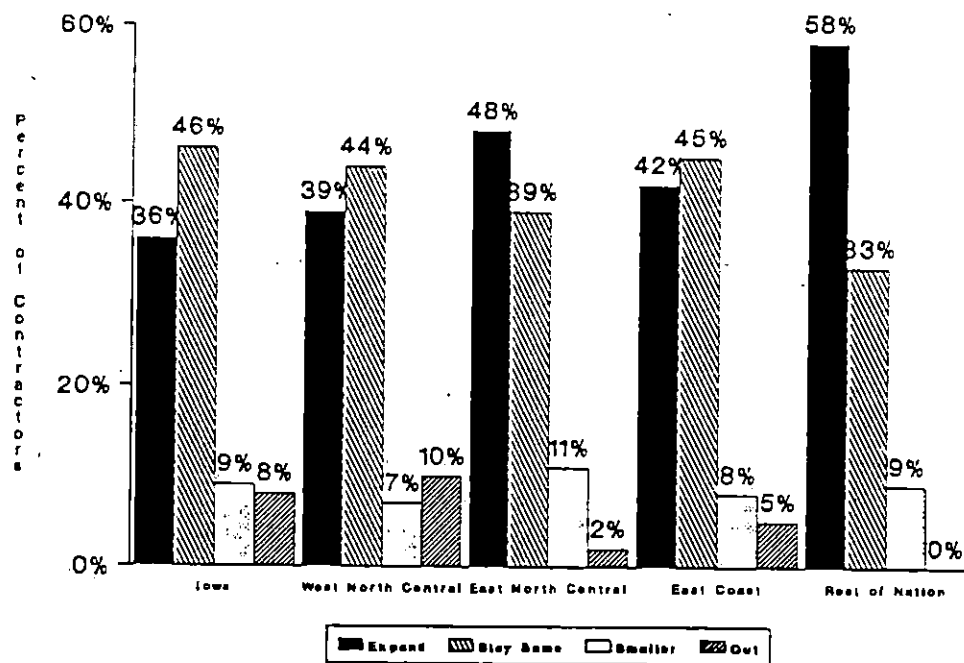


Figure 9. Contractor Production Plans for 1992



Additional surveying would be needed to fully understand reasons why Iowa contractors indicated they were less likely to expand. However, speculation may provide some insight into why these differences occurred. Part may be associated with the improved farm economy. As stated previously, one of the possible factors contributing to the growth of contracting in Iowa was the farm crisis of the early 80's. With an improved farm situation in the late 1980's and the desire to be independent, more growers may feel positive about the ability to make it "on their own" rather than through contract production. Additionally, in Iowa, a higher percentage of the contractors were independent operators with some hogs finished on contract. Additionally, Iowa contractors were relatively new entrants when compared to those on the East Coast. Thus, there would likely be more fall-out as the industry develops. Others may be nearing retirement and the business will not continue as it would with other structural arrangements.

Figure 10. Production Plans by Contractor Type (Iowa)

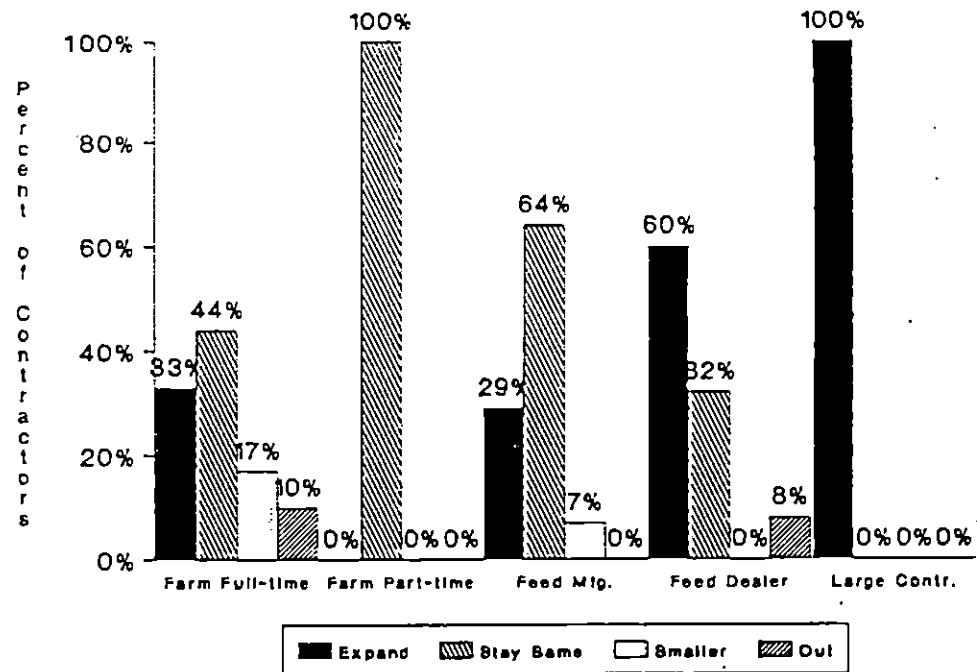


Figure 10 provides information on production plans by type of Iowa contractor. The Iowa contractor responses mirrored the national contractors' plans. This figure provides more information on potential changes in number of hogs under contract. All (100%) large contractors planned on expanding their production. Six out of ten feed dealers planned on expanding. Thus, those who were the biggest in contract production planned on expanding. In comparison, all part-time farmers planned to stay the same size. Those who were the smaller contractors exhibited a greater tendency toward exiting the industry. The structural implications from the shifts should be evident.

Summary

Iowa contract production mirrors the country in many aspects: most reasons why growers contract, satisfaction of growers and contractors with contract agreements, and motivations for independents to stay out of contract production. Still, there are several areas where Iowa stands apart: less market risks, the

number of growers wishing to become independent producers and a higher percent of contractors who anticipate leaving contract production by 1992.

Currently, Iowa hog producers have numerous market outlets. Thus, there is less pressure to enter into contractual relations as a means for market access. The structure of the pork packing industry in the future will impact this response. Contractors and growers alike indicated they were satisfied with the contractual arrangements. For an industry to be sustainable over time the satisfaction will need to be maintained. It will not be sustainable with one party dissatisfied. Returns will need to be apportioned similarly to the share of resources supplied and risks absorbed by the respective parties.

Growth of hog contracting in Iowa will be influenced by different forces. One important factor will be the situation of the farm economy itself. Due to the well-developed hog industry in the state and the independent nature of the Iowa producer, most producers would prefer independent operations unless tough economic times force the producers to pursue methods to share and lessen risks. Level of risk bearing ability will impact level of contracting.

Contracting can provide a favorable environment for young operators or other individuals with limited capital resources. However, the ability of these producers to return to independent operation over time is questionable. Only 40 percent of Iowa growers reported that they felt contract income was sufficient to replace their facilities. If this is the case, it brings into question the potential to become independent producers. Without sufficient income, growers will be forced over time to leave hog production altogether as they will be unable to replace depreciated facilities. Or, they will continue as contract producers because they are unable to amass the equity needed to become an independent producer.

Another factor affecting the future of contract production is the laws limiting the type of hog production which is allowed in the state. Iowa law currently restricts packers from owning and producing hogs which they would use in their own facilities. An important issue for the Iowa hog production industry is the type of production system which may or may not be allowed. The answer may lie in the desire to remain competitive. The bottom line is to be a cost leader in the industry and provide the services necessary to be a

cost leader. Competitiveness can be enhanced through development of many structural forms of hog production.

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Appendix A

Hog Contracting Survey Regions

Northeast (NE) -- Connecticut, Massachusetts, Maine, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont

East North Central (ENC) -- Illinois, Indiana, Michigan, Ohio, Wisconsin

West North Central (WNC) -- Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, Nebraska, South Dakota

South Atlantic (SA) or East Coast (EC) -- Delaware, Florida, Georgia, Maryland, North Carolina, South Carolina, Virginia, West Virginia

South Central (SC) -- Alabama, Arkansas, Kentucky, Louisiana, Mississippi, Oklahoma, Tennessee, Texas

West (W) -- Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, Wyoming

* No responses from this state.

Appendix B

Definitions³

Single unit: reported no contracting nor any production outside a single (home-base) operation.

Multi-unit: operates 2 or more separate units but does not do any contracting.

Farm contractor: supplements own output by contracting with 1 or more other producers for farrowing and/or for finishing. Some farm contractors may have extra units of their own production besides their contract units. Any farm contract operation of more than 50,000 head is defined as a contractor rather than a farm contractor.

Contractor: an agribusiness that focuses on contracting (but may have its own production units) and is generally larger and more complex than a farm contractor. "Small contractors" refers to operations producing under 50,000 market hogs annually, "large contractors" those producing over 50,000 head per year.

Contractee (grower): produces pigs or finishes pigs owned by a contractor or farm contractor. May operate more than one unit.

Sow corporation: operations owned jointly by a few finishers to produce pigs that may be for their own finishing or other operators.