

# New Generation Grain Marketing Contracts: How Have Top Farmer Opinions and Usage Changed?

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New generation grain marketing contracts (NGC) were introduced to the market five years ago and are now widely available to producers. These contracts offer producers additional tools for pricing grain. To better understand NGC availability and usage, Top Farmer Crop Workshop attendees were surveyed in July 2003 and July 2005.

## What are New Generation Grain Marketing Contracts?

New generation grain contracts are generally classified into the following three categories:

- **Automated pricing contracts** follow predetermined and nondiscretionary pricing rules over a specific time period, the pricing window. The most common is an average pricing contract that is designed to give the producer an average price by pricing an equal amount of bushels every business day during the pricing window. There are more complex automated pricing contracts that allow the producer to establish more parameters in the pricing criteria.
- **Managed hedging contracts** are where pricing decisions are made by an individual analyst chosen by the producer. The producer will choose the number of bushels to price and the analyst, at which point the producer takes a passive role in pricing the designated bushels.
- **Combination contracts** are where the producer still utilizes automated pricing rules, but is allowed to share in gains, if any, from pricing decisions made by the pricing analyst.

## How Producer Usage of NGC Has Changed

The results of the survey showed that NGC are widely available, with over two-thirds of the respondents saying that the grain handlers to whom they deliver offer NGC. However, of the producers who have access to NGC, only about a third these producers have used them. Looking to the future (Table 1), a majority of respondents in 2003 indicated that they were planning to increase their use of NGCs. These numbers were lower in 2005 as compared with 2003, probably because there were a slightly larger proportion of producers in 2005 who are currently using NGCs.

Table 1. Producers' planned use of new generation contracts in 2003 and 2005.

<i>Action</i>	2003		2005	
	Use NGC N=10*	Do not use NGC N=28	Use NGC N=12	Do not use NGC N=30
Increase in future	60%	61%	42%	37%
Stay at current usage	20%	39%	50%	63%
Decrease in future	20%	0%	8%	0%

\* N = the number of respondents to this question

## Producer Opinions about NGC

All groups of producers believe that the biggest advantage of NGC is “to provide producers with discipline in their pricing strategy.” In 2005, an equally important advantage among all producers is that NGC “helps get the emotion out of pricing.”



Pricing Diversification In both years, all producer groups agreed that NGC “provide the producer with pricing diversification.” In 2005, producers who use NGC are significantly more likely to agree that providing pricing diversification is an advantage than producers who do not use NGC. This is the only statistically significant difference of opinion between the two groups of producers in 2005. This suggests that the producers who use NGC do so in order to diversify their pricing strategy.

Margin Calls “Not having margin calls” is an advantage of NGC to producers, as indicated both years. In 2003, producers who used NGC agreed more strongly that no margin calls is an advantage than producers who do not use NGC. By contrast, in 2005, producers who do not use NGC rated no margin calls more highly as an advantage than did producers who use them. While the advantage of no margin calls may have been the reason producers used NGC in 2003, producers now appear to be more interested in NGC as a tool for pricing diversification.

Pricing Alternatives In both years, all producer groups agreed that an advantage of NGC is to “provide more pricing alternatives” and disagreed that a disadvantage of NGC is that “too many pricing alternatives” are offered. This indicates that producers continue to appreciate the expanded marketing alternatives.

Pricing An interesting result of the survey is that in both years, producers who use NGC weakly agree that NGC “may increase net price.” However, they also weakly agree that NGC “may lower net price.” This inconsistency may imply producers who use them do not believe NGC will have a major impact on net price in either direction and that these producers use NGC for reason other than increasing their net price. In contrast, the producers who do not use NGC disagree that they may

Table 2. Likert Scale<sup>a</sup> Measures for NGC Advantages and Disadvantages

	2003		2005	
	Use NGC	Do not use NGC	Use NGC	Do not use NGC
<i>Advantages</i>				
Provides discipline in pricing	4.55	4.22	4.55	4.00
Provides pricing diversification	4.33	3.88	4.27*	3.33*
Helps get the emotion out of pricing	4.33	3.77	4.55	4.00
No margin calls	4.25*	3.77*	4.00	4.07
Provides more pricing alternatives	4.00	3.77	3.73	3.20
Reduces time spent marketing	3.66	3.25	3.27	3.87
May increase net price	3.44	2.88	3.55	2.93
<i>Disadvantages</i>				
Service fees	3.55	2.75	3.64	3.60
May lower net price	3.44	2.88	3.36	3.67
Too many pricing alternatives	2.22	2.12	2.45	2.53
Too complex to understand	2.00	3.37	2.45	2.33

<sup>a</sup> 1= strongly disagree, 3= neutral, and 5= strongly agree.

\* Statistically significant at the 90% level of confidence.



increase net price in both years. Further, in 2005 producers agree that NGC may lower net price. This suggests that one reason producers do not use NGC is that they believe these contracts will lower their net price.

Complexity In 2005, both users and non-users disagreed that NGC are “too complex to understand.” This marks a sharp change from 2003 when producers who did not use NGC weakly agreed that they were too complex to understand. This sharp change suggests that producers now feel they have a better understanding of NGC, and when producers choose not to use NGC it is for reasons other than a lack of understanding.

### **Conclusions**

NGC do offer producers additional tools for pricing their grain. Although use by producers increased only slightly between 2003 and 2005, both users and nonusers of NGC appear to have improved understanding of the characteristics of NGC and their potential role in marketing. Producers who use NGC, do so mainly to diversity their pricing strategy.

### **For More Information**

Hagedorn, Lewis A., Scott H. Irwin, Darrel L. Good, Joao Martines-Filho, Bruce J. Sherrick, and Gary D. Schnitkey, 2003, “New Generation Grain Marketing Contracts,” AgMAS Project Research Report 2003-01. Available at: [http://www.farmdoc.uiuc.edu/agmas/reports/2003-01/agmas\\_2003-01.pdf](http://www.farmdoc.uiuc.edu/agmas/reports/2003-01/agmas_2003-01.pdf)

