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Understanding Grain Marketing Strategies is Critical for Success

The greater number of grain marketing tools available allow producers to increase their returns and reduce risks. Successful grain marketing involves a series of choices. It calls for tradeoffs among the:

- farmer's willingness and ability to accept price risk;
- amount of production risk associated with a farmer's financial situation and related cash needs;
- grain market outlook; and
- producer's understanding of grain marketing strategies.

This fact sheet lists the important factors producers should consider in selecting a particular marketing strategy, describes the typical marketing tools available to grain producers, and discusses the advantages and disadvantages of each option.

No Single Marketing Tool will be Appropriate for Every Individual or Situation

Producers should consider several factors to when selecting grain marketing tool:

Price Risk. Grain producers face different situations and have varying attitudes toward risk. Some producers like risk and may even thrive on it; others have a natural aversion to risk. A farmer's choice of the best marketing tool should incorporate his or her attitude toward risk.

Sincere and honest answers to the following questions should give producers insight into the correct marketing decision for their operations:

- What is the worst that could happen if prices dropped dramatically?
- Would I have sufficient cash to survive?
- Would it have severe financial consequences on my operation?
- Does the possibility of falling prices make me very nervous?
- Could my family survive the emotional stress created by falling prices?

Production Risk. Some marketing tools can create severe financial problems if a producer significantly overestimates production. When locking in a futures price, a producer guarantees a specified quality and quantity of grain. A producer will incur financial penalties if he/she cannot deliver the anticipated production.

Crop insurance is a risk management tool for production risk. Producers should consider purchasing crop insurance at the various levels of protection. Crop insurance can also help producers set a bushel (bu) marketing goal (e.g., average production is 100,000 bu of corn, crop insurance is purchased at 70%, market no more than 70,000 bu).

Financial Situation and Cash Needs. An individual's financial situation and cash needs play an important role in selecting a marketing tool. With some decisions, producers may receive partial or no payment which can aggravate cash flow problems. Financial planning, in conjunction with good marketing, will increase returns and reduce risks.

Grain Marketing Outlook. Other things equal, if prices are expected to rise significantly, producers should wait to sell their grain. Conversely, if prices are expected to fall, producers should sell their grain immediately. Unfortunately, it is impossible to know with certainty which direction prices will move. Droughts, floods, wars, export/import polices, plantings and a host of other factors can change in sometimes dramatic and unexpected directions.

The unpredictably of grain prices does not mean that farmers should ignore the price outlook. . It does mean that producers should interpret any outlook projections with caution. The outlook for the grain market should not be the sole factor incorporated into planting and marketing decisions.

Marketing Tool Knowledge. All pricing tools will not be available or appropriate for every producer. However, if a producer does not consider pricing tools because of a lack of understanding, potential returns will be lower and financial risk increases.

Producers Can Only Make Informed and Appropriate Marketing Decisions with Adequate Knowledge of Grain Marketing Tools

There are advantages and disadvantages to each grain marketing tool.

Cash Forward Contracting: A cash forward contract is a legal agreement between a producer and a grain elevator, processor or other grain buyer to deliver a fixed quantity and grade of grain or relinquish grain in commercial storage, at a specified price to a designated location. Producers may receive premiums and discounts for grain that does not meet the contract's specifications (usually grade and moisture), as well as penalties for noncompliance by either party. At the producer level, cash forward contracts are more prevalent before the grain is harvested.

Advantages of Cash Forward Contracting

1: **Eliminates price risk** by locking in a price.

2**: Rules out basic risk** by locking in a price.

3: **Extends the marketing year**. Producers do not need to rely solely on cash harvest prices.

4: Easily understood.

5: **Removes need to sell in fixed increments** (1,000 or 5,000 bushels).

6: **Omits margin money requirements**.

Disadvantages of Cash Forward Contracting

Increases production risk. Cash forward contracts normally require producers to guarantee delivery of the grain or buy back the contract. This can be expensive if the grain is not harvested and there is no production.

Reduces potential profits. Elevators or processors will often hedge forward contracts in the futures or options markets. Sometimes it is more profitable for the producer to hedge the grain directly rather than through a forward contract.

Selling at Harvest for Cash: A farmer can sell grain to an elevator, processor or other buyer for cash at harvest. The farmer simply accepts the cash harvest price. This alternative is the most popular method of marketing grain among U.S. producers. It may be the best method under certain circumstances and should be used with other pricing tools.

Advantages of Selling Harvest for Cash

1: **Eliminates storage charges**.

2: **Does away with interest charges**.

3: **Easily understood**.

Disadvantages of Selling Harvest for Cash

1: **Shortens the marketing year**. Pricing opportunities are often limited to only a few weeks in the marketing year.

2: **Lowers prices**. Because of easy availability of grain during harvest and related pressure on facilities, the basis is often depressed during harvest and results in low local prices.

Storing Grain on the Farm and Selling Later: With this decision, a farmer puts the harvest grain in on-farm storage, and waits to sell it until the price is acceptable. The producer is long cash grain and is speculating on cash prices. This method is becoming more popular with the increase of on-farm storage facilities.

Advantages of On-farm Storage for Selling Later

1: **Extends the marketing year**.

2: **Allows greater delivery flexibility**. Because commercial elevators charge in-and-out fees, the producer with grain stored on farm has more control over where to deliver the grain when it is sold.

Disadvantages of On-farm Storage for Selling Later

1: **Decreases grain quality**. Producers inexperienced with storing grain or not continually monitor grain conditions can experience quality losses.

2: **Increases costs**. A producer incurs storage, interest and shrinkage costs.

3: **Reduces timelines**. Producers may receive premiums for grain covered by a warehouse receipt. Producers with farm stored grain will miss such opportunities.

4: **Involves price risk.**

5: **Entails basis risk**.

Storing Grain in a Commercial Elevator and Selling Later: Farmers using this marketing tool store their harvested grain in commercial storage facilities and wait until prices reach acceptable levels before selling. Like the on-farm storage option, the farmer is long cash grain and is speculating on cash prices.

Advantages of Commercial Storage for Selling Later

1: **Extends the marketing year**.

2: **Ensures quality**. The elevator is responsible for maintaining grain quality.

3: **Guarantees timeliness**. The producer can take advantage of opportunities to sell quickly. Sometimes premiums are given for grain with warehouse receipts to reflect this timeliness.

Disadvantages of Commercial Storage for Selling Later

1: **Decreases delivery flexibility**. Because of in-and-out charges required by elevators, a producer has less flexibility in choosing where to deliver the grain.

2: **Increases costs**. Producer has storage and interest charges.

3: **Involves price risk**.

4: **Entails** basis risk.

Deferred (Delayed) Pricing Contracts: Producers using this option deliver grain to the elevator and agree to sell the grain, but establish the price of grain sold before a specified date. Price is generally tied to the purchasing elevator's posted local bid price.

Typically a farmer delivers grain to an elevator and signs a contract to sell all or a portion of the grain to the elevator by a specified date. In the event that a farmer does not sell the grain by the specified date, most contracts require that the grain be sold at the local bid price on that date. Partial payment is sometimes received at the time the grain is delivered, and storage charges are sometimes waived.

Advantages of Deferred (Delayed) Pricing Contracts

1: **Extends the marketing year**.

2: **May eliminate storage costs**.

3: **Denotes partial payment often**.

4: **Omits need to trade in fixed increments** (1,000 or 5,000 bushels).

Disadvantages of Deferred (Delayed) Pricing Contracts

1: **Increases costs** (partial interest).

2: **Entails bankruptcy risk**. If the elevator goes bankrupt, the producer becomes an unsecured creditor.

3: **Involves price risk**.

4: **Contains basis risk**.

5: **Requires the producer to refund a portion of partial payment** (if one is received) if prices decline dramatically.

Basis Contracts: This marketing tool requires a producer to deliver grain to an elevator and to agree to sell the grain, but establishes the price of the grain sold before a specified date. Price is tied to a predetermined basis. For example, a producer would deliver grain to an elevator and would sign a contract agreeing to sell it to the elevator before a predetermined date and at a predetermined basis level. If the farmer negotiated a 15 cent corn basis on the March corn contract, the farmer could sell his grain to the elevator at 15 cents above the March corn contract price at any time before the expiration date specified in the contract.

If the farmer takes no action before the specified date, most contracts require that the grain be priced at the basis level on the expiration date. Producers often receive partial payment when the grain is delivered to the elevator, and storage charges are often waived.

Advantages of Basis Contracts

1: **Extends the marketing year**.

2: **May eliminate storage costs**.

3: **Denotes partial payment often**.

4: **Removes basis risk**. It allows the producer to bypass a possible weak harvest basis.

5: **Omits need to trade in fixed amounts** (1,000 or 5,000 bushels).

Disadvantages of Basis Contracts:

1: **Entails costs** (partial interest).

2: **Involves bankruptcy risk**. If the elevator goes bankrupt, the producer becomes an unsecured creditor.

3: **Contains price risk**.

4: **May require producer to refund a portion of partial payment received**, if prices decline dramatically.

Hedge to Arrive (HTA): This marketing strategy allows a producer to lock in a future price, but not set the basis at the time of the contract. The buyer and the seller will determine the basis by a certain date. For example, if the basis is weak and futures are favorable, a producer may lock in the futures price with the elevator for delivery. The producer will then accept basis risk until it is locked in or grain is delivered. To effectively use the HTA, producers must know the local basis and the factors affecting it.

Advantages of Hedge to Arrive:

1: **Eliminates price risk**. Price is locked in, subject only to basis risk and interest charges. Basis is much more predictable than price.

2: **Omits need to trade in fixed amounts** (1,000 or 5,000 bushels).

Disadvantages of Hedge to Arrive:

1: **Involves basis risk**.

2: **Increases production risk**. HTA contracts require the producer to guarantee delivery of the grain. This can be expensive if the grain is not harvested and there is no production.

Hedging With a Futures Contract: In this instance, a producer sells futures contracts and buys them back when the cash grain is sold. A farmer using this tool contacts a broker and sells the appropriate number of 5,000-bushel futures contracts. When the cash grain is sold, the farmer contacts the broker, and buys the same number of futures contracts. It is possible for a producer to make actual deliveries against the futures contracts to satisfy the contracts instead of repurchasing them. However, such occurrences are rare. This tool locks in a price subject to the producer's ability to predict basis. A farmer may hedge grain pre-harvest or post-harvest.

Advantages of Hedging with a Futures Contract

1: **Eliminates price risk.** The price is locked in, subject only to basis risk and interest charges. Basis is much more predictable than price.

2: **Extends the marketing year**.

3: **Contains high liquidity**. Because futures are publicly traded at a relatively high volume, farmers may reverse their positions quickly and easily.

Disadvantages of Hedging with a Futures Contract

1: **Involves basis risk**.

2: **Raises interest costs because of margin calls**. This can cause cash flow problems.

3: **Must sell in 1,000-or 5,000-bushel increments**.

4: **Requires marketing knowledge**. Hedging with the futures markets is generally less understood than some other forward pricing mechanisms, and involves greater marketing know-how.

5: **Overlooks rising prices**. Since prices are locked in, the producer cannot take advantage of rising prices. Also, margin calls from rising prices can cause emotional distress and cash flow problems for unprepared producers.

Hedging with a Put Option Contract: Using this tool, a producer buys ***put*** options, which are then sold when the producer sells the grain. The producer contacts a broker and buys the appropriate number of 5,000-bushelput options. When the grain is sold, the producer contacts the broker and sells the same number of put options, if the options have value. Otherwise, the producer lets the put options expire. Although it is possible for a producer to exercise put options and establish short positions in the futures market, most producers either sell the puts or let them expire. This marketing decision establishes a minimum price for the producer's grain, subject to his or her ability to predict basis accurately.

Advantages of Hedging with a Put Option Contract:

1: **Eliminates price risk**. Buying a put is similar to purchasing insurance against falling prices.

2: **Allows producers to take advantage of rising prices.**

3: **Omits margin requirements**. Producers do not have to worry about margin calls and related cash flow problems.

4: **Extends the marketing year**.

5: **Ensures high liquidity because options are publicly traded**. Producers may quickly and easily reverse their position to take advantage of temporary price declines.

Disadvantages of Hedging with a Put Option Contract:

1: **Involves basis risk**.

2: **Requires buying the option in 1,000- or 5,000-bushel increments**.

3: **Entails greater marketing knowledge**. Options trading can be confusing for those unfamiliar with the terminology.

4: **Involves a lot of data**. Because there are several options on each futures contract, it is easy for a producer to become overwhelmed with data.

5: **Requires premiums which may make the option too expensive**.

6: **Incomplete protection against falling prices**. Since option contracts expire the month before the underlying futures contract, there could be a month when the producer's grain is unprotected against falling prices. Farmers can take advantage of strategies which will provide protection for this uncovered month, but they are more complex and require more knowledge.

Storing with a Call Option Contract:

This marketing tool allows a producer to sell grain at harvest and then purchase ***call*** option contracts. Producers sell their grain at harvest, contact their broker, and purchase call options because they expect market prices to strengthen. Later, they either sell the same call options (if they have value) or let them expire. If grain prices increase, producers who purchased calls will benefit from the higher prices.

Advantages of Storing with a Call Option Contract:

1: **Eliminates storage and interest costs**.

2: **Allows producers to benefit if prices rise later.**

3: **Omits margin requirements**.

Disadvantages of Storing with a Call Option Contract:

1: **Requires buying** the option in 1,000 or 5,000 bushel increments.

2: **Demands greater marketing knowledge**. Options trading uses terminology which can be confusing for those unfamiliar with it.

3: **Involves a lot of data.** Because there are several options on each futures contract, it is easy for a producer to become swamped with data.

4: **Requires premiums** which may make the option too expensive.

For more information visit www.extension.umd.edu/grainmarketing

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