Corn - Marketing

THE USE OF CONTRACTS IN CORN MARKETING

Summary of Remarks by W. S. Farris
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Farmers are usually interested in contracting their corn crop in order (1) to establish a price and/or (2) to obtain a "home" for the corn with the opportunity for pricing it at a later date. Grain handlers may want to contract corn (1) in order to obtain volume for efficient operation, (2) to fulfill commitments or to be able to make commitments for later delivery, and/or (3) to obtain a quality or type of corn for a specific customer or trade use.

Contracting in corn marketing is a device which farmers and agri-business managers use for reducing uncertainty in volume, price and quality. The amount of contracting seems to ebb and flow with a degree of uncertainty regarding any one or all of these factors. An elevator manager or corn processor may by contracting "make sure that his information regarding price, volume, and to some extent quality is correct."

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Unit costs in assembling, processing, and distributing can usually be lowered if the manager can plan on the volume, time, and quality of grain he can expect to receive. In other words, injecting more certainty (or reducing uncertainty) into his business is worth money to him.

Advance Pricing Through a Futures Hedge

Many farmers look for an opportunity to hedge their corn crop when the distant futures (usually December) reflects an attractive local price. The farmer engages in this form of contracting his corn crop because he is afraid that the harvest price may be less than the target price which he calculates sometime in advance of harvest. If his fear materializes he is usually able to buy back his futures contract with enough profit to apply to his harvest selling price to bring it approximately to his target price. If the farmer's judgment proves to be wrong and he "hedges in a loss," he is quickly disenchanted with this form of contracting in advance for a price.

Local Elevator Price Contracts

The same result as hedging can in principle be achieved by contracting corn in advance of harvest with a local elevator. Some grain buyers will offer this type of contract as soon as the December futures comes on the board. Others begin about planting time, while others do not begin contracting for the new corn crop until late summer. The elevator's contract bid on a given day will usually be the Chicago December future less a historic harvest time basis. At Lafayette, Indiana, for example, when December futures are quoted at $1.20 per bushel at corn planting time the contract bid for new corn is about $1.03 per bushel (or on a basis of 17 cents per bushel). Such a contract is usually relatively simple and merely states the quantity of corn, the contract price, the approximate shipping date or delivery date, and the authorized signatures. A set of generally accepted conditions may be implied, or they may be specifically written on the contract.

This type of contract does not determine the quality of corn delivered on the contract except that provisions are usually made to discount grain of less than No. 2 quality and may prohibit the delivery of very low quality corn in fulfillment of the contract.

The above is a type of hedging contract, but the grain elevator does the hedging instead of the farmer.

Local grain buyers may also contract to receive grain at harvest time under a delayed pricing contract with the farmer. Under this type of contract the farmer has the assurance that he can place his grain into commercial channels during or shortly after harvest and delay pricing and settlement for the grain until sometime later when hopefully the price will be more attractive. The buyer, as in the case of the straight price contract, does the hedging instead of the farmer. This "delayed pricing" contract affects quality only in that it provides discounts for grain of lower quality than No. 2 and may also put restrictions on very low quality corn.

Contracting for Special Type Corn

Where both volume and quality considerations are important, contracts may be used to control both of these. The best example of this in Indiana and Illinois is the experience of the National Starch Company in contracting for waxy maize. Some contracting had been done by the company for several years, but in 1969 contracting was expanded to develop an increased volume of waxy maize and at the same time control the quality. The contract specified a choice of varieties, conditions of delivery, conditions of drying, and a price which was a 12 percent premium over the cash price for Chicago No. 2 yellow corn adjusted to a local basis.

Under this contract quality was controlled by providing a range of varieties acceptable to the company, specifying storage and drying conditions, and assuring purity through inspection by the company's field agents. (A copy of the 1969 contract is attached.)

Contracting for "Distillery Quality" Corn

While some distillers may contract with individual farmers for the corn they need, it is my observation that most distillers obtain their corn through corn buyers who are familiar with their requirements. Here is the way a corn merchant described the distiller's needs to me.

"The grade standards for distillers' quality, in most cases, is No. 1 yellow corn, with the test weight being 56 pounds or better, moisture 14 percent or less, damage under 2 percent, and foreign material under 3 percent, if it is cracked corn. The distiller mills the corn to a very fine texture, which reflects the need for dry corn. The distiller produces as much whisky as is possible (yield-wise) from each pound of corn, thus the heavy test weight requirement. He wants the whisky to be free from foreign tastes, which necessitates the damage and foreign material standards. Blue eye mold damage, especially, is a problem for them because of the fact that the mustiness, which comes from mold damage, cannot be distilled out of the whisky. Of course foreign material (other than cracked corn), cob dust, and so forth, would present the same taste problem as they cannot be distilled out.

"It should be noted here that I have seen corn grade No. 1 yellow according to U.S.D.A. grading standards but which would not be suitable for grading 'distilling quality' due to immaturity or some other problem.

"One of the most important points of the 'some other problems' is improper drying. Drying corn at heat which is too high, and taking out too much moisture at one time, will affect the arrangement of the starch cells in the corn, thereby greatly curtailing the yield of whisky per bushel of corn. A generalized statement of the meaning of 'distillers quality corn' would be something to this effect: 'corn that has been properly matured, been properly dried (under 160° F) to a level under 14 percent and maintained in such a condition as to be free of damage and foreign matter.'"

A modified form of contracting which this grain buyer arranges is that he sends a fieldman into the major corn areas and takes samples of stored corn. When the demand for a certain type of corn materializes this corn buyer can survey his records and locate corn which will likely be acceptable for a given purpose. (An example of one of these sheets is attached.)

Thus the distilling industry which requires much No. 1 corn acquires it through offering a premium above the going No. 2 price and depends upon the selectivity available in the grain trade to fulfill this need.

(Note: white corn which was formerly contracted in Southern Indiana is now usually sold on a negotiated basis for individual lots. White corn was recently bringing about 20 cents per bushel premium for white corn of milling quality free from odor or contamination.)