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February 1986

Use of Agricultural Options Among North Dakota Country Elevators (December 1985)

Steven P. Gunn
William W. Wilson

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Highlights

Options trading on agricultural futures began on a trial basis in October 1984. Use of options enables an elevator manager to lock in a price and take advantage of favorable price movements. In this report the usage of options by country grain elevators in North Dakota was examined.

The number of elevators using futures and options, the usage of options for corn, HRS wheat, and soybeans, as well as the method of usage, are examined in this report. The views and understanding of options by elevator managers are also examined. Cooperative and noncooperative elevators are compared on their usage of options. Elevators with small, intermediate, and large annual shipment volumes of corn, HRS wheat, and soybeans were also compared on their usage of options.

The authors express their appreciation to the country elevator managers who responded to the mail survey. Without their help this study could not have been completed.

USE OF AGRICULTURAL OPTIONS AMONG NORTH DAKOTA COUNTRY ELEVATORS (DECEMBER 1985)

Steven P. Gunn and William W. Wilson*

The history of commodity trading in the U.S. is filled with stories of intrigue and conflict, of great fortunes gained and lost. The stories of commodity options trading are perhaps the most fascinating.

Commodity options trading has been conducted in the U.S. on an intermittent basis since the early 1860s. At that time the Chicago Board of Trade passed a rule forbidding options trading by its members. The trading of options was on and off several times as pro-option and anti-option groups fought in the legislature, in courts, and in the board rooms. In 1936, Congress banned the trading of agricultural options completely with the passage of the Commodity Exchange Act of 1936.

In 1974, during hearings to revise the Commodity Exchange Act, Congress addressed the question of trading agricultural options. After much testimony on the economic virtues of commodity options, Congress decided to continue the ban on agricultural options while the trading of nonagricultural options was allowed under the Commodity Futures Trading Commission. The commission developed a set of rules for exchange-traded options and in 1981 approved a three-year pilot program for options trading on sugar, gold, and treasury bonds. In 1982, the Futures Trading Act lifted the ban on trading agricultural options. An experimental three-year program of organized trading in selected agricultural options was developed and began in October 1984. Among the ag options traded were Hard Red Spring wheat at the Minneapolis Grain Exchange and corn and soybeans at the Chicago Board of Trade. This study is an examination of the usage of ag options by country elevator managers in North Dakota after one year of options trading.¹

A questionnaire was developed to determine the usage of ag options by North Dakota country elevators. Questions about the use of futures and the manager's understanding and views of ag options were also asked. The questionnaire used in the survey is in Appendix B.

Characteristics of Participating Elevators

One hundred seventy-three North Dakota country elevators responded to the survey on use of ag options. The responding elevators were grouped by organizational structure and by size of annual shipments of corn, HRS wheat, and soybeans.

*Gunn is a research assistant and Wilson is an associate professor, Department of Agricultural Economics, North Dakota State University, Fargo.

¹Details on the mechanics of the use of option is reviewed in a report by John Satrom, Alfred Chan, and William Wilson called "Commercial and Producer Applications Using Options on Grain Futures" available upon request from the Agricultural Economics Department, North Dakota State University, Fargo.

The responding elevators varied by organizational structure (Table 1).² The structures were grouped into cooperatives (including Harvest States line elevators), locally owned private elevators, and line elevators of a large private company. Each group was represented, but most of the responding elevators (64.2 percent) were locally owned cooperatives.

The responding elevators also varied by size of annual shipments of corn, HRS wheat, and soybeans. Corn shipments averaged 81,525 bushels among the elevators and ranged from 0 to 2,500,000 bushels. HRS wheat shipments ranged from 0 to 7,200,000 bushels with an average of 665,091 bushels. Soybean shipments averaged 64,699 with a high of 2,000,000 and a low of 0.

Country elevators from every crop reporting district in North Dakota responded to the survey (Table 2). At least 25 percent responded to the survey in each district and almost 34 percent of all of the elevators receiving questionnaires responded.

Over half of the managers (58 percent) responding to the survey stated that they used futures in their merchandising activities. Since the use of options is closely related to the use of futures, it was hypothesized that managers using futures may be more apt to use options.

The managers were asked to identify one of the following items as their primary sources of commodity price information: radio/television, local newspaper, trade journals, wire service, commission companies, and other (Table 3). Commission companies (68.0 percent) and wire service (48.5 percent) were the most common responses. Among the sources listed as "other" were: floor traders, other local elevators, main office, and the Minneapolis Grain Exchange.

Use of Ag Options Among Participating Elevators

Since the trading of ag options was begun on a trial basis in October 1984, commission companies, the grain exchanges, the Agricultural Extension Service, and others have been giving seminars to explain ag options and how they can be used. One hundred and thirty-three or 76.9 percent of the responding elevator managers reported that they had attended at least one seminar on the use of ag options. The percentages of the responding elevator managers attending various ag options seminars were: 28.3 percent for the Agricultural Extension Service seminars, 15.0 percent for the Minneapolis Grain Exchange seminars, 50.9 percent for commission company seminars, and 9.8 percent for "others" seminars. Listed among the "others" giving seminars were Farmland Industries, Merrill Lynch, Sigco Sunflowers, and the North Dakota Grain Dealers Association.

Most of the responding elevator managers reported that they did not use ag options in their operation; only 30.6 percent used ag options. Reasons given for their usage varied from hedging their own inventories (39.2 percent), to speculation (1.8 percent), to contracting with producers (59.0 percent).

²All tables are located in Appendix A.

The managers were asked which methods they employed for each of these three uses. The percentage of elevators using each method is given in Table 4. Offering a producer a floor price contract accounted for almost half of the option usage.

Just over half (54 percent) of the managers of elevators offering options contracts for producers administered the contract themselves. The remainder reported that a commission company or track buyer administered the contracts. Companies listed as administrators were Benson-Quinn, Atwood-Larson, Harvest States, Peavey, International Multifoods, and Continental.

Most elevator managers using options tended to use them on a small percentage of their total transactions (Tables 5-7). Although the percentage of elevators using options for more than 25 percent of all transactions was small (7.1 percent for corn, 13.2 percent for HRS wheat, and 3.7 percent for soybeans), over 90 percent of the elevators using options had used them for HRS wheat, 6.3 percent had used them for soybeans, and 28.5 percent for corn.

All of the managers were asked to rate their understanding and views of ag options. Only 2.3 percent reported that they had no understanding of ag options, 64.2 percent had limited understanding, 27.7 percent had good understanding, and 5.8 percent had very good understanding of ag options. Most of the managers (63.0 percent) had a neutral view of options while 27.7 percent had a positive view and 9.3 percent had a negative view.

Analysis of Responses

Comparisons were made of agricultural options usage between private and cooperative elevators and between elevators with various annual shipment volumes. Elevators in each category were compared on futures and options usage, methods of using and administering options, understanding of options, and views toward options.

The comparison of private and cooperative elevators revealed that the privates used futures slightly more than the cooperatives but both were very similar in their usage of ag options (Table 8). The privates and cooperatives were also similar in their methods of using options; about half the total usage was for producer contracts with a floor price. Half of the cooperatives responding administered their own options contract to producers compared to 60 percent of the private elevators. In addition, the private and cooperative managers were also quite similar in their understanding of, and views toward, ag options (Table 9).

The elevators were next compared by their size of total annual combined shipments of commodities for which ag options were traded (i.e., corn, HRS wheat, and soybeans). The elevators were grouped according to the size of their total shipments of these grains into the following three groupings: less than 300,000 bushels, between 300,000 and 600,000 bushels, and more than 600,000 bushels. The elevators of each size grouping were compared in their use of futures, usage and administration of ag options, understanding of ag options, and view toward ag options.

The usage of futures and ag options varied among elevators in the different size groupings (Table 10). The larger the annual shipments the higher the percentage of elevators using both futures and ag options. In each grouping the use of options was about half that of futures. The heavier usage of futures and options among the larger shippers would be expected.

The method of using ag options, however, was very similar among the size groupings. Purchase contracts was the method used by approximately 60 percent of the elevators in each shipment grouping, speculation was used by about 2 percent of the elevators, and hedging own inventories by 40 percent. The most common method of using options was as a purchase contract to producers with a floor price.

The administration of producer option contracts varied by size of annual shipments (Table 11), but the views and understanding of ag options varied only slightly (Table 12). Small shippers led in the percentage of elevators administering their own producer option contracts, second were the large-volume shippers, and last were the intermediate-volume shippers. The large-volume shippers demonstrated a slightly better understanding and a more positive view towards ag options, probably because they used options more.

Summary and Conclusions

A survey of country elevators was conducted to determine their usage of ag options one year after ag options trading was reinstated. About 30 percent of the responding elevator managers reported using options, and almost twice that amount (58 percent) used futures. Hedging own inventories and producer contracts were the most common uses of ag options; specifically, a producer contract with a floor price was the most common method of usage. Among the elevators using options, the heaviest usage was for HRS wheat, second was soybeans, and last was corn. The elevator managers indicated that they lacked understanding of ag options. As a group, they varied in their views of ag options but most managers viewed ag options neutrally.

The usage of futures and ag options was compared between cooperative and private elevators and among elevators with large, intermediate, and small total shipments of corn, HRS wheat, and soybeans. The private and cooperative elevators proved quite similar in all of the comparisons. However, the large, intermediate, and small shipment elevators varied in their use of futures, use of options, and understanding and views toward options. The large elevators tended to have a higher understanding and more favorable view of options and tended to use options and futures more than the small and intermediate elevators.

Appendix A

TABLE 1. TYPE OF ORGANIZATIONAL STRUCTURE AMONG RESPONDING ELEVATORS
(DECEMBER 1985)

Organizational Structure	Number	Percentage
Locally owned cooperatives*	117	67.7
Locally owned private elevators	39	22.5
Line elevators of a large private company	17	9.8

*Includes Harvest States line elevators.

SOURCE: Question I.3.

TABLE 2. CROP REPORTING DISTRICTS AND PERCENTAGE OF ELEVATORS RESPONDING
IN SURVEY OUT OF THOSE RECEIVING QUESTIONNAIRES (DECEMBER 1985)

Region	Number Participating	Percentage Participating Out of Those Receiving Questionnaires
1 (Northwest)	21	32.8
2 (North central)	14	31.8
3 (Northeast)	44	39.6
4 (West central)	6	25.0
5 (Central)	16	32.0
6 (East central)	29	35.4
7 (Southwest)	10	32.3
8 (South central)	13	39.4
9 (Southeast)	<u>20</u>	<u>27.8</u>
Total	173	33.9

SOURCE: Question I.2.

TABLE 3. SOURCES OF COMMODITY PRICE INFORMATION

Source of Information	Number	Percentage
Radio/TV	20	11.8
Newspaper	7	4.1
Trade Journals	2	1.2
Wire Service	82	48.5
Commission Companies	115	68.0
Other	32	18.9

Note: Sources listed as "other" include floor traders, other local elevators, main office, and Minneapolis Grain Exchange.

SOURCE: QUESTION II.2.

TABLE 4. METHODS OF USING AG OPTIONS AND THE PERCENTAGE EACH METHOD IS USED BY PARTICIPATING ELEVATORS USING OPTIONS (DECEMBER 1985)

Method of Using Option	Usage Percentage
Hedge cash position, (long cash, long put)	12.3
Hedge cash position, (long cash, short call)	10.8
Hedge cash position, (short cash, long call)	7.7
Hedge cash position, (short cash, short put)	7.7
Speculation, (long put)	0.4
Speculation, (short call)	1.0
Speculation, (long call)	0.0
Speculation, (short put)	0.6
Customer contract, (floor price)	49.0
Customer contract, (basis contract)	10.5
Customer contract, (other)	<u>0.0</u>
Total	100.0

SOURCE: Question III.8.

TABLE 5. USE OF OPTIONS FOR CORN AMONG RESPONDING ELEVATORS USING OPTIONS
AND HANDLING CORN (DECEMBER 1985)

Options Usage Category	Number	Percentage
More than 75 percent of all transactions	0	0.0
Between 25 and 75 percent of all transactions	2	7.1
Have used but less than 25 percent of all transactions	6	21.4
Have not used options on corn	20	71.5

SOURCE: Question III.4.

TABLE 6. USE OF OPTIONS FOR HRS WHEAT AMONG RESPONDING ELEVATORS USING
OPTIONS AND HANDLING HRS WHEAT (DECEMBER 1985)

Options Usage Category	Number	Percentage
More than 75 percent of all transactions	2	3.8
Between 25 and 75 percent of all transactions	5	9.4
Have used but less than 25 percent of all transactions	41	77.4
Have not used options on HRS wheat	5	9.4

SOURCE: Question III.5.

TABLE 7. USE OF OPTIONS FOR SOYBEANS AMONG RESPONDING ELEVATORS USING
OPTIONS AND HANDLING SOYBEANS (DECEMBER 1985)

Options Usage Category	Number	Percentage
More than 75 percent of all transactions	1	3.7
Between 25 and 75 percent of all transactions	0	0.0
Have used but less than 25 percent of all transactions	16	59.3
Have not used options on soybeans	10	37.0

SOURCE: Question III.6.

TABLE 8. COMPARISON OF PRIVATE AND COOPERATIVE ELEVATOR USAGE OF FUTURES AND AG OPTIONS AMONG PARTICIPATING ELEVATORS (DECEMBER 1985)

Category	Cooperative*	Private
	- - - - - percent - - - - -	
Use futures	53.5	67.9
Use ag options	30.4	33.3
<u>Option Uses</u>		
Hedge own inventories	34.7	45.5
Purchase contract to producer	64.7	49.9
Speculation	0.6	4.6
Total	100.0	100.0
<u>Method of Option Usage</u>		
Hedge (long cash, long put)	13.5	9.8
Hedge (long cash, short call)	7.3	20.2
Hedge (short cash, long call)	6.8	6.7
Hedge (short cash, short put)	7.1	8.8
Speculate (long put)	0.6	0.0
Speculate (short call)	0.0	2.8
Speculate (long call)	0.0	0.0
Speculate (short put)	0.0	1.8
Producer contract (floor price)	51.2	45.0
Producer contract (basis contract)	13.5	4.9
Producer contract (other)	0.0	0.0
Total	100.0	100.0

*Includes Harvest States line elevators.

SOURCE: Question I.3, II.1, III.3, III.7, and III.8.

TABLE 9. UNDERSTANDING AND VIEWS TOWARD AG OPTIONS OF PARTICIPATING PRIVATE AND COOPERATIVE ELEVATOR MANAGERS (DECEMBER 1985)

Type of Elevator	Amount of Understanding			
	None	Limited	Good	Very Good
	- - - - -percent- - - - -			
Cooperative*	0.8	67.0	27.0	5.2
Private	5.7	58.5	30.1	5.7
	View Towards Ag Options			
	Positively	Negatively	Neutral	
	- - - - -percent- - - - -			
Cooperative*	28.7	7.8	63.5	
Private	25.9	11.1	63.0	

*Includes Harvest States line elevators.

SOURCE: Question I.3, III.10, and III.11.

TABLE 10. COMPARISON OF USAGE OF FUTURES AND AG OPTIONS BETWEEN SPECIFIC CATEGORIES OF ANNUAL SHIPMENT-SIZED ELEVATORS (DECEMBER 1985)*

Category	Less than 300,000 Bushels	Between 300,000 and 600,000 Bushels	Over 600,000 Bushels
	- - - - -percent- - - - -		
Use futures	35.2	56.9	79.0
Use ag options	14.5	36.5	41.9
<u>Option Uses</u>			
Hedge own inventories	41.2	40.8	36.0
Purchase contract to producer	54.8	58.1	62.1
Speculation	4.1	1.1	1.9
Total	100.0	100.0	100.0
<u>Method of Option Usage</u>			
Hedge (long cash, long put)	6.3	13.6	13.2
Hedge (long cash, short call)	18.1	13.3	8.8
Hedge (short cash, long call)	6.3	8.3	5.8
Hedge (short cash, short put)	10.5	5.6	8.2
Speculate (long put)	0.0	1.1	0.0
Speculate (short call)	0.0	0.0	1.9
Speculate (long call)	0.0	0.0	0.0
Speculate (short put)	4.1	0.0	0.0
Producer contract (floor price)	50.0	43.9	52.3
Producer contract (basis contract)	4.8	14.2	9.8
Producer contract (other)	0.0	0.0	0.0
Total	100.0	100.0	100.0

*Shipping size is combined annual shipments of corn, HRS wheat, and soybeans.

SOURCE: Question I.4, II.1, III.3, III.7, and III.8.

TABLE 11. ADMINISTRATION OF PRODUCER OPTION CONTRACTS AMONG ELEVATORS WITH SPECIFIED SHIPPING SIZES (DECEMBER 1985)*

Size of Annual Shipments	Percentage Administering Their Own Producer Options Contracts
	- - - - -percent- - - - -
Less than 300,000 bushels	75
Between 300,000 and 600,000 bushels	38
Over 600,000 bushels	60

*Shipping size is combined annual shipments of corn, HRS wheat, and soybeans.

SOURCE: Question I.4 and III.9.

TABLE 12. UNDERSTANDING AND VIEWS TOWARD AG OPTIONS OF ELEVATOR MANAGERS, BY SPECIFIED ANNUAL SHIPMENT SIZE (DECEMBER 1985)*

Size of Annual Shipments	Amount of Understanding			
	None	Limited	Good	Very Good
	- - - - -percent- - - - -			
Less than 300,000 bushels	3.8	66.0	24.5	5.7
Between 300,000 and 600,000 bushels	2.0	68.6	27.4	2.0
Over 600,000 bushels	1.6	58.1	32.2	8.1

Size of Annual Shipments	View Towards Ag Options		
	Positively	Negatively	Neutral
	- - - - -percent- - - - -		
Less than 300,000 bushels	22.6	9.4	68.0
Between 300,000 and 600,000 bushels	21.1	11.6	67.3
Over 600,000 bushels	37.0	6.5	56.5

*Shipment size is combined annual shipments of corn, HRS wheat, and soybeans.

SOURCE: Questions I.4, III.10, and III.11.

Appendix B

North Dakota State University
OF AGRICULTURE AND APPLIED SCIENCE
FARGO, NORTH DAKOTA 58105

AGRICULTURAL ECONOMICS
MORRILL HALL
P.O. BOX 5638

TELEPHONE 701-237-7441

December 18, 1985

Dear Sir:

The Agricultural Economics Department of North Dakota State University is conducting a statewide mail survey of grain merchandisers on their use of agricultural options. The purpose of this survey is to determine the percentage of grain merchandisers using options and how they are using them. Regardless if you use options or not we ask that you fill out the questionnaire and return it to us.

Enclosed with this letter is a two-page questionnaire containing some general questions about your elevator and your usage of agricultural options. Please fill out the enclosed questionnaire and return it to us. The responses will be aggregated in such a manner to maintain individual confidentiality in reports and publications using the information.

We wish to express our gratitude for your assistance in conducting this survey. If you have any questions please contact either Dr. William Wilson (701) 237-7472 or Steven Gunn (701) 237-7990 or write Department of Agricultural Economics, North Dakota State University, Fargo, North Dakota 58105.

Sincerely,



William W. Wilson
Associate Professor

WWW/djc

Enclosures

SURVEY ON USE OF AGRICULTURAL COMMODITY OPTIONS BY COUNTRY ELEVATORS
December 18, 1985

I. Description of Firm

1. Name of firm _____
2. Location of firm: Town _____ State _____
3. This elevator is a _____
 - (a) Locally owned cooperative elevator
 - _____ (b) Harvest States line elevator
 - _____ (c) Locally owned private elevator
 - _____ (d) Line elevator of a private company
 - _____ (e) Other _____
4. What was your estimated total shipments for the 1984-85 crop year for each commodity listed (in bushels)?

_____ Corn
_____ HRS Wheat
_____ Soybeans

II. Use of Futures

1. Do you currently use futures? _____ Yes _____ No
2. What is your primary source of commodity price information?
_____ Radio/TV _____ Local Newspaper _____ Trade Journals
_____ Wire Service _____ Commission Company _____ Other _____

III. Use of Options

1. Have you ever attended a seminar on the use of agricultural options? _____ Yes _____ No
2. If yes to No. 1, please indicate the number of seminars presented by the following groups:

_____ (a) Agricultural Extension Service
_____ (b) Minneapolis Grain Exchange
_____ (c) Commodity Commission Company
_____ (d) Other _____
3. Have you ever used agricultural commodity options?
_____ Yes _____ No

If no, please skip to Question 10.
4. How often do you use options for corn?

_____ (a) Do not handle corn
_____ (b) More than 75% of all transactions
_____ (c) Between 25% and 75% of all transactions
_____ (d) Have used options for corn but less than 25% of all transactions
_____ (e) Never used options on corn

5. How often do you use options for HRS wheat?

- _____ (a) Do not handle HRS wheat
- _____ (b) More than 75% of all transactions
- _____ (c) Between 25% and 75% of all transactions
- _____ (d) Have used options for HRS wheat but less than 25% of all transactions
- _____ (e) Never used options on HRS wheat

6. How often do you use options for soybeans?

- _____ (a) Do not handle soybeans
- _____ (b) More than 75% of all transactions
- _____ (c) Between 25% and 75% of all transactions
- _____ (d) Have used options for soybeans but less than 25% of all transactions
- _____ (e) Never used options for soybeans

7. What percentage of your options usage would be classified as:

- _____ Hedging a cash position
- _____ Part of a purchase contract to producer
- _____ Speculative

8. What percentage of your total options usage would fall under each of the following methods? (Sum of a, b, and c should total 100%.)

(a) Hedging own inventories

Method Used:

- _____ Long cash/long puts
- _____ Long cash/short calls
- _____ Short cash/long calls
- _____ Short cash/short puts

(b) Speculative

Method used:

- _____ Long puts
- _____ Short calls
- _____ Long calls
- _____ Short puts

(c) Contract with producer using options

Contract used:

- _____ Floor price with opportunity for higher price
- _____ Basis contract
- _____ Other _____

9. If you use producer contracts which incorporate options, is that contract administered by:

- _____ (a) Yourself
- _____ (b) Commission Company--name of company _____
- _____ (c) Track Buyer--name of company _____
- _____ (d) Other _____

10. How would you assess your current understanding of agricultural options?

_____ None _____ Limited _____ Good _____ Very Good

11. How do you view agricultural options trading in general?

_____ (a) Positively _____ (b) Negatively _____ (c) Neutral

12. Comments:

