Quality Pays

CAB grid premiums rise despite lower grid volume.

Story by
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Grid premium rewards for hitting the *Certified Angus Beef*® (CAB®) brand target have increased during the past two years, a January survey shows. However, the beef industry has not embraced grid marketing as rapidly as predicted, and that limits the efficacy of the pricing system.

A biannual survey of CAB-licensed packers had shown a meteoric rise in grid premiums for the CAB component of value-based marketing, from $7.5 million in 1999 to nearly $37 million in 2002 before settling back toward $23.4 million in 2005 as cash sales grew more attractive. The latest data show an increase in those CAB grid premiums to $24.6 million in 2006 and then $27.8 million last year (see Figs. 1 and 2). The percentage of USDA-inspected Choice and Prime carcasses (see Table 1) did not increase during those years.

Several packer representatives noted they also pay more on the cash market for cattle their buyers expect to achieve CAB acceptance, but those numbers cannot be pinned down.

From 1978 through 2007, CAB packers paid producers nearly $250 million in direct grid premiums related to CAB acceptance, 95% of it in the last eight years. In addition, they have funded the CAB program by paying $140 million in commissions throughout the years, on sales of 7 billion pounds (lb.) of CAB-branded products.

Packers supply gross dollar totals, which are added together so that no single packer's share can be seen. The 2007 total can be seen as $535,000 per week, $10,700 per day, $1,338 per hour or about $22.25 per minute of operation that CAB-licensed packers pay to producers for cattle that hit the CAB grid target. The mean for CAB grid premiums was reported at approximately $5 per hundredweight (cwt.), though it cannot be stated precisely due to variations in volume and grid pricing requirements.

Those figures do not include the Choice premium compared to Select, which all CAB cattle earn. Nor do they include yield grade premiums or those paid for CAB Prime.

Grid share stalls

Since the beef industry's "War on Fat" report in 1990, research has pointed to value-based marketing as a means of sending clearer pricing signals from consumer to producer. Higher-quality, leaner cattle earn more premiums on the value-based grids, which quickly gained acceptance in the late 1990s. Grids were more efficient in pricing, but what of their efficacy in developing a supply of higher-quality beef?

Clem Ward, Oklahoma State University economist, says a 2002 feedlot survey conducted with land-grant universities in Kansas, Nebraska and Iowa suggested grid pricing would reach 62% of marketings by 2006.

"That didn't happen," Ward says. Although research has not yet determined why, most economists figure the share has eased back to

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Table 1: USDA-reported fed-cattle harvest grading percentages

	All regions % Ch & Pr
2000	55.53%
2001	55.61%
2002	57.25%
2003	54.98%
2004	56.23%
2005	55.77%
2006	54.28%
2007	55.24%

Fig. 1: Historical packer grid premiums paid for CAB®

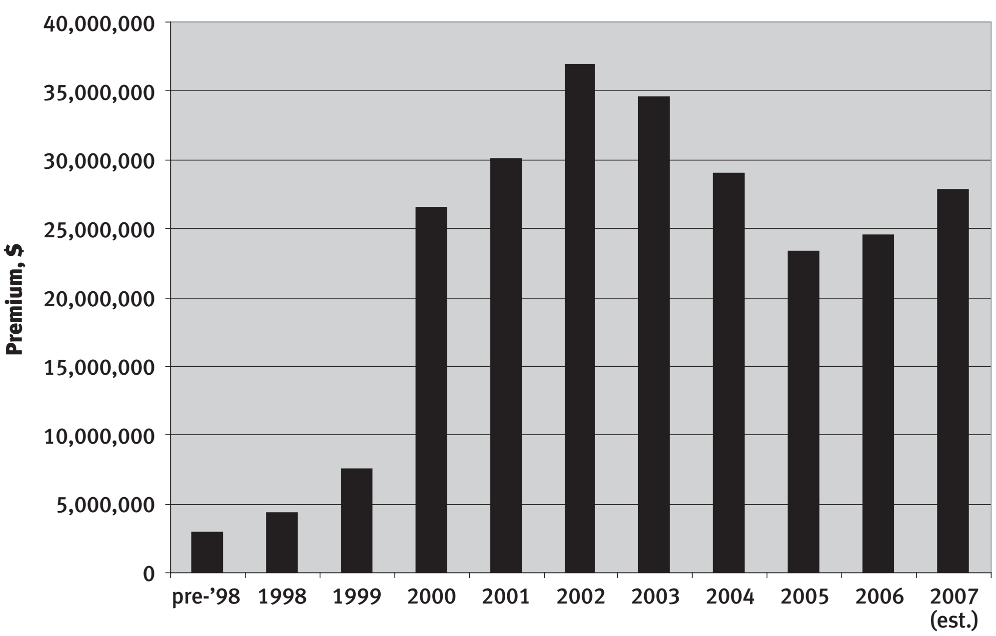
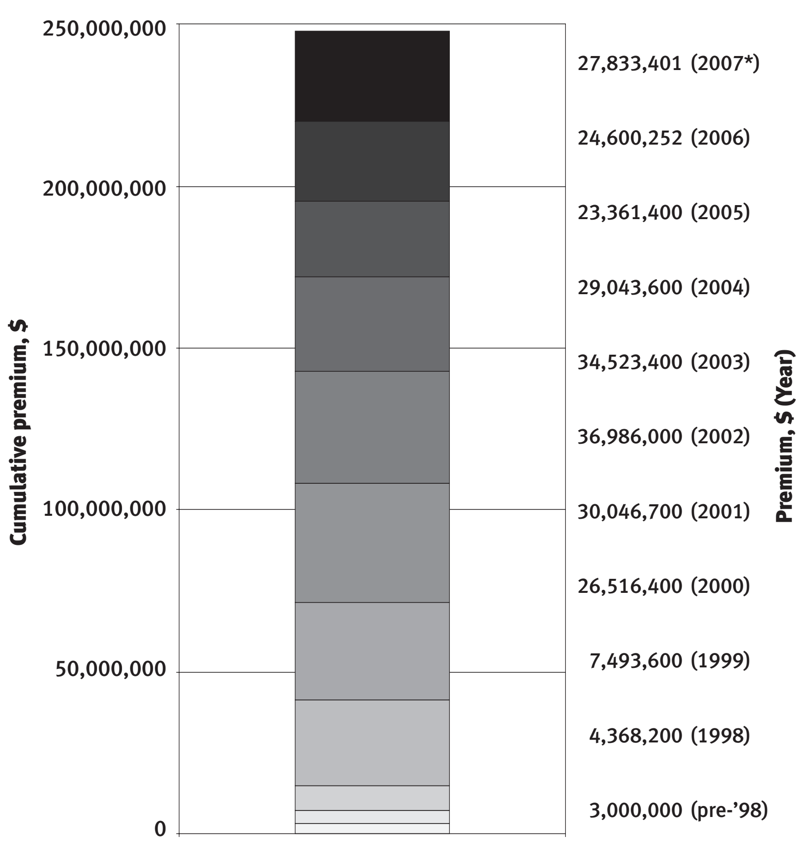


Fig. 2: Cumulative packer grid premiums paid for CAB®



*estimated

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perhaps 45% of all finished cattle sold today.

Just this year, in February, South Dakota State University (SDSU) economist Scott Fausti presented an analysis of negotiated grid pricing volume. Work on his paper, "The Efficacy of the Grid Marketing Channel for Fed Cattle," was hampered by limited access to data, Fausti admits.

A 1998 Fausti paper had warned that the risk of discounts when selling fed cattle of largely unknown genetic potential would limit widespread adoption of grid pricing. "Packer buyers are highly skilled, but even they fall short of being able to guess the level of potential discounts in a pen," Fausti says. "It's a bigger problem for producers."

Still, articles from the popular press to academic journals suggested grid pricing was fast becoming the dominant form of marketing. Fausti tried to investigate volume through the federal Agricultural Marketing Service (AMS) weekly data from mandatory price reporting.

Variable volume

The only volume number he could nail down was a narrowly defined "negotiated grid transaction," sometimes called "bid the grid." That category ranged from 4.8% to 17.2% of all fed-cattle weekly harvest during the past three years, with an average of 9.1%. In conclusion, Fausti says that finding "suggests the industry view of grid market share is overstated."

Economists agree the apparent lack of efficacy in the U.S. grid marketing system needs further study. Record-high feed prices and overcapacity in the packing sector do not bode well for a short-term increase in the grid's power to dictate cattle type.

A better-supported Fausti conclusion is that the grid share of weekly harvest "exhibits greater relative variability than average pricing." In turn, that points to "instability in the flow of information to producers, reducing the ability of the grid pricing mechanism to provide consistent information to fed-cattle producers over time."

The variation in method of pricing is "more than I would have expected," Ward says. However, he adds, "Negotiated grid pricing has declined as a share of overall grid marketing since the time when it was first reported. It was thought to be 'the' solution to formula trading. Maybe feeders found that not to be the case."

A 2005 Ward paper noted that having lower-quality cattle to sell increases the probability that they will be sold on an average, liveweight basis. Fausti's recent study found that the share of steers in the Plains area that could be sold without suffering discounts increased from 1997 into mid-2000 and then gradually declined. Indeed, overall USDA-reported quality has shown no improvement since then.

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