Price Risk Management for Cow-Calf Producers: Part 2

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Most cow-calf producers face price risk. Likewise, most producers manage price risk, even if they do not have an explicit "price risk management strategy." Three major price risk management strategies are self-insurance, marketing flexibility, and formal price risk management tools. More than one strategy can be used.

The primary price risk management strategy used by most cow-calf producers is self-insurance. While self-insurance might be perceived as "not managing price risk", any producer who continues a cow-calf operation after a low-income year manages price risk. The primary method of self-insurance is income diversification, either through farm income diversification or off-farm income or both. For example, a producer may both produce crops and have a cow herd, with crop income typically being sufficient to absorb losses from low calf prices and (potentially) vice versa. Similarly, a producer and/or their family members may work off farm. In addition to the advantage of access to affordable health insurance, off-farm income can cover family living expenses during low price years. A potential disadvantage is that opportunities for herd expansion and time spent on management may be limited.

A second strategy is marketing flexibility, in terms of both the type of market and the timing of marketing. Niche or value-added markets, such as direct-marketing, as well as marketing arrangements with breeders, processors or a feed yard are examples of types of markets that that can be part of a price risk management strategy. More specifically, a marketing relationship with a feed yard might result in more predictable prices than with a sale barn. Some producers also use the timing of marketing to manage price risk. For example, a producer might feed calves for a few months after weaning in hopes of stronger markets in the late fall or early winter. All of these marketing strategies have the advantage of shielding a producer from price risk in commercial markets. However, these strategies are not failproof or without risk: no market is guaranteed, or prices might not increase enough to cover additional feed or other costs.

The third strategy is using formal price risk management tools: specifically hedging or insurance. Both hedging (future and options) and insurance (Livestock Risk Protection-LRP) allow a producer to protect themselves against *unexpected declines* in the market price. These strategies require some upfront costs and an investment of time into learning about commodity markets. An advantage is they can protect a producer who is expanding or highly leveraged or otherwise would be hurt by a decline in expected prices.

Cow-calf producers use various price risk management strategies that are tailored to their individual situation and needs. The next article in this series will cover hedging basics.