

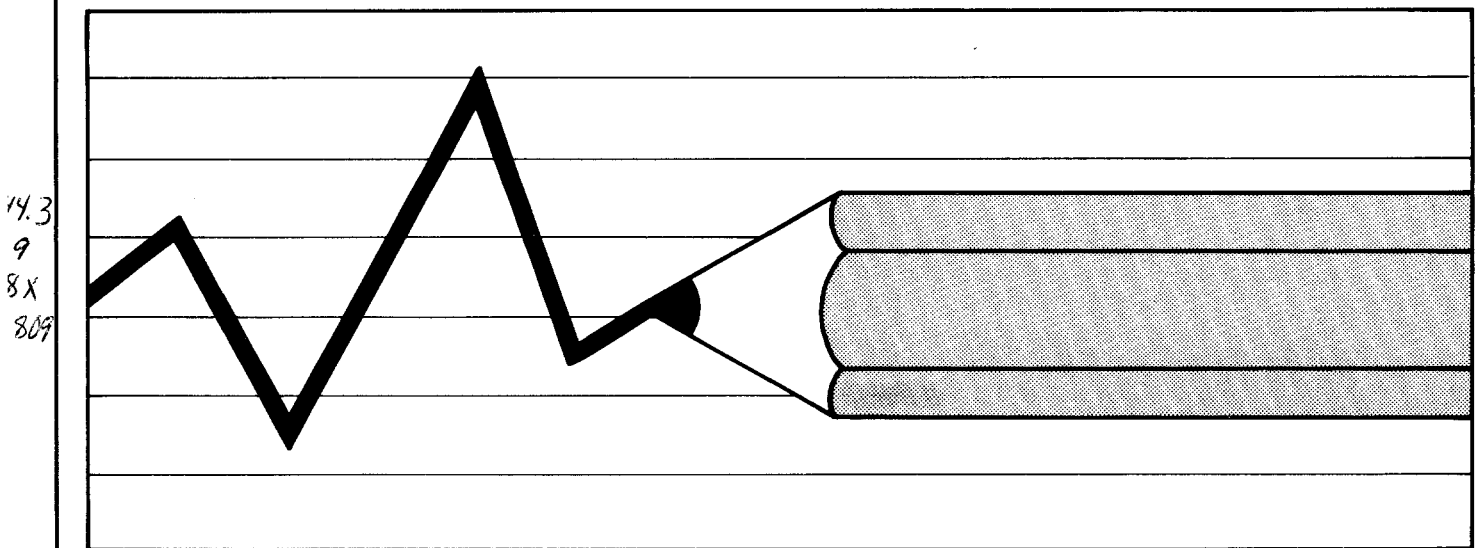
# Developing A Marketing Plan



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North Dakota crops and livestock are generally sold in open, competitive markets where the producer has little control over the market price. When a producer decides to sell, the price offered is the price received. The decision on when to sell is often based on various economic pressures, rather than on the basis of an attractive price. Common pressures include the need for cash to pay taxes, make loan payments, purchase inputs, and for family living expenses. Often, a producer is forced to sell stored grain simply to provide space for a soon-to-be-harvested crop. For hog and cattle feeders, there is the need to sell animals as they reach market weight, since holding to an "over-fat" condition may be costly.

A marketing plan should help producers take control of the marketing situation rather than feeling like a victim of "the system." The intent of a marketing plan is two-fold. First, it should remove, as much as possible, the pressures that can result in selling at an inopportune time. Second, it should help set price targets and identify those times when the market is offering an acceptable price. In other words, it can be considered a plan of attack.

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## Reducing the pressure to sell

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Under the first purpose, reducing the pressure to sell, two useful tools are: (1) cash flow planning and (2) forward contracting. Cash flow planning considers the yearly and long-term financial requirements of the farm and family, as well as the timing of cash requirements. The cash flow plan provides a map of both personal and business expenses as well as anticipated receipts and credit needs. By forcing the producer to anticipate cash needs, it should help relieve the pressure and frustration of selling at whatever the price happens to be when there is a need for cash.<sup>1</sup>

Forward contracting can provide additional freedom in marketing. Price volatility creates pricing opportunities as well as pricing hazards. The market may be offering an acceptable price months ahead of harvest or slaughter or, in the case of storable commodities, months following harvest. Taking advantage of the full range of market opportunities requires a knowledge of how to use all available pricing alternatives.

Forward contracting can be accomplished in either the cash or the futures market. The major advantages and disadvantages of forward cash con-

tracting versus use of the futures market are indicated in Table 1. In either case, the process allows product pricing at almost any point during the marketing year. The benefit is having many price offers rather than having to accept whatever price is being offered when production is completed, when delivery is made or when pressure to sell is felt.

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**Table 1. Major Advantages and Disadvantages of Forward Cash Contracting Versus Use of the Futures Market.**

	<b>Forward Cash Contract</b>	<b>Futures Market</b>
Advantages	Simpler than futures	Flexibility to get out of futures at any time
	No security deposit	Deliver to any cash market preferred
	Quantity of commodity generally not limited	Performance guaranteed
	Most commodities can be contracted	
Disadvantages	Commitment to deliver may be irrevocable	More complicated than forward cash contract
	Must deliver to specific market	Requires security deposit ("margin" money)
	Risk of buyer default	Contract calls for specific quantity
		Does not offer contracts on all commodities

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## Recognizing a market opportunity

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The second purpose of a marketing plan is to help the producer recognize when the market is offering favorable pricing opportunities, to set price targets and to make the pricing or selling decision. Comparing production alternatives, keeping up on market factors and outlook information, being familiar with historical price patterns and understanding the opportunity cost of money provides the basis for more profitable pricing and marketing decisions.

### Comparing Production Alternatives

When comparing production alternatives, marketing and production decisions should be evaluated together. Too often, this decision is made on the basis of the quality or grade of product that is

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<sup>1</sup>A good outline for determining cash flow needs can be found in Section VIII, No. 1, of the North Dakota Cooperative Extension Service **Farm Management Planning Guide**.

easiest to produce and most convenient to market, rather than on the basis of profit potential. Comparison of alternatives requires making three major judgments for each alternative to be considered.

1. A realistic estimate of yield potential in terms of bushels per acre or pounds per animal.

An examination of yields on your own operation the last three to five years is the best guide you have in making this estimate.

2. What it costs to produce a given unit of output.

Knowing the cost of production is an important part of any marketing plan. Production costs vary widely from farm to farm due to differences in production systems, use of inputs, managerial ability and personal preferences, so it is important to know the production costs of your own operation.

The cost estimates should include both variable and fixed costs of production. Variable costs are those associated with the actual production and sale of the commodity, such as seed, fertilizer, feed, transportation, labor and management. Fixed costs are those incurred whether or not a commodity is produced, such as land payments, insurance on buildings, and real estate taxes. All these costs, along with expected yields, must be known to be able to determine breakeven prices that cover variable costs, fixed costs and total costs. In the long run, returns must cover all costs of production to assure survival of the business, but in any one year, when prices are below the breakeven point the best marketing decision may be to market for a price that will cover as many costs as possible.<sup>2</sup>

3. Comparison of potential market prices.

By estimating the market price or loan rates of the different possible crops, you can now determine the gross returns of the different crops. For livestock, you can estimate the gross returns to different management systems. For example calves vs. feeders or feeder pigs vs. fat hogs.

## Market Factors and Outlook

Here, the objective is to keep up on market conditions and outlook beginning before the production decision is made and continuing throughout the year or as long as the product is held. Keeping track of market factors on a continual basis gives producers an insight into price trends and expected general price levels that they will never develop by looking at the markets only occasionally.

While many sources of information are available, producers should develop their own price targets. One approach that may be useful is to make three

price level projections. First, project the highest price thought to be even remotely possible under normal conditions. Next, project the lowest price thought possible, and finally project a price between these extremes as the most likely based on current outlook information. Studying the effect on income of three different possible price levels provides a clear idea of the profit potential and the amount of risk carried by each pricing alternative. Worksheet 1 contains an example of how this exercise can be done.

Keeping price charts is helpful in identifying trends and price targets and will greatly improve market timing. Charts can be prepared by the individual or obtained through subscription to a chart service.

Some key supply and demand indicators to watch when forecasting price trends include forecasts of current and future production, disappearance, stock levels, and prices of competitive products. Government policies regarding imports, exports, and farm programs are also important indicators, along with the general state of the economy. USDA situation reports, stock reports, agricultural supply and demand estimates, market advisory services and university publications are good sources of information to keep current in these areas.

## Historical Price Patterns

An essential requirement to improve timing of the pricing decision is acquiring a knowledge of historical price patterns.

These patterns include both seasonal price movements and price cycles such as the hog and cattle cycles. Once factors that account for certain historical patterns are identified and understood, it becomes a matter of assessing the differences and similarities in these factors between the past and current situation.

## The Cost of Holding a Given Unit of Output

Whenever a commodity is held for later sale, there is an interest cost involved. This interest cost is called an opportunity cost, because by holding the commodity, the producer gives up the opportunity to invest the returns in an income earning activity or to pay off an existing loan. The producer who has a 12 percent operating loan and chooses to hold grain for later sale should add 1 percent per month to the value of the grain for the period held to obtain a true picture of the cost. Of course, the fixed and variable costs of storing must be added to the opportunity cost to obtain the total cost of holding a product. The added costs for holding livestock include interest cost and additional feeding costs (See Worksheet 1).

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<sup>2</sup>A good guide in estimating production costs is found in Section IV of the North Dakota Cooperative Extension Service **Farm Management Planning Guide**.

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## Marketing strategies

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No marketing plan reaches its full potential without consideration of marketing strategies, which are nothing more than a plan of action to fulfill the marketing plan. The strategy decided upon should consider business and personal goals, the current financial situation and tax situation of the farm and the farm operator's attitude toward risk. While there are numerous strategies, several of the more common are:

**1. Strive to achieve yearly average prices.**

During most years, many producers fail to achieve the yearly average price for their products. Yet, this strategy is one of the easiest to follow. For the grain producer with storage capacity or the hog producer using multiple farrowing, marketing an equal proportion of yearly production each month will yield an average price for the year that approximates the yearly average. However, even within each month, prices may still vary considerably.

This strategy has the advantage of providing several marketing opportunities, rather than just one or two, while still allowing for some flexibility in the marketing schedule. For example, the hog producer who farrows to allow six marketing periods during the year has reduced risk and provided more stability to his income than the producer who farrows only twice a year.

**2. Strive for higher than average yearly prices.**

This strategy requires a bit more refinement than just hitting the average. To "beat the average" requires some idea of what the average price for the year might be under expected conditions.

Keeping price charts, following the daily markets, knowing historical price patterns and keeping up on the current market indicators can all help identify price trends that should make this strategy a reality.

**3. Obtain a "reasonable" profit.**

While defining reasonable profits may be somewhat arbitrary, keeping the farm and family goals in mind will help identify the price target necessary to meet these goals.

Costs of production must be known to be able to identify a price that will provide the producer's definition of reasonable profits. Being realistic is important. The price target must be within the realm of possibility during any given marketing year.

**4. Meet cash flow objectives.**

While most marketing years offer some profit opportunities, some do not. When the price outlook for a commodity suggests that a profit opportunity may not exist, the best strategy for

business survival may be to take advantage of pricing opportunities that will meet cash flow needs and cover variable costs and as many fixed costs as possible.

Knowing cash flow requirements and when they occur ahead of time is helpful in planning marketings. It may also be appropriate to adjust the timing of cash needs to fit more appropriate marketing periods.

**5. Market an increasing proportion of product on an uptrending market.**

To "average-up" on marketings can be a good way to take advantage of a favorable trend.

Too often, producers hesitate to sell or price on an uptrending market, expecting prices to continue to climb. In other words, they are attempting to "hit the top." Then as prices begin to decline, they hold, hoping the market will again turn around. These producers usually end up selling at substantially lower prices than they could have realized had they sold while the market was on the way up. Hitting the top is not marketing — it's next to impossible.

**6. Use of the government program.**

This is not often thought of as a marketing strategy, but it is important to understand the programs and know how they can be used to meet the objectives of the marketing plan. Government programs can be particularly useful in meeting cash flow needs and still retaining control of the product.

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## Preparing the marketing plan

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Write it down on paper! Don't be afraid to alter or modify the plan as new information becomes available. Use forms such as Worksheets 1, 2 and 3 at the end of this circular or make forms of your own that will allow you to record on paper the financial obligations, costs, breakeven prices, price targets, units of product on hand, amount sold, amount under loan, hedged or contracted at what price, and the net price received per unit of product sold.

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## Summary

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In summary, a marketing plan should provide the information necessary to make the most profitable decisions with the least possible stress.

Developing the marketing plan involves several steps:

1. Set realistic business and family goals.
2. Develop a cash flow plan.
3. Know costs of production and breakeven prices.
4. Know current market factors and price trends.
5. Set price targets.
6. Evaluate production and marketing alternatives.
7. Develop a marketing strategy that will accomplish the goals and meet price targets.
8. Modify or change your marketing plan as necessary to keep current.

The knowledge required to develop and execute an effective marketing plan is available to all producers. It does, however, require a dedicated effort. Marketing plans become more refined with use. The second year plan will be more useful and accurate than the first year. There is no single marketing plan or strategy that will fit every farm operation or that can be used year after year. Plans must be tailored to fit the needs and conditions of the farm business in each given year or production cycle, and must be flexible enough to allow adjustment for changing marketing conditions.

**Worksheet 1**

(Example 1)

**EVALUATING THE COST OF HOLDING VS. SELLING NOW**

*Wheat*

(crop or livestock)

		Product price per bu. or cwt.	Total returns if sold now <u>Aug. 15</u> (date)	Total returns by holding until <u>Feb. 15</u> (date)	Added costs for holding until <u>Feb. 15</u> <sup>1</sup> (date)	Net returns by holding	Potential gain or loss by holding <sup>2</sup>
Probable prices on <u>Feb. 15</u> (date)	Current price	<u>\$4.00</u>	<u>\$4.00</u>				
	Lowest likely	<u>4.10</u>		<u>\$4.10</u>	<u>— .30</u>	<u>\$3.80</u>	<u>— .20</u>
	Most likely	<u>4.25</u>		<u>4.25</u>	<u>— .30</u>	<u>3.95</u>	<u>— .05</u>
	Highest likely	<u>4.40</u>		<u>4.40</u>	<u>— .30</u>	<u>4.10</u>	<u>+ .10</u>

<sup>1</sup>For storable commodities such as grain, the added costs to be considered are the storage costs and the opportunity cost of holding the grain. For example: Assume on-farm storage costs .06 per bushel and the opportunity cost (interest cost) of holding \$4.00 wheat is 12 percent per year or 1 percent per month ( $\$4.00 \times 12\% \times 6 \text{ month} = .24$ ). Thus total cost of holding 6 months is 30 cents.

<sup>2</sup>Net returns by holding minus total returns if sold now. A negative value indicates reduced returns by holding. A positive value indicates increased returns from holding.

**Worksheet 1**

(Example 2)

**EVALUATING THE COST OF HOLDING VS. SELLING NOW**

*Calves*

(crop or livestock)

Probable prices on Apr. 15 (date)		Product price per bu. or cwt.	Total returns if sold now	Total returns by holding until	Added costs for holding until	Net returns by holding	Potential gain or loss by holding <sup>2</sup>
			Nov. 15 (date) <i>(425 lb. calf)</i>	Apr. 15 (date) <i>(600 lb. feeder)</i>	Apr. 15 <sup>1</sup> (date)		
	Current price	\$68.00	\$289.00				
	Lowest likely	60.00		\$360.00	— \$85.00 =	\$275.00	— \$14.00
	Most likely	65.00		390.00	— 85.00 =	305.00	+ 16.00
	Highest likely	70.00		420.00	— 85.00 =	335.00	+ 46.00

<sup>1</sup>For storable commodities such as grain, the added costs to be considered are the storage costs and the opportunity cost of holding the grain. Example: Costs of holding, in this case, backgrounding, reflect a 150 day feeding program with an average daily gain of 1.25 pounds and an ending adjustment for shrinkage of 2 percent. The added cost of \$85 per head represents a cost per pound gained of 45 cents. However, each operator should prepare his own budget and base cost estimates on his own records and experience.

<sup>2</sup>Net returns by holding minus total returns if sold now. A negative value indicates reduced returns by holding. A positive value indicates increased returns from holding.

**Worksheet 1**

**EVALUATING THE COST OF HOLDING VS. SELLING NOW**

(crop or livestock)

Probable prices on (date)		Product price per bu. or cwt.	Total returns if sold now	Total returns by holding until	Added costs for holding until	Net returns by holding	Potential gain or loss by holding <sup>2</sup>
			now (date)	until (date)	(date)		
	Current price	_____	_____				
	Lowest likely	_____		_____	— _____ =	_____	_____
	Most likely	_____		_____	— _____ =	_____	_____
	Highest likely	_____		_____	— _____ =	_____	_____

<sup>1</sup>For storable commodities such as grain, the added costs to be considered are the storage costs and the opportunity cost of holding the grain.

<sup>2</sup>Net returns by holding minus total returns if sold now. A negative value indicates reduced returns by holding. A positive value indicates increased returns from holding.

**Worksheet 2**

Example

**MARKETING PLAN: 1983**

Commodity:	<u>Wheat</u>	<u>Calves or Yearlings*</u>
1. Amount: (operators share) (bu., cwt., head)	<u>20,000 bu.</u>	<u>100 hd.    100 hd.</u>
2. Price necessary to:		
a. Cover variable costs <sup>1</sup>	<u>\$1.75</u>	<u>\$55/cwt.    \$61/cwt.</u>
b. Cover total costs <sup>1</sup>	<u>\$3.60</u>	<u>\$85/cwt.    \$63/cwt.</u> <u>(378/hd.)</u>
c. Meet pro-rated portion of annual cash flow requirements <sup>2</sup>	<u>(80%)</u>	<u>(20%)</u>
d. Meet profit objectives <sup>3</sup>	<u>\$4.10</u>	<u>\$87/cwt.    \$75/cwt.</u>
3. Personal price target	<u>\$4.00</u>	<u>\$75/cwt.    \$67/cwt.</u> <u>(402/hd.)</u>
4. Probable month or months of sale	<u>Nov.</u>	<u>Apr.    Apr.</u>
5. a. Lowest price expected for month of sale <sup>4</sup>	<u>\$3.60</u>	<u>\$3.80    \$60/cwt.</u>
b. Most likely price expected for month of sale <sup>4</sup>	<u>\$3.80</u>	<u>\$4.00    \$65/cwt.</u>
c. Highest price expected for month of sale <sup>4</sup>	<u>\$4.00</u>	<u>\$4.20    \$70/cwt.</u>
6. Total cash receipts at personal target price (line 1 × line 3)	<u>\$80,000</u>	<u>100 × 402 = \$40,200</u>
7. Total cash receipts to cover total costs (line 1 × line 2b)	<u>\$72,000</u>	<u>100 × 378 = \$37,800</u>

<sup>1</sup>Farm Management Planning Guide, Section VIII, No. 1, January, 1982, Cooperative Extension Service, North Dakota State University.

<sup>2</sup>Farm Management Planning Guide, Section VIII, No. 1-A, September, 1980, Cooperative Extension Service, North Dakota State University.

<sup>3</sup>Set to fit each individual farm and family goals.

<sup>4</sup>Take from Table 2.

\*Example: In this example, the operator would sell calves in the fall if the average price for steer and heifer calves were to be \$75/cwt., his personal price target. If prices are not at this level (he does not expect them to be) he will background the calves with intended sales the following April.



**Worksheet 2**

**MARKETING PLAN: 19 \_\_\_\_\_**

Commodity: \_\_\_\_\_

1. Amount: (operators share) (bu., cwt., head) \_\_\_\_\_

2. Price necessary to:

a. Cover variable costs<sup>1</sup> \_\_\_\_\_

b. Cover total costs<sup>1</sup> \_\_\_\_\_

c. Meet pro-rated portion of annual cash flow requirements<sup>2</sup> \_\_\_\_\_

d. Meet profit objectives<sup>3</sup> \_\_\_\_\_

3. Personal price target \_\_\_\_\_

4. Probable month or months of sale \_\_\_\_\_

5. a. Lowest price expected for month of sale<sup>4</sup> \_\_\_\_\_

b. Most likely price expected for month of sale<sup>4</sup> \_\_\_\_\_

c. Highest price expected for month of sale<sup>4</sup> \_\_\_\_\_

6. Total cash receipts at personal target price  
(line 1 × line 3) \_\_\_\_\_

7. Total cash receipts to cover total costs  
(line 1 × line 2b) \_\_\_\_\_

<sup>1</sup>Farm Management Planning Guide, Section VIII, No. 1, January, 1982, Cooperative Extension Service, North Dakota State University.

<sup>2</sup>Farm Management Planning Guide, Section VIII, No. 1-A, September, 1980, Cooperative Extension Service, North Dakota State University.

<sup>3</sup>Set to fit each individual farm and family goals.

<sup>4</sup>Take from Table 2.

PRICING AND SALES RECORD

1983

Wheat

Year

Commodity

UNITS ON HAND

DATE	UNITS ON HAND			METHOD OF SALE								DELIVERY DATE	CASH RECEIVED		
	IN	OUT	BALANCE	Government Loan		Forward Contract		Hedge		Delayed Price Contract				Cash	
	xxxxxx	xxxxxx	On-farm _____ Off-farm _____	Units	Price	Units	Price	Units & Month	Estimated Net Price	Units	Price			Units	Price
Beginning Inventory															
Jan. 1															
January															
February															
March															
April															
May															
June															
July															
August	20,000		20,000	20,000	\$3.65									\$73,000	
September															
October															
November		10,000	10,000								10,000	\$4.00	Redeem CCC	Net \$2,588	
December															
Total Dec. 31	Balance on hand On-farm <u>10,000</u> Off-farm _____													\$75,588	
January															
February															
March															
April			10,000								10,000	\$4.20	Redeem CCC	Net \$3,066.67	
May															
June															
July															
August															
September															
October															
November															
December															
Dec. 31	Balance on hand On-farm _____ Off-farm _____														

**PRICING AND SALES RECORD**

DATE	UNITS ON HAND			Year		Commodity		METHOD OF SALE				DELIVERY DATE	CASH RECEIVED		
	IN	OUT	BALANCE	Government Loan		Forward Contract		Hedge		Delayed Price Contract				Cash	
	xxxxxx	xxxxxx	On-farm _____ Off-farm _____	Units	Price	Units	Price	Units & Month	Estimated Net Price	Units	Price			Units	Price
Beginning Inventory															
Jan. 1															
January															
February															
March															
April															
May															
June															
July															
August															
September															
October															
November															
December															
Total Dec. 31	Balance on hand		On-farm _____ Off-farm _____												
January															
February															
March															
April															
May															
June															
July															
August															
September															
October															
November															
December															
Dec. 31	Balance on hand		On-farm _____ Off-farm _____												

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