

Pork Production in Missouri: A Look at Contract Production

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Currently three million Missouri raised pigs are sent to Iowa to finish. Finishing pigs provides economic benefit to individual producers and the state's economy. If Missouri could retain and finish only half, 1.5 million head, of the pigs sent to Iowa for finishing, the state will receive more than \$80 million in economic impact during the first five years excluding the economic activity and benefits associated with any processing that might also be attracted as part of the program (Pierce).

One way to increase the number of hogs finished in Missouri is to increase contract hog production. Contract production offers two major benefits to local producers. First, it adds income to an existing business – perhaps allowing young people to return to the farm. Second, it reduces income risk by diversifying sources of income. Additionally, crop producers can benefit from contract hog production by offsetting fertilizer expense with manure nutrients generated by the livestock enterprise.

Interviews with Integrators

Production contracts in Missouri are considered proprietary information and therefore the terms can not be shared between growers or with researchers. This lack of information by both the growers and researchers makes providing information and assistance difficult. Interviews with a number of current integrators in Missouri about the contract relationship provide the information presented in this report. The fact that production contracts are proprietary information does not mean that the contract specifications are not disclosed to financial and legal advisors.

This paper provides some insight into production contract opportunities in the Missouri pork industry. In this paper the contractor of the agreement will be referred to as the integrator. Integrators can be either national corporations or local producers. The integrator generally provides the pigs, transportation, feed and other services to the producer. The producer, or grower, is the individual who supplies the building, utilities and labor required to care for the pigs.

Contract Opportunities

There are a number of contract opportunities currently available to Missouri producers. Integrators are looking to expand current operations by adding additional finishing spaces. The majority of the current contracts available are for wean-to-finish or grow-to-finish. However there are opportunities for contract nursery and sow multiplication operations. Only one of the integrators we interviewed indicated that future expansion was unclear; all others planned on increasing current capacity. The expansion will not occur totally with new growers; facilities of current growers may also be expanded. The locations of future facilities depend on a number of factors – namely 1) the location of the feed mills and process facilities and 2) state and local regulations.

There are a number of challenges facing expansion. The lack of factual information about the pork industry and the negative public perceptions lead to most of the challenges. One integrator indicated that if a producer went through the neighbor notification phase, required for Class I permitting, and encountered significant oppositions they work with the potential grower to make sure this was a sound decision before proceeding. A number of counties have enacted county health ordinances that can stop the construction or expansion of facilities in the county. Currently the permitting process can take as long as six months and with the increasing construction costs this can pose a real challenge.

Contract Terms

The production contracts are based on a relationship between the integrator and the grower, each providing a specific set of resources. The integrators generally provide the pigs, feed, transportation, veterinary services, and technical assistance, and pay the insurance and property tax on the animals. One integrator stated we provide anything that goes in or on the pig and the grower provides everything else needed to care for the animal. The growers provide the building, pay utilities and the insurance and property tax on the building, supply the labor required to care for the pigs and facility, and manage the manure storage and application. The grower is also responsible for obtaining a permit, if necessary, and following all of the Missouri Department of Natural Resources and local regulations. Some contracts offer additional services that benefit the grower such as labor for sorting, loading and vaccinating.

The length of contracts for new construction varies from 7 to 12 years. Contracts for existing facilities are usually shorter than those of new construction, as short as a few months or up to 10 years. The new construction contract length is partially due to lenders requiring contract length equaling or exceeding the loan repayment period. The new contract terms and educated lenders have resulted in greater ease in obtaining necessary capital to construct a facility.

The longer term contract offers more certainty for the grower as well as protection against falling contract prices. However, the trend over the last several years has been for contract prices to rise. The shorter term contracts leave the growers susceptible to more risk including the possibility of not renewing or being unable to find a contract. But, the short-term contracts allow the producers to take advantage of the increases in price paid per pig space.

Contract hog production payments are generally based on pig spaces. The standard pig space for a finishing building is between 7.25 and 7.75 square foot per pig. In the past, the contracts were more marketing based, paid on the delivery of high quality, target weight pigs. This is can be a disadvantage to the grower. If the grower received a group of poor performing animals, they would be discounted for the poor performance - a characteristic that was out of their control. With the change of payments to per pig space the grower faces less risk; they will receive a guaranteed payment. Growers face contract

risk when they are responsible for factors of production out of their control, such as the health of the animal at delivery or growth potential.

Wean-to-finish contract rates average between \$36 and \$40 per pig space. Grow-to-finish contract rates range from \$34 to \$41 per pig space. Payments are generally received on a monthly basis. Additional, non-monetary benefits of the contract, such as load out and vaccination assistance, may also exist that are not directly reflected in the per pig space payments.

Bonuses are another benefit offered by a few integrators; however integrators seem to be phasing out bonus payments. Integrators commented that if the grower is paid enough per pig space bonuses are unnecessary. One integrator commented that if the grower becomes dependent on the bonus and for some reason does not receive the bonus it could lead to financial difficulties. Prepayments are another way of providing additional income to the grower outside of the per pig space payments. Discounts to growers are currently not common in contract pork production.

Contract terminations by the integrator are rare. Factors that could lead to termination include animal neglect, unaccounted inventory and waste management problems. Most issues between the integrator and grower have been worked apart from the courts. Some contracts specify that arbitration is to be used to settle disputes between the integrator and the grower.

The labor requirement for a 2,400 head barn is estimated at 2-3 hours per day, therefore it can be a good option for underutilized labor. One integrator estimates labor requirements to be between \$6 and \$7 per pig space.

Building requirements

Each integrator has specific requirements for finishing buildings, working with building from 1,000 to 5,000 head. The trend for new buildings seems to be 2,400 and 4,800 head buildings. One integrator commented they were less worried about the size of the building and more about the total number of spaces at the location. There are a number of features within the building including feeders, waterers and the system ventilation that must meet standards. Wet-dry feeders are preferred by most integrators. Animal performance on wet-dry feeders was indicated as better than that of dry feeders but wet-dry feeders are difficult to regulate. The two most common ventilation systems are natural and tunnel. The ventilation system will depend, in part, on the size and location of the building. Whichever system is used, the grower must maintain air quality standards. Another feature of the building that can vary is the size of the pens, 25, 50 or 100 head. The smaller pens allow for easier viewing of all animals while the larger pens minimize the “pecking order” of the animals. One integrator commented they want to work with the grower to construct the cheapest possible building that will meet their requirements.

The cost of buildings has increased considerably over the last two years. The cost of a building construction contract may only be guaranteed for a short amount of time, which

may only be a few days. This is an important factor to consider when working with cash flow estimates and securing a loan. Building cost estimates include all building requirements, dirt work, roads, water supply, electrical work, buildings, and equipment; the cost of everything but the land. The per pig space building costs range from \$185 to \$235, depending on the type of building (wean- versus grow-to-finish), manure storage and equipment. Deep pits are normally more costly to construct but the value of the nutrients are much greater than with a lagoon. For producers who are able to use the nutrients, deep pit storage provides the best option. Integrators are encouraging growers to use deep pits for manure storage, decreasing the management aspects of the lagoon and adding additional value to the system through the nutrients.

The grower needs to consider what works best during the contract period, as well as what would be most useful after the contract expires. The building should last longer than the contract so the useful life of the building should be the planning horizon of the grower.

Water supply is a very important component when determining a building site. Surface and well water are the two most economical options. Surface water may require regular testing to make sure it is free of fecal coliform. Rural water is available in most areas but is cost prohibitive. Rural water offers a valuable backup system in case something happens to the primary water source. Surface and well water were both affected by recent droughts; water is a valuable resource in producing hogs.

Other contract specifications

The grower is responsible for ensuring there is an adequate feed inventory for the pigs. There are two systems of feed delivery. One system requires the grower to call in once a week and report the feed inventory. The other system requires the grower to call 48 hours prior to needing feed. The feed mill is responsible for keeping the feed budget and changing the rations as necessary.

Farm visits are made by the integrator to assess the operation. During these visits integrators can check for animal health and care, building temperature and air quality, manure management and answer any question or concerns of the grower. The frequency of the visits depends both on the integrator and the needs of the growers. Visits can be as frequent as weekly for new growers and those needing additional assistance to monthly visits to those with well running operations. A visit may also be made to ensure the building is clean and ready for the next lot of pigs.

Record keeping is an important part of production. Growers are required to keep a number of records like inventory and death loss for the integrator and factors surrounding manure storage and handling such as rainfall and lagoon level for the Department of Natural Resources. The records required by the integrator vary from weekly to monthly reports. Additional records like water and utility usage and temperature are kept by some growers. The more records a grower keeps the better they will be able to determine what part of production is the most efficient and what could be improved. Records can also be compared with other growers or from year to year to see if changes in management are

having an effect on production. Integrators compare records and performance from the different growers to determine which locations are the most efficient.

Educational training is offered to growers in both formal and informal settings. The integrators work to ensure the growers have all the information necessary to succeed. Technical assistance is offered during start-up and operation on an as-needed basis. If new technologies or changes are introduced into the systems the integrators make sure the growers have sufficient education to successfully implement the change.

Becoming a producer

There are a number of characteristics integrators look for in growers. With the life of new contracts averaging approximately 10 years, this is a relatively long term decision. The integrator wants someone who is interested in raising and caring for the animals and not just interested in the additional income or the nutrients from the manure. The grower must have a suitable location for the facility and have the ability to use the nutrients or an agreement where land is available for application. If the potential grower is liked by the neighbors this is a good indication of the person's character and how they interact with the community. Stability and work ethic are important characteristics of growers. The integrators makes ensure what the growers says is going to get done truly gets done. The condition of the current location will also tell a lot about the person; if they care enough to keep the place looking nice and mowed they will probably also take the time to care for the animals in the same way. An additional component the integrator may consider is the proportion of income the contract will provide. If the contract will only provide a small portion of the income this may be an indication how important this sector of the farm will be. Potential growers are encouraged to talk to others who currently have production contracts about the time and management requirements. One of the most important things to consider when looking into a contract is if the two parties will be able to work together to produce high quality pigs for the contract period.

Summary

Contract pig production offers great benefits to both the grower and the integrator. The grower has the ability to enter into a long-term, relatively low risk contract to raise pigs. This allows the grower to have a guaranteed income for a set number of years. This additional income may be used to add value to a current operation or allow additional family members to return to the farm or offer young persons the ability to start up a new operation. In respect to long term contract, the grower needs to understand how the change in labor, utilities and maintenance cost will affect the bottom-line because most of the time no changes are made to the original contract. In return the integrator is guaranteed that the grower will produce pigs for the operation for a set number of years at a set price. This allows the integrator to know the capacity of the operation and to be able to expand while helping out local communities by adding value and jobs to rural communities.