A Farmer's Guide to using procurement agreements for selling livestock

Future procurement mechanisms

A future procurement mechanism is where a pre-determined price or pricing mechanism is agreed between two parties for supplying products of a specified quality, quantity and time scale. Forward pricing mechanisms are widely used in agriculture, although rarely in the beef and sheep sectors where spot pricing is still predominantly used.

Such agreements may achieve higher returns than spot prices. They also offer a guaranteed market for stock and give the producer a clearer idea of potential margins to help cash flow and budgeting. They can sometimes, but not always, limit a producer's exposure to widely fluctuating market prices.

The most effective agreements are those where both parties are willing to acknowledge and share the risk. In addition to monetary links, there may be other benefits, such as access to technical advice, managerial experience, technological advances or bulk input buying.

There are various types of agreement including:

- **Fixed Price -** specifies the price at slaughter
- **Base or Minimum Price -** specifies a guaranteed minimum price for the agreed specification at the time of entering the agreement. The actual price achieved depends on the plant's base price at the date of slaughter. If this is greater than the original agreed minimum price, the greater price will prevail. If it is lower, the minimum price will be payable
- **Base & Ceiling Price -** (also referred to as Price Windows, Min & Max or Top & Tail) - upper and lower payment thresholds are set. Provides 'insurance' for both parties
- **Minimum Price Plus Premium -** this agreement offers a guaranteed minimum base price, as well as a premium if the market price exceeds the minimum price on the day of slaughter. In most cases this is used for a specific breed or production system
- **Pain & Gain -** a midpoint price is agreed, with the actual price paid being plus or minus 50% of the difference between the midpoint and the plant's base price
- **Cost Plus**

  Two main forms:

  - Producer and abattoir agree the typical cost of production for the type of system. A margin over this is then agreed and used to set a fixed price for the agreed period / supply
  - Three elements, of equal weighting, are taken into account to produce an agreed price:
    - Cost of production or cost of feed
    - Wholesale meat price
    - Industry market price

Key factors to consider:

- **Price (including any other benefits)**
- **Quantity and delivery period**
- **Penalties**
- **Feedback**
- **Arbitration**

Points to consider when entering an agreement:

- Agreements are generally legally binding. Obtain independent advice before entering into an agreement. Even simple verbal agreements should be written down
- It is vital to know the cost of producing finished stock to determine the value of the agreement. See EBLEX Business Pointers at **www.eblex.org.uk** for a guide to costs of production
- Choose the most appropriate contract for the production system
- Agree specifications carefully, e.g. carcase classification, weight, age, breeds, assurance status, residency periods, feed regimes, etc. Agree achievable numbers and timings for delivery. Penalties may arise if delivery periods are not met. Consider the inclusion of Force Majeure clauses to cover any unforeseen event out of both parties control that means the agreement cannot be met
- Some agreements can be on a per animal basis, recognised by the individual ear tag, or for a volume of animals at a specified time. In the case of a per animal basis, it is important to understand if the agreement is for the lifetime of the animal and when the agreement starts
- Consider spreading the risk of fluctuating prices by selling stock on different pricing agreements, a proportion on a spot price basis or via an alternative marketing channel
- Understand the implications for stock falling outside of the agreed specification. These may be subject to price penalties or an alternative buyer may have to be sought
- There will be financial penalties for not fulfilling the agreement, such as having too many animals falling outside the required specification or stock numbers not matching the agreed quantity. Penalties may be based on the cost difference of fulfilling the contract at the current market price
- Transport costs may be included within the agreement. If not, they need to be built into the cost projections before an agreement is entered into
- Feedback and notification of rejections should be supplied back to the producer quickly so that the quality of future consignments can be ensured. Condemnations or stock falling out of specification need to be notified quickly to allow for any counter claim
- Agreements should include a procedure for dispute settlement, detailing rights of appeal or arbitration
- Payment terms should be set out including the time scale and manner that payment will be made
- Occasionally agreements may provide the participant with other benefits such as free advice or access to discounted input prices such as feed and veterinary products

For more information see Annex 1 of the NFU publication: Livestock Buyers and Sellers Checklist available to view and download at **www.nfuonline.com**

EBLEX, Agriculture and Horticulture Development Board,
Stoneleigh Park, Kenilworth,
Warwickshire CV8 2TL

Telephone: 024 7669 2051
www.eblex.org.uk

National Farmers Union, Agriculture House,
National Agricultural Centre, Stoneleigh Park,
Kenilworth, Warwickshire CV8 2TZ

Telephone: 024 7685 8500
www.nfuonline.com