
SOME LITTLE PIGGIES DON'T GO TO MARKET

The changing organization of pork production

Large pork producers control an increasing amount of the nation's hog production and are viewed by many family farmers as a threat. Thirty firms now control 45% of all US sows in full production, whereas just a decade ago the total was 15%. The top three firms alone control 21% of the sows. In 2004, Smithfield Foods, the self-proclaimed largest hog producer and pork processor in the world, owned 825,000 sows, more than 12 times the number it owned in 1994.

In response, federal and state lawmakers are considering a variety of policies to protect independent pork producers. A bill before Congress would make it unlawful for a packer to own, feed, or control livestock intended for slaughter. Another proposal would require packers to procure at least 25% of hogs from spot markets. Several states already have anti-corporate farming laws that prohibit ownership and husbandry of livestock by large pork producers; yet, these controversial laws are being severely tested in the courts.

Increasingly, many large pork producers also are involved in processing, with the top three producers also being the first, seventh, and thirteenth largest US pork packers. This trend highlights the degree of integration taking place in the industry.

SQUEAL TO MEAL

The top thirty "Pork Powerhouses," as ranked by *Successful Farming* each October, often contract out production of their hogs to independent producers (*contracting*). Yet, it is becoming increasingly common for these large firms to carry out production on company-owned farms with hired management (*integration*). Seaboard, the third largest firm, raises over 60% of the hogs processed at its Oklahoma plant on its own vertically integrated farms; this includes the breeding, farrowing, nursery, and finishing stages. Premium Standard Farms, the second largest firm, relies solely on company-owned farms for its Texas operation, and heavily on them for its Missouri and North Carolina operations. Smithfield, the largest firm, raises 35% of the hogs produced from its breeding stock on company-owned farms with hired management. (Figures are from each firm's annual report or website.)

Current policy proposals hope to shore up spot markets and help farmers who are not fully engaged in contract production. Yet, survival even for independent producers who do receive contracts from the large pork firms also might become precarious if the trend continues whereby large firms choose to fully integrate their operations, according to Smithfield's annual report, from "squeal to meal."

CONTRACT OR INTEGRATE?

The FSRG study assessed the likelihood of large pork producers choosing to integrate their operations, thereby further shrinking the opportunities available to independent growers, by examining the determinants underlying a pork firm's decision to either (a) *contract* out stages of production to independent growers, or (b) *integrate* all aspects of production on company-owned farms using a hired manager. In both organizational forms, the pork firm supplies many of the inputs, such as feed, medicine, and feeder pigs or breeding stock. Under contracting, however, the grower retains ownership and operation of the production facilities, including land, housing, feed bins, and waste handling and disposal facilities. Under integration, these facilities are owned by the pork firm, and the "grower" is a hired manager instead of an independent owner-operator.

Incentive schemes to reward good performance by a grower are common in contract arrangements. Certain dimensions of performance, however, are difficult to write into contracts and enforce. "Incomplete" contracts—with gaps, missing provisions, or ambiguities—can lead to a pork firm losing the ability to exercise control over what happens at the production stage. Integration can prove to be ideal when there are increasing burdens on the pork firm, such as reputation and liability concerns, or when the complexity of grower obligations are not easily handled by contracts. Also, integration speeds the implementation of new genetic traits and eliminates the need to write formal production contracts that attempt to handle the complex tasks associated with animal waste management. In such instances, a salaried manager may be the more viable option. Yet, the study's model shows that once the industry is more mature and stable, contracting usually would be the better option as independent owner-operators generally have more incentives to reduce costs.

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ISSUES: Survival of independent hog producers. Integration in the livestock sector. Use of production contracts to raise swine.

FINDINGS: When a large pork producer contracts out the stages of production to a independent grower, its costs tend to be lower (*contracting*). When a producer integrates all stages of production within its own firm, it gains control over management decisions (*integration*). Integration is useful when the industry is undergoing rapid change and there are increasing burdens on processors. When the industry becomes more mature and stable, then contracting might again be the best option, with costs becoming lower.

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