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NAFTA: Effect on the Cattle Industry Structure

For many in the cattle industry, NAFTA is the scapegoat for whatever is wrong. They are vociferous in their accusations of negative impacts of which there are a few. For the cattle industry's business minded producers, feeders, processors and packers, it represents opportunity that would not exist today without it. For both of these groups as well as all those falling between in opinion, NAFTA has meant change, even structural change.

NAFTA has emphasized that the beef market is, indeed, a global market affected by conditions all over the world. In both Canada and Mexico, as well as Australia and much of South America, a pound of beef can be produced at a lower cost. Cost is a key factor in market share. To be more competitive, vertical integration has occurred to better manage costs and more effectively purchase inputs. This is a structural change with one of two things happening: an entity owning two or more major production business components; or, two or more separate entities forming a new entity, functioning as one but remaining separate in identity while united in production.

To further explain the first structural change, lets look at a couple of examples. Tejon Ranch diversified their business to encompass the cow - calf business and the stocker business, and then purchased their own feedyards so that cattle would not change hands until they went to the packer or, under contract, to the supermarket. A similar example is the R.A. Brown Ranches which today produce their own horses, their own herd sires through a Purebred operation, have a commercial cow/calf operation to produce calves for their own stockering operation, and then have major ownership in a feedyard where their animals are specification finished for a supermarket. These entities are able to reduce duplicative costs, eliminate paying someone to facilitate the change of ownership, tremendously reduce outliers and produce a higher quality; more uniform product without significantly increased costs. One must also realize that this has required additional capital, more risk to be managed and a bold attitude to break from the traditions of the past.

Operational vertical integration has resulted from independent entities functioning as a single production and marketing entity. A number of the new alliances fall into this category. Premium Beef and Ranchers Renaissance are two such examples. Both are alliances of independent producers of stocker and feeder cattle, packers and supermarkets operating as one. Their benefits are similar to those outlined above with two major differences-decreased need for additional major capital investment, and the ability to remain an independent business, a trait long cherished by many in the cattle producers. A hybrid of these two is the new Future Beef operation in Kansas where the legal structure consists of independent entities but the supplier partners and end users own a portion of the packer partner. This hybrid, scheduled to begin operating July 1, 2001, may have found a new structure even more profitable than the two previous examples.

Cross-border production has also "evolved" since NAFTA. "Cross-border production" as referred to here is the movement of animals across the border one or more times during the production phase for the purpose of decreasing the cost of production by locating each phase in the least cost country. This is occurring on both the Mexican and Canadian borders because it is frequently more cost-effective to finish an animal in Canada and slaughter it in the United States. An animal may be born in Montana, stockered in South Dakota, fed in a feedyard in
Alberta and slaughtered in Nebraska. Though transportation costs have significantly increased
the decreased cost of production at each point along the way has made the process profitable for each of its participants.

Mexico has experienced similar production initiative. Born in northern Mexico, calves are shipped to U.S. feedyards for finishing due to the availability of lower cost grain, and then shipped back to Mexico for slaughter and further processing where labor is much more economical. The meat is frequently shipped to end users in both Mexico and the United States, with the higher quality cuts moving north and the cheaper cuts and offal product moving south.

Such changes have not come without a price. The alliances have proven difficult to keep unified as each production segment has historically experienced a profit at the price of another. Trust has taken years to build. Transparency of operation with a previous competitor and possibly future competitor if the initiative fails has been nearly impossible to evolve. The new Future Beef initiative has faced construction set backs and increased costs since the plan was initially written and the start-up capital assembled.

The good news is that NAFTA abetted structural changes that have occurred, and have produced a more consistent, more desirable, more cost-competitive product. That result alone will continue to drive additional changes. These first players most certainly will continue to be emulated by others. Production/marketing alliances have been increasing at a rapid rate, many of the associations without proper foundation. This proliferation with insufficient basis, incompatible partners lacking similar vision and “limited homework” will result in a number of failures leading to a pullback by yet others who may both fear failure and lack the business expertise. That inevitable set back will not affect the long term changes underway. These structural changes appear to be both positive and permanent for the producers experiencing them, the customers profiting from them and the increased market share for beef, the first in fifteen years.