Livestock Risk Protection-Management Considerations Price Risk Management for Cow-Calf Producers: Part 8

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Cow-calf producers use various strategies to manage price risk, including futures and options. Livestock Risk Protection (LRP) is a type of livestock price insurance that typically costs less than a put option. LRP makes payouts (indemnities) that replace the income that is lost due to a price decline. For cow-calf producers interested in the price risk management and income benefits of LRP, some preparation is necessary before purchase. This article discusses how LRP might fit with typical cow-calf management strategies.

Cost-focused management- Many cow-calf producers focus on minimizing costs and self-insure against price declines. These operations can survive low price years because they are able to rely on other income sources. For this group, LRP may not seem attractive because it (1) an additional expense is incurred (for example, the most expensive LRP feeder cattle endorsements currently available have premiums over $7.00 per cwt) and (2) requires a substantial investment of time, especially initially. One consideration for producers in this group is that the LRP premium is not paid until after the end of the endorsement period. Further, producers in this group may want to consider using LRP for catastrophic-type coverage. While large declines in expected market price are rare, they can be substantial in some years. For example, in 2015, feeder cattle prices dropped over $50 per cwt within a few months. The lowest LRP coverage levels[1] will pay out for this magnitude of large price decline (which happens infrequently but causes a large drop in calf income) and cost around $1-$2 per cwt.

Active management- Larger operations and operations that are more reliant on cow-calf production for income are most likely to fall into this category. These operations know their cost of production, have a marketing plan, and have some experience with hedging or other types of price risk management. For these operations, assessing the value of LRP should be a straightforward exercise. LRP might be a cost-effective form of risk management, although the flexibility relative to more complicated hedging strategies may be a concern for some producers. While LRP limits on head enrolled per year[2] may be a limitation for some feedlots covering fed cattle, most cow-calf operations should not be affected.

Moderate Management- Some cow-calf producers fall in between cost-focused management and active management. For example, operations with "moderate management" might track some production expenses and have considered using futures or LRP in years with high prices. While calf income may not be "make or break" for this type of operation,

[1] While LRP coverage levels can be as low as 70%, the lowest coverage levels currently available for LRP feeder cattle endorsements are around 90%

[2] LRP endorsements have a maximum size of 6,000 head for feeder or fed cattle and the total annual maximum is 12,000 head.

lower prices are a serious concern. For this group, LRP provides the opportunity for more predictable calf income, at a cost favorable to producers. In other words, LRP makes payments in years when prices drop and is designed so that in the long run the producer pays less in premiums than they receive in indemnities. Recommendations from previous articles in this series may be helpful for this group of producers when considering LRP:

1. If price risk management is an unfamiliar concept, it might be useful to consider comparable expenses such as vaccines that are already common for cow-calf operations. Is the cost and benefit of LRP comparable to existing use of vaccines or other investments that decrease risk?
2. Find a trusted and knowledgeable livestock insurance agent. This is generally important but is especially critical for a producer that is unfamiliar with hedging and is considering LRP for the first time.
3. LRP requires an investment of time in understanding futures markets and selecting acceptable LRP coverage price. Further, LRP can be complementary to efforts to improve financial management and record keeping or develop a marketing plan. Many resources are available for cow-calf producers to aid in these processes, including contacting your local extension agent.

For all types of producers, it is important to keep a realistic perspective on price risk management and LRP. Research has shown that many producers adopt crop insurance only *after* they experience a drought. Focusing on recent events can bias insurance decisions and lead to disappointment. Some years will have no payouts because prices do not decrease, while large payouts occur infrequently. A long-term perspective, combined with understanding of how LRP works, will make price risk management decisions easier. The purpose of this series has been to inform cow-calf producers about how LRP works and how it might fit into different management strategies. The series will conclude with a final article that describes a decision aid on historic payouts for LRP under different coverage levels and typical Kansas scenarios.

This article is the 8th article in a 9-part series on price risk management for cow-calf producers. The first part of the series focused on price risk and different management alternatives. The later part of the series focuses on Livestock Risk Protection, an insurance product available to Kansas producers, that pays out when market prices for feeder cattle (or fed cattle or swine) are lower than expected. While LRP has been available for 2 decades, recent policy changes make it more affordable to producers. *Funding for this work was provided by the North Central Extension Risk Management Education Center, the USDA National Institute of Food and Agriculture Award Number 2018-70024-28586.*

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