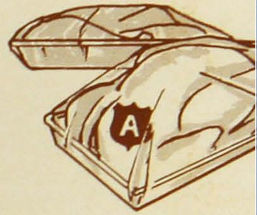
th Central Regional Extension Publication No. 15

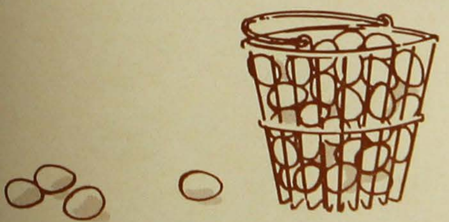
July 1963

Business Coordination in Agriculture

The Poultry Industry



University of Minnesota Extension Bulletin 309



Agricultural Extension Services of Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin; Farm Foundation and U. S. Department of Agriculture, cooperating.

Agricultural Extension Service
UNIVERSITY OF MINNESOTA
U. S. Department of Agriculture

FOREWORD

The objective of this bulletin is to help provide a better understanding of the many different phases and involvements in business coordination, horizontal and vertical integration, and special contract arrangements in agricultural production.

Extension personnel are responsible for providing information and conducting educational programs in this area. This publication was arranged and prepared to help meet this responsibility. County Extension personnel should also find it to be a valuable reference bulletin.

The authors feel that "business coordination" is a more comprehensive and accurate term than "integration" or "contract farming" to describe the combination or coordination of the decision-making process at two or more stages in production and marketing. In some vertical integration and special contract arrangements there is no combination and coordination in the decision making.

The various types of coordination and the possible benefits and limitations of coordination are described and analyzed in the first section of this bulletin. The second section contains more specific reference to production and marketing coordination in the poultry industry with regard to basic elements in contract arrangements and important considerations in the arrangements that can be made.

The members of the North Central Extension Marketing Committee believe that a more complete understanding of business coordination as it involves the participating individuals and affects the industry will help in judging any proposed agreements on merit rather than emotion.

C. B. Ratchford
Administrative Adviser

Contents

This bulletin was prepared by the North Central Egg and Poultry Marketing Subcommittee under the direction and general guidance of the North Central Extension Marketing Committee. The authors consulted frequently with members of the subcommittee which prepared NCR Extension Publication No. 14, *Business Coordination in the Livestock Industry*, Iowa State University, April 1963. The business coordination section of this bulletin is similar to the first section in NCR Extension Publication No. 14; the two subcommittees prepared the material jointly.

The first section of this report contains analyses and gives reasons for the changes and developments in the broader aspects of agriculture. The second section contains analyses and gives reasons for the changes and developments in the poultry industry. Because of the recent strong trend toward integration in the poultry industry, special attention is given to coordination arrangements in the poultry business.

Members of the egg and poultry marketing subcommittee include William H. Dankers, chairman, extension economist-marketing, University of Minnesota, St. Paul 1; Leonard Eggleton, poultry marketing specialist, Iowa State University, Ames; Henry Larzelere, extension economist-marketing, Michigan State University, East Lansing; Ted Joule, extension economist-marketing, University of Missouri, Columbia; and Homer S. Porteus, economist, marketing and utilization sciences, Federal Extension Service, Washington 25, D.C.

MEMBERS OF THE NORTH CENTRAL COOPERATIVE EXTENSION MARKETING COMMITTEE

Administrative Adviser: C. B. Ratchford, University of Missouri

L. F. Stice	University of Illinois, Urbana
W. S. Farris	Purdue University, Lafayette, Indiana
Lee R. Kolmer	Iowa State University, Ames
Norman Whitehair	Kansas State University, Manhattan
R. C. Kramer	Michigan State University, East Lansing
William H. Dankers	University of Minnesota, St. Paul
Jean Evans	University of Missouri, Columbia
Clyde C. Noyes	University of Nebraska, Lincoln
H. W. Herbison	North Dakota State University, Fargo
Riley Dougan	Ohio State University, Columbus
Leonard Benning	South Dakota State College, Brookings
Gale L. VandeBerg	University of Wisconsin, Madison
Raymond Scott	Federal Extension Service, USDA, Washington, D.C.
Joseph Ackerman J. R. Hildreth	Farm Foundation, Chicago, Illinois

Cooperative extension work in agriculture and home economics, University of Minnesota, Agricultural Extension Service and U.S. Department of Agriculture cooperating, Skuli Rutford, director. Published in furtherance of Agricultural Extension Acts of May 8 and June 30, 1914. 6,800—7-63

BUSINESS COORDINATION IN AGRICULTURE— PRODUCTION, PROCESSING, AND MARKETING

The U. S. agricultural economy has been characterized by change throughout its history. The more obvious changes resulted from new technology and equipment applied in agriculture. Each implementation of new technology resulted in changes in the economic aspect of the total farm business. These changes, while not very obvious to outsiders, have been a major part of the nature of the farm business. One of the results of the widespread use of new technology and equipment in American agriculture has been a continuing increase in capital requirements in the farm business.

As individual units in agriculture became more specialized and as the production units became larger and more complex, the processing and distribution system for agricultural products also became more complex. The growth of population and the shift from an essentially local market to a nationwide system of food distribution has resulted in greater capital requirements, more price uncertainty, and increased risks for producers, processors, and distributors.

Individuals in the food production, processing, and distribution business have taken various steps in the past to try to increase their profit opportunities, to increase returns to capital invested, and to improve efficiency of operation and thereby reduce the amount of risk involved in the production, processing, and marketing of food products. Both types of coordination, horizontal and vertical, are examples of the steps taken by individuals and firms to reduce the amount of their risk in the production, processing, and distribution of a given product.

Horizontal integration, the combination of similar units in production, proccessing, and marketing, usually improves efficiency and reduces risk. It helps to broaden the base and spreads the market for the goods and services. For example, if one processing or marketing plant located in the eastern United States is under temporary price pressure, other plants owned by the same firm or individual which are located in various other parts of the country perhaps could offset this price pressure and enable the company to avoid short-term reverses in the one area. The more obvious examples of horizontal integration in the food business include meat packing plants, fruit and vegetable canning plants, and large food stores. This type of integration has resulted in large organizations that sell their products largely in a national market. Such integration serves to expand the firm's profit opportunities and spreads operating risks over the national economy rather than leaving business fortunes dependent upon the economic health of a particular region.

One definition of vertical integration or coordination is: "The combination or coordination of two or more of the successive management decisions in the production and marketing process." This may be through joint ownership or contract arrangements. Producers, processors, and distributors have applied the vertical coordination concept in an effort to reduce the risks and uncertainties involved in the production, processing, and distribution of agricultural products. By coordinating management decisions at different stages in the production and marketing process the individual interests expect to increase control of the quality and quantity of the output which enters the market at a given time and place. The incentive is the expectation that their opportunities to avoid losses and to maximize profits will be improved. This does not mean that they attempt to control the quality and quantity of output for an entire industry. Rather, they attempt to control the quality and quantity of output of their individual combination in order to be in a more advantageous position in prevailing market conditions.

Vertical coordination is not a new concept in agriculture. All farm products have had coordinated processes in the channels from producers to consumers. However, closer forms of coordination are being used in combinations and in sectors of the agricultural industry that previously were not involved. Many of our farm products reach the consumer through integrated production, processing, and marketing arrangements. The farmer who produces fancy smoked pork products, quality eggs, or fresh vegetables and sells them directly to consumers, practices integration in a simple form. He has achieved all of the essential requirements for integration: coordinated control of two or more stages in production and marketing. However, producers of agricultural products who enter into supply agreements with processors or handlers, such as egg or milk handlers and processors, and who follow specific management practices jointly determined by the producer and handler are also participants in a closely coordinated program.

Forms of Business Coordination

Business coordination of the agricultural producing units and the processing and handling units may take several forms. One form is through expansion of vertically integrated ownership. A single individual or firm owns one or more operations required in the successive stages of production, processing, and distribution of a product. This is essentially the type of coordination practiced by producers selling eggs directly to consumers. In such instances the producer assumes all the risk and has complete control of the production, processing, and distribution of the product.

Vertical coordination is not confined to small producer operations. Retail food chains that own egg assembling facilities or own and operate dairy processing and marketing facilities are using this type of coordination—direct ownership and operation of assembling, processing, and retail distribution facilities—in order to increase the return on total capital invested. Such ownership also provides some assurance that the quality and quantity of eggs and milk products needed for retail distribution are always available.

Another form of vertical business coordination is achieved through contractual arrangements between farm owners and operators and nonfarm firms. In this case, part or all of the functions associated with production and marketing of one or more agricultural products are, by contract, brought under *unified* control or management. This type of coordination does not necessarily mean that the entire farm business or the entire processing or distributing business is involved in the coordinated process. For example, it may only involve the production of eggs, or broilers, or turkeys, or hogs from a single farm. Or it may involve only one portion of the processing and distribution activities of a given company.

A third form of business coordination is achieved when groups of individuals or firms act jointly to purchase, handle, or process the inputs or outputs for their businesses. Through cooperative associations, agricultural producers arrange for cooperative processing and purchasing of farm supplies and other production materials. Retailers can jointly own and operate their wholesaling and warehousing facilities and jointly purchase their wholesale supplies. While individuals are involved in different phases of production and marketing, the basic intent is the same: to arrange for the cooperative operation of business units that supply input items for their business.

Farmers and processors or distributors may also own facilities jointly to process and distribute the output of their businesses. In the case of farmers these are the cooperative processing and marketing associations for eggs and poultry products, dairy and livestock products, etc. In the case of processors, it is the cooperative ownership and operation of distribution facilities for a federation of processors. The method of combination and the size of the operation depend upon such factors as the nature of the market, the amount of capital available to the participating firms, and the managerial ability in the firms involved in coordination.

Possible Incentives and Benefits of Coordination

Because of the nature of competition, certain economic wastes seem inherent in various stages of production and marketing. Excess processing capacity and the resulting high fixed costs to individual companies are typical in poultry processing, meat packing, soybean processing, and feed manufacturing. Crosshauling, resulting in high transportation costs, is another aspect of economic waste. Duplication of selling efforts because of the nature of competition in both farm supply and marketing industries is another reason for excessive costs, and an economic waste.

Horizontal coordination of assembling, processing, and marketing agencies, and the vertical business coordination of processing and distribution of farm production may provide opportunities for the reduction or elimination of some economic wastes. It may reduce the amount of crosshauling that now occurs, it may reduce the procurement costs of individual handlers and processors, and it may reduce the selling costs of the processors and distributors. It should be arranged to result in higher profits to the producers, processors, and distributors involved.

The rate at which a particular form of coordination will take effect and expand in any area depends primarily upon the incentives and basic efficiencies it can provide a given group of producers, processors, or distributors. The extent to which basic efficiencies or incentives are gained in any given area is mainly determined by the area's existing level of efficiency, the managerial resources available to the firms involved, and the size of the potential market. Some possibilities for increased efficiency through coordination are:

1. Lowering or distributing risk:

Vertical business coordination through ownership or contractual agreement may enable individual businesses to reduce production and marketing risks through coordinating the supplies, the outputs, and the outlets of the marketing firms involved. Farmers, processors, and distributors may be able to reduce the uncertainty of the quality and quantity of the product entering the market, and to some degree the price, by coordinating management decisions. Reducing or spreading the risk has been one of the stronger motivating forces for integrating or contracting. This applies to the producer who coordinates his egg production operation through cooperative ownership of an egg handling and/or processing plant. Livestock processing companies have attempted to reduce or distribute risk by setting up a series of buying stations in a producing area to reduce the uncertainty of obtaining the quality and quantity of livestock they need. Considerations to reduce the risk have also been partially responsible for the coordination of raw material, supply management, and manufacturing activities in nonagricultural industries—for example, paper pulp mills and ownership of timberland, steel production, and ownership of ore and coal deposits.

Farmers hope to gain by having a more certain price for their products. This does not necessarily mean a higher price, but rather less uncertainty as to what the price will be. Processors hope to gain by having an assured supply of a uniform quality product. Suppliers, feed companies for example, hope to gain by having a greater proportion of their total sales distributed more uniformly throughout the year and thereby reduce the handling and selling costs.

2. Leveling out the seasonal supplies:

Agricultural production has varied extremely in the past from season to season and from year to year. This extreme variation in the supply of different agricultural commodities has contributed substantially to the costs in the processing and distribution of such farm commodities. The possible savings in reducing seasonal and cyclical variations is one of the incentives that coordination offers to the handlers, processors, and distributors of agricultural commodities. Processors hope to level out the present supplies or provide additional sources of supply for off-season processing, thereby reducing overhead processing costs. A hog slaughtering and processing plant of sufficient size for the peak fall marketings may be used at only 50 percent or less of its capacity during the summer season. A 1960 study of poultry processing facilities conducted by USDA's Economic Research Service indicated that 50 percent of the turkey processing plants were sometimes utilized at less than 30 percent of their potential capacity and that 85 percent of the turkey processing facilities were sometimes utilized at less than 50 percent of their potential capacity.[1]

The problem of seasonal variation has its counterpart with the suppliers in the feed and equipment industry who depend upon farm production as an outlet for their products. Facilities required for the production and/or storage of feed and equipment which are needed for the peak season demands are, in many cases, uneconomical. Agreements and contracts among farmers, suppliers, and processors may make it possible for suppliers to reduce inventory requirements and have a more even seasonal distribution of output and sales.

3. Adding some resources or balancing the present resources:

Business expansion can be achieved by adding new resources or by making more efficient use of present resources. This has always been a major goal of farm and plant management. By entering into agreements whereby a portion of the decisions for individual production, processing, and distribution business units are made jointly, the individual business unit often has a greater opportunity to obtain the use of additional resources, such as capital or management assistance, than would otherwise be available to it. By the same token the development of coordinated management decision making between two or more units may result in more efficient utilization of the present resources. For example, the storage facilities of the supplier may be utilized more fully and efficiently if he can contract for off-season delivery in exchange for price concessions.

In recent years the supply of operating credit has been one of the major provisions for coordination in the poultry and livestock industries. However, the addition of capital in the form of land or equipment has the same effect. The form of capital added to a production unit or a firm is not the crucial issue. The important point is this: Does the individual who supplies the additional capital to the operator participate in the management decisions of the enterprise? If he does, it is a closer form of coordination. If he does not, it is merely the traditional arrangement that exists between lenders and borrowers in any industry.

---

[1] George B. Rogers and Earl H. Rinear. "Cost and Efficiency in Turkey Processing Plants." Marketing Economics Division, USDA, ERS-26. 1961.

4. Improving production methods:

The coordination of some management decisions in production, processing, and marketing may speed up the adoption of desirable practices and new technology. This may enable the producer to increase his production efficiency. It may also enable the handler, processor, or distributor to gain some of the advantages previously mentioned. The improvement of production methods and the resulting product is, of course, not confined to the farm. The existence of supply contracts between producers and processors may also enable the processor to install more efficient equipment, or to make supply guarantees to his buyers that will enable him to sell a higher quality product in a more uniform and larger volume.

5. *Controlling the quality or the type of product:*

The control of quality or the type of product is essential in many agricultural enterprises to insure efficient and effective processing, marketing, and consumer acceptance. Marketing firms may seek to coordinate their supply, processing, and distribution functions by contracts with producers to insure delivery of a given quality or a specific kind of raw material. This is one reason for coordination in the fruit and vegetable processing industry. Varieties of both fruits and vegetables are carefully selected and controlled by the processors and the acreage is contracted well in advance of the canning season. In fruit growing and processing some varieties may be in the orchards under contract for 5 to 7 years before the processor can buy a crop for canning. Such long-term projects are needed to get the most adaptable and desired varieties on the market in the shortest possible time.

In some commodities a lack of coordination between producers and processors has resulted in the failure of quality programs. The result is low prices, poor quality, and declining consumer acceptance. By contracting with producers for a given volume and the quality of output, processors are assured of the necessary volume to meet current and future commitments. Thereby they can also provide an incentive to the producer to participate in such a program. These contracts, in many instances, have specifications for management practices to insure certain qualities and quantities of output at specific times during the year.

6. More effective marketing and distribution:

Another incentive for additional coordination in various parts of agricultural production and marketing is for more effective marketing and distribution of farm products. If this can be accomplished, producers, marketing firms, and consumers benefit.

The methods of assembling, processing, merchandising, and distributing which are applied to agricultural output today are significantly different from the methods applied to the same products in the past. The primary function of wholesalers and jobbers in the past was to accumulate stock for distribution through retailers. Little specific attention was given to maintaining consistent quality and quantity and to overall geographic distribution of the product. A well-coordinated operation that encompasses the production, assembling, processing, wholesaling, and retailing functions places increased emphasis on *orderly marketing* of the total output. The improved flow of products may provide profit opportunities to all sectors involved. While there is emphasis on orderly marketing, even without special coordination, the closer coordination of management decisions may help to more rapidly improve the quality and type of products. If this occurs, the incentive to coordinate production, processing, and marketing will continue to increase and more orderly marketing will be achieved more rapidly and effectively.

The items listed are *possible* incentives or benefits that may accrue to individuals or firms that become involved in coordinated activities. However, the mere fact that some activities are closely coordinated does not guarantee that some or all of these efficiencies will be attained. Nor does it mean that a particular type of coordination is the only way that these efficiencies may be attained. Nevertheless the profit incentives that exist may provide the impetus to individuals or firms to use coordination as one of the tools or methods for achieving some or all of these gains. In this sense, any form of business coordination is merely one of a series of devices that have been considered and adopted in the agricultural industry as one way of meeting the requirements of today's markets and to utilize and exploit the opportunities that exist in a competitive economy.

Limitations and Deterrents of Coordination

The above incentives provide some of the reasons why producers, processors, and distributors are interested in adapting and using the tools of coordination in their operations. However, under certain conditions there are also significant limitations and deterrents to the use of particular forms of vertical coordination. Some of the limitations are:

1. Exploitation:

There is always the possibility that one or more of the parties in a contractual arrangement may be exploited for the benefit of the other party or parties. This could happen to the producer, the processor, or the retailer, depending upon the nature of the agreement. If exploitation is to be avoided, an important question is "How will the distribution of risk and profit be determined?"

The individual producer may sometimes have little bargaining power. The supply company or the processing firm may then be able to exploit producers. In some instances where the processors or handlers are in a position to control the outlets for a given product, producers may be required to forfeit a major share of production management, even though they must retain most of the risks. Under such conditions the incentives for coordinating may be very great for the processors or handlers and the alternatives facing the producer are: (a) accept this unattractive distribution of risk and profit or (b) go out of production. Such a situation could lead to exploitation of the producer.

There is no general formula that can be applied to determine the equity of different forms of coordination. Equitably and ideally, the division of gains or losses should be based upon the relative amount of inputs supplied by the different parties and the relative amount of risk which is assumed by each party. With such an agreement the parties involved become economic partners in sharing the costs, the risks, and the profits. This does not necessarily assure profitableness but it does provide for equitable distribution of costs, risks, and profits or losses.

2. Possibilities of overproduction

Excess output of a given product or products may result from coordination. While the basic objectives of all parties in a coordinated agreement is to maximize profits in their individual businesses, this does not necessarily mean that a level of output which will maximize the profits in one sector—for example, in supplying feed—will also maximize the profits in another sector—for example, in poultry or livestock production. Processors may also be in a position to maximize their profits by utilizing their plant capacity at the highest possible level. In such cases processors will be actively interested in a continuing expansion of farm production and the necessary farm production facilities, though the price of a farm product might then drop substantially.

However, the expansion in farm production is largely a result of the addition of technology into the farm business, rather than the result of close business coordination. Regardless of the reason, the additional capital and technology moved into the agricultural production process will contribute to high levels of output for some time in the future. Under conditions of excess capacity in a given product the low price situation may be intensified. However, some vertically coordinated programs may actually provide a buffer to the income shocks caused by the addition of capital and introduction of new technology. An equitable distribution of control and of risks among the parties in an agreement may make the adoption of new technology worthwhile, with more efficient production and a higher level of income possible to the participants.

3. Lack of flexibility:

The more highly coordinated a production and marketing procedure becomes, the less flexible it may be. This may be one of the prices paid to obtain some of the advantages listed earlier. The larger number of production and processing functions involved and the larger number of managerial units and personnel involved may result in more rigidity in management functions. If each phase of the operation is interdependent with other phases, any change made at one level of operation must be coordinated with the necessary changes at other levels. This becomes increasingly difficult as the coordinated operation is made more comprehensive and thereby more complex. The lack of flexibility may sometimes be the result of physical, biological, financial, or managerial limitations. The loss of flexibility may make it more difficult for coordinated operations to meet changing conditions and to quickly exploit profit opportunities or react quickly to loss situations.

However, a vertically integrated firm may also achieve *added flexibility* in some areas because of its larger scope and size. The scope of profitable capital investments may be greater at times because more diversified operations are being undertaken. The firm or firms may be able to utilize available managerial ability to better advantage because more alternative uses of available management are present. The firm may also have greater flexibility in determining and developing a more optimum product mix for the entire operation because of the larger output and broader scope.

On balance some firms may lose flexibility in some areas while gaining in other areas. The degree of gain or loss of flexibility will depend largely upon the capabilities of management.

4. Institutional problems:

In addition to the problems of control and possible overproduction, the limitations imposed by marketing firms, social institutions, and vested interest groups must also be considered. Consumers may demand goverment action to prevent large-scale combinations of the functions of production, processing, and distribution. Present marketing agencies may be unwilling to invest the capital and provide the required management to develop the type of facilities and functions necessary for efficient coordination of production, processing, and marketing. If this means that new processing and marketing channels must be devised, the cost of such channels may deter further vertical coordination.

5. Technical problems:

Technical problems are an important aspect of changes in the agricultural industry. There may be limitations on the efficient size of production and processing units. Production units might be too small for the efficient use of modern equipment and technology, and too large for effective disease and parasite control. And there might be procurement cost problems for processing units. While technical problems do not necessarily prevent coordinated activities they may delay or limit the degree of vertical coordination which is possible in a given enterprise over a period of time.

Distributing the Benefits of Coordination

The economic advantages obtained through coordinating production, processing, and distribution of farm products will vary among the individuals and firms involved. In the short run the economic gain will primarily depend upon *where* the coordination takes place in the process and *how* and *what* changes are made.

In the poultry and livestock enterprises much of the impetus for contracting has come from feed suppliers. Feed suppliers have had the objective of increasing the volume of feed sales and reducing the handling and selling costs. For a short time, the added profits that can be obtained in this way may be retained by the feed supplier. However, competing feed suppliers will soon try to protect themselves from losing customers and their volume of feed sales to the initial contracting supplier. This may be in the form of price discounts, additional management service, or a coordinated system similar to that of the original contractor. This competition among feed suppliers will result in some of the gains of coordination being shifted from suppliers to producers.

However, the shifting of some gains of coordination from the supplier to the producer may not occur in instances where the contractor (feed company, equipment supplier, or processor) has a unique or patented product or a combination of services that is part of the contract agreement and that is not available to his competitors. It may be a patented feed formula or a particular equipment franchise that is protected by patents or other unique technological devices. Even in this case, the initial contractor cannot hope to indefinitely retain all of the benefits of contracting. Eventually competing organizations will have the same or similar devices to offer to prospective contractors.

Feed companies or other suppliers who are not interested in contracting may sometimes be instrumental in forcing the distribution of gains to the farmer. If a feed supplier counteracts the contract proposals of his competitors by reducing feed prices and making feed credit more readily available, a farmer may benefit from the contracting arrangements though he is not personally involved.

When suppliers initiate the contracting process and competition for business then occurs between supply organizations in the same industry, the distribution of gains over a period of time will go from the suppliers to the producer. However, the producer can only expect to retain these gains in his business in the short run. In the long run producers will pass a substantial portion of these gains on to the consumer in the form of a larger supply of farm products at the same or lower price.

Vertical coordination in the egg enterprise has also been initiated by retailers or by egg handlers. In this type of coordination, the benefits of integration are also retained by the initial contractor for only a short period of time. But instead of the gains being forced back to the farm level, as required when the feed suppliers initiated the contracting process, the gains in this instance pass more quickly to consumers. Consumers benefit or receive some of the gains of integration more quickly in this case because the retailer can use a portion of the gains from contracting as a competitive device to improve his sales volume and profit position. He can offer price advantages or quality advantages to attract consumers to his retail outlet. There is relatively little incentive to pass the gains back to the farmer. The handler or retailer needs only to pass enough of the gains to the producer to induce him to maintain production of the necessary quality and quantity.

In either case, the feed supplier and the retailer are trying to increase profits. Each relinquishes only a portion of the gains when competition forces him to do so. It is the competitive position of each that determines whether these gains will be directed to the producer or the consumer. Farmers are the first beneficiaries from competitive actions of feed suppliers because they are the final customers. Therefore, any benefits are shifted first from the supplier to the farmer, and secondly from the farmer to the consumer. In the case of the handler and retailer, the homemaker is the final customer and the benefits of coordination are passed directly to the consumer with the farmer receiving a relatively minor share.

As indicated previously, even in the short run the total gain of coordination cannot be completely retained in any individual company and to some extent must be shared with the producers or consumers. However, in the long run, if coordination results in more efficient production, processing, and distribution, the consumer will be the main beneficiary. Over a longer period of time, assuming continued competition between firms and the different sectors of the agricultural industry, it matters little where the initial coordination takes place. Competition will eventually force the largest portion of the gain to the consumers. This has happened in the egg and poultry meat and in the fruit and vegetable enterprises. Therefore the long-time effect of coordination is no different than the long-time effect of any other innovation in agriculture. Because of the competitive nature of the agricultural industry the consumers are the eventual beneficiaries.

BUSINESS COORDINATION ARRANGEMENTS IN THE POULTRY INDUSTRY

Basic Elements in Contract Arrangements

Contractual arrangements are an especially important form of business coordination in the poultry industry. Special attention should be given as to *how* and *to what extent* different individuals and firms are involved.

A contract is an agreement between parties who are competent to contract; thereby each party is to do or to refrain from doing some legal act. Contract arrangements with regard to business coordination and integration, as frequently referred to, may involve more than *two* parties. Therefore it is especially important that the parties know their relationship and responsibilities to each other. When there are more than two parties in the integrated and overall contract arrangement the relationship and responsibilities between the first and second parties to the contract may be quite different from those between the first and third parties, between the first and fourth parties, between the second and third parties, etc. The contract that is in effect should provide all the necessary guidelines for all parties participating. Because of the different relationships and interrelationships between the participating parties the basic elements of a contract must be kept clearly in mind and the contract should be properly, carefully, and clearly drawn.

1. Competent parties

The first basic element of any contract is that *the parties must be competent* (of legal age, etc.). For example, under some circumstances a contract with a minor as one of the parties is voidable and may be disaffirmed at the minor's option. In any written contract the names of all participating parties should be clearly written in for accuracy of identification. It usually helps to include the addresses of the contracting parties to provide further identification and location.

2. The legal objects

A second basic element of any contract, including a business coordination arrangement, is that the performances agreed upon and the expected accomplishments must be in compliance with the prevailing law. Stated differently, a contract must pertain to *legal objects*.

3. Considerations

A third basic element of any contract is referred to as the *consideration*. Each party is to act, or refrain from acting, for his consideration in the agreement. In a sense, consideration is the promise or value which one person pays for the promise or act of another. It may consist of the payment of money, the delivery of goods (resource inputs), or the performing of certain services (labor and other service inputs).

4. Agreement—offer and acceptance

A fourth basic element of any contract is that there is an agreement, or as frequently referred to, *a meeting of the minds*. There should be mutual understanding between the participating parties before a contract results. One person must make a proposition which is agreed to by the other or others. The proposal to enter into a certain agreement is called the *offer*. The consent to be bound by the terms of the offer is called the *acceptance*.

When the basic elements of a contract, as outlined, are carefully considered, along with the fact that some business coordinations and special contract arrangements involve more than two parties, it is obvious that the contracts should be clearly arranged and written. It is necessary to spell out what each participating party shall contribute to the total inputs required to operate the coordinated business. Stated legally, it must be clearly stated what consideration is to be provided by each participating party. It then follows that each party to the contract should also know whether his agreement and his arrangements are actually with the second party, the third party, or with whom, in the overall coordinated arrangements.

The many factors and complexities involved in any coordinated business arrangement require that the clearest possible language should be used in drawing up any contract of this type. People can hardly be expected to live up to their responsibilities in any contract arrangement unless there is sufficient indication that they should know and understand their responsibilities.

Important Considerations, and Some Questions to be Answered

Sugar beets and canning crops have been produced on a contract basis for many years. More recently special agreements have been made and many contracts have been arranged in the poultry enterprises; especially in chicken broiler and turkey production, but also in the further coordination of production, processing, and marketing of eggs, chicken broilers, and turkeys.

All those engaged in and concerned with the poultry industry have reasons to become familiar with the various types of contract arrangements, to analyze and compare the different kinds of contracts, to understand what is involved if they enter a contract, and to know their responsibilities and rights if they become a participating party in such a special agreement and contract.

Incomplete contracts or verbal agreements can easily lead to lawsuits. Therefore, complete agreements should be made and should be in writing. Then the contract should be carefully read and studied by each party involved before it is signed.

When business coordination arrangements are to be made in any poultry enterprise it is of real merit to those who can and want to participate to give full consideration to the many different phases of the special agreements and contract arrangements:

1. Identification of parties. The different parties in a contract should be carefully and clearly listed and their addresses should be given so that the proper contacts can be readily made.
   a. Who can and shall represent the parties in the contract for a corporation or a partnership?
   b. Is the landlord, the tenant, or both, required to sign the contract?
   c. Is the husband, the wife, or both, required to sign the contract?

2. Contract period. The period to be covered by the contract should be definitely specified. Both the starting and termination dates should be clearly indicated.

3. Renewal provisions. Provisions can be made for the automatic renewal of a contract—if there is not an advance written notice of cancellation. If there is an automatic renewal the contract will continue in force, as originally arranged.
   a. How much advance notice is required for cancellation?
   b. How much advance notice is required for renewal if renewal is not automatic?

4. Cancellation provisions. All parties in a contract should understand the circumstances under which a cancellation, recision, or revocation of the contract may be made. The opportunity for cancellation should be equal between all parties in the contract.
   a. Is the contract cancellable by only some or by all of the parties?
   b. Can it be cancelled for noncompliance of the other party or parties?
   c. Can the contract be cancelled in case of unprofitable operations?
   d. What happens in the case of Acts of God, such as fire, wind, flood, or lightning?
   e. What happens in case of condemnations?
   f. What happens in case of physical or mental illness or death of a party in the contract?

5. Assignment of interest. In many contracts the parties are prevented from assigning their duties to another party without written consent of all parties involved. If any party expects that he may need to transfer his duties and his responsibilities during the contract period, he should make special provisions for this matter before the original contract is arranged and signed.
   a. Do any or all parties have the right to assign or sell the responsibilities and resources which they must assume or provide under the contract?

b. What special conditions must be met for the assignment or sale of responsibilities and resources?

6. LEGAL RELATIONSHIPS OF PARTIES. Because of the different types of arrangements, the legal relationships of the parties should be clearly stated in each of the different contracts.

a. What are the relationships
— employer and employee?
— partnership?
— joint venture?
— independent contractors?
— landlord and tenant?
— creditor and debtor?

b. Do those who want to arrange a contract understand and know what the personal responsibilities and liabilities are in the different relationships?

7. SUPPLIES AND OTHER ITEMS AND SERVICES TO BE FURNISHED OR PAID FOR BY THE DIFFERENT PARTIES. The production and other resource items to be furnished by each party in a contract should be clearly outlined. The contract should also be explicit regarding what is to be furnished when there is a variety within a certain resource item. A contract arrangement for business coordination should contain specific indication of who should pay for insurance on buildings, equipment, animals, birds, and feed supplies, and who should pay the taxes.

a. Who is to furnish and own the fixed assets and facilities—the land, buildings, and necessary equipment?
b. Who is to arrange for and furnish the operating supplies and service —the birds (what breed, strain, and age?), litter, feed, medicinals, veterinary services, electricity, and other miscellaneous operating supplies and services?
c. Who is to arrange for and provide the labor and supervision service?
d. Who is to arrange for and pay for the insurance?
e. Who is to pay the taxes—real estate, personal property, income tax, or special use or sales tax?
f. Who is to arrange for and supply the credit needed for any of the aforementioned items?

8. MANAGEMENT DECISIONS. In business coordination there should actually be joint management decisions. If for any reason the provisions in a contract are such that the integrator (a handler or processor) is to make the major management decisions, the producer (farmer) should fully acquaint himself with the integrator's management program. If he disagrees with such a program and cannot make the necessary and satisfactory management decision arrangements, he should not sign the contract.

Many production management program questions should be raised, and satisfactory answers obtained.

a. What is the indicated minimum size of the flock—number of pullets, number of laying hens, number of broilers, or number of turkeys?
b. What type of housing is required?

c. How much floor, feeder, and water space is required per bird?
d. What are the feeding program requirements?
  — what feeding method shall be used?
  — may homegrown grains be used?
  — must only one brand of feed be fed?
  — what feed additives may be used, if any?
e. Is a specific poultry house lighting program required?
f. What is the sanitation program?
g. What is the vaccination and medication program?
h. Must all birds on the farm be of the same age?
i. Must different lots of birds be separated?
j. What are the replacement arrangements?
k. Are there restrictions on having other poultry enterprises on the farm?
l. How much field service is available for management assistance?
m. Are special services such as debeaking, dewinging, etc., required? If so, when and how can they be obtained?
n. Who must prepare and maintain the records?
  — are they sufficiently detailed and complete?
  — are they available to all of the parties in the contract?

9. MARKETING PROGRAM AND PRODUCER PAYMENTS. In some contract arrangements for business coordination the producer is required to follow certain product handling and marketing procedures. The producer is then to receive a certain rate of payment per unit for his product or a price for his product which is so much above or below a certain market quotation at the time of marketing. In such an arrangement a specific quotation for a specific market should be given, and the specific grade on which the price is to be based should be stated. If a contract has provisions for bonus or incentive payments to the producer, the basis and the method of computing the amounts should be written in a clear and understandable way. The following handling and marketing questions require special attention:

a. Are there special requirements for the method of handling the product at the farm?
b. Who decides when to market the product?
c. Is a specific market designated where the product must be sold?
d. Are there limitations with regard to the use of the product for home consumption, or retail sales, or sales to competing firms?
e. Is the product to be sold on a graded basis?
f. What provisions are made for differences in price because of differences in quality?
g. What happens in the case of undergrade or condemned eggs and/or birds?
h. Who shall decide whether there are cull birds, and if it is decided that there are, who then salvages them?
i. What are the provisions for paying the various marketing costs?
j. How is the price and the payment to the producer determined?

k. What is the rate of payment, or the basis of payment to the producer?
l. When is it paid?
m. Is it fully paid in cash, or what are the other provisions?
n. Are there provisions for prior assignment of sales receipts?
o. Is it a profit-sharing program? If so, how is it arranged and computed?
p. Are bonuses paid for production efficiencies? If so, how are they measured?
   — high production? — good feed conversion?
   — high quality? — other production efficiencies?

10. Arbitration provisions. If the contract is well written and each party understands his duties and his rights, disputes will rarely arise. However, if there is nonconformance or for other reasons disputes should arise, *the contract should contain provisions for settlement* without long and costly court procedures. Such arbitration provisions (*where enforceable under the state law*) should be explained in detail in the contract.

a. Can arbitration be called for by either party?
b. When can arbitration be used?
c. What constitutes nonconformance?
d. What shall be the penalty for nonconformance?
e. How many arbitrators shall there be?
f. How are the arbitrators to be selected?
g. Will the decisions and the report of the arbitrators be binding? If so, how and when?
h. Who pays the cost of arbitration?

Summary

A thorough application of the analyses and the preceding checklist in a contract arrangement will help to clarify many features of the contract and will provide detailed knowledge to the various parties about the stipulations and their responsibilities as set forth in the contract. While this is desirable, the knowledge gained by using this checklist does not place emphasis on a readymade decision for the various parties. The individual and/or firm must still combine the results of the provisions of the contract in a manner which will provide answers to the following questions:

1. Are all the parties who are involved in the contract really willing to submit to joint decision making in all areas of activities as stipulated in the contract?

2. Is the division of risk, costs, and profit as arranged in the contract acceptable to all the parties in the contract, or does an individual or the representative or representatives of a firm consider that a more effective and advantageous situation could and should be arranged for in some other way?