4

Country Merchandising and Country Bids

Kenneth W. Stotler

I have been asked to discuss country merchandising and talk to you about bids for country run grain which we make to the country elevators and tell you how our bids are determined and how they work. I am happy to have this opportunity to talk to you about the economic aspects of country merchandising and explain what I strongly feel are the real economic functions we perform. Methods are much the same for all grain so we will talk about corn in particular.

. . . I sincerely believe that country merchandising is one of the most interesting and fascinating areas of the grain business and perhaps the least understood by both the general public and even the grain trade itself. When people ask me what I do for a living and I tell them I merchandise grain, they just look at me, shrug their shoulders and say, "So what." They seem to feel that we have a pat hand with a built-in profit and assume no economic risk. Nothing could be further from the truth.

First let me define a country merchandiser or interior merchant. He is one who buys grain from country elevators and sells it to terminal markets, exporters and processors. There is really nothing difficult or mysterious in being an "interior grain merchant." All the merchant has to do is pay the country elevator at least ½ more than anyone else and sell it to the processor, terminal operator or exporter for less money than they can buy it for themselves either direct from the point of origin or from other merchants. This is obviously a difficult task but it is exactly what we attempt to do.

For example, if you include only the grain that our company handles at a profit we are probably the smallest firm in Illinois, but if you include the grain we handle for nothing we are one of the largest in the state. My uncle before me used to say that he made all of his profit on 40% of the grain he handled but that was a long time ago and that percentage has been declining ever since and our expenses have been steadily rising, making our problem that much more difficult.

The greatest concentration of interior grain merchandisers today is in East Central Illinois and this is mainly because this is one of the major surplus grain producing areas in the United States. This surplus producing area is north of the Illinois river and west and south of Chicago and extends on south along the Illinois river to Peoria and on south through Springfield and then over east below Effingham to the Indiana line up to Kankakee. This is the area I wish to talk to you about today.

There is also a heavy corn producing area west of the Illinois river but this is mainly a feeding area and very little corn moves in commercial channels except in the fall at harvesttime when farmers move their surplus over crib room and again perhaps in the spring when they sell the surplus over their feeding requirements.

In this area east of the Illinois river are found the deep black soils of the original grass praries. Much of this land was wet and poorly drained until the early 1900's but with the development of drainage projects, intensive grain farming followed. It was only logical that grain buyers should be attracted to this fertile area. The question arises as to why brokering or interior grain merchandising operations haven't developed all over the middle west. There are not nearly as many similar operations conducted in Iowa or Indiana. This is probably due to the fact that this is such a surplus producing area with an abundance of good trasnportation for the many markets such as Chicago, Peoria, St. Louis, Decatur, Danville-Kankakee, Paris, Baltimore and New Orleans. In other words, there is excellent billing in all directions by rail and water. In this region is a vast network of modern railroads crisscrossing the country and also the Illinois and Mississippi rivers as efficient means of transportation. If the movement of corn was in one direction from this area, there would probably be less tendency for this interior merchandising operation to develop. Whatever the reason, this area was early a center of grain brokerage operations and today is a center of interior grain merchandisers.

Some of the old grain firms operating today in East Central Illinois were started in the early 1890's as strictly brokers. The grain broker merely acted as the agent for several processing or terminal firms and here we find the basic difference between a grain broker and the merchandiser of today. A broker did not take title to the commodity the sale of which he negotiated. Actual ownership was with one of the principal parties such as the country elevator on the one hand and the processor, terminal elevator, or exporter on the other. The grain merchandiser does acquire title to the commodity and is therefore subject to all laws and regulations governing ownership of property. Now the difference between an interior merchant and the rest of the trade is merely in the matter of storage. Country elevators and terminal elevators are all identified by their physical capacity to store but this is not true of the merchandiser. Often, all that can be found to show such a business is being carried on is a small office with telephones and perhaps a direct wire connected with a terminal grain dealer.

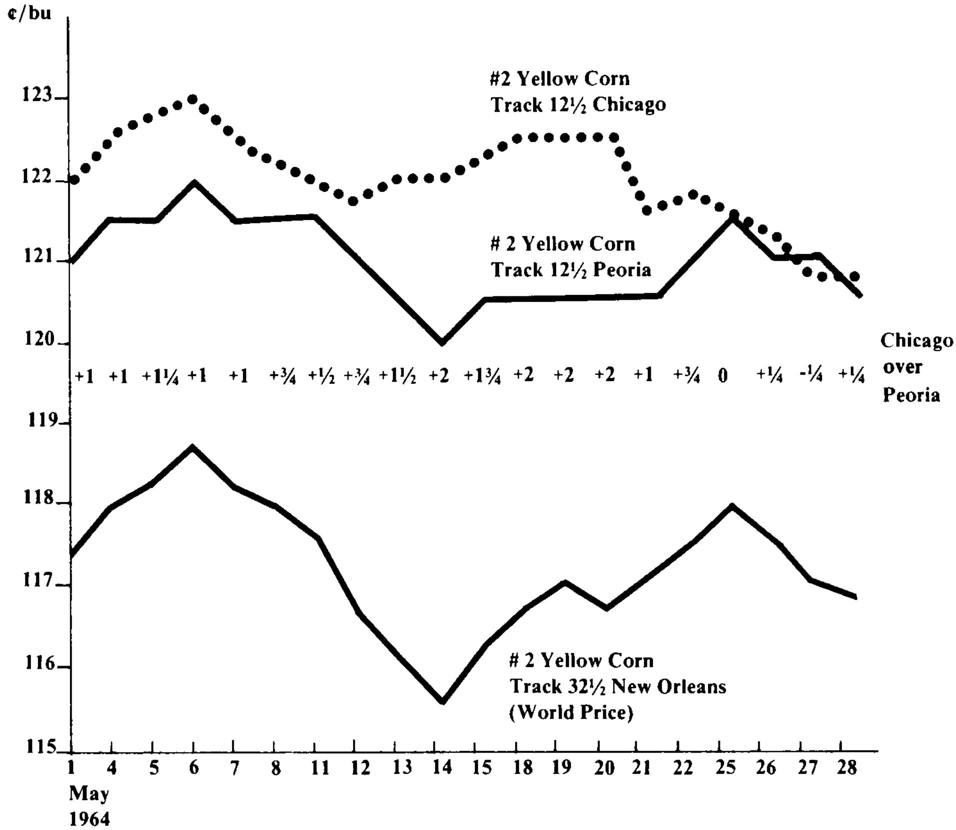
Theoretically, a grain merchant should simply buy and sell grain and in the process provide the buyers with adequate supplies and provide the seller with a satisfactory market and adequate service. An important service of a merchandiser is as a clearing house for grain market information as to prices, general market conditions, freight rates, hedging possibilities, government regulations and to see that he takes advantage of options on contracts such as time of shipment and discount schedules. He must also maintain a strong financial position so that the buyer and seller can be assured of fulfillment of all contracts. Probably the greatest service which a merchandiser performs for country shippers is to be in the market at all times and provide the top bid. The merchant can provide higher prices by being alert in using the elements of time, freight rates, billing, and volume in changing markets and circumstances. The switching of billing is probably one of the most complicated and fascinating operations of the merchant and in its simplest form it is merely the shifting of purchases and sales to take advantage of changes in prices to different destinations.

In order to switch billing you must first have some billing to work with and to obtain this billing we must have bids that are attractive enough to buy corn in volume. We do this by checking bids at all markets in the country and then setting up our bid equal to or even ¼ to ½ more than we can sell it for. Then as we start to accumulate this corn we sell part of it as cash grain and the balance in the Chicago futures market. In this manner we have part of our inventory hedged in cash at no profit and the balance in the Chicago Board of Trade futures. At this point we assume a risk in basis change and as we have this large inventory of cash corn bought from the country elevators and sold as cash or futures we are ready to take advantage of any favorable basis change. Now the basis is usually defined and correctly so as the difference between the cash corn and the futures market and the hedger makes his money by being alert to the widening and narrowing of this difference. However, the basis change we are more interested in as a country merchant is the billing basis on different freight structures or I might say geographic basis change. The prices in the various terminal markets such as Chicago, St. Louis, and Peoria fluctuate back and forth and we attempt to sell to the high market and buy in the low market.

On this chart I have plotted on the lower line the price of No. 2 Yellow corn track 32½ New Orleans rate for the month of May 1964. I like to think of this price as the world price of corn as it truly reflects the price the world buyers are willing to pay. Actually, this world price then becomes our base price as corn cannot sell lower in this area and our domestic prices will fluctuate at premiums above this world price as our different local buyers come into our market for corn. On this middle line I have plotted the price of corn track 12½ Peoria rate. The 12½ Peoria rate covers most all shipping points within a radius of seventy-five to a hundred miles of Peoria which is a very heavy corn producing area. On the top line I have plotted the price of corn on a 12½ rate to Chicago and like Peoria this area is the area seventy-five to a hundred miles around Chicago. On the center line have I have plotted the premium for Chicago corn over Peoria corn and you will note it varies from plus two to minus ¼—a difference of 2¼¢.

You will note that from May 1st to 7th Chicago corn was 122 to 123 and Peoria corn was 121 to 122 or a difference of 1¢. On May 11th Chicago corn

Prices, No. 2 Yellow Corn



was 122 and Peoria 121½—a difference of only ½¢ per bushel. So from May 1st to May 11th Chicago corn was only ½ to 1¢ over Peoria. Then on May 14th Chicago was 122 and Peoria was 120 or a difference of 2¢ and the same condition prevailed from May 15th through the 20th and then on the 21st the prices were 121½ Chicago and 120½ Peoria—a difference of only 1¢ and then it really began to narrow until on May 25th the price was the same on both Chicago and Peoria or 121½ track. On May 26th Chicago was back to ¼ over Peoria and then, lo and behold, on May 27th Chicago was 120¾ and Peoria 121 or ¼ premium for Peoria and then it reversed again and on May 28th the price was 120¾ Chicago and 120½ Peoria.

Now what does all this fluctuation of prices back and forth mean to the central Illinois merchandiser? Simply this, we attempt to buy on the low market and sell on the high. In other words, when Chicago is only ½ to 1 over Peoria we buy Chicago billing and sell Peoria billing and when Chicago is 1½ to 2 over Peoria we reverse our field and sell Chicago and buy Peoria.

In this particular operation we are actually making an intermarket spread as we cannot ship the Peoria area corn to Chicago or ship the Chicago area corn to Peoria. The present freight rate structure will not permit such a movement. A large inventory of corn from both areas is necessary at all times so that we will always have corn on hand to sell to either market as the premiums move back and forth.

For example, from May 1st to May 11th we bought Chicago corn at 122 to 123 and sold Peoria corn at 121 to 122, a difference of 1¢. Then from May 13th to May 21st we reversed our operation and sold Chicago at 122½ to 123 and bought Peoria at 120½ to 121, a difference of 2¢. This was a profit of 1¢ per bushel and we did not have a wide open market position nor did we charge any commission to either the buyer or seller. Let me show you exactly how this works: On May 1st we sell 100,000 corn to Peoria at 121 and on May 14th we buy 100,000 Peoria billing at 120 or a profit of 1¢. Also, on May 1st we buy 100,000 Chicago corn at 122 and sell it at 122 on May 14th which is the same price or no profit or loss.

In other words, we bought and sold 100,000 bushels of corn on May 1st and we bought and sold 100,000 bushels of corn on May 14th and the net result is a profit of 1¢ per bushel on 100,000 or ½¢ if you assume we handled 200,000 bushels. Theoretically, if we were real lucky and had put this spread on at 2¢ and taken if off when it went minus ¼ we could have made 2¼¢.

I realize I may have oversimplified this example but by observing this chart you can see several opportunities to make one or two cents and still perform a real economic service. By selling corn to Chicago when they are high we help to keep that market from getting too high and then by selling to Peoria as they come into the market we keep that market from getting too high. By buying in the market that is low, we help bring prices back up. In other words, we act as the great price equalizer.

When we sell to the high market each time, we are able to always pay the country elevator on both the 12½ Chicago rate and the 12½ Peoria rate as much or more than he would get selling either direct to our buyer or to some other merchandiser.

I have always admired the merchandising methods of Sears, Roebuck and Company in that I feel assured of quality merchandise at a good price. I like to feel that we perform a similar service for the grain business. Our aims are to pay the country elevator at least as much as he would receive if he sold directly to the people we sell to, and to sell to our buyers for less then they could buy for directly from country elevators. It sounds impossible—but it is done every day in good merchandising operations.

This paper was originally presented in 1964 at the Agricultural Writers Conference at the Chicago Board of Trade.