

How a Soybean Processor Makes Use of Futures Markets

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... In the management of our own particular company, the futures markets are used for the purpose of providing stability to our operating margins. We use the futures markets to avoid the risk of large inventory loss. In using futures markets for this purpose, we must forego the opportunity of making large profits. We conduct a manufacturing operation and look to our conversion or crushing margin as the source of our profit. In so doing, our crushing costs assume a position of great importance to us. A mill must operate on a very efficient basis to survive. To sum up thus far, we as soybean processors use the futures markets for the purpose of protecting our investment in raw materials. In addition we use it to buy or to sell end products which cannot be handled on a cash basis at a time when such transactions are considered desirable.

The soybean crushing industry itself has been developed to the point where soybean oil and meal are in large supply, if not in a domestic surplus. In this situation, a cash buyer is naturally reluctant to commit himself very far ahead unless he feels bargains are available. It follows that the soybean processor, if he wishes to make forward sales, can often best do so through the medium of the futures market. The alternative may be the sale of the cash commodity at prices which are probably below current true value. It also follows that futures markets provide the processor with opportunities for speculative sales or purchases if he is so inclined.

A soybean crushing business under most circumstances cannot be operated profitably when raw materials are bought on a hand-to-mouth basis over the period of a year. Sellers are unpredictable and, in some areas, supplies are not available to mills for a good part of the year. As a result, large raw material stocks are normally accumulated in the fall when crops are moved to market. Some of the oil and meal content of the soybeans held on inventory can be sold on a cash basis for current or future delivery. A large part of the oil and meal content cannot be sold at the time the soybean inventory is purchased.

To protect himself, the crusher then has the choice of hedging his risk in the soybean inventory by selling soybean futures or by selling soybean oil and meal futures. Later on, when products can be sold, the soybean futures may be covered and the actual crushing margin determined, or, if oil and meal futures have been sold, these can be covered as cash products are sold. Of course, each trade in the futures market is a definite contractual obligation which must ultimately be met if not offset by a reverse transaction similar in both size and time of delivery. Stated in these terms, this sounds like a simple procedure, however, in actual operation we find so many variations that actual experience may become quite highly involved. Good judgment is an absolute necessity. Relationships of cash to futures are constantly changing, thus a correct diagnosis of the direction of the markets is essential to success.

It is true that in the minds of many, government support prices tend to create a price floor on commodities which are not substantially in surplus. Soybeans and cottonseed may be given as examples of such commodities. Currently, much of the business activity in which we engage is controlled largely by forces which are political rather than economic. Under such conditions, we feel it is highly desirable for a businessman to be even more aware of the possibility of an overnight change in the price structure due to a sudden change in political policy or action. The idea that a market situation created out of political activity can be only of a bullish or a stable nature is sheer nonsense. Futures markets offer an excellent means of avoiding or partially eliminating such risks.

The mechanics of futures trading are quite simple and I am sure understood by you. The actual operating personnel of a soybean processor is necessarily small, and the group is divided in assignments. Some concern themselves primarily with soybeans, others with the soybean oil and soybean meal. The actions which they take are governed by management policies which must be soundly conceived to give direction to a business. A small processor operating from a single location has a relatively simple job and, in most cases, the futures operations can be conducted by one or perhaps two people. Multiple operating locations generally require more people and a somewhat broader viewpoint. In our own particular situation, we operate from some sixteen mill locations and handle soybeans at all except three of them. Some areas are managed commercially in a manner which is common to the Midwest operation as a whole. In the Midwest area, prices move more or less rigidly in relation to futures market quotations. Transit rail rates are available for use generally. Other areas, such as the South, operate in a different manner. Here soybean marketing has tended to follow the same pattern as has been developed in cottonseed; daily price fluctuations are less erratic; movement is primarily by truck from country points to the crushing mill; activity by exporters in areas tributary to Gulf and Atlantic ports can easily distort local markets; transit rates on products are generally not available and product price variations due to location are many and can change quite rapidly. So, here too, the use of futures markets is necessary for the protection and proper operation of the business. In this case, the need is brought about not only by domestic economic change, but also by factors involved in exporting. In any case, price insurance is badly needed and, short of actual cash transactions, no better medium has been developed than the futures market.

It is practically impossible to remain completely hedged at all times and I do not regard this position as being wholly desirable. Anticipatory sales and purchases must be made and, in so doing, the element of risk again is introduced. The most common forms are the sale of futures against anticipated cash purchases and the purchase of futures against anticipated cash sales.

In some instances, use of futures extends beyond the areas normally associated with a domestic business. I am referring to the futures market in money. In the operation of a foreign subsidiary, exchange rates are of great importance to a soybean processor who must import and pay for his imports in currency other than his own. A similar situation exists in connection with sales of products for foreign currencies. Exchange rates often fluctuate widely and, with commodity prices at current levels, it takes only a relatively slight fluctuation in money values to substantially affect costs or realizations. To stabilize the results of such an operation, purchase or sale of exchange should be made simultaneously with the purchase of raw materials or the sale of products.

I would like to point out again that the use of futures markets for hedging purposes does not entirely eliminate risk nor does it assure profits. Its chief function is to reduce substantially the chance of loss due to price decline. Soybean futures prices do not necessarily move in a consistent relationship to soybean oil and meal prices. The element of risk remains, but it is substantially reduced. The market itself must be fluid and must reflect realistic prices. . . .

