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Telephone Auctions: An Overview

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The case for electronic selling methods for agricultural commodities has been presented in my earlier paper. The rationale for using electronic media to facilitate remote centralized trading, the necessary conditions for success, and advantages and disadvantages to same have been set forth. This paper takes a closer look at one form of electronic selling, the telephone auction or teleauction. My purposes are to review where and how teleauctions have been used and to examine the pros and cons of some of their more important features. I will not review the teleauction concept.

Feeder Pigs

The most widely accepted use of teleauctions in the U.S. has been for the sale of feeder pigs. In fact, the first record of a teleauction was in 1962 when the Virginia Department of Agriculture, Division of Markets, and the Chesapeake and Potomac Telephone Company developed the concept of a telephone auction and applied it to the marketing of feeder pigs. Since then, feeder pigs have been sold by teleauction in at least Wisconsin, Minnesota, North Dakota, Missouri and Ohio, in addition to Virginia. While no precise data are available on total sales through these teleauctions, a reasonable guess would probably be in the neighborhood of 250,000 head per year.

All feeder pig teleauctions operate in essentially the same manner. A cooperative marketing agency assembles consigned pigs in selected yards where they are inspected, weighed, graded and sorted into lots of roughly uniform size and quality. A description of each lot is then circulated to prospective buyers at remote bidding locations which are interconnected by conference telephones. At an appointed time, an agent of the marketing association auctions each lot via the telephone network. Buyers purchase on the basis of the description provided and bid competitively against buyers at other locations. After the sale, the marketing agency arranges for transportation from their yards to the buyers.

These sales have been feasible because of the development and acceptance of grades that consistently and accurately describe the quality of the livestock being traded. Clearly, such remote selling would be infeasible in the absence of such standard descriptions.

These sales have increased significantly the number of both buyers and sellers in a given market, greatly increasing the competitiveness of the bidding process and resulting in a significant price advantage to sellers. For example, in 1974, prices for graded feeder pigs sold in Ohio through teleauction averaged almost $4 per cwt. more than those sold through conventional auctions.

A couple of problems have emerged in these sales, particularly with regard to the physical movement of livestock. Because these pigs are assembled in yards used for other purposes, they normally have to be shipped out shortly after the sale. This has created a substantial logistics problem for the marketing agency and perhaps for the buyer who may find it inconvenient to accept delivery on a schedule that coincides with the scheduled sales dates. Additionally, sellers lose a degree of control over their sale-no sale decision, as once they have moved their pigs to the assembly yard, they are less inclined to "no sale" them on a low price bid than if they retained physical control over them.

Market Lambs

Again, Virginia pioneered in the development of teleauction selling of market lambs. In 1971, a group of Virginia lamb producers organized the Eastern Lamb Producers Cooperative for the purpose of selling lambs over a telephone auction. By 1974, they were selling about 30,000 market lambs for producers in Virginia, North Carolina and West Virginia. In 1974 the Pacific Northwest Livestock Producers Marketing Cooperative was formed to market lambs through teleauction in Oregon and Idaho.

The auctioneering process for the lamb markets is essentially the same as for the feeder pig markets. However, these markets have significant logistical differences. While the feeder pig markets assemble pigs prior to sale, the lamb markets sell lambs prior to assembly. That is, the lamb markets are designed to overcome the logistical and market control problems associated with the prior-to-sale assembly characteristic of the feeder pig markets by the use of on-farm selling.

In the lamb markets, sellers contact an agent of the marketing association up to 3 weeks before they are ready to put their lambs on the market. The marketing association arranges for a grader to visit the seller's farm to inspect and estimate the number of lambs that will fall into each grade category by the sale date. This information is recorded on a consignment form which is signed by the seller, thus binding his lambs to the sale. The Eastern Lamb Market contracts with the Virginia Department of Agriculture for the grading service, as Virginia has a number of full and part-time graders that regularly grade several species of livestock both at concentration yards and on farms. The Pacific Northwest Market apparently uses graders that are hired on a part-time basis directly by the cooperative.

The consignment forms are forwarded to the sale manager who comingles the lambs on paper and assigns them to truckload lots. They are offered for sale in these truckload lots F.O.B. a specified concentration or assembly point. After the sale, the buyer specifies a delivery date. He can select any of the seven working days following the sale. On the specified delivery date, the lambs are called into the concentration yard where they are weighed, grade verified, and loaded for shipment to the buyer. The title actually changes hands when the lambs pass over the scale at the concentration yard, and the invoice accompanies the truck to the buyer. The operator of the concentration yard is responsible for collecting and dispersing payments.

The lambs are described by a combination of weight and grade, resulting in three categories: blue "o" which are prime-choice 90-115 lb. lambs, red "o" which are prime-choice 80-89 lb. lambs, and heavy mediums. Others aren't accepted. All bidding is done in terms of blue "o" lambs with a $2/cwt. discount for red "o" lambs and a $6 discount for heavy mediums.

Because the lambs remain on the farm until after the sale, a "no sale" option can easily be exercised on any lot that isn't bid an acceptable price, thus increasing the seller's control over the actual sale-no sale decision. In the lamb auctions, the no sale option is exercised by the sale manager when, in his judgment, a lot is under bid. Furthermore, on-farm selling facilitates the delayed delivery option which substantially mitigates logistical problems.

A detailed analysis of the Eastern Lamb Market by economists at the Farmer Cooperative Service, USDA, shows that the lamb teleauction has consistently added $2.30 to $2.60 per cwt. to sellers net-back, after marketing charges, compared to conventional lamb markets. These gains reflect both the advantages of more competitive bidding as in the feeder pig sales plus the economic advantages associated with on-farm selling.

Slaughter Hogs and Cattle

A couple telephone auctions have been established to sell slaughter cattle and butcher hogs. These are of almost inconsequential volumes, and are mentioned here only for the completeness of the record on teleauctions. Clearly, the most significant applications of electronic selling to slaughter livestock are the various Canadian hog boards. As those utilize the teletype rather than the telephone auction, they are beyond the scope of this treatise.

The Iowa Farm Bureau, cooperating with two commission firms, has just recently begun to sell butcher hogs by teleauction. Little volume has yet been reported. Virginia has had a slaughter cattle teleauction operating for several years, but at a low volume, about 3000 head per year. These markets utilize on-farm selling with estimated weights and grades. Minimum lot size is half a truckload, with sellers encouraged to comingle lots among themselves to generate a truckload lot. Bidding is done on a carcass basis with actual settlement based upon carcass weight, yield and grade as measured by Federal inspectors at time of slaughter. Delayed delivery is allowed, and sellers can specify a reservation or no sale price for each lot consigned. Little information is available on the impact these markets have had on prices and other terms of trade, but it has probably been minimal due primarily to low volume.

Feeder Cattle

The teleauction most relevant to our interests in the feeder cattle market is the Virginia Feeder Cattle Tel-O-Auction. Early experience was gained with special sales in the autumn of 1974 and spring of 1975. There were three regularly scheduled sales in the early autumn, 1975, handling almost 1500 head or a total of 28 truckloads, mostly yearlings with 4 or 5 loads of calves. Consignments have been primarily Virginia cattle and most buyers have been midwestern feeders or order buyers, many from Ohio, Michigan, and Indiana.

The feeder cattle teleauction operates in a manner very similar to the market lamb system, featuring on-farm grading, on-farm selling, paper comingling and delayed delivery. Like the slaughter cattle system, it allows a seller-determined reservation price or no-sale option.

Potential sellers of feeder cattle contact the marketing agency about 30 days prior to a scheduled sale. A contract grader from the Virginia Department of Agriculture is then scheduled to visit the consigner's farm, usually in the period 1 to 3 weeks prior to the sale. The grader inspects the cattle and estimates weight and grade. The Virginia standard feeder cattle grades are used and animals falling into the following three grade categories are accepted for sale: Choice (fleshy, above average frame), Good (fleshy, below average frame) and Medium (lean, above average frame).

Truckload lots of uniform quality and weight cattle are preferred. If an individual seller does not have such a lot, he has two options: 1) consign a truckload (approximately 42,000 lbs.) of mixed grades and weights, or 2) consign partial truckloads of feeders relatively uniform in grade and weight for comingling on paper with other consignments into truckload lots. When an individual seller consigns a truckload lot, he can specify whatever reservation price he desires. For comingled lots, the consigning sellers must agree on a reservation price, if any is specified. The market manager facilitates the paper comingling and specification of reservation prices.

At the time of on-farm inspection by the grader, accepted cattle are given an identification mark. Highway stripping paint is used, and has demonstrated acceptable durability. Virginia officials report that a grader can typically inspect an average of 200 head per day on farms. The on-farm inspection fee is 50 cents per head, compared to 25 cents per head for in-market inspection.

The lots are actually sold on a description basis with the average weight per head and range in per head weights in each lot estimated. At the close of the teleauction, the buyer can designate any of the subsequent 10 days for delivery. On the selected delivery date, the cattle are brought in from the sellers farms to cooperating concentration yards where they are weighed and rechecked for grade. Cattle that have gone off-grade since being inspected on-farm are rejected, although there have been few such rejects. Frequently, the same trucker picks up the cattle from the sellers, moves them to the concentration yard, then on to the buyer.

Transfer of title actually occurs when the cattle are weighed, and the settlement price is determined. If the actual average weight of any lot deviates from its estimated average by more than 50 pounds, a 1 cent per pound discount is taken off the price. As with the lamb teleauction, the invoice accompanies the truck to the buyer's destination, and the operator of the concentration yard is responsible for financial transactions.

This teleauction has received favorable reaction from both feeder cattle buyers and sellers. Buyers seem to readily accept description selling when they have knowledge of and experience with the grading system being used. Undoubtedly, the development and use of graded feeder cattle sales, both in Virginia and elsewhere, has been a key factor in gaining acceptance for description selling.

Buyers rank particularly high the ease of buying feeders over the teleauction and the related cost savings, the reduced shrink and stress on the animals due to reduced handling and less time spent in market yards, and the logistical flexibility in delivery. Sellers like the increased competitiveness of bidding and find it easier to get their livestock on the market when they don't have to be physically moved prior to the sale. Preliminary information indicates that these are being manifested in about a $3 per cwt. price advantage for sellers.

Teleauctions in Perspective

In this overview of teleauctions, a number of benefits have been identified that have been associated with such selling methods. These include:

1. Increased competitiveness. The number of buyers bidding on any load of livestock is increased appreciably. Buyers that were never before able to reach the sellers can now enter the market. In the Virginia teleauctions, some buyers have been as much as 700 miles away. As a result, higher prices have been evidenced.

2. Increased market size. Teleauctions can interconnect the selling efforts of producers delivering through a large number of concentration yards, thus concentrating their offers in a single sale. This attracts more buyers and creates a price discovery process that is more representative of the overall supply-demand conditions in the market.

3. Increased efficiency. Buying efficiency is improved as buyers use the telephone rather than personal visit to purchase their

needed supplies. Selling efficiency is improved by using one organization to conduct the sale and perform other necessary functions.

4. Improved quality. The ability to improve the quality of livestock being produced in the long term by selling on the basis of quality-related grades and standards has been well demonstrated. Because teleauction selling requires such description selling, this process is enhanced significantly.

Additional advantages accrue to those teleauctions that have utilized on-farm selling. These include:

1. There is less handling of the livestock, thus less stress and shrink than in conventional auctions.

2. Assembly facilities can be smaller since market yard activities can be spread over the several day period within which buyers can take delivery.

3. Fewer graders are needed as their services can be spread out over several days, not limited just to sale days.

4. Livestock does not have to be sold on the day they are put on the market if the price is unreasonably low.

5. Buyers gain a scheduling advantage on shipments as delivery can be arranged to best fit their needs.

6. On-farm grading can provide an important source of management advice to producers.

Partially offsetting these advantages are some limitations. These include:

1. Sellers must get their livestock up twice, once for grading and again for loading.

2. Spreading out the number of days over which livestock are assembled may mean keeping a yard crew on the payroll for 5 or

6 days a week instead of one or two.

3. A significant educational effort is required to help potential buyers and sellers better understand how to trade via a teleauction and the reasons for doing so.