Before you approach any task, it's important to first have a general understanding of what it is you are trying to accomplish. You must know the objective, the rules and the desired outcome if you are going to succeed. The same is true for merchandising.

Gaining a clear understanding of merchandising involves an awareness of the grain business as a whole. You must have an understanding of the opportunities that merchandising offers and some general guidelines for what's to be accomplished.

The following provides a general overview of the grain business and the concepts involved in merchandising. The goal is to raise your level of understanding so that you're ready to move forward on the foundation with clarity, confidence and purpose.

**The Country Elevator's Place In The Grain Industry**

It's important to understand how your business fits into the industry in order to fully realize the opportunities you have. In general, the elevator is a collection point for grain in the country. It buys grain from farmers and then redistributes it throughout the year based on the market's needs. In this process, the elevator plays a vital role in bridging the gap between the time the farmer wants to sell and when the buyer wants to buy.

Being the "middleman" in this process puts the elevator in a unique position to provide valuable services to both buyer and seller.

- For the producer, it means valuable marketing alternatives that will enable him to sell at a profit.
- For the user, it means a steady supply of grain year round and the ability to lock in costs.
- For a larger grain company, it's a dependable source of grain in volume to meet its own obligations.

Unlike the traditional middleman, the elevator does not make a profit at the expense of his customers. Although the costs of physically handling the grain is typically factored into the price paid to the farmer, any additional profit margin is taken from the marketplace, not the elevator's customers.

This unique situation allows a grain merchandiser to provide fair prices to both buyers and sellers and still realize a good profit margin on grain that the elevator handles.

**A CLEAR UNDERSTANDING IS:** Recognizing that, in addition to storage and handling, the elevator plays a valuable part in the marketing and distribution of grain.

**The Role Of The Futures Market In Merchandising**

The futures market is vital to the grain industry and is the reason we have such open and accessible markets. It provides several important functions to the grain trade; most importantly, 1) the ability to manage risk, and 2) price discovery.
With the availability of the futures markets, businesses that buy and sell commodities can manage their risks by offsetting cash positions with futures contracts. This ability to manage price risk is what makes our markets so efficient. Just think what it would be like if businesses didn't have futures and had to manage the price risk themselves. They would have to charge the farmer more to cover their risk and limit their participation in the marketplace - this could greatly limit the ability to buy and sell grain on demand.

The price discovery feature of the futures market is also important because it gives us the ability to trade grain for various delivery periods. Without futures, farmers would have less opportunity to sell grain ahead when prices are high. Users would have less opportunity to lock in their costs when prices are low. Futures give businesses the ability to look ahead and plan their "future" needs.

Sometimes it's easy to forget how vital the futures market is to our industry because so much media attention is placed on the speculative aspects of the market - this is what draws a broad audience. Speculators do play an important role in the market, but it's important to remember that the futures market was developed for and its primary use is still for the commercial user.

The speculative input the futures market receives is good for the markets because it provides liquidity. If only commercial users were in the market, there would be wider gaps between the bids and offers. Speculators bridge this gap, thus making the market more cost efficient. Speculators are also the ones who assume the risk that commercial users don't want and provide capital into the market.

We're fortunate to have the ability to discover prices and see trades that are made for all delivery periods. However, in the price discovery process we must keep in mind that prices we see on the screen are, in fact, history. They are trades that have already been made and any new transactions may differ from the last. The futures industry has many safeguards in place to insure that all orders are treated equally and are executed at the best available market price.

**A CLEAR UNDERSTANDING IS:** Seeing how important and vital the futures market is to the grain industry.

**The Benefits Of Basis Over Price**

As Tom Gilliam said in his interview, "basis is the grain business!" It is the accepted method of trading within the industry.

"Basis" is the difference between the local cash price and the futures price, and it is how the industry determines the value of grain. It is this "difference" between the cash and futures that is merchandised. The reason the industry trades grain at a basis is that price is simply too volatile. Whereas, the basis on grain is more consistent and predictable.

Basis is predicable because there is a consistent cycle to the grain business. Harvest produces the supply once a year and demand dictates how it is used throughout the season. As the supply and demand for grain fluctuate throughout the year, so does the basis.

It is this "change" in the basis that provides the opportunity for merchandising. The objective is to buy low basis grain and hold it until a period of high basis (or vice versa). By hedging grain and taking "long" or "short" basis positions in the market, you are able to enhance the margins made on the grain over and above the typical back-to-back transaction.

**A CLEAR UNDERSTANDING IS:** Accepting the fact that "basis" is the way grain is traded.
Natural Forces

There is one important rule of merchandising, and that is to **adhere to the needs of the market**. Those who work to fulfill the wishes of the marketplace are rewarded with good margins. However, those who try to fight the natural force of the market usually find disappointment in merchandising.

It's not a difficult process to determine what the market wants. You simply need to turn to the futures market. The structure of the futures spreads is an indication of the long-term needs of the market. When supplies are in excess of demand, the market wants grain to be carried and is willing to pay to do so by building "carry" spreads into the futures. On the other hand, when demand is greater and the market wants grain, spreads "invert" as a way to encourage grain into the marketplace.

The structure of the futures is a roadmap that clearly indicates the long-term needs of the market. Look to it as a way to determine when you can carry grain and when you cannot.

**A CLEAR UNDERSTANDING IS:** Realizing the "market" will tell you what it needs.

The Opportunities Basis Creates In Your Business

The most important aspect of achieving a clear understanding is seeing the opportunities available for **your** business. By recognizing the direct benefits of merchandising, you will be more inclined to put forth the effort to learn the skills and establish the routine it takes to effectively manage the basis curve.

The greatest, and most obvious benefit of basis trading is the ability to generate better margins. By learning to identify and meet the needs of the market, you may have the potential to improve your "bottom line" significantly.

Basis and merchandising provides other opportunities as well. Mainly, the ability to provide valuable grain marketing alternatives to your customers, both buyers and sellers. Consider the possibilities you may have to attract new customers and increase market share simply by fulfilling your role in the industry.

Don't miss out on the opportunities that merchandising can provide your business just because you don't yet clearly see them. Merchandising opportunities are available to everyone in the grain business. "Basis" works for every (hedgeable) crop and in every location. There is no place where the market is "different" and the basis doesn't work. If you don't see the opportunities you just need to work harder to gain a clear understanding.

However, the understanding alone will not accomplish the job. Merchandising takes certain skills and disciplines to master. It may even mean the need to change old habits. Success in merchandising isn't something that happens without effort. It takes a commitment to continually improve your skills and the strength to put forth the work and effort to "build a strong foundation."

**A CLEAR UNDERSTANDING IS:** Knowing that merchandising provides such good opportunities for your business, you're willing to make the commitment to do it!