JOURNAL ARTICLE

Profit Margin Hedging

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Hyun Seok Kim, B. Wade Brorsen, Kim B. Anderson

American Journal of Agricultural Economics, Volume 92, Issue 3, April 2010, Pages 638–653, https://doi.org/10.1093/ajae/aap038

Published: 28 January 2010 **Article history** ▾

Abstract

Some extension economists and others recommend profit margin hedging as a way to choose the timing of crop sales. However, the theory behind this strategy recommendation is not well developed. This article determines the producer's utility function and price processes where profit margin hedging is optimal. Profit margin hedging is shown to be an optimal strategy under a highly restricted target utility function even in an efficient market. Profit margin hedging is profitable if prices are mean reverting.

JEL: C12 - Hypothesis Testing: General, C15 - Statistical Simulation Methods: General, Q12 - Micro Analysis of Farm Firms, Farm Households, and Farm Input Markets, Q13 - Agricultural Markets and Marketing; Cooperatives; Agribusiness, Q14 - Agricultural Finance

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