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# AGRIBUSINESS MANAGEMENT

## AGRIBUSINESS AND PHASE II

### PHASE II AND BEYOND

by Lester V. Manderscheid\*

"Price-wage freezes, labor walkouts from the pay board, and possible controls on raw food prices have dominated recent economic news. These are important issues and their resolution affects all managers. But let us step back from the day-to-day operating problems to view the larger picture. What are the lessons of recent months with respect to future policy?

"Generally, price-wage controls were directed at power concentrations in our society -- the large business firms and large unions. For a Republican administration to embark on this policy suggests that neither party will stand aloof when future wage-price decisions of major power blocs appear out of line with the national interest. The major questions involve the extent and nature of legal control and relative "bias" of the political decision process.

"The danger is that we focus on price-wage controls and ignore the many other changes in national economic policy that are now on the horizon. What are some of those changes? One is a renewed emphasis on productivity. Appointment of the Productivity Commission, studies of the feasibility of conversion to the metric system, and increasing research and development funds in the federal budget are signs of concern for increasing

productivity. The root causes for this concern are found in the severe international balance-of-payments difficulty and in the realization that only increased productivity can justify increased wages.

"Another area likely to receive attention is tax reform. Recent court rulings regarding the legality of property tax for financing schools, added to Congressional discussions, suggest a situation ripe for significant change. Tax law changes now appear directed toward closing "loopholes" in the income tax and a greater emphasis on income and sales (including Value Added) taxes with less emphasis on property taxes. Revenue sharing and related techniques will increase reliance on state and federal revenue systems and reduce the locational advantage related to low property taxes.

"Politically, the emphasis will be on greater "equality" of treatment with respect to location and type of income. But, remember that "loophole" to one person is "fairness" in the eyes of another -- thus the political battles may be extended.

"Consistent with these changes is the probability of increased attention to income distribution questions. Managers should recognize the implications for increased demand for goods sold to lower income groups and some offsetting demand changes among higher income groups -- especially those hit hardest by tax law changes.

"Thus, managers must be alert to change -- there will be new rules that affect your decisions. Some will improve your profits, others will not. The successful manager will

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\* Professor of Agricultural Economics, Michigan State University, reprinted with permission from "Managing for Profit," Vol. 11, No. 3, July 1972, Michigan State University, Lansing, Michigan.

not only adapt to the new rules, he will participate in the process of developing rules so that the rules are consistent with both efficient business and achievement of societal goals."

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It's highly possible that some day in the future agribusiness managers will look back on Phase II with the same respectful nostalgia they now reserve for the rationing system and "meatless Tuesdays" of World War II. Right now, however, Phase II is no laughing matter and many managers are confused, disillusioned, and downright fearful about the impact it may have on their firm's operations.

The fear and confusion are understandable. This second portion of President Nixon's major economic stabilization program began in August 1971, and is in many regards far more difficult to comply with than the hard price and wage freeze which preceded it. These compliance difficulties, particularly those confronted by many agribusiness retailers, arise from two major areas of uncertainty.

### **UNCERTAINTIES**

First of all, Phase II is of indeterminate length. Many firms' long-range plans and management strategies have been dumped or postponed indefinitely as a result of this uncertainty. Other firms refuse to formulate plans or strategies until the impact of the economic constraints have been more clearly identified. Regardless, a wait-and-see attitude has developed within an industry, which can hardly afford the luxury of procrastination.

Current legislation extends the President's control authority through April 30, 1973. Yet economists and government officials are mostly undecided and often in disagreement as to how long the controls will be required. Some feel that by April 1973, the entire control mechanism can be dismantled — it having, by then, served the

purposes intended. Others feel this period of price and wage constraints will only bring about the desired results if they are enforced for a period of no less than ten years. Politics will, no doubt, play a decisive role, and the fall elections could cast a whole new light on the situation.

A second major area of uncertainty revolves around the fact that the once-frozen prices and wages have now been replaced by a set of so-called "economic guidelines" that are professed to allow for flexibility and customized decision. So what are the guidelines and how well are they working? In the words of one retail executive, "...trying to report on the wage and price guidelines is akin to a newspaper reporter trying to write a wrap-up report on a basketball game still in progress. It's a game where not only the score but even the rules are changing before our very eyes."

### **A COMMON DENOMINATOR**

To secure an understanding of Phase II policies and their likely impact on your firm's operations and policies, you must first search through all the regulations for a common denominator. At least as of this writing, there exists only one control that is common to all kinds of businesses. This common control states that there exists a freeze on pretax profit percentages at a point no higher than that earned by a company during any two of its last three years.

Yet for the agribusiness retailer, a second important step in understanding Phase II requires an elimination of a common misconception. This misconception concerns the belief that Phase II controls for manufacturers, wholesalers, and retailers are all alike. In fact they are not alike. More specifically, under Phase II, manufactures' prices and margins and profits are controlled, while only wholesalers' and retailers' margins and profits are controlled. This difference may appear slight, but in reality, it is responsible

for the bulk of management confusion and unfavorable customer reaction. For example, once a retailer has complied with regulations according to his company classification, he may proceed to charge any price for his merchandise that competition will allow, so long as his markups or margins do not exceed those he realized during the pre-freeze base period. In other words, you, as a retailer, may pass along to your customers increases in the cost of the merchandise you sell, but you may not pass along to your customers any cost increases that you yourself control.

### **REPORTING MARGINS**

For the agribusiness retailer, reporting margins during the pre-freeze period, or so-called base period, becomes a most crucial exercise. The manager has a choice of three alternative reporting systems. First, margins may be reported on an item-by-item basis. Too many retailers (e.g., farm supply and equipment dealers), this system generally proves to be too complex and too rigid. In fact, for the retailer handling as many as 2,000 different farm supply items, this system would require that a whole battery of accountants be employed for reporting purposes.

Margins may also be reported on a department-by-department basis. Or, all retail outlets within a product-oriented division, or each outlet of a multiple outlet firm may be treated as a one margin-reporting category. These options also create some difficulties for those retail firms where departmental cost and sales figures have not been separately classified, or for those multiple-outlet firms where market conditions vary noticeably between regions.

Finally, management may elect to report a single corporate profit margin figure. Most firms appear to pursue this option because it seems to allow for more flexibility; i.e., margins on single items, margins on entire product lines, or margins of one (of multiple) retail outlets may be adjusted at will as long as the profit margin remains

constant (or decreases) on a corporate basis.

It does not matter to the Price Commission which of the reporting options is chosen. What is important is that the firm follow "normal business practice" and that the composite margin for each item, product line, outlet, division, or company remains the same as or lower than it was during the base period.

### **WHO REPORTS**

Those firms in the "pre-notification" category (\$100 million or more in annual sales) must break out and describe their categories and margins before they can adjust their prices and report monthly variations thereafter. Firms in the \$50-100 million annual sales bracket may adjust prices at any time, but must report categories and margins within 30 days after the end of their first fiscal year quarter following November 15, 1971. Firms with smaller annual sales volume, which include many agribusiness firms, need not report at all, but must keep data in their files to prove they are maintaining their margins according to regulation.

### **FURTHER CONFUSION**

The lack of customer understanding of the price -- but not margin -- flexibility retailers have under Phase II has contributed greatly to adverse customer reactions. The average customer fails to realize that single-item price increases are perfectly legal so long as total firm margins are not affected. The seasonality of the agribusiness industry aggravates this customer confusion because natural seasonal price increases are misconstrued as being in violation of Phase II constraints. Unfortunately, few retailers have bothered to explain to their buying publics the conditions under which item price increases can be in full accord with the so-called guidelines.

## THE DOUBLE STANDARD

The double standard of the Phase II wage and price controls is probably the single most critical problem for agribusiness retailers. It is hoped that price inflation will be held to around 3 percent per year. Yet wages will be allowed to inflate at about 5.5 percent per year. The difference, of course, if not recovered in the form of greater labor productivity, is going to chip away at existing net profits and is bound to trigger operational changes designed to soften the blow.

A harder look will be taken at personnel requirements within the industry. Every attempt will be made to obtain maximum productivity per man-hour. To compound problems, many retailers must now honor freeze-suspended labor contracts exclusive of the 5.5 percent guideline. Recent Pay Board actions have been vague and subject to unexplained reversals. Tandem relationships, or "me-too" contracts, settlements to relieve interplant or intra-plant wage inequities, and contract involving new work rules or additional employee benefit plans have all been excepted from the 5.5 percent ceiling.

## SUMMARY

As my colleague, Les Manderscheid, notes in his introductory remarks, many of the component aspects of Phase II have dominated recent economic news. The news items themselves are confusing and, to a degree, disappointing. Yet the agribusiness manager runs the danger of focusing too much attention on wage-price control specifics, while ignoring many other changes in national economic policy that may also affect their businesses. Phase II and all its specific components will not conveniently disappear. All or parts of the Nixon economic program could be with us for many years. Attempt to develop an understanding of Phase II among your staff, employees, and your customers. But don't fail to look ahead to those other major economic issues, which could have

an impact on your firm's operations in the decade of the 1980's.

## PARLEZ-VOUS PHASE II?

**Allowable cost** — Any cost, direct or indirect, unless disallowed by the Price Commission.

**Base period** — Any two of a company's last three fiscal years ending before August 15, 1971. The years may be chosen at the discretion of the company. For purposes of computing a profit margin during a base period, a weighted average of the company's profits during the two years chosen will be used.

**Base price** — Or "ceiling" price — highest price permitted in the Phase I period beginning August 16, 1971, and ending November 13, 1971. Highest price is normally the highest price at which at least 10 percent of the units were sold to any class of purchasers.

**Base price lists** — A listing of base prices on all controlled products: in nonfoods, a listing of the 40 highest dollar-volume items, or those items doing 50 percent or more of total nonfoods sales, whichever is less. A sign must also be displayed informing customers of the availability of base prices on all items not posted, plus the availability of such information request forms. Lists cannot be maintained in the manager's office; they must be available for easy perusal. This applies only to retailers doing over \$200,000 a year.

**Customary initial percentage markup** — Markup normally applied when item is first offered for sale (should be item's highest markup), according to company's normal pricing practice. This can be the last markup prior to November 14, or an average during the last company fiscal year ended before August 14, 1971.

**Customary price differential** — Price difference based on a discount, allowance, add-on, premium; or an extra based on

difference in volume, grade, quality, term of condition of sale or delivery.

**Freeze base period** — July 16, 1971, through August 14, 1971. For an operation with no transactions of a given product during that period, the base period becomes the nearest such 30-day period when transactions did occur.

**Non-reporting firms** — Manufacturers, wholesalers, and retailers with less than \$50 million in sales. No reporting is necessary, but standards must be followed and these companies are subject to spot checks and complaint investigations.

**Pre-notification firms** — Manufacturers, wholesalers, or retailers doing over \$100 million a year in sales in their last fiscal year. These companies must pre-notify the Price Commission on proposed price increases (or initial markup figures in the case of retailers).

**Reporting firms** — Manufacturers, wholesalers, or retailers doing between \$50 and \$100 million a year in sales. These companies may make price changes in accordance with guidelines published, but must report all changes in prices, costs, and profits to the Price Commission on a quarterly basis.

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## Phase II Price Controls—A Basic Guide to Retailers

