



A FUNDAMENTAL REVIEW OF AGRICULTURAL MARKETING

What is the role, function, and intent of agricultural marketing? Most farmers would be ill-prepared to answer this question. They remain in awe of the entire process and express confusion, or even contempt, when the topic of marketing emerges. Earlier in our history, the role of marketing focused on the act of market clearing, the function revolved around the physical transfer of the product, and the intent was one of value trading between producer and consumer. Within this simple context, the farmer viewed marketing as the sale of his cattle at an auction or the delivery of his produce to a buyer. Over time, the marketing system grew more complex as market intermediaries expanded their roles or as consumers demanded that more value-added services be added to food products. An even more complex component was added as various public institutions (marketing boards, government agencies, commodity commissions) intervened in the food chain between the farmer-producer and the consumer. Little wonder, therefore, that many American farmers now view the agricultural marketing system as a vast wasteland of conflicting interests. Even worse, this institutional intervention in the food chain was, by intent, designed to insulate agricultural producers from the impacts of free market forces. Insofar as government subsidies now comprise a significant part of farmers' incomes, farmers have gradually been lulled into a state of complacency regarding the all-important role of converting raw agricultural products into consumer products. Also, some farmers now view marketing as someone else's affair, while their responsibility ends with the

primary production of a high-quality meat, grain, dairy, poultry, or horticultural product. In brief, as marketing forces have grown more important and complex, agricultural producers have developed an ever-more myopic view of the process. As noted earlier, institutional intervention is much to blame for this outcome. Yet in the absence of this public intervention and its subsidies, it can be argued that our agricultural economy would, today, be in a very chaotic state. The question that obviously arises is whether or not public intervention, of the magnitude currently sustained, will continue to impact the future of our agricultural markets. I'm convinced the answer is "no" and that as such intervention is slowly removed, farmers will return to a period of direct confrontation with the realities and importance of marketing. This gradual disappearance of market intervention is predicted for the following reasons:

1. It now appears that governments, at almost every level, have higher priorities for their limited funds. Even if government agencies were inclined to directly or indirectly support farm prices at current levels, budgetary constraints and the commodity surplus situation would seem to prevent this. Agriculture must compete with a vast array of other public and social programs for limited public revenues. Agriculture will gain no exemption from governmental efforts to restore control over expanding budgetary deficits.
2. The political base for American agricultural interests continues to erode. As the emphasis has shifted to a cheap food policy and away from a subsidized agricultural economy, legislative support

for farm programs is more difficult to assemble.

3. There is a growing awareness among agricultural producers that they alone retain a vital interest in their long-range future. It was once thought that the agribusiness industry, in its broadest context, would serve as an ex officio guardian of the farmers' interests. The fortunes of farmers and marketplace middlemen were once judged to be mutually interdependent. Now, at critical phases in the marketing process, this is no longer so evident. Middlemen were once considered to be the "heavyweights," but as our production economy continues to restructure itself, it will soon be found that farmers, not middlemen, have the greater dollar investments per unit of output.
4. Droughts in Ethiopia and elsewhere notwithstanding, our world is shifting from a food deficit to a food surplus mode. Developed economies, in particular, are no longer finding easy markets for their products abroad. Domestically, our surpluses of grains, tobacco, dairy products, and other foodstuffs have reached a burdensome level. There exists little logic and even less political support for maintaining commodity prices or supports when surpluses exist. Finally, international exchange rates and rising dollar values counteract America's attempt to sell surplus products abroad.

Marketing Expectations

As noted earlier, marketing is a complex process, not well understood or appreciated by many producers. Beginning with a textbook definition, the purpose of marketing is to "meet consumer requirements with products in various forms desired by consumers, at times they desire them, with a dependable, continuous supply, at prices consumers are willing to pay and at which producers are willing to produce." Obviously, this definition suggests a rather high level of

marketing expectations. While farmers think they produce a commodity for the purpose of earning a profit, in reality this will likely be achieved only after the complex marketing expectations have been achieved. Despite aggressive positions taken by some middlemen, the consumer retains the dominant edge in the market. Profits cannot be long sustained in an environment where consumer needs are not being met.

Market Clearing Price Expectation

As defined above, the marketing process must achieve a price where the amount of a commodity farmers are willing to produce is just equal to the amount consumers are willing to buy. In a free market, supply and demand adjust to that point where an equilibrium price is established and all product successfully clears the marketplace. In theory, this adjustment process is easy to describe, but at times when market functions do not work smoothly and public intervention persists over extended periods of time, producer perceptions and expectations transcend true market forces and troublesome imbalances emerge.

Price Discovery Expectation

A market that functions well will provide farmers with signals or instructions on what to produce and when. Persistent low prices serve as a red light to halt future production. High prices become the green light signaling farmers to accelerate production. When these price signals include subsidies and/or supports, a distortion results and signals become mixed. Because many farmers are ill-prepared to make major short-run changes in their production decisions, any distortion in this price-discovery process results in major misallocations of resources.

Equity Expectations.

A market that functions smoothly will provide for the equitable treatment of its participants. Equity in marketing is a difficult concept, but it generally means that market participants will share in the returns proportionate to their individual contributions, that terms of trade are based on equality, and that farmers,

middlemen, and consumers have equal access to a net transaction gain. Once again, theory provides a simple proposition; i.e., no single participant in the market has the ability to exploit the position of another, but the real world is rarely so benevolent and farmers (as opposed to middlemen and consumers) tend to lag more often in attainment of equity in the marketing process. The reasons for their relative mistreatment are clear. Contrary to the theoretical basis, farmers have few alternative outlets available for selling their product. Indeed, for some specialty crops, the producer may discover that no alternatives exist and that "direct" marketing (farmer to consumer) is, thereby, required. Further, farmers too often have the least amount of market information available to them. As markets function, and signals are thereby generated, those receiving the signals first may hold a competitive edge. As farmers operate at the end of the communications network, their information may be late or filtered. Agricultural production is also very atomistic in nature. Each individual farmer's output is so small a part of the buyer's volume that withholding product from the market has little if any impact on price levels. Being large entities and being located closer to the point of final consumption, processors/middlemen are in a better position to influence the market system. While middleman influence was once very substantial, the growth of large retail food chains has neutralized this trend by placing generic and private-label foods in the same competitive arena with brand-name products. Retailers, of course, control shelf space and with modern checkout technology, store management can monitor sales and product turnover quite precisely. Eye-level shelf space adjustments and sharply improved inventory practices now provide retailers with profit-control mechanisms never before dreamed of. Conversely, farmers remained somewhat tied to production practices; i.e., once the crop is planted, the farmer has little choice but to continue through the harvest stage, regardless of what market signals may suggest to the contrary.

The Stomach-Line Constraint

In my work with agricultural commodity groups of all kinds, I'm often impressed with the marketing acumen of those persons responsible for establishing marketing and product promotional strategies. Their sense of small market adjustments is acute and their data are reasonably accurate. As agricultural production levels increase, commodity marketers shift into high gear as they search for every possible means of expanding the market's ability to absorb these growing supplies. But the underlying weakness in this process is that in a developed nation such as ours, the total demand for food is largely affected by population growth. While consumers show a desire to shift their purchases among food products, the total amount of food consumed is quite constant. This "stomach-line constraint" suggests that to expand consumption of one product, another must be displaced. While food consumption patterns continue to change (e.g., less milk and red meat is being consumed), there are some limits. For example, this year's "Alberta Clipper" may have seriously altered the nation's supply of Florida orange juice. Will this result in a sharp increase in the amount of apple juice consumed? Probably not, as there are some physiological limits to the volume of any juice that a person will consume.

Likewise, let's not forget that not all commodities meet a similar price responsiveness in the marketplace. The concept of "price elasticity" (the measure of consumers' responsiveness to relative price changes) reflects consumers' ability or willingness to substitute among products or do without. Many farm products face a very inelastic demand. A small increase in supply leads to a large decrease in price, other things remaining unchanged. As a result of normal variations in seasonal production, and a fairly level annual demand, relatively large year-to-year price fluctuations will occur at the farm level. Instability of farm incomes thereby results.

Improved Marketing Strategies

Production contracts, price supports, and subsidies emerged as vehicles for buffering the wild variations in annual farm income. As short-run aids, they are an effective means for tempering such variations, particularly those that result from unusual or non-recurring events. Such programs and most other forms of public intervention have never proven effective over the long run, as their impact on the market over longer periods results in rigidities in supplies, a misallocation of resources, and may serve to isolate producers from changing consumer preferences, i.e., the market signals received by producers are distorted. When payments are received from government, the government is soon perceived to be "the market." Therefore, the customer is not really the consumer of the items produced. If farmers are going to improve their marketing performance, they must confront the ultimate consumer and become reeducated regarding consumer needs and preferences. Nearly a quarter of a century has passed since American farmers last received undistorted signals from their major commodity markets. During that period, the consumer unit has changed dramatically.

For example, the average size of American households has grown much smaller. Smaller families purchase in smaller quantities, thereby expanding the packaging requirements for food products. Second, consumers are doing much less physical labor now than was true 25 years ago. The current exercise craze notwithstanding, required food intake quantities are reduced. Indeed, the types of food demanded now are much less characterized by a high content of sugar and carbohydrates. Next, we must realize that American families have more leisure time. This active pursuit of leisure may cause families to eat together less frequently. As more women are employed outside the home, fewer meals are prepared "from scratch." Modern communications, the exercise craze, the rise of "nouvelle cuisine," the aging of American society, and a rising

level of health consciousness can all be shown to impact current patterns of food consumption, both in content and location. If government programs are removed from the market, albeit slowly, farmers must reawaken to a new world of consumption preferences. As clear signals are once again received, they must be in a position to respond.

If American producers fail to respond, the void will rapidly be filled by products imported from other countries. If you have doubts about this, take another look at the products displayed at your local deli or the fruit and vegetable section of your food store.

Another strategy for improving marketing performance in the United States is the use of production contracts. They are called production contracts because they are agreed to prior to the farmers' initiation of the production phase. Contracts, when used as a component in total marketing strategy, provide several basic benefits. First of all, risks are reduced. Assuming the terms of the contract specify price, the production phase is initiated within an environment where marketing is no longer an uncertainty. Insofar as operating capital is required to support production, external financing is easier to obtain when the lender is provided with a sound basis upon which to judge a farmer's repayment capacity. Uncertainty for the processor/middleman is also reduced with reasonable assurances regarding source, quantity, and quality of product. The processor may then have the basis to advance contract for future delivery to customers. Finally, contracts form the basis for regulating the physical flow of product through marketing channels. The more extensively such contracts are used, the greater the prospects that surpluses will not emerge.

The use of futures contracts comprises yet another marketing strategy. Since production contracts are rarely used for wheat, corn, or other cereal grains, the use of the futures market becomes a reasonable alternative. Without considering the speculative

component, farmers may use futures transactions to lock in a guaranteed price for a product to be delivered at a future date. While such futures contracts are rarely allowed to mature, the subsequent offsetting transaction does reduce the farmer's exposure to volatile post-harvest price fluctuations.

Yet another marketing strategy attractive to some producers of specialized crops is vertical integration; i.e., the linking together of successive stages in the food chain to gain control over access to markets. Contrary to popular opinion, vertical integration need not be undertaken on a grand scale or at great expense. Orchardists, for example, usually produce primarily for a large-scale processor or packer. Yet an orchardist may also establish a roadside stand for direct sale to consumers. While this operation may be small and seasonal, it does provide a direct marketing alternative that insulates the producer from volatile prices in the larger market.

The concept of joint ventures is often mentioned as a final marketing strategy. Joint ventures occur when producers and/or companies decide they can more effectively achieve profit or market objectives by joining forces. In its most basic form, a marketing cooperative is a producer-owned and operated joint venture. Other joint ventures may involve a group of livestock producers agreeing to construct and operate a feed mill for their mutual benefit. Or it may be two or more processors/middlemen working together to establish an export trading company. As would be expected, all such partnerships imply a reduced level of autonomy in decision making by each participant. Marketing decisions now reflect mutual agreements wherein all parties are impacted. As a tradeoff to this reduced autonomy, producers seek added marketing advantages where costs are reduced, new markets penetrated, and/or risks are shared.

Summary

A rapid reading of agricultural trade literature would suggest that changes are pending in our agricultural marketing system. Public (government) intervention in the marketplace, in its many diverse forms, will diminish and perhaps even disappear in some select markets. As this occurs, the market will once again function more freely, with clear signals being directed to producers, middlemen, and agribusiness firms. In particular, producers will become less insulated from the impacts of changing consumer tastes and preferences. New marketing strategies will emerge as producers respond to market signals and seek equitable treatment in the market. The basic concepts of marketing will become more evident and farmers must grow more familiar with the process and their roles/opportunities. If our agricultural economy is to remain viable, it must adjust rapidly to those changes resulting from a gradual departure of the "public" from its markets.

Sincerely,



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