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Contracting in Fresh Produce: Wave of the Future?

by

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Perosio, Debra J., Edward W. Mclaughlin, Sandra Cuellar, and Kristen Park. 2001.
Supply Chain Management in the Produce Industry. Produce Marketing Association,
Newark, DE. October 2001.

The data gathered from this year's *FreshTrack 2001* retail respondents corroborate a trend established in virtually all of the previous *FreshTrack* studies: buyers and sellers of fresh produce are departing from traditional practices of transacting sales through daily spot sales in favor of engaging in a wide range of contractual agreements. Of course, this is not happening overnight, but the evidence collected in this year's study demonstrates that it is happening relatively quickly for a number of reasons.

Opportunistic buying and selling of merchandise, where one or the other party finds itself facing unusually unfavorable short-term conditions, is not part of the long-term mission and operating strategy of the ever larger, sometimes multinational, companies now part of the community of produce buyers and sellers. Indeed, many of these large companies are now playing a channel-dominant role. These companies have been more aggressive in adopting supply-chain management practices where the objective is year-end, not

weekend, results. Their interest is net returns, not gross returns. What's more, in recent years, the produce industry has experienced more "long" than "short" situations. Such a condition generally shifts the advantage of contracting to the buying side of the market, once again providing retail buyers additional motivation over the past several years to increase their contracting.

Despite a number of considerable disadvantages, in general, today's buyers and sellers alike appear to be won over by the greater price certainty that contracting makes possible. It facilitates their ad planning, sales, planting, harvesting, and packing decisions. Moreover, it ensures sellers an outlet for at least a portion of their produce and it ensures buyers a source of produce, particularly in difficult supply conditions.

However, high degrees of product perishability, weather uncertainty and resulting price volatility, and structural differences between and among produce buyers and sellers create significant challenges to the design of the produce contract. Contract characteristics range widely from those that are concerned only with quantities and product specifications to those that focus more narrowly on price. Additionally, a growing number of contracts today specify various fees and services that one or the other participant will perform.

A contract developed during the 2001 marketing season prominently cites prices to be paid as well as packaging specifications, quarterly and annual volume targets and, importantly, rebates and promotion. Advertising schedules are laid out, including so-called BOGO ("buy-one get-one" free) allowances. Finally, it should be noted that natural disasters, crop failures, and "acts of God" clauses are now being routinely included in fresh produce contracts to protect buyers and especially sellers.

"Smart Marketing" is a monthly marketing newsletter for extension publication in local newsletters and for placement in local media. It reviews the elements critical to successful marketing in the food and agricultural industry. Articles are written by faculty members in the Department of Applied Economics and Management at Cornell University.

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