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SMART
Marketing

A Compilation of *Smart Marketing* Articles
November 1999 - September 2001

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"*Smart Marketing*" is a monthly marketing newsletter developed 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. This series is coordinated by Wen-fei Uva and Brian Henehan, and articles are written by the faculty members in the Department of Applied Economics and Management at Cornell University.

Special appreciation is expressed to colleagues in the Department of Applied Economics and Management at Cornell University for contributing articles to the series. All *Smart Marketing* articles can be found at *http://aem.cornell.edu/special_programs/hortmgt/index.htm*, including past articles from February 1988 through January 1994.

November 1999

What is Marketing?*

Max E. Brunk
Professor of Marketing

This piece is the first in a new series of "Smart Marketing" articles published by faculty in the Department of Agricultural, Resource, and Managerial Economics at Cornell University. We want to commemorate the contribution that Professor Max Brunk made towards a better understanding of marketing food and agricultural products. When Max passed away this year, we lost an exceptional teacher who taught a lot of us about what marketing is.

Many of our most outstanding farm leaders hold to a philosophy of marketing expressed in the early writings of Plato, who describes marketers in this way: "Their business is to remain on the spot in the market, and give money for goods to those who want to sell, and goods for money to those who want to buy ... these in well-regulated states are, generally speaking, persons of excessive physical weakness, who are of no use in other kinds of labor." Plato, the strict materialist, visualized marketing as little more than a necessary evil — as nothing more than the process of negotiating exchange. In marketing he saw no value added and, consequently, no basis for profit. Selling and marketing were synonymous, and so it remains in much of our thinking today.

The views of Aristotle are also revealing. They can be heard at almost any meeting of farmers because he regarded marketers as "useless profiteering parasites" and he condemned marketing as "unnatural, mercenary, exploitative and corrupting." It would seem that we still have among us many disciples of the Greek philosophers, many who, in their drive to increase production, have not had the urge to learn what marketing is all about or what it can do for them.

Contrary to popular opinion among farmers, markets are not a right. No one individual, no one industry, owns a franchise on the market. You have to work and scheme and sweat to produce the raw products of agriculture, but that does not give you the right to a market. To get that right you also have to work and scheme and sweat to create markets, to take markets away from someone else, to keep someone else from taking your market.

This has been true in the past and it will continue to be true. The size and strength of your market is nothing more and nothing less than what you choose to make it.

Success in this respect depends on your ability to anticipate the wants of buyers, packers, processors and consumers for both product and services — to anticipate your competitors' actions and to play the game within the rules prescribed by government.

Accordingly, we must understand that marketing is the creation of utility, the creation of both product and service values. Marketing and selling are not synonymous. To sell means to get rid of — to transfer ownership. Anybody can do that.

On the other hand, to market means to create value — to perform a service for which someone is willing to pay — to perform a service on which a profit can be made. When we regard marketing as only a selling function, we forego the profit opportunities marketing offers. Marketing *is*, and always should be, a production function.

Marketing calls on the highest of creative skills. Food marketing is but the simple process of adding some value to some raw material. Consumers use few foods as found in their natural state. The job of the marketer is to add effective consumer appeals to raw commodities so they are competitively attractive in the marketplace.

Far too many in our society have accepted the false doctrine that marketing is only a cost. Very much to our disadvantage, we have come to believe that the increased expenditures for producing marketing services are borne, unjustifiably, by producers of farm commodities and/or by the ultimate consumer. Based on this belief we have assumed that reducing marketing costs will, *per se*, benefit either producers or consumers. This is spurious economic doctrine that totally fails to distinguish between the costs incurred and the values added.

The difference we are seeking here is the contrast of expenditure with the values created. Costs are involved in both production and marketing. If the values produced are greater than the costs, in either case, the costs have been appropriately justified. And who does, who should, evaluate the ratio of the one to the other?

People want and can eat just so much food. When this basic need is met they begin to search for better qualities and more services — marketing services. And it is well to remember that those marketing services called trivia today will tomorrow be the necessities of a population having a standard of living far surpassing that which we now enjoy. If indeed marketing is a cost, then we can only reach one conclusion. Marketing does not cost enough!

We need also recognize that much of the value of any product lies not in the product itself but rather in the invisible bundle of services wrapped around it. Those who perform such services are creators of an economic good every bit as much as those who produce a physical product.

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* Extracted from Brunk, M. E., "What is Marketing," *American Cooperation 1983*. American Institute of Cooperation, Washington, DC.

December 1999

Travel the Road to Success with a Marketing Plan

Wen-fei L. Uva
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Successful marketing requires planning. Marketing involves more than the product you are selling. Developing a sound marketing plan that works for you is the first step to improving profitability. A marketing plan serves as a road map. It establishes objectives, assigns responsibilities, and recommends actions for achieving goals. A marketing plan requires the individual to think through the process of how a product/service will be sold. It minimizes the emotion and guesswork when making a marketing decision.

The following outlines the steps in developing a marketing plan:

I. Situation Analysis – gather market information

Explore who the consumers are. It is important to take a moment and determine who the consumers are and their needs and wants. A good start is to identify the geographic area you wish to serve and analyze consumer demographics, their lifestyles, income, and expected changes in the future.

Research the industry and the environment. It is wise to collect as much information as possible about the industry you are in as well as relevant elements in the competitive environment, including government policies and regulations, technological changes, effect of globalization, social and cultural behavior, and industry trends.

Assess your strengths and weaknesses. A self-analysis will help you develop strategies which take advantage of the firm's strengths and opportunities –- neutralizing weaknesses and avoiding threats.

Investigate the competition (current and potential). Important information about the competition includes who they are, their location, their products and services, their price range, their reputation, their promotional activities, and what they do better than you can. You can develop your competitive edge based on this information.

Develop product or service ideas. Your product or service ideas should be developed based on the information from the consumer and industry research. You should be able to answer the following questions: What are your products and services?, What are the benefits of your products?, and What makes them different from your competitors' products and services?

Determine the target market. A target market is not just who is buying, or will buy your products, but a market segment which you identified as the most desirable and profitable. A firm can compete more effectively in a limited number of market segments. Criteria useful to segmenting a market include demographic, geographic, psychographic, consumer behavior, and business markets information.

Test the market potential. This refers to estimating the expected sales of a product/service for the market over a specific time period. A starting point for an existing firm can be based on recent history. One way to test a new product/service is to conduct simple-test market research, i.e. offer a free trial period to a small focus group and collect their honest opinions.

II. Determine your marketing objectives.

Objectives are measurable, quantifiable, and realistic statements of what you expect to accomplish. For example, specific objectives for the next two years might be to increase sales by 15%, increase net profit by 15%, or increase your market share by 15%.

III. Select the marketing strategies.

Marketing strategies are about how you expect to accomplish your objectives. Strategies can include product differentiation, market segmentation, new product introduction, diversification, business positioning, and any number of alternatives.

IV. Implementation.

This is to determine *who* is responsible, *what* tasks they are responsible for, and *when* the tasks are to be completed. Tactical actions are designed to implement the strategies and meet the objectives. They can be grouped as product/service, price, promotion, distribution, and people.

Products are more than the physical item that a buyer purchases. All agricultural products can have services added to them. Services can include packing, grading, storing, inventory management. **Prices** are determined by market conditions and competition. While the price received for an agricultural product often depends on the distribution channel through which the product is sold, marketing texts admonish us not to "lack courage in pricing!" **Promotion** includes a variety of advertising, public relations, and sales promotion activities. To maximize the effect of your promotion, select your media and activities based on your target market. **Distribution** includes product delivery systems, hours of operation, and number of locations. A company wants a distribution channel that meets customers' needs as well as provides an edge on competition. **People** are perhaps the most important part of a marketing plan. A marketing plan eventually becomes a schedule of activities, and responsibilities are assigned to individuals who must get the job done.

V. Monitor, evaluate, and modify the plan.

This is the control phase of a marketing plan. It requires setting up performance standards to monitor the progress made toward achieving the objectives. Four key control areas are monitoring sales, costs, net margin, and customer satisfaction. The plan might have to be modified according to the evaluation results. It is important to note that a good plan must be flexible.

Marketing plans can be developed to answer questions, such as whether a specialty crop should be added to the product mix of an operation; or plans can be used to consider more complex questions, such as entrance into a new market. Develop a marketing plan tailored to your needs, and you are ready to travel the road to success.

Reference

White, G. B. and Uva, W. L. 2000. *Developing a Strategic Marketing Plan for Horticultural Firms*. E.B. 2000-01, Dept. of Agricultural, Resource, and Managerial Economics, Cornell University, Ithaca, New York. *http://www.cals.cornell.edu/dept/arme/hortmgt/pubs/eb2000-01.PDF*.

Knowing Your Market – The Most Challenging Part of a Business Plan

Charles Schlough
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"Can you tell me how to find customers for my products?" and "How much can I expect them to buy?" are probably the most troubling business questions that agriculture extension educators hear from small farm operators. Lack of experience and techniques and uncertainty about selecting effective strategies make a mystery of projecting sales revenues. The uncertainties inevitably translate to the level of confidence given to projected bottom line outcomes.

Projecting sales revenue for a new or expanded enterprise can be the most challenging and sometimes speculative part of a business plan. Of all the numbers it contains, "projected sales" is likely to be the least precise number in the absence of historical experience or careful market research and planning. Since the best answer derives as much from art and luck as from science, precision is not possible. Getting as close as reasonable to a consensus level of comfort is about as good as it gets.

The amount of market research needed increases with the complexity of the enterprise and the number of customers needed to reach sales goals. If you're just loading trailers and tankers at the farm gate for shipment to one or a few customers, market research doesn't really matter. But as a farm-based business expands or diversifies, the number of customers, the number of products, and the complexity of processing or other added-value activities make market knowledge and business planning essential.

For many small farm businesses, writing a business plan doesn't happen unless a prospective lender requires one. When submitting a business plan for a loan, a prospective lender is not the most important person to be persuaded that confidence is warranted. Remember that the lender is going to rely upon <u>you</u> to repay the loan. So ultimate confidence must rest with you and the homework you do. Get as comfortable as possible with the numbers you reasonably expect (not hope) to achieve. If not, you may be sadly facing far greater discomfort if you cannot repay the loan. Look for weaknesses in your assumptions. Which ones leave you a bit uneasy? Those are the ones that need further attention.

Confidence about revenue projections relies on several underlying decisions and activities. How reliable are your production capacity and plans? Can you grow and process enough product at an acceptable level of quality in a timely manner to generate the revenues you project? Will you have adequate access and distribution to your projected customers? Whether you are marketing directly or indirectly, without access and delivery channels to your projected buyers, production capacity may be over invested and sales projections too high.

In addition to production, marketing, and distribution, the overall business plan should consider how you manage natural and physical resources that support planned production levels. There will be constraints of terrain, soil, water, nutrients and by-products that will impact labor and equipment requirements, sustainability, environmental, and regulatory concerns.

The level of confidence you create in the projected sales figures should be foremost in your mind and in the plan document whether preparing a business plan for yourself, a lender, partner, or investor. Higher levels of confidence will depend upon good market knowledge and planning based on <u>justifiable</u> and convincing assumptions about sales. The best way to do that is to undertake and demonstrate good homework.

Gaining Knowledge of the Market. An important part of making reliable sales projections is to reasonably estimate the size, location and purchase criteria of the customers you intend to attract. How do you do that?

It all starts with asking questions. Either you do primary research -- going directly to the prospective customers -- or get secondary research, like census and demographic data. Secondary data are more difficult to gather and analyze without training or paying for expensive professional time. Furthermore, market research data are not available for very small market areas or specialized products or niches. But the larger the geographic reach or volume of business you expect to achieve, the more important and affordable this approach becomes.

For farm-based direct marketing to consumers, the process is much less refined, less difficult, and more interesting. Here are some good sources of information to learn about your prospective market:

- Cooperative Extension educators who specialize in your product area;
- Specialized publications and newsletters;
- The internet holds a vast amount of information;
- Libraries – local public libraries and specialized land grant university libraries;
- Associations that specialize in the product area of your interest;
- Ask your prospective customers what they want, what they are not finding among current choices. Learn what would satisfy their needs and wants;
- Talk to buyers, talk to neighbors, and observe operations that are successful;
- Ask your family and employees what

they think the strengths and weaknesses are of your present operation and of any possible new ones. Get their input.

If you sell commodities or consumer products that are well established in the marketplace, you should determine what distinguishes your product from that of competitors. Understand your competition. How well are they serving the needs of the market? What are customers saying about them? What can you learn about the market from their example? Are they positioned to capture the same market opportunity as you are? What isn't working for them? Do they demonstrate anything that you haven't considered?

When selling into markets other than direct to consumers, you will rely upon retailers, wholesalers, and brokers. They know their customers, their history, their unfulfilled needs and wants for distinctive attributes and products. Make contact with their customers if possible and learn what they want.

It is very helpful to keep in mind that successful food marketing today must consider four basic characteristics consumers look for: is it healthy, is it safe, is it gratifying, and is it convenient? Apply these as a test to your products, processing, pricing, packaging, and promotion.

To add further confidence to your business plan, consider what unexpected external or market factors can upset your marketing plans and sales projections and consider what responsive measures you might take if necessary. Think about alternative plans and strategies. You should be prepared to demonstrate flexibility, resilience, and resourcefulness in the face of the unexpected, for that is very likely the condition that will unfold.

The bottom line of this message is – your assumptions about market size and market capture make sales projection a vulnerable figure in a business plan. Use the process of business planning as one of discovery, thinking, and frequent rewriting. It's better as a tool for planning success than merely a device to get a loan (and maybe get into trouble if done too casually). A business plan written only to please a lender won't assure you that you can repay the loan, but a business plan prepared as if your livelihood depends on it can bring great rewards.

Are Your Products Relevant?

Kristen Rowles
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In a recent editorial in *The Fruit Grower News* (August 2000), publisher Matt McCallum challenges the apple industry to make radical changes to adapt to new market conditions. He points out that the potato industry, facing similar challenges, responded by trying to make itself relevant to today's consumers. He quotes Tim O'Connor, president of the National Potato Promotion Board, "The future of the potato industry will be determined by how relevant our products remain to the consumer." The apple industry, as well as many other agricultural producers, would do well to take a tip from their potato-growing brethren.

Across the country, apple growers know that change is needed. They face a difficult set of challenges: sustained low prices, slow growth, stagnant per capita consumption, and heightened global competition. Bargaining power is being lost to increasingly strong and consolidated retail chain customers. Processing markets are particularly challenging as low price juice foreign concentrate has dropped the market's floor price level. These pressures are not unique to the apple industry. Producers of other agricultural products can relate to many similar concerns.

The question of whether products are relevant to today's consumers is one of the most important questions that producers can ask. Most agricultural producers operate in mature markets, and the maturity of these markets requires shifting from a focus on selling to a focus on fulfilling consumer's needs. New product development is an important part of making products relevant to consumers. It is a risky, but often necessary, step in revitalizing a mature industry.

Current research at Cornell University aims to assist the apple industry in stimulating product innovation and market expansion for processed apple products. As a part of this research, in June several New York processing apple industry leaders attended a workshop focused on new product development. The day-long session led to a number of lessons learned about the innovation process.

First, new products must stimulate a consumer to take the risk of purchasing them. To do so, new products must appeal to basic consumer motivators. Today's top consumer motivators are:

Convenience. Consumers' need for more time drives the purchase of on-the-go foods, meal solutions, and functional packaging.

Wellness. Fears about aging, declining health, and medical costs drive consumers to prevent and self-treat health problems with food and beverage products that offer health benefits.

Food quality and safety. Consumers are drawn to products that offer quality assurance and reliable food safety.

Gratification. Disposable income levels have been rising in the current strong economy, and consumers are seeking indulgence for themselves and their children. They are drawn to buy gratifying products that taste good and offer the feeling, "I'm worth it."

Second, innovation is a key to success. The workshop was held in a unique facility that has a collection of over 65,000 products from the past thirty years. The workshop facilitators offered stories about why various products failed in the market. They emphasized that the biggest reason for product failure is a lack of innovation. "Me-too" products that imitate other products frequently fail.

Third, there is much to be learned from both the successes and failures of products in other categories. The workshop facility provided a rich environment for stimulating creative thoughts because there was so much information that could be gleaned from other product categories. Ideas for packaging, positioning, flavors, colors, and features can come from what appear to be completely unrelated products. And the mistakes of others provide ample opportunity to learn what not to do.

Moving forward, this research project will try to integrate these lessons into the process of evaluating new product ideas for the processed apple industry. While this research can help, alone it will not make apple products relevant to current and future consumers. Keeping any agricultural product relevant requires investment in continuous innovation. Whether you're in the apple industry, the potato industry, or any other agricultural industry, a commitment to innovation, driven by the goal of fulfilling consumer motivators, is critical to success in today's markets.

Develop a Successful Promotion Program

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Promotion is an intricate part of market mix. Marketing mix includes product, price, place/distribution and promotion (the 4 Ps). The activities of the first three Ps -- product planning, pricing, and distribution -- are performed mainly within the firm or between the firm and its marketing "partners." With promotional activities, a firm communicates directly with potential customers.

Promotion is an attempt to influence. Promotional activities are designed to inform, persuade, or remind the market of the firm and its products and ultimately to influence consumers' feelings, beliefs, and behavior. A successful promotion program should include all the communication tools that can deliver a message to a target audience. A promotion program can include five components: advertising, sales promotion, public relations, sales force, and direct marketing.

Advertising. Advertising is a paid form of nonpersonal communication by an identified sponsor. The mass media used can include TV, radio, magazine, billboards, newspapers, and direct mailing. Advertising is the most effective tool for building awareness of a company, product or service. It is also relatively inexpensive based on the cost per thousand people reached. However, broadcasting a message to everyone through media such as television is not very targeted. The most effective advertising is narrowly targeted and uses media targeting specific audience interests. The drawback is that most advertising does not deliver sales quickly. It works mostly by changing minds, not changing behaviors.

Sales Promotion. On the other hand, sales promotion changes behavior. Customers will act upon a sale, an offer, or a chance to win something. Sales promotion activities include coupons, discounts, in-store displays, trade shows, samples, in-store demonstrations, and contests. A company can also sponsor trade promotion, in which supermarkets or other retailers are given discounts to promote a specific product. However, most incentives are short-term in nature. In addition, sales promotion targeting consumers weakens consumer brand loyalty. Consumers increasingly expect to buy products below listed prices. Consumers simply buy whichever brand is on sale during a particular week and switch to a competing brand when it goes on sale. The only situation where sales promotion is profitable is when the company truly has a superior product paired with low product awareness. In this case, sales promotion will get people to try the product, and they will be less likely to switch to a competing brand when sales is over.

Public Relations. Because sales promotion often loses money, and advertising is becoming less effective and expensive, companies should investigate the impact of marketing public relations. Marketing public relations is designed to create a positive image of the company to a target market. It uses nonpaid communication by presenting commercially significant news in a published medium or obtaining favorable presentation of the business or product on radio or television.

Tools to create publicity include publications (reports and brochures); events (sponsoring activities and trade shows); news (favorable stories about the company, its people, and products); community involvement (time or money invested in local interests); identity media (business cards, stationary, and signs); lobbying activity; and social responsibility to the environment and society.

Sales Force. The more complex the product or service, the more necessary to use sales people who can answer questions and help customers. However, a company's sales force is one of the most expensive marketing communication tools. Across all businesses, more money is spent on personal selling than on any other form of promotion. What is important is not the sales person's costs but his/her costs in relation to the sales he/she generates. A top sales person can often sell five to ten times more than an average sales person. Companies trying to save money by paying less to the sales people often have the highest costs-to-sales ratio with high turnover rate and high training costs.

In addition to hiring good people, a company should help its sales people be more productive by providing them sales tools, i.e. computers, fax machine, and e-mail, and giving them easy access to company data to help them become more informed. Sales people offer the advantage of one-on-one selling. They should be trained to consciously find out what customers want and alert the company.

Direct Marketing. Direct marketing by mail, phone, or personal contact can be used to effectively communicate with a very narrowly targeted group. Lists for direct marketing purposes can be purchased from different sources. However, for direct marketing to be effective, it is important to maintain a comprehensive customer database in the company and manage the database in a way that it can be divided into subcategories for different promotional programs.

All the promotional activities must be integrated to deliver a consistent and positive message. A multi-media promotion campaign is usually more effective than any promotional activity alone. For example, if a company is launching a new product or program, it can contact the media to get free press and then run an advertisement offering information, combined with offering sales promotion, direct marketing by mail or phone, and product demonstration, or a visit by sales people.

In developing a promotion program, a company must first determine the target audience, the most important objectives, and a promotion budget and then design the promotion activities accordingly. Promotional objectives can include providing product information, stimulating demand, increasing store traffic, differentiating products, building a brand image, reminding current customers about product benefits, countering competitors' offers, responding to the news, smoothing out seasonal demand fluctuation, and improving customer relationships. Promotion must be integrated into a firm's strategic planning because all elements of the market mix – product, price, place, and promotion – must be coordinated in order for a promotion program to be successful.

March 2001

Smart Pricing Strategies

Wen-fei L. Uva
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Pricing is an important piece of smart marketing. The price a farmer receives depends largely on the distribution channel used to sell the product. Farmers are usually price-takers at terminal and wholesale markets. One of the major attractions of direct marketing for farmers is the opportunity of gaining control over the prices they can charge. Yet frustration often arises when trying to determine prices, and one of the most difficult problems in direct marketing often centers around the all-too-common practice of price cutting.

Price provides income, guides the quantity supplied and demanded, serves as a signal to customers, and transfers ownership. Questions one should ask before determining prices include: How much do the competitors charge? How much are customers willing to pay? Does the product have additional value for which the price may be raised? What is the cost to produce the product? And if you slash prices (below competition), how will you maintain profitability?

The most basic element of pricing is knowing your costs, including variable costs and fixed costs. Variable costs are cost items directly related to production -- plants, seeds, fertilizer, labor, packaging, etc. Fixed costs are cost items that do not vary with production volume, such as rent, taxes, management salaries, and cost of capital. The price of one item should at least cover variable costs in the short run and need to cover both variable and fixed costs in the long run. It is important to establish a gross margin that will cover the total costs of growing and marketing the product and provide a satisfactory profit for the business. Gross margin is the difference between the cost of the product and its selling price.

$$\text{Gross Margin \%} = \frac{\text{Selling Price - Cost}}{\text{Selling Price}} * 100$$

$$\text{Retail Price (\$)} = \frac{\text{Cost of Goods Sold (\$)}}{\text{100(\%) - Desired Gross Margin (\%)}} * 100$$

After the prices are established based on the desired gross margin for each product, it is often necessary for the smart marketer to adjust the prices to match the marketing strategy. One might want to lower prices of certain items to meet competition, attract customers to the retail outlets (i.e. advertised specials), or sell products that may have been damaged, overstocked or seasonal. Sometimes, one will want to increase prices of certain items to reflect the value of a unique product, a special service, or a prestige image. When considering changing prices, it is important to calculate the impact of such a reduction or increase on the total gross margin of the business. This can be done as illustrated in the following example.

Assume a direct marketer is selling just five major items from a farm stand. The direct marketer has calculated the gross margin for each product sold using the cost of goods (a cost of production or market wholesale price) and has also estimated the approximate sales for each product as a percent of total sales. The percentage of sales and gross margin for each product are shown in Table 1.

In this situation, the direct marketer decided to lower the price on pumpkins as a Halloween promotion to meet a lower price by a competitor or to sell out the seasonal stock. If the price reduction resulted in a gross margin of 10 percent (a drop from 30 percent) and stimulated sales to increase to 20 percent of the total (up from 15 percent), the impact of the price reduction on the total sales and profits of the business could be calculated as in Table 2.

Therefore, the direct marketer could forecast a drop in total gross margin from 26.50% to 22.65%, or a loss of -3.85% in gross margin. Assuming that sales for the business averaged $5,000 per week, this would mean a loss of: $ 5,000 x –3.85% = -$192.50.

However, if the lower price on pumpkins attracted more customers or more sales for the business, and resulted in an overall increase in sales of more than $192.50, the result would be an increase in total gross revenue for the direct marketer.

For example:

Gross margin before the price reduction
$5,000 x 0.265 = $1,325.00

Gross margin after the price reduction (with a $900 sales increase) $5,900 x 0.2265 = 1,336.35

Now there is a slight gain in total gross margin.

Remember that having the "lowest price in the market" image can't get you higher prices for higher quality products. Having a "value" image is to reach an optimal combination of quality, service, information and price. Price competition in a market

Table 1. Contribution to Total Sales and Gross Margin before Price Reduction

Item	*A. Percent of Total Sales (Estimated)*	*B. Percent Contribution to Gross Margin*	*C. Total Gross Margin (C = A x B)*
Apples	35	30	10.5
Mums	10	35	3.5
Pumpkins	15	30	4.5
Sweet Corn	10	20	2.0
All Others	30	20	6.0
Total	**100%**		**26.5%**

Table 2. Contribution to Total Sales and Gross Margin after Price Reduction

Item	*A. Percent of Total Sales (Estimated)*	*B. Percent Contribution to Gross Margin*	*C. Total Gross Margin (C = A x B)*
Apples	33	30	9.90
Mums	9	35	3.15
Pumpkins	20	10	2.00
Sweet Corn	10	20	2.00
All Others	28	20	5.60
Total	**100%**		**22.65%**

situation with multiple similar sellers in one location can cause severe consequences.

The following are some pricing strategies for *Smart Marketers*.

- **Price-lining**. Price-lining features products at a limited number of prices, reflecting varying product quality or product lines. This strategy can help smart marketers to sell top quality produce at a premium price and an "economy line", e.g. overripe or smaller fruits. Price-lining can also make shopping easier for consumers and sellers because there are fewer prices to consider and handle.
- **Single-pricing**. The single-price strategy charges customers the same price for all items. Items are packaged in different volumes based on the single price they would be sold for. With such a policy the variety of offerings is often limited. The strength is being able to avoid employee error and facilitate the speed of transactions. Also, customers know what to expect. There are no surprises for customers.
- **Loss-leader pricing**. A less-than-normal markup or margin on an item is taken to increase customer traffic. The loss-leaders should be well-known, frequently purchased items. The idea is that customers will come to buy the "leaders" and will also purchase regularly priced items. If customers only buy the "loss leaders," the marketer is in trouble.
- **Odd-ending pricing**. Odd-ending prices are set just below the dollar figures, such as $1.99 a pound instead of $2.00. Some believe that consumers perceive odd-ending prices to be substantially lower than prices with even-ending. However, it might not be suitable in some markets. For example, in a farmers' market situation, products should be priced in round figures to speed up sales and eliminate problem with change.
- **Quantity discount pricing**. A quantity discount is given to encourage customers to buy in larger amounts, such as $2.00 each and three for $5.00.

Gross margins should be computed on the quantity prices.

- **Volume pricing**. Volume pricing uses the consumers' perception to its advantage, and no real discount is given to customers. Rather than selling a single item for $2.50, two are priced for $4.99 or $5.00.
- **Cumulative pricing**. Price discount is given based on the total volume purchased over a period of time. The discount usually increases as the quantity purchased increases. The type of pricing has a promotional impact because it rewards a customer for being a loyal buyer.
- **Trade discount/Promotional allowances**. Price is reduced in exchange for marketing services performed by buyers or to compensate buyers for performing promotional services.
- **Cash discount**. A discount is given to buyers who pay the bills within a specified period of time to encourage prompt payment.
- **Seasonal discount**. This type of discount is used to induce buyers to purchase at the end of the season or during off-season.

While the above strategies are widely used and proven effective, smart marketers should not be limited to these strategies. Creative pricing ideas can help you differentiate your products and services. No matter how you price your products, always go back to check it against your bottom-line. Make sure prices for your products reflect your business image and target market and make a profit. Smart pricing can be a good marketing strategy.

Adapting to Changing Markets with New Products

Kristin Rowles
Marketing Analyst
Finance and Business Management

The replacement of mature and declining products with new products is often critical to maintaining and building sales. Existing products are always vulnerable to changes in the market environment. Consumer needs, tastes, and interests change. New technologies can make current products obsolete. Increased levels of competition, both foreign and domestic, can threaten an existing product's market position. To adapt to these changing market conditions, the development of new products can be an important business strategy.

New product development includes a wide range of activities: the creation of innovative products that are completely new to the market, additions to existing product lines, improvements to existing products, product re-positioning, or the development of new flavors, colors, or packaging. Each of these actions requires marketers to take on new risks, costs, and uncertainty. However, those that do not develop new products put themselves at risk in a competitive market environment.

Products are often said to have a life cycle with distinct stages: introduction, growth, maturity, and decline. In today's economy, the product life cycle is compressed. As a result of increased competition and rapidly changing consumer interests, products move through the life cycle stages more quickly than in the past. As product life cycles have shortened, new product development has also accelerated. In 1997, over 25,000 new products were introduced — a more-than-fourfold increase since the early 1980s.

New product development is a challenging process for a business of any size. A widely cited statistic emphasizes this challenge: eight out of ten new products fail. A new product faces many barriers to success:

1. **Costs** -- Successful new products require significant levels of investment in product development and introduction. Some companies lack access to the capital or human resources needed to carry a new product through development and into the market successfully.
2. **Competition** -- Heightened competition has shortened product life cycles and product development timelines.

Products are easily copied by competitors. A marketer must accelerate the product development process to beat competitors to market, and a product must be successful quickly to provide a favorable return on investment.

3. **Market fragmentation** -- With increased competition, markets tend to fragment into smaller segments. Fragmentation may limit a marketer's ability to attract a wide audience with a single marketing strategy, and it increases the difficulty and costs of marketing. Fragmentation can also limit a product to a smaller market, thereby limiting the product's profit potential. However, market fragmentation may offer a competitive advantage to smaller firms that can focus on providing products to narrow market segments.
4. **Public concerns and government regulation** -- A company needs to address the concerns of the public and comply with government regulations on issues such as food safety and environmental concerns. In addition to these barriers, a company also faces the challenge of entering markets already crowded with new products. In today's food industry, about 34 new products are introduced per day.

Additional barriers to new product development, however, are slowing the current rate of new food product growth. Food product introductions decreased by 26% between 1995 and 1997. Retailers are putting a damper on new product introductions through the use of slotting allowance and failure fees. These charges increase the expense and risk of introducing new products. Also, time-constrained consumers appear to be seeking simpler choices in the shopping aisles. Retailers and food manufacturers may respond to this trend by narrowing choices and focusing on popular brands.

Despite the recent slowing, many consumers will continue to demand products offering new features, tastes, and experiences. Variety will remain a central tenet in many segments of the food industry.

In this competitive environment, the challenges of new product development appear daunting. However, a company can improve the odds of success. A successful new product is not solely the result of someone's good idea. Most successful new products are backed by:

1. **Marketing research** -- Make the customer a part of the product development team. Successful new products have a lot of marketing research behind them. Companies that invest in gathering information from their target markets enhance the probability of success.
2. **Company-wide support** -- Get the whole team behind the new product. Successful new product development requires the commitment of high-level company officials and people through-

out the company.

3. **Investment** -- Be willing to spend big. The costs of developing and introducing a new product successfully are high. Success will require taking on a significant financial risk.

These factors are necessary, but not sufficient conditions for success with new products. Most successful products have these factors working in their favor, but even with these factors, success is not guaranteed. Without them, however, the odds are stacked quite unfavorably against new product success.

Market Research for New Products

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In a changing market, staying competitive often requires the development of new products. As consumer tastes and needs change, products must also change. Developing new products, however, is a risky and costly venture. Experts estimate that eight out of ten new products fail. With such formidable odds, it pays to be informed and prepared to meet the challenges of introducing a new product. Market research is an essential tool to help boost the chances for success.

The new product development process has at least six stages. In each stage, information about the market and consumers is needed to support critical decisions about the product. The list below outlines the stages of product development, information needed at each stage, and research techniques that may be helpful.

I. Opportunity Identification

To start, you should seek holes in the market that might be opportunities. At this stage, the following information gathering techniques are useful: focus groups, consumer surveys, analysis of customer suggestions and complaints, brainstorming, industry research (size of market, consumption patterns), and analysis of competitors' products. From the beginning, remember that your customers are an important source of information. Make them a part of your product development team by listening to their suggestions and complaints.

II. Concept Screening

Next, you will move from generating ideas to testing ideas. In concept screening, you describe the product idea to potential customers and ask, "Would you buy this product?" If consumers do not like the idea of your product, the physical product will probably not do well either. Concept screening allows for the evaluation of winners and losers early in product development -- before substantial resources are committed to a product's development. At this stage, focus groups and consumer surveys are useful research methods. Be sure to conduct research in the product's target market so that the results accurately reflect the potential consumers.

III. Marketing Strategy Development

Next, you will set a plan for your

marketing mix (the four Ps):

Product. Define your product in terms of varieties, quality, design, features, brand, packaging, sizes, service, and warranties.

Price. Develop a pricing strategy. Consider how you will use list price, discounts, allowances, payment periods, and credit terms.

Place. How will your products get to your customers? Which channels will you use (retail, wholesale, foodservice)? Consider the best locations to reach your target market. Also, consider transportation, inventory, and storage.

Promotion. How will you use the following: sales promotion (coupons, allowances, discounts), advertising, salespeople, public relations?

IV. Product Development

At this stage, using the information you have collected and the decisions you have made about the 4 Ps, you will design and create the physical product, as well as its packaging, name, logo, and advertising. Research at this stage usually involves repeated cycles of product improvement and testing. Product testing includes both physical performance (e.g., shelf stability) and consumer reactions. Some research techniques useful at this stage are surveys, tasting panels, and in-home placement testing.

V. Market Testing

This stage is a last check on the product before it enters the market. At this point, product performance tests are complete. Market testing aims to evaluate advertising, awareness, and usage (AAU) of the product in test markets. The techniques used include simulated store testing and controlled test marketing. Some marketing research firms offer AAU studies.

VI. Product Introduction

As you introduce the product to the market, you should test the distribution of the product. Is the product getting on the shelves? Is it getting a favorable presentation on the shelves? Again, evaluating advertising, awareness and usage is important.

For companies that do not have in-house research capabilities, market research consulting firms can provide needed services. However, whether in-house or out-sourced, market research can be expensive. Many companies do not invest in all of the techniques mentioned above. In deciding what kind of investment to make in marketing research, your company must balance the risk of product failure with the costs of marketing research.

Marketing research is not only costly, but it also takes time. In selecting marketing research techniques, you must balance the needs of your schedule. If you want to enter a market quickly, you may not have time to complete all of the marketing research studies mentioned above. Again, balancing your resources and your risks is key in your decisions about marketing research.

With new products, success will not result solely from a good idea or from reliance on a talented sales force. Successful new product marketers learn how to *delight* customers by studying their needs and behaviors. Marketing research can provide you with that information, and it's an investment well worth making to help you beat the odds and succeed in new product development.

Smart Marketing Includes Services and Relationships — Not Just Products

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In agriculture, we have a tendency in marketing to focus most of our attention on the hard products we produce and bring to market -- fruits, vegetables, meat, grains, milk, or cheese. Today's markets demand more attention to the services and relationships associated with marketing the actual product itself. The smart marketer is one who not only produces a high quality product, but also delivers needed services and builds effective relationships with customers.

A useful way to examine these questions of services and relationships is to begin with the old journalistic outline of who, what, where, when, why, and how. We also need to understand the distinction between a customer and the consumer. Our customers may actually be consumers if we are direct marketers. But usually a relationship with some type of intermediary customer is required to get the farm product to the end-user, the consumer. Typical intermediary customers in the food system include: wholesalers, retail supermarket buyers, food service buyers, brokers, or processors.

Who are you doing business with? If you are a direct marketer, know your consumer. Who are they in regards to age, income, residence, family size, gender, ethnic group, etc.? How is your consumer base changing? What services will enhance your relationship with your consumers? If you are working with other types of customers, learn about their operations: sales, distribution, terms of trade, transaction protocols, etc. How do your customers understand the consumers who buy your products? What information about consumers can they share with you, or you with them, to assist both of you in better serving them?

What makes your product superior? What differentiates your product from the rest of the pack? What will make your product more attractive to your customers or consumers? What will your product bring to the assortment of products your customer markets? What information can you provide along with your product (nutritional values, recipes, portion sizes, variety, etc.) to increase sales?

Where will your product have to end up to effectively serve your customers or consumers? How will your product hold up in transit? Will your product arrive in a package ready for store display or use in the kitchen? Are there any ways to make life easier for those who buy your products in regards to scheduling or delivery? Can you better coordinate shipping with other firms shipping similar products in your area?

When does your product need to arrive? Time is of the essence for all of us. How can you cut your customer's time spent receiving or handling your product? Are there ways to minimize the time your consumer (convenient parking, check-out) or customer (processing invoices or payment) does business with you? Just-in-time delivery and automated inventory replenishment are becoming standard business practices in both the retail and food service industries.

Why should your customer do business with you in regards to the services you offer and the value you bring to the business relationship? Why should you be considered a "preferred" supplier by your customer? Why should your ability to attract consumers to your product add value to your customer's business?

How will you better understand what services and relationships will be needed to insure the effective marketing of your products? In a rapidly changing marketplace, those services and relationships are changing. How will your services increase the productivity and profitability of your customers?

In summary, smart marketers not only deliver high quality products that are relevant to consumers, but must also provide valuable services to build effective relationships with customers. Hopefully, answering some of these questions might shed some light on how to improve your marketing capacity. In the haste to produce the hard product itself, don't forget the needed services and relationships that will keep your product on the shelf, on the plate, or in the hands of consumers.

Using a Web Site to Keep the Attention of Your Customers

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Professor of Marketing

In my 20s I worked briefly walking thoroughbreds after races and workouts. There is no doubt they are big, skittish animals who always tried to bolt whenever startled by the 'beep beep' of a backing truck or dumpster dropped to the ground. My natural response to a rearing horse was to cower, but when that proved ineffective, I would try to tug them back into line. In the end, the best approach was calmly to return to their routine walk, at which point the disturbance went completely out of mind. As best as I can tell (and at a risk of affronting horse fanciers), thoroughbreds can hold only one idea in mind at a time.

What, though, does this have to do with marketing? I am certainly not going to say (in print) that customers can retain only a single idea at a time. But, like racehorses, we all tend to forget nonroutine matters quickly and return to our customary patterns. For those who serve as nonrouting shopping experiences, this tendency is clearly a threat. Indeed, much of marketing is an effort to keep your product name constantly in front of consumers. That is why soda companies pay to have their products appear in movies, and why sports stars carry sponsors' logos. Short of the big bucks, though, that is not a model which can be followed.

For agriculture-related businesses which operate on a year 'round basis, keeping your name in front of your customers is not such a problem. A garden supply firm for example could, following any fall sales, move onto pumpkins/Halloween, then wreaths/Christmas trees. Houseplants could fill the depth of the winter, followed by seeds, etc. into the spring planting season. The point is to keep customers thinking of you, and coming back regularly. Strictly seasonal operations like roadside stands, though, have a problem – how to help assure your customers will return when you again have product.

Web pages can serve that purpose admirably. They are relatively inexpensive (see below) ways to communicate with customers, particularly during the off season. Your page firms your identity with customers while keeping your name in front of them on an ongoing basis, yet few are taking advantage. A quick Yahoo search turned up only three listings under 'farmers' markets' in New York. One site had nice photos only, and another was for the Metro area, mentioning 38 locations but not identifying them.

The most complete was for Ithaca. That site listed operating dates, products, location (w/map), handicap access, and a vendor list. The list of over 75 food and agricultural vendors had but four with their own web sites, and of those, three were single pages (one under construction). The fourth was more complete with a current catalogue and prices so as to promote direct sales also. Certainly the remaining 70+ producers are missing an opportunity. All, though, did have email addresses as well as telephone numbers, but phone calls can be a real disruption while email messages require specific responses.

I also looked under 'farms – New York' and found a handful of listings. Most compelling was a you-cut operation which listed sales dates for this coming winter, mentioned sleigh rides available, and pushed off-season sales of live trees. Massachusetts is a little ahead of us here in New York with a site for all roadside stands including an easy search function by product or location. Each stand (according to the site) could establish a web site without additional cost, but few did so.

What you may wish to include on your site is your decision. I suggest looking over a number of existing sites for ideas and perspectives on ease of use. Likely you will want a map of some form, and list of dates and/or products and prices. A key factor is attracting repeated 'hits'; without that, the whole point of keeping your name out there is lost. Several strategies and combinations are available. One is to offer useful information – how to keep deer off your newly purchased plants, or winter treatment for new plants, etc. These need periodic changing, so involve some time commitment. Another approach is to provide useful links so your site will be visited repeatedly. Such things as local tourist sites may be appropriate for transient clientele, or related (but noncompeting) sellers. Ideally, customers will 'book mark' your site for easy access, but failing that, an easy memorable name (site address) is best.

What will this all cost you? Certainly you can spend plenty, but need not do so. For preparing your site, try advertising at a nearby high school or college – the skills needed aren't great and can be readily mastered by teenagers. Expect a charge of around $300 for up to 15 pages. Note, though, a disadvantage of itinerant help is that you will regularly be looking for replacements to provide updates. You will also need space on a server to hold your site. Typically 15 MB is adequate for which a local vender (try the yellow pages) charges $10 a month. Registering the domain name costs an additional $35 a year so, once prepared, you are looking at the order of $150 annually to support a site.

Returning to walking horses, my job was soon automated by a merry-go-round-like device run by a washing machine motor. If you like, you can think of a web site as a slightly more sophisticated device for keeping your customers circling around your business.

Retaining Good Employees is Smart Marketing Too!

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All agricultural businesses are faced with rising costs but have little control over pricing. This dilemma creates an on-going profit squeeze with which most agricultural businesses are all too familiar. One way to approach the problem is to add value to products to earn a greater share of the "marketing margin" represented in retail prices. Many agricultural businesses have had success in this arena by becoming more vertically integrated through direct marketing or by value-added processing or packaging of otherwise commodity-type items.

Another way to approach the profit squeeze dilemma is to become more efficient on the cost side of the equation. Of course, many of the great production advances in agriculture over the decades have been great examples of increasing efficiency. This notion of "taking costs out of the system" has also been a driving force in the food distribution industry for almost 10 years and the results have produced lower costs and helped maintain industry profit levels. Likewise, food retailers and wholesalers have worked with great success with their suppliers to reduce the cost of delivered product. Much inefficiency has been identified and eliminated, forever reducing the cost of bringing a product to market. Despite huge strides in this area, there are still great opportunities to further reduce costs.

Often overlooked in the quest for marketing efficiency is the cost of employee turnover, a problem plaguing almost all businesses in today's tight labor market, especially food and agricultural businesses. In light of record low unemployment and a very prosperous economy creating many new entry-level jobs, there is a shortage of people available to work at the entry level. This abundance of opportunities combined with increased mobility in the workforce creates an environment where many people 'feel comfortable, frequently changing jobs for a wide range of reasons.

A major study of the employee turnover problem in the supermarket industry (*New Ideas for Retaining Store-Level Employees*, Coca-Cola Retailing Research Council, January 2000) estimated that the total direct and indirect costs to replace a supermarket cashier earning $6.50 per hour was at least $3,637. Considering that many supermarket companies experience employee turnover rates of 100% or more in some job categories, the total company turnover cost has a major affect on profits. In fact, the Coca-Cola study estimates that "the annual cost of employee turnover in the supermarket industry **exceeds** the entire industry's annual profit **by more than 40%.**" While these specific numbers apply to the supermarket industry, similar situations exist throughout the food chain from agricultural production through wholesaling.

In her new book *The Road to Retention: Build and Keep a Strong Workforce* (1999), Ann Jones, Ph.D., states that cost components such as recruiting, interviewing, hiring, processing, orienting, training, supervising, and paying overtime to other associates to cover for the person who left represent the **direct costs of turnover.** These direct costs are relatively easy to measure and quantify in dollars. However, turnover also creates **indirect costs** which are less easily measured but which also negatively affect profitability. Some of these less obvious costs are lost sales due to customer dissatisfaction, inexperience of new employees in suggestive selling and merchandising, decreased quality due to errors, and reduced morale of co-workers who are charged with training another new person. Each of these components must be measured and understood to appreciate the "bottom line" cost of turnover and therefore the economic value of retaining good employees.

In addition to the obvious dollar cost of turnover, marketers should also appreciate the more subtle economic benefit of good employees. Good employees are key to the customer oriented marketing approach that is so critical to success in today's overly competitive marketplace where market channel customers and consumers have many choices and options from which to purchase goods.

As competition for their purchase dollar increases, savvy consumers realize that most leading products are available from a wide range of retail stores, catalogs, or internet-based retailers. Today's consumers are value conscious and are looking for great shopping environments and experiences. An experienced, knowledgeable, customer-oriented employee is often the difference that sways consumers to choose one outlet over another. The confidence that key employees inspire allays the concerns most consumers harbor about the quality and safety of products they purchase for themselves and their families.

Recruiting and retaining good employees are both formidable challenges in today's tight labor market; however, the long-term rewards to agricultural businesses of retaining long-term quality employees are well worth the effort required in this aspect of *Smart Marketing*. Please contact Rod Hawkes of the Cornell University Food Industry Management Distance Education Program (email: *gfh3@cornell.edu*) if you have any questions or comments about this article.

Evaluation of Producer Gains from Commodity Checkoff Programs: Research vs. Promotion

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Agricultural producers have invested over $750 million annually into self-financed "checkoff" programs primarily designed to increase demand for various commodities. Examples include generic promotion programs such as "got milk," "another white meat," and "beef's what's for dinner." Advocates argue that these programs have been effective and important means for producers to collectively market their commodity. In contrast, some researchers challenge this traditional view. For example, Wohlgenant examined the distributional effects of commodity checkoff funds used for research versus promotion and concluded that research on farm production generates greater returns to producers than consumer promotion programs. This finding has drawn important policy implications for the allocation of checkoff funds and is of special significance to some producer groups (e.g., dairy, beef, and pork) who have spent a large share of the checkoff funds on consumer promotion. The study argued, "one reason more resources are not allocated to research is that legislation, enabling spending of producer checkoff funds, is limited to promotion and certain research activities. For example, the Beef Promotion and Research Act of 1986 limits research to studies relative to the effectiveness of market development and promotion efforts, studies relating to the nutritional value of beef and beef products, other related food science research, and new product development." Consequently, this study suggested Congress should consider expanding the scope of activities to directly include funding of farm-level research activities.

The conclusion of Wohlgenant's study is based on three assumptions: **(1) farm and nonfarm inputs have a nonzero elasticity of substitution, (2) each checkoff activity is equally efficient** (i.e., retail demand and farm supply curves are shifted by the same amount vertically), and **(3) shifts in demand and supply are parallel**. While a **parallel** shift in demand implies that consumer promotion results in a constant increase in sales at every level of price, a **pivotal** shift in demand implies that promotion effects are greater at low prices than at high prices. Similarly, a pivotal shift in supply implies that research generates greater cost reduction for high-cost farms than for low-cost farms. Several studies in the literature of marketing and agricultural economics have already indicated possibilities of pivotal shifts in demand (e.g., Kuehn; and Prasad and Ring) and supply (e.g., Lindner and Jarrett; Voon and Edwards; and Alston, Sexton, and Zhang) caused by consumer promotion and research activities, respectively. Therefore, it is important to reinvestigate previous findings under the assumption of pivotal shift before making general policy prescriptions.

We re-examined earlier findings with the assumption of **pivotal** rather than **parallel** shifts in demand and supply, and found that consumer promotion benefits producers more than research activities. Our results indicate that the ranking of producer gains from research and promotion activities depends on the type of shifts in demand and supply curves. The results, therefore, suggest that erroneous *a priori* generalization about the nature of the demand and supply shifts might lead to incorrect policy recommendations for the allocation of checkoff funds.

Although Lindner and Jarrett discussed several cases where researchers could envision the nature of the supply shifts, we know of no study that actually estimates the types of shift directly from technology transfers and promotion activities. Rose argued that, ".. it is unlikely that any knowledge of the shape of the supply curve, or the position at which the single estimate applies, will be available. The only realistic strategy is to assume that the supply shift is parallel." However, since the assumption on the type of shift turns out to be a key determinant of the optimal allocation of checkoff funds, it may not be appropriate to simply assume parallel shifts without having any knowledge regarding the shifts. The policy conclusions from research results relating to the distribution of gains from checkoff programs, therefore, should be made with caution until researchers are able to identify the nature of the shifts. Further research on identifying the nature of demand and supply shifts will significantly contribute to our understanding of the relative producer gains from research and promotions.

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A Growing Dilemma: Responding to Industry Consolidation

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In 1999 the Food Industry Management Program at Cornell conducted a study of produce buyers and shippers which was sponsored by the Produce Marketing Association in Newark, Delaware. Although the study was conducted for the produce industry, it can serve as a demonstration of how retail buyers' operating practices are impacting our agricultural producers and middlemen.

Two findings in the report should cause shippers to review, in particular, their sales strategies. First, retail produce executives were asked what percentage of their produce purchases are from their top 10 suppliers. Currently, on average, retailers buy 69.3 percent of their produce purchases from their top 10 suppliers. By 2004, retailers report that this will increase to 70.1 percent with most of this increase being driven by large retailers with over $1.5 billion in annual sales.

This concentration of purchasing by large grocery firms is particularly interesting when juxtapositioned with discussions about global procurement. Talks and experiments with global procurement are underway in some retail companies who are looking to negotiate with one or a few shippers the opportunity to supply all the companies' stores. For example, one shipper may be asked to provide all the kiwi fruit for 2,000 stores.

Second, the same large firms reported, on average, that they will decrease the number of suppliers from the current average of 450 down to an average of 404 by 2004. It is these large-sized firms who do the majority of direct purchasing from grower/shippers. Therefore, downsizing the number of suppliers from whom retailers purchase may affect the supplier population.

What are some strategies which could be used by grower/shippers to meet these changes in the retail environment? One obvious strategy is to grow to expand your control horizontally and/or vertically. In this same study, shippers were asked how their company has grown in the last 5 years. Most shippers indicated that they are adding growers to their roster of growers for whom they sell. The growers could be local growers or growers in distant production areas with complementary growing seasons. In addition, most were adding different commodities to their sales sheets and thus expanding into new product lines.

Very few, however, in fact less than a

handful, mentioned expanding their control through acquisitions, mergers or alliances. A couple of thoughts occur as to why this might be. One, most of the shippers interviewed were not the larger, national or branded shippers. Therefore, many of them are independent operators or are in partnership arrangements, and mergers may cut to the heart of these shippers. These shippers who are still entrepreneurs may find it hard to be objective about sharing their business with other stakeholders. A hypothesis is that smaller and medium-sized shippers are not planning growth through mergers or acquisitions, but are relying on expansion by increasing the number of producers represented or by encouraging increased production of existing producers.

If this is so, smaller and medium-sized shippers may be left out of buyers' offices as mergers and alliances continue in the top tier of shippers. Mergers and alliances among larger shippers are starting to escalate and will form even larger suppliers with resources beyond the grasp of smaller firms, while growth of smaller firms through increases in grower numbers and productivity is likely to be more limited.

To remain competitive you may want to consider some of the following strategies already strengthening competitive conditions for the firms which have adopted them.

Expand Control--Horizontally or Vertically

Consolidate horizontally. Acquire, merge and/or form alliances with other grower/shipper organizations. Means need to be found to coordinate with other grower/shippers to obtain the supplies required to do business with ever-larger wholesale and retail accounts. Organizational opportunities include joint sales agencies, various forms of cooperative activity, contracting, and new creative equity alliances.

Become a multi-region and/or multi-commodity shipper. This means expanding the product line by extending into new commodities and/or new geographical regions to become more of a "one-stop shopping" source on a year-round basis.

Integrate vertically. Although vertical integration is common in the produce industry among growers, packers and shippers and between wholesalers and retailers, there have been very few attempts at vertical organizations that bridge the gulf between grower/shipper and wholesaler/retailer. Yet such innovative arrangements may be a breath of fresh air for the traditional industry structure. Moreover, many growers may be well served by considering aligning themselves more formally with packing and selling companies. Otherwise, the picture for certain agricultural producers may be dim: if they are not adding value in meaningful ways, they will be able to claim only whatever system residual is left, if any, after others have extracted their returns. Many of the newly forged "partnerships" between produce shippers and retailers, although short of formalized ownership integration, are certainly steps in the direction of more effective vertical coordination.

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Marketing Implications of Retail Food Industry Consolidation

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The fact that the retail food industry in the United States is in the midst of a period of rapid consolidation is well documented.

Table 1. United States Grocery Retailing

	1994	*2000*
Grocery Sales ($ Billions)	401.7	90.0
Market Share of the Ten Largest firms	27.3%	50%

Source: *Progressive Grocer*, Hoover's, The Food Institute (Sales for items normally found in supermarkets).

An examination of food retailing during the last half of the decade of the 1990s reveals classic signs of industry maturity:

- **Nominal sales growth** – averaging 3-4% per year.
- **Overcapacity** – measured both by the number of stores and total square footage relative to population.
- **Increased inter-industry competition and channel blurring** – the growth of supercenters and food sales in other retail channels such as drug stores, discount stores and restaurants.
- **Consolidation and concentration**.

The recent consolidation activity, while itself a symptom of maturity, is also a response strategy on the part of the industry. Wall Street stock valuations require sales growth in excess of what can be organically produced in a saturated marketplace – the response has been significant acquisition activity on the part of the large industry players. Also driving acquisition activity has been a desire to achieve scale economics in purchasing and technology, particularly in light of the rapid growth of Wal-Mart. Finally, acquisition has been a means for large players to boost otherwise pressured profit margins via the elimination of supply chain redundancies.

Independent operators, both local and regional, are in many cases responding to intense competition, increased sophistication of operations, and rising capital intensity by divesting – selling to the large industry consolidators such as Kroger, Safeway, Albertsons, and Ahold, among others.

Consolidation poses many challenges to the industry. Large acquirers are pressured to effectively assimilate the acquired companies, and importantly, deliver the "promised" synergies upon which the acquisitions are predicated. Remaining smaller competitors face ever-larger more sophisticated competitors. The balance of power between retailers and manufacturers is shifting to the favor of retailers – spawning a host of new trade relation issues and behaviors. More subtle are the marketing oriented challenges posed by consolidation:

"**Sameness**" - The large industry consolidators operate similar formats (combination stores and superstores) that share relatively common characteristics in terms of size, assortments, service levels and pricing. We are seeing a convergence of positioning strategies as the industry consolidates. This format and marketing convergence is compounded as the consolidators turn their attention inward toward acquisition assimilation, rather than outward toward the marketplace and the creation of differentiation. In contrast, the acquirees - in many cases regional or local independent operators – have historically been format innovators with very distinctive positioning strategies and identities. As formats and "go to market" strategies converge in the new environment, it will be incumbent upon the large industry player to create meaningful differentiation strategies. Retail competition based on differentiation is efficient from both the retailer and consumer perspective. In contrast, competition in an environment of sameness tends to stress industry economics, limit consumer choice, and be attrition-based.

The consequence of strategies that results from consolidation will also create new opportunities for smaller players - in a marketplace of sameness, distinctiveness is a powerful strategy.

Closeness to the Consumer - The past several years have witnessed the acquisition of many local and regional food retailers whose marketing strategies were largely predicated on serving the unique needs and preferences of consumers at the local level (Carr's in Anchorage, Genuardi's in Philadelphia, Bruno's in Alabama, Dick's in southwest Wisconsin, to name a few). It remains to be seen how well the large consolidators balance the need for scale economics against the preservation of these retailers' uniquely consumer-oriented strategies.

Technology based Customer Relationship Marketing (CRM) strategies that are based on linking customer identities with purchase behavior offer unique opportunities for the large consolidation to devise unique customer oriented strategies. The large retailers are only now beginning to tap the potential of these programs.

Redefinition of Markets – All businesses have a tendency to define their industries and markets according to their experience, immediate surroundings and at the end of the day, "whatever suits their needs". Food retailing has more than many industry groups exemplified this way of thinking and approach to strategy. Food retailers have historically adhered to a formula of "selling food" to the exclusion of related product lines or services. Meanwhile, food retailing has been greatly impacted by discount stores adding food and creating the Supercenter format, drug stores reaching outside their traditional channel and selling food, the creation of the warehouse club format, and the restaurant channel developing the takeout aspect of their business. Food retailing has been slow to react… but as the industry consolidates, the largest players are beginning to expand beyond the traditional industry boundaries. Many food retailers, to the dismay of the convenience store channel, are adding gasoline to their product offerings. The most innovative are diversifying into related industries where fragmentation offers significant growth opportunities via further acquisition. Ahold's acquisitions in the food service industry are a good example.

It is likely that further "inter-industry" growth on the part of traditional food retailers will occur during the next 3 – 5 years.

Consolidation poses many challenges to US food retailers. While the tendency is to focus on the short-term issues spawned by acquisition activity, it is the less clear marketing issues that will define the industry for years to come.

Buy-Local Marketing Programs Taking Root in New York

Duncan Hilchey
Senior Extension Associate, Farming Alternatives Program

The phrase "Buy Local" is beginning to ring loudly around the state and the Northeast. Once the slogan of direct marketers and small growers, "buy local" is becoming a maxim of big business, including larger commercial growers, supermarket chains, and state departments of agriculture.

Massachusetts, for example, recently made funds available to support the establishment of regional agriculture marketing campaigns in that state. Here in New York, meanwhile, county-level Cornell Cooperative Extension field staff have been hatching their own fledgling efforts, such as "Hudson Valley Harvest," "Finger Lakes Culinary Bounty" and "Our Lakes Make it Local."

NY Farms! — a statewide consortium of agricultural organizations — has provided seed money for a number of these initiatives around the state, and has plans to provide ongoing financial and educational resources.

The buy-local concept, has been around for many years — typically an informal seasonal effort initiated by an individual grower, a farmers' market, or a grocery store. Over the last decade numerous states also have established campaigns to promote their fruit and vegetable industries such as "Jersey Fresh," "Massachusetts Grown and Fresher," and our own "Pride of New York," which have had an impact.

This new wave of buy-local marketing campaigns includes:

- an array of increasingly sophisticated strategies being employed to promote local agriculture and the community,
- a surprisingly broad spectrum of organizational involvement in the community, and
- a trend toward public financial support of these campaigns.

The driving force behind these local marketing campaigns is essentially the same thing that the tourism industry discovered long ago. Our state is so diverse — culturally, geographically, and demographically — that a growing number of communities want to capitalize on their unique differences.

The concept is that place names such as Adirondack, Finger Lakes, Niagara, Catskills, Mohawk, and Long Island have more value in terms of agriculture and food products in certain markets (especially within the state) than do the words "New York" alone. This does not negate the value of our Pride of New York program, which can generate value within the state and elsewhere.

Benefits to Growers

The bottom-line benefit of a buy-local campaign is market exposure — potentially leading to increased sales and profit. The new buy-local campaigns generally have a long-term view. Individual growers can spread out marketing costs over a larger group of growers participating in the campaign.

Other benefits to the grower include the opportunity to contribute to consumer education about agriculture in general and about the farmer's specific product or commodity in particular, as well as the goodwill which being an active "local booster" in the community generates.

Examples of Innovative Buy-Local Marketing Strategies

The following are examples of some of the strategies that the new wave of buy-local campaigns are employing (beyond the usual point-of-purchase materials and marketing slogans):

- After market research suggested that consumers would respond to the idea of supporting local farmers, a Western Massachusetts group called Community Involved in Sustaining Agriculture (CISA) rolled out its creative "Be A Local Hero" campaign. The underlying concept is to provide immediate positive reinforcement to those consumers who consciously choose to buy locally produced agricultural products.
- In response to the growing number of chefs interested in seasonal menus, the Finger Lakes Culinary Bounty has begun experimenting with "restaurant clusters," which are groups of farms, wineries, and restaurants working together to support their mutual interests. Some buy-local campaigns use a "food fax" in which a coordinator contacts local growers to find out what is ready in the fields, then faxes the consolidated information to potential buyers who then buy directly from farmers.
- Special events are also on the menu of some campaigns. Hudson Valley Harvest is planning a "Hudson Valley Can Do! Community Canning Festival," at which local volunteers will process tomatoes donated by area farmers into sixteen-ounce promotional jars of Hudson Valley Tomato Sauce. Their hope is to raise awareness of local farm and food processing products.
- The "Select! Sonoma" program in Sonoma County, California, has developed a set of trademarked logos for fresh agricultural products as well as for value-added products (Sonoma Made T and Sonoma Grown T). To be able to use the trademarked labels, farmers and processors in the county must certify that the products are, in large part, produced in Sonoma

County. Through year-round marketing activities (especially in the nearby San Francisco Bay area) consumers are encouraged to look for products with these trademarked labels, and patronize local businesses which carry them.

- Finally, a number of buy-local campaigns are jumping on the "Dot-Com" bandwagon and developing Web sites, with links to Web pages of growers and food businesses. Announcements of events and about product availability keep program participants and local consumers informed about the campaign (see links below).

The Challenges

Naturally all of these activities come with a price, and as these campaigns grow and become more sophisticated, their staffing and financial needs commensurately increase. Even the most experienced programs struggle with funding and balancing the books. Sonoma County's annual budget of over $150,000, for example, is barely enough to keep up with the growth of the program.

Fortunately, they have volunteers who put in extra hours to keep the program functioning year after year. About one-third of their budget comes from the 80 paying farm members of their organization, while the remainder comes from associate memberships comprised of restaurants and food processors, and grants from foundations and other public sources. A budget of such magnitude would be difficult for most New York regions (let alone counties) to match.

Buy-local campaigns also need to do a better job of evaluating their marketing programs. Very few programs have done pre- and post-campaign consumer studies to help them "tweak" their strategies and determine where they can get the most bang for the buck. However, as public dollars are increasingly spent on these programs we are likely to see more accountability. The Department of Agriculture in Massachusetts is keen on seeing its buy-local initiatives evaluated.

Finally, multiple slogans and labels have the potential to create confusion in consumers' minds. It is quite possible that during the 2001 growing season some New York shoppers might see county, regional, and state marketing labels in a single grocery store or farmers' market. Is this really helpful? Is it overkill? This remains to be seen, but with leadership from New York's Department of Agriculture and Markets some creative multi-level integration of labels may take place in the near future, especially in the context of the department's current review of the Pride of New York campaign.

Summary

Buy-local (and statewide) marketing campaigns have the potential to offer an ongoing and cost-effective presence in the marketscape. Growers of fruits, vegetables, flowers, and other fresh and value-added products should consider participation in these programs as part of their overall marketing strategy. Even processors and their contract farmers should look into this growing opportunity that is taking root in New York and elsewhere in the Northeast.

Additional Contacts and Resources

For a list of existing and proposed "buy-local" campaigns mentioned in this article and others in New York State, contact Duncan Hilchey at *dlh3@cornell.edu* or 607/ 255-4413.

Must See Websites

- Select! Sonoma
  http://www.sonomagrown.com/
- PlacerGrown
  http://placergrown.qcmnet.com/
- CISA Community Involved in Sustaining Agriculture
  http://www.buylocalfood.com/

The Promotion World According to Retail

John L. Park and Gene A. German
Research Associate and Professor Emeritus
Food Industry Management Program

As agricultural producers start to budget promotional activities to retailers, it is important for them to understand how various types of retailers rate the effectiveness of different promotional programs. This report is based on a study of the promotional preferences of supermarket, drug store, and mass retail executives.

Responses were received from the key retail companies in each channel of distribution, including over 40 responses from the nation's top supermarket chains. Retail executives were asked to evaluate 22 promotional programs in terms of the promotion's effectiveness in (a) increasing product movement and (b) increasing overall store sales. In addition, respondents identified the programs that were used most frequently in their company, and answered questions relating to their company's interest in increasing spending for account specific marketing.

Status of Promotional Activities

The top seven programs that were used most frequently by retailers were:

- In-Store Demos and Sampling
- Shipper Displays
- Promotion with a Local Charity
- Targeted Direct Mail
- In-Store Coupons
- Co-op Radio
- Retailer Generated Shelf Talkers

It is important to note that the frequency of use does not necessarily relate to the retailer's evaluation of the promotion's effectiveness in moving product or in increasing overall store sales. It must be assumed that these are promotions that are frequently offered, easy to implement, and that match the company's promotional strategy.

Although in-store coupons ranked very high among all three retail groups, there was a wide difference in the distribution methods of the coupons. For example, more than half of all supermarket executives reported using paperless coupons while very few mass or drug retailers used paperless. Instant redeemable coupons (IRC), however, were reported to be used by over two-thirds of all types of retail companies.

What Works?

Product Movement. The promotions that retail executives rated the most effective in terms of moving product included:

- Shipper Displays
- Targeted Direct Mail
- Frequent Shopper Programs
- In-Store Demos and Sampling

All three types of retail companies included in this survey rated shipper displays and targeted direct mail as very effective at moving product. Supermarket executives rated frequent shopper programs higher in product movement effectiveness than did executives from either drug stores or mass retail outlets.

What Works?

Overall Store Sales. When retail buyers and merchandisers were asked to evaluate promotions in terms of their effectiveness in increasing overall store sales, they chose all but one of the same top four promotions considered most effective in increasing product movement. These four were:

- Targeted Direct Mail
- Frequent Shopper Programs
- In-Store Demos and Sampling
- Retail Generated Shelf Talkers

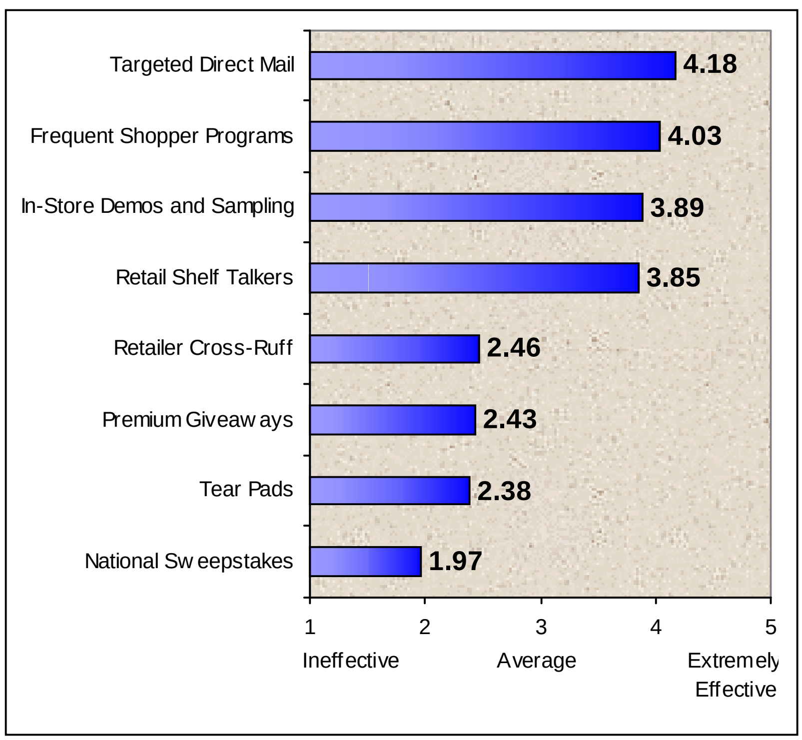
Shipper displays (which rated high in effectively moving product) were not considered to be as effective in increasing overall store sales. Retailer generated shelf talkers were considered effective at increasing overall store sales by all retail groups, with drug store executives giving this promotion their highest rating.

The promotional program that was identified as the least effective of all 22 promotions by executives from all three retail groups was national sweepstakes.

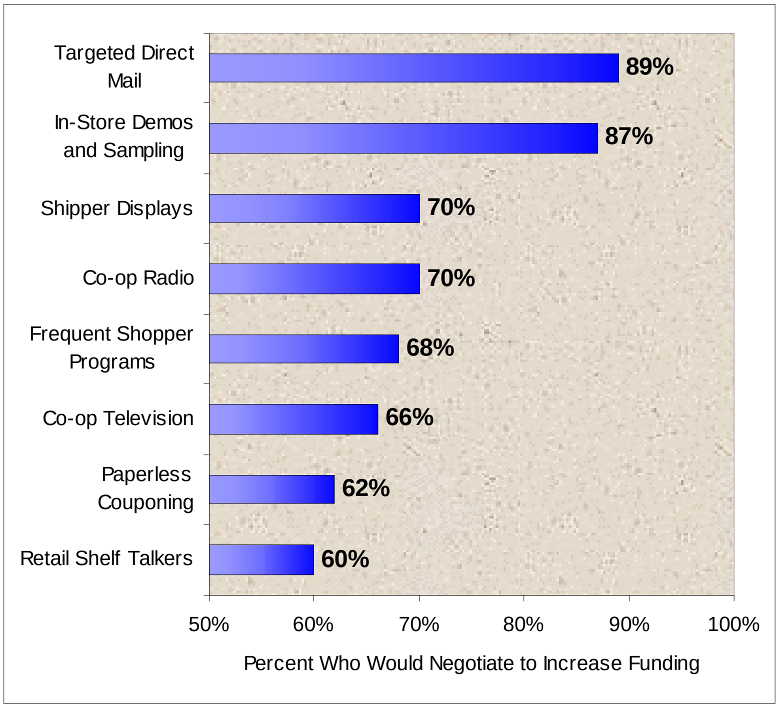
Funding Preferences

We asked retail executives "which programs would you negotiate to increase (or decrease) funding?" The following were identified as the top five promotions for which retail executives would try to negotiate a funding increase:

- Targeted Direct Mail
- In-Store Demos and Sampling



***What works in terms of increasing overall store sales** is led by targeted direct mail and frequent shopper programs. What didn't work? Again, national sweepstakes is at the bottom of the pack.*



***Negotiations for increased funding** were most often indicated for targeted direct mail and in-store demos and sampling.*

- Shipper Displays
- Co-op Radio
- Frequent Shopper Programs

Here we can see that the ratings reflect the buyers' beliefs regarding the effectiveness of the promotions as well as the ease with which the promotion can be implemented. This choice is also an indication of the trends in marketing strategy now being employed by leading retail firms.

Respondents to this survey also identified promotions for which they felt funding should be *decreased*. The five promotions receiving the most votes to decrease funding were:

- National Sweepstakes
- Premium Giveaways
- Tear Pads
- Chain-Wide Sweepstakes
- Manufacturer Generated Shelf Talkers

There was general agreement among all retailers regarding the funding decrease for these five types of promotions.

Summary

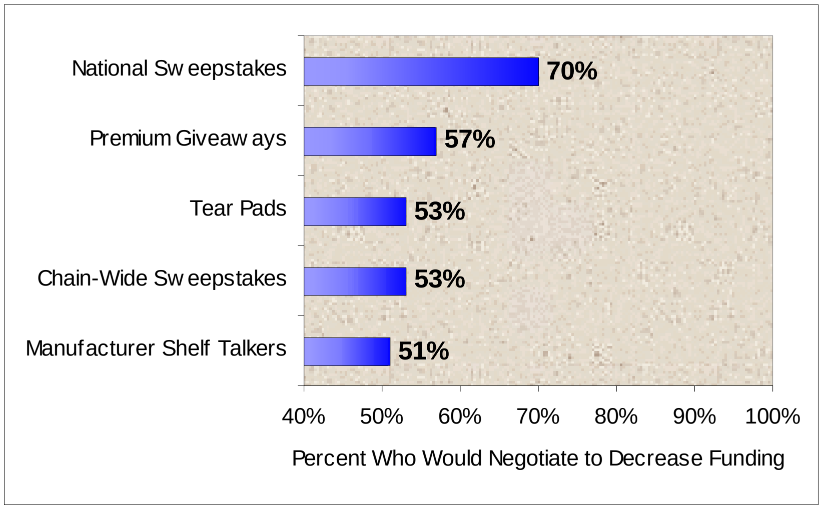
Of the 22 promotional programs that retail executives were asked to evaluate regarding effectiveness (to increase product movement or overall store sales), twelve consistently rose to the top of list. Likewise, the other ten were consistently perceived as average or below average in their effectiveness at either moving product or increasing store sales. Each group is listed below.

Lackluster Promotions

- Chain-Wide Sweepstakes
- National Sweepstakes
- Near Pack Offers
- Premium Giveaways
- Manufacturer Shelf Talkers
- Tear Pads
- Internet Programs
- Retailer Cross-Ruff
- In-Store Advertising
- Promotions Tied to Local Charities

Shining Promotions

- In-Ad Coupons
- In-Store Coupons
- Paperless Coupons
- Instant Redeemable Coupons
- Retail Shelf Talkers
- Co-op Television
- Co-op Radio
- Targeted Direct Mail
- In-Store Demos and Sampling
- Frequent Shopper Programs
- Shipper Displays
- Manufacturer Purchased Display Space



Negotiations for decreased funding *were most often indicated for national sweepstakes, which scored well above other promotional programs.*

Glossary of Terms Used in the Promotional Preference Survey

Chain-wide sweepstakes - a sweepstakes promotion offered in all stores through a retail chain.

Co-op media - promotional advertising for a manufacturer's product that appears on a retailers' television or radio ad and is funded by the manufacturer.

Frequent shopper programs - the support by manufacturers of promotions offered by the retailer through its loyalty card program (i.e., discounts - paperless coupons, etc.)

In-ad coupons - coupons for manufacturers' products that appear in the print ad of <u>one</u> retail company and are redeemable only through that one company.

In-store advertising - point of sale advertising in the retail store; on shopping carts, aisle markers, in-store radio or TV, etc.

In-store coupons - coupons that are distributed in the retail store.

In-store demos/sampling - the sampling of products in the retail store.

Instant redeemable coupons (IRC) - coupons that are attached to products in the retail store.

Internet programs - promotional programs that are offered to consumers through the retailer's web page.

Manufacturer purchased display space - special displays that are built in the retail store in space that is paid for by the manufacturer.

National sweepstakes - a sweepstakes promotion advertised and promoted by a national organization and available through various types of retail stores throughout the country.

Near pack offers - premiums that are offered by manufacturers as an incentive for purchasing a product and are available in the store.

Paperless coupons - coupons that are made available to consumers through a frequent shopper program or some type of card marketing program.

Premium giveaways - any promotion that offers a premium to consumers as an incentive for purchase a product, often a mail-in offer. This promotion can also be one that offers a premium to a store or department manager.

Promotion tied to local organization or charity - a special promotion where the retailer and manufacturer agree to contribute a portion of the sales to a local group.

Retailer cross-ruff – promotions or coupons delivered on one product (national brand) that are good on another product (retailer brand).

Shelf talkers - point-of-sale signage designed to hang over the edge of a shelf and deliver a promotional message. They may be produced by the retailer (usually price oriented) or by the manufacturer (usually product oriented).

Shipper displays - product that arrives at the store in its own display unit.

Targeted direct mail - promotional mailings sent to specific customers or a retail store encouraging the purchase of a specific product or brand.

Tear pads - promotional information in the form of a tear pad that is posted in the store - either by the product or at a central location such as a bulletin board.

Are Consumers Buying More Private Label (or Store Brand) Products?

Gene German
Professor Emeritus, Food Industry Management Program

Over the past few years, supermarkets, drug stores and general merchandise stores have been selling more of their own store brand products at the expense of nationally advertised manufacturers brands. And the forecast is that this trend will continue.

Twenty years ago supermarket chains offered consumers store brand products that attempted to duplicate the most popular manufacturer brands, but were priced slightly below these products. In most cases the quality of these store brand products was "as good" or "nearly as good" as their manufacturer brand counter parts. Because these products were produced by or for the supermarket chains, they incurred no selling or advertising costs and therefore, even when they were sold at a retail price that was slightly lower than comparable manufacturer brands, they returned a higher gross profit margin for the retailer.

Over the years retailers have continued to follow most elements of this strategy and consumers have found more and more satisfying store brands that include traditional canned food and packaged goods as well as personal care products such as toothpaste and deodorant.

During the 1990s, sales of store brand products in supermarkets increased approximately 13.5 percent of store sales to nearly 16.0 percent. The number of units sold increased from about 17 percent of the total number sold in supermarkets to over 20 percent during this same period. During the past year, private brand sales in supermarkets grew more rapidly than manufacturer brands. Store brands grew at 6.3 percent compared with a 4.1 percent for all manufacturer brands.

Last year store brand products had a greater market share than the strongest manufacturer brand in nearly 30 percent of all categories within the supermarket. Store brand ranked number one in 79 out of 266 individual product categories (categories such as pasta, cheese, baby food, ice cream, etc.). Store brand products were either the number 1 or number 2 brands in 131 product categories – nearly 50 percent of the 266 categories in the store.

This strength in store brand performance in recent years can be attributed to several factors. Perhaps of most importance is the new approach that supermarket companies have taken in the marketing of store brand products. The new marketing approach includes better packaging, improved quality and specific advertising and promotional programs designed to increase customer awareness and sales of store brand products. Also, during the 1990s many supermarket companies began to develop premium quality store brand products as well as new and unique products that were not being offered by national brand manufacturers. For example, in upstate New York, Tops Supermarkets introduced a premium quality line of private label products called "President's Choice"; Wegmans introduced a premium quality line of pasta and related products under its "Italian Classics" line. This trend has been adopted by other supermarket chains and has resulted in consumers changing their perception of store brand products from one of low quality to one of premium quality. As the quality of store brand products has increased so have prices. The result is that not only are consumers buying more store brand products than ever before, but they are also paying higher prices which has contributed to a higher overall spending level for store brand items.

Although grocery chains such as A&P and Kroger have sold store brand products since their inception more than 100 years ago, the concept is relatively new to retail drug chains and general merchandise companies such as K-Mart and Walmart.

Retail drug stores have found that consumers are receptive to private label products, and sales have increased in recent years. Between 1993 and 1999 the number of units of private label products sold in drug chains increased from about 8 percent to nearly 14 percent of all items sold. In mass merchandise stores the sale of private label products increased from just over 8 percent to slightly over 12 percent of total units sold during this same time period.

At the end of last year retail executives from supermarkets, drug stores and mass merchandise firms were asked to forecast the growth in sales of private label products during this year (2001). Retail executives from mass merchandisers were the most optimistic with a forecast of 15.9 percent growth, followed by drug store executives who forecast an 8.1 percent growth, and supermarket executives who projected a 6.7 percent growth of private label products in their stores.

What does this mean for the overall food system? Certainly it is a signal to national manufacturers of food and grocery products that competition from store brands will continue to increase. As retailers focus more on their own brands, they will focus less on manufacturer brands, especially on nationally advertised brands that have a weak marketing program and small market shares. These weaker brands will be in jeopardy of being eliminated from the shelves of retail stores. Retailers will want to use this space for the ever-increasing number of store brands that the company offers to consumers.

Customers could also benefit from a wider variety of higher quality store brand products to choose from and these products, in most cases, can be purchased at prices lower than comparable manufacturer brands.

Consumers should look for drug stores and general merchandise stores to add store brand products at a faster rate than supermarkets. The product mix in all types of retail stores will continue to change, but look for the shift to favor the store's own brands.

Impact of Generic Milk Advertising on New York State Markets

Harry M. Kaiser and Chanjin Chung
Professor/Director and Associate Director
Cornell Commodity Promotion Research Program

In New York State, farmers contribute $17 million annually to federally-authorized dairy promotion and advertising programs. Given the amount of this investment, it is fair to ask: Are farmers getting their monies worth? This article summarizes the results of recent research that investigated this question.

The $17 million spent each year on dairy promotion and advertising is allocated to national, as well as authorized regional, state, and local promotion programs. The largest regional program operating in New York State is the American Dairy Association and Dairy Council (ADADC). Other programs receiving financial support from New York dairy farmers include Milk for Health on the Niagara Frontier, which is located in the Buffalo area, and the Rochester Health Foundation. New York dairy farmers choose to devote all of the state promotion dollars on fluid milk advertising and promotion since increasing Class I sales benefit farmers more than increasing manufactured dairy product sales given the Class I premium.

The New York Milk Promotion Advisory Board (NYMPAB) has sponsored research with agricultural economists at Cornell University to develop a model of fluid milk demand for New York City, Albany, Syracuse, Rochester, and Buffalo media markets. These economists use the model to examine whether advertising significantly increases fluid milk demand in each of these five markets. The model is representative of real life conditions in that it incorporates farmer- and processor-funded advertising expenditures for fluid milk into the demand models for each of the five markets. If advertising is indeed effective, then the commercial demand for fluid milk should increase. This, in turn, should cause the demand for farm milk and thus farm prices to rise beyond what they would have been without such a program. By accounting for milk and dairy product prices, prices of substitutes (e.g., other beverages), consumer income, population, season of the year, and various demographic factors, the model can measure the net effect of advertising on demand and price over time.

Recent results indicate that generic milk advertising has had a positive impact on milk demand in all markets. Advertising had the largest impact on per capita demand in Buffalo, which was followed closely by New York City. These results are consistent with earlier findings by Cornell. While increasing demand is important, the true indicator of effectiveness is whether advertising raises farm prices and incomes by more than the cost of the program.

To look at this issue, the Cornell milk demand model was simulated to determine the impact of the New York State portion of advertising expenditures on producer milk prices and returns. The model was simulated with and without the New York portion of advertising to determine the impact of advertising on blend prices. From 1986-97, the average cost of the New York State portion of the advertising program was 5.5 cents per cwt. The results indicate that New York State blend prices averaged 8.8 cents per cwt higher due to state sponsored fluid milk advertising. Put differently, had there been no New York State program over this period, the blend price would have been almost 9 cents lower than it actually was.

Benefit-cost ratios (BCR) were also estimated for each of the five markets. The weighted average BCR for the five markets was 2.82, i.e., an additional dollar spent on state generic milk advertising resulted in an average increase of $2.82 in Class I revenue. Since the BCR for New York State is well above 1.00, this indicates that New York State's contribution to the overall advertising program had benefits that exceeded costs, on average, over this period of time. In terms of individual New York State markets, New York City had the highest BCR, which was followed closely by Buffalo.

These results show that dairy farmers, as a group, are benefiting from New York State milk advertising. Without milk promotion, consumer demand for dairy products would be less; this would negatively affect all dairy farmers.

Ways to Add Value to Farm Milk

Mark Stephenson
Sr. Extension Associate
Cornell Program on Dairy Markets & Policy

Prior to the mid-1800s it was common for farmers to be both the producers of milk and the processors of dairy products. Home delivery of farm milk, butter and cheese was usually done by the farmers who produced the milk and further processed the product. In recent years, a widening farm–to–retail price spread and other factors have left dairy producers wondering whether dollars are being left at the bargaining table with processors and whether a movement back to on–farm processing currently makes sense—or should I say cents? In the quest to add value to farm milk, it is not necessary to further process the product. Milk may have different values as a result of space, time and form.

Space, Time and Form

Space speaks to where milk is produced relative to demand. A farm near a plant in a metropolitan area may have the obvious drawbacks of difficult neighbor relations or a high property tax burden, but federal and state milk marketing orders generally recognize that this milk is worth more because of the lower costs of transportation to the market place. Lower costs to transport the raw product to the marketplace is also a factor with farms located near a major highway or at least good secondary roads and an easily navigable driveway.

Time can be a factor in the value of milk according to when it is produced. Historically, milk has been more valuable in the fall when demand for dairy products is at its peak and total milk production is declining. Timing calving cycles to anticipate the expected seasonal peek prices adds value to your product. Although not as prevalent today, it was a common practice to further accentuate market price movements with seasonal incentive plans through cooperatives or federal and state milk marketing orders. More subtly, timing the completion of your milking to coincide with a preferred time for your hauler to pick up farm milk may give you some edge in negotiating hauling rates.

Farms have some ability to control the form of their milk. Higher component values (butterfat, protein and other solids) will be rewarded through multiple component pricing in the new federal and state order systems. Voluntary premiums may be paid above and beyond the federal order minimums for milk components, and premiums are often paid for low somatic cell count milk. Other premiums for form may include the certification of your milk as meeting an organic, kosher, or other market segmentation standard.

Further Processing

It is quite typical for individual farms in the New York Dairy Farm Business Summary to have annual milk prices that differ by as much as $2.00 per hundredweight in any given year. Space, time or form can add value to your raw milk but further processing is also a possibility; however, the desire to add value to farm milk by further processing should be carefully planned and implemented. There are relatively few good reasons for producers to consider further processing: perhaps the market is not paying you the full value for your milk; there might be an unfilled marketing niche that you have identified; it is possible that you have better management skills to run a plant than your competition would have; or you are bored with milk production and need a bigger challenge.

Although rare, there are examples of producers who were able to demonstrate through further processing that the market had underpaid them for their milk. In the 1980s, twelve Jersey producers in Hilmar, California argued for several years that the value of their milk to a cheese plant was more than they received. With no satisfaction from milk buyers for their claims, they decided to build a cheese plant. Today, Hilmar Cheese is the largest single site cheese plant in the world. For a commodity product like cheddar or mozzarella cheese, a minimum plant size in today's market place probably requires two million pounds of milk a day to run through a plant. This is the milk from about 30,000 cows — considerably more than any single farm in the Northeast produces. In fact, a plant of this size would require all of the milk produced in Wyoming County.

If the scale of successful commodity processing is not feasible, then finding a market niche may be an alternative. The term "niche" connotes a small place often filled with a highly regarded object. Finding an empty niche is not easy but our proximity to eight million ethnically diverse people is an advantage. Many cultures have a fondness for dairy products not readily available in our supermarket-oriented society. If an unfilled demand can be identified, then the first and arguably largest hurdle has been crossed. The second and considerable challenge is to research the process of manufacturing a non–standard product. And finally, developing and maintaining marketing channels is no small task.

As with dairy farms, there are degrees of successful management in dairy plants. I would contend that a minimum demonstration of a producer's ability to run a dairy plant is to first operate a very successful dairy farm. The next step may be an accounting of the management skills that you possess which are transferable to a processing operation. Perhaps motivating employees and good input purchasing are among those transferable skills, but market development abilities and other essential proficiencies are probably untested.

It is not easy to compete with people who have years of experience in the processing arena.

In Conclusion

Before making a decision to invest in a processing plant, consider whether or not the returns to space, time and form have been fully exhausted. The dairy processing sector is an intensely competitive arena with little room for error. Success stories like Hilmar Cheese can be found, but tales of broken dreams are more common. We have developed a list of questions that we think should be answered by anyone considering dairy product processing. These questions can be found in the miscellaneous publications section of our web site at *http://cpdmp.cornell.edu*.

Dairy Farmers Bargaining in Unfavorable Market

Brian Henehan and Bruce Anderson
Sr. Extension Associate and Professor, Agricultural Cooperatives

Following some of the highest milk prices ever, dairy farmers are seeing what the flip side of a market can bring as milk prices continue to drop. Commercial inventories of cheese and other dairy products remain high. International markets for dairy products are weakened some due to sagging exchange rates versus the dollar. Commercial prices for cheese and nonfat dry milk are at or below support levels.

For years many dairy farmers have argued for a "free market" with less government involvement. As this wish is fulfilled, new lessons will have to be learned while the dairy industry becomes more market oriented. With the federal government backing away from supporting prices, greater fluctuations in price will continue to occur. Expect to see increased risk and uncertainty as players in the market adjust to the new rules of the game and a new structure of the industry.

With moderately tight supply conditions and strong product demand over the last two years, dairy farmers enjoyed the fruits of the market. Farmers in the right situation were able to bargain for even higher premiums. Farmers could readily switch to handlers offering the best price. As the market flips, this situation has changed.

Along with increased premium payments came thinner margins for many buyers of milk, creating economic stress within some firms. Increased mergers and acquisitions in the dairy processing industry have caused plant consolidations and firms to reevaluate their Northeast operations. The end result is fewer buyers of milk at a time when more and larger groups of farmers are negotiating prices.

Federal order changes have resulted in a new component pricing system (MCP) and plant point pricing in the entire Northeast has affected the way producers are paid. A reallocation of hauling costs has also had an impact at the producer level. Producers in the old New York-New Jersey Order No. 2 are still acclimating themselves to the new rules.

So what can farmers expect from the flip side of the market?

- Having a secure market will become more important.
- There will be strong downward pressure on premiums.
- Opportunities to move from handler to handler will evaporate.
- Some farmers will be dropped by

some handlers.

· Several plants will close or be consolidated as merger pressures continue.

Under these market conditions, the opportunities for farmers to bargain for prices will change in the following ways:

- The bargaining power of smaller local bargaining groups will diminish.
- Operating cooperatives will play a more important role in surplus markets.
- Balancing facilities will experience increased utilization.
- Market-wide or larger bargaining groups will increase in importance.

One further point, New York State has more small local cooperatives than any state in the country. In fact, it has about 25 percent of ALL U.S. dairy cooperatives. This has somewhat been due to the four cent "cooperative payments," which disappeared on January 1, 2000 as well as Upstate New York's close location to major consumption areas. We expect the elimination of cooperative payments to reduce the number of small local cooperatives.

Dairy farmers might minimize detrimental effects from the shift to a more competitive market by taking the following actions:

- Analyze the impact of changing market conditions on your individual marketing opportunities.
- Reevaluate actual market power as individuals or small groups.
- Sell to buyers with high market security and proven performance.
- Support market-wide bargaining groups.
- If the market dictates, be proactive in dissolving ineffective small bargaining organizations and seek organizations likely to have longevity and profitability.

Smart marketing involves understanding and anticipating changing markets. Farmers who adjust to unfavorable market conditions by developing a long-range strategy will be in the best position when prices become more favorable. This is a dynamic market, which requires dairy farmers to be "smart marketers".

Understand Your Milk Check First

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A drop in milk prices, such as we had last year, sometimes leads milk producers to think about the "greener pastures" of changing their milk handler. Comparing prices with neighbors can provide a hot topic at the local coffee shop. In a study of over 200 milk checks from New York producers in August 2000, we found significant variability of pay prices. But producers really need to understand their milk check first, before they can understand and evaluate the alternatives. In some ways, Federal Milk Marketing Order (FMMO) Reform implementation has made this process even more difficult.

The implementation of multiple component pricing (MCP) explains some of the variation. In our milk check study, total component values per cwt. ranged from $9.19 to $12.66 — although the high was $10.84 for herds under 4% butterfat. We have a simple spreadsheet[1] available that can help producers evaluate alternative component test and production trade-offs on revenue.

However, when comparing prices, components should be taken out of the analysis since component prices are the same for all handlers procuring milk in New York. The only exception is somatic cell adjustment for milk priced under the Mideast order (generally in Chautauqua county). Instead, comparison should be made on the net "non-MCP price" including the Producer Price Differential (PPD) plus premiums and minus deductions. Comparison of any of these elements in isolation otherwise can distort comparison.

[1] Can be downloaded: *http://www.cpdmp.cornell.edu/CPDMP/Pages/FMMO/MCP.html.*

The PPD is Only Part of the Story

The PPD is basically the weighted average classified value of the milk in the market pool less the average component values paid to producers (with a few other adjustments). The PPD for the Northeast Order is announced at Boston and a producer's PPD is adjusted for the location of the plant of first receipt. The PPD varies from month to month but the location difference between plant zones does not. For example there is a $.75/cwt. lower price for a plant located in Syracuse than one located in Boston. The difference reflects a portion of the hauling costs from a general area of milk supply to a milk deficit metropolitan area.

Some producers in lower priced zones may have the option of shipping to handlers in higher PPD city zone locations but this needs to be evaluated along with the likely increase in hauling costs. Proprietary handlers that move a producer's milk to multiple locations for the month pay a weighted average PPD. Cooperative handlers who move a producer's milk between plants, may or may not pay the exact weighted average PPD but instead may adjust the hauling such that a producer may receive a consistent PPD regardless of where the milk actually goes.

Premiums and Deductions

Premiums generally include any positive adjustment to prices over and above the minimum federal order prices. Quality, volume, and what can generally be called "market" premiums are paid by many handlers. However premium levels and program requirements can vary significantly by handler and region. Some producers also receive a Northeast Interstate Compact payment. This can be included among the premiums and should be factored into weighing the options as we found that other market premiums tend to be lower.

Deductions usually include the hauling cost that is typically based on a per hundredweight rate and often an additional charge per pick-up (or "stop charge"). Other deductions could include co-op dues or market order fees paid by independent producers. The promotion fee of $.15 does not vary among handlers.

Look Before You Leap

The preliminary results (see table) of our New York milk check study showed wide variability across the state of the PPD, premiums and deductions individually and of the net non-MCP price (PPD + premiums – deducts) adjustment. But many additional

New York Milk Check Analysis – August 2000 ($/cwt)*

	Average	*Range*
PPD (plant zone adjusted)	***$2.48***	***$1.92-$3.26***
+ Market	$0.21	$0.00-$1.14
+ Quality	$0.11	$0.00-$0.70
+ Volume	$0.14	$0.00-$0.70
+ Compact	$0.13	$0.00-$0.91
Total Premiums	***$0.58***	***$0.00-$1.65***
- Hauling	$0.55	$0.00-$1.38
- Other deducts	$0.04	$0.00-$0.18
- Promotion	$0.15	$0.15
Total Deducts	***$0.74***	***$0.16-$1.55***
Net Non-MCP Price	**$2.32**	**$1.11-$3.69**

*****Preliminary results from 214 milk checks from August 2000 collected from New York State producers. The simple average of farms is reported.

issues arise when considering market alternatives. The long-term record of financial stability and service of the co-op or proprietary handler is important to consider. The distributable profits (and equity) associated with cooperative membership were not included in the study but in some cases are significant. Similarly some proprietary handlers may pay signing bonuses that also were not included in our study. The co-op or proprietary handler may provide other valuable services that should not be ignored. Finally keep in mind that premiums can and do change over time. If considering an alternative market, it is important to contact your current handler, as well as any alternative handlers, to understand <u>exactly</u> how your payment might change. Price variation among handlers may offer producers opportunity, but as always "look before you leap."

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Farm to Retail Price Relationships for Fluid Milk

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The relationship between farm prices and the retail prices of milk and dairy products has received a great deal of attention recently. As farm milk prices fell to low levels last year, farm groups questioned why the price of milk at the supermarket didn't seem to be falling to the same degree. When the issue of the relationship between farm and retail prices arises, it is often focused on fluid milk, because that product undergoes relatively little transformation from the farm to the supermarket. The decline in the proportion of the consumers' dollar received by dairy farmers is often cited as evidence that "something is wrong" with farm-to-retail price relationships.

How have farm-to-retail price relationships for fluid milk changed over time? To explore this question, it is helpful to adopt a long-term perspective. During the past 30 years, both farm and retail prices have increased for fluid milk (Figure 1). Since 1990, farm milk prices have been highly variable but average prices have not increased. National average prices of fluid milk at the farm and retail level tend to be highly related over this period.

The *gross marketing margin* is defined as the difference between the retail price and the farm equivalent value of the milk used in the product. It includes all costs associated with transforming, transporting, and selling the product at the wholesale and retail level, it is not directly equivalent to profits earned by wholesalers and retailers. For fluid milk, the gross farm-to-retail marketing margin has increased in steps over the last 30 years. What accounts for widening marketing margins? A variety of factors have been advanced as the underlying cause, all of which likely have some merit. At a basic level, however, increases in the marketing margin over time can reflect increases in marketing costs (for processing, transportation, distribution, etc.), increases in the profit margins of processors, wholesalers, or retailers, or a combination of the two.

There are four underlying reasons for these increases in the gross marketing margin for fluid milk: increased costs of labor, packaging, and fuel for fluid milk processors and food retailers; costs associated with development of new products and changes in the packaging; changes in retailer perceptions about the role of milk and milk prices in the retail store; and consolidation of firms in milk processing and retailing. Statistical analyses of national-average data indicate that much of the increase in gross marketing margin is associated with increased costs for processors and retailers. That is, increases in margins do not reflect primarily increases in profits by dairy processing companies or retailers at the expense of dairy farmers.

Another main theme in the debate about dairy price relationships concerns whether dairy product prices respond "adequately" to changes in the underlying farm milk price. There is a commonly-held perception that retail prices can and should respond immediately and to both increases and decreases in the farm milk price. It is often stated that retail prices of dairy products respond only to increases in the farm milk price, but not to decreases. This "asymmetric" response to price changes is seen as evidence that wholesalers and retails are taking advantage of farmers and consumers by using variation in farm milk prices to increase profits.

Statistical analysis of what is called "price transmission" from the farm to retail level is used to examine this question. A number of studies have been made since the mid-1980s, and most of them have found evidence that wholesalers and retailers respond more quickly to farm milk price increases than to decreases, at least over the period of a few months. As a result, wholesalers and retailers tend to earn higher net margins for a short time when farm prices drop than if they responded equally to farm price increases and decreases. This "short-run asymmetry" is sometimes cited as evidence of unfair treatment of farmers and consumers.

However, it can also be viewed as a retailing strategy that helps maintain price stability for consumers, because retailers tend not to pass on the full amount of a farm-price increase. The evidence about the long-run effects of price changes at the farm level, where an increase in the farm milk price results in a permanent increase in the retail price even if farm prices subsequently decrease, is much less consistent. This "long-run asymmetry" has been found in certain periods in certain regional markets, but does not seem to characterize all fluid milk markets at all times.

It is helpful to consider additional sources of information to evaluate how marketing margins for milk have changed over the last three decades. One is whether increases in retail dairy product prices and margins are in line with increases for food products more generally. A 1999 USDA study reported that retail prices for all food items increased 61% from 1982 to 1997, but retail prices for dairy products increased only 47%. This suggests that retail price and marketing margin increases for dairy products are similar to—but somewhat less than—increases for other food products. A second source of information is the profitability of dairy processors and food retailers over time. Many dairy processors are privately held firms, so information on their profitability over time is largely unavailable. Profitability information reported by Coopers and Lybrand for 12 US dairy processing companies in 1999 indicated that the average return on assets was 3.7%, far less than the 11.9% average for all food industry companies. Publicly traded food retailers earned about 3% return on assets in 1999. These figures suggest that fluid milk processing and food retailing are low net margin, volume-driven businesses.

In summary, the gross marketing margin for fluid milk has increased over the past 30 years. This is primarily due to increases in costs of processing and retailing. There is a strong relationship between farm and retail prices, although for short periods of time retail prices may increase more rapidly than they decrease in response to changes in the farm milk price.

OTHER A.E.M. EXTENSION BULLETINS

EB No	Title	Fee (if applicable)	Author(s)
2001-16	New York Economic Handbook 2002	($7.00)	Extension Staff
2001-15	Income Tax Management and Reporting for Small Businesses and Farms		Cuykendall, C. H. and G. J. Bouchard
2001-14	Dairy Farm Business Summary: Eastern New York Renter Summary, 2000	($12.00)	Knoblauch, W. and L. D. Putnam
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