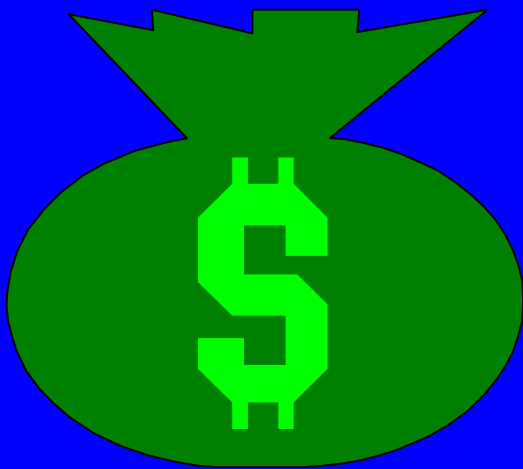


Food Marketing Costs



AGBU 430
Chapter 11





**Food Marketing Doesn't
Cost - It Pays!**

Questions

- Does food marketing cost too much?
- Why are marketing costs so high and rising?
- How do marketing costs affect farm and retail food prices?
- How could food marketing costs be reduced?
- Are food marketing profits excessive?

Marketing Margin

- Marketing Margin: portion of the consumer's food dollar that goes to marketing firms; difference in what the consumer pays for food and what the farmer receives
- Price of all utility adding activities
- Includes all expenses and profits

Who Pays For Rising Marketing Costs??

Price

Retail
Price

Farm
Price

Payment to Marketing

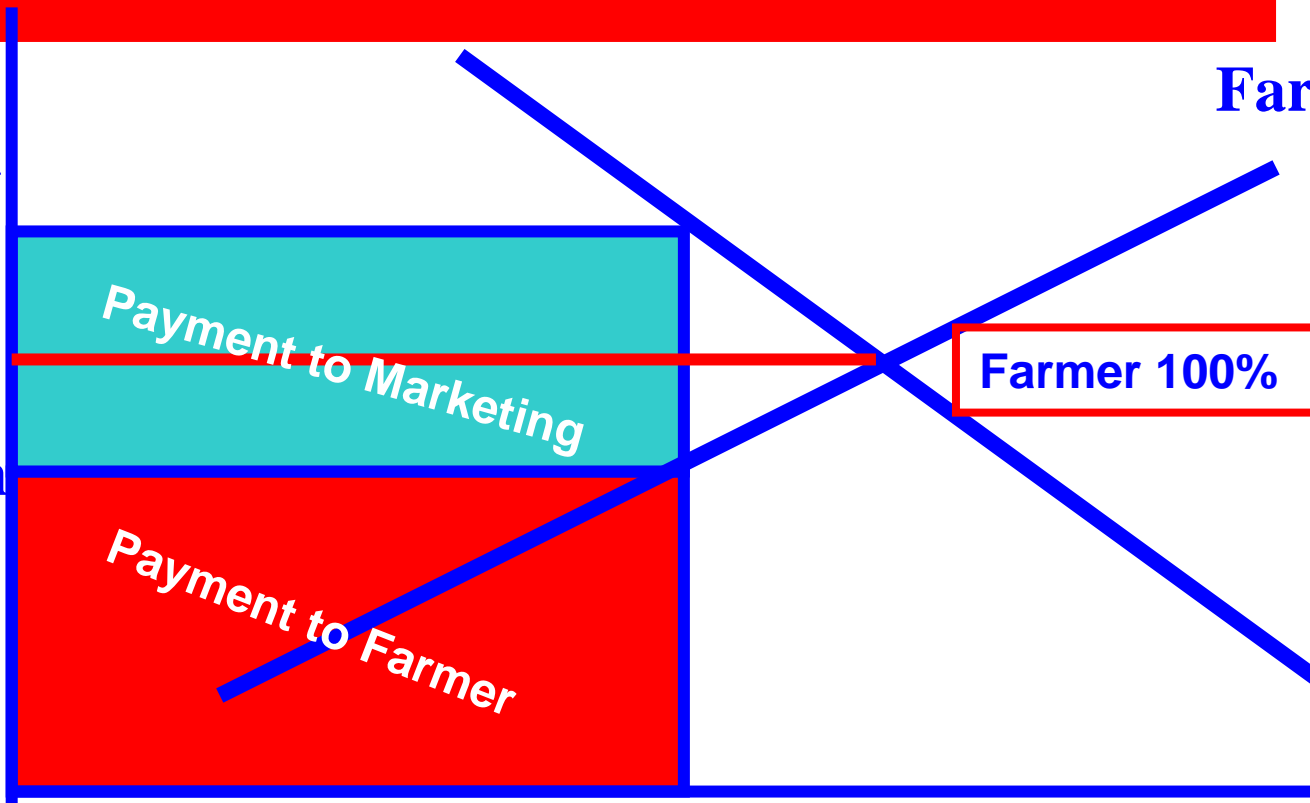
Payment to Farmer

Farmer 100%

Farm Supply

Retail
Demand

Quantity



Marketing Margin Myths

- Small marketing margins denotes efficiency
- Large marketing margins reflect “too many” middlemen
- Large marketing margins cause low farm prices
- Marketing margin reflects profits to marketing firms

Marketing Bill

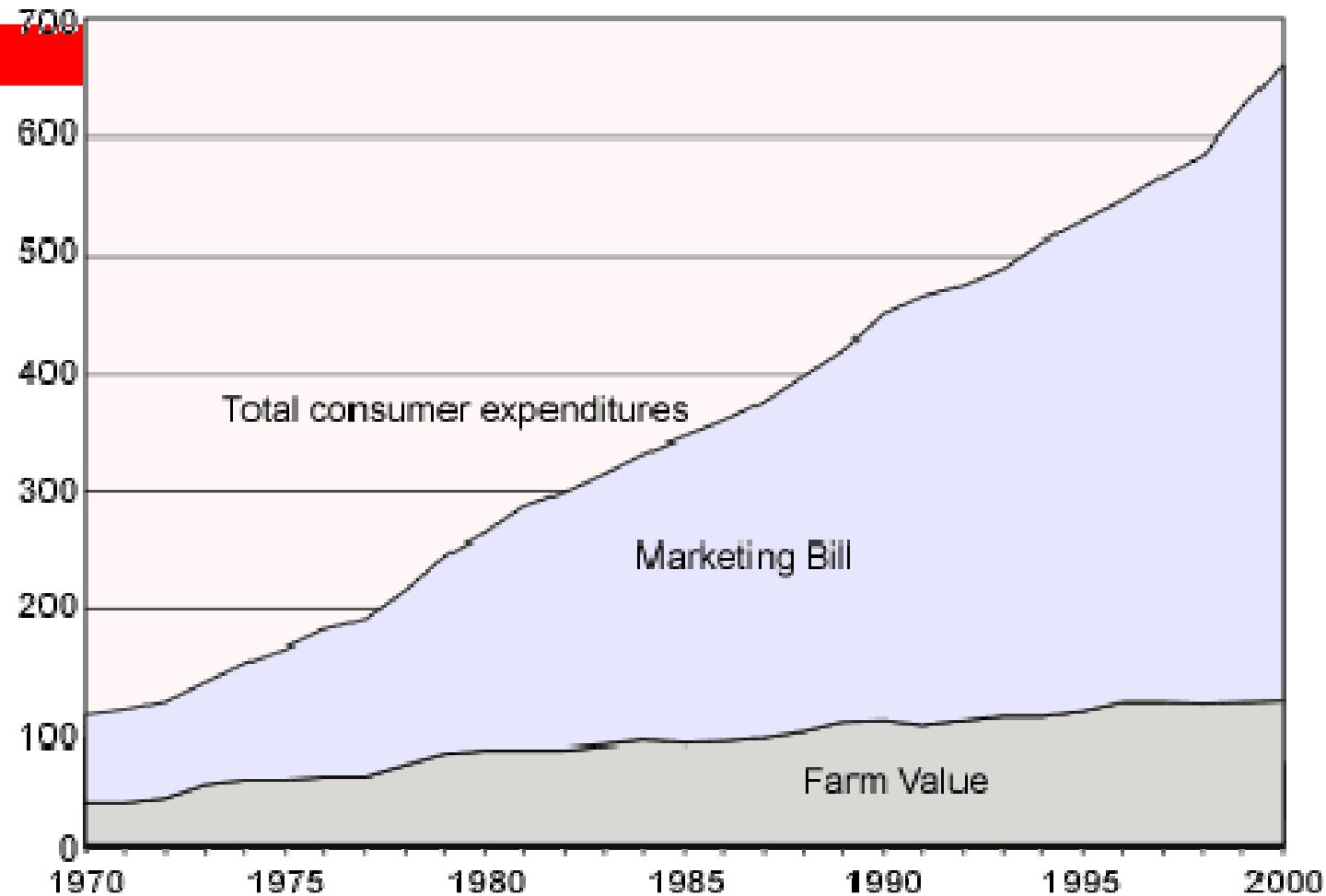
- Marketing Bill: difference between consumer expenditures for all domestically produced food products and what producers receive for equivalent farm products
- 80% to marketing
- 20% to producers

Trends in Food Spending, Marketing Bill, and Farm Value, 1970-2000

billion dollars

current dollars

constant (deflated) dollars



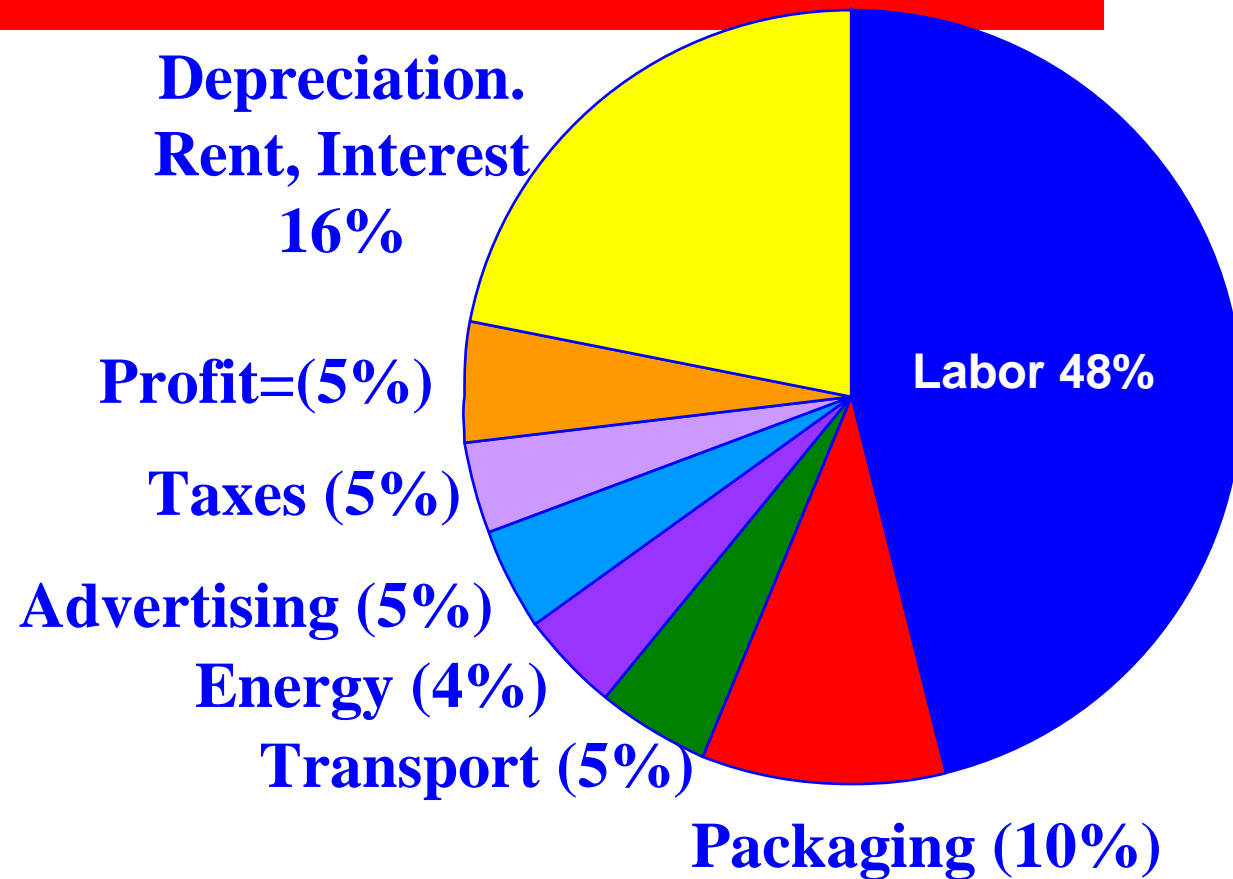
Reasons For High and Rising Food Marketing Bill

- Increased population growth
- Increased income which increases Demand for marketing services (packaging, convenience, etc.)
- Rising costs of marketing (labor, energy, etc.)

Component of Marketing Bill

- **LABOR!!!**
- **Packaging**
- **Interest & repairs**
- **Transportation**
- **Advertising**
- **Depreciation**
- **Taxes**
- **Energy**

Components of the Food Marketing Bill



Food Marketing Labor Costs

- 48% of Marketing Bill
- Three Consequences:
 - Bill rises with general labor costs
 - Make margin inflexible downward
 - Encourage mechanization, productivity

Profits in Food Marketing



- **Increasing over time**
 - Differentiated products
 - Diversified companies
 - Plant operation efficiencies
- **Net Profits as a % of Sales**
 - Show the share of consumer's dollar going for profit
 - Makes food industry profits seem lower
- **Return on Investment**
 - Compares returns to invested dollars
 - Makes food industry profits seem higher

Food Industry Profits

- High
 - Frozen foods
 - Bakery products
 - Breakfast cereal
 - Dairy products
 - beverages
- Low
 - Meat
 - Sugar
 - Edible oils
 - Milk

Do you notice any trends?



Marketing Cost Index

- Marketing Cost Index: shows the annual changes in variable operating costs incurred in processing, wholesaling, and retailing foods.
- Ratio of current costs of food marketing inputs to cost of these inputs in a base year
- Reflects changes in labor, packaging, materials, transportation, advertising, energy, rent, maintenance, and interest

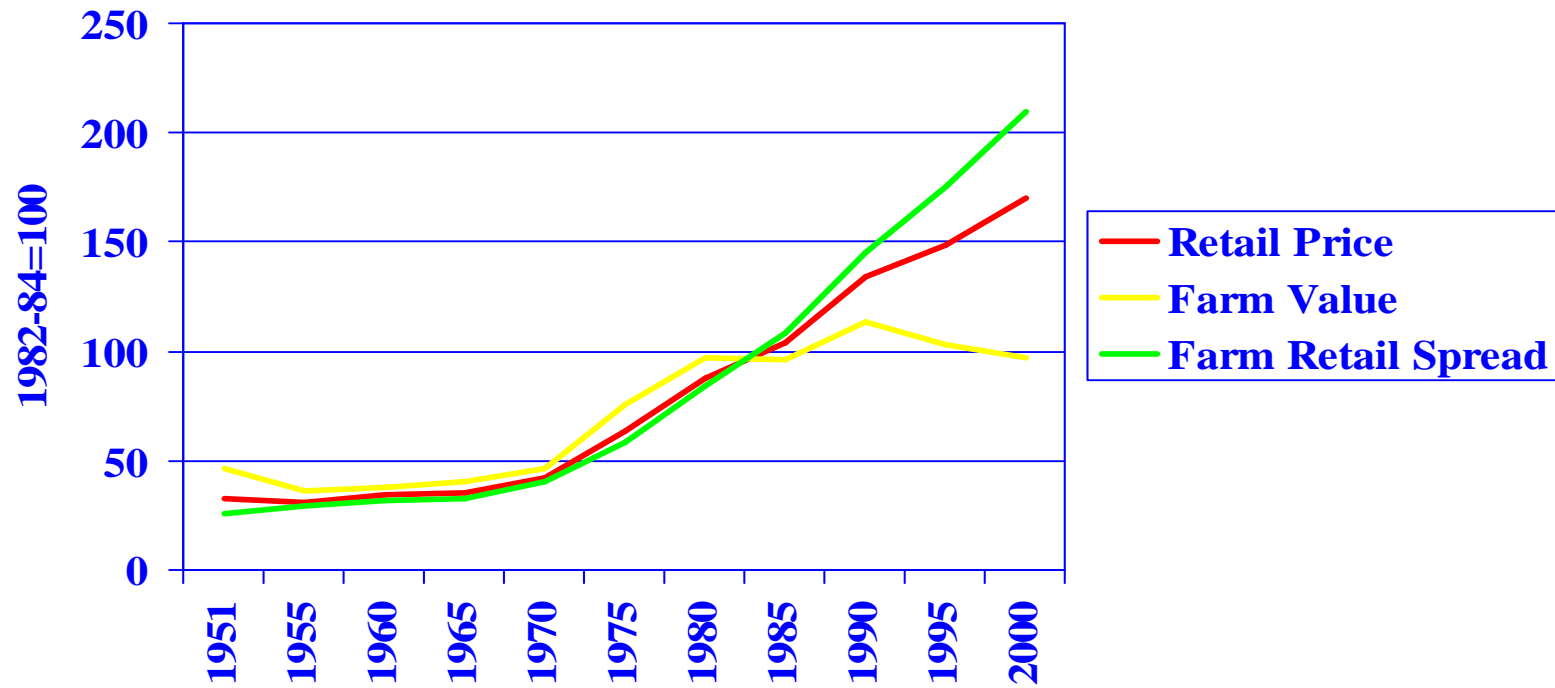
Farm-Retail Price Spread

- Farm-Retail Price Spread: measure of marketing margin; represents payments for marketing functions after the good leaves the farm
- Marketing bill is concerned with expenditure margins for all foods in a class
- Farm-Retail price spread is concerned with price margins for individual foods

Farm-Retail Price Spread

- Not difference between farm and retail prices
- Is difference between farm and EQUIVALENT AMOUNT of food sold by farmer
- Ex: 1000# steer gives 417# retail beef cuts, so 2.4# live steer = 1# beef cuts
- If live steer sells for \$0.75# and retail for \$3.50#
- Farm-Retail price spread \$1.70#

The Farm-Retail Price Spread, 1950-2000



Farmer's Share

- Farmer's Share: difference between retail price and marketing margin
- Changes caused by:
 - Change in marketing costs
 - Changes in supply and demand
 - Change in preferences

Farmer's Share

- A lower share of a higher farm value is still more money!
- Decreases in farmer's share:
 - More processing
 - Transportations costs

Farmers' Share of Retail Price by Commodity

• High Farmers Share:

- Eggs 47%
- Chicken 49%
- Beef 49%
- Milk 39%
- Cheese 32%
- Pork 25%
- Frozen OJ 35%

• Low Farmers Share

- Corn Flakes 5%
- Bread 2%
- Canned Tomatoes 7%
- Frozen French Fries 10%
- Chicken Dinner 15%
- Applesauce 18%

Meaning of the Marketing Margin

- **False: Excessive Profits???**
- **False: Poor Marketing Efficiency????**
- **False: Too Many Middlemen????**
- **False: Cause of Low Farm Prices????**
- **True: Value Added by Farmers, Marketing Firms**

How Do Rising Marketing Costs Affect Food Prices??

I. Derived Demand Theory:

Retail Price

Less Marketing Costs

Equals Farm Price

II. Cost-Plus Theory:

Farm Price

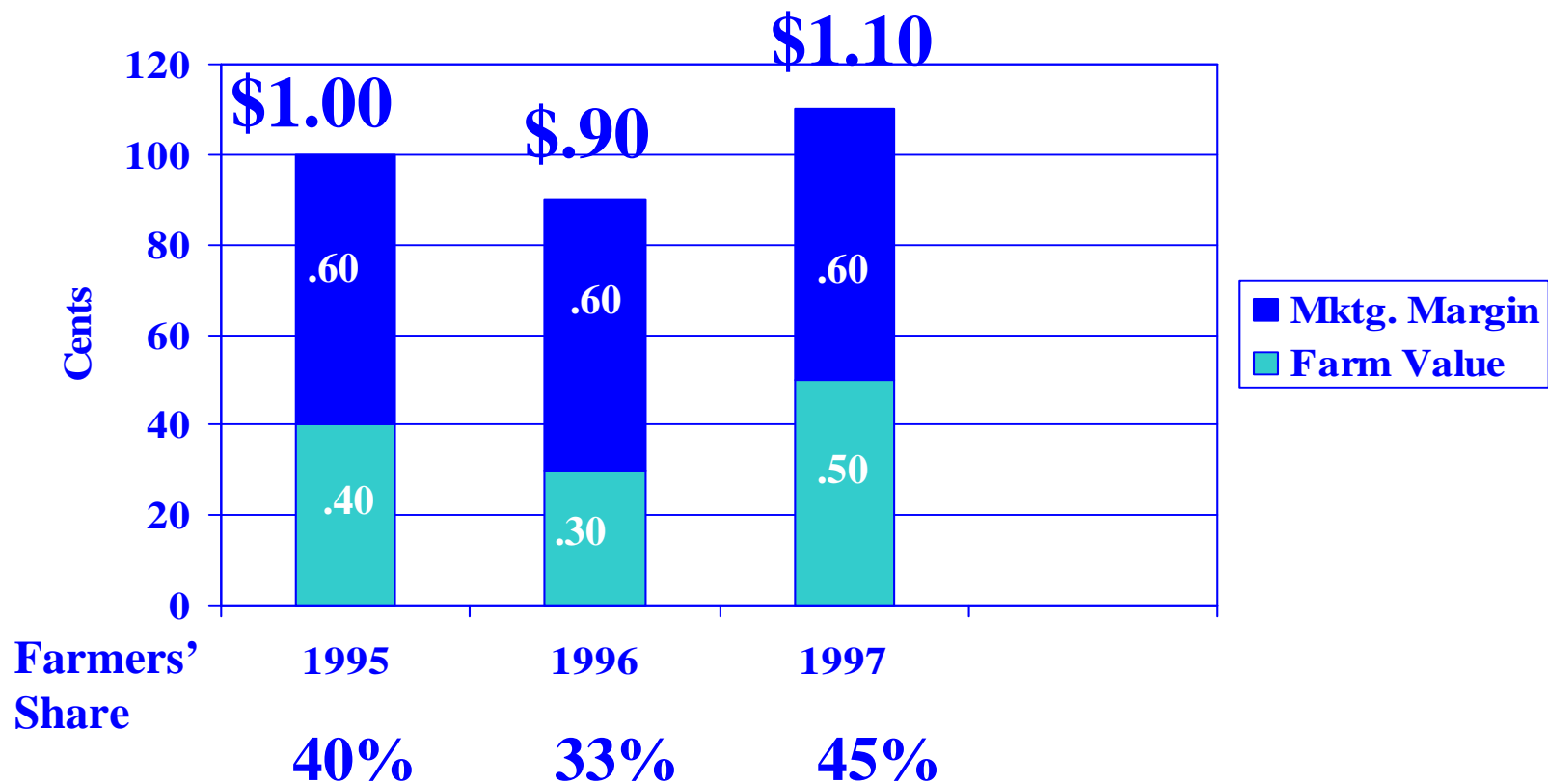
+ Marketing Costs

Equals Retail Price

The Sticky Marketing Margin

- **\$ Margin Does Not Change With Retail, Farm Prices**
- **Causes Variability in Farm Prices, Farmers' Share**
- **Reasons for Stickiness:**
 - Large Wage Component
 - Marketing Costs Based On Volume, Not Value
 - Imperfect Competition

Impact of Sticky Margin



How Can We Reduce Food Marketing Costs?

- Reduce Food Marketing Services??
 - Advertising
 - Packaging
 - Etc.
- Increase Competition, Reduce Profits
- Reduce Inflation
- Improve Efficiency