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Determining the Rationality of Marketing Strategy on Farms

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Abstract

The focus of farm management, as a discipline, has reflected historically the assumption that farms are embedded in near-perfectly competitive market structures. The common validity of this assumption is plain. As open systems, farms have asymmetric relationships with their environment: they are significantly more influenced by it than influencing it. However, farmers seem often not to appreciate the implications of this for their management options. Nor, arguably, is the farm management discipline yet well equipped to analyse initiatives that farmers might contemplate to enhance their control over market outcomes, specifically, as a means of exerting greater control over business performance.

In this paper a framework for the analysis of the prospects for product differentiation of farm output is presented in an attempt to fill this lacuna.

Introduction

As an academic discipline, historically farm management (FM) has been focused on management decision making (Charry and Parton 2002). The domain of physical agricultural production activities may have been taught within farm management qualifications, but the discipline has persistently involved analysis for decisions. Within it farms are characterised as purposeful, open, complex systems having to cope with substantial stochasticity (Dillon 1992). Economics has been the discipline used to most effect to analyse farm management decisions (Malcolm 2004).

Concern has been expressed, from time to time, at the low impact the farm management discipline appears to have had on farmer practices. Thoughtful analyses (by, for example, Charry and Parton 2002 and Kemp et al. 2005) have explored the waxing coverage and relevance of FM to farm management practice, especially in the context of the emerging challenge of sustainability (Bawden 1991). One analysis has suggested that farm management analysis and advice has too often been 'from an outside perspective' rather than usefully adopting the perspective of the farmer (see Brennan and McCown 2001). This may be so generally, or not, but does seem valid in one respect. This is with regard to the farmer's contemplation of their strategic marketing management: the choice of the products it is most appropriate for them to make.

Notwithstanding the open systems perspective that now is widely believed to pervade FM thinking, some assumptions are attached to it which restrict the purview of the FM analyst and, more concerning, are usually implicit and not necessarily shared by farmers. Those assumptions are to do with the competitive structure of production agriculture. Assumptions of output homogeneity and price taking enable the partitioning of a farm from its off-farm environment to such an extent that the latter can comprehensively be mapped with data series. That is, dealing with the off-farm environment is assumed to involve coping with stochasticity in all of input availability, input prices and output prices. This lends production economics its powerful relevance; managing farms is not much more than being a production manager facing stochastic demand for outputs. The products to be made, or the set from which they are chosen, are determined elsewhere, infrequently, in the management process.

Explicit theorising about farms using systems theory has been uncommon since Dillon's (1992) work. One result of this, arguably, is that insights generated have been rather few and obvious. They have also been incomplete. They have brought analysts' perceptions of the complexity and interconnectivity of farms, their environment and farm management closer to those of farmers, and reality, but could usefully go further. One fruitful extension is available from the systems work that deduces control over organisation performance from the nature of the external (particularly the competitive) environment

(Emery and Trist 1965). (This approach of categorising environments, and inferring rational behaviour, will be familiar to economists.)

Emery and Trist, using the notion of relevant uncertainty and its sources, argued the need for distinctive approaches to strategic management depending on the environment an organisation was facing. Most attention in systems theory literature has been paid to the most evolved of these environments: 'turbulent fields'. However, the category that they argue denies 'strategy' any meaning, for lack of relevant predictability, is the least complex environment and their equivalent of perfect competition, 'placid, randomised' environments. Many segments of Australian agriculture appear to be in such environments. Here, strategy is indistinguishable from tactics and survival is contingent on the capacity of the organisation to absorb the negative consequences of poor foresight. Knowledge of the environment comes from trial-and-error learning.

The combination of the atomism of perfect or near-perfect competition and the non-existence of perfect information leads to the radical reduction in the worth of the best feature an open system has going for it: the ability deliberately to modify entropy, the inevitable demise of closed systems (von Bertalanffy 1968). Contemplating the prospects for rational marketing strategy amounts to more than scanning for clever initiatives in an existing competitive space. For marketing strategy to become rational, it has to be possible to move away from perfect competition in meaningful ways. Unless one can do this, open systems theory indicates that farm management is bound to have limited impact on long-term farm survival.

The business of farming is complex and often uncertain on-farm, probably moreso than in any other economic sector. This makes it difficult to manipulate resources to achieve multiple objectives of even a strictly physical kind for output quantities and qualities, resource stewardship and labour use effectiveness. The prospect of x-inefficiency is very high as a result of input and related production process variability alone and, arguably, the bulk of FM attention is to the reduction of this inefficiency. Hence, the degree of

closedness in the emphasis in management of farms as open systems; the internal, production orientation, as conceived in FM.

Farmers, meanwhile, like most business managers, yearn to escape near-perfect competition, to differentiate their output or otherwise modify their environment to better control their returns. They seek to impact on the market component of their economic environment, an outcome that product differentiation enables (Einav and Levin 2010, p.148). Arguably, most who believe this possible are naively optimistic; but some are not. Many farmers (amongst others; eg, see Parliament of Australia, Senate Economic References Committee 2010), likewise, believe that their lack of control over price, especially compared to that of 'middlemen', is iniquitous. Not all are necessarily wrong.

For completeness in farm management analysis it seems necessary to move beyond both the bio-economic details of farms as factories and beyond applied production economics. The market-oriented, strategic analogue of the very specific FM analysis of on-farm production decisions requires an analytical framework capable of detecting whether or not it is valid for a farmer to contemplate influencing market outcomes via product differentiation. Without an analytical framework sufficient to the task of framing the role of a farm in its marketing system, it is not known whether a farm is best managed as a substantially closed system or whether active, market-oriented strategic management should be a major concern in the management of the farm. Nor can it be known whether a farm may be moved from one state to the other.

To express this another way, it is apparent that some farmers are successfully differentiating into niche markets: for branded, high quality meat; for farmers' market produce; for wool for specific wool processors; and so on. For FM to afford comprehensive relevance to farmers, analysts have to be able to identify when such attractive thwarting of the implications of perfect competition is possible and when not.

A framework designed for such a purpose is outlined below.

Managing relationships with the environment

Managing open systems involves managing inputs, including information, and outputs in ways that achieve the objectives set for the organisation (Dillon 1992). Achieving objectives, for a sustained period, requires that outputs are valued, on average, more highly than the inputs required to create them. A logical implication of this is that managers are best placed to achieve objectives if they understand, a priori, the relative value of the various outputs they are capable of producing¹. Marketing theorists press this reasoning a little further by suggesting that an understanding of customer needs and preferences, and competing (substitute) offerings, enables efficient production decisions. This direct linking of customers and output value causes marketing analysis to overlap considerably with strategic management, in its broadest form, as a decision-making domain.

As straightforward as this approach to contemplating markets for output may be, it has severely restricted relevance. Implicit in the reasoning is the assumption that these understandings about demand can enable the adroit application of inputs to the production of (most, or at least highly) valued output. That is, it is assumed that the manager has substantial control over any characteristics of the output that determine its fit with customer preferences *and* its competitiveness. To use marketing jargon, these characteristics may be anywhere in the 'marketing mix', the group of sets labelled product, place (distribution), promotion or price (McColl-Kennedy and Kiel 2000, Malcolm, Makeham and Wright 2005).

This assumption of sufficient control may be imperilled in either of two ways: by variation intrinsic to production or distribution processes; or by lack of control arising from salient competitive structure. In many areas of farming the former is considerable due to weather and pestilence, bearing strongly on output quantity and physical aspects of quality. For the latter, in the great majority of product categories in agriculture competitive structure undercuts control. This is due to two causes: near-perfectly

¹ Clearly, the management decision making being contemplated here is more likely to be occasional than routine. It is, in effect, decisions about enterprise mix but analysed in terms which may extend productive effort well beyond 'production agriculture'.

competitive structures at farm level; and imperfectly competitive, or oligopolistic, competitive structures in markets either side of farms in marketing systems. The latter enables, though not ordains, poor price transmission.

The multiple dimensions of the marketing mix track into the notion of control. Control may thus relate to product quality, to product accessibility for customers, to prices (and margins) achieved by the producer of interest, and so on. Whether lack of control renders knowledge of customer preferences useless depends on (a) whether the lack of control is accompanied by variation, (b) whether the customer cares (ie, there is a non-zero elasticity for variations in the dimension) and (c) given (b), whether associated premiums and discounts flow back to the producer.

A question that arises immediately here is ‘who is the customer?’ or, more specifically, ‘which market level is being contemplated?’ This links to a concern that many farmers have which is that, while they provide valuable product characteristics to final customers, this does not seem to impact on outcomes of their encounters with their own, nearer customers at farmgate markets. This line of thinking may readily confuse undifferentiated marketing with niche marketing (McColl-Kennedy and Kiel 2000) and slide over the substantial business redefinition implicit in a farmer entering wholesaling or retailing. However, there is a kernel of validity to the concern: in a contestably competitive marketing system the starting point for the valuation of that system’s output is the value the final customer places on it. There is no incentive for a producer to be more distant from the final customer of the marketing system than is necessary.

A reasonable, idealised model of strategic analysis by a farmer, as any producer, would be one that sought to identify, by tracking back through market levels from the final customer, which, if any, farm output characteristics both varied and mattered to final customers (Wright 1996). That is, is there a significant and recognisable part of farm output in the total marketing mix (including retail services, etc) that the final customer is presented? Unless there is, the farmer must look to closer and closer markets in the marketing system until an affirmative answer is found. In the absence of such a relevant,

identifiable part of output, it is meaningless for the farmer to contemplate a customer for the final product to which they contribute as one of *their* customers. A clear example would be a plantation forester viewing a purchaser of pine furniture as a customer, which is plainly silly. Another, though, would be Monsanto viewing purchasers of highly processed, GM-produced grain-based foods as customers. Those final customers who are concerned about the presence or absence of the GM attribute *are* Monsanto customers, in this sense. (There is little evidence that Monsanto sees the world this way.)

It has to be cautioned that it is seductively easy for any producer to imagine that there is a market niche composed of final customers who care intimately for the characteristics the producer imparts to the final product. The model being outlined here is not to do with such imaginings but with data. The matter of populating this approach with factual information is problematic. Substituting information with hope, however, is no solution.

At the very least, the nearest market to a farm in the marketing system will satisfy the criterion for meaningful customer identification. Otherwise, no sales of the farm's output would ever occur. Wherever the most functionally-distant relevant market level is, the key strategic marketing question is whether the farmer has control over variable salient characteristic(s) and whether premiums and discounts will flow back for the exercise of control. This defines the potential profitably to differentiate output.

To summarise: farm output can be sold to any buyer who seeks it. The ability to differentiate output is necessary for control over its price. This ability requires control over output characteristics which otherwise vary and matter to a buyer, and that the exercise of this control earns the producer a premium. The focal buyer may not be in the first market for farm output; the market that should be addressed is the one that satisfies these three criteria and is nearest the final customer. It is likely also to be necessary to attend to the preferences of markets between the farm and this most functionally distant market. (This series of markets between the 'target' level and the producer is what marketers define as 'the marketing channel'; see McColl-Kennedy and Kiel (2000).)

If a buyer does exist, whatever the market level, their preferences should be identified and targeted, assuming this can be done profitably. If no such buyer exists, differentiation is not possible and the aspiration to manage market relationships must remain unmet. One qualification must be made here: if the buyer is believed not to exist as a result of marketing system idiosyncracies, it may be possible to reconfigure the marketing system to 'create' them. This amounts to vertical integration although this term masks, somewhat, the qualitative drivers for the intervention. The incentive is not to imitate the role of existing agents in the system so much as to create new linkages between farm output characteristics and interested buyers beyond the nearest market, or to create premium flows to the producer that are currently being absorbed in the marketing system.

A good example is successful entry into farmers' markets by producers. Such producers are adopting distribution roles normally performed by other agents. However, the incentive is not to capture the margins of those agents but to present a quite different, and differentiated, offer to a segment of food consumers (Broderick 2009). The strategy relies intrinsically on the producers having meaningful points of differentiation to offer to customers at these markets.

Framing output

The skill and knowledge required to produce output arguably has the unfortunate affect of making producers possibly the least able of all people to 'put themselves in the shoes' of final customers: producers think more about the output and know more about it. They are highly involved with the output, unlike most final customers. This is one reason it is so easy to imagine that some niche must be pining for one's output.

Compounding this impediment to disinterested analysis of customer preferences is the ubiquity of purveyors of magic ('advertising and branding always work', eg) and simple economic ignorance ('marketing is always relevant', eg). The analysis of product value to customers is on a more secure footing when the context for which output is an input is understood. That is, when the usage context that output must serve is understood,

substitutes can be identified and the prospects for differentiation can be distilled. (The same logic applies to the analysis of the prospects for the adoption of innovations; see Kaine, Lees and Wright 2007.)

For all customers, including final customers, a production process exists for which purchased outputs are inputs (Muth 1966). Whether this is transforming a beast into meat or a broadcast or ice cream into satisfaction of human needs, there is a technology involved, a need to access inputs, producer capabilities and preferred outcomes. Jointly, these elements comprise the ‘usage context’ (Ratneshwar and Shocker 1991).

The usage context is the satisfaction production domain in which the producer/consumer evaluates alternative inputs. Inputs will vary in their capacity to appeal to buyers according to either their fit, relative to substitutes, with the modus operandi of the usage context or their inimitable provision of valued output characteristics. There are the two sources of input value identified here because desired output attributes can be either of two kinds. A desired attribute may be manufactured in the production process by working with inputs. Examples include flavour, shelf life, package/portion size and ease of acquisition by customers. Other attributes cannot be manufactured: to exist in the output they must be present in the input. Examples include credence attributes (such as kosher status of food, GM-free production, organic production and product origin), the freshness of unprocessed food, aesthetic appeal and novelty. Manipulation of inputs lacking such attributes cannot create them.

Any output can thus be described in terms of characteristics which offer *fit* with the production process to which they are input or a *defining* contribution to its output. The valuation of fit and defining characteristics will depend on customer preferences, for output characteristics given the production process, and substitution possibilities. Fit and defining characteristics may be traded off. In broad terms, sacrificing consumption satisfaction for convenience is a common example.

Defining characteristics have the greater capacity to travel through a marketing system, by definition: they are inimitable. This is very evident in the case of products available in generic (brandless) form and branded form, such as plain flour. Those final customers who attach value to brands for flour may validly be targeted by brand-owning flour producers. Those final customers indifferent to brands of flour cannot be targeted by any flour producer. The last targetable customers for the flour producers in that context are the retailers. Brand is a defining characteristic.

Defining characteristics convey a form of monopoly to their creators and thus the base for differentiation. Whether this is useful depends on the relevance to customer preferences of the characteristic and the ability to profit from providing it to them. This is much more likely, and enduring, than differentiating on fit characteristics. This is because these are normally exposed to a wider array of substitution threats.

No characteristic lasts forever as a point of differentiation, of course, as technology changes customer valuation of them. A current example would seem to be the steady decline in the value of defining characteristics of apparel wool fibre.

Conclusion

The purpose of the framework outlined here is to enable the strategic analysis by farmers, inter alia, of their current role in their marketing system(s) and potential roles in these or modified systems. The focus is here described as ‘identifying the potential for differentiation’. It could also be described as ‘identifying the relevance of a market orientation’.

The wish is to enable the identification of the prospects for exerting greater influence over impact on markets and thus revenues.

How often these prospects are present and are attractive, and what actions may be required to pursue them, is not considered here. This is simply a proposed way of

checking whether it may be possible to inject some imperfection into the competitiveness confronting a farmer and, with it, somewhat greater control over financial outcomes.

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