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A. E. A. (pd)

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7-6
LESSONS LEARNED FROM 275 DAIRY OWNERSHIP CHANGES
(Remarks of Charles E. French, and William A. Jarrett
Milk Industry Foundation Annual Convention,
Chicago, Illinois, December, 1958)

Typically, we have looked for our economic lessons in plants operating for long periods without major troubles or ownership changes. At Purdue, we decided to try a novel approach. We have studied our plants which have made ownership changes. Many of these plants have been in economic trouble and we felt that their experiences could afford valuable economic lessons. Today we want to share that study with you.

The General Setting

An outstanding aspect of a food business today is its tendency to grow larger. Mergers are occurring rapidly and the "Automation Revolution" is being hailed - or condemned - as a force comparable with the Industrial Revolution itself.

Food operators have been among the last to apply corporate mass methods. Until recently, the technological processes necessary for food preparation and marketing were so simple that large-scale methods were unnecessary and uneconomical. When the producer sold his unpasteurized milk directly to his neighbor, elaborate industrial techniques were unnecessary. Today, however, food industrialization is bringing changes in ownership which put us all on the edge of our economic seat.

As late as 1939, our food establishments averaged less than 20 workers per establishment. But, by 1954 they averaged 41 workers. Increased efficiency has allowed this. Our research at Purdue shows the dairy industry achieving a given output with about one-third as many inputs as were required 40 years ago. Improvements in fluid milk plant efficiency are also documented in the records of large groups of plants such as shown by USDA studies and the cost comparisons of the Edward B. McClain Company.

Although late in getting started, the technological and industrial surge in dairying is now in full swing. Many plants are changing ownership and the merger rate has been high. Dr. Stewart Johnson, University of Connecticut, gives us an idea of the mortality rate of fluid milk plants, (Table 1).
Table 1. Drop In Number of Fluid Milk Distributors, 1950 to 1956, Selected States.

State	Number of Distributors		Decrease 1950-1956 (%)
	1950	1956	
Montana	331	99	-70
Wisconsin	571	310	-46
Ohio	821	545	-34
Maine	683	463	-32
Massachusetts	1,605	1,177	-27
California	2,181	1,598	-27
Washington	434	323	-26
Connecticut	857	633	-26
Rhode Island	264	202	-23
Pennsylvania	1,928	1,482	-23
Vermont	224	185	-17
New Hampshire	344	301	-12
New Jersey	2,258	2,134	- 5
New York	3,056	3,010	- 2

Source: Dairy Marketing, Extension Publication of College of Agriculture, University of Connecticut, Storrs; Stewart Johnson, October, '56.

Larger companies have acquired many small ones. However, the greatest total number of acquisitions have occurred among the smaller companies, with cooperatives accounting for more than one-fifth of them. However, the ten largest companies accounted for about one-fourth of the acquisitions between 1948 and 1954 according to University of California research.

The Study

The Indiana dairy industry in many ways is quite typical of the national picture. We have a widely diversified industry which has had its share of the post-war adjustment problems. We have gone from 405 licensed plants in 1946 to 212 now. In this reduction process between 1946 and 1956, 275 ownership changes occurred. We focused our study on these changes; they involved

177 fluid plants, (Table 2). Sixty-three percent of the fluid plants changing ownership actually went out of business entirely. Another twenty-nine percent became distributors for other, usually larger, dairies. The other eight percent changed ownership and continued to operate.

Table 2. Classification of Plants Which Changed Ownership, Indiana, 1946-1956.

Fluid Plants	177
Closed Operations Completely	112
Became Distributors for Other Companies	51
Changed Ownership but Continued Operations	14
Combination Fluid and Manufacturing Plants	22
Manufacturing Plants	59
Receiving Stations	17
TOTAL	275

These changes in ownership in fluid plants continued regularly during this period with only a slightly higher rate of change between 1951 and 1953, (Table 3). The decline in numbers is still continuing.

Table 3. Changes in Ownership of Indiana Fluid Milk Plants, 1946-1956.

Year	Number that:			Totals for Year	Percent of all Plants
	Closed Operations Completely	Became Distributors for Other Companies	Changed Ownership but Continued Operations		
1946	10	1	2	13	3.2
1947	10	1	1	12	3.0
1948	11	3	3	17	4.2
1949	7	3	0	10	2.6
1950	16	4	0	20	5.2
1951	16	6	2	24	6.6
1952	14	7	2	23	6.7
1953	11	9	1	21	6.8
1954	6	2	1	9	3.2
1955	2	9	2	13	4.3
1956	9	6	0	15	5.4

These fluid plants which made ownership changes tended to have the following characteristics:

1. Small volume. Three-fourths of these plants processed less than three million pounds of milk per year, about one-half had Grade A milk and nearly one-half had to depend upon other operations to bottle certain of their products.
2. Older operations. Over one-half of these plants had been in business at least 20 years with at least sixty percent having started as producer-distributors. Most were owned by indiv-

iduals or partnerships. The operations in the smaller towns had the highest percentage of ownership changes.

3. Poor records and reports. Most of these plants had inadequate records - often the only record of note was a cash account. Personal business was intermingled with the company business in most cases. Over one-half of these plants depended upon other operators to set prices in their market -- partially, at least, because they had inadequate knowledge of their own costs.
4. Poor financial condition. Eight out of ten of these plants had experienced declining profits during the five years before making the ownership change. Volume of business had dropped in most cases.
5. Lack of good management. Many of the operators were good dairy technicians, but poor managers. Few had good replacement people to take over the management. Most of them were family operations.
6. Operating limitations. Many of these plants had recently remodeled. Several had rather good physical conditions. However, most of them were limited in capacity for expansion and more than one-fourth had operating bottlenecks. Over 70 percent were limited on capital.

The men associated with these plants gave the following reasons, in the order listed, for their economic difficulties:

1. Paper packages.
2. Limited working capital.
3. High labor cost and labor problems.
4. High costs of meeting grade A requirements for processing.
5. Unfair competition in wholesale and retail channels.
6. Lack of capable replacement management.
7. Reduced margins.
8. Lack of volume to obtain efficiencies in processing.

An ownership change was finally made for one reason, but this was usually only the "straw that broke the camel's back". These plants were caught in a web of economic relationships, many of which apparently led to their economic troubles. These many relationships became manifested in the last one which was noticeable at the time of ownership change.

Most of these relatively small plants were fairly well established in business prior to World War II. The controlled price and competitive situation of the war tended to protect their status. New technologies, especially paper packaging equipment, after the war required increased capital outlays

which required increased volume which in turn meant widening markets resulting in more intense competition. These plants basically did not have management skill, knowledge of costs, efficiency of operations, volume of business, and/or quality of product necessary to compete effectively in this new environment. Most of the personnel connected with these plants freely admitted this and did not attempt to place the blame for their economic plight elsewhere. Only one-third thought their competition unfair by their own standards.

Here is what happened to the plants which made the following ownership changes:

Closed Operations Completely: Nineteen percent sold to chain companies and the remaining went to large companies in the state. Some plants sold everything while others sold only segments of their business. Few plants had prior working relations with companies with which they completed negotiations. Many did not know about or understand the distributor type of operation. The plants which wanted to sell generally made the original contacts.

Book value (cost minus depreciation), comparative prices, and bids were starting points on establishment of a final price. Eighty percent of book value was received by most plants, but the book value of most plants lagged behind actual value. Thus, these plants generally received much less than what their business was worth. Their share of the local market was usually small.

Changed Ownership but Continued Operations: Forty percent of these operations were sold to chain companies. The same methods were used to evaluate the business as in the closed plants. The majority of this group received full book value for their businesses. These plants were usually in good bargaining position at time of sale. They controlled the major share of their local market.

Became Distributors for other Companies: There were three types of distributorships:

1. Straight-distributor - plant owned by original party or parties but distributing another company's milk under the bottling plant's name.
2. Custom-package distributor - plant distributing another company's milk under the local operation's name. Sometimes processing is carried on in this operation also.
3. Branch-plant distributor - plant owned and operated as separate unit of a "mother plant", but no processing at local level.

These plants usually had a simple ownership structure, younger managers, and a real desire to stay in business. They usually controlled a major share of the market.

Most plants liked the distributorship better than processing because of fewer headaches and less work. Most distributors felt that they were their own boss. When compared to the last year of processing, over one-half of the distributors were making more money. The amount of labor needed declined and the men worked fewer hours at a higher wage. Capital needed was reduced as distributors usually paid for their products two weeks after selling them.

Lessons Learned

1. Size is Important. There are efficient small plants and there will continue to be such plants. However, there are certain difficulties of operating an extremely small operation in today's economic climate. Most of these plants gave as a general summary of their economic trouble, the fact that they were just too small to operate in today's environment. Many of the plants under three million pounds annual volume admitted that they existed more through economic tenacity than economic efficiency.

2. A Distributorship is a Rational Alternative - The development of distributors for larger companies is well established and can apparently be a quite successful institutional arrangement. The number of such institutions will probably increase. Distributorships are available to most plants. Such an arrangement should not be looked upon as a temporary program designed to delay a plant in going completely out of business. Distributorships are designed basically to capitalize on the processing efficiency of large scale and the close market contact of the local distributor. More specific agreements tended to be needed on certain points including the margins involved, advertising expenses, methods of handling returned products, boundaries for distribution areas, methods of sharing advertising expenses, and the length of time before the distributor will consider going into business for himself. Many of these things should probably be in writing.

3. Changes Should Be Made Before it is Too Late - Nearly two-thirds of these operations were losing money before they decided to make a change. This put them in an extremely poor bargaining position, and many of them seemed to realize very little on their business value. Often the decision to make the change was on short notice and worked hardships on the employees and pro-

ducers supplying the plant. Many operators failed to do a good job of merchandising their operation. Although they used advertising and such general selling techniques to move individual pieces of equipment, they were hesitant to do this on the entire operation. They contacted very few people in the process of selling and many of them contacted only one buyer. Most of them had no systematic way of evaluating the worth of their business and many of them had made no plans to protect themselves against losing individual routes before the business in total was sold.

4. Knowing Costs is Mandatory. Forty-three percent of these plants admitted freely that they got together with other plants to set prices. However, most of them admitted that they did not know their own costs and approximately two-thirds of them depended upon other companies to set the price. Product line is an important factor in competition, but a plant can diversify only so far as it can specialize. It can determine a line of specialty only if it knows its cost. Indecision concerning product line and ill chosen product lines figured heavily in the plight of many of these firms. Some type of cost comparison plan should have been quite valuable to operations in this type of environment.

5. More Ownership Changes Will Occur. There seems to be little evidence that the rate of ownership change is decreasing. As we reduce the number of plants, number of ownership changes will decrease but they will continue to occur. Many of the small-to-medium operations have very little provision made for perpetuating their existence. A tightly held family business can many times fail to survive the decision of one of the partners or stock holders to get out of the business. Many times the death of an individual is also the death of the business.

6. Plants Must Industrialize Their Processes. Food industries have been late to industrialize, but in recent years, the newer technologies have brought about large-scale organization in order to spread the cost of

these technologies. The present wave toward automation mandates scale of operation. Many of these smaller plants had grown haphazardly and one-fourth of them freely admitted that they had severe processing bottlenecks. Labor efficiency was low and costs high though only five percent were unionized. Low-cost operations are imperative in the price cost situations which will exist over the next few years.

7. A Plant Must Adapt to the Times. These operations were not "fly-by-night" operations, but were old established businesses. However, less than one-half of them had a full line of products. Many of them had attempted to move into competition on a large scale in the wholesale channels. Wholesale competition intensified their need for closer supervision of costs, use of various discount plans, and often times use of special packages. These operations for the most part did not have the necessary facilities and staff to operate in this environment. Managers seemed to think that adjustment to the remaining segment of retail trade would have given them much greater chance for survival.

8. Good Management is Vital. A very small part of these plants had good replacement management. Most of the managers had come up through the producer-distributor route and were good technicians but were not managers. Management today is a science and requires well-trained specialists. Basically you can have specialists only where you have scale of operation. Moreover, most of these plants did not take advantage of the possibilities to buy needed special types of management assistance. Very few of them used any type of consulting service and often they did not know that such services were available. In many cases a reasonable outlay for a specialized type of management service may have been all that was needed to save the organization.

9. The Economic Climate is a Many-sided Thing. Apparently no one thing tended to force an ownership change upon a plant. A complex of economic variables operated upon each plant. Therefore, the required skill of management

and flexibility of operation were much greater than that required prior to World War II. Such problems as exist today seem to call forth high powered types of analysis. For instance, many of these problems require solution by such techniques as digital computers, mathematical formulation, and other scientific approaches.

10. A Need Exists for More Research. In many instances, managers freely admitted that they lacked information about their alternatives, their operating conditions, the extent of their market, basic trends in the industry, new management techniques, availability of consulting services, the wisdom of cost knowledge, and other well-established management aids. Some of these answers were available and unknown to these people; however, many of them are yet to be discovered. Public agencies will continue to develop much needed research data, but individual businesses must have a place in their operation for research on their own specialized problems. Again, the small operator may have trouble spreading this overhead expense.