AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Marketing
of
products

1978

EFFECTS OF MARKETING BOARDS
ON THE AGRIBUSINESS SECTOR

Thomas F. Funk
and
Martin T. Rice

August 7, 1978

Paper presented at AAEE meeting,
Blacksburg, Va., Aug. 6-9, 1978.

The titles of the two previous papers are indicative of the current and past emphasis of research and discussion concerning marketing boards. Although these institutions have effects outside the producer and consumer sectors, these effects have not been the direct subject of research by agricultural economists. This is unfortunate, because as Lyons has pointed out, marketing boards should be studied in relationship to the "entire competitive framework and overall marketing efficiency if we are to take a broad view of food policy issues."

I have been asked to look at the question of the effects of marketing boards on the agribusiness sector. Undoubtedly these effects vary depending upon the type of industry and marketing board involved; however, because of the lack of research evidence covering a variety of situations, my comments will pertain mainly to the Ontario Broiler Industry and its supply management marketing board, the Ontario Chicken Producers' Marketing Board (OCPMB). This industry was the subject of a recent study to determine the nature and extent of possible effects of a marketing board on agribusiness, and therefore should serve as a useful case study from which tentative inferences can be made to other situations. The study was conducted in early 1978 and consisted of in-depth personal interviews with general managers from all the major sectors of the Ontario Broiler Industry. Rice provides a detailed discussion of the methodology and results of this research.

To approach the question I would like to make a few general observations on what I believe to be the major effects of marketing boards on agribusiness. Although the term agribusiness can be defined very broadly, I will use it here to include only those firms having direct contact with the production sector. In the case of the broiler industry this includes hatcheries and feed companies on the input side, and chicken processors on the output side.

The most obvious effect of a supply management marketing board on agribusiness is the transfer of market power from agribusiness sectors to the production sector. In the broiler industry this transfer of market power resulted in two fundamental changes: first, the supply of broiler chickens is no longer determined primarily by feed companies and processors through contracts and financing agreements, but rather through the quota allocation decisions of the marketing board, and second, prices of chickens are no longer determined primarily by market forces or negotiations between buyers and sellers, but rather through the pricing formula established by the board. These two basic changes in the environment in which agribusiness firms operate have had important effects on the broiler industry which I will discuss in the remainder of this paper.

INTEGRATION

The first effects are those dealing with industry structure. Beginning in the 1950's, there was a rapid movement on the part of hatcheries, feed companies, and processors to integrate their operations. Although much of this integration was with the production sector through direct ownership or contractual arrangements, a certain amount of it involved integration with other allied sectors.

Since the inception of the OCPMB in 1965, there has been a sharp curtailment of integration activities. This has been particularly pronounced in the case of integration to the production sector because of the marketing board's policy not to permit increases in quota ownership by an individual or organization beyond 75,000 square feet, or amalgamation of quota on one premise in excess of 35,000 square feet. Although there are certain loopholes which permit agribusiness firms to accumulate more quota, further integration to the farm level has been limited by the cost of obtaining additional quota and the

fact that the maximum production capacity at any one location is too small to justify the purchase price of the premises and quota rights. The result of these factors has been to hold the ownership of production quota by agribusiness firms to approximately the same level which prevailed at the time the marketing board was introduced.

The fact that integration to the production sector has been slowed by the restrictions of the marketing board has resulted in a production sector characterized by a large number of relatively small producers. Although large, integrated firms report that this creates some inefficiencies in the form of higher selling and distribution costs, smaller independent firms attribute their very existence to this situation. They claim that in the absence of the marketing board they would have eventually lost their markets or sources of supply to the integrated concerns, and therefore been forced to leave the industry or sell out to another firm.

Integration of agribusiness firms with other sectors of the broiler industry also appears to be declining. Despite the fact that "package deals" are still viewed as desirable by many growers, the available evidence indicates that many firms are offering these more on the basis of working arrangements with other firms than through ownership of these firms. To some extent industry managers attribute this situation to the marketing board's restrictions on the accumulation of quota under one owner on one premise. Because they feel that the ownership of the farm level is necessary to take full advantage of vertical integration, and because this is not possible under the current situation, they have decided to limit their integration into other sectors as well. In addition, the reduced profitability of the processing sector in recent years has made potential investments in this sector by feed companies and hatcheries very unattractive.

MARGINS

In addition to influencing changes in the rate of vertical integration among firms in the broiler industry, the presence of a marketing board also has had an effect on gross margins. However, unlike the situation with respect to vertical integration, the effects on gross margins have not been felt equally by all sectors. Survey results showed that most hatcheries and feed companies reported increased gross margins since the introduction of the marketing board, whereas all processors reported decreased gross margins.

The increased gross margins reported by hatcheries and feed companies were attributed mainly to the improved financial situation of producers brought about by the policies of the marketing board. Because of this situation many industry managers felt that prices for chicks and feeds have increased faster than they would have in the absence of a marketing board. In addition, the improved financial situation of the industry has also reduced the amount of bad debts experienced by these firms. This is a very significant change for firms who, prior to the marketing board, had experienced substantial losses on contracts and mortgages held with their customers.

The decrease in gross margins reported by processors were also attributed to certain policies of the marketing board, particularly those related to pricing. Given the pricing formula used by the board to establish live broiler prices, most processors reported gross margins are depressed because they (the processors) are positioned between a relatively inflexible, cost of production determined price for their inputs, and a downward, flexible, market-determined price for their processed products. In addition, they claimed that because of the board's restrictions on production through its quota allocation decisions, their fixed costs are spread over a much smaller volume of output resulting in significantly higher unit operation costs.

The situation with respect to gross margin changes has been met with a variety of responses. In the feed and hatchery sectors, the increased gross margins have been responsible for some improvements in product quality, services to customers, and profits. In the processing sector, on the other hand, the decreased gross margins have been absorbed by decreased profits with little or no reported changes in product quality or customer service.

OPERATING POLICIES

Another possible influence of a marketing board on agribusiness is in the area of internal policy formulation with respect to such factors as pricing, promotion, product development, market development, and inventories.

Research results here show that most managers in the broiler industry feel that competition within their sector, and not the marketing board has had the greatest effect upon their decisions in the areas of pricing, promotion, and product development. A possible exception is that some feed company executives feel that pricing is not as important as it was prior to the introduction of the marketing board when producers were under greater pressure to obtain the lowest possible price for their inputs. Moreover, despite the fact that the OCPMB is involved in some promotional activities for broilers, managers in all sectors reported that this had no effect on their promotional decisions.

The situation is somewhat different in the area of market development. Here most managers in all sectors felt strongly that the pricing policies of the OCPMB eliminated the possibility of developing new markets for Ontario broilers outside of the Province. In responding to questions in this area, a surprisingly large number of managers cited what ostensibly is an industry credo: "The marketing board should be called a production board because they have nothing to do with marketing." They supported this statement by explaining that the board takes no responsibility for marketing live broilers after they

have been picked up at the farm by the processors despite the fact that the board sets production levels and live prices which have significant impacts on the availability and retail prices of the final product.

In the area of inventory policy no changes were reported by the feed and hatchery sectors. Processors, however, reported sizeable inventory increases since the introduction of the marketing board. These increases were attributed to the pricing policies of the board which resulted in what they termed "unrealistically high prices" and a lack of proper incentives for growers to produce the weight categories in greatest demand.

TECHNOLOGY AND CAPACITY

Other examples of specific influences of a marketing board on agribusiness firms can be found in the areas of technology and capacity utilization. As expected, research findings substantiate important influence in these areas.

First, in relation to the adoption of new technology, the presence of a marketing board was found to reduce the incentives to make investment decisions of this nature. This was particularly true in the processing sector where managers cited the lack of market growth and inadequate margins as reasons for adopting new technology at a slower rate than they would have in the absence of these conditions.

Capacity utilization was also found to be adversely affected by the policies of the marketing board. With the exception of a couple of processors who specialized in processing imported chickens, all firms in all sectors reported operating below desired capacity. For a large proportion of firms the difference between desired and actual capacity was significant as it exceeded twenty percent. As in previous cases, the problem of inadequate capacity utilization was found to be somewhat more serious for processors than for firms in the feed and hatchery sectors because of the recent influx of eviscerated

imports and the specialized nature of most processing plants.

RISKS

A major area of influence of a marketing board on related agribusiness firms is in the area of risks. Since the inception of the marketing board in 1965, the Ontario Broiler Industry has seen a transfer of risks from the feed, hatchery, and production sectors, to the processing sector. This transfer of risk to processors, however, has not been accompanied by any risk premium for this sector. As a matter of fact, available evidence seems to indicate that the opposite situation prevails.

According to current operating policies, broiler producers assume the least amount of risk of any participants in the system. Because most of them sign contracts with processors before undertaking production they are assured of a market for their product, and because their product is priced on the basis of a cost of production formula they are assured that the price they receive will normally cover their production costs plus an allowance for a certain return on investment. As a result, about the only economic risks they face are associated with the value of the quota they own.

Feed companies and hatcheries also have less economic risk than before the marketing board came into existence. This is mainly because of the stabilizing influence of the board which has led to less bad debts and fewer contracts and mortgages held by these firms.

Processors, on the other hand, have assumed substantially more risks as a result of the marketing board. These firms are now in a position where they must contract for their supplies three to five months before production without knowing: first, the price the board will set in the week the birds will be delivered; second, the percentage of basic quota which will be in effect at that time, hence the exact number of birds they will be obligated to purchase;

and third, the price of eviscerated imports and the demand for broilers at the time of processing. This situation, together with the chronic low profitability of this sector, clearly illustrates the fact that processors have assumed the major economic risks in the industry without any real possibility of receiving compensation for the assumption of these risks.

OTHER MARKETING BOARD POWERS

So far my comments have centered on the two fundamental powers of any supply management marketing board, the power to set prices and the power to determine and allocate production quotas. Many marketing boards, however, have additional powers which, if exercised, can have beneficial or detrimental impacts on agribusiness firms.

Figure 1 shows ten powers and four procedures of the OCPMB and an assessment of the impact of these powers and procedures on agribusiness firms. To obtain this information, managers from each sector of the broiler industry were asked to indicate the extent to which they felt each power or procedure influenced the operation of their firm. Their responses were placed on a scale which varied from very detrimental (-3) to very beneficial (+3). The midpoint of zero was assigned to the response of "no effect".

The first observation that can be made from Figure 1 is that the assessment by industry managers of the effects of the board's powers to set prices and determine and allocate production quotas is about what one would have expected given earlier findings. Feed and hatchery managers perceive that while these powers have some detrimental and some beneficial aspects, in general they have very little overall effect on their firms. Processors, on the other hand, find these powers to have an overall "detrimental" effect.

Two other powers, the powers to pool and to purchase quantities of broilers are viewed as either "somewhat beneficial" or "beneficial" by many

industry managers, particularly managers in the processing sector. The power to pool the proceeds from the sale of broilers in any week and then distribute these proceeds to producers on the basis of the amount of live chicken sold, was felt to be a means of allowing the marketing board to vary prices from day to day to meet competition from imported chicken without penalizing producers who happened to sell on days when prices were lower. This power is not currently used by the marketing board and, as a result, importers can wait until the weekly price is determined to make their pricing decision. Many managers felt that this was an important factor contributing to the present situation of a high level of imports from the United States into Ontario, and thus partially responsible for unused capacity and reduced profits in the Ontario industry.

The second power which is viewed as being beneficial by industry is the power to purchase quantities of chickens deemed advisable by the board. Although this power likewise has not been exercised, most industry managers feel that it should be used so management of the marketing board may obtain a more thorough understanding of the complexities of the market that can be used in improving their pricing and quota allocation decisions.

The third observation I would like to make concerning the information in Figure 1 is the relative effects of the OCPMB on the three sectors we have been discussing. From this information, it is apparent that the board does not have the same impact on each of the three agribusiness sectors. In general, the board is perceived as being somewhat beneficial to the hatchery sector, somewhat detrimental to the processing sector, and having little or no effect on the feed sector.

SUMMARY AND CONCLUSIONS

In conclusion, I would like to briefly summarize the important influences of a

marketing board on agribusiness. Because the following summary statements are derived from very limited observations, they should be viewed as hypotheses for further research rather than as definite conclusions.

First, the extent to which a marketing board influences agribusiness depends upon the specific powers of the board and the extent to which these powers are exercised. Agribusiness views some powers as beneficial, some as detrimental, and many as having little or no effect.

Second, the extent to which a marketing board influences agribusiness also depends upon specific operating policies of the board. For example, boards that become more involved in marketing activities for the commodities they represent are likely to be viewed as having more favourable impacts than boards which are not involved in these activities.

Third, the powers of setting prices and determining and allocating production quotas, which are characteristic of supply management marketing boards, can influence related agribusiness firms in the important areas of industry structure, margins, capacity utilization, the adoption of new technology, and to some extent, the formulation of operating policies.

And, finally, the influence of a marketing board is not the same for all related agribusiness sectors. In general, the impact on firms in output sectors such as processing is more direct and detrimental than on firms in various input sectors.

FOOTNOTES

Thomas F. Funk and Martin T. Rice are, respectively, associate professor and research assistant in agricultural economics, University of Guelph.

The authors gratefully acknowledge the assistance of Agriculture Canada in conducting the research on which this paper is based.

REFERENCES

Loyns, R. M. A., and R. L. Loucks. Competition and Public Policy on Competition in the Canadian Food Industry. Department of Agricultural Economics and Farm Management, University of Manitoba. Occ.Series No.7, May 1977.

Rice, M. T. The Impact of Marketing Boards on Agribusiness: The Case of The Ontario Broiler Industry. M.S.Thesis, University of Guelph, 1978.

FIGURE 1.

Aggregate Impressions of the Impacts of Various Board Powers and Procedures.