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**PRICING PROBLEMS IN THE FOOD INDUSTRY
(With Emphasis on Thin Markets)**

A compendium of papers presented at the Symposium on Pricing
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THE NATIONAL CHEESE EXCHANGE

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While a "thin market" may be difficult to define, the National Cheese Exchange (NCE) is aware of what is referred to when that term is used and for many years we have dealt with it.

From my standpoint as President of NCE, this symposium addresses itself to the question of how can the sale of a relatively small amount of cheese at a 30 minute trading session held once a week in Green Bay, Wisconsin affect the price of cheese — and therefore the price of milk — all over the United States.

It is sometimes misunderstood that our trading sessions are exactly 30 minutes long and at the end of 30 minutes we stop trading. Our rules provide that the trading session continues for so long as trading is active, so that if at the end of the 30 minutes there is still trading, I, as presiding officer, permit trading to continue until it has come to rest. This effectively prevents any last minute attempt to manipulate. It has been our experience that around 30 minutes is adequate for our members to complete whatever trading they desire.

Many are surprised to learn that our minimum trading unit is a 36,000 lb. carload of cheese. This means that when a car of cheese is traded, the buyer is going to have to pay around \$35,000 for that car at current prices within 7 days at the most. There is no leverage permitted. This is a cash market.

The NCE has about 44 members, give or take a few each year. It is organized as a non-stock, non-profit corporation. Most of the major cheese interests in the United States are represented at each trading session. It would probably be safe to say that the owners of 80-90% of all the cheese in the United States are represented at these trading sessions.

Our members consist primarily of what we refer to as assemblers and processors — companies that buy their cheese from factories, package and merchandise it. Some members of course, own their own factories. Large cooperatives such as Land O'Lakes, Mid-America, Mississippi Valley and AMPI are members, so that you might say that the farmers also have representation.

Our members are people who have cheese to sell or who want to buy cheese. This is quite different from the Chicago Board of Trade and other commodity markets used by speculators for trading in future where margin requirements of only 5-10% of contract values are common and where I understand less than 3% of the contracts traded result in the commodity actually changing hands because of sales cancelling purchases.

Transactions at NCE result in the product always changing hands and we require that a copy of the invoice and bill of lading be forwarded to the Exchange on every sale. Our rules require shipment to be made within three days following the trade session and payment for the cheese within 7 days, or, if requested, prior to shipment. Our members are not speculators jumping in and out of the market to make a quick profit as futures traders do.

The primary purpose of the Exchange is to furnish facilities for those who want the Exchange as a source of supply and as a place to dispose of surplus. It is an alternate market but it cannot be used for distressed or otherwise unmarketable cheese. The Exchange can and does furnish a comfortable market alternative in a highly competitive business. Most trading in cheese, however, is done in regular commercial channels — retail and wholesale outlets. The primary value of the NCE lies in its availability.

The emphasis placed on the meaning of Exchange transactions overshadows the real function of the Exchange. Perhaps this is a result of the transactions being of such great interest to so many people other than the members of the Exchange. However, I wish to emphasize that the Exchange does not exist to furnish an index as to the value of cheese. It serves as an index because, as Professor Graf discovered in his research, it more openly and actively reflects supply and demand conditions than other sources of information.

At NCE everyone is aware of what is offered and what is bid for. The concentration of buyers and sellers at one time and place creates opportunities that traders might not otherwise be aware of. All bids or offers are posted on a blackboard, are widely reported and guide everyone in the industry in their private negotiations. However, the Exchange does not issue an opinion or quote or set prices.

Our members are very knowledgeable, competitive companies. Most have large inventories of cheese and are quick to exploit a situation of someone bidding for cheese at what they consider an unrealistic price. Anyone attempting to raise the price of cheese by bidding will soon run out of money. On the other hand, our members are also quick to take advantage of a bargain and anyone offering cheese in an attempt to lower the price will soon run out of cheese.

We do not deny that we are concerned with the significance placed on the transactions at the NCE. We are aware and proud of the fact that we are a recognized factor in the economic life of the cheese industry.

In 1971, a large cooperative claimed credit for raising the price of cheese at the Exchange by virtue of bidding on 40 lb. block which, because of an interpretation of our rules, could only be filled by cheese manufactured in Wisconsin. Because of the lack of available Wisconsin 40 lb. blocks, the bids could not be readily filled by other traders at the Exchange trading sessions. It is not inconceivable that the price of that item could have been bid to an absurd level. An unfilled bid would, of course, under these circumstances, be meaningless to an informed person. The geographic location of a cheese factory cannot realistically have any significance. Such a transaction, however, could reflect adversely on all Exchange transactions. We therefore amended our rules in 1971, to prohibit persons from specifying the state of origin in bidding or offering 40 lb. blocks. As far as the NCE is concerned, a 40 lb. block manufactured in Oklahoma is the same as a 40 lb. block manufactured in Wisconsin so long as it meets USDA standards.

If a product is so scarce that it is held by only a few traders, exchange transactions in that product are of no significance and we feel that the Exchange should not permit its facilities to tempt those few traders to participate in rigging activities involving that product.

Our rules are designed to insure good faith trading and to prevent collusion or price manipulation. A free and open market where the law of supply and demand can work is where true prices are expressed.

We feel that we have an obligation to see that our rules encourage and do not restrict trading. No rule should inhibit a seller from offering his cheese or a buyer from purchasing cheese. No rule should permit the rigging of a market and we are therefore not concerned with cheese styles that do not lend themselves to commodity trading. A trader increasing a bid for a product that is not available is not engaged in a valid transaction and it should not be interpreted or held out as such.

It is fundamental that in order for Exchange transactions to reflect the market value of a particular style of cheese, there should be a substantial volume of the product available and the product should be dealt in by knowledgeable people who are actively competing with one another. The elements of quantity and competition are in my view absolutely essential.

Transactions in a product manufactured in small quantities or in the hands of only a few members lack the element of competition, the main characteristic which gives NCE trading reliability as a pricing base. To assure this reliability, our rules are never static. We now trade in only 40 lb. blocks, barrel and Swiss. Trading in cheddars, longhorns, daisies, and brick cheese was discontinued a number of years ago because it was felt that those styles were not widely held nor manufactured in sufficient quantities.

Low trading volume, in comparison to total United States production, does exist on the NCE. But we feel that this is true of most commodity exchanges. Further, values of most things change as a result of relatively few transactions. Real estate is an example. I don't think that the term "thin market" is necessarily derogatory but I don't like it being applied to the NCE. I think it is a relative term and that it has more emotional than descriptive value.

While we are always seeking ways to increase trading volume, I am not sure that I would characterize the NCE as a thin market and I would prefer to see how trading at the NCE compares to the other cash markets prior to coming to any conclusions.

On February 1, 1978, 152,000 shares of American Telephone and Telegraph common stock were traded on the New York Stock Exchange. This represents .02% of total shares outstanding. The stock closed that day at 58-3/4 — up 87½¢. There are 643,459,000 shares outstanding. Transactions involving .02% of the shares created a capital gain of \$563,026,625.00. Trading of that .02% of the shares resulted in a price increase of 1.48%. We don't know how many of those shares traded more than once that day.

Volume of trading on the NCE varies depending on market conditions. When members' supplies are about balanced with demands, the volume of sales will be low. When there is a surplus of cheese, offerings tend to be heavy. When there is a shortage, it is reflected in bids and purchases.

Volume of trading varies from year to year. Here are some statistics:

Year	Total Sales	Weekly Average
1970	6,818,200	133,699
1971	4,208,550	82,520
1972	2,520,000	50,400
1973	828,000	16,235
1974	1,764,000	36,000
1975	7,056,000	135,692
1976	18,180,000	349,615
1977	20,376,000	391,841
1978 (to 2/24/78)	3,168,000	396,000

NCE transactions attest to the value of cheese because those buying and selling can be presumed to know what they are doing. If a mistake is made or others disagree, the situation is promptly corrected. The transactions between traders serve to reflect the value of cheese not traded through the application of logic and common sense which are merely the laws of the market place. Prices are determined as a result of buyers and sellers forming an opinion from credible data. The opinion may not always be absolutely infallible, but like the jury system, cash exchanges have been around for a long time and no one has come up with a better idea.

Trading at the NCE is supervised and reported fully and widely. We prefer and enjoy operating in the "gold fish bowl" and welcome constructive suggestions for improvement. We emphasize to observers of these transactions that they are the sole judge of the transaction, that they are free to place on the transactions whatever weight they choose and that a visit to a trading session is of great value in judging its quality, which is sometimes a better measure than quantity.