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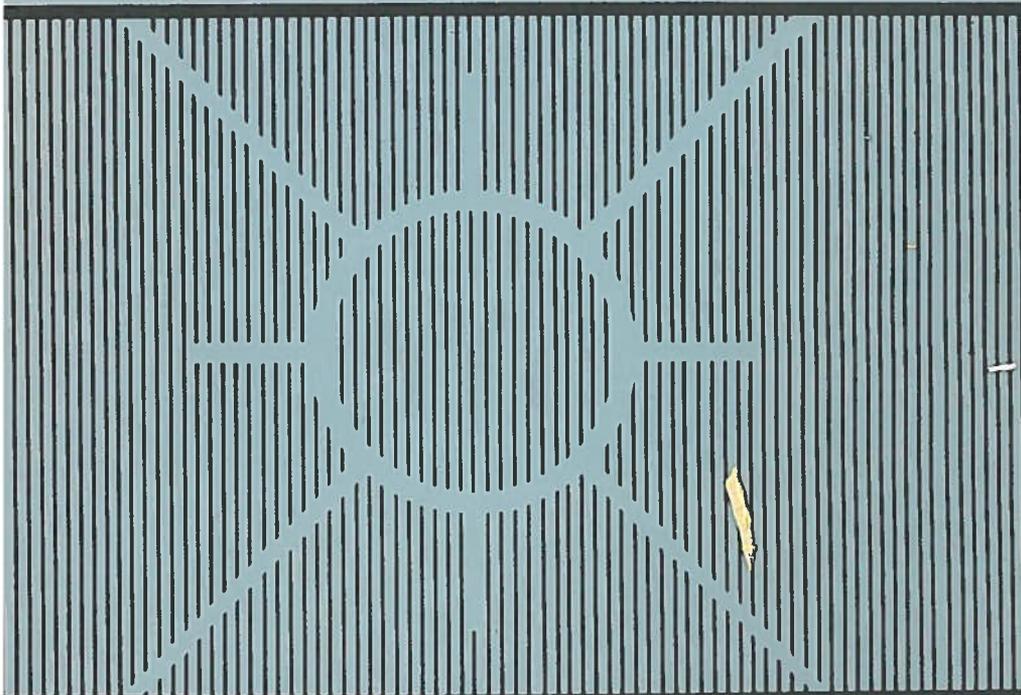
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THE TART CHERRY SUBSECTOR OF U.S. AGRICULTURE: A REVIEW OF ORGANIZATION AND PERFORMANCE



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Chapter 8

EVOLVING ORGANIZATIONAL AND INSTITUTIONAL CHANGES

A set of far-reaching changes in the organization and performance of the industry includes changes in processing ownership, grower price determination, bargaining, and frozen cherry sales. These important inter-related aspects are currently changing at a fairly rapid pace.

A distinct trend has been to more grower-owned processing, both through cooperatives and with individually-owned processing facilities (as discussed more fully in Chapter 4). A lack of industry processing capacity, especially with mechanical harvesting, has motivated growers to protect their investments in orchards and machinery by trying to insure access to processing facilities for their crop. To accomplish this, some of the larger growers are building on-farm processing facilities. Others are buying cooperative membership stock in processing facilities. Cooperative-corporation vertical joint ventures are also becoming increasingly important.

PROCESSING COOPERATIVES

Trends to more grower-owned processing, including cooperatives, have occurred in the tart cherry subsector because of: (1) the potential for close technical coordination of mechanical harvesting, cooling, and processing; (2) reduced risk to growers from insufficient processing capacity in large-crop years; (3) Environmental Protection Agency (EPA), Occupational Safety and Health Administration (OSHA), and other regulations which have forced some processors out of business; (5) the fear of some proprietary processors of Michigan's bargaining legislation coupled with the processing cooperative exemption in that law; and (6) large growers being willing to make additional investments in processing facilities. It is expected that these factors will continue to encourage the trend to an even higher percentage of grower-owned processing.

Although cherry growers who integrate into processing have an additional potential profit center, this forward integration also involves additional risks to the grower. There is no longer a specified cash price for raw cherries to the growers using this approach. With weak or falling markets, the growers will feel the disadvantage of carrying this risk, while strong markets will often provide growers favorable returns for bearing the additional market risks. Processing growers will also have increased risk from their investment in processing plant facilities.

With the increase in grower cooperatives and on-farm processing plants, there has been an increasing number of sellers of frozen cherries. Thus, the freezer-processors have become somewhat more atomistically competitive than a few years ago. New entrants have little or no market power in this commodity cherry market. This means that the selling side of the frozen cherry market is becoming even more competitive while the buying side remains significantly oligopsonistic. The behavior of these firms can distort the supply and demand conditions and the price-discovery process.

The increase in number of freezer-sellers has been held in check somewhat by the fact that some of the new firms have entered into centralized marketing arrangements. Some new firms have decided to market their cherries exclusively through an existing processor or broker while other new grower-processors have formed a marketing cooperative. These and other coordination arrangements which center on the market for processed cherries, rather than on the raw cherry market as does bargaining, will likely become increasingly important in the future.

With the increasing percentage of cherry tonnage handled by grower-owned processors and the possibility of increasingly strong bargaining under Michigan's new law, many of the remaining proprietary processors are concerned that they will be in a position of even greater risk in the future. Proprietary processors fear that they will be pressured to pay a specified cash price to growers at harvest time while they sell in competition with cooperatives which are not committed to a specified grower price. The cooperatives also usually delay full payment to growers until after the processed cherries are sold. This situation is especially risky to a proprietary processor when supplies are large. Because of their concerns about this situation, a number of proprietary processors are threatening to: (a) become a cooperative, (b) form a vertical corporation-cooperative joint venture, or (c) implement a participation plan, common in the Florida citrus industry and with some California tomatoes.

Historically, the cherry industry processing and bargaining cooperatives have had generally positive attitudes toward one another. Each recognizes that both types of cooperatives have a similar general goal — trying to improve cherry commodity marketing effectiveness and to further the interests of their grower members in both the short-run and the long-run (subject to the limitations of market and economic conditions). Processing cooperatives usually see the advantage of, and generally support, the bargaining cooperatives' goals: (a) aiding in the price discovery process toward a firm but realistic farm price for cherries, and (b) reducing risks to processors. Bargaining cooperatives generally understand and support processing cooperatives in their goals for efficient processing, marketing cherries and cherry products in a manner as strong as possible given market conditions, and achieving long-run market growth.

There are at times differences in judgment between bargaining and processing cooperative organizations regarding most appropriate strategies and decisions for specific situations. Nevertheless, the existence of both kinds of cooperatives can improve marketing performance for a sub-sector like tart cherries. This potential is generally recognized by both types of cooperatives.

Processing cooperatives can provide useful information to bargaining cooperatives in regard to supply and demand conditions, market and trade trends, and economic conditions affecting processors. These types of information can be useful to bargaining associations as background for making realistic decisions regarding their price and terms of trade negotiations with proprietary processors.

Bargaining cooperatives provide information and influence processing cooperatives through information to growers, through some dual membership in both types of cooperatives, and through their bargaining activ-

ities as they affect price levels, even though bargaining cooperatives do not bargain directly with processing cooperatives.⁸

For those processing cooperatives which have individual commodity pools, the bargained grower price is commonly used by growers in the processing cooperative as a benchmark to measure cooperative performance. This is one important area of interrelationship between the two types of cooperatives.

In addition to using bargained price to measure cooperative performance, processing cooperatives remind their grower members of the need to evaluate the value of special services provided to the members by the cooperative. Proprietor processors emphasize the cash-flow and interest-cost advantages to growers of sales for cash at harvest time compared to the delayed payment plans common for most cooperatives. Both cooperatives and proprietary processors feel that growers often inaccurately assess some of the non-price factors when they compare cooperative and non-cooperative performance.

In the case of a few processing cooperatives in the industry, growers' returns are based upon a single pool of a number of commodities handled by the cooperative. In certain other cases, returns to cherry members of the processing cooperative are directly influenced by bargaining, since the basic payment to cherry growers is based upon an average price paid by proprietary processors in the industry. (The remaining portion of grower payments is based upon the overall net returns to the cooperative from the single pool composed of a number of commodities and products). In such cases, the activities of the bargaining association are especially important to the members of the processing cooperative because of the influence on the allocation of the cooperatives' returns from cherries vs. other commodities.

In the long-run, in a subsector like tart cherries which has both a substantial processing cooperative element and a substantial proprietary processor element, net returns to cherry growers from cooperatives and proprietary processors, including accurate values for non-price services offered by both types of firms, need to be approximately equal. If an imbalance occurs over a period of several years, growers will tend to shift to the type of processing organization which returns the higher net for their cherries. During the past three decades there have been some shifts in the balance between cooperatives and proprietaries because of this phenomenon. In recent years, cooperatives apparently have had average returns to their growers which are equal to or greater than those returned by proprietary processors. This has been the case including an average of several years, even though in a few specific years some cooperatives did not return payments equal to the proprietary processors'. Processing cooperative returns have over a period of several years been at least equal to and at times higher than returns from proprietary processors, and this is one factor contributing to the recent trend toward more grower-owned processing.

⁸The discussion in this section and in the later section on grower bargaining (page 123) draws from W. Compton Chase-Lansdale, *The Political Economy of Farmer Bargaining: Cooperative and Proprietary Processor Responses to Farmer Bargaining*, Unpublished Ph.D. Thesis, Department of Agricultural Economics, Michigan State University, East Lansing, Michigan, 1980.

COOPERATIVE-CORPORATION JOINT VENTURES

Some joint ventures between a cooperative and a food marketing corporation have been used in the tart cherry industry. One large vertical joint venture has been operating in this subsector for several years and is apparently viewed as successful by both grower-members and the food marketing company. A few other joint ventures have recently been started. At least two additional joint ventures were tried, but were unsuccessful and have been terminated. A number of existing proprietary processors have indicated that they are considering the use of a joint-venture approach to improve vertical coordination from their point of view.

The major cooperative-corporation joint venture for cherries provides the grower-members advantage in regard to effective consumer access and demand expansion for cherry pie filling through the company's strong brands. Most grower-members in the cooperative sell only a portion of their cherry crop through the joint venture, relying on other vertical coordinating mechanisms for the remainder of their crop. Grower cooperative members in this joint venture share in the profits from all company products whether or not the grower produces the crops used as an ingredient. In recent years this arrangement has provided some significant additional profit opportunities for cherry growers in this cooperative. Primarily because of the successful experience of this joint venture, it appears that vertical cooperative-corporation joint ventures may become somewhat more important in the cherry industry in the future. Growth of this type of joint venture will probably be held in check somewhat by the experience with the unsuccessful joint ventures which were terminated. In the future, joint ventures between a cooperative with a strong brand and another commodity cooperative, as well as the cooperative-corporation joint ventures, may be used somewhat more.

GROWER BARGAINING IN A CHANGING ECONOMIC ENVIRONMENT

In the tart cherry subsector bargaining has been used as an important coordinating feature with emphasis on raw product pricing. Grower bargaining increased in importance primarily during the 1950s and 1960s when processing was handled predominantly by proprietary firms, usually paying a definite cash price to growers at harvest time. Bargaining was undertaken, in part, to: (a) aid in the price discovery process, (b) reduce risk to an individual processor that a competitor would be able to buy cherries more cheaply, and (c) alter the market power situation in favor of the growers.

High risks in cherry marketing, along with strategies of other participants to shift the risk-bearing function heavily to the growers, contributed to the development of grower bargaining. Grocery retailer-wholesalers were able to shift most price and inventory risks to processors.⁹ Food manufacturers were able to shift some risks to processors

⁹Grocery retailer-wholesalers' behavior was considerably more important when bargaining associations were first formed because a substantial percentage of the tart cherries were retailed as canned cherries in that period.

(although to a lesser extent than did grocery firms). Processors facing high risks shifted some risks to growers through: (1) widespread "discounting" of the grower raw product prices to allow for risks; (2) some custom processing; or (3) a limited amount of participation plans. Use of these strategies was most pronounced in large-crop years when risks to processors are highest. The result was that growers bore a substantial amount of the short-run market risks, but certainly not all of the risks, while growers had very limited market information and little ability to make changes which might reduce the risks.

Bargaining has provided tart cherry growers a degree of market influencing ability. One result has been to shift some of the risks forward to the processors. Although growers often perceive processors to have strong risk-bearing capabilities, most processors are small, family-owned, specialized firms which are not well suited for this responsibility.

Grower bargaining has also had an impact on market information. The bargaining association has been able to help build, organize, and publish information in the subsector. This has occurred, in part, because the bargaining relationship creates an interdependency among participants. By virtue of this interdependency, participants are encouraged to provide information to influence the terms of trade determined by bargaining. Thus, the bargaining association invests in market intelligence and uses this information as it presents its case to the processors with whom it bargains and to its grower-members. Similarly, to establish their best bargaining position, it behooves the processors to respond with their own market insights. The result can be a pooling of market information from which more informationally-endowed decisions are derived. The result may be terms of trade that reflect improved coordination between demand and supply conditions.

Grower bargaining, as it alters the distribution of market power in the grower-first-handler transaction, can shift risk and move the grower from the position of residual claimant. Furthermore, by adding to comprehensive market information in the subsector, grower bargaining can improve the informational content of the price discovery process.

The market power of cherry bargaining associations is somewhat limited by: (a) the tonnage processed by cooperatives, (b) the tonnage of growers who are not association members, and (c) the highly perishable nature of the crop. Since bargaining for cherries has been approached through an association of state bargaining cooperatives, there is an element of national bargaining oligopoly, but this is limited by the aforementioned factors. The degree of oligopoly power of the bargaining association is also not particularly great in years of large production since processor-buyers may in some instances essentially ignore the bargaining association when supplies are large. If a system were developed to permit future cherry bargaining to be done under Michigan's unique bargaining legislation, this could increase the market strength of grower-sellers.

Michigan's Agricultural Marketing and Bargaining Act (Michigan Public Act 344) permits: (a) exclusive agency bargaining, (b) binding arbitration, and (c) mandatory collection of bargaining fees from growers. This legislation can strengthen grower raw product bargaining if it is

approached realistically by the bargaining groups in light of the national market for processed cherry products and in view of the production in other states. The exclusive agency provision facilitates a bargaining association obtaining an especially strong market position within Michigan.

Michigan's dominant position in tart cherries with 70% of the nation's production would seem to enhance growers' ability to use this state's strong bargaining law in cherry pricing. However, tart cherry bargaining in most recent years has not been done on an exclusive agency basis. This is primarily because of a court case challenging the new bargaining law. If bargaining for tart cherries were to be done on an exclusive agency basis, the market structure at this level would exhibit a greater oligopolistic nature. This position would nevertheless be significantly limited by the following factors: (a) the exclusive agency approach is presently limited to Michigan, and (b) a substantial percentage of the cherry tonnage is not handled by processing cooperatives which are potentially excluded from Michigan's bargaining law.

With the processing cooperative exemption from the law, many proprietary processors fear that Michigan's law accentuates the risks of possible financial difficulties when the proprietary firms pay a definite cash price to growers. In part because of this differential treatment under the law, some cherry processors have recently become grower-owned cooperatives or in some years bought cherries under a "cooperative" arrangement involving an unspecified price and delayed payment. Other proprietary processors have stated that they may become cooperatives in the future.

The cooperative exemption feature of the law is a controversial issue. Some proprietary processors feel that the law should be eliminated. Some feel, at the very least, that the law should be modified to include cooperatives on the same basis as non-cooperative processors. This is due, in part, to the fact that proprietary processors and cooperative processors compete with one another both in finished product sales and for raw product supply.

Explicit inclusion under the Michigan law would be expected to produce some adjustment in the cooperative processing sector. Such a change might elicit, for example, cooperative processing to individual grower accounts or increased retains in the cooperative in the especially profitable years.

An alternative to a rule stipulating cooperative inclusion in the bargaining law is to further cultivate interdependencies between the bargaining association and cooperative processors such that these processors are economically encouraged to base decisions on the bargained price level. One way to do this is for cooperative management and boards to announce a commitment to the bargained price. Presumably, processing cooperatives would want substantial influence in determining the bargained price level before making such a commitment to it. Simultaneous membership by cooperative processing growers in the bargaining association is one means of creating support for close interdependent behavior. There exists in the cherry subsector both substantial simultaneous membership, and interdependent behavior between bargaining associations and processing cooperatives.

Another means of creating support, and hence growers' loyalty, to a bargained price level is to expand use of the bargained prices as an allocation rule in multiple-commodity processing organizations. Empirical evidence of cooperatives using this approach suggests that where bargained price levels are used to allocate the returns to *pooled* commodities, the cooperative decision making and performance evaluation processes recognize a strong interdependency with bargained association activity. Michigan's tart cherry subsector primarily has cooperative processing with each commodity accounted for separately. However, for these cooperative processors where the commodity accounts are comingled, the cooperative processor management pays grower returns for a given commodity based on bargained price levels instead of some internal pricing system.

Establishing interdependencies between the bargaining association segment and the cooperative processing segment may serve to elicit a greater cooperative-processor contribution to price discovery. Such contribution, including the provision of information, can help "thicken" an otherwise "thin" market for price discovery at the raw product level. One important task in addressing thin markets is to ensure enough information to make decisions that influence participant choice in the subsector.

Because of the trends to a smaller percentage of the tart cherry crop bought by proprietary processors and an increasing percentage handled by cooperatives and on-farm grower processing, the proportion of the crop which is directly affected by raw product bargaining has been decreasing. Therefore, raw product bargaining is becoming a "thinner" market. Some industry analysts predict that in 5-10 years, cash purchases of tart cherries may constitute no more than 15-20% of Michigan's tart cherry production. This prediction could well come true if the present trend continues. The trend may be halted or possibly even reversed if the Michigan bargaining environment is altered to include processing cooperatives under its provisions. Other means to mitigate problems of price discovery in a thin market may be found by developing market-wide comparative information on processor performance or by moving price discovery by bargaining forward in the subsector to deal primarily with the processed product.

In summary, grower bargaining for tart cherries has probably been modestly successful from the point of view of growers. Because of the situation in other parts of the cherry marketing system, bargaining has probably had little significant effect upon consumer prices.

OVERVIEW

Challenges remain in tart cherry marketing to stabilize supplies and prices, reduce risk to participants, improve vertical coordination, encourage desirable product development, and encourage needed production and cost-reducing investments. The approaches discussed in this chapter are some of the relatively recent steps being tried in the industry to improve certain aspects of cherry marketing performance.