



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.*

No endorsement of AgEcon Search or its fundraising activities by the author(s) of the following work or their employer(s) is intended or implied.

Historic, archived document

Do not assume content reflects current scientific knowledge, policies, or practices.

A231.9 Reserve
Ag 83E

ERS-364

OUTLOOK FOR MARKETING SERVICES AND IMPLICATIONS
FOR FOOD PRICES

MARKETING ECONOMICS DIVISION
ECONOMIC RESEARCH SERVICE
U.S. DEPARTMENT OF AGRICULTURE

Reprinted From
The Marketing and Transportation Situation
November 1967

OUTLOOK FOR MARKETING SERVICES AND IMPLICATIONS FOR FOOD PRICES 1/

One of the most noticeable and persistent trends in the food marketing system has been the tendency of marketing firms to provide increasing quantities of marketing services per unit of product. This has resulted, in part, from the changing consumer tastes and preferences. Many of the tasks of food preparation have been shifted from the home to the marketing system. One of the most noticeable examples of this trend is found in the changing consumption patterns for potatoes. Per capita consumption of fresh potatoes, where the basic preparation is done by the housewife, has declined about 25 percent during the past decade. During the same period, per capita consumption of potatoes, which require a minimum of home preparation, such as frozen, canned, and dehydrated, has more than tripled. 2/ As a result, the proportion of potatoes going into processed form has increased from 14 percent to 41 percent since 1956. Sales of prepared frozen dinners provide an equally dramatic illustration of the shift of the food preparation function from consumers to the marketing system. Sales of prepared frozen dinners increased from \$173 million in 1962 to \$336 million in 1965--or about doubled in the short period of 4 years. 3/ Sales of other prepared foods, some equally as impressive as these examples, clearly demonstrate that the marketing system is performing many of the tasks formerly done by housewives.

Away-from-home eating involves the most elaborate form of services associated with food marketing. It is difficult to establish the precise rate of growth occurring in this market due to the lack of complete data. Based on retail trade reports published by the U.S. Department of Commerce, per capita sales (in constant dollars) by public eating places increased 25 percent since 1957-59. By comparison per capita food sales by retail food stores increased 4 percent. Consumer expenditure data, however, indicate that while consumers increased their expenditures for food away-from-home, the gain was due to rising prices. 4/ On the basis of rising consumer incomes, more women employed away from home, more white collar workers, and increased vacationing and traveling among the population, it seems reasonable to conclude that the relative importance of this market has increased. One estimate indicated that over the next 10 years the size of this market will increase 75 percent compared with a population increase of 15 percent. 5/ This represents an increase in per capita consumption of about 55 percent.

It is to be noted that food preparation is not the only type of service provided by the marketing system. Food retailers provide a variety of marketing services. These include air conditioned and attractive stores, variety in merchandise offerings, grocery pickup, and large parking lots within easy walking distance to the store. In general, these services also appear to have grown over time.

1/ By Wendell E. Clement, Agricultural Economist, Marketing Economics Division, Economic Research Service, U.S. Department of Agriculture.

2/ Based on utilization reported by Crop Reporting Board, Statistical Reporting Service, USDA.

3/ Data obtained from December 1966 and earlier issues of Quick Frozen Foods, E. W. Williams Publications, Inc., Division of Cahner's Publishing Co., New York, New York.

4/ Money Value of Food Used by Households in the United States, Spring 1965, Agricultural Research Service, USDA. Preliminary Report, September 1966.

5/ Ogren, Kenneth E., Marketing Research: A Tool for Decision Making, Economic Research Service, USDA. Paper given at spring meeting of the Society for the Advancement of Food Research, Washington, D.C., April 18, 1966.

The sum of these changes result in a marketing system today that provides more services with each unit of product sold than it did in past years. Since 1940, the quantity of marketing services has increased by 100 percent while volume of food marketed increased 73 percent (figure 1). Thus, the volume of services per unit of product increased about 16 percent. This increase in volume of services is of interest because it has affected the price structure for food and has implications for farmers, marketing firms, and consumers alike.

Demand and Outlook for Marketing Services

Product innovations and technologies of processing and transportation have been the foundation for much of the increase in marketing services and are likely to be important in the future. The rate of product innovation has been quite rapid and shows no indications of abating in the future. For example, it is estimated that 55 percent of the food items on the market today were not in existence 10 years ago. The rapid rate of product innovation is also implied by the fact that retail food stores currently carry about 8,000 items compared with 5,000 ten years ago.

A second factor influencing the trend in demand for marketing services is the nature of competition between marketing firms. In recent years, there has been a trend to more nonprice competition among firms which often includes offering more marketing services. Due to some consumer resistance, some forms of nonprice competition, such as stamps and games may not grow as rapidly in the future as in the past. However, services such as variety of products offered, shopping conveniences, and more attractive stores probably will become more important.

A third reason for the growth in demand for marketing services is the entrance of more women into the labor force which created a need for foods which can be quickly and easily prepared. Women now constitute about 35 percent of the labor force compared with 30 percent in 1950. In absolute numbers, they increased from about 18 million to 25 million.

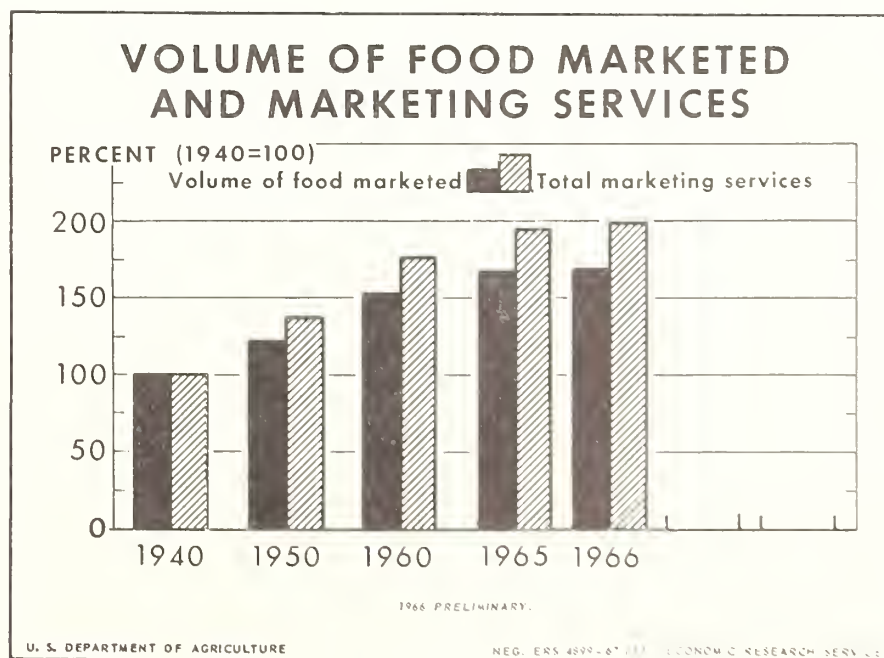


Figure 1

Fourthly, increasing affluence among the population allows consumers to accommodate their changing tastes and preferences for more services. Economists have conducted several studies to measure the impact of consumer incomes on demand for marketing services. These studies have provided estimates of income elasticities that range from 0.7 to 1.32. ^{6/} Using the more conservative of these estimates, it appears that a 10 percent increase in consumer income is associated with about a 7 percent increase in demand for marketing services. Thus, growth in consumer incomes will be a basic determinant of the direction of consumer demand for marketing services. Most economic projections show a rise in consumer real incomes throughout the 1970s. On the basis of income elasticities for marketing services and for farm food entering the marketing system, it seems likely that the demand for marketing services will increase several times as fast as the demand for food entering the system in response to income changes. The income elasticity of demand per capita for food entering the system is probably around 0.2 or 0.3 and income elasticity per capita for food use is probably even lower. Prices of marketing services also affect demand. Latest studies suggest that the price elasticity of demand for marketing services may be around -0.6 or -0.7. Historically, the real price of marketing services has remained fairly stable so that the price effect most likely will not cancel out the income effect. ^{7/}

These analyses of the nature of consumer demand for marketing services raise a number of significant questions. How will a rapid advance in use of marketing services affect the structure of food prices and farm prices? What are the implications for farmers, marketing firms, and consumers? What implications does this trend portend for public policy?

Effect on Price Structure

Civilian expenditures for food may be viewed as being comprised of 2 components--the farm value of the food and the value of marketing services. The value of the marketing services is a function of the quantity of services provided and the price of these services. Due to the fact that these 2 variables have increased at a faster rate than farm value, the value of marketing services has grown steadily in importance in the total retail price structure. Since 1953, the proportion of civilian expenditures for food attributed to marketing charges has increased from 62 percent to about 68 percent (figure 2). This trend, of course, has resulted in a decline in the farmer's share of civilian food expenditures.

Even if farm prices increase as rapidly as the price of marketing services, the farmer's share of civilian food expenditures may decline.

A partially offsetting influence in this trend could be a substantial shift by consumers in the kind of food consumed. If, for example, consumers accelerate the substitution of high farm resource using foods, such as beef, for more highly processed products, such as cereals, the declining trend in farmer's share would be retarded or stabilized. This results from the fact that the farmer's share of the consumer dollar is 60 percent for beef as compared to about 10 percent for some cereal products. Actually, such a shift has been taking place and probably will continue in the future.

The possibility of a declining farmer's share of civilian food expenditures raises basic questions relative to both the farm and marketing sectors of the economy. On the farm side, there is the question of the effect of a possible decline in farmer's

^{6/} For an example of such studies and references to others, see Daly, Rex F., "Demand for Farm Products at Retail and the Farm Level," Journal of the American Statistical Association, Vol. 53, No. 283, Sept. 1958, also Waldorf, William H., "The Demand for and Supply of Food Marketing Services: An Aggregate View," Journal of Farm Economics, Vol. 48, No. 1, February 1966.

^{7/} Ibid. Waldorf.

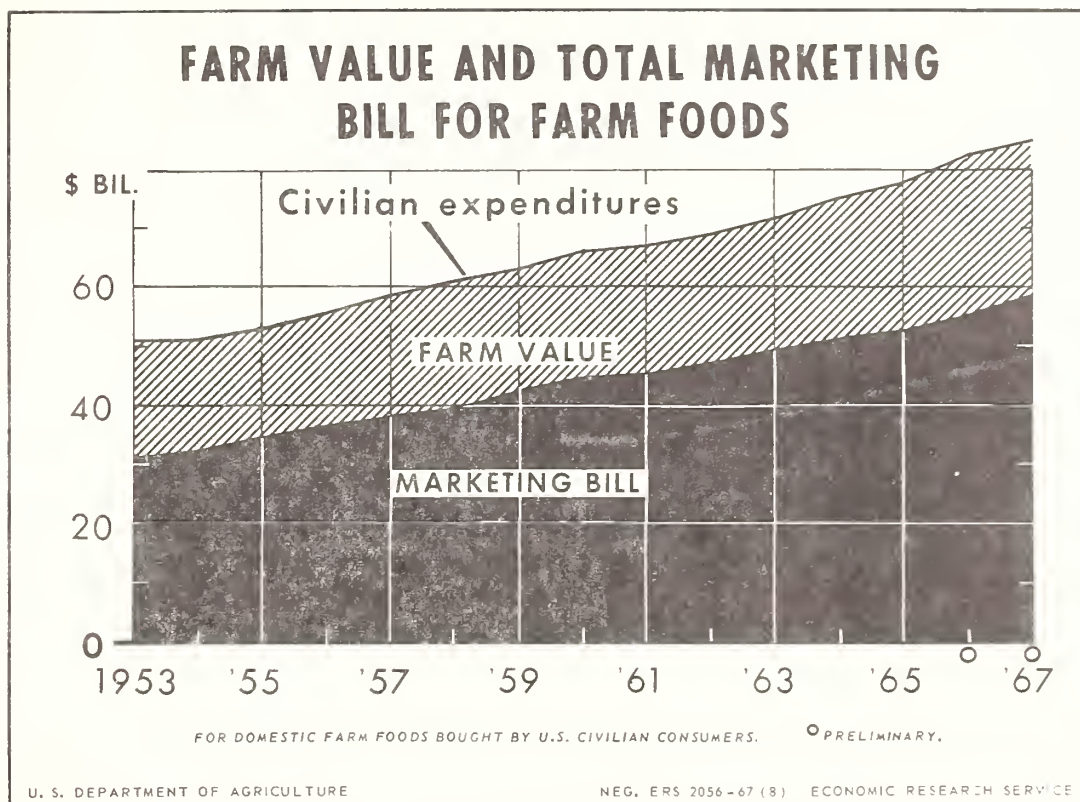


Figure 2

share on net farm income? On the marketing side, there is the difficult question of whether consumers want the services provided by the system and whether the system is providing these services efficiently? Additionally, there is the question of whether the system is competitive enough to insure that farmer's share is not changing solely due to the exercise of economic power by marketing firms? These questions will be difficult to answer but are important in understanding the meaning and impact of a change in farmer's share of civilian food expenditures.

Retail Price Behavior

The changing demand for marketing services implies that the future level of retail food prices and our ability to hold the line on food costs will continue to depend more upon cost and efficiency in the marketing and processing of foods than upon farm prices.

Retail prices for food have been tied to price movements of the overall economy for many years. This relationship will likely become even more pronounced in the future. These points may be demonstrated by the price structure for bread. The farmer's share of the retail price of bread is so small that it would require a price reduction of more than 30 percent in the farm value of wheat to reduce the retail price of bread by 1 cent per loaf. It seems that in the long run more foods will tend toward this kind of price structure, reducing the impact of farm price on retail price.

It can also be observed that the farm value of wheat in bread has changed little in the past 20 years. Yet, the retail price of bread has risen steadily (figure 3). This has resulted from the fact that the price of marketing services comprises the major component of the retail price and has been steadily rising.

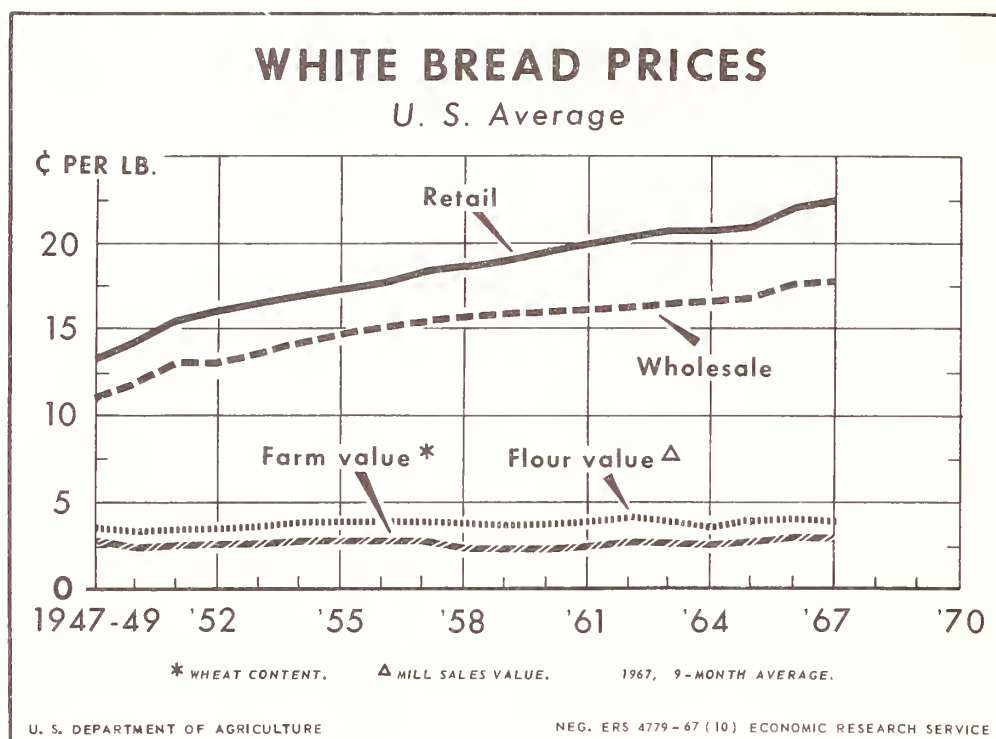


Figure 3

Comparisons of price of food at home with price of food away from home give further evidence on this point. Until recently, the price index for food at home has been somewhat below the consumer price index for all consumer goods and services. The exception was during the Korean conflict (figure 4). On the other hand, food away from home, which involves considerably more services, has increased at a much faster rate than the consumer price index.

The growing importance of marketing services puts substantial pressure on the marketing system to reduce costs because prices of the inputs they purchase have generally risen with the overall economy.

Labor costs which comprise about 42 percent of the marketing bill, reflect the continuous advance in average hourly earnings. Since 1957-59 labor costs per hour in food marketing establishments increased about 39 percent. However, due to increased output per man-hour unit labor costs increased only 14 percent.

Prices of other inputs bought by marketing firms have also increased. Intermediate goods and services have increased about 12 percent over the 1957-59 period. Services which include such items as rent, property, insurance and maintenance, and telephone service increased the most or about 23 percent since 1957-59. The rising costs of inputs used by marketing firms will continue to put pressure on the system to find more efficient ways of moving food from farm to consumer. Some progress has been made in offsetting rising cost levels as reflected by increases in output per man-hour in food marketing since 1957-59. But even with these improvements, the marketing system has not been able to completely offset increased costs of inputs. The implications seem clear that the future level and direction of food prices will largely depend upon growth in consumer buying power and in the performance of marketing firms in coping with the problem of rising cost levels.

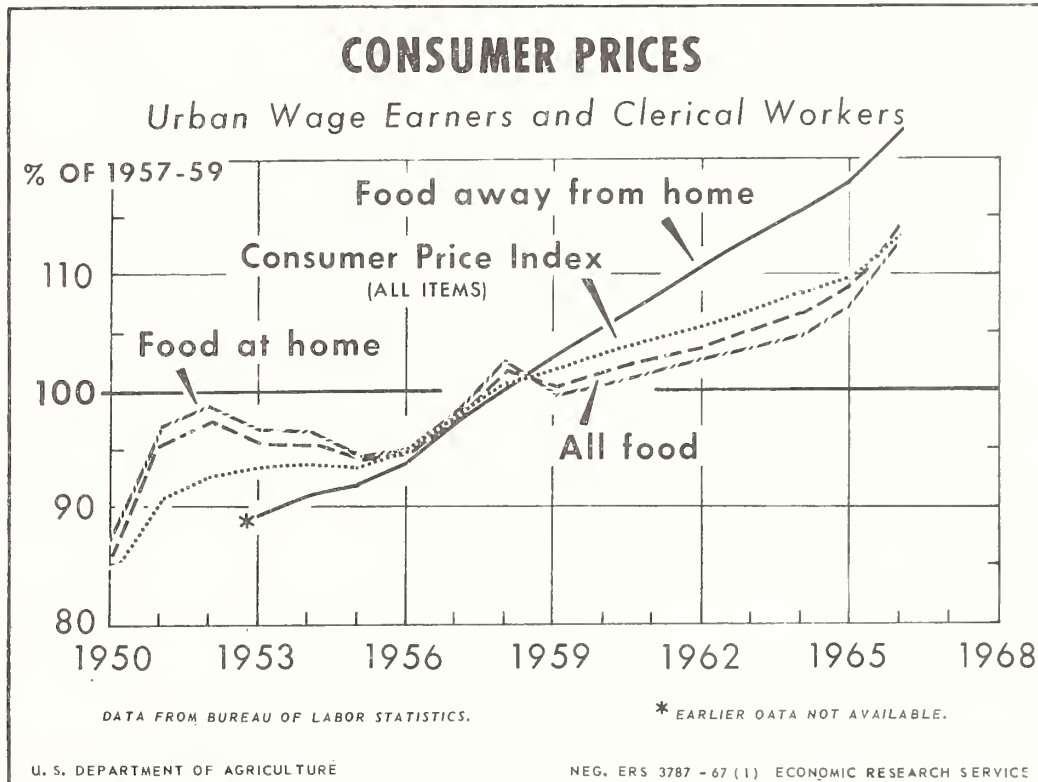


Figure 4

Public Policy

Events of recent years have demonstrated that when farm prices are low or retail food prices high, questions arise as to the cause of changing prices. Since the cost of marketing services will probably become a larger component of food prices, the performance of the marketing system will become a more important issue in the future. More specifically, interest centers on such matters as whether the system is: (1) equitably distributing the sales proceeds among those who participate in the production and marketing of food, (2) progressive in terms of finding better and more efficient ways of doing things, and (3) incurring unnecessary costs which provide no utility to consumers.

As marketing firms search for ways of increasing efficiency, there probably will be as many changes in the future as in the past. Many of these changes will likely be made to adapt to new technology and to achieve better performance. The impact of other changes may not be so apparent. It seems clear, however, that better measures of performance are needed to better appraise the impact of these changes on food costs and efficiency. Moreover, better performance measures are needed to provide insights into the kinds of enterprise organization and structural arrangements which tend to promote efficiency, equity and progressiveness. Basic economic problems such as ease of entry, integration, market power, economies of scale and functioning of the pricing mechanism will continue to be important. Public policy requires that these issues be thoroughly and competently analyzed if the most desirable economic institutions of the future are to be shaped.

