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## PROCEEDINGS



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# DAIRY MARKETING ISSUES

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I am a subscriber to the pendulum school of economic forecasting, which means that when most projections start moving too far in one direction, one should seriously think about moving in the opposite direction. I have some concern that the pendulum theory may be applicable to some of the optimistic forecasts being made about milk production and government purchases for 1987. Many analysts are projecting milk production next year to be down about 2 percent with CCC purchases falling into the 5-6 million pound range, primarily in response to the Dairy Termination Program (DTP). I hope that these projections are right. There are some economic signs that indicate we may not have yet really turned the corner on surplus milk production, nor reduced the incentive to produce too much milk.

The single biggest question we face as we project out to 1987, of course, is: What will the non-participants in the herd buyout do? This big question mark makes the 1987 production outlook particularly uncertain. Projections by USDA and others indicate that the expansion by non-DTP farmers will be moderate, thus leaving milk production and CCC purchases in 1987 below 1986 levels.

With only some slight modifications in those assumptions, however, one could easily argue that milk production will be very close to 1986's record levels and government purchases will still be in the 8-9 billion pound range. How could this come about? Admittedly, during the first half of 1987 there will not be a great deal of room for showing different effects as cow numbers decline. The real difference will be what happens during the second half of 1987.

If non-participants go into a real expansion mode, which is an actual possibility, we would expect to see cow numbers hold steady during the first half of 1987 and start increasing in late summer. Culling rates have been averaging about 29 percent in recent years, but if this rate were to drop to a more normal 25 percent, this would keep about 400,000 cows in the herd. There are probably enough heifers available to support this. But, let's assume this is too extreme and we only add 200,000 cows or roughly 2 percent of the herd. This would still leave us with about 10.6 to 10.7 million cows for 1987. If we further assume that output per cow will increase by about 2 percent in 1987 to 13,600 pounds, this would result in a milk production total of 144.2-145.5 billion pounds, very close to that of 1986. And if the recent, rather dramatic increases in commercial use moderate, as many expect, to something in the 1-1/2 to 2 percent range, this would suggest government purchases will total 8-9 billion pounds.

How can a scenario like this be supported? Next year we are looking at large supplies of most feeds at very favorable prices. Corn supplies will be plentiful and forage readily available. The milk feed price ratio is now about 1.7 and is likely to remain very favorable through most of 1987, indicating continued high levels of concentrate feeding.

Another big factor in this analysis is the relative profitability of dairy farming, both in comparison to a year earlier and to other farm alternatives. In USDA's most recent milk production cost report, it showed that total cash expenses for milk production were down almost $1.00 in 1985 to $9.74 from $10.64 per hundredweight (cwt.) a year earlier. Even with the lowering of the milk price support by $1.00 per cwt. in 1985, returns to owned inputs were up by 10 cents per cwt. in 1985 compared to 1984. While data for 1986 are still not readily available, costs of most major items were down further in 1986 with crop prices, energy costs and interest expenses leading the way.

With moderate inflation projected for 1987, lower feed and fuel costs and a lack of viable farm alternatives, there will be a strong incentive to continue to produce too much milk. We have drawn this scenario not because this is the direction we wish it to go, but as a caution against undue optimism that the surplus problem is solved.

The 1985 Farm Bill started us in the right direction, and the buyout program may buy us a year or so, but the underlying economic incentives to produce too much milk, I am afraid, are still there. The price adjustments contained in the Farm Bill are our insurance policy to guarantee that the right signal will be there if the surplus problem persists. We certainly do not need a supply management program. The Farm Bill amendments will do the job if they are not interfered with.

Now I would like to change the focus of my remarks to coincide with the topic assigned ... dairy marketing issues. This is an area where much, much more work is needed. With so much emphasis placed on how to control production, marketing, until recently, has often taken a back seat to other dairy issues.

A consistently bright spot in the dairy industry in recent years has been the dramatic growth in commercial use. After many years of 1 to 2 percent gains, we have recently witnessed three consecutive years with increases of more than 3 percent each year. What is even more heartening, is that this growth has been spread over a large number of dairy products. For the first six months of 1986, for instance, we experienced an overall growth in dairy product sales of 4 percent compared to a year earlier. American cheese sales were up 6 percent; butter sales up 5 percent; ice cream sales up 2.5 percent; and, while total fluid milk sales were up only 1.3 percent, skim and lowfat milk sales were up almost 6 percent.

While there are a number of factors responsible for this widespread growth, the single biggest factor may be the fact that, over the past few years, dairy products have been a good buy relative to other foods and beverages. Although the consumer price index has increased by a factor of 3.3 to 329 since 1967 and the index for all food and beverage items stands at 314, the dairy product price index has held fairly steady at about 258. Dairy products are a bargain compared to other food items. The price index for cheese, for instance, now stands at 151 compared to 270 for beef and 293 for pork. The index for whole milk stands at 227 compared to 322 for cola drinks. Favorable prices for dairy products have led the way in boosting dairy product sales.

Another factor that has helped sales is the emphasis on marketing and the focus on consumer lifestyles. We have seen this with many dairy products, particularly in the cheese, ice cream and yogurt markets, as companies develop products to meet changing lifestyles.

In the industries we represent (beverage milk, yogurt, cottage cheese and ice cream), we, too, have been guilty for many years of "slighting" our marketing efforts. The ice cream industry in recent years has enjoyed rapid growth. After a long period of hibernation, the industry has awakened with a mighty leap and is enjoying some of its best years. The ice cream industry is rapidly becoming one of marketers, instead of just manufacturers. The ice cream industry has greatly segmented its market and now there is an ice cream for every age group, every lifestyle and every pocketbook.

The ice cream novelty market has become even more segregated than the packaged market. We now have adult novelties, bite-size novelties, juice bars, gourmet bars, and all variations of these, plus all the traditional products. An even bigger development is the repositioning of the industry's thought process to acknowledge that novelties are a part of the $6 billion snack market. This bodes well for this part of the ice cream industry. The competition for novelties is not just other ice cream products; it is all other snacks, like soft drinks, juices, candy, granola bars, etc. These changes can be attributed directly to the emphasis placed on marketing.

Now I would like to concentrate on beverage milk, a product that utilizes the largest segment of the total milk supply, about 36 percent. This, I believe, is the greatest untapped potential for marketing and sales in the dairy industry, and there is still an enormous amount of work that needs to be done to market beverage milks effectively.

In the United States, total beverage consumption is increasing at about 1.2 percent per year, with soft drinks enjoying the largest rate of increase recently, about 4.4 percent. Alcoholic beverages had strong growth in the 1960's and 1970's, but in recent years, with the exception of wine, have been relatively flat. Milk consumption has been fairly stable, but, as a percent of the total beverage market, has lost shares to other beverages. In 1960, milk consumption accounted for about 14 percent of the total market and ranked third as a beverage behind water (39 percent) and coffee (20 percent). Soft drinks accounted for only 9 percent of the market in 1960. By last year, however, the soft drink share had nearly tripled to almost 27 percent of the total beverage market. The major losers were water (down 38 percent), coffee (down 33 percent) and milk (down 22 percent).

On a per capita basis, there has been virtually no change in the consumption of non-alcoholic beverages since 1960. The 10-gallon increase in per capita consumption of all beverages was a result of increased consumption of alcoholic beverages, principally beer and wine. While the per capita consumption of non-alcoholic beverages has remained relatively flat, there have been significant changes in the make-up of that category. Soft drink consumption (51 gallons per person) now exceeds water consumption (47 gallons). The big winners over the past 25 years have been soft drinks, beer, wine (which started from a small base) and fruit juices/drinks. The big losers have been water, coffee and, again, milk.

What is behind these trends? Beverage milk today is a relative bargain compared to other beverages as the following table demonstrates:

HOW MUCH CONSUMERS SPENT PER GALLON

| | 1970 | 1985 |
|---|---|---|
| BEER | $2.31 | $5.01 |
| FRUIT JUICE/DRINK | 1.52 | 4.65 |
| SOFT DRINKS | 1.16 | 3.15 |
| MILK | 1.12 | 2.29 |

I would argue that the level of advertising and promotion has had a lot to do with these trends. In 1985, beer topped the list of beverage advertising expenditures with $774 million - six times the 1970 level. Soft drink advertising was next with $505 million -- four-and-a-half times the 1970 level, followed by coffee ($185 million) and fruit drinks ($150 million). Milk is a distant fifth at $45 million and is less than ten percent of the advertising spent on soft drinks.

On a per gallon basis, milk advertising also ranks low, only 1 cent per gallon, compared to 14 cents per gallon for beer, 6 cents per gallon on fruit juices and drinks, 4 cents on soft drinks and 3 cents spent on coffee.

And what about future advertising expenditures? Beer advertising is projected to level off somewhat, soft drink advertising will continue at a rapid pace, and fruit juice and drinks will increase substantially. We cannot let milk advertising remain the same.

The answer is clear. We must respond with innovative and creative marketing programs to meet the challenge, and MIF, through input of its member companies' marketing experts, has moved to meet this exciting challenge. Our newly initiated milk and cultured products marketing research project will provide fluid milk companies with data they can immediately use to improve their existing marketing programs or assist in developing new ones.

Our research will determine which household members consume whole, lowfat, skim and flavored milks, when they consume these products, and why, who influences the purchase decision for each product, and a whole range of other data. With this information, companies will be able to develop strategic marketing programs that position their various fluid milks to the appropriate consumer segments. The study will identify non-user, as well as user attitudes, and the benefits and attributes consumers associate with the various milks as opposed to competitive alternatives. Similar information will be obtained for yogurt, cottage cheese and sour cream.

These survey results will be available by next spring -- in time for companies to incorporate the results into next year's marketing programs. We are also discussing the development of a cooperative generic and branded advertising program for fluid milk with the dairy farmer organizations responsible for generic advertising programs. We are just in the discussion stage, but there appears to be a great deal of interest and I am optimistic that the total effort to do a better marketing job and sell more beverage milk products is just around the corner. The effort would involve processors committing new monies to advertising their fluid milk brands, with the expenditure of equivalent new funds by the dairy farmer organizations. The incentive of support from the dairy farmer organization should spur a tremendous increase in branded advertising expenditures. This, when combined with generic programs, should work to expand the total market for fluid milk.

Further, now is the time to act because of the particularly positive consumer attitude toward milk and concern with calcium, and overall nutrition and health.

Both the National Dairy Board and the United Dairy Industry Association have expressed enthusiasm with the program, and we are continuing to work to develop this concept. The goal of this new program is to increase fluid milk consumption by effectively competing in the $122 billion beverage industry.

Thank you.