The implications of vertical integration

by MICHAEL BUTTERWICK

Institute of Agriarian Affairs, Oxford

SINCE THE ENDING of the War we have lived through a generation of economic exhortation. We have been constantly urged by the press, by our associations, by our colleagues and superiors, and most of all by politicians, to improve our economic performance. The exhortations have bred clichés—productivity, export-orientated, cost-effectiveness and the rest, which have so drummed on our ears as to make us deaf to whatever meaning they ever had. In this respect farming has suffered like any other industry. Perhaps the exhortation that has been most frequently made to farming audiences is that agriculture needs to improve its marketing. It is very rare to come across any important statement concerned with agricultural policy which does not stress the urgency of improvements in marketing.

It would be ironical if the frequent repetition of the theme had dulled farmers' responses at just the moment when they should be at their keenest. Whatever other mertis can be attributed to the Conservative Government's agricultural policy, which is receiving flesh and bones this year, it is certain that it will force producers to be aware of agricultural markets in a way which some have not thought necessary up till now.

The switch-over from a system in which farm income is drawn partly from the market, partly from deficiency payments and partly from production grants will compel farmers to be more aware of the close relationship between market trends and their incomes. Most people concerned with agricultural policy must have been aware for some time that the system had become far too difficult and complicated for most farmers to be able to understand. It is therefore interesting to have the evidence of Mr. Ian Stewart's recent survey of price information in the cereals market. This revealed that few farmers knew what were the guaranteed prices for the year in question or even what had been the trend in the guaranteed prices. Only a small minority reported that their farming plans had been influenced by price changes. Evidently, despite all these exhortations, most farmers are still primarily production rather than market orientated.

Appeals from government and other sources are not, of course, the only influence on farmers prompting them to look more closely at their marketing plans. The principal motive is economic—the cost-price squeeze which farming has undergone for roughly the last decade. For all but a fortunate fe it has become extremely hard to make a reasonab living from farming taking account of the need f a fair return on capital employed. In these circur stances and allowing for some ignorance of the d tails of the guarantee system itself, it would be su prising if farmers were not looking increasing closely at how they sold their products to make su that the conditions of sale were as advantageous possible.

Those well-known trends in British agricultu concentration and specialisation in productic which have been the dominating features of the pa 10 or 15 years, have been associated with low profit per unit of output. Nowadays a small chan in the marketing return can have a much grea effect on the profit from the farm business. In ad tion farmers must now be much more aware of i comes and returns from invesment in other ind tries. More than ever we are now constantly r minded of increases in incomes obtained by oth occupations. I have no doubt that farmers' dissat faction about incomes, and consequently their co sciousness of market returns, must be very larg due to a feeling that the standard of living of oth is improving faster than their own. Unrest on t score is particularly prevalent elsewhere in Weste Europe where farmers may only recently have beg to expect a regular annual improvement in their e nomic condition.

Important as these influences must be on farme marketing plans, the developments occurring larg outside agriculture, and therefore to a considera extent outside the influence of producers or th organisations, may be equally significant. The mainder of this paper will be concerned with th developments and their possible implications f farmers. The developments referred to can be d cussed under a number of headings, including cha ges in food retailing, in food processing and dist bution, in the types of products available for p chase by farmers, and in the structure of the ind tries supplying these farm inputs. These are t changes that provide the underlying causes for t trend towards vertical integration and contract far ing which is the subject of this paper.

So many developments have come together force the pace of vertical integration that it is di cult to arrange them in any order of priority. P haps one should begin at the extreme end of the agricultural marketing process, the retailing of food, where the changes are well known and apparent. Here again the development is complex. For the present purposes it is perhaps only necessary to observe that the growth of self-service in food retailing has taken place against a background of rising labour costs and that it has been closely associated with a number of partly extraneous developments, such as the use of more sophisticated packaging, the improvement of food conservation, the wider ownership of cars, and the growth of product promotion, particularly through television advertising.

In turn the increasing concentration in food retailing can be associated in particular with the high capital costs of self-service supermarkets and the advantages which the larger organisations evidently possess in bargaining with their suppliers. So far as the latter point is concerned the last decade has witnessed a fierce struggle over brand names between processor and retailing organisations from which the latter have often emerged the winners.

Britain is not the only country to undergo rapid change in methods of food distribution. The movement has been led by North America and the trend is strongly evident in many of the more developed countries of Western Europe. In Germany, for instance, where concentration is proceeding rapidly, some 15 multiple chains account for close to 10 per cent of the retail food market, most of them being affiliated to one central buying group. Many thousands of outlets are grouped under two retailers' buying co-operatives (about 18 per cent of food sales) and the voluntary chains (over 30 per cent). The consumers' co-operatives, whose importance is less than in Britain, consist of some 200 societies, many of them grouped for buying purposes under one supplier, GEG (Grosseinkaufsgesellschaft Deutscher Konsumergenossenschaften). Every year the importance of the independent retailer becomes less.

In the face of this concentration at the retail level there has also been some changes in wholesaling. In 1965, the most recent date for which information is available, there were some 8,000 firms engaged in food wholesaling in Britain, but many of these were very small. (The number of wholesalers in France is even larger and this perhaps contributes to the high cost of food at retail). A recent estimate puts the number of buying points in the non-independent grocery trade, accounting for 77 per cent of total turnover of 746.[1] This represents a very considerable concentration already, but there seems little doubt that this trend will continue.

The food retailing revolution has yet to be fully worked out. The exogenous influences on it include the spread of car ownership, the desire for leisure and the quest for convenience foods. Perhaps one should also take account of the influence of the change in the generally accepted view of the role of the sexes.

Food buying is no longer regarded as the work of the housewife. Joining in on the job with fewer preconceptions men are probably more disposed to make this activity efficient and enjoyable. Once the man takes part and makes available the family car, large purchases at less frequent intervals, and at lower prices, become more likely. The rapid development of the French hypermarché, a step beyond the supermarket is strongly associated with this development. The director of one of the Carrefour establishments recently reported that over two-thirds of his customers shopped in couples.

Concentration has occurred to at least as great an extent in food processing, the trend being apparent throughout Europe. This growth industry is now dominated by relatively few companies, some of which have been engaged in it for many years, others being new entrants diversifying in the manner of the British tobacco interests. For the purposes of this paper the point can perhaps adequately be made by mentioning a few of the more important of these companies, such as Unilever, Nestlé, Corn Products, and Imperial Tobacco. Some food industries, like milling and baking in Britain, have been concentrated for some time. In others, like the Italian confectionery industry, the development is more recent. The concentration spreads, of course, across frontiers, particularly in the EEC, and there is no sign of it halting.

I have placed emphasis on the changes that have occurred among agriculture's customers because it appears that farmers in general are less aware of the concentration among the buyers of their products than they are of the same process among the suppliers of their inputs. Every farmer knows that there are few manufacturers of fertilisers or farm machinery and that the compound feed industry is rather concentrated. But the existence of merchants in many product markets may help to disguise from farmers the fact that the users of their products are in many cases very few in number. Besides there is a disposition among farmers to associate vertical integration exclusively with the activities of the feed compounders and to forget that pressures from their customers are really more important.

It is however impossible to ignore the part that is being played in vertical integration in Britain by the compound feed manufacturers. The reasons for this

1. Consisting of 430 co-operatives, 100 head offices of multiples and 103 of their subsidiaries and 113 wholesalers serving 23 symbol groups. **Nielsen Researcher,** March/April 1970.

development have been described elsewhere.[1] and need be no more than summarised here. Conditions in the feed industry over the past decade have been extremely competitive. The market for feed has failed to expand at the same rate as new capacity has been installed, mostly away from the ports. In several parts of the country capacity greatly exceeds demand which has been further curtailed by the growth of on-farm mixing of feeds particularly prevalent in large integrated units in the poultry industry. Feed manufacturers have consequently made strenuous efforts to make contracts with their farmer customers for the supply of feed in order to guarantee throughput for their mills even if these contracts (which often include credit and technical advice) are sometimes acquired on an unremunerative basis.

Once a feed manufacturer is tied up with a farmer in this way it is a short step to taking an interest in, and a responsibility for the marketing of the livestock or livestock products resulting from the farm enterprise. It sometimes appears an equally short step from the contract relationship to the development of farm production under the full control and ownership of the feed manufacturer or in conjunction with other interests such as hatcheries, packing stations, slaughterhouses or even the larger retailers.

To understand the interests of the British feed industry in vertical integration it must be appreciated that some of the largest companies are already part of groups engaged in food processing, as producers of edible oils and fats, as flour millers, as manufacturers of meat products, pet foods and so on. Extension of these interests through the links of vertical integration is often seen as a logical development. Despite this the group that includes the largest feed manufacturer is only moving very slowly towards linking up its feed production with its wide-range of food products.

An example of a move away from integration is provided by the decision of a large supermarket chain to sell off its principal interest in poultry production. The problem of testing efficiency at each stage of an integrated process, the difficulty of providing specialised management skills at each of these stages and the strain on capital resources of engaging in agricultural production can provide effective deterrents to the ambitions of non-farm interests to engage in integration.

The feed industry is not the only supplier of agricultural inputs which has established new relationships with farm production. Over a fairly wide range of the more sophisticated farm requirements the supplier has moved closer to the farmer-purchaser, either because the product is expensive and credit is required, or its application is complex and technical advice is wanted, or because it may be potentially dangerous and the supplier cannot afford to risk his reputation by allowing it to be used in unskilled hands.

The new relationships caused by reasons of thi kind do not constitute vertical integration. But the are worth mentioning here to illustrate the extent t which the old barriers between farming and the foo and agricultural industries have been broken dowr The consequence of this trend is that it is a goo deal less easy to define exactly where the functio of a farmer begins and ends.

In countries in which the state already intervene in its agricultural industry it would, of course, b possible for arbitrary definitions to be made whic could have the effect of excluding industrial farmer from the benefits of price guarantees or input sub sidies and thus preserve the field for the family farm Measures of this kind have been used in some west ern European countries, but they can normally b got round by the would-be farmer and it is question able whether these restrictions are in the best inte ests of agriculture. Whatever the feeling of farmer about being joined by people or concerns which the think of as being non-farmers, there is no disputin the advantages of fresh sources of capital for agr culture and a new look at farming problems whic should accompany these incursions.

There are, therefore, strong pressures on farmin from both sides: from the food industry anxious t secure its supplies and prepared if necessary to er gage in farm production; and from the agricultura input industries, who are likewise anxious to secur their sales, and who (in the case of feed manufa turers) are increasingly looking at their products a raw materials for the production of livestock an livestock products, which cannot stand large expen ditures on sales promotion and distribution and re main competitive with integrated enterprises. Th penetration of agriculture by interests which hav traditionally been regarded as "non-farm" coul only be disconcerting for many producers jealous t preserve the sanctity of their domain.

No doubt some farmers have by now come t terms with these developments, learned to live wit them, and even profited where possible from then The first requirement for this is to understand th total economic environment in which the farmer operating, to understand the problem of the inpu suppliers and the buyers of farm products wit which the farmer is dealing.

The general nature of these problems have bee indicated earlier but of course they vary greatl from product to product. Having fully understoo the objectives and difficulties of his suppliers and h customers a farmer should be better able to appr ciate how he can benefit from them. To achieve the

1. **Vertical integration in agriculture and the ro of the co-operatives.** The Central Council f Agricultural and Horticultural Co-operatio 1969.

objectives both are prepared to offer things from which the farmer can benefit—lower priced inputs in exchange for a guarantee of supply, high prices for farm outputs in exchange for contracts to provide stated quantities of a guaranteed quality. Credit with strings attached to the offer, and technical assistance equally with strings attached, generally come into the package. Both the latter require particularly careful assessment.

Still more important, as a result of careful scrutiny of his two "partners" on either side of his business the farmer can better identify what he has to offer to them. This will include physical assets, land and buildings, and his own capital for joint enterprises. It will also include the farming skills which he possesses. But probably the most significant will be the drive and initiative supplied by the profit-conscious farmer which may be lacking from a full scheme of vertical integration.

The emphasis here has been placed on the farmers' own response to the pressures of vertical integration rather than the possible engagement of farmers' organisations in feed production, livestock slaughtering, meat processing, etc., with a view to controlling by themselves a large part of the vertical integration process. In Britain such an expectation is, for most products, unrealistic due to the great strength of exising interests in the field. Even elsewhere in Europe where producers' organisations have much greater administrative and financial strength it seems likely that producers' interests may be better served by collaborating with these non-farm interests rather than trying to defeat them.

Collaboration of this kind can best be undertaken by farmers acting together in groups, thus improving their marketing strength which would otherwise be weak compared with that of the interests with which they must deal. The trends in vertical integration which have been briefly outlined in this paper provide a great opportunity for producers' buying and selling organisations to create on behalf of their members the balanced partnerships with non-farm interests which appear to be the best response on the part of farmers to these developments.

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VERTICAL INTEGRATION

DISCUSSION SUMMARY

1. Much of the discussion centred around a conflict of views on the aims of vertical integration (VI) They were expressed in terms of the desire of producers to get a bigger share of the market: higher prices and producers' suspicions of being at the mercy of large retailers who could dictate price and quality to the detriment of the producer. Suggestions were put forward that producers should consider methods of combating retail outlet monopoly by such measures as co-operative buying and selling groups as well as through co-op producer groups.

2. Mr Butterwick was at pains to affirm that the aims of supermarket retailing were not in conflict with the aims of producers. Supermarkets wished to safeguard continuity of supply, quality and p possible. They were not necessarily orientat providing cheap food for consumers; their air good quality at a reasonable price. He fo with less stable markets available to the pro much more development of producer contract as exist in the UK in pea growing. The pro would require to assure his market outlet. He d see much development of producer marketin processing because of the capital involved.

3. Farmers should certainly get togethe they must think more of safeguarding their r as a reasonable price rather than going for prices all the time.