

Recent Evidence About Marketing Margins for Milk and Dairy Products

Chuck Nicholson
Associate Professor, Agribusiness
Cal Poly San Luis Obispo



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Outline

- ❖ Background: DOJ workshops on competition and margins
- ❖ Margin relationships for fluid milk and cheese
- ❖ Evidence about marketing costs
- ❖ Dynamic impacts of reducing marketing margins

Background

- ❖ DOJ workshop in Madison, WI
 - ❖ One in a series of workshops exploring "Competition Issues in Agriculture"
- ❖ Final workshop in Washington, DC
 - ❖ December 2010
 - ❖ Attended by Vilsack and Holder
- ❖ Session at final workshop on "Margins in the Dairy Industry"
 - ❖ Panel: 2 dairy farmers, DeSantis (PMMB), Lopez from (Uconn) and Nicholson (Cal Poly)

Messages from Workshop

- ❖ **Farmers:** "Times have been tough, but we don't have a problem with margins (or coops or marketing). Our bigger problem is price and profitability fluctuations"
- ❖ **DeSantis:** "Our margin regulation program works well and to the benefit of dairy farmers in PA."
- ❖ **Lopez:** "Marketing margins in dairy are too large and are indicative of market power by processors and/or retailers."

Marketing Margins in Dairy

- ❖ How to calculate the margins is a challenge
- ❖ Limited specific cost information available for US as a whole
 - ❖ For retailers and processors (PMMB is exception?)
- ❖ Typically, compare price series at different "market levels"
- ❖ Example: Retail less wholesale price = Gross retail marketing margin
- ❖ NOTE: **Gross margin** is not the same as retailer/wholesaler processor **profits**

Processor Margins in Dairy

- ❖ We generally don't know (at least specifically) the price paid by processors for milk
- ❖ Minimum regulated prices provide a range
 - ❖ Imply roughly similar costs for different buyers for milk used for the same product
- ❖ Over-order premiums are common
- ❖ Obligations under orders depend on component usage, not just on class price

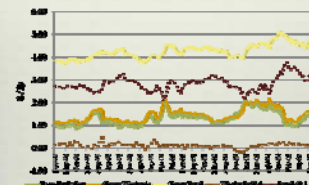
Common Perceptions?

- ❖ Margins are always increasing for wholesalers and retailers
- ❖ Farm prices and wholesale or retail prices don't move together
- ❖ Farm price falls and wholesale or retail price doesn't
- ❖ When farm price increases, retail price increases but when it falls retail price does not

Margins 2000 to 2010

- ❖ For representative margins that we can calculate
- ❖ Cheese (Farm to Wholesale, Wholesale to Retail)
- ❖ Fluid milk (Farm to Retail)

Cheese Margins

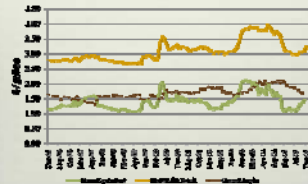


Cheese Margins

- ❖ Wholesale and Farm Equivalent prices move closely together
- ❖ Wholesale and Retail prices move less closely together
- ❖ Wholesale margins relatively small
- ❖ Retail margins larger, have increased since 2009, but not much during 2000 to 2008
- ❖ (Again, GM are not equal to profit)

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Fluid Milk Margins



National level data (but a similar pattern exists in many other markets)

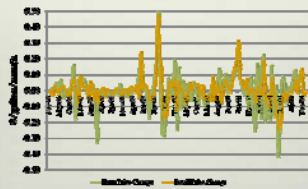
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Fluid Milk Margins

- ❖ Farm and retail fluid milk prices move closely together
- ❖ True for both price increases and decreases
- ❖ The degree of "pass-through" of farm milk price (cost) changes is considerable
 - ❖ Numerous statistical studies agree
- ❖ Margins have increased over time on average but recent margins not that different than in 2000

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Fluid Milk Price Changes



National level data (but a similar pattern exists in many other markets)

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Fluid Milk Price Changes

- ❖ Farm and Retail Fluid Milk price changes are highly correlated
- ❖ This is true for both up and down changes
- ❖ But retailers tend to "smooth" prices compared to farm price
 - ❖ Average change is the same for both series (0.3¢/month)
 - ❖ Lower variation (s.d.) for the retail series

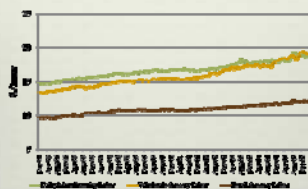
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From Gross to Net?

- ❖ Gross margins are more easily calculated, but net requires specific cost information
- ❖ Usually, this is not available
- ❖ Can look at cost index measures for dairy processing and food retailing

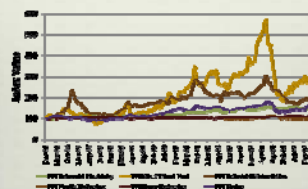
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Wage Rate Indexes



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Input Cost Indexes



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From Gross to Net

- ❖ Many input cost items have increased for processors and retailers
- ❖ **Caution!** Productivity has probably also increased, so these "unit cost" increases probably don't represent impact on actual costs
- ❖ (Farmers costs have also increased)

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Summary So Far

- ❖ Prices at different market levels do tend to move (reasonably) closely together
- ❖ Margins have increased, but not rapidly or dramatically
- ❖ Marketing costs have also increased, to an uncertain degree

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A Key Unanswered Q?

- ❖ Are margins in dairy “too large”
 - ❖ Unfair? Anti-competitive?
- ❖ If so, what are the implications for dairy farmers?
 - ❖ Margins “too large” means higher prices and fewer sales?

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Impact of Lower Margins

- ❖ Not often assessed, yet crucial to understanding what (if anything) to do about current margin relationships
- ❖ A preliminary assessment can be undertaken with simulation modeling
- ❖ Use a dynamic simulation model of US dairy industry (Nicholson and Stephenson, 2010)
- ❖ Permanently reduce fluid milk gross margin by 20%
 - ❖ What are the impacts on farm milk price?

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Impact of Lower Margins



Simulated impacts on US average all-milk price, Jan 2010 to Jan 2019. Baseline and mandatory reduction of 20% in retailer markup beginning in January 2012.

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Implications

- ❖ Mandating lower margins will have limited impacts on farm milk price average or variability
 - ❖ Average farm milk price increases < 2¢ per cwt
 - ❖ Coefficient of variation unchanged
- ❖ Increases sales volume and producer revenues
- ❖ Benefits consumers
- ❖ More work of this type is needed to help inform discussions of margins

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More Information

- ❖ http://www.dairy.cornell.edu/CPDMP/Pages/Publications/Pubs/Nicholson_DOJ_USDA_Workshop.pdf

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