



RISK MANAGEMENT

MARKETING RISK

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This is the third article in a series of six that provide an overview of agricultural risk management.

Success in marketing is largely determined by taking advantage of opportunities. It is essential to understand how markets function, prices are set, and decisions are made.

Marketing is that part of your business that transforms production activities into financial success. Unanticipated forces, such as weather or government action, can lead to dramatic changes in crop and livestock prices. As agriculture moves towards a more global market, these forces stem increasingly from world factors. When these forces are understood, they can become important considerations for the skilled marketer.

Marketing Principles

There are some basic marketing concepts or principles that must be followed regardless of the commodity being marketed, or size of the farm operation. Each stage of the marketing system (production, assembly, processing, wholesaling, retailing, consumption) enhances the desirability of the good to the consumer by producing a form, place, time, or possession utility. All of these conditions need to be satisfied to meet the desire of current consumers for convenience and service. Being aware of these utilities that drive product desirability to consumers, farmers can do a better job of meeting these requirements.

The form utility comes from having the product in the right form for the consumer to gain the maximum utility from its consumption. The place utility comes from having the product where the consumer wants it. The time utility comes from having the product when the consumer wants it. Possession utility comes from transferring physical possession and ownership in the fashion the consumer desires.

Marketing Risk is defined as any marketing related activity or event that is uncertain leading to the variability and unpredictability of prices farmers both receive for their products, and pay for production inputs.

Marketing includes all of the activities that help coordinate production with consumer demand. In this framework, marketing is defined as the best set of economic and behavioral activities that are involved in coordinating the various stages of economic activity from production to consumption. Understanding this definition is important because there are opportunities and risks associated with each of these stages of economic activity.

Economic Principles

Marketing decisions have economic consequences. In order to avoid negative consequences and take advantage of positive economic consequences it is helpful to understand some basic economic concepts and principles as they apply to marketing.

Returns to factors of production: Every factor of production earns a return, including management and marketing skill.

Price is set by the market: We live in a free market society where prices are set

in the marketplace. Individual producers are price takers rather than price makers. Understanding how the market sets prices allows one to take advantage of relatively favorable prices.

Factors that influence demand: Understanding what factors determine demand is important because then one can deliver products that have the characteristics of high demand.

Market integration: This is somewhat related to the general concept of the returns to factors of production in the sense that every step along the chain, from production inputs to final consumer consumption, requires a payment. The more stages of this chain you control, or provide, the more the payment.

Elasticity: This measures the sensitivity of a product to price and income. If a product is very sensitive to price, a slight increase in price will be met by a large decrease in demand.

Market Coordination Contract

Changes in marketing have increased the payoff from closer coordination of successive stages of production in order to assure that products meet the specifications of the market at each successive stage. Products that do not meet the specifications are sold at a lower price.

Vertical coordination is when one firm controls two or more stages of production. It is occurring at many levels and in multiple ways. Contracting is just one way vertical coordination is accomplished.

Vertical integration is one method of coordination, which involves control exercised by ownership of two successive stages.

Contract coordination occurs when an individual or firm (contractor) establishes a legal agreement with a producer that binds the producer to specific production or marketing practices.

However, one individual or firm does not own all of the inputs involved in production or marketing and different individuals own and contribute various inputs into the coordinated system.

Horizontal coordination is when two or more units of production within the same economic stage are brought together under common management. Large companies use horizontal coordination to achieve economies of scale in large quantities of production, and use vertical coordination to control multiple stages.

Marketing Decisions

There are six basic decisions with each marketing activity. The answers to these questions/decisions determine the outcome.

1. When to price? This decision requires determining the time when the price for the particular product or input will be established. This could be at delivery or at some other time.
2. Where to price? The number of market outlets has decreased for some commodities in some areas of the country, but have increased in others. Contracting opportunities have also changed where products are priced.
3. What form, grade, or quality? Some commodities are very price sensitive to quality issues. Other commodities have no recognized, uniform standards. When contracting, this needs to be explicitly stated.
4. What services to use? This is more important with some commodities than others. Dealers offering similar products distinguish them by added service components.
5. How to price? This involves choosing among various alter-

natives to set the price. Commodities that have multiple marketing alternatives (cash and futures) have more pricing alternatives. Generally, pricing a product at delivery results in lower prices and lower profits.

6. When and how to deliver? This is usually closely connected to how the decision to price is set. Transportation and storage costs need to be considered, as do impacts on quality.

Marketing Alternatives

Marketing is an activity that requires effort because there are so many different options available and issues to consider. The simplest marketing is to just market at harvest to the elevator or auction barn or similar outlet. Doing this removes the thinking and planning; but it also removes much of the profit.

There is no single "best" way to market that works for everyone or for every situation. About the only definite is that by not planning a marketing strategy or approach, one becomes a total price taker. By planning and working at marketing, one can generally improve price and profit.

The objective for everyone should be to get the highest return on the factors of production they have put into the product (not necessarily the highest price), reduce the variability in income so they can meet all obligations and needs for family living, and keep risk exposure at the level the farm can withstand and that they are interested in bearing.

When looking at various marketing alternatives available, there are many factors and issues to consider. At a minimum, consider:

Availability: Is the market option realistic given its availability?

Cost: What is the cost of this alternative?

Complexity: How complicated; do I understand it well enough to be successful?

Level of Risk: How much risk am I going to be exposed to?

Type of Risk: What is the source of risk; am I able to manage this risk effectively?

Net Selling Price: Will I make a profit after I have covered my costs or is my net price lower than with a different alternative?

Market Outlook: What is the expected supply and demand condition in this market?

Financial Situation: Do I have the financial position to accomplish this marketing strategy?

Constraints: What is there that can/will potentially prevent me from succeeding and how do I plan to overcome these obstacles?

Niche or Specialty Marketing

Niche marketing can be thought of as providing a product to a small segment of consumers. Some important marketing management fundamentals must be considered and implemented to make this alternative work. These considerations center around the customer, the product, place, promotion, and price. Once these concepts have been considered, one should have a good idea of how to develop a profitable niche marketing strategy. A marketing strategy specifies a target market and the mix of product, place, promotion and price to be used to satisfy customers and make a profit.

At the center of having a profitable niche marketing strategy is

the customer. Consumer appeal means the product must offer significant and desirable benefits to the consumer. The best question to ask yourself is, "What attributes does my product offer consumers that they can not already get?"

DIRECT TO RETAILERS AND CONSUMERS

One popular marketing option that allows farmers to receive a higher return for their crops is direct marketing. Instead of paying packers, shippers, and brokers to market their crops, direct marketing allows farmers to sell directly to consumers. Some of the benefits include cash sales, immediate payment, and more control over prices. Barriers that farmers may encounter include insurance liabilities and zoning restrictions.

Five popular direct marketing alternatives are to: 1) sell directly to grocery stores and restaurants; 2) set up a roadside market and sell to passing motorists; 3) join a Farmer's Market; 4) arrange for consumers to come on the farm and harvest their own purchases; and, 5) Community Supported Agriculture (CSA) enterprises where local consumers support local producers in a cooperative type of arrangement.

Marketing Plan

Managing marketing risk begins with a marketing plan. A marketing plan is the way you have decided you will market your production after evaluating your options and deciding what will be the best way to meet your goals and objectives. It sets the

specific actions you will take and the steps to reach your goals. It requires commitment and discipline to create and follow a marketing plan. Marketing involves emotion, science, discipline, and analysis. The best plan will fail without the discipline to stay on track.

A marketing plan alone does not guarantee success, but it does indicate that many of the factors that affect the profitability and continued survival of the operation have been given consideration. A marketing plan is usually part of a larger business plan that includes production, financial, staffing and management plans.

Marketing is an essential element of small and large agricultural enterprises. The marketing environment exerts a strong influence on the nature of the farm. The crops and animals grown are determined less by a farmer's personal tastes than by what the market will absorb at a price the farmer is willing to take.

A good market plan for direct marketing broadly aims to define the consumer, the products or services they want, and the most effective promotion and advertising strategies for reaching those consumers.

References

There are numerous sources of outstanding materials on all aspects of marketing and managing marketing risk. Contact your local Cooperative Extension office for assistance and direction.

The Risk Management Education web site maintained by the University of Minnesota is an excellent starting point. This vast and current library of information can be accessed at: www.agrisk.umn.edu. **TODAY**

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