

Chapter 2. The Marketing System

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Special Topic—The “Local” Story

“Locally grown” is the hottest trend in food right now among consumers concerned with reducing fuel and pollution generated by moving food all over the world, and with keeping farms in their communities,” Carol Ness, Chronicle Staff Writer, San Francisco Chronicle, Wednesday, July 26, 2006

“Local” has been on the move for a while now, but it has recently been strengthened 1) by the increase in fuel prices and 2) as somewhat of a backlash against major retailers’ moves into organics. Advocates of supporting local small and medium size farms in rural areas have found solace in organic agriculture. And for many years “organic” has been a term which also provided a sense of local agriculture. But this past spring Wal-Mart made its announcement to increase their offerings of organic products by 100%. Concerns about meeting this with already rising demand from retailers such as Whole Foods include concerns about pressures on production which would weaken organic standards and also lead to imports of organics from foreign countries. In addition, whether true or not, the latest food safety scare with spinach has resulted in many consumers looking harder at organics and looking more to “local”. They feel more confident, and perhaps more in control, in knowing that their food was grown by a farmer they know. Is it now time for “local” to experience the next boom (or boon) to smaller-scale agriculture?

In November, Cornell Cooperative Extension hosted its “Strategic Marketing Conference” in the heart of food country—right down the road from the Culinary Institute of America in Hyde Park, NY. The conference supported panels of speakers from agriculture, retailing, and food service. The word from the buyers was that “local” is in demand, and they can’t find enough of it.

Demand from food service is primarily from white table cloth restaurants looking for means to differentiate their business. Chefs have found “local” to be synonymous with higher quality in terms of freshness and shrink. It also provides the story to engage customers who want their restaurant to provide stimulating entertainment and conversation as well as a quality meal. According to Dan Barber, owner and chef at the Blue Hill and the Blue Hill at Stonebarn restaurants, the greatest trend is in pasture-raised be it pigs, chickens, sheep, lambs, or ducks. “The quality difference for chefs is unbelievable,” and “Grass based system is the future for meats.”

Is there is good story for vegetables as there is for meats? Barber said that every chef hears [from producers] that the Northeast is the worst growing region in the US. Yet, he stated that he gets the best and sweetest root vegetables here, around the autumn/winter season after the freeze. Barber’s ending comment was to know what is possible to produce here, to capitalize on regional tastes, and to provide a story about you and your farm to the consumer.

Demand from retail can come from local independent food retailers or even from regional and national chains. Wendy Carter, Locally Grown Coordinator for the supermarket chain Hannaford says, “Hannaford is passionate about supporting local community and supporting the farmer.” When the customer knows they have locally-grown product, they can’t keep it in the store! Their challenge is letting the customer know it is there. Her advice for farmers looking to start selling to a retailer, which was echoed by the other panelists, was to always start conversations at the store manager level and in the winter so both parties can start plans for the marketing season. Hannaford encourages produce managers to value long-term

relationships. This also means that they do not want the store manager to not buy random truckloads for the spot buy.

Adams Fairacre Farms, a 3-store retailer in the Hudson Valley, does \$100 million annually with produce being the single largest department. Being a local business they like to sell local farm products. They have greatest demand for lamb, beef, and cheeses. Their challenge is finding farm product. Farmers in the region are drawn to the Greenmarkets in NYC, and do not generally have enough product for the retailer. While they have relationships with local apples and sweet corn, they are trying to find ways to work with farmers to get product. One way is to let their Ulster County store serve as a drop-off point for farmers while they provide their own inter-store trucks to transport product to the other stores.

The comments by these buyers at the conference were encouraging. Even nationally, “local” is on the move. Whole Foods, the recent supermarket marvel growing at levels unheard of in food retailing, has said that it plans to buy more from smaller growers. In addition, it recently announced 5 initiatives to support local agriculture. Whole Foods plans to:

- Give \$10 million a year in low-interest loans to help small, local farmers and producers of grass-fed and humanely raised meat, poultry and dairy animals. Select Regional and Store Buyers will be empowered to extend these loans to help support smaller scale agricultural entrepreneurs.
- Raise its standards of humane care for the animals who supply meat, eggs and dairy to the stores. Whole Foods has hired an "animal compassionate field buyer" to work with producers to ensure that they meet the standards.
- Set up Sunday farmers' markets in the parking lots of some Whole Foods stores.
- Whole Foods Market is changing the job responsibilities of our Regional Buyers to focus more on sourcing local products for their stores.
- Give Regional and Store Marketing Teams direct responsibility for communicating and educating our customers about locally produced products to tell the stories of local producers.

While Whole Foods is only 1 retailer, albeit with 189 stores, it is in the competitive spotlight and you can be sure that other retailers are taking note of its actions.

The U.S. Food Marketing System Update

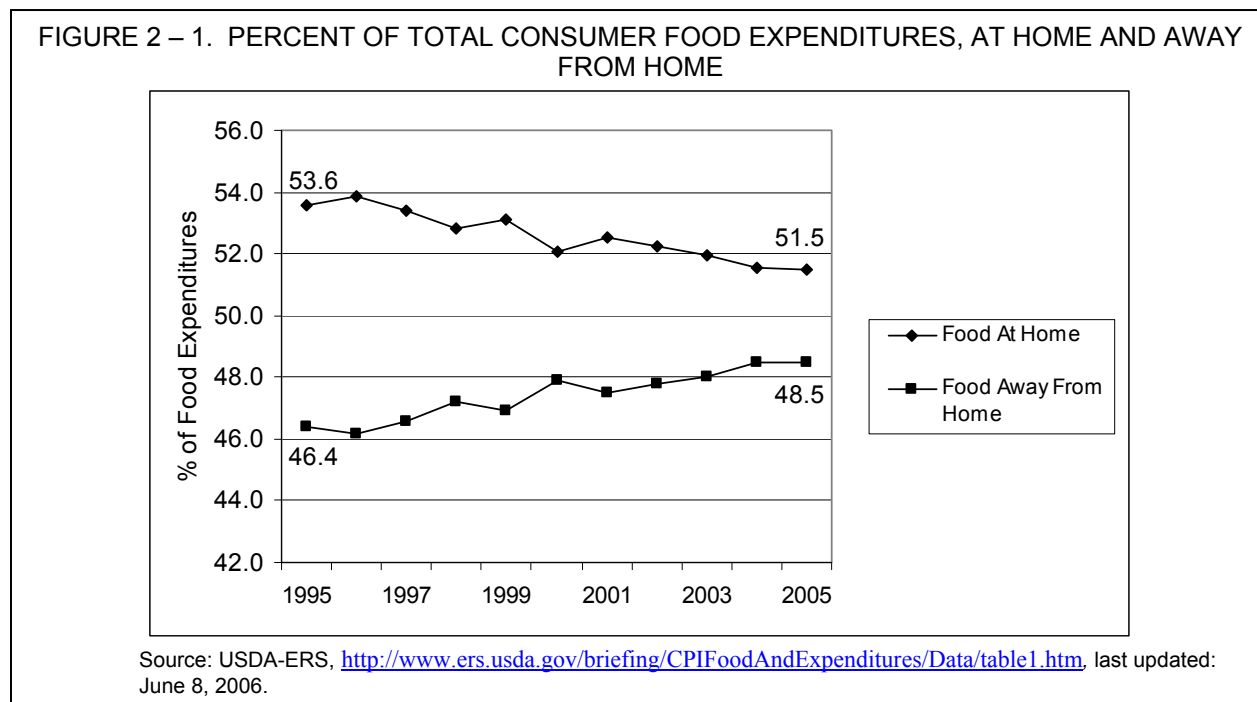
Food and beverage sales grew nicely in 2005, increasing \$66 billion from 2004 to a total of \$1.1 trillion (Table 2 – 1). Growth paced approximately 6.0% for total food and beverage sales as well as for all subcategories. Food-at-home sales as well as food-away-from-home sales grew 5.9% and 6.0% respectively. Food and beverage sales fed approximately 300 million Americans, as the U.S. Census announced in October that U.S. had reached the mile mark with an estimated 300 million residents living in the country.

Sector	Sales 2004	Sales 2005	Increase	Growth
	--\$ billion--		--\$ billion--	--% change--
Total food and beverage sales	1,039,909	1,105,910	66,001	6.0
Total food sales (excluding alcohol)	915,616	973,658	58,042	6.0
Food at home sales	489,520	520,319	30,799	5.9
Food away from home sales	426,096	453,339	27,243	6.0
Alcoholic beverage sales	124,293	132,252	7,959	6.0

¹ Does not include home production, donation, or school lunch program expenditures

Source: USDA-ERS, <http://www.ers.usda.gov/briefing/CPIFoodAndExpenditures/Data/table1.htm>, last updated: June 8, 2006.

The USDA Economic Research Service calculates expenditures beyond dollar sales. When all food consumption expenditures are estimated, including food produced at home (at-home consumption) and school lunch programs and other child nutrition subsidies (away-from-home consumption), at-home food expenditures are approximately 51.5% of all food expenditures (Figure 2 – 1). This figure held steady from 2004. Food expenditures away from home are estimated to be 48.5% of total food expenditures. Numbers from USDA have been updated and revised since last year when they reported that away-from-home expenditures were greater than at-home expenditures.



Food-away-from-home expenditures are catching up to food-at-home expenditures, although it did not reflect this in 2005. The increase is not only due to an increase in volume of consumption—more consumers eating out more often—but also in a slight increase in restaurant prices relative to retail (at-home) prices. Table 2 – 2 illustrates this slight trend for increasing restaurant prices relative to retail prices.

TABLE 2 – 2. RELATIVE PRICES OF FOOD AT THREE STAGES OF THE SYSTEM			
Year	Restaurant prices	Retail store prices	Manufacturers' and shippers' prices
<i>Percent of retail store prices</i>			
1995	172.9	100.0	54.2
1996	170.9	100.0	54.1
1997	171.5	100.0	52.3
1998	172.7	100.0	51.1
1999	173.7	100.0	50.4
2000	173.8	100.0	50.0
2001	173.2	100.0	49.8
2002	175.4	100.0	48.5
2003	175.3	100.0	49.5
2004	173.9	100.0	49.5
2005	176.0	100.0	49.3

Source: USDA-ERS, CPI, Food and Expenditures, <http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/table13.htm> October 2006.

The outlook for changes in consumer food prices are shown in Table 2 – 3 below. In 2005, the CPI for all food was 2.4, meaning the prices for all consumer foods increased approximately 2.4% from the previous year. This was a relatively small increase compared to very recent years'; however, the annual average inflation rate over the past 10 years (1996-2005) has been 2.5 percent. Fierce competition among retailers handling food and the increased competition by low-price, discount stores exert pressures to keep food prices low, even though these will be partially offset by increases in energy and transportation costs.

CPIs for some of the major food groups are also reported in Table 2 – 3. The groups which did well in 2005 included beef and veal and fresh fruits and vegetables. Poultry, eggs and dairy products did not do as well and reported CPIs less than that of food overall.

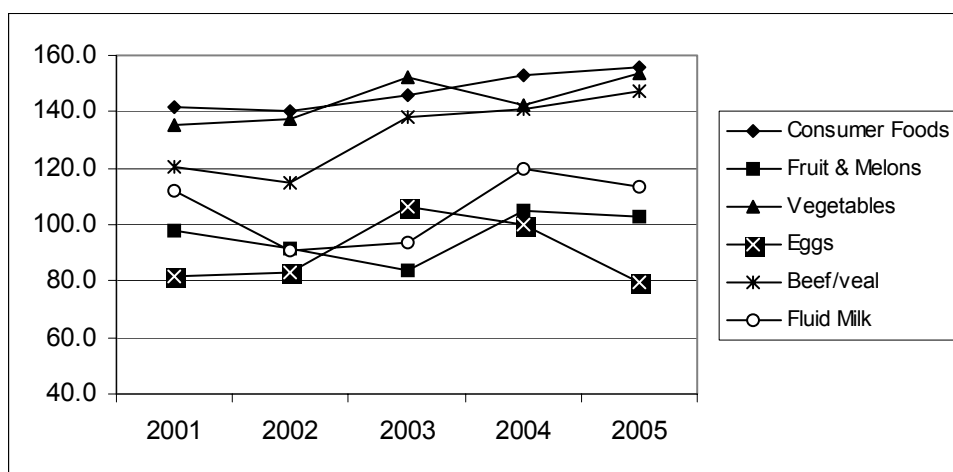
The forecast CPI for all food for 2006 is about the 10-year average and for 2007 is slightly higher than average. Again, fresh fruits and vegetables should fare well, and eggs should be able to start to see an increase over the previous year. Unfortunately, beef and veal prices are expected to slide. Poultry and dairy products actually are forecast to see a decline in overall prices in 2006 and an increase less than the average in 2007. Further information on the CPI forecasts for major food groups can be found at the USDA-Economic Research Service's Briefing Room: <http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/outlook.htm>

TABLE 2 – 3 CHANGES IN CONSUMER FOOD PRICE INDEXES, 2004 THROUGH 2007				
Item	2004	2005	Forecast 2006	Forecast 2007
	<i>percent change from previous year</i>			
All food	3.4	2.4	2.0 to 3.0	2.5 to 3.5
Food away from home	3.0	3.1	2.5 to 3.5	2.5 to 3.5
Food at home	3.8	1.9	1.5 to 2.5	2.0 to 3.0
Beef and Veal	11.6	2.6	0.0 to 1.0	0.0 to 1.0
Poultry	7.5	2.0	-2.0 to -1.0	1.0 to 2.0
Eggs	6.2	-13.7	2.5 to 3.5	4.0 to 5.0
Dairy products	7.3	1.2	-0.5 to 0.5	0.0 to 1.0
Fresh fruits	2.8	3.7	5.0 to 6.0	3.5 to 4.5
Fresh vegetables	4.3	4.0	5.0 to 6.0	3.5 to 4.5

Source: USDA-ERS, CPI, Food and Expenditures, <http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/cpiforecasts.htm> October 24, 2006.

The Producer Price Index (PPI), unlike the CPI, is based on prices received by producers from whomever makes the first purchase. For many farm products it has not changed much since 1982 which is the base year. For example, a PPI of 100.0 reflects a farm price equal to that of the base year, 1982. The PPIs shown here, in Figure 2 – 2, including that for all consumer foods, have all hovered between roughly 80 – 160%, a testimony perhaps to the great output and efficiencies of the agricultural system but also to the downward price pressures put on the system. Since 2001, fresh vegetables, excluding potatoes, have shown more consistent, overall farm price gains with a 2005 PPI of 153.5. Beef and veal have shown stronger prices in the last 2 years, while others shown below have exhibited low and fluctuating producer prices.

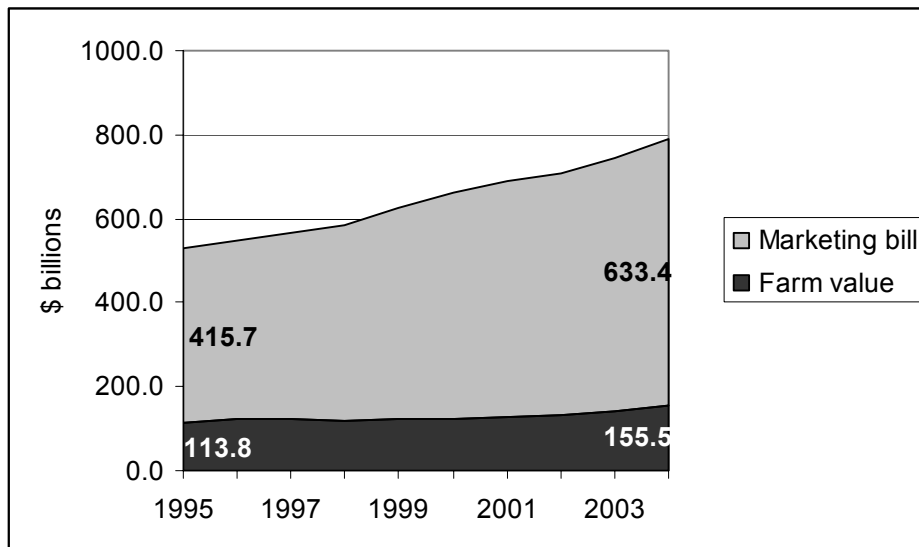
FIGURE 2 – 2. PRODUCER PRICE INDEXES, FARM PRODUCTS
Base Year = 1982



Source: USDA-ERS, Agricultural Outlook <http://www.ers.usda.gov/publications/agoutlook/aotables/2006/10Oct/aotab07.xls> October 2006.

As consumer food expenditures are increasing, so too are the farm value and marketing portions of expenditures. Farm value increased to \$155.5 billion in 2004, the latest year reported, while marketing costs increased to \$633.4 billion (Figure 2 – 3). These marketing costs constitute a greater and greater portion of consumer food expenditures, approximately 79% in 1995 and 80% in 2004. Reasons include greater increases in marketing costs, including processing and transportation costs, outside of the farm sector. It also is a reflection of the greater transformation of farm products to consumer ready-to-eat products. In addition, food-away-from-home costs are greater than retail costs as they include chef preparation and restaurant overhead costs. And as consumers eat out more these costs constitute a greater portion of the marketing bill.

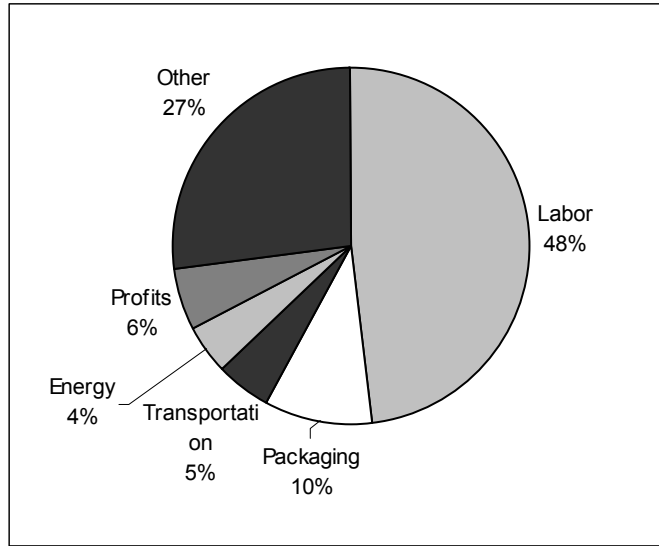
FIGURE 2 – 3. U.S. FARM VALUE AND MARKETING BILL, 1995 - 2004



Source: USDA-ERS Food Marketing and Price Spreads, <http://www.ers.usda.gov/Briefing/FoodPriceSpreads/bill/table1.htm> August 2006.

Marketing costs tracked and calculated by USDA-ERS are all the costs to transport and transform first point of sale farm food to food purchased by the consumer at retail or restaurant. These costs include all those costs associated with processing, wholesaling, transportation, retailing costs, and profits. In general, most of the marketing costs on a percentage basis remain steady (Figure 2 – 4). Energy as a percent of marketing increased slightly in 2004 as well as did intercity transportation, but over the past decade these costs have remained steady if not decreasing slightly. Labor has shown a slight increase over the last decade as well as corporate profits before taxes.

FIGURE 2 – 4. MARKETING BILL COMPONENTS FOR FOOD PRODUCED IN THE U.S., 2004



"Other" includes depreciation, rent, advertising and promotion, interest, taxes, licenses, insurance, professional services, local for-hire transportation, food service in schools, colleges, hospitals, and other institutions, and miscellaneous items

The marketing bill is the difference between the farm value and consumer expenditures for these foods at both food stores and restaurants. Thus, it covers processing, wholesaling, transportation, retailing costs, and profits.

Source: USDA-ERS, Food Marketing and Price Spreads, <http://www.ers.usda.gov/Briefing/FoodPriceSpreads/bill/table2.htm> August 2006