

## MARKETING AGENCIES-IN-COMMON

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### *Why The Interest In Marketing Agencies-In-Common?*

The current federal dairy price support program is highly market oriented. Market forces determine manufactured dairy product prices, with the exception of butter, and in turn the manufacturing milk price is determined by competition rather than the support price most of the time. This market orientation stems from a reduction in the support level for dairy. With the decline in federal supports, dairy cooperatives have been exploring options for improving their price bargaining through joint cooperative action.

The support level for manufacturing milk prices has been reduced significantly since 1981. The federal support price for manufacturing milk was lowered by \$3 per hundredweight from \$13.10 for 1981 to the current level of \$10.10. The Commodity Credit Corporation (CCC) purchase prices under the dairy price support program for butter, cheddar cheese and nonfat dry milk were reduced accordingly. CCC purchase prices per pound for these products for 1981 were: butter \$1.52, nonfat dry milk \$.94, cheddar cheese in blocks \$1.395, and cheddar cheese in barrels \$1.365. In 1992, CCC purchase prices per pound for these same products are: butter \$.7625, nonfat dry milk \$.9730, cheddar cheese in blocks \$1.1175, and cheddar cheese in barrels \$1.0875.

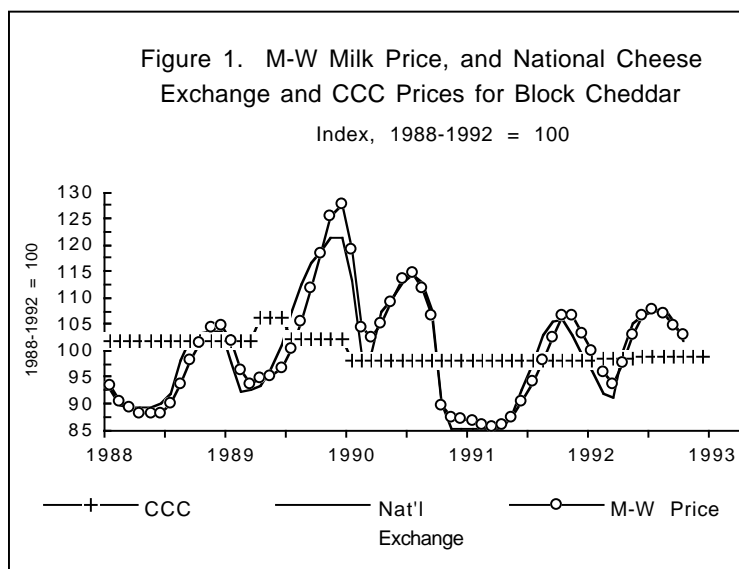
This market-oriented environment produced record changes in manufactured dairy product prices and farm milk prices during the 1989-91 period. The primary driver of changes in farm milk prices was record changes in cheese prices, as illustrated in Figure 1.

Tightness in the milk supply and demand situation and cheese markets during fall 1989 caused block cheddar cheese prices on the National Cheese Exchange to increase from \$1.1775 per pound at the end of January 1989 to a peak of \$1.545 by early November. The Minnesota-Wisconsin Price Series (M-W price)

during 1989 increased by \$3.95 per hundredweight from \$12.02 for March to a record \$14.93 for December.

A come-back in milk production and cheese production beginning in the second half of 1990 brought record drops in cheese prices and farm milk prices. Block cheese prices on the National Cheese Exchange dropped from \$1.4675 per pound at the end of July 1990, to just \$1.0975 per pound by early October. The M-W price dropped from \$13.43 per hundredweight for July to \$10.58 for October and ended the year at \$10.19. The M-W continued to decline to a low of \$10.02 per hundredweight for March 1991.

Both cheese and farm milk prices began increasing by June 1991, but these higher prices are probably not sustainable. The price volatility during 1989-91 was difficult not only for dairy farmers, but for manufacturing plants as well. Dairy farmers experienced financial management problems and some severe financial stress with low milk prices. Manufacturing milk plants found managing dairy product inventories difficult and many experienced substantial losses from



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reduced inventory values as cheese markets plummeted during late summer and fall of 1990.

Dairy farmers and some cheese plants became disturbed when lower farm milk prices and wholesale cheese prices in late 1990 and early 1991 were not matched by declines in retail cheese prices. Some charged major cheese buyers and retail food chains with taking abnormal profits from cheese.

The reduction in the federal dairy price support program, market price volatility and perceived concentration of market power by major cheese buyers have fostered interest on the part of dairy farmers and cooperatives to consider enhanced bargaining and marketing power through a cooperative structure.

Dairy cooperatives in the Upper Midwest (Wisconsin, Minnesota, Illinois, Iowa, North Dakota and South Dakota) and in the West (California) have been considering marketing agencies-in-common and other joint activities for manufactured dairy products. Fourteen Upper Midwest dairy cooperatives launched a Dairy Marketing Initiative (DMI) in 1991. The purpose of the DMI is to work together to increase and stabilize farm level milk prices and manufactured dairy product prices through joint venture activities and strengthening their bargaining power in the market place. The ultimate goal is to strengthen marketing power by organizing a marketing agency-in-common.

Also beginning in 1991, a California trade association, the Alliance of Western Milk Producers with membership of seven dairy cooperatives and two producer groups, launched an effort similar to the DMI group. It is too early to evaluate the success these two groups of dairy cooperatives will have in establishing marketing agencies-in-common and other joint activities. Thus far the Alliance of Western Milk Producers has not been successful in organizing a marketing agency-in-common for butter, nonfat dry milk or cheese. However, for a start, the cooperatives have agreed to form an informational sharing organization. The dairy cooperatives who are members of this organization agree to share information on current and planned production, inventories and product prices. However, no uniform prices nor joint selling activity takes place. Recently a similar informational sharing organization was established by six dairy cooperatives located in the West, Midwest and Northeast for nonfat dry milk. The DMI group is considering a similar informational sharing organization for manufactured products as their initial beginning. Improved market information could be very beneficial in both production and marketing of manufactured dairy products by dairy cooperatives. Once dairy cooperatives develop a good working relationship in an informational sharing organization the next step may be the organization of

a marketing agency-in-common. This paper specifically discusses the opportunities and limitations of marketing agencies-in-common for manufactured dairy products.

### ***Marketing Agency-In-Common Defined***

Associations of dairy producers meeting the terms and conditions of the Capper-Volstead Act of 1922 may have a common marketing agency. A marketing agency-in-common, by definition, is a grouping or combination of marketing cooperatives, or a grouping or combination of marketing cooperatives and individual farmers who market products under a common agreement. Member cooperatives maintain operational independence while capitalizing on the economies and market power of a larger organization.

Some would maintain that a pure marketing agency-in-common is, in fact, a federated cooperative or mixed cooperative<sup>1</sup> whose sole responsibility is to serve as a marketing agent of its members. It does not physically handle products, and it generally does not take title to them. Its sole responsibility is to arrange for the sale of its members' products. Some cooperatives, however, may choose to form a federated marketing cooperative that takes title to members' products and has the major authority in handling, pricing and marketing of the products. These joint arrangements are also normally referred to as marketing agencies-in-common. Thus, marketing agencies-in-common may refer to those joint arrangements between cooperatives that simply arrange for the sale of its member products to those arrangements where the agency has the complete authority to price and market the members products.

Marketing agencies-in-common may be organized to spread the astronomical costs of establishing consumer-recognizable brand names for differentiated products. Dairy cooperatives have formed marketing agreements with Land O'Lakes, Inc., for example, to take advantage of the nationally recognized Land O'Lakes brand of butter. Independent turkey processing cooperatives have signed contracts with Norbest, Inc. to take advantage of Norbest's marketing services and brand names.

### ***Additional Examples of Marketing Agencies-In-Common***

Sun-Maid Raisins, Diamond Walnut Growers, Sunsweet Prunes and Valley Fig Growers market commonly through Sun-Diamond Growers of California. Cooperating Brands, Inc. is a marketing agency-in-common initiated by a fruit and vegetable processing cooperative for marketing juice. Members are classified by the brand name used for their major juice products: Citrus World for oranges, Welch Foods for grapes, Ocean Spray for cranberries, Tree Top for apples, and

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<sup>1</sup>A mixed cooperative is one whose membership includes other cooperatives and individuals (dairy farmers) who are not members of the member cooperatives.

Tri/Valley Growers for tomatoes. Sugar beet cooperatives in the Red River Valley have used a marketing agency-in-common for merchandising by-products. In cotton, regional cooperatives in the major producing areas of Mississippi, Texas, and California use Amcot as a marketing agency for identifying customers overseas.

In dairy, marketing agencies-in-common have been primarily used to market fluid milk. Marketing agencies-in-common have been used for over-order pricing of class I (beverage) milk in a number of federal milk marketing orders. Central Milk Producers Cooperatives in the Chicago Market, for example, is composed of 13 cooperatives who unite in negotiating over-order premiums for dairy farmers. Similar examples are found in Indiana, Michigan, the Middle Atlantic states and other markets.<sup>2</sup>

### **Potential Objectives of Marketing Agencies-In-Common**

Dairy cooperatives may organize a marketing agency-in-common to achieve one or more of the following objectives:

1. *Enhance the price of member-patrons' milk, the price of milk products and milk by-products.* Normally this is the foremost objective of a marketing agency-in-common. The marketing agency-in-common is used as a coordinated marketing entity to eliminate competition among cooperatives that are relatively smaller than their buyers of milk products, just as producers eliminate competition among themselves through memberships in their cooperatives. A coordinated bargaining and marketing effort potentially enhances milk prices to member-producers, and the prices of milk products and by-products manufactured and sold by cooperatives that are members of the agency.
2. *Reduce product price volatility.* Related to the price enhancement objective is more stable prices for manufactured dairy products. Coordinated marketing efforts through a marketing agency-in-common may prevent sharp declines in cheese prices such as those in the summer and fall of 1990.
3. *Provide improved market information.* The first two objectives, price enhancement and reduced price volatility, may be better achieved through improved market information by cooperative members of the marketing agency-in-common. Sharing information like product inventories, production volumes and production plans would benefit bargaining and marketing strategies.
4. *Reduce marketing costs.* There are potentially significant savings in marketing costs through eliminating duplication of marketing efforts among the members of the marketing agency-in-common.

5. *Handle and dispose of surplus milk products in an orderly fashion.* A marketing agency-in-common could coordinate the volume of product entering the commercial marketing channel and, thereby, maintain stronger prices for products marketed. Excess or surplus products could be held off the market for later sales or channelled into some other domestic use or even international markets. If whey product prices are depressed, for example, a marketing agency-in-common could encourage members to reduce whey processing. Unprocessed whey may be disposed of in some other means such as spreading as field fertilizer.
6. *Provide export marketing.* Marketing in international markets requires special expertise. Individual dairy cooperatives may not have or be able to afford the services of specialized international marketing exports. A marketing agency-in-common could explore and foster an expanded international market of milk products and by-products for its member cooperatives.
7. *Pool resources for product development.* Improved returns to dairy farmer members of cooperatives could be achieved through value-added products and new product development. Both require special production and marketing skills as well as relatively large financial commitments and associated market risks. However, these efforts may be more feasible through the pooling of financial resources by members of the marketing agency-in-common.
8. *Establish brand identification.* Cooperatives have been able to command market respect, market share and improved product prices through established regional and national brand names. Sunkist oranges, Welch's grape products, Ocean Spray cranberries, Diamond walnuts, Sunmaid raisins, Norbest turkeys, Sue Bee honey, Land O'Lakes butter, and Lake-to-Lake cheese are just a few examples. Once again, establishing a recognized brand name demands considerable financial investments and marketing expertise that may be best provided through a marketing agency-in-common.
9. *Provide legislative and regulatory representation.* Although dairy cooperatives already have legislative and regulatory representation through trade associations such as the National Milk Producers Federation and their own political action funds, a marketing agency-in-common could still foster a building of consensus and support for legislative and regulatory issues.

### **Conditions For A Successful Marketing Agency-In-Common**

As with an individual dairy cooperative, certain conditions must exist for the successful operation of a bargaining

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<sup>2</sup> See Jacobson's "Regional Milk Bargaining Agencies," Leaflet M-5.

organization or marketing agency-in-common. Following are the primary conditions such organizations should strive to satisfy:

1. *Provide a control over supply.* Although several elements are required for successful bargaining for a price, the most important is controlling supply. Dairy cooperatives already market the major share of dairy farmers' raw milk, and process and market a major share of manufactured dairy products. About 82% of all milk at the farm level is marketed through cooperatives.<sup>3</sup> Dairy cooperatives' market share of major dairy products at the wholesale level are estimated to be: fluid (beverage) milk 15%, butter 65%, hard cheese 55%, and dry milk products 90%. These market shares may be sufficient to impact market prices and other terms of trade. Yet, because dairy cooperatives compete with one another in marketing and don't market together, they weaken their bargaining power. Concentrating their efforts through a bargaining association or marketing agency-in-common enhances supply control and market power.

Significant shares of milk and milk products remain outside the dairy cooperative marketing structure. This reduces the market power of dairy farmers through their cooperatives. It also presents a "free-rider" problem. A free-rider is a dairy farmer who benefits in the marketplace from efforts of the dairy cooperative organizations but is not a member and does not share the costs of supporting the association. A successful marketing agency-in-common may enhance the market prices for the member-cooperatives' milk and milk products and in turn the raw milk prices of member-producers of the cooperatives. Prices to non-members producers will no doubt also strengthen.

Of course, supply control involves the amount of total production. The inability of dairy cooperatives to control the amount of total milk produced by dairy farmers is a major supply control problem. If a marketing agency-in-common successfully enhances prices to dairy farmers and their response to improved prices is expanded milk production, then the agency will not be able to maintain these improved prices.

2. *Ensure that each member cooperative is better off in the agency than outside it.* In order to hold the membership of a marketing agency-in-common together, each individual cooperative member must be at least as well off within the agency as outside it. Relative market competi-

tiveness can only be maintained if the agency is structured so that each member cooperative's marketing position relative to other agency members is protected, while the cooperatives' marketing position as a group is significantly enhanced. The agency must avoid any unfair economic benefit or damage to any member cooperative.

3. *Provide equitable sharing of control and benefits.* Closely related to conditions 1 and 2 is a feeling by each individual cooperative member that they have an equitable share in the control of the marketing agency-in-common and over the benefits generated.

4. *Promote a disciplined membership.* Member commitment is essential for successful bargaining and marketing. Dairy farmers must be committed to their individual dairy cooperative. In turn, the individual dairy cooperative must be committed to the marketing agency-in-common. Members must be aware of the importance of meeting obligations. Members need to consider the "general welfare" of dairy producers and dairy cooperatives rather than "individual welfare." That is, individual members of any agency may be tempted to sell or market outside the agency for short term benefits (higher price for example) at the long run expense of all involved. Membership contracts may be useful to ensure discipline of agency members.

5. *Maintain and enhance market recognition.* A bargaining or marketing agency-in-common can be effective only if it gains recognition among firms with which it seeks to market. It can do this best when it demonstrates substantial market power. Buyer recognition may be achieved through controlling a substantial share of supply as well as an established recognition for product quality, service and/or brand name.

6. *Provide mutual benefits to buyers and sellers.* A bargaining or marketing agency-in-common needs to recognize that the buyers of their products are in competitive positions as well, and both parties must understand the mutual benefits of their long-term business survival.<sup>4</sup> Negotiated prices and other terms of trade need to be realistic. A buyer of products from a marketing agency-in-common may also benefit from services provided and, therefore, be willing to pay a higher price. A buyer of cheese paying a higher price to the marketing agency may benefit from the dual guarantees of consistent quality and a dependable supply of cheese to meet their specific needs.

<sup>3</sup>USDA, ACS, "Co-ops' Share of Farm Marketings, Production Supplies at 27 Percent." *Farmer Cooperatives* (May 1992):4 and USDA, ACS, "Co-ops' Share of Farm Business Stabilizes at 24 Percent." *Farmer Cooperatives* (March 1991):12.

<sup>4</sup>USDA, ACS, "Fruit and Vegetable Cooperatives." *Cooperative Information Report* 7, Section 13 (November 1990 revision):26.

### *Specific Challenges of Marketing Agencies-In-Common For Dairy*

As already indicated, highly successful marketing agencies-in-common exist for fruits and vegetables and for some other commodities. Marketing agencies-in-common have demonstrated success in the marketing of fluid milk in federal milk order markets. The question being raised is, can marketing agencies-in-common successfully market manufactured dairy products such as cheese, nonfat dry milk, and whey products? The answer is, “yes” and successful joint marketing efforts already exist, such as with butter under the Land O’Lakes brand. However, marketing agencies-in-common for manufactured dairy products must recognize and overcome some unique challenges. Some of the major challenges include the following:

1. *Widely dispersed production.* Producers of most major fruits and vegetables are fairly concentrated within a particular geographic region of the United States. Therefore, the processors and marketers of these products are also geographically concentrated. Experience demonstrates that market structure characteristics that enhance control over supply include (a) a geographic concentration of production, and (b) a relatively small number of producers and processors of a given product. While these characteristics are met by most marketing agencies representing fruits and vegetables, they do not exist for milk and manufactured dairy products. Five leading dairy states, Wisconsin, California, New York, Pennsylvania and Minnesota, produce about 52% of the nation’s milk supply, but this is hardly a geographic concentration of production. Indeed, milk is produced in all 50 states. The major share of cheese, butter, milk powder, whey and whey products are produced in a handful of states, but they are scattered geographically west and east from the Upper Midwest.
2. *National markets.* Not only is the production of manufactured dairy products geographically scattered, the markets for these products are national in scope. Although the markets for fruits and vegetables are also national, they do not have the problem of widely dispersed production. If, for example, dairy cooperatives located in Wisconsin and Minnesota form a marketing agency-in-common to price and market cheese, the success in enhancing the price of their cheese products and marketing them nationally is limited by significant cheese production from states such as New York and California. Ideally, the marketing agency-in-common for cheese would include the cooperatives making cheese in all of

the key cheese producing states. The geographic separation of these cooperatives makes forming such a marketing agency-in-common more difficult.

3. *Substantial market share by investor-owned firms.* Although dairy cooperatives manufacture 65% of all butter and 55% of the hard cheese, that leaves a substantial share manufactured by investor-owned firms. Some of these firms are also major buyers of the cheese manufactured by dairy cooperatives.
4. *Lack of federal marketing orders for manufactured dairy products.* Marketing agencies-in-common for fluid milk benefit from existing federal milk marketing orders in achieving their objective of enhanced prices for fluid milk. Federal milk marketing orders establish minimum prices milk handlers (serving a specific marketing area) must pay producers for milk. The marketing agency-in-common, therefore, has an established minimum price from which to bargain with fluid milk handlers.

Federal marketing orders are oriented toward fluid product markets. Although the dairy price support program sets a floor under butter, nonfat dry milk and cheddar cheese prices and in turn manufacturing milk prices, the current support price is at a low level that subjects these products to considerable potential price volatility.

Federal marketing orders have been beneficial to fresh fruit and vegetable bargaining associations and marketing agencies-in-common. Marketing orders are utilized by fruit and vegetable agencies to deal with product variability and to accommodate fluctuating supplies with market demand.<sup>5</sup> Fruit and vegetable market orders rely primarily on quality control, market flow, and volume management regulations to enhance the level and stability of producer returns. Cooperatives play an important organizational and leadership role in creating and maintaining these market orders.

5. *Manufactured dairy products serve as the balancing wheel.* Grade A milk marketings that cannot be utilized for fluid purposes are channeled into manufactured dairy products—butter, nonfat dry milk and cheese. Manufactured dairy products serve as a balancing wheel for the dairy industry. Marketing agencies-in-common that are involved with manufactured dairy products must contend with a milk surplus problem, both seasonal surpluses as well as possible annual surpluses. This complicates the supply-control issue for manufactured milk products.

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<sup>5</sup>USDA, ACS, “Fruit and Vegetable Cooperatives.” *Cooperative Information Report* 1, Section 13 (November 1990 revision):52.

6. *Differences in functions performed.* Dairy cooperatives involved with manufacturing dairy products perform different functions. Some manufacture and market only commodity products: block and barrel cheddar cheese or dry whey, for example. Others are heavily involved in value-added activities—further processing and packaging products directly for consumer use. Some have already established nationally recognized brand names for value-added products. These cooperatives have invested significant amounts of time and money in developing their products and labels and should not be expected to turn over these valuable assets to a common marketing agency without adequate compensation.

Two schools of thought exist towards treating those with significant value-added and nationally-identified products. One is to exempt these value-added products from the marketing agency-in-common. The dairy cooperatives that have developed these products would continue to market them on their own outside of the marketing agency.

The second school of thought is to include value-added products in the marketing agency-in-common. Others can then benefit from the already established expertise in manufacturing and marketing value-added products. After all, cooperatives that produce only commodities and those with value-added products could both benefit from a common marketing agency. Cooperatives with value-added products also gain from the increased price on commodity products through the bargaining agency, due to the relationship between these commodities and value-added products. If the price of dry whey increases, for example, so may the price of whey protein concentrates, and whey protein. Channeling more of the production of the membership of the common marketing agency into the value-added products (utilizing the experience of the cooperatives that developed them), could benefit the entire marketing agency. The issue here is how to determine equitable compensation to the member cooperatives that have developed these value-added products.

7. *Internal use of products.* This issue applies to any agency that markets both commodities and value-added products, and has long been recognized by fluid milk bargaining cooperatives. Bargaining problems could arise if a dairy cooperative has its own milk bottling operation and also sells grade A milk to other bottlers compensating with the cooperative (in the same fluid market for the same retail amounts). Fluid handlers may be reluctant to purchase grade A milk from the cooperative at a negotiated price fearing the cooperative will not pay its own member-producers an equivalent price. This would enable the cooperative to sell bottled milk into the retail market at a lower price.

A marketing agency-in-common that markets whey protein and also markets value-added products that utilize whey protein could pose a similar problem. The value-added product of the marketing agency-in-common may compete in the same market with a buyer of whey protein that markets the same value-added product. The buyer may be reluctant to pay the marketing agency-in-common a negotiated price for whey protein.

One possible solution to this internal use issue is for members of the marketing agency-in-common to agree to pay (or cost out) the same price for commodities used internally for value-added products as the marketing agency sells these commodities to their buyers.

### *Summary*

The issues discussed here represent challenges to organizing and operating a successful marketing agency-in-common for manufactured dairy products. Nevertheless, with a market-oriented dairy price support policy and increased market concentration among buyers of milk and milk products, dairy producers and their cooperatives have strong incentives to consider enhancing their market power through the use of marketing agencies-in-common. The potential for benefits for the dairy industry are (a) enhanced and more stable manufactured dairy product prices and (b) enhanced milk prices to member-producers through common marketing.