THE BUSINESS OF INDIAN AGRICULTURE

Module 4: Agribusiness Economics and Marketing

Participant Guide

First Nations
Development Institute

The Business of Indian Agriculture

MODULE 4: Agribusiness Economics and Marketing

Lessons

This module covers the following lessons:

- Agribusiness Inputs (Supplies and Services).
- Agribusiness Marketing.
- Value-Added Products.

Module 4: Agribusiness Economics and Marketing

LESSON 1: Agribusiness Inputs (Supplies and Services)

LESSON 1: Agribusiness Inputs (Supplies and Services).

Lesson Topics

This lesson covers the following topics:

- The Importance of Inputs (Supplies and Services) to Agribusiness.
- Supply Inputs.
- Service Inputs.

Learning Objectives

Upon completion of this lesson, participants will:

- Understand agricultural inputs and their importance to an agribusiness.
- Understand supply inputs and their significance to agribusinesses.
- Understand service inputs and their significance to agribusinesses.

Definitions

Service Inputs: Those services that agribusinesses use to produce a product or service for sale. They may include farm contract services, veterinary services, breeding and genetic services, agents and brokers, and accounting services.

Supply Inputs: Those supplies that agribusinesses use to produce a product or service for sale. They may include feed, fertilizer, livestock, pesticides and herbicides, fuel and energy products, and farm equipment and machinery.

TOPIC 1: The Importance of Inputs (Supplies and Services) to Agribusiness.

Learning Outcome: Students will understand agricultural inputs and their importance to an agribusiness.

- There are two major categories of inputs for agricultural operations.
    - First, natural inputs such as land, weather and soil microbes, over which the producer has very little control.
    - Second, man-made inputs that include supplies and services, and which are the focus of this topic.
    - Inputs (both natural and man-made) provide the "ingredients" that agricultural processes (such as planting or raising livestock) use to produce outputs (products and services).
- According to the Farm Census in 2012, about $329 billion was spent on agricultural inputs.
    - Animal feed represented about 23% of total farm input expenses.
    - Livestock and poultry purchases accounted for about 13%.
    - Hired labor (8%); repairs and maintenance (6%); cash rent (6%); and seed (6%) all together accounted for about another 26% in input expenses.
    - Fossil fuel-based products, including gasoline, fuels and oils (5%), chemicals (5%), and fertilizer (9%) all together represented about another 20% in input expenses.
    - Other miscellaneous inputs accounted for the rest of total agricultural inputs.
- Understanding agribusiness inputs is important because, first, inputs collectively represent a significant business expense and managing those input costs is essential to a successful operation. Second, the supply of critical inputs must be secure so that operations cannot fail because of a lack of supply.
    - Historically, many agribusiness inputs were generated on farm, such as when animal power was used to cultivate land or seeds were saved. Now, most inputs are purchased and agribusinesses are vulnerable to price increases of inputs (especially those related to fossil fuels).
    - Prices for many agricultural inputs have been on the rise in recent years, and this has resulted in a dilemma for many producers as their input (supply) costs rise, but there is strong market pressure to keep output (sales) prices low. This is sometimes referred to as a "cost-price squeeze."

        - The pressure between rising input costs and low sales prices has meant that profit margins for many agribusinesses have been at historical lows.
    - Successful operators will constantly be looking to control input costs through better pricing, new suppliers and service providers, and more efficient products and practices.
        - Better pricing strategies might include locking in at lower prices, taking advantage of volume and other discounts, or bundling/ packaging a variety of purchases.
        - In a competitive marketplace, new suppliers and service providers will always be looking to win your business by offering lower prices or more attractive terms.
        - Improved technology can result in products that are more efficient and save input costs, particularly in the area of fossil fuels. For example, purchasing a new high-efficiency tractor may be justified by fuel cost savings over time.
        - Alternatively, operators can look for ways to provide some inputs themselves (for example, through business diversification), thereby saving costs and securing supply.
    - Because securing inputs is done at the front-end of the agricultural product life-cycle, short-term credit is often used to purchase inputs, with a plan of repaying the credit when the final product or service is sold.
    - Other considerations of inputs may be important. For example, farm inputs would need to be strictly controlled when producing organic or kosher products.
        - Following sustainable agriculture principles usually includes reducing off-farm inputs. These principles may include alternative farming practices and input products.
        - Sustainable agriculture practices may have environmental or health benefits, as well as cost implications.
- Agribusiness inputs are wide-ranging, and can be classified as major, minor and other inputs.
    - Major inputs include the big four: feed, fertilizers, agricultural chemicals and farm machinery and equipment.

- Minor (but still significant) inputs include fuel and petroleum-based products, seed, soil amendments, veterinary supplies, packing and transportation materials, and building materials.
- Other inputs that are often overlooked might include hardware and tools, utilities (such as power, water, gas, telephone and Internet), credit, insurance, contractors and service providers (government and private).

TOPIC 2: Supply Inputs.

Learning Outcome: Students will understand supply inputs and their significance to agribusinesses.

- Supply inputs (as opposed to service inputs) include those supplies that agribusinesses use to produce a product or service for sale. Because the range and variety of agribusinesses is so great, the variety of possible supply inputs is also great.
    - Each agribusiness will have a few major, mission-critical supply inputs that represent the bulk of their input costs. These major supply inputs should be carefully evaluated for cost and supply management.
    - First focusing your attention on your major supply inputs will provide you with the biggest potential costs savings, as well as ensure that your critical supply chains are secure.
- One of the major supply inputs in many agricultural operations is feed.
    - The feed industry has become highly sophisticated with products that are tailored to particular types of livestock, various stages of their growth, and supplements such as vitamins and minerals.
    - The market structure of the feed industry includes large manufacturers and a network of retail dealers and direct-sales firms. Some cooperatives are also involved in feed supply.
    - Keeping feed costs under control can make a significant impact in your profitability. Feed is typically the greatest expense associated with keeping farm animals and raising livestock.
        - Maintain good feed practices (such as securing it from wildlife/ rodents or preventing forage spoilage) can help you get the most benefit out of your feed supply.
        - Also, making sure that your animals are getting just the right amount of feed and nutrients (not too little, not too much) is an important feed practice.
        - On-farm production of feed (such as hay or grain production, or pasture) can save money and reduce the need (and cash flow) for purchasing feed.
        - Shopping around and comparing prices among the many feed dealers may result in better pricing and cost savings.

        - Looking for more efficient and cost-effective feed mixes can lower your feed costs. For example, shifting to smaller grains when corn prices are high might be a good cost-savings strategy. Using alternatives to standard nutritional supplements may also lower costs.

- Another major supply input for many agricultural operations is fertilizers.
    - The commercial fertilizer industry is comprised of about 50 major manufacturers and thousands of marketing centers that supply dry and liquid fertilizer mixes and blends.
    - Controlling fertilizer costs can make a big impact in an agribusiness's bottom line. Because fertilizer manufacturing is very energy dependent, fertilizer prices often track with global energy costs, and so are susceptible to rapid price increases.
    - There are a number of strategies that may help reduce the costs (and risks) of fertilizer inputs:
        - The first and most straightforward way to save fertilizer costs is to make sure that the right amount (not too much, not too little) of fertilizer is applied. This usually requires getting soil tests and soil fertility recommendations.
        - Optimum fertilizer rates are based on many factors, including soil conditions, crops and climate. You should consult with your local extension specialist for more information on optimal nitrogen and other fertilizer rates.
        - A relatively new method of calculating nitrogen rate recommendations is based on the economics of nitrogen and grain prices, instead of basing the rate recommendations on yield only.
            - When prices are factored in, nitrogen rates may be more cost-effective and economical at lower rates than recommended for optimal yields.
        - The right application methods (such as banding versus broadcast) and timing (especially with nitrogen) are also important ways to get the most out of your fertilizer inputs.
        - Make sure that all soil conditions are optimal for nutrient availability and uptake. For instance, controlling the soil pH is an important factor for soil health and nutrient availability.

- Standard blends (such as 10-10-10) of uniform granular size may be more expensive than mixed fertilizers. Compare prices per acre before deciding what to use.
- If appropriate, alternative and low-input fertilizer strategies such as manure, green manure, cover cropping and compost may be used.
    - However, these alternative inputs and methods should be tested first to determine their nutrient and mineral compositions, as well as recommended application rates and methods.
- Finally, consider all the potential environmental consequences of fertilizer rates and applications, and the potential economic and environmental risks and benefits.

➢ For ranchers, livestock purchases can be a significant input cost. Replacement heifers can be purchased or raised, and the most cost-effective strategy will depend on several factors, including:

- **Market conditions.** Cycles of high and low prices happen regularly and ranchers should time their livestock replacements accordingly. Studies have found that keeping more heifers when calf prices are low results in the best return on investment.
- **Herd size.** Typically, producers with large herds find it more economical to raise heifers while smaller producers prefer to buy replacement heifers. There may be exceptions to this rule, so producers should think about their own specific costs.
- **Management.** Raising heifers requires more management, facilities and feed/pasture. These added costs need to be considered when deciding whether to raise or purchase replacement heifers.
- **Non-reproductive heifers.** Producers typically raise about 20% more heifers than they will keep because of non-reproductive issues. These added costs need to be counted as well.
- **Direct and indirect costs.** The costs of raising versus purchasing replacement heifers needs to be calculated and compared. All direct and indirect costs should be considered, including the opportunity costs (lost market value of retained heifers) and labor costs (of raising heifers).
- **Herd Health.** Raising and keeping heifers reduces the risk of introducing disease from purchased outside heifers.

- **Genetics.** Raising heifers allows the producer to select for favorable genetic characteristics, such as heifers that bear early in the calving season and that have calves with higher weaning weight. On the other hand, cross-breeding provides genetic advantages which may make purchasing heifers a good choice.

- There are many other supply inputs to consider, and an agribusiness should carefully study its top mission-critical supply inputs for cost management. Some examples of other major supply inputs follow.

  - **Pesticides and herbicides.** This class of agricultural chemicals can represent significant costs to an agribusiness operation.

    - As discussed with fertilizers, applying the appropriate amount of pesticides/herbicides and in the correct manner will ensure that the operator is receiving the maximum benefit at the minimum cost.

    - The costs and benefits to the environment and human health is also an important factor to include in a pesticide/herbicide decision.

    - Alternative low-input strategies, such as integrated pest management, biological control agents and tilling practices should be considered.

      - Integrated Pest Management (IPM) uses a variety of methods of pest controls and monitoring to reduce pesticide use. IPM combines pesticide use with crop management strategies to minimize pests and the negative impacts of pesticide use, while maximizing profitability.

      - Weed management using cultivation and tilling practices is the primary low-input alternative to herbicide use. Mulching, crop rotations, and other practices might also be appropriate.

  - **Fuel and other energy products.** These inputs include gasoline and diesel, propane and heating oil. Although fuel and energy prices are determined by the global market, there are some cost management strategies that operators can follow.

    - If fuel/energy prices are expected to rise, a producer may want to "lock in" prices for some period of time. Of course, there is a risk that prices may fall, so the producer should be careful of the lock-in price and the time period.

    - Another option may be to use on-farm storage so that fuel can be purchased when prices on low and then stored on the farm. This also saves the time and cost of refueling in town.

        - Fuel conservation practices can be used by comparing the fuel needs and costs of various tractors and tilling practices. A producer may find a more cost-effective cultivation practice that saves fuel costs.
        - Likewise, being extra efficient in the number of trips (tillage, spray, seeding) made over the field can save fuel costs.
        - Also make sure that your tractors and field equipment are in good operating condition and are appropriate for the field conditions.
    - **Farm equipment and machinery.** The tractors, farm equipment and machinery needed to operate a farm or ranch represent a significant input cost. While these inputs may not be frequent, they are big-ticket items that require careful planning and budgeting.
        - Module 3, Lesson 2: Understanding Credit; Topic 3: Intermediate Operating Credit or Loans, discusses the considerations in making equipment and machinery purchases.
        - Being smart to forecast your equipment needs, and then buying while prices are low or when a good deal comes along, can save thousands of dollars.
        - Likewise, careful planning will help make sure that equipment will not fail at a critical moment in operations. This includes maintaining your equipment in good condition and knowing the useful lifespan of equipment.
- In summary, supply inputs that are important to the agribusiness should be carefully managed to keep costs low, and to secure a steady supply.
    - Generally, each supply input should be assessed regularly for better pricing, cost-savings practices, more reliable supply and any alternative low-input practices.

TOPIC 3: Service Inputs.

Learning Outcome: Students will understand service inputs and their significance to agribusinesses.

- Service inputs (as opposed to supply inputs) include services that agribusinesses use to produce a product or service for sale. Like supply inputs, the range and variety of agribusinesses are great, and so the variety of possible service inputs is also great.
  - Each agribusiness will have some mission-critical service inputs that represent significant costs and/or cannot be missed. These major service inputs should be carefully evaluated for cost management and availability.
  - By first focusing your attention on your major service inputs, you will get the greatest potential costs savings, as well as ensure that services are available when you need them.
- Service inputs can include many types of contracting relationships. Some of these are discussed below, but you should always consider the specific service inputs that are important to your agribusiness.
  - Farm contracting services includes specialized jobs done by contractors with certain skills and specialized equipment.
    - Some of these jobs may include clearing and leveling land, installing irrigation, tilling, planting, spraying, harvesting, packing and transporting.
    - It may be more cost-effective to use farm contract services than to do the tasks yourself. For instance, it may be smarter to pay for someone to harvest your crop than to purchase, operate and maintain a combine for just a few months per year.
    - Contract services can also reduce the need and costs to have farm employees on the payroll.
  - Another class of service inputs is those services that are so specialized that the agricultural producer probably must contract for that service.
    - For example, veterinary services are only provided by very specialized individuals and might only be provided by a few people in the area.
    - Breeding and genetic services are also included in this category of inputs.
    - Soil, water and plant testing laboratory services are another example of specialized service inputs.

- Farm machinery and equipment repair and maintenance services may need to be contracted.
- Brokers and agents might be needed to buy or sell agricultural products, or to provide financial products used by the agribusiness.
- Accounting, bookkeeping and tax preparation services might be needed if the necessary skills and time are not available within the agribusiness.

➢ Developing a cost management strategy for a service input will depend on several factors.

  - First, controlling prices will depend, in large part, on how competitive the marketplace is for that particular service. If there is little or no competition in the local area, then prices are likely to remain high. If there are many competing service providers, then prices will be lower and it may pay to shop around.
  - Second, prices may depend on the relationship that has been built between the service provider and the operator. If there is a long-term and loyal relationship, then pricing might be more favorable.
  - Third, services that could be completed in-house should be carefully studied for their costs and benefits. If a service can indeed be accomplished by the agribusiness at the same quality and at a lower cost, then consider doing that job yourself.
  - Fourth, for those services that must be contracted, consider ways to reduce the number of service calls and/or level of service needed. For example, could some emergency veterinary calls be prevented by reasonable precautions?
  - Finally, consider alternative low-input practices that might eliminate the need for a service. For instance, could no-till practices or raising a breeding bull eliminate the need for some contracted services?

➢ Ensuring reliable access to essential service inputs will also depend on several factors.

  - Annual or long-term contracts can help secure reliable access to the service provider over time (and perhaps at a lower price). Make sure that the contract contains provisions and penalties if services are not provided as needed.

- Consider a retainer and balance payment schedule, where some portion of payment is made upfront to retain services, and then the balance is paid throughout the course of the contract, or at the very end. This provides a strong incentive for the service provider to complete the work and fulfill the contract.
- Fostering a good working relationship with the service provider will help make sure that you are considered favorably. This includes paying your bills on time and scheduling your service calls well in advance.
- Developing relationships with multiple service providers will give you alternatives and back-up options if your primary service provider is unable to deliver.
- If possible, developing a backup plan to complete the job yourself will make sure that the job gets done if the service provider can't do the task.

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Module 4: Agribusiness Economics and Marketing

LESSON 2: Agribusiness Marketing

The Business of Indian Agriculture

MODULE 4: Agribusiness Economics and Marketing

LESSON 2: Agribusiness Marketing

Lesson Topics

This lesson covers the following topics:

- Introduction to Marketing and Marketing Channels.
- Marketing Strategies.
- Marketing Functions.

Learning Objectives

Upon completion of this lesson, participants will:

- Understand agricultural marketing and marketing channels.
- Understand marketing strategies and their importance to agribusinesses.
- Understand the basic marketing functions of an agribusiness.

Definitions

Advertising: ways of communicating information about your product or service to potential customers.

Public relations: communicating favorable information about your company, products and services.

TOPIC 1: Introduction to Marketing and Marketing Channels.

Learning Outcome: Students will understand agricultural marketing and marketing channels.

- For the agribusiness owner, marketing includes all the tasks and processes that it takes to deliver a product or service into the hands of the customer.
    - Marketing is much more than selling. It is forward-thinking and strategic business planning that maximizes the profits and revenue that come from a product or service.
    - Depending on the type of business, the customer may be an intermediate customer (for example, the grain cooperative) or the final consumer (at the family meal).
    - The type of agribusiness, the type of product or service and the type of customer will lead to the specific marketing strategies to consider.
    - In every case, the first step in developing an effective marketing strategy or plan is to conduct a market study (which ideally should have been done when the agribusinesses was formed, as part of the business plan). For a review of the market analysis in the business plan, see Module 1-3: Preparing a Business Plan.
        - The market study should answer many of these questions:
            - Who are the customers? What are their characteristics?
            - How many are there, and where are they?
            - How much money do they have? What do they like to buy?
            - What is the need and desire for the product/service?
            - What features and prices increase the need and desirability of the product/service?
            - What characteristics (location, times, packaging, delivery services) increase the need and desirability of the product/service?
            - What advertising and promotions increase the need and desirability of the product/service?
            - What is the supply and demand for the product/service in the marketplace, now and in the future?

- What is the competition for the product/service?

- Another helpful way to think of market studies is that they attempt to answer the "four Ps":
  - Product (what's the right product?)
  - Price (what's the right price?)
  - Place (where's the right place?)
  - Promotion (what's the right promotion?)

- A market study is conducted by carefully researching the data to answer the questions above.
  - It may involve studying large-scale industry and consumer trends, surveying and interviewing potential customers, researching similar businesses and their products/services, or providing products/services in test markets.

- Ideally, the results of your market study will feed directly into your business plan so that your products or services will meet (or exceed!) your customer's needs and desires, and ultimately make your business profitable.

➢ Marketing channels and strategies will be specific to your type of agribusiness and customer, and will support your market plan. Some of the more common agribusiness marketing situations are as follows:

- Production agriculture. Smart marketing is a must for production agriculture of commodity products. Marketing strategies should include:
  - Identifying types and costs of various markets (for example, retail, wholesale or processors).
  - Considering transportation costs from field to markets.
  - Determining the most profitable delivery product (size, weight, packaging).
  - Knowing seasonal cycles and demand.
  - Eliminating unnecessary steps and agents between you and the customer.

- Auction Markets. Auction markets are the most popular way of marketing livestock and are especially attractive for small producers.
  - In an auction market, the public bids on animals to purchase them, and an auctioneer conducts the sale.

- The auction receives a commission for each sale, and the commission prices vary depending on the animal.

- Other types of livestock marketing channels include terminal markets (where livestock are sold by an agent) direct sales (where producers sell directly to a processor), and cooperatives (formed by groups of producers).

- Grain Markets. There are several types of markets that are available to gain producers.

    - Forward contracting sets a fixed, pre-harvest price where the producer tries to avoid any possible price declines. However, it also locks in the amount of profit that can be made if prices rise.

    - Lenders find this market attractive when determining the credit worthiness of a producer.

    - Harvest pricing is the more traditional market where grain is harvested, transported to the local elevator, and then sold at the current market price or spot price. The downside to this strategy is that market prices are often at their lowest point during harvest time.

    - Post-harvest pricing involves finding a price some months after harvest and holding delivery until that time when prices are higher. This requires the producer to have storage capacity for the needed waiting period.

- Fruit and Vegetable Markets. There are a number of marketing options for fruit and vegetable producers.

    - Direct Consumer Markets. There are several fruit and vegetable market channels that are direct to consumers and that eliminate intermediate steps and costs.

        - Roadside markets are growing in popularity across the country and offer a way to sell produce directly to the consumer with very little overhead costs. Although mostly seasonal, roadside stands operate year-long in some parts of the country.

        - Farmers markets are also growing in popularity, catering to an urban consumer who is looking for fresh and local produce. There are overhead costs to selling at farmers markets (such as vendor fees), and the competition can be fierce.

        - Pick-your-own marketing lets customers pick their own fresh produce and experience a fun, family activity. A farm needs to be located near an urban/suburban population for this to be successful.

- Food brokers buy and sell fruits and vegetables for retailers, restaurants and institutions. The produce is transferred directly from producer to customer with no intermediate handling.
- Wholesalers buy product and will store it and may package it for sale to retailers, restaurants and institutions.
- Processors will buy product from producers and then process the product into some other form (for example, canned or frozen) for the consumer.

- Specialty Markets. Finally, there are many specialty markets being discovered every day that represent potential marketing opportunities for the producer.
    - These marketing opportunities are only limited by creativity and profitability. They may include such markets as organic markets/customers, range-fed beef, ethnic foods, wineries, specialty brands (such as Native American-made) and web-based sales.

Case Study: Mary's Business Idea: Will It Work?

Mary had always been an avid gardener and was well-known for growing the best produce in the county. Over the years, as her garden grew in size, and as she planted more vegetables (corn, squash, melons, cucumbers, peppers, tomatoes), she harvested more and more produce. She gave much of her produce away until one day a friend suggested that she sell some produce at the farmers market in town.

Mary had always wanted to run a business, and the idea of selling at the farmers market made her think of other ways to make money doing what she loved. Perhaps she could sell her produce to the local grocery store and the diner in town. Would the local schools or the hospital buy her produce? Maybe she could open a roadside stand.

Mary was a careful person and had many questions, but the basic question was, would her business work? Would it make money? Would people buy her produce? Who would be her customers? What are their characteristics? How many are there, and where are they? How much money do they have? What do they like to buy? What is the need and desire for fresh produce?

Mary started to work on a market plan to answer these questions and decide if her business idea was worth pursuing.

TOPIC 2: Marketing Strategies.

Learning Outcome: Students will understand marketing strategies and their importance to agribusinesses.

- There are several important marketing strategies to consider for a successful marketing effort. Every agribusiness should at least think about the following five marketing strategies:

    1. Advertising includes ways of communicating information about your product or service to potential customers.

    2. Price promotions include setting prices that will lead to increased sales.

    3. Merchandise or service promotions include the presentation or delivery of your product or service in an appealing way that increases sales.

    4. Public relations include communicating favorable information about your company and its products and services.

    5. Coordination combines and integrates the above-mentioned strategies into a single campaign that multiplies the impact of any single strategy.

- Advertising distributes messages through various media (TV, radio, the web, newspaper, billboards, etc.) about your products and services to potential customers.

    - Advertising can promote a product and service for sale, or can raise the image of your agribusiness.

    - While advertising tries to influence a customer's perception and attitude about your product/service, its first goal is simply to let the customer know that your product/service exists. After all, if customers don't know about your product/service, they can't buy it.

    - Effective advertising also tries to keep current customers loyal, bring in new customers, and create a lasting image of your product/service in the marketplace.

- Effective advertising will use data from the market study to tailor its messaging to specific customers in a persuasive way.
- However, advertising can never fix or gloss over a serious problem in a company or with its product/service.
- Sophisticated professional advertising can be very expensive (and effective), but there are many advertising tactics that the producer can do themselves at little cost.
    - For example, taking out ads in local newspapers or on radio stations are often an inexpensive way to reach local customers. Be sure that any ad is error-free and presents a professional image.
    - Placing professional signage at your business location and on your work vehicles can help to advertise your product or service.
    - Listing your business in the yellow pages of the phone book or in local business directories may be useful.
    - Having one-on-one conversations and using professional-looking business cards is a very effective way of advertising. These conversations (also called messages) can generate other conversations and help your messaging go viral, or in other words, multiply its effects exponentially. Leaving something, like a brochure or pamphlet, about your product/service can also be very effective.
    - Web-based advertising through social networking sites (like Facebook or Twitter) or e-mail may be effective, but be careful that your messages do not become perceived as spam, in other words, annoying and unwelcome advertising.
    - Other effective ways to advertise depend on your specific product/service, customer set, and your imagination and creativity. New media channels, markets and advertising tactics are being developed all the time.
- An advertising budget should be considered as a business investment and, as such, should be linked closely with your business goals and plans. You should spend just enough to accomplish your goals, not spending any more or less.

➢ Price promotions assume that you have set a standard pricing strategy that maximizes your profits and revenues, while protecting your share of the market. Of course, this strategy may not apply if your products are commodities where prices are set by the market.

- Pricing your product/service too high may generate more profit per unit sold, but it may also lower total sales (and total profit) by pricing yourself out of the market. In this case, you may lose valuable customers and market share, which is very difficult to regain.
- Pricing your product/service too low may increase sales and market share, but squeeze your profit margins so that you are not making enough to meet your business goals. This is often called "buying the business" and may be a temporary tactic to build a customer base and increase market share, but is unsustainable in the long run.
- Lowering your price below its standard level can be an effective marketing strategy for generating quick sales, increasing customers and growing market share.
  - Price promotions can also include rebates, coupons, cash backs, volume or bulk rates, as well as sale prices.
- Make sure that any price promotions are counted as a marketing cost in your financial accounts so that you can track their cost effectiveness.

➢ Merchandise or service promotions focus on the point-of-sale experience of the customer.

- Merchandise promotions may include using attractive displays, packaging, signage and demonstrations.
  - This is particularly important when dealing with retail customers or at farmers markets and roadside stands.
  - It is also used quite often to introduce new products to the customer.
- Service promotions may include offers that include a free trial service for a period of time or money-back guarantees.
  - Customers may also be offered a finders reward for referring new customers, such as a discount on their service.
- As with price promotions, make sure that any merchandise/service promotions are counted as a marketing cost in your financial accounts.

➢ Public relations include a wide range of activities that try to improve the image of the company and its products and services. The following examples are just a few of the public relations activities that an agribusiness might consider. The possibilities are as many as your creativity will allow.

- Supporting and sponsoring local civic events (such as pow wows, fairs or rodeos) and/or community sports (Little League, softball leagues, high school teams, etc.).

- Supporting public TV or radio, and other charitable activities (school programs, church activities, youth groups or food banks).
- Using media stories (not paid advertising) to share information about the company and its products/services. This would include stories about the company being a good community citizen, and feature stories on customers and employees.
- Hosting company events such as cook outs, receptions or dinners that celebrate achievements and give thanks to the community.

- Coordination combines all your marketing strategies into a single campaign with a specific focus.
  - For example, your agribusiness may be ready to introduce a new product line or service to the market.
    - Through paid advertising and public relations activities, your marketing campaign will try to announce and inform customers and the public about your company and its new product/service.
    - The campaign will also include price or merchandise/service promotions to encourage customers to try your new product/service.
  - Or, your company may begin offering its products/services in a new community and you will need to build a new customer base there.
    - Public relations activities and paid advertising will introduce your company to the community, while promotions will help gain new customers.
  - The key to a successful coordination strategy is to maintain a single goal and focus, and to make sure that all marketing activities work toward that goal.

TOPIC 3: Marketing Functions.

Learning Outcome: Students will understand the basic marketing functions of an agribusiness.

- In many cases, marketing is the most important of the many functions of running a business. After all, if there are no customers buying your product or service, then the rest of the business is a wasted effort.
  - Many agribusiness owners are surprised to learn that marketing will take a considerable amount of their time, attention and money.
  - Yet, it is far better to prepare for successful marketing of the business than to be surprised, unprepared and unsuccessful in selling your product/service.
  - Marketing is usually associated with advertising and while this is true, marketing is much more than just advertising. It is any and all activities that involve a customer, including customer inquiries, referrals, service complaints, sales, invoicing and collecting payments.
  - There are at least six major marketing functions to consider: selling, transporting, storing, delivering, financing and collecting market data.
    - Selling involves providing the best product/service at a profitable price to a willing customer. Your product/service must meet a customer need or desire.
    - Transporting and storing are holding and/or moving your product to the customer at the right time at the right place. It can affect your pricing and inventory costs, and can be a key part of customer satisfaction.
    - Delivering means providing the right quality and quantity of a product or service, as promised. A major consideration is maintaining adequate inventories (for products) and capacity (for services). If you fail to deliver as promised, your customer satisfaction and business will suffer. Financing includes the financial terms that you are able to make with your suppliers, which will affect how you structure your product/service pricing terms. Financing can also influence any credit that you provide your customers.
    - Collecting market data means keeping up to date on market and consumer trends through research and customer information. Keeping good records of your customers' purchasing histories is a key source of market data.

- Selling, or sales, is about matching the right products/services with the right customers at the right prices.
  - Developing and providing the right products/services should be a regular "business as usual" activity for the agribusiness.
    - Products/services should have the right features, be of high quality, be current (not obsolete), and meet a customer need or desire.
  - Finding and cultivating the right customer involves understanding your target customer and their needs and desires.
    - Your market study will tell you where your customers are, and how to reach them with your messages.
    - Whoever your customers are (retail consumers, public auctions, cooperatives, elevator operators, processors), it pays to develop a personal relationship with them. The old sales saying still holds true: people buy from people they like.
    - Be persistent, but not a pest. Anticipate customer questions and have your answers ready. Be prepared to provide all relevant information about your company, product and/or service.
  - Setting the right prices means making sure that you earn a profit but are not priced so high that you lose business.
    - Researching the "going rates" or prices for comparable products or services is a good place to start.
    - You will also need to know your total costs to produce the product or service so that you never lose money on your sales. Make sure to factor in overhead and indirect costs into your totals.
    - If competition or other market factors force you to price lower than your costs, then you will need to lower production costs or add perceived value to your product so that you can justify higher pricing.
- Transportation and storage functions will depend on the specific nature of the agribusiness, and may involve the following considerations:
  - A careful cost/benefit analysis should be made on whether to do the transportation and storage job yourself, or to contract for those functions.
  - Make sure to factor in all overhead and indirect costs, such as labor costs, inventory carrying costs, insurance, purchase and maintenance of vehicles and storage facilities, and administrative costs.

  - If transportation/storage functions are contracted, be sure to understand the chain of responsibility, transfer of ownership and other legal conditions that may apply.
  - If anything should damage your product during transportation or storage, you will want to be sure that you are financially protected.

- Delivering is the marketing function that presents the customer with a highly satisfying buying experience. It is more than simply selling and placing a product in a customer's hands – it's about good customer relations and high satisfaction.
  - Delivery first ensures that the right product in the right quantities is provided at the right time. The minimum service level should be to meet the customer's expectations – nothing less.
  - Exceeding customer expectations should be the ultimate goal. That may mean delivering early, adding extra value or service, demonstrating exceptional professionalism or making a personal connection.
  - The delivery function should also provide a personal touch that helps build the customer relationship.
    - This could simply be a follow-up phone call (or mailing) to make sure that the customer was pleased with the product/service.
    - It could involve a personal delivery or a simple handshake and thanks for the business.
    - It could also include a customer satisfaction survey, which provides invaluable marketing data.
    - Keeping a file for each customer is a good idea. Aside from business-related data, information about the customer's likes, dislikes and personal notes is useful in creating a friendly relationship.

- Financing your supply chains is a major factor in how you deliver your products, services and lines of credit to your customers.
  - For example, if your agribusiness requires large, high-cost supply inputs (such as feed, seed, fertilizer), your credit obligations to purchase these supplies may mean that you can work only with customers who can pay on delivery.
  - However, if your supply line financing allows for more flexible repayment terms, you can pass this financing flexibility on to your customers by providing them lines of credit and flexible payment plans.

    - By providing flexible payment options, you expand the pool of potential customers for your products or services.
    - Customer credit can also spread out your incoming revenue streams so that it is more steady and reliable, and so it becomes easier to forecast budgets.

- Collecting marketing data should be a continuous function performed by the agribusiness. Without current and accurate information about your customers, industry and competitors, your agribusiness's success is based more on hope than on fact.
  - Industry and consumer trends can be found in trade journals or other business reports. A lot of useful information can be picked up in mainstream newspapers and news media.
  - Local information can be collected through word-of-mouth conversations, community networks and local news outlets.
  - The U.S. Census provides demographic (population) data on potential customers down to the neighborhood block level.
  - Consumer database companies can sell you valuable information on your potential customers' purchasing history and profile.
  - Surveys of both existing and potential customers can provide very useful marketing information.
  - Be sure to work with someone who is experienced in developing surveys so that your questions result in unbiased and accurate information.
  - Studying your competition and watching what they do is also an important part of marketing data collection.

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Module 4: Agribusiness Economics and Marketing

LESSON 3: Value-Added Products

The Business of Indian Agriculture

MODULE 4: Agribusiness Economics and Marketing

LESSON 3: Value-Added Products

Lesson Topics

This lesson covers the following topics:

- Introduction to Value Added Products and Services.

Learning Objectives

Upon completion of this lesson, participants will:

- Understand value-added products, services and marketing.

Definitions

Contract farming: A contractual relationship between a producer and a processor. Typically, it refers to the situation where a large corporate processor commands the entire processing chain by contracting with farmers to provide the raw input products.

Value-added products: The situation where value is added to a product through processing and/or distribution enhancements, and the price for that product increases, as well as the opportunity to earn profits. Value can be captured or created. Captured value refers to enhancing the distribution chain between the raw product and the consumer. Created value refers to enhancing the processing chain between the product and consumer (value can be actual or perceived).

Value-added services: Typically refers to additional services provided to the customer at no or minimal charge that are outside the core service.

Vertical integration: The controlling of more of the processing and distribution chain from the raw input to the finished consumer product. The more chains are controlled by the agribusiness, the more profits can be realized.

TOPIC 1: Introduction to Value-Added Products and Services.

Learning Outcome: Students will understand value-added products, services and marketing.

- When a "raw" product (such as a food crop or beef cattle) is transformed into a finished product for a consumer (such as a dinner meal), value has been added throughout the chain of processing and distribution that goes from farm (or ranch) to fork.
    - When value is added to a product through processing and/or distribution enhancements, the price for that product increases, and so does the opportunity to earn profits.
    - Added value can be created or captured.
        - Created value refers to adding to the processing chain between the product and consumer (this value can be real or perceived).
        - Captured value refers to enhancing the distribution chain between the raw product and the consumer.
    - Value is created during each processing step by inputting (or adding) things such as labor, ingredients, processing and/or packaging. The costs and profit margins for each of these inputs are then added to the cost of the product.
    - Value can be created in five ways:
        1. Creating new and innovative products.
        2. Enhancing an existing product.
        3. Enhancing services.
        4. Creating brands and product identities.
        5. Developing unique customer experiences.
    - Value can be created at any point in the journey of the product to the customer. It could involve added service or convenience, or an enhanced experience at the point of sale. Pick-your-own farms (for example, fruit orchards, berry farms, pumpkin patches) and agro-tourism activities (for example, hay rides, corn mazes, petting pens) are included in this category.
    - Value can also be created through using special production practices such as organic, sustainable, free-range, grass-fed or locally produced agriculture. These practices can command a premium price because a customer perceives an added value for the product, environment, the community or the local economy.

- Attaching a location to a product can also add value to it. For example, "Made in…" branding may command a higher product price. Many states and agricultural regions use location branding to market their products.
- Bundling products can also create value. For example, packaging cheese, crackers and salami together can command a higher price than if those products were sold separately.
- Producing a product that saves costs along the processing chain can also add value. For example, a seed producer who markets a new variety of seed that is more resistant to disease can command a higher price.

➢ Another important consideration in value-added products and marketing is risk.

- Risk is a factor in any business venture, and the amount of potential reward for a business activity should match the amount of potential risk.
- If a value-added opportunity represents great risk but low reward, then it should be reviewed very carefully. On the other hand, a value-added opportunity with high potential reward and low risk is a good one to pursue.
- In general, capturing (as opposed to creating) value in a distribution chain is a highly competitive business, and so the risks may be high and the rewards low.
- Creating value may be less competitive (depending on the niche or idea), and its risks will depend on the investments needed for new inputs and processes, and the potential profits.
- In many ways, entering into a value-added venture should be treated in the same way as entering into a new business or enterprise.
  - A business plan should be developed and all the basic start-up questions should be answered.
  - A marketing plan should also identify the customer need and desire for the value-added product.
- USDA can provide support for entering into a value-added venture. The Value-Added Producer Grants (VAPG) may be used for planning activities and for working capital for marketing value-added agricultural products.
  - Eligible applicants include independent producers, farmer and rancher cooperatives, agricultural producer groups, and majority-controlled producer-based business ventures.
  - You can contact your State Rural Development Office to get additional information and assistance.

- Major profit opportunities can be found by an agribusiness that controls more of the value-added steps, through what is called vertical integration.
  - Vertical integration means controlling more of the processing and distribution chain from the raw input to the finished consumer product. The more of these chains that are controlled by the agribusiness, the more profit can be made.
  - Vertical integration tries to capture value by streamlining the distribution chain. It tries to create value by owning steps along the processing chain.
  - Vertical integration also reduces transaction costs, which is the added management and coordination needed for every transaction between parties in a processing chain. Saving these transaction costs saves money and potentially increases profit.
  - While vertical integration can provide many profitable opportunities for an agribusiness, one form of vertical integration called contract farming presents both opportunities and limitations.
    - Contract farming typically refers to the situation where a large corporate processor controls the entire processing chain by contracting with farmers to provide the raw input products.
      - This practice is common in the poultry and hog industries, but is also found in other agricultural industries to some extent.
      - The corporation may provide the animals, feed and most other inputs, and the farmer is contracted to raise the animals (or crops) to a specified age, weight or amount.
    - The advantages of contract farming are that it can lower the risk for both farmer and processor by specifying and locking in advance the terms and prices of the transaction.
    - The disadvantages include the loss of control and flexibility of the farmer to make business decisions in his/her best interests. There also may be a power imbalance where the corporate processor can demand concessions from a contract farmer who has become financially dependent on the processor.
  - Other forms of vertical integration include direct marketing (straight to the customer), producer alliances and cooperative activities.
    - Direct marketing can include such activities as roadside stands, selling "on the hoof," selling homemade products (jams, pickles, soaps), and web-based selling (such as eBay).

        - Producer alliances are when companies at about the same level of the processing/distribution chain work together to provide and/or market a superior product.
            - For example, a number of small beef producers may work together to provide a steady quantity of beef at a specified quality to local restaurants.
        - Cooperative activities include selling cooperatives where producers combine their outputs for greater bargaining power and better prices.

- Value-added services (as opposed to products) typically refer to additional services provided to the customer at no or minimal charge that are beyond the core service.
    - This business concept is usually associated with the telecommunications industry where services such as voicemail, call forwarding and call waiting features are added to the core telephone service.
    - In an agribusiness setting, an example of a value-added service may be a soil testing company offering a no-charge consultation to review the results and help the producer apply the test results to their particular crop.
    - Another example might include a farm equipment company offering free maintenance for six months after a service call.
    - Many times, the value-added service can simply be sharing the expert knowledge and experiences of the service provider with the customer, so that the customer feels that they have been given something useful and extra.
- Ultimately, agribusinesses use value-added products, services and marketing to try to earn more profits by doing the following:
    - Increasing the customer base by providing new or improved products/services that more people want to buy.
    - Receiving a greater portion of revenue from the finished products by controlling more of the processing and/or distribution chain.
    - Becoming more strategic and influential players in the marketplace by establishing greater presence and competitive advantages.

Case Study: Should I Sell Value Added Beef?

Joe Granger had been running a successful small-scale cow-calf operation for over 20 years, and was looking for a new business idea. In addition to making some extra money, Joe wanted to try something new and challenging. However, he loved his work, knew his beef, and didn't want to go into something completely different. Joe recently attended a workshop on value-added products and started to think about how he might be able to create or capture additional value from his operation. Currently, Joe sells his calves at about six months at the regional auction yard. The auction yard arranges for cattle haulers to transport the calves on a certain date. The action yard charges a 3% commission per head. Transportation costs are added, depending on how many calves are moved. It has been a simple and easy way to sell his cattle.

Joe feeds his Herefords on pasture on a beautiful scenic ranch on Native American land in northwestern Montana. He raises his own replacement cattle and is careful about controlling the quality of his breed and introducing any disease or unfavorable genetic characteristics. His ranch is located about a two-hour drive from a city of about 21,000 people, where a lot of well-off retirees and recent West coast transplants live. There have been a lot of new businesses opening in the city, including coffee shops, organic stores, and arts & crafts galleries. Every summer, tourists flow into the city from all around the country to enjoy mountain fishing, hiking and camping.

Joe is an optimist, and sees many value-added possibilities for business success. One day, he sits down at his desk and starts to put some of his ideas down in writing…

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