Perplexities of Pricing

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Let's see…ninety-nine cents a pound for the thirty-five pounds of romaine lettuce in that box comes out to $34.65. That's a substantial markup, to say the least, from the $12.50 the grower received. Actually, here in the Northeast, we haven't seen less than $1.59 per pound for romaine for several years, but the farm value has dropped, more often than not, below $10 per box. The only thing that upsets growers more than walking through a produce department and seeing those kinds of price differences is finding imported and out-of-state produce selling for less, or worse, it's the only product on the shelves when the local crop is being harvested. But that's another story.

The USDA's Economic Research Service (ERS) calculates the farm portion of the retail food dollar has dropped to below twenty cents. Produce growers tend to be better off than other farmers as they are actually on the high side of that average. Traditionally that's because there is less processing between the farm gate and the consumer.

However, according to the recent ERS report, *U.S. Fresh Produce Markets—Marketing Channels, Trade Practices, and Retail Pricing Behavior*, that advantage is changing rapidly with the advent of fresh-cut processing and in-store meals-to-go. The diagram below shows the growth of the U.S. produce industry between 1987 and 1997, along with some new estimates for 2002. In ten years, consumer purchases of produce grew by about eighty percent, from $34.6 billion to $61.1 billion, but the farm value increased only a little less than sixty percent ($11.2 to $17.8 billion) during that time. The biggest growth occurred in the food service category, which more than doubled.

That still doesn't answer the question why such a big difference between the farm gate and the consumer's plate. Take a closer look at the diagrams. All those lines between the farmer and the consumer represent a different path that products travel, and every step along the way adds value to the product. Those are the marketing costs, from transportation, labor, packaging and processing, to depreciation, taxes, and advertising for each business along the way. Remember the ERS says the farmer gets less than twenty cents of the consumers' dollar. Those other lines represent the rest of that dollar.

Those costs are also the reasons why the retail price doesn't fluctuate as rapidly, and especially as greatly, as the wholesale price. Using the twenty percent rule, if you cut the farm price in half, you've only reduced the total retail costs by ten percent. The retailer can't cut the price in half to sell more of your product because the cost hasn't dropped that much. On the other side, consumers only buy so much produce. Dropping the retail price may not generate enough new sales to make up for the lost revenue due to the lower price. To make up the difference for dropping the price ten percent, how many more boxes of that romaine would a retailer have to sell? Hmmm…to make it simple, let's figure the retail price was $1.00 per pound and the farm price just dropped from $10 a box to $5. The retailer drops the price ten percent to $.90 per pound. The income from lettuce sales went from $35 per box to $31.50. The store was selling 10 boxes a week for $350 income just lost $35. To make up that difference, will the $.90 per pound create enough demand to sell more than 11 boxes (11.11 X $31.50 = $350)? A good produce manager may understand the customer base well enough to know if one more box will sell, but the store can't sell nine more boxes to make up for the lost income for the farm.

It is perplexing to see little response from retailers to big price swings at the farm. There are two ways to come out ahead in this situation. If you wholesale, you must control costs to below your average price received to still have net gains through tight markets. Alternatively, follow the dotted line around all the middle to retail directly to the consumer.

If you can provide all the value-added services for less than other shippers and handlers, then you'll keep more of the consumer's dollar.

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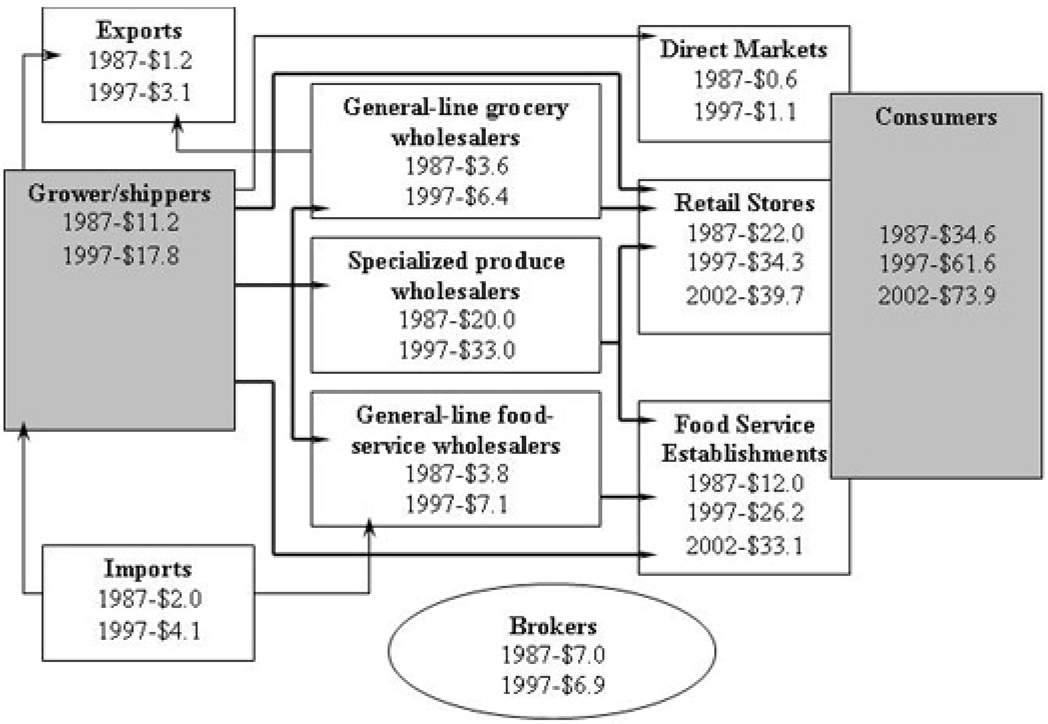
Diagram 1 – Fresh fruit and vegetable marketing channels 1987 and 1997, with 2002 estimates for retail and food service sales (all values in $ billion)



(Adapted from: DIMITRI, C., A. TEGENE and P. R. KAUFMAN. 2003. U.S. Fresh Produce Markets—Marketing Channels, Trade Practices, and Retail Pricing Behavior. Agricultural Economic Report No. 825. USDA Economic Research Service (www.ers.usda.gov/publications/aer825/). Washington, D.C. 21 p. and KAUFMAN, P. R. 2003. Personal communications.)

Diagram 2 – The food chain from farmer to consumer (VanVranken, 2001)