

VERTICAL INTEGRATION

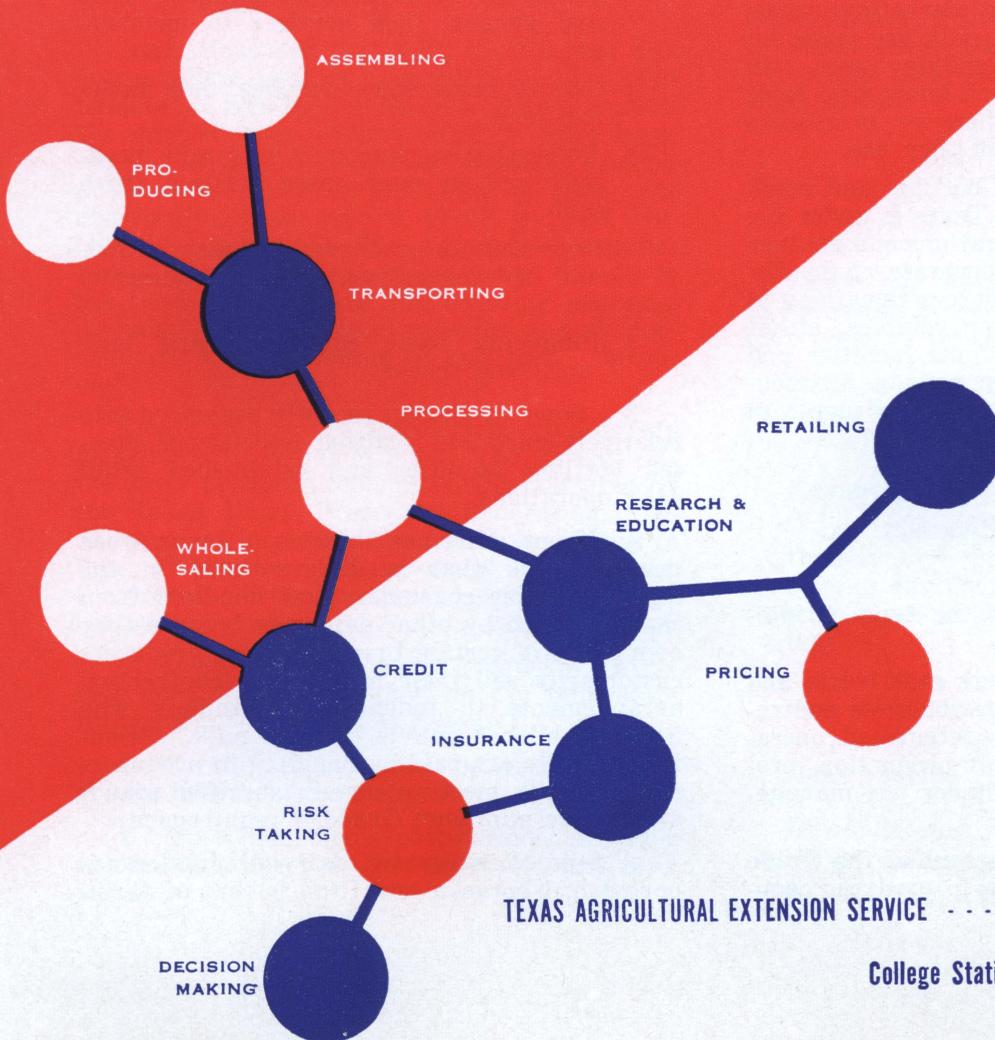
IN TEXAS AGRICULTURE

Dairying



Partial vertical integration seems to be the trend in the dairy industry. Two or more stages of marketing or processing—testing and processing facilities and cooperative ownership of transportation—are linked together through producer cooperatives. There has been less vertical integration in dairying than in other types of animal agriculture.

A large percentage of Texas milk producers operate under federal milk marketing orders. Most of those who do not sell under such orders operate through highly organized cooperatives.



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Nature and Extent

Integration among Texas dairymen differs from that which existed some years ago when individual dairymen bottled, transported and retailed their own fluid milk or processed and sold their own butter. Large private corporations now bottle, distribute and retail milk while cooperative associations have assumed other functions associated with the movement, assembly and sale of producer milk. With this change, milk producers are able to concentrate on efficient milk production and herd management.

Integration in Texas dairying has been largely through producer cooperative associations. Dairymen's marketing associations have become stronger in recent years. They have increased their membership, strengthened their financial position and have improved greatly the services and functions they performed for their members. They also have strengthened their bargaining power with milk distributors and processors, regardless of whether they operate under a federal milk marketing order. Contractual agreements for milk are made by parties removed from the milking area. In many cases, dairymen do not know who buys their product nor do handlers or processors know who produced the milk they use.

About 57 percent of the bottling and retail distribution of fluid milk in Texas is under the control of single-plant corporations and another 40 percent is handled by corporate chain distributors. Most milk distributors remaining in business are handling larger volumes, either through expansion of their own facilities and output, merging with other private distributors or by increasing the number of plants in the chain.

Management Practices and Contractual Arrangements

Four variations exist in the type of integration by Texas dairymen.

1. A few large producers still bottle and distribute their own milk at wholesale and retail. These are completely integrated operations in that all functions of production, processing and marketing are under one management.

2. Approximately 90 percent of the Grade A dairymen in Texas belong to producer coop-

erative associations and market their milk through arrangements with cooperative management.

Two types of contractual arrangements are used in cooperative marketing—between individual producers and the cooperative and between the cooperative milk distributors. Services that cooperatives now perform for their members include:

- a. Testing members' milk for butterfat and bacteria count.
- b. Paying producers for their milk.
- c. Weighing, receiving and hauling producers' milk from farm to plants or receiving stations.
- d. Control of surplus milk through cooperatively owned processing facilities or selling it into deficit milk-producing areas.
- e. Sale of milk for account of producer and negotiating price with the purchaser.
- f. Furnishing marketing information on production and prices, quality control and general field services to membership.
- g. Sale of basic dairy supplies, bulk tanks and feed.
- h. Processing surplus milk into milk products and in some cases bottling fresh milk.
- i. Representing producers' interests at federal order hearings, order amendments, etc.
- j. Financing basic equipment and bulk tanks and trucks.

3. Some producers recently organized into relatively small and localized associations, erected bottling facilities and established retail sales operations.

4. Some dairymen in several Texas areas produce milk that is differentiated in the minds of some consumers and handlers from that produced by other dairymen because they own herds of certain breeds. These producers customarily sell their milk under contractual arrangements to independent handlers who have established outlets for this milk. Premiums usually are paid by handlers to producers for this milk meeting certain specified standards above minimum Grade A requirements.

A type of integrated dairy production reported in Nebraska and Utah is that of farm-

ers joining resources and combining facilities in their dairy herd feeding, milking, milk testing, cooling and storage and milk movement and marketing operations. The plan is for a group of dairymen to share the costs of building a Grade A milking parlor and the expense of hiring labor to do the milking, feeding and milk cooling. They also pool their bargaining power to establish a Grade A milk market and obtain highest prices. These are small community-type cooperatives and such arrangements lend themselves only to limited geographic areas.

A contract feeding, milking and marketing enterprise was established recently in Iowa under which cow owners place their cows in a "pool." They pay \$30 per cow per year to defray housing and equipment costs, and receive their share of net proceeds from sales after deducting all operating expenses plus 5 percent of net income to the manager of the enterprise.

Future Developments

Indications are that milk distributors will expand their sales and retail more milk. The number of retailers is likely to decrease since the smaller ones cannot compete with large independents and chains in expanded market areas or benefit from economics of scale. As distributing areas expand, profit per unit likely will be narrowed. This, coupled with higher cost of new equipment necessary to remain in the fluid milk bottling and retailing business, probably will force small retailers and producer-distributors to merge or sell to the larger ones.

Small cooperative associations already are merging with larger groups. The strength of the dairy producer cooperatives is bolstered by the Texas Dairy Producers Federation. All dairy producer associations in Texas belong to this Federation. Dairymen's associations, therefore, continually strive to strengthen their bargaining position.

Complete integration by groups of dairymen does not appear likely in the immediate future, for the following reasons:

1. Cordial relations exist between producer groups and most handlers.
2. Most dairymen's cooperatives are able to bargain effectively for favorable raw milk prices.

3. Texas cooperatives are sufficiently strong to perform high-quality, efficient services for their membership.

4. A sample of cooperative management opinion suggests that they are not interested in entering the fluid milk bottling and retail field.

5. Fluid milk bottling and retailing by private industry in Texas is highly competitive, operated by competent management for the most part; and there is no concrete evidence that cooperative ownership of bottling and retailing operations would result in material benefits to producers or in increased efficiency of the industry.

Two things might develop in the milk bottling and retailing field, however, that would lend to more complete integration in the dairy industry: (1) producer associations might find it profitable to bottle and retail fluid milk if the price spread between producers and consumers became sufficiently attractive, and (2) custom bottling, by either handlers or producer associations for large chain stores, might develop further if present handlers were unable to retain their share of sales in competition with chain food stores owning their own bottling plants.

Advantages and Disadvantages to Producers

There are advantages and disadvantages to producers in operating under any one of the four types of integration in Texas:

1. Completely integrated operations of production, bottling, distribution and wholesale and retail sales.

Advantages

- a. Possibilities of receiving higher-than-average prices for fluid milk by obtaining any profits to be made at the various stages in the production-to-retail system.
- b. More direct control by management over milk quality and all facilities.
- c. Ease of adjusting production to sales volume.

Disadvantages

- a. The large amount of capital required to undertake the operation.

b. Sales areas restricted, with the producer controlling a small volume compared with large corporations or chains in the area. Expansion is costly and difficult because of stiff competition and high cost of equipment.

c. Integrator providing his own services.

2. Marketing through contractual arrangement with cooperative management.

Advantages

a. Collective bargaining power increased greatly by cooperative control over larger volumes of milk.

b. The individual farmer assured a market for his milk. (He will not be "cut off;" if handlers do not want all the milk produced, the surplus can be processed in association-owned plants.)

c. Possibly more and better field services furnished.

d. The association member receiving as much as any other producer for milk of identical quality.

Disadvantages

a. The producer having to pool his milk with other members and losing control of his product as it leaves his milk house.

b. No control by producer over the price he receives by virtue of his own production level.

c. The producer having to accept the "average" price.

d. Abiding by the majority rule regarding cooperative policies and regulations; thus, less opportunity to implement producers's own decisions.

3. Cooperative ownership of small bottling and milk retailing facilities.

Advantages

a. Same benefits obtainable as by producers marketing through contractual agreement with the management of a larger cooperative association.

b. Possibility of obtaining higher prices for fluid milk by sharing in any profits resulting from milk bottling and retail sales operations.

Disadvantages

a. Same disadvantages in varying degrees as producers operating through large cooperative bargaining associations.

b. Sales areas restricted and expansion difficult because of high cost and limited volume.

c. Losses resulting from the milk bottling and retailing functions to be supported by the producers.

d. Field services furnished by larger cooperatives possibly unavailable to these producers.

4. Producing a differentiated product and contracting to sell fluid milk to certain handlers.

Advantages

a. The possibility of obtaining a higher price than other producers receive for milk because of the quality factor.

Disadvantages

a. Sales area or market limited to the handler with whom the contract is negotiated.

b. Field services provided by the handler limited in extent.

c. Extra trouble and cost of producing milk according to the handler's specifications, not always compensated fully by the higher price or premium received.

d. Producers possibly having to relinquish some of their initiative and desired practices when they are forced to abide by the rules of handlers as regard to breed and composition of herd, milking and milk handling practices.

Vertical integration refers to the linking together of two or more stages of production, processing or marketing activities under one management. The key feature of vertical integration is the centralization of decision-making, risk-bearing and supervision.

This is the sixth leaflet in the series "Vertical Integration in Texas Agriculture." Similar releases on other crops and livestock important to the Texas economy will follow.

By bringing together present knowledge and current practices regarding vertical integration in Texas agriculture, the staff of the Texas Agricultural Extension Service and Texas Agricultural Experiment Station in the Department of Agricultural Economics and Sociology hope to help you make wiser decisions about this matter.

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