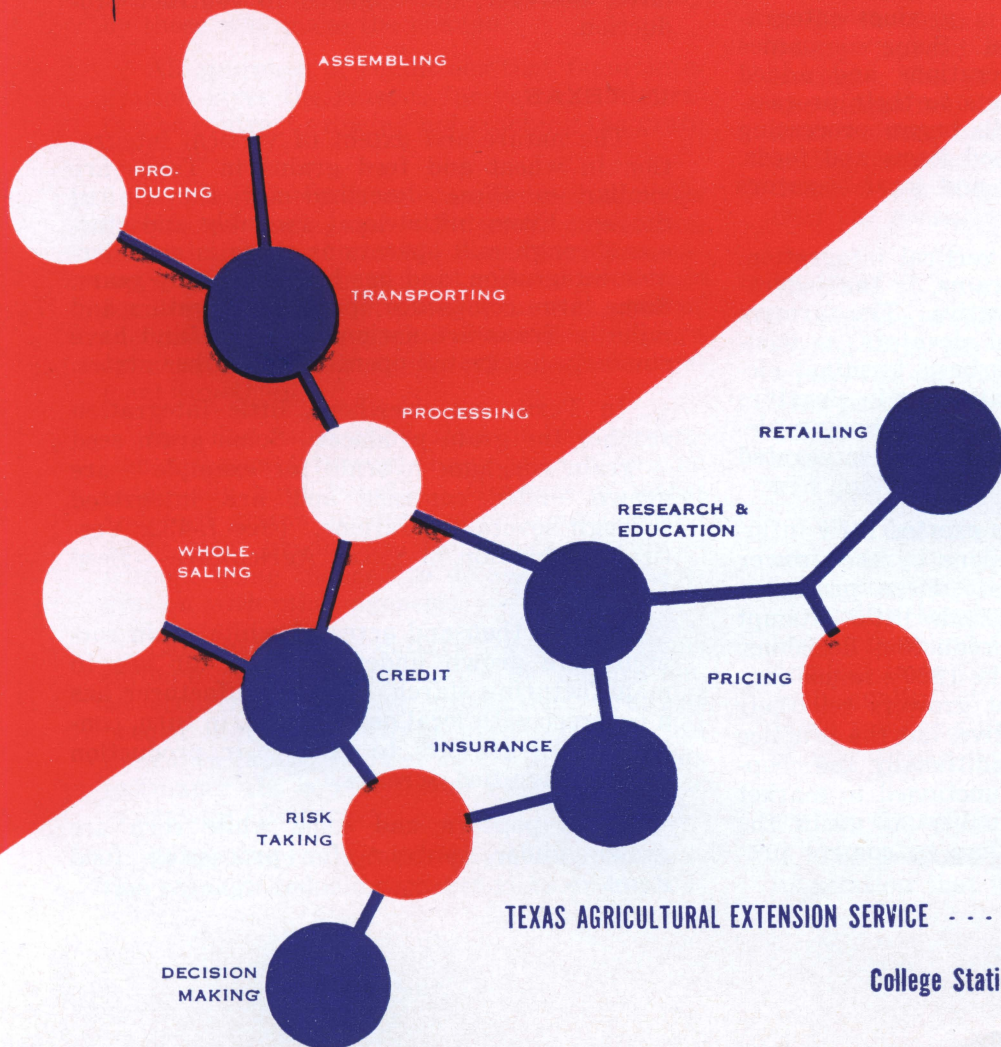


VERTICAL INTEGRATION

IN TEXAS AGRICULTURE

Grains

TO WHAT EXTENT has integration occurred in growing and marketing wheat and feed grains in Texas? What are its potentials? Similar procedures for growing and marketing wheat and feed grains justify discussing them together in this leaflet.



CLARENCE A. MOORE
Associate Professor
Texas Agricultural
Experiment Station

HOWARD S. WHITNEY
Assistant Professor
Texas Agricultural
Experiment Station

CECIL A. PARKER
Farm Management Specialist
Texas Agricultural
Extension Service

ALVIN B. WOOTEN
Economist
Texas Agricultural
Extension Service

in the
Department of
Agricultural Eco-
nomics and Sociology
*The Texas A. & M.
College System*

TEXAS AGRICULTURAL EXTENSION SERVICE . . . TEXAS AGRICULTURAL EXPERIMENT STATION

College Station, Texas

Past Development and Present Status

IN THE UNITED STATES

INTEGRATION of assembling, storing, buying and selling, transporting and processing grains occurred early in the development of commercial agriculture in the United States. It started by *horizontal* integration — linking together management or ownership in only one stage rather than two or more as in vertical integration — of local elevators through line elevator firms. Local elevators, owned and operated by the same company, were set up at different locations.

Many line elevator firms later integrated vertically by adding terminal elevators and flour and feed mills. Many local elevators also operated small local feed mills in conjunction with storage and merchandising operations under one management.

Another development is product integration at the processing level. Some companies began with feed mill operations and added other feed and food products to their processing operations. Flour mills began processing breakfast cereals, other food items and feeds. They also added terminal and local elevators to their operations.

An additional type of vertical integration, in both wheat and feed grains, is the federated type of regional cooperative. The farmers own local elevators. Local elevators, as business entities, own the overhead terminal elevators. Many local cooperative grain elevators also are integrated horizontally — having elevators at different locations under integrated management.

Vertical integration has exerted little influence on management decisions by the grower of wheat and feed grains. Even producer-owned cooperatives have made little attempt to centralize control of production decisions. Some effort was made in the 1920's to use contracts which specified that growers sell their grain through the cooperative, but the practice was soon abandoned. Traditionally the cooperative organization has functioned to market whatever quantity and quality of grain the grower supplied, rather than to control production decisions.

Vertical integration in grains has not tended to increase or decrease recently — but there are two possible exceptions.

First, government policy and action redistributes management decisions between public and private agencies — including farm operations. It is a form of both horizontal and vertical integration, and has increased in the past three decades. For example, the loan-price support program integrates decisions regarding price at certain levels among farmers and marketing agencies. The Commodity Credit Corporation's requirements on grain storage integrate storage decisions as well.

Second, the increasing complexity of modern farming forces the farmer to growing dependence on technical information, provided by both public and private agencies, in making his production decisions. It is a form of integration that needs consideration in the expanding economy. Grain growers have been affected by trends in public policy and greater reliance on technical information services. They have, however, not engaged in contract production.

IN TEXAS

The nature and extent of vertical integration in wheat and feed grains in Texas are similar to those described for the United States. From initial local assembly and storage through mill operations there is considerable integration, and has been for many years. Some large companies operating elevators and mills in Texas are national in scope and have similarly integrated operations in other states.

In Texas, as elsewhere, little integration reaches the grain producer. Some grain seed — grain sorghum hybrids for example — are grown under contract and are integrated through several operations. (See L-432, Vertical Integration in Texas Agriculture — Seed Production.)

Several thousand acres of white grain sorghum are grown under contract for use in manufacturing starch. The manufacturer has a contract with local dealers who, in turn, contract with growers to take their production from a specified acreage.

Some popcorn and some white corn are grown under contract for processing food items.

IN TEXAS AGRICULTURE

Grains

These cases, where integration does reach the grain producer, involve only a small fraction of the total grain grown in Texas.

Future Considerations

In earlier days, considerable grain was sold on a commission basis. Marketing firms acted as agents for farmers. As the market system developed, most of the grain came to be handled on a purchase-sales basis with title changing hands as the grain moved through the market. This pattern offered less inducement for contract integration with growers, but offered more inducement for integration of functions between the grower and ultimate consumer. Thus, the development of this market pattern has influenced the type of integration that occurred in grains.

Amid the competitive economy in this country, changes that occur in the structure of production and marketing usually are in response to a need for greater efficiency. Savings in cost or gains in returns are obtained initially by those who make the change.

An appraisal of conditions that favor integration gives the reasons for vertical integration or contract growing not reaching the grain producer.

Application of more standardized or more specialized management in grain production through integration with marketing, processing or supply firms has not offered potentials for large benefits. The reason is that most of the grains entering market channels are grown on commercial farms with efficient management practices.

Inducing rapid application of new production techniques through integration offers no potentially large benefits. Growers of wheat and feed grains are innovation conscious and adopt new production techniques rapidly — without being induced to do so through integration with other agencies.

Larger financial outlays for capital items through credit arrangements by integration, as occurred in broiler production, are less needed in grains. Grain producers can use their own capital or existing credit institutions to finance the larger capital requirements for increasing efficiency.

Great benefits are not possible by integration through reducing market risks or improv-

ing the competitive strength of the grower in marketing his grain. Grain can be held safely in storage over long periods. Too, the grain market is highly sensitive and competitive. Local prices paid farmers are responsive quickly to terminal and mill price conditions. Some market risk with regard to future prices exists for grain growers, but it results mostly from changes in supply due to weather hazards and other uncontrollable or unpredictable conditions, rather than conditions that could be changed materially by integration. The producer's cooperative organization, as well as the competitive structure that has developed in other marketing firms for both wheat and feed grains, has made it possible for the grower to reap benefits by improving his competitive strength without losing his management responsibility.

The greatest source of potential benefits by integrating production of wheat and feed grains would seem to be that of growing products of specified quality and form.

An ever-widening breach has developed between the farmer and the consumer as the industry "spread out" to advantage by specialization. The problem is that of translating knowledge and incentive, in the form of price differentials, back through the complex marketing agencies to the farmer that he may be induced to produce the kind and quality of product the consumer values most.

WHEAT

For years the wheat industry has been concerned with the problem of obtaining quality wheat for particular milling and baking uses. This problem likely will increase in the future. Integration, or "contract growing," may become an effective means of obtaining the kind and quality needed for different uses.

The major problem of quality production and marketing of wheat is that of (1) determining the major components and ingredients of quality in wheat for different milling and baking uses and (2) devising efficient and economical tests that determine the existence of such quality at the local elevators. Should these problems be overcome, contract growing of wheat may increase.

FEED GRAINS

The greatest potential for benefits through integration that includes the feed grain grow-

er appears to be product specification, as in wheat. The problem for feed grains at present does not appear as pressing as in wheat. One reason is that product specification is only important for feed grains used for food or industrial purposes. The growth under contract of white sorghum for starch, and popcorn and white corn for food products indicates this fact. As greater effort is made to develop new industrial uses for feed grains, the problem of product specification may become more important and potential benefits from contract growing of feed grains may increase.

The following potential advantages and disadvantages are given as a guide to the grain producer should contract growing become an alternative in his operations.

Advantages

1. Higher price for quality grain. Possibly, more orderly marketing that would improve the price of all grain.
2. Saving of time ordinarily spent marketing or storing grain in rush harvest.
3. More knowledge of the price that the grower will receive before planting time.
4. Technical services and useful advice in improving production.

Disadvantages

1. Loss of some control of production decisions, depending on the type of contract.
2. Loss of potential to bargain among buyers for higher price at or after harvest, depending on the type of contract.

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 ninth 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.

Tyrus R. Timm

Head, Department of
Agricultural Economics and
Sociology