

Where Does the Money Go? Food Marketing Margins Explained

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Farm and Ranch Series | Economics



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Domestic wheat and corn prices made significant gains in 2011 (Figure 1). Food prices also rose considerably in the final months of 2011, resulting in food price inflation at 4.8 percent for the year—somewhat higher than economists expected (USDA/ERS/Briefing Rooms). Contrary to popular belief, higher prices paid to agriculture producers contribute little to food price inflation. Sudden increases in commodity prices make headlines, particularly when accompanied by increases in retail food prices. The real cause of higher food prices is frequently improvement in economic conditions—domestic and international. As economies improve demand increases for commodities and food, and these demand increases result in higher prices for both.

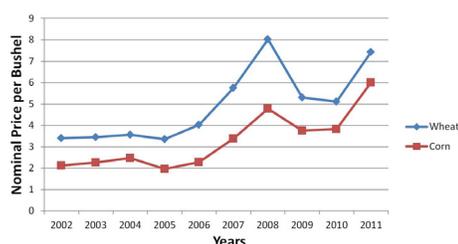


Figure 1: Average Annual U.S. Wheat and Corn Price, 2002-2011. Source: USDA, National Agricultural Statistics Service.

Marketing Margin

The major components of the marketing margin (or marketing bill) include labor, packaging, profits, advertising, energy, and transportation. On average, labor and packaging require 39 percent and 8 percent respectively of the consumer's food dollar; while transportation, energy, advertising, and marketing profits each take about 4 percent (Figure 2). The marketing margin is essentially the cost of activities performed by

food manufacturers, processors, distributors, wholesalers, and retailers.

Farmers and ranchers only receive about 19 cents of each consumer dollar spent on food. This varies depending on the food product and is a reflection of the amount of processing, packaging, and handling that items receive after leaving the farm or ranch. In general, food items that undergo significant processing and handling, require substantial packaging, or receive sizeable advertising constitute smaller producer shares. For example, the farm value of wheat in bread, and the farm value of corn in flakes and chips, is around 5 percent. The wheat or corn farmer receives only a nickel from each consumer dollar spent on these items. Items requiring less handling and processing tend to have larger producer share values. For example, because livestock products such as beef, pork, poultry, lamb, and dairy go through minimal processing relative to non-livestock products, the producer's share for these items often approaches 50 percent.

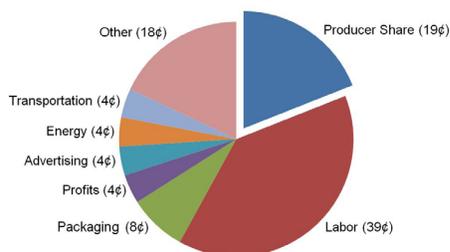


Figure 2: Breakdown of Consumer Food Dollar in 2006. Source: USDA, Economic Research Service.

The marketing margin exists because consumers demand (and have the ability to pay for) food with 'value added'. This added value is found in numerous food items appealing to a diverse set of shoppers.

Quick Facts

- Farmers and ranchers receive only a fraction of the consumer's expenditure on food. On average, agriculture producers receive 19 cents of each consumer dollar spent on food.
- The major components of the marketing margin (or marketing bill) include labor, packaging, profits, advertising, energy, and transportation.
- The marketing margin exists because consumers demand (and have the ability to pay for) food with 'value added'. This added value is found in numerous food items appealing to a diverse set of shoppers.

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For example, rather than buying flour and other ingredients, many consumers would rather purchase ready-to-eat bread and other bakery products. A consumer purchasing bread rather than flour is also buying convenience and saving time. The U.S. food industry continually evolves in an effort to satisfy an increasingly diverse clientele demanding a growing variety of food products containing varying degrees of added value.

Commodity Costs of Food Prices

To illustrate how commodity costs account for a small fraction of food costs, consider some common food purchases. For example, a one-and-a-half pound loaf of whole wheat bread contains approximately 16 ounces of wheat flour. This amount of wheat equals 1/60 of a bushel. Hard red winter wheat priced at \$3.50 per bushel places the value of wheat in the bread at 5.8 cents. If wheat prices rise to \$7.00 per bushel (a 100 percent increase), wheat in the bread is now valued at 11.6 cents. This increase represents 4.8 percent of the cost; given value-brand bread priced at \$1.25 per loaf. More expensive bread would result in a smaller percent of the total cost for the same value increase.

Over time, livestock producers in the United States have made grains a significant portion of livestock feed rations. For example, approximately 45 percent of our field corn is fed to domestic livestock. Therefore, an increase in grain prices will have some effect on the cost of producing meat and poultry. Consider corn fed to poultry. Assume it requires 2.5 pounds of corn to produce a pound of chicken. At field corn prices of \$2.50 per bushel, the value of corn in a one pound chicken breast is approximately 11 cents. A corn price increase to \$5.00 per bushel means that the value of the corn in a pound of breast meat becomes 22 cents. This increase represents 5.5 percent of the cost when breast meat sells for \$2.00 per pound; and 2.75 percent when the price of chicken is \$4.00 per pound. Again, the commodity cost represents a small portion of the retail food price.

Prices Increases Dampened by Substitution

Cost increases can be mitigated by substitution among producers and consumers. When producers (either at the grower or food manufacturing level) face rising input costs, a vehicle for holding down costs is input substitution. Producers may have limits on their ability to substitute, but the extent to which they can substitute limits the effect commodity price increases have on food costs. For example, if corn prices rise, livestock producers may substitute another feed grain for corn.

In an effort to save money when prices change, consumers also frequently substitute one item for another. These substitutions include one type of meat for another, or one form of grain product for another. For example, if beef prices rise while pork prices remain constant, some consumers will substitute the now relatively less expensive pork for higher price beef.

Export Demand

Export demand is an additional factor that causes increases in commodity and food prices. The U.S. exports about 17 percent of domestic corn production, as well as significant levels of wheat, other grains, oilseeds, and livestock products. In addition, there are exports of many food items that contain farm and ranch products as ingredients. One factor leading to growth in export markets has been increasing incomes, especially in developing countries. For example, both Mexico and China have significantly improved per capita incomes. As incomes increase in these countries their demand for food in general increases; livestock products in particular. As a result we send Mexico livestock and livestock products, and we send them feedstuffs (corn and soybeans) to meet the needs of their growing livestock industry. Likewise, we send soybeans to China to feed their growing poultry and pork industries.

These strong and growing export markets compete with our domestic market. The Chinese consumer in Beijing and the Mexican consumer in Mexico City compete with U.S. consumers for the food that we produce domestically, which causes prices to rise. However, we also import much of our food, and that competition keeps some downward pressure on domestic food prices.

Conclusion

Farmers and ranchers receive only a fraction of the consumer's expenditure on food. On average, agriculture producers receive 19 cents of each consumer dollar spent on food. Contrary to popular belief, commodity price increases contribute little to food price inflation. Increased demand, domestically and internationally, leads to increases in both commodity and food prices. Price increases can be somewhat mitigated at the producer and consumer levels by substituting higher cost items with relatively less expensive items.

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