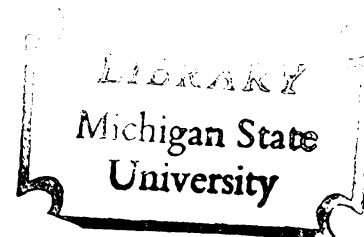




THESIS



This is to certify that the
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AN EVALUATION OF THE ECONOMIC POTENTIAL
FOR COORDINATION OF EXPORT MARKETING
BY U.S. FARMER COOPERATIVES

presented by

Mark D. Newman

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of the requirements for

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FOR COORDINATION OF EXPORT MARKETING
BY U.S. FARMER COOPERATIVES

By

Mark D. Newman

A DISSERTATION

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ABSTRACT

AN EVALUATION OF THE ECONOMIC POTENTIAL FOR COORDINATION OF EXPORT MARKETING BY U.S. FARMER COOPERATIVES

By

Mark D. Newman

This research identifies and evaluates opportunities and methods for U.S. farmer cooperatives to improve their competitive positions in international markets through multicooperative and multicommodity arrangements. As individual cooperatives attempt to profitably increase their exports, they are often constrained by limited export sales volume and experience, limited financial strength, and limited product lines. To the extent that size or scale economies in the performance of individual export functions can be exploited, these limitations may be offset through coordination of export marketing activities.

An analytical framework was developed based on a model of the export process comprised of nine component functions, (1) procurement, (2) processing, (3) transportation and physical distribution, (4) market information, (5) sales, (6) financial, (7) documentation, (8) risk management, and (9) regulatory. Data collected in interviews with individuals associated with the export process were employed to draw qualitative, and to the extent possible, quantitative conclusions on the potential for achieving scale or size economies in the performance of individual functions. Additionally, the potential for six organizational arrangements to facilitate cooperative exporting was evaluated.

Data collection involved over 130 personal and telephone interviews with a purposively selected sample which included management and staff

of cooperatives, corporate exporters, financial institutions, freight forwarders and export management firms. Diverse geographic and commodity expertise were included in the sample. Represented were over 35 percent of all U.S. cooperatives which made direct export sales in 1976, and more than 55 percent of those with direct sales of more than \$10 million.

Research conclusions identified numerous possibilities for cooperatives to increase marketing efficiency and competitiveness through collective action. Similarities in the functional export marketing requirements for different commodities and cooperatives can permit achievement of coordinational economies. Coordination can consist of increased size or sales volume, product extension, diversification of geographic markets, or harmonization of successive stages in the marketing process.

The range of commodities for which functional requirements are similar and the extent to which economies increase with sales volume varies by function. This may result in advantageous collaboration in performing single functions. However, interdependence among functions necessitates that trade-offs in satisfying overall export marketing requirements of individual cooperatives be evaluated.

Significant opportunities for achievement of economies were identified in the functions listed above. Economies in financial and regulatory functions can be achieved across the broadest commodity lines. For other functions, the greatest short and medium term coordinational advantages may be obtainable within each of two general commodity groups, (1) bulk commodities, such as grains, soybeans and other feed ingredients, and (2) perishable, processed or branded products, including fruits, nuts, vegetables and some meat products.

Evaluation of six types of organizational arrangements led to the conclusion that the greatest advantages to cooperatives in coordination of export marketing may be obtained through Cooperative Export Management arrangements, Multicommodity Federated Export Cooperatives, Joint-Ventures, and Webb-Pomerene Associations. Two arrangements found to have significantly less promise were a Cooperative Trade Information Service and a Cooperative Brokerage Organization.

The usefulness of each type of organizational arrangement as a mechanism through which a cooperative can gain access to size economies or other export marketing advantages through collaborative activity will depend upon both functional and organizational factors. Functional economic factors are the necessary conditions for profitable coordination.

A distinction between export market development and sporadic export sales is useful in categorizing the marketing objectives of an individual cooperative and its potential contribution to any collaborative exporting arrangement. Management styles, the distribution of power and control in a proposed arrangement, participant size and sales volume and the necessities imposed by the marketing environment in which each cooperative operates must also be considered in establishing sufficient conditions for advantageous coordination of export marketing.

To the Memory of my Grandparents,
Harrison and Rosetta Newman

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A number of individuals and organizations made substantial contributions to this dissertation. Harold Riley, who supervised my research, provided guidance and encouragement as well as unfailing confidence that the job could be done. Donald Ricks, Lester Manderscheid and Vernon Sorenson all provided useful comments, as did Carl Eicher, who also supervised my overall graduate program. Many other faculty and graduate students at Michigan State contributed to both the research and the quality of my graduate education.

Financial support for the research was provided by the Cooperative Marketing and Purchasing Division of the Economics, Statistics, and Cooperatives Service, United States Department of Agriculture. Interaction with Randall Torgerson, James Haskell, Arvin Bunker, Donald Hirsch and Bruce Reynolds throughout the research was quite useful.

This study would not have been possible without the significant contribution of time and insights by the management and staff of U.S. Farmer Cooperatives, and others involved in the export trade. A special debt of gratitude is reserved for the panel of six cooperative leaders who reviewed the entire manuscript.

Eleanor Noonan was of tremendous assistance in typing earlier drafts of the manuscript. Cathy Cooke raced against time and the stork in typing the final copy with assistance from Nancy Creed and Katherine Lehman. My debt to them is quite large.

The personal and professional contributions of my wife, colleague and editor, Carol Kramer, cannot be overstated. Amanda and Peter provided helpful distraction throughout the research process and my graduate career.

Needless to say, I alone remain responsible for any errors of fact or analysis.

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CHAPTER I

INTRODUCTION

1.1 Background and Problem Statement

Farmer cooperatives offer important marketing options to U.S. producers of diverse agricultural commodities. As the importance of effective marketing of U.S. agricultural commodities around the world gains increased recognition, the incentives for increased cooperative attention to export marketing also grow. This research is directed at the identification and evaluation of opportunities and methods for U.S. farmer cooperatives to improve their competitive position in international markets through multicooperative and multicommodity arrangements.

Agricultural exports contribute significantly to the health of the U.S. economy. In FY 1979 these exports were valued at \$32 billion, almost one-fifth of total U.S. exports.¹ As rising prices for imported oil and the depreciation of the dollar vis-a-vis other currencies contributed to a more than quadrupling of the U.S. import bill between 1970 and 1979, agricultural exports helped to lessen balance of payments deficits.

As the value of the dollar has fallen on foreign exchange markets, the price of U.S. goods has become relatively attractive to holders of

¹"U.S. Agricultural Exports Total \$32 Billion in Fiscal Year 1979," Foreign Agricultural Trade of the United States (FATUS), November 1979, pp. 4-5.

other currencies. At the same time, the price of imports in dollar terms, has been increased. In order to eliminate balance of payments deficits, domestic demand for imports can be decreased, foreign demand for U.S. exports can be increased, or some combination of these can be pursued. The current project focuses on the export side of the equation.

Export markets have often been used to get rid of excess supplies of farm products with little attempt to develop exports as an integral part of the production and marketing program. While producers may be better off in the short run by using export markets for adjustment purposes, longer run access to foreign markets may require a more serious commitment to foreign market development.

Farmer cooperatives will not develop export markets if it is not profitable to do so. This research examines economies in marketing which sometimes make irregular or small scale export marketing less profitable and more risky than necessary. An understanding of conditions conducive to decreased risk and more profitable export marketing will usefully contribute to evaluation of marketing opportunities at home and abroad.

The Foreign Agricultural Service (FAS) of USDA and its agricultural attaches overseas receive regular inquiries from foreign buyers indicating an interest in dealing directly with agricultural cooperatives. This is the result of a combination of factors, including the reputation of cooperatives for providing high quality products; the belief that costs of buying directly from producers will be lower; and an apparent ideological preference for dealing with producer organizations rather than other marketing intermediaries.

Many U.S. cooperatives have products available for the export market. Much of the produce of cooperative members which ultimately reaches foreign buyers is exported indirectly. It passes through intermediaries such as international trading firms, U.S. export agents, and others who purchase commodities for sale abroad from many sources, U.S. and foreign, cooperative and non-cooperative. The contingencies of reinforcement are such that these firms or agents will generally be interested in selling those products which offer them the greatest profit margins, regardless of their origin, rather than selling the products of U.S. cooperatives. Direct exports, where buyers and sellers deal directly with each other or their representatives, may permit cooperatives to increase returns to their members, as well as contributing to increased exports of U.S. produced commodities.

However, as cooperatives attempt to increase their direct exports, several problems become evident:

- The volume of exports by single commodity cooperatives may be insufficient to compete effectively with large multi-commodity private trading firms and state trading firms operating in international markets. Building up foreign markets often requires the ability to bid regularly on tenders from buyers.
- The financial strength of many individual cooperatives may be inadequate to assume the risks of international trade. With low volume, the spreading of those risks is difficult. This places cooperatives with small export programs at a competitive disadvantage.

- The range of products offered by most individual cooperatives is limited. Foreign buyers may prefer "single source" suppliers. This decreases the transaction costs involved in purchases of multiple products.
- Single product cooperatives may have limited ability to cover the large fixed costs of becoming established in foreign markets--hiring necessary marketing expertise, developing market intelligence, maintaining foreign sales representation, etc.

These considerations suggest that if predominately single-product cooperatives can combine their efforts, the barriers to entry into exporting for individual cooperatives may be reduced.

This research has been conducted under a cooperative research agreement between the Michigan State University Department of Agricultural Economics and the Cooperative Marketing and Purchasing Division (CMPD) of the Cooperatives Program; Economics, Statistics, and Cooperatives Service (ESCS); U.S. Department of Agriculture (USDA). It is part of a larger research program being undertaken by CMPD directed at broadening the informational base of cooperative decision makers with respect to the development of effective export marketing programs by cooperatives.

The CMPD research program has included studies on export marketing techniques,¹ evaluations of cooperative grain exporting and possibilities

¹Donald E. Hirsch, Export Marketing Guide for Cooperatives (FCS Marketing Research Report 1074; Washington: USDA, March 1977).

for its improvement,¹ and surveys of the export activities of farmer cooperatives.² Additionally, studies are presently being conducted on the possibilities for multinational cooperative coordination in the grain trade³ and the prospects for cooperative ocean freight chartering.⁴

The present study is directed at examination of the potential for coordination of export marketing activities among U.S. cooperatives handling a variety of different commodities and products. At the behest of CMPD, the commodity emphasis of this study has remained extremely broad. Accommodation of this breadth of focus has been accomplished through emphasis on the functional components of export marketing and similarities in the process which cross commodity lines. Although this wide commodity coverage has necessitated some trade-offs in terms of the analytical depth with which the export of individual commodities could be treated, many tentative conclusions which may be of use to handlers of specific commodities have been developed. The results may be considered a "pre-feasibility study" that sorts out a wide range of options for collaboration among cooperative exporters but does not evaluate specific combinations of cooperatives or commodities.

¹ Stanley K. Thurston, Michael J. Phillips, James E. Haskell and David Volkin, Improving the Export Capability of Grain Cooperatives (FCS Research Report 34; Washington, D.C.: USDA, June 1976).

² Donald E. Hirsch, Agricultural Exports by Cooperatives (Farmer Cooperative Research Report 5; Washington, D.C.: USDA/ESCS, August 1979).

³ Ronald D. Knutson, Michael Cook and Thomas L. Sporleder, International Cooperative Coordination in World Grain Trade (College Station: Texas A&M University, 1978).

⁴ Donald E. Hirsch, Ship Chartering Alternatives by Grain Exporting Cooperatives (Washington, D.C.: USDA/ESCS, forthcoming).

The research problem has been framed in the broad context of evaluating opportunities to coordinate export marketing activities of U.S. farmer cooperatives. Such an approach has been judged preferable to a more restrictive examination of the merits of a single multi-commodity cooperative export sales organization. The broader perspective adopted here permits analysis of a wide range of functional and institutional factors which affect possible advantages and disadvantages to individual cooperatives considering collaboration in exporting.

The central research question is whether coordination of export marketing can offer access to advantages to cooperatives through increased efficiency and improvement of their competitive positions in international markets. Two fundamental concerns are:

1. whether similarities in product attributes and export marketing requirements permit the achievement of economies of size or scale through coordination of export marketing by U.S. farmer cooperatives; and
2. whether export marketing coordination by cooperatives could lead to advantages, such as spreading of risk, which could enhance their ability to compete with multi-national firms, state trading companies and marketing boards in international trade.

1.2 Research Objectives

A central goal of this research is to provide useful information to management of regional cooperatives of diverse size, interest and product emphasis. This necessitates that it be both descriptive and analytical. The four principle research objectives were to:

1. Review the role of exports in U.S. agriculture, with special emphasis on the importance of exports to farmer cooperatives. This included identification of structural characteristics of export markets and marketing which make consideration of cooperative export coordination important.
2. Develop an analytical framework for evaluation of the potential for coordination of export marketing. This includes identification of functional components of the export process, and methods for their analysis which would reflect export marketing requirements for different agricultural commodities.
3. Identify and evaluate factors which might be conducive to export coordination by cooperatives. This included identification and evaluation of functional similarities in commodity marketing and trade characteristics, and economic factors influencing coordination potential.
4. Identify organizational arrangements which might serve the needs of U.S. cooperative exporters and describe and analyze economic considerations which would influence their success.

1.3 Procedures

The research procedures employed can be divided into seven steps:

1. Literature review and interviews with USDA and trade personnel to develop an understanding of the export process and marketing requirements of specific agricultural commodities.
2. Development of an analytical framework for evaluation of the economic potential for export coordination by cooperatives, including a functional model of the export process.

3. Development of a research issues outline for use as the survey instrument in the interview process.
4. Interviews with cooperative leaders to develop an understanding of cooperative experience, potential and interest in exporting and export coordination, and to identify some of the trade-offs involved in coordinated export marketing.
5. Interviews with individuals associated with the export process in order to identify some of the costs and risks associated with individual export functions and to develop a qualitative, and to the extent possible, quantitative, view of the potential for achieving scale and size economies in the performance of those functions.
6. Use of the functional analytical framework and interview data to evaluate functional factors and the opportunities that they provide for export coordination by cooperatives.
7. Use of interview data and information from the above sources and others to evaluate the potential for six organizational arrangements to facilitate cooperative exporting.

A research issues outline was used as a survey instrument in the interview process. It was developed in consultation with researchers specializing in marketing and international trade at Michigan State University and in USDA. It was then tested and evaluated in interviews with several cooperative leaders and revised to reflect the findings developed there.

Interview data were collected in five subject areas:

- 1) physical factors related to commodities exported and their handling,

- 2) institutional factors related to experience in exporting and those involved in facilitating exports,
- 3) longer range impressions of cooperatives and their potential as exporters,
- 4) experience with various organizational arrangements related to exporting, and
- 5) potential advantages and disadvantages to individual coordinated exporting arrangements.¹

Much of the data collected in this research were qualitative in nature. Where quantitative data were available, they generally took the form of case study examples. Analysis of such evidence has been used here to draw indicative conclusions. However, it is not possible to test hypotheses in a strict statistical sense on the basis of such data. This factor should be considered in evaluating the findings of this research.

1.4 Sampling Procedures

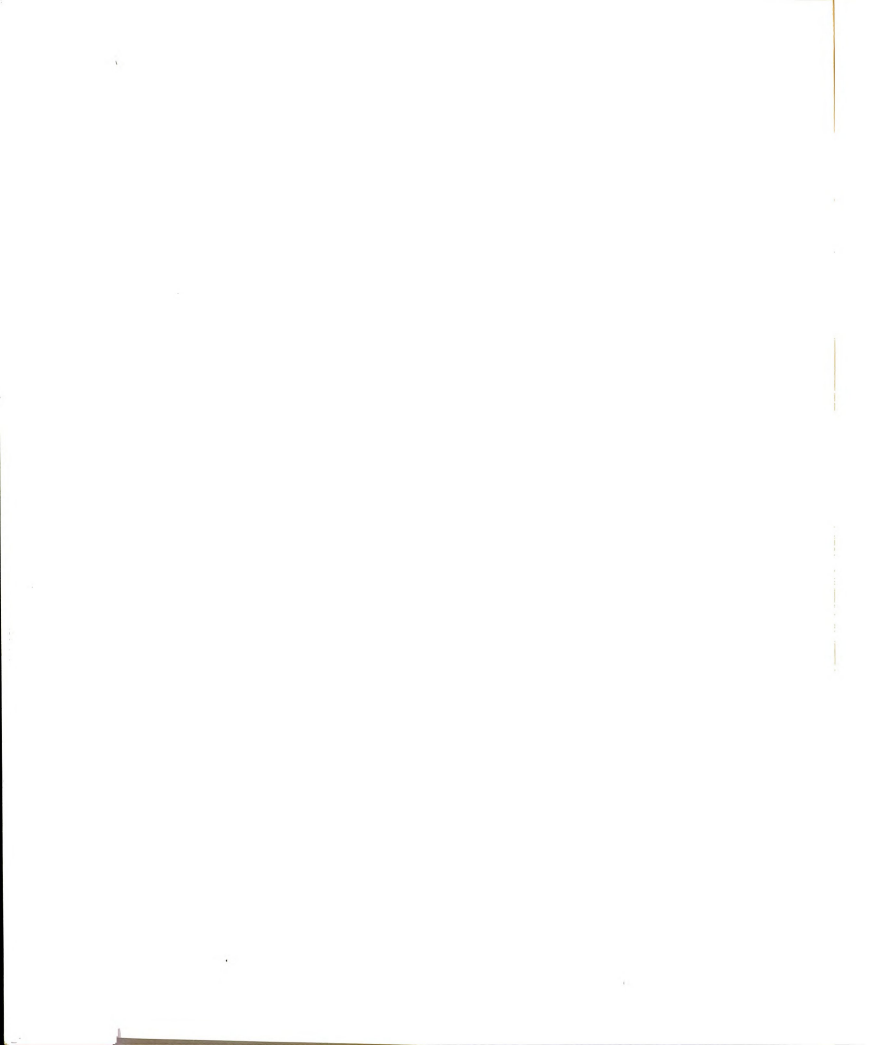
The data collection process involved personal and telephone interviews with 130 people during the period September 1978 through August 1979. Those interviewed included: cooperative management and export staff; corporate exporters; management and staff of financial institutions; freight forwarders; export management firms; university researchers; personnel of the USDA and other government agencies; and others. A breakdown of the sample by institutional affiliation is presented in Table 1.1.

¹The research issues outline is included as the Appendix.

TABLE 1.1. INTERVIEW SUBJECTS: NUMBER AND INSTITUTIONAL AFFILIATION

| Type of Institution/Enterprise | Number | Number of People Interviewed |
|--|---|------------------------------|
| Cooperative | 30 | 57 |
| National Cooperative Organization | 2 | 2 |
| Corporate Exporters and Export Managers | 4 | 7 |
| Trade Promotion Organizations | Regional: U.S. - 1 Foreign Country - 1 | 2 |
| International Transportation Specialists | 3 | 4 |
| Financial Institutions | 4 | 5 |
| Management Consultants | | 1 |
| Universities (except MSU) | 7 | 14 |
| Federal Government-USDA | | 39 |
| Dept. of Commerce | | 1 |
| FTC | | 2 |
| State Government | 1 | 2 |
| Total | | 130 ¹ |

¹Excluding dual affiliations.



In selecting people to be interviewed, an attempt was made to include diverse experience with and knowledge of the export process and farmer cooperatives. The nature of the problem under study is more consistent with a purposive sampling approach than with a random sampling procedure. Objectives in selection of the sample included access to a wide range of commodity expertise, geographic perspective, and experience at different hierarchical levels in exporting organizations. Experience with past attempts at coordinated export marketing was considered useful. Additionally, it was deemed desirable to identify the constraints facing both large and small exporters.

While there was no list frame from which to identify all agricultural exporters, cooperatives which made exports directly to foreign customers during 1976 were the subject of a CMPD census. A list of the population of "cooperative direct exporters, 1976" was made available to this researcher by the USDA in the fall of 1978. It was stratified by commodity group and headquarters location of the cooperatives included, although no data reflecting total sales volumes or export sales volumes of individual cooperatives were obtainable prior to completion of the interview process. As a result, it was not possible to perform ex ante stratification of the population by direct export sales volume, a variable which could serve as a proxy for experience in exporting. This constraint necessitated the selection of people for the interview sample on the basis of reputation for knowledge of exporting, the export process, or farmer cooperative affairs. Assistance in the selection process was obtained from cooperative leaders, USDA personnel, trade organizations, and university researchers.

The 30 cooperatives from which representatives were interviewed were selected purposively from a sampling frame which included the population of 73 cooperatives identified as direct exporters in 1976 and other cooperatives listed in directories compiled by the National Council of Farmer Cooperatives and the USDA.¹ Data which became available in October 1979 made possible an ex post comparison of the cooperatives from which representatives were interviewed in this research with a size distribution of the population of direct exporting cooperatives. This is presented in Table 1.2. It indicates that more than 55 percent of all cooperatives with annual direct export sales of \$10 million or more in 1976 were represented in this study. According to Hirsch, the 18 cooperatives with direct export sales in that category accounted for 94 percent of the direct export volume of all U.S. cooperatives in 1976.² Overall, more than 35 percent of all cooperatives which made direct export sales in 1976 were included in this study. Additionally, five other cooperatives which were not identified as direct exporters in 1976 were interviewed.

In addition to cooperative management and personnel, representatives of national cooperative organizations, corporate exporters, trade promotion organizations, universities, and federal and state government agencies, as well as various functional specialists working in the export field, were selected to be interviewed on the basis of expectations that

¹Hirsch, 1979; National Council of Farmer Cooperatives, Names to Know-1979 (Washington: NCFC, 1979); Clement Ward, J. David Morrissy, Cooperative Brands and Processed Foods (FCS Information 110; Washington: USDA, September 1977).

²Hirsch, 1979, p. 6.

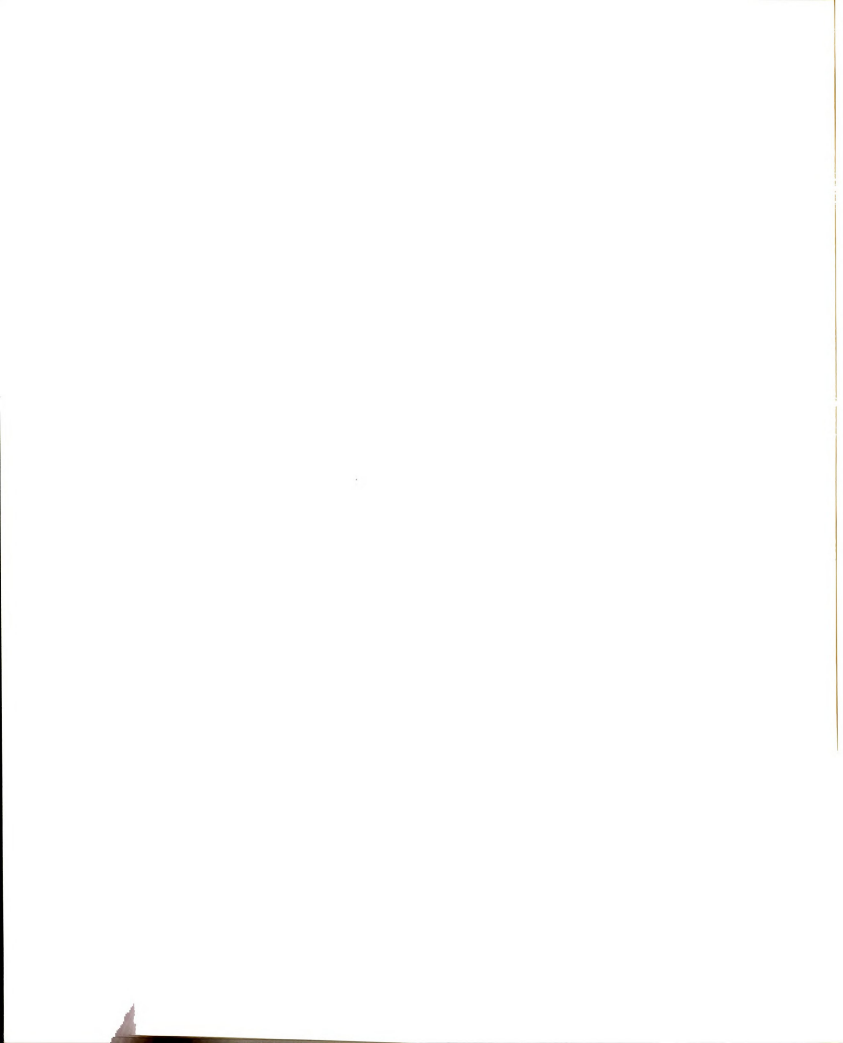
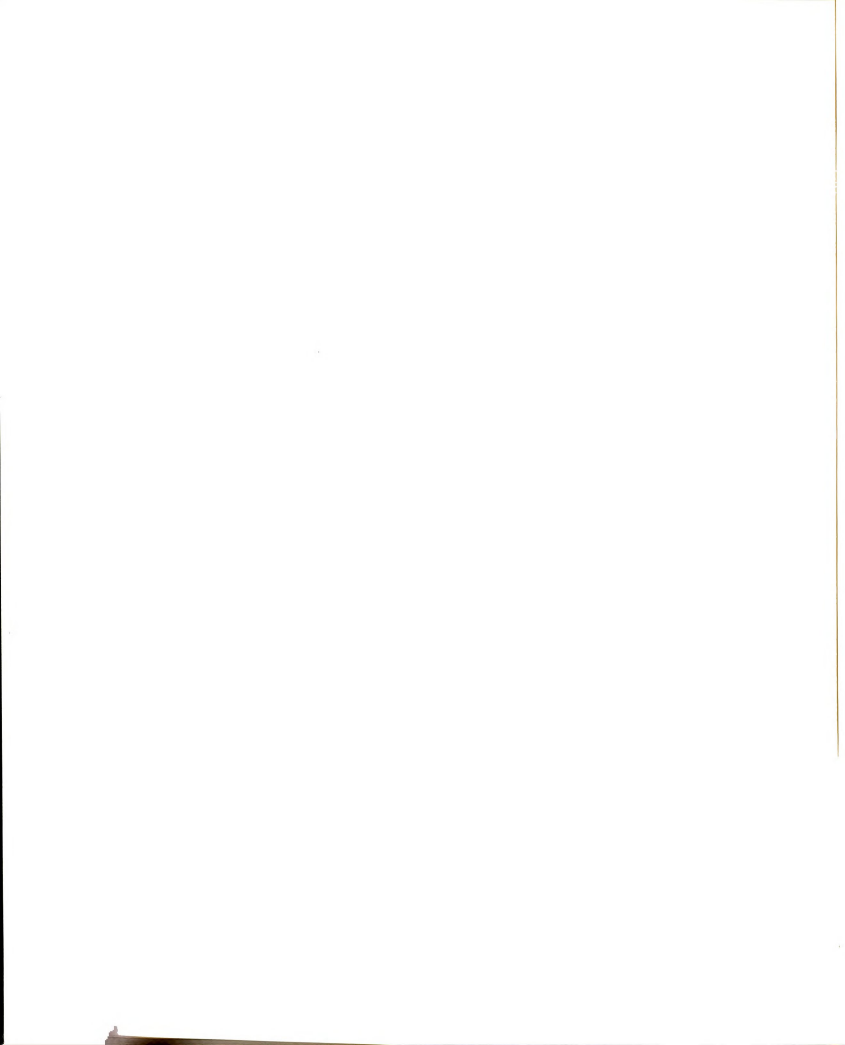


TABLE 1.2. COOPERATIVES INTERVIEWED IN THIS RESEARCH COMPARED TO POPULATION OF DIRECT EXPORTING COOPERATIVES IN 1976: SIZE DISTRIBUTION BASED ON DIRECT EXPORT SALES VOLUME.

| Value of 1976 Direct Exports \$ Millions | All Cooperative Direct Exporters, 1976 | | Cooperatives interviewed, 1978-79 which were part of earlier population of direct exporters | |
|--|--|-------------------------------------|--|---|
| | Number | Percent of total Cooperatives | Number ¹ | Percent of Cooperatives in sales volume category |
| Less than \$1.0 | 25 | 34.2 | 4 | 16 |
| 1.0 - 9.9 | 30 | 41.1 | 12 | 40 |
| 10.0 - 24.9 | 6 | 8.2 | 3 | 50 |
| 25.0 - 99.9 | 5 | 6.8 | 3 | 60 |
| 100.0 and over | 7 | 9.6 | 4 | 57.1 |
| Total *** | 73 | 100.0 | 26 | 35.6 |

Derived from: Hirsch, 1979 and unpublished USDA data.

¹This comparison excludes five cooperatives which were interviewed in conjunction with this research but which were not identified by Hirsch as members of the population of cooperative direct exporters in 1976.



they could contribute to the objectives in sample selection listed above. Without the benefit of lists from which to select such individuals, it was necessary to rely upon assistance from cooperative leaders or USDA personnel, trade organizations and university researchers in both the identification of potential interviewees and their selection.

Satisfaction of USDA project objectives necessitated that a broad-based commodity orientation be maintained in this research. In order to set some bounds upon the breadth of commodities considered, greater emphasis has been placed on foods, feeds and their products than on other agricultural commodities. Thus, most of the people interviewed had interests in the export of grains, oilseeds, fruits, nuts, vegetables, animals and/or products of these commodities. Relatively insignificant attention was devoted to cotton and tobacco because of their unique marketing requirements.

Table 1.3 identifies the commodity specialization of those interviewed who had commodity specific expertise. It can be seen that 42.3 percent of those interviewed had expertise related to grains, oilseeds and products; 39.2 percent were knowledgeable with respect to fruits, nuts, vegetables and products; and 18.5 percent could be classified as experts in animal and animal products. Some individuals were familiar with marketing requirements for commodities in more than one group, while others had no particular commodity-related expertise. Thus, the total percentages reflected in the table do not add to 100.

Analysis of the geographic distribution of people interviewed can provide some insights into the breadth of regional experience considered in this study. It is useful to note that the geographic interests represented by those interviewed often crossed regional boundaries. For

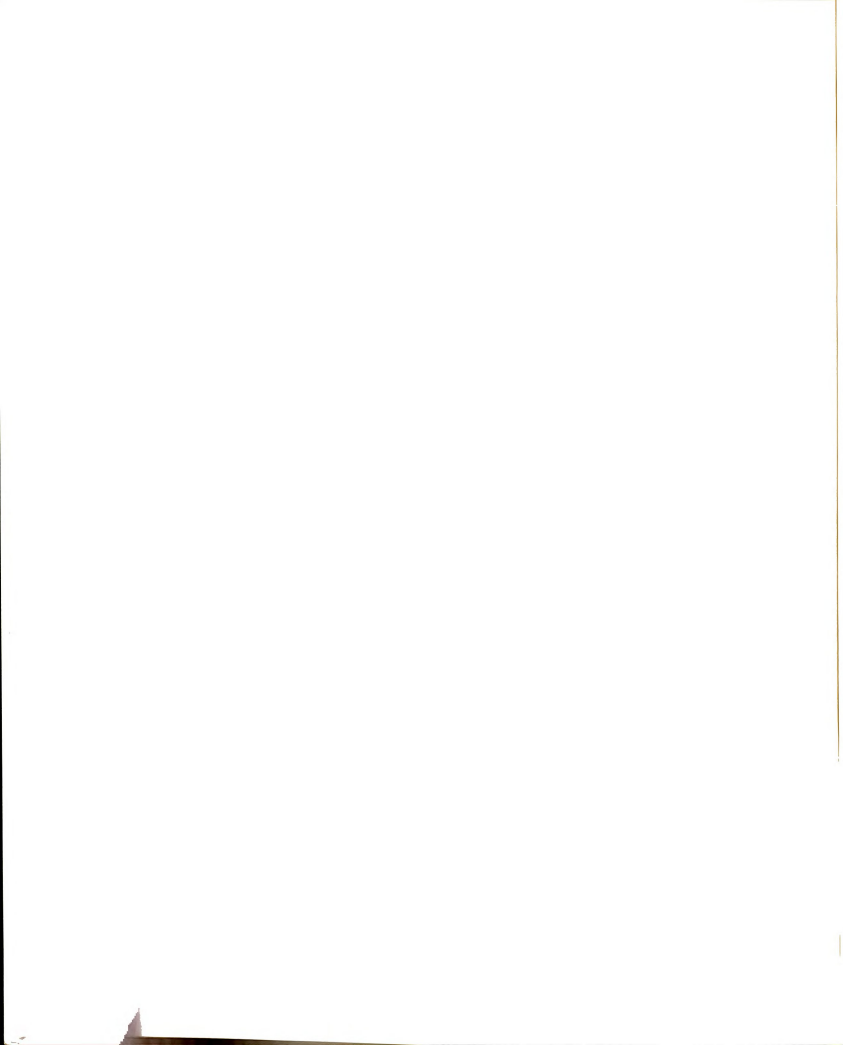


TABLE 1.3. COMMODITY FOCUS OF INTERVIEWS *

| Commodity Group | Number of Cooperatives interviewed which handle commodities | Number of Cooperative Managers and Personnel interviewed | Other Commodity Specialists Interviewed | Total Number of People interviewed with commodity expertise | Percentage of total interviews (130) |
|---|---|--|---|---|--------------------------------------|
| Grains, oilseeds and Products | 16 | 32 | 23 | 55 | 42.3 |
| Fruits, Nuts, Vegetables and Preparations | 15 | 31 | 20 | 51 | 39.2 |
| Animals and Animal Products | 7 | 16 | 8 | 24 | 18.5 |
| Cotton, Tobacco and Products | 0 | 0 | 5 | 5 | 3.9 |

* Column totals would be meaningless because some persons interviewed have multiple commodity interests and others are not commodity specialists.

example, federal government employees located in Washington, D.C. were included in the Northeastern region. This results in an overestimate of the importance of interviews conducted in the Northeast as a contributor to a balanced regional view of this research.

Additionally, the varying sizes of individual regional and inter-regional cooperatives affect the geographic regions which they represent. Table 1.4 identifies the headquarters locations of individual cooperatives by geographic region. Some cooperatives actually represent producers in several geographic regions. For example, one interregional exporter with headquarters in the Great Plains region has members and/or facilities in every other region of the country. Data which would permit assessment of such coverage for all cooperatives and others interviewed were not available. Inaccessibility of sales data for individual cooperatives also prevented comparison of the importance of those interviewed relative to total cooperative exports by region.

1.5 Plan for Presentation of the Study

The audience for this study is expected to vary widely in their interest and experience with U.S. farmer cooperatives, international trade and the export process. While this study makes no pretext of presenting a complete description of the mechanics of exporting, it does attempt to provide enough descriptive information so that a cooperative manager can recognize some of the complexities of individual export functions. It also attempts to provide enough background on exports and cooperatives so that the research problem can be placed in context.

Chapter II provides a brief overview of exports and U.S. agriculture. It identifies the importance of exports and export trading

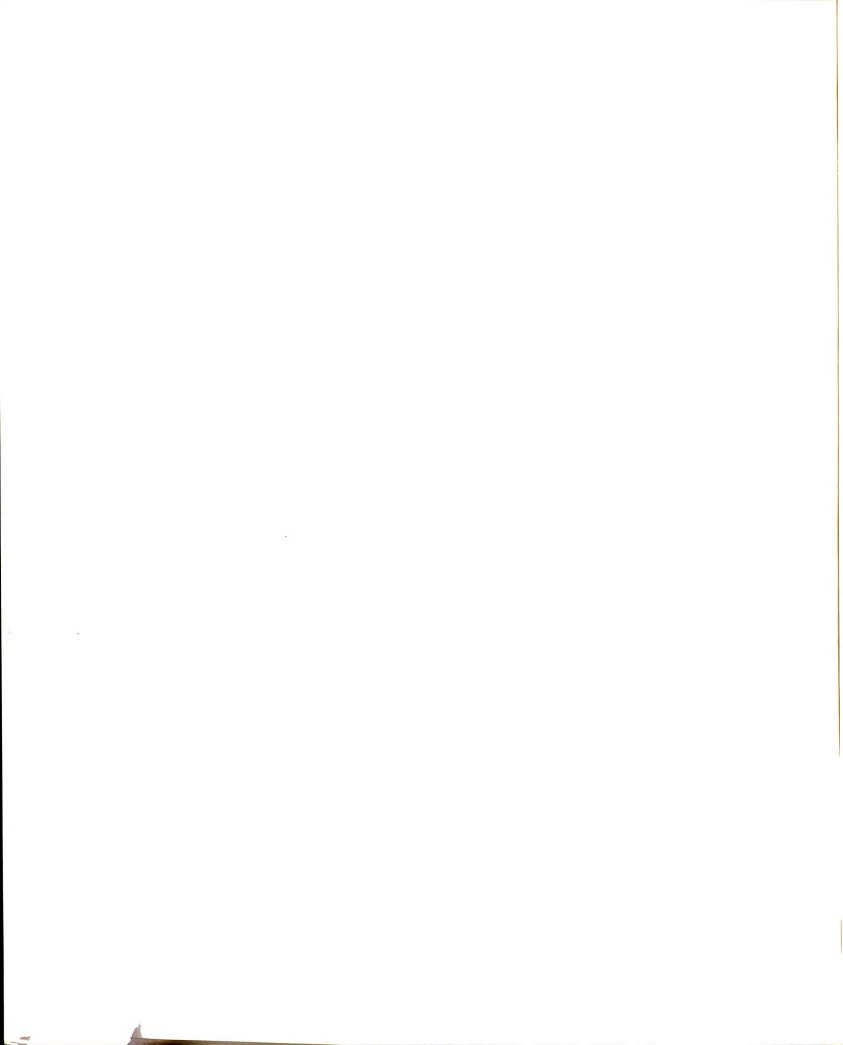
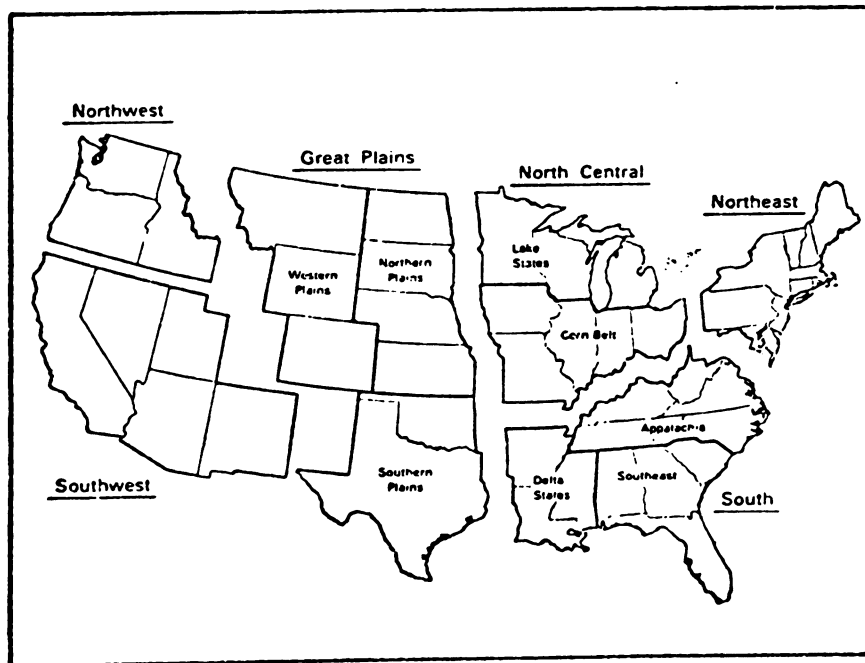
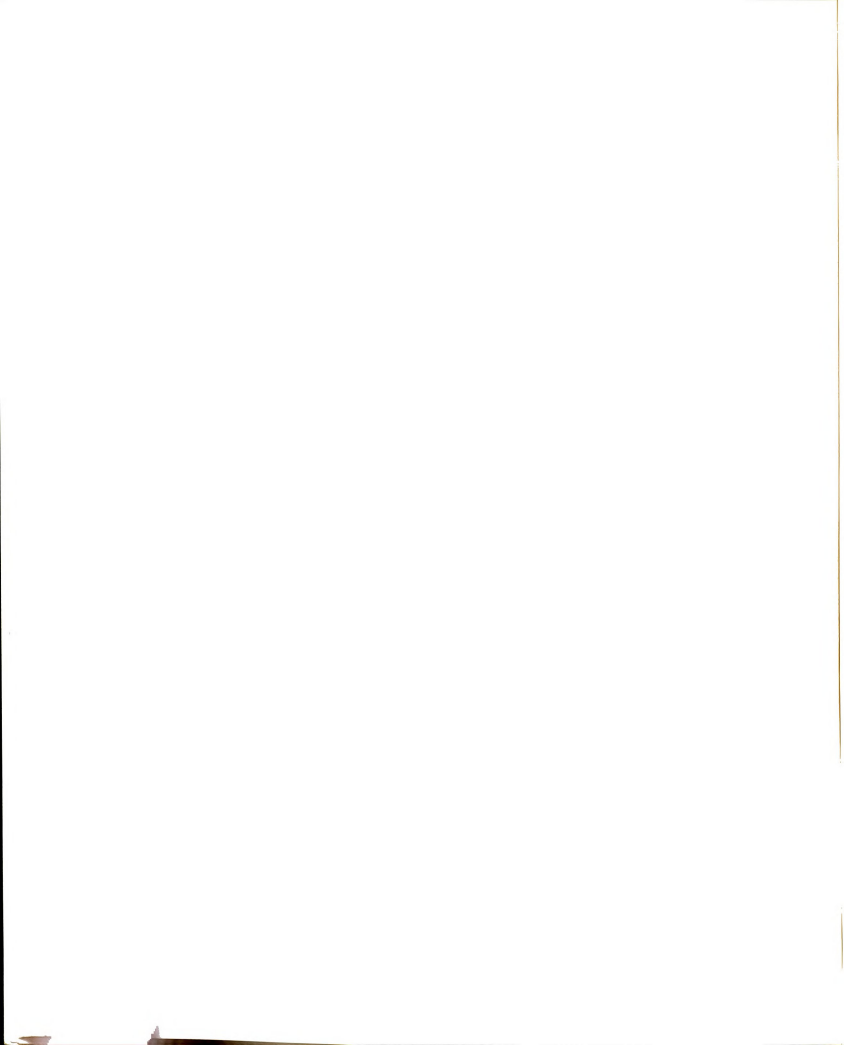


TABLE 1.4. GEOGRAPHIC DISTRIBUTION OF INTERVIEWS

| Region of the U.S. | Number of Cooperatives Interviewed with Headquarters in Region | Number of Cooperative Managers and Personnel Interviewed | Percent of Cooperative Interviews | Total Number of People Interviewed | Percentage of Total Interviewed |
|--------------------|--|--|-----------------------------------|------------------------------------|---------------------------------|
| North Central | 8 | 12 | 21.1 | 24 | 18.5 |
| Northeast | 1 | 5 | 8.8 | 50 | 38.5 |
| South | 4 | 4 | 7.0 | 9 | 6.9 |
| Great Plains | 4 | 14 | 24.6 | 21 | 16.2 |
| Northwest | 3 | 6 | 10.5 | 7 | 5.4 |
| Southwest | 10 | 16 | 28.1 | 19 | 14.6 |
| Total | 30 | 57 | 100 | 130 | 100 |





partners for individual agricultural commodities. It also compares some of the structural characteristics of international markets for different agricultural commodities.

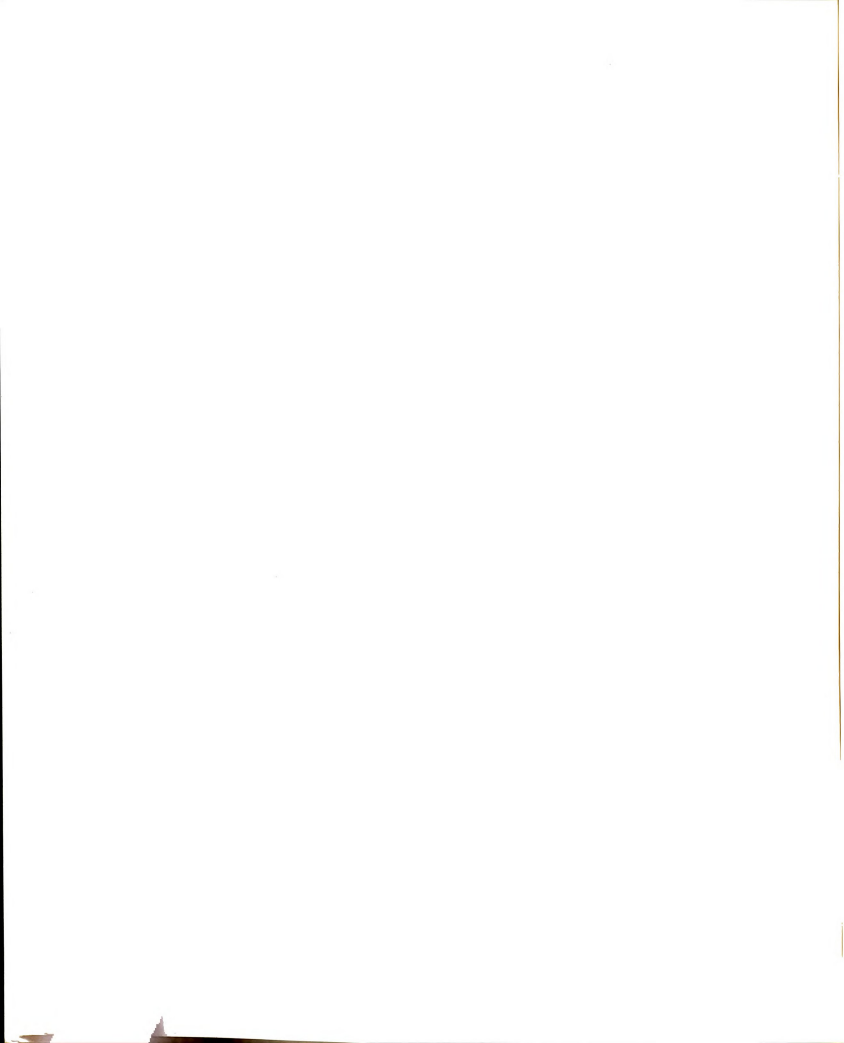
Chapter III is an overview of the historical and legal foundations of U.S. farmer cooperatives and their importance in domestic and export marketing. The chapter also reviews related research on cooperative exporting.

Chapter IV presents the analytical framework for this research. It includes discussion of the theoretical basis for analysis of coordination in export marketing. Additionally, a functional model of the export process is presented.

Chapter V is an economic analysis of functional components of the export process. Individual export functions are analyzed and conclusions on functional coordination potential are developed based on evidence collected during the research process.

Chapter VI describes and evaluates the economic potential for coordination of cooperative export marketing through six types of organizational arrangements. The analysis draws upon case study evidence as well as other empirical findings.

Chapter VII presents the overall research conclusions and suggests some further steps for evaluating export marketing coordination potential.



CHAPTER II

EXPORTS AND U.S. AGRICULTURE

2.1 Overview

Agricultural exports are a major contributor to the health of the U.S. agricultural economy. Overall, the production from almost one out of every three harvested acres is exported.¹ For some commodities, exports are of even greater importance. In FY 1979, for example, the U.S. exported 79 percent of sunflower seed production, 67 percent of all wheat and almonds, and 55 percent of all soybeans produced. Export shares of production for other commodities are presented in Table 2.1.

The physical volume of U.S. agricultural exports has more than doubled since 1970. Coupled with higher prices, this has resulted in a more than four-fold increase in the dollar value of exports.² While agricultural imports more than doubled in value during the same period, the net contribution of agriculture to the U.S. trade balance reached \$15.8 billion in FY 1979.³

¹USDA, 1978 Handbook of Agricultural Charts (Agricultural Handbook 551; Washington, D.C.: USDA, 1978), p. 71.

²USDA, 1979 Handbook of Agricultural Charts (Agricultural Handbook 561; Washington, D.C.: USDA, 1979), p. 78.

³FATUS, November 1979, p. 5.

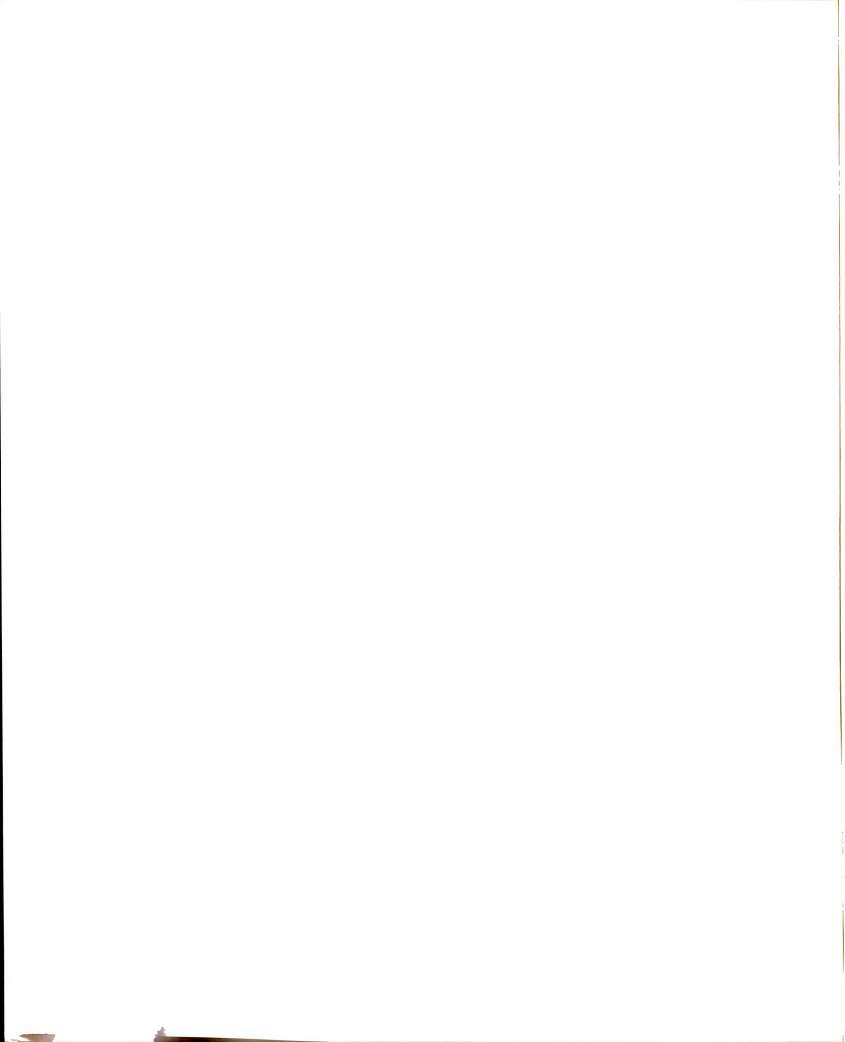


TABLE 2.1. EXPORT SHARES OF PRODUCTION FOR SELECTED
AGRICULTURAL COMMODITIES
FY 1976 -- FY 1979

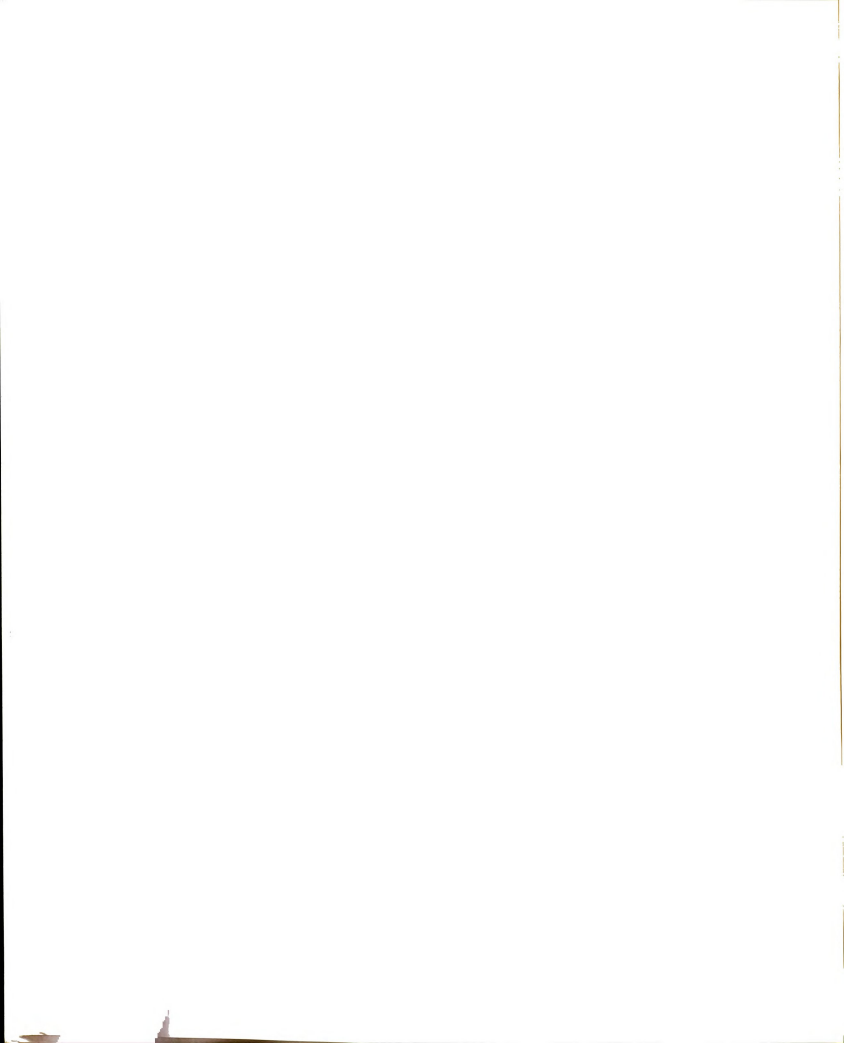
| Commodity | Export Share of Production | | | |
|--------------------------------------|----------------------------|------|------|------|
| | 1976 | 1977 | 1978 | 1979 |
| Sunflower Seeds | 57 | 36 | 72 | 79 |
| Wheat ² | 54 | 44 | 61 | 67 |
| Almonds (shelled basis) | 59 | 47 | 52 | 67 |
| Cattle Hides ¹ | 57 | 57 | 55 | 59 |
| Rice (milled basis) | 50 | 66 | 76 | 58 |
| Cotton, Linters | 39 | 43 | 42 | 57 |
| Soybeans ² | 50 | 55 | 56 | 55 |
| Hops ² | 47 | 48 | 43 | 54 |
| Tallow, inedible | 43 | 46 | 42 | 44 |
| Prunes, dried | 43 | 36 | 36 | 36 |
| Tobacco, unmanufactured ³ | 31 | 33 | 36 | 35 |
| Corn, grain | 29 | 27 | 30 | 30 |
| Peanuts (shelled basis) | 10 | 21 | 30 | 28 |
| Grain Sorghum | 30 | 34 | 27 | 27 |
| Beans, dried | 17 | 23 | 26 | 26 |
| Walnuts (unshelled basis) | 59 | 56 | 23 | 22 |
| Lemons, fresh | 20 | 39 | 24 | 21 |
| Edible Offals | 13 | 15 | 15 | 14 |

Source: FATUS, December 1979, p. 34.

¹Cattle hides in 1000 pieces.

²Includes grain equivalent of products exported.

³Export weight.



2.2 Foreign Markets for U.S. Agricultural Products

U.S. agricultural commodities are marketed throughout the world. However, during 1974-1978 almost one-half of all U.S. agricultural exports went to the European Community, Japan or Canada.¹ These countries serve as both major markets and competitors of substantial significance. Rankin has categorized other groups of countries according to the degree and variability of their significance as U.S. markets, competitors or both.² This is presented in Figure 2.1.

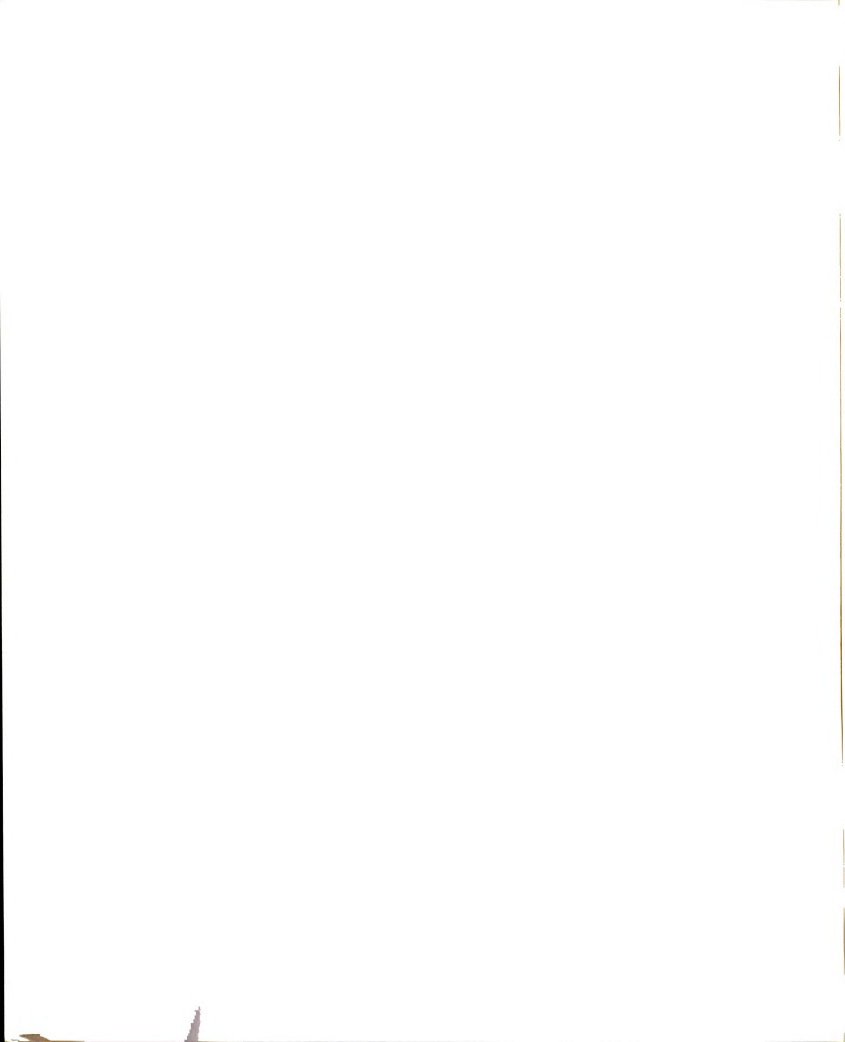
This classification reflects the aggregate importance and variability of certain countries as markets for agricultural exports. For cooperative exporters seeking to evaluate specific marketing opportunities, aggregate export market rankings are only a first step in the identification of potential coordination opportunities in the export of multiple commodities.

Such evaluation may be improved through less aggregated assessments of relationships among trade in groups of commodities and individual foreign market areas. Similarities and differences in the geographic patterns of trade for various commodities can provide useful initial indicators of potential correspondence of interest or requirements in exporting.

The commodity composition of U.S. agricultural exports to selected regions of the world in 1976 is presented in Table 2.2. Additionally, the importance of individual export regions as markets for 1976 exports

¹Peter Rankin, "Review of Country/Commodity Analytical System: Final Report" (Washington, D.C.: USDA/ESCS, April 1979).

²Ibid.



| Group | Country | Significance |
|---------|--|---|
| Group 1 | European Community Japan Canada | General markets (and competitors) of major and lasting significance |
| Group 2 | USSR China India | Markets for basic commodities with high propensity to fluctuate and potential for change |
| Group 3 | Brazil Argentina Australia South Africa Thailand | Competing exporters of basic commodities with substantial propensity for fluctuation and longer term change--and some significance as markets |
| Group 4 | Korea Spain Mexico Taiwa- Egypt Piland Venezuela Portugal Indonesia Philippines | Significant markets with substantial domestic production (and some export) capability |

Source: Peter Rankin, "Review of Country/Commodity Analytical System: Final Report," Washington: USDA/ESCS, April 1979).

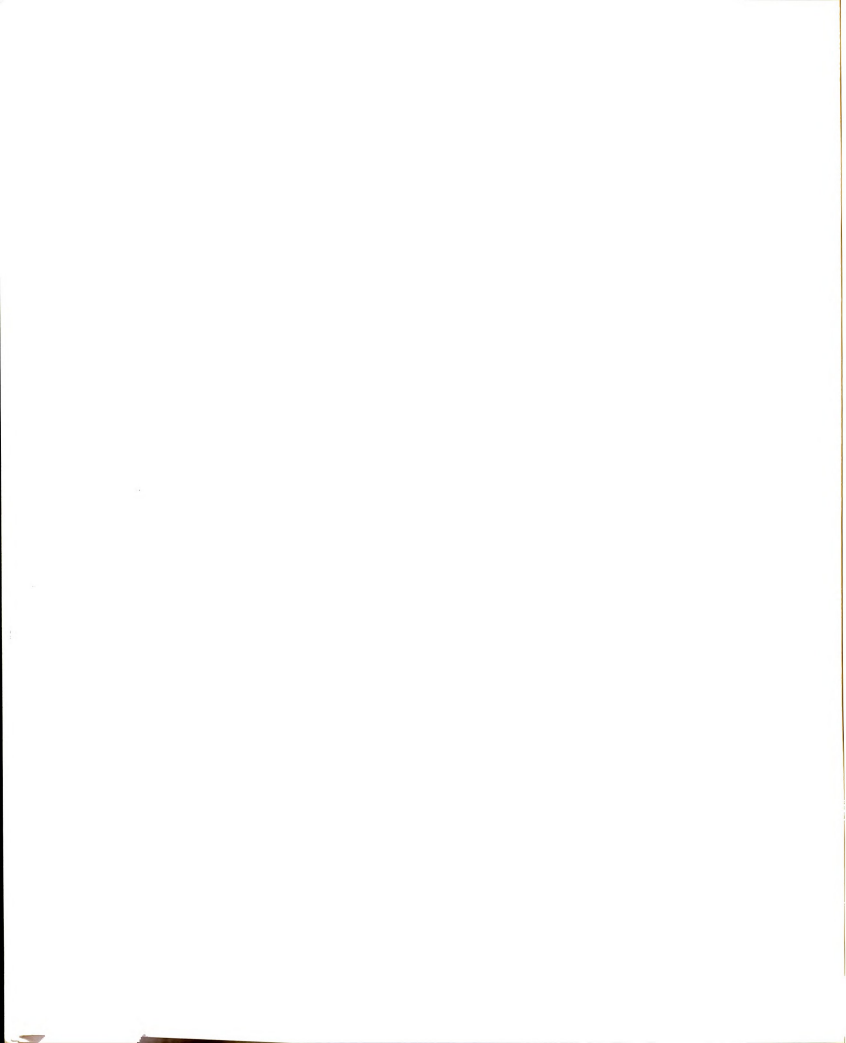
FIGURE 2.1. GROUPS OF MAJOR COUNTRIES IN ORDER OF SIGNIFICANCE TO U.S. AGRICULTURAL TRADE

TABLE 2.2. COMMODITY COMPOSITION OF U.S. AGRICULTURAL EXPORTS TO SELECTED WORLD REGIONS -- 1976

| Commodity Group | North America | Latin America | West Europe | Japan | ASIA (excluding Japan) | OPEC | COMECON | World |
|--|---------------|---------------|-------------|-------|------------------------|-------|---------|--------|
| Percentage of total value of U.S. agricultural exports to region | | | | | | | | |
| Grains and Preparations | 9 | 51 | 38 | 44 | 54 | 64 | 81 | 47.3 |
| Oilseeds and Products | 16 | 14 | 34 | 21 | 12 | 12 | 14 | 22.0 |
| Cotton, raw-excluding linters | 3 | -- | 1 | 7 | 15 | 4 | -- | 4.6 |
| Fruit and Preparations | 19 | 2 | 3 | 4 | 2 | 2 | 1 | 3.4 |
| Vegetables and Preparations | 14 | 5 | 3 | 1 | 1 | 4 | -- | 2.9 |
| Nuts and Preparations | 1 | -- | 2 | -- | -- | 2 | -- | 0.9 |
| Animals and Animal Products | 24 | 17 | 9 | 13 | 1 | 9 | 3 | 10.4 |
| Other | 14 | 11 | 10 | 10 | 15 | 3 | 1 | 8.6 |
| Total (Percentage) | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| Total (\$ million) | 1,485 | 1,942 | 7,882 | 3,563 | 4,019 | 1,346 | 2,376 | 22,997 |

-- = less than 1%

Derived from: USDA, U. S. Foreign Agricultural Trade Statistical Report, Calendar Year 1977, Washington: USDA/ESCS, June 1978), pp. 98-144.



of specific groups of commodities has been broken down in Table 2.3. Comparisons of data presented in these tables may be useful in the identification of markets where exporters of particular commodities are already quite active as well as the importance of those commodities in trade with certain geographic market areas.

For example, from Table 2.2 it can be seen that in 1976 grains and oilseeds made up relatively similar percentages of total U.S. exports to Western Europe (38 percent and 34 percent respectively). However, from Table 2.3 it can be seen that Western Europe was a more important market to producers of oilseeds and products (53 percent of exports) than it was for producers of grains and preparations (27 percent of exports). Similarly, it can be seen that while nuts and preparations made up only two percent of the value of trade with Western Europe, 65 percent of nut exports went to Western Europe. Similar comparisons can be made for other commodity groups and market areas.

For cooperative exporters, the identification of similarities of interest or activity among exporters of different commodities is another preliminary step in the pursuit of coordinational arrangements directed at achieving economies in the performance of export marketing functions. This may involve markets which are already important to all potential participants in such an arrangement or areas where complementarity of products and market contacts may permit broadening of geographic market focus based upon synergism of marketing activities. Evaluation of past flow patterns of international trade is thus one useful indicator of similar interest or activity which could be conducive to coordinated export marketing efforts.

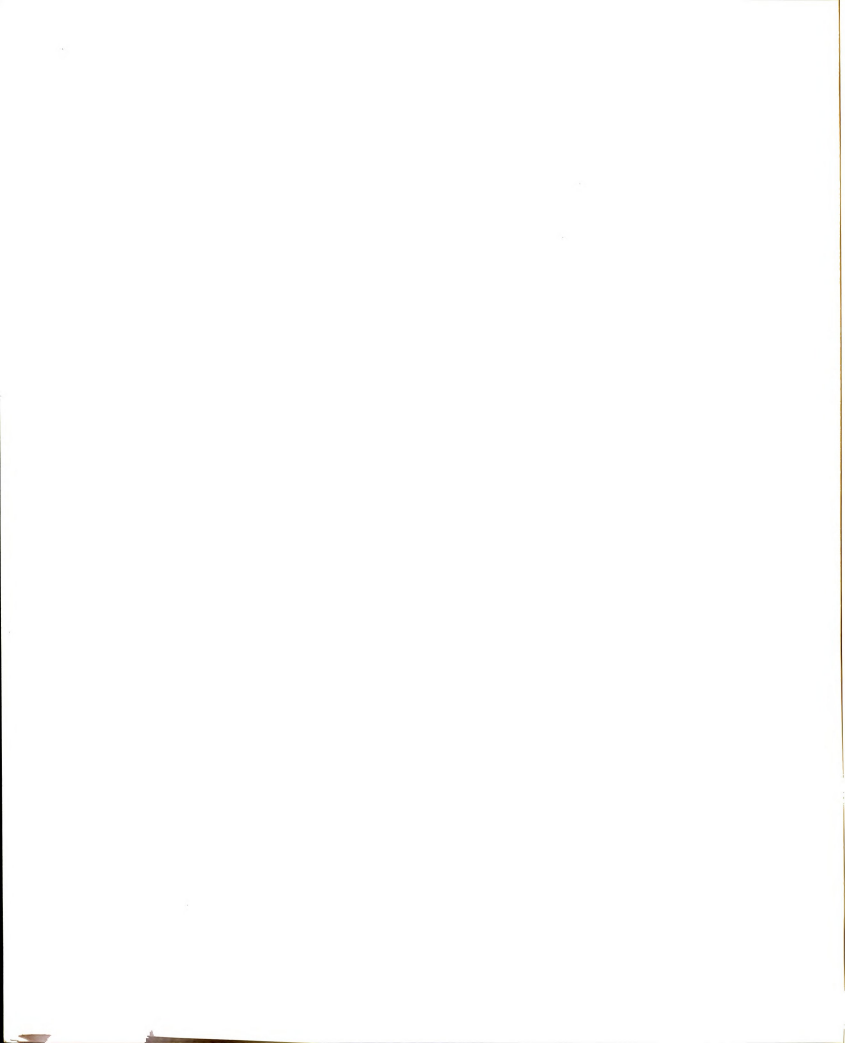
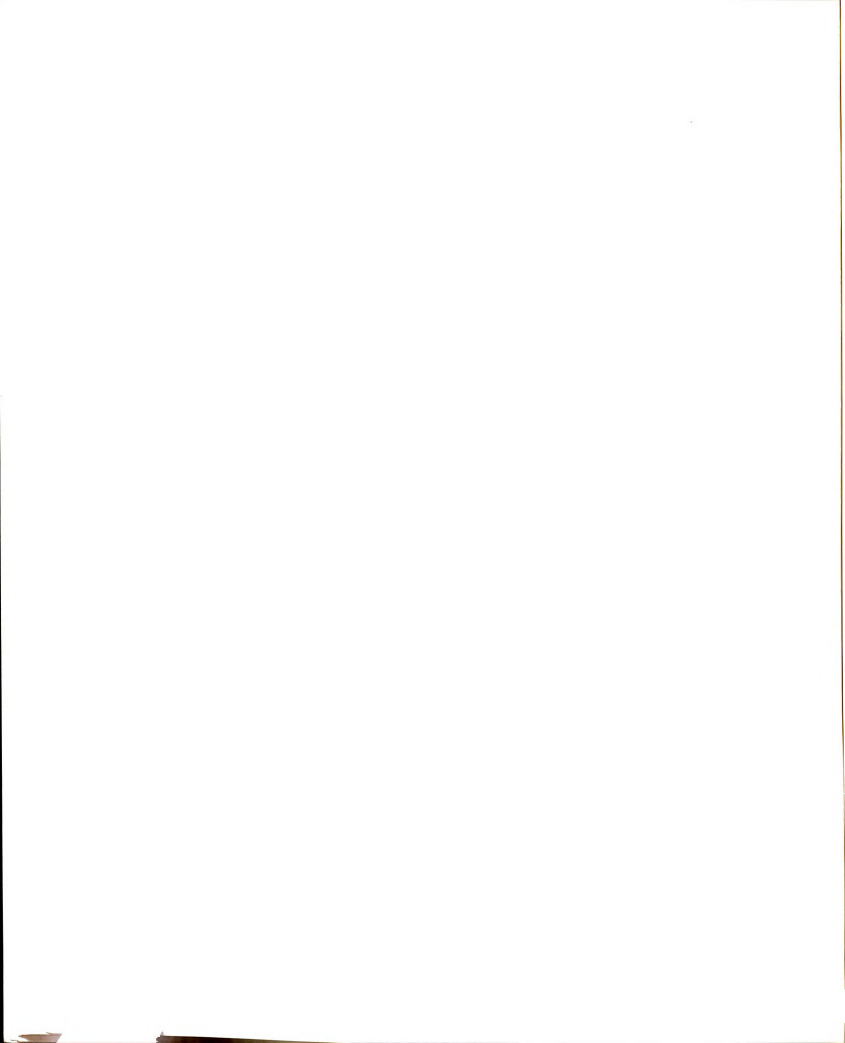


TABLE 2.3. REGIONAL DISTRIBUTION OF U.S. AGRICULTURAL EXPORTS BY COMMODITY GROUP -- 1976

| Commodity Group | North America | Latin America | West Europe | Japan | Asia (excluding Japan) | OPEC | COMECON | Other | World |
|--|---------------|---------------|-------------|-------|------------------------|------|---------|-------|-------|
| Percentage of total value of commodity group exports going to selected world regions | | | | | | | | | |
| Grains and Preparations | 1 | 9 | 27 | 14 | 20 | 8 | 18 | 3 | 100 |
| Oilseeds and Products | 5 | 5 | 53 | 15 | 9 | 3 | 7 | 3 | 100 |
| Cotton, raw-excluding linters | 5 | - | 10 | 25 | 57 | 5 | 1 | - | 100 |
| Fruits and Preparations | 37 | 5 | 26 | 17 | 10 | 3 | 2 | - | 100 |
| Vegetables & Preparations | 31 | 14 | 33 | 7 | 8 | 8 | - | - | 100 |
| Nuts and Preparations | 9 | 4 | 65 | 12 | 4 | 3 | 1 | 2 | 100 |
| Animals and Animal Products | 15 | 14 | 28 | 20 | 13 | 5 | 3 | 2 | 100 |
| Percentage of Total Exports by Region | 6 | 8 | 34 | 15 | 17 | 6 | 10 | 4 | 100 |

Derived from: Ibid.



2.3 International Market Structure

Another important set of variables to consider involve the structure of international trade in specific commodity groups. These include the importance of individual countries as exporters and importers, the U.S. share of world exports, as well as the structure of the trading industry handling specific commodity groups.

The top four exporting and importing countries and their cumulative shares of trade among market economies for selected three-digit SITC agricultural commodity groups are identified in Table 2.4. It also indicates the U.S. share and rank in market economy exports for those commodities. These data permit assessment of some aspects of functional complementarities among commodity groups. One example is the identification of similarities in geographic sources of market information with respect to foreign markets and competitors. In comparing the four most important importers for wheat and rice, the absence of overlap might limit the advantages of coordinated sales representation or collection of market information for exporters of the two commodities relative to other potential combinations. At the same time, similarities among major importers of corn and oilseeds is indicative of some value to exploration of coordination possibilities including those commodities. Comparisons among other commodity combinations will permit the identification of geographically-related similarities and differences in the flow of agricultural commodities in international trade.

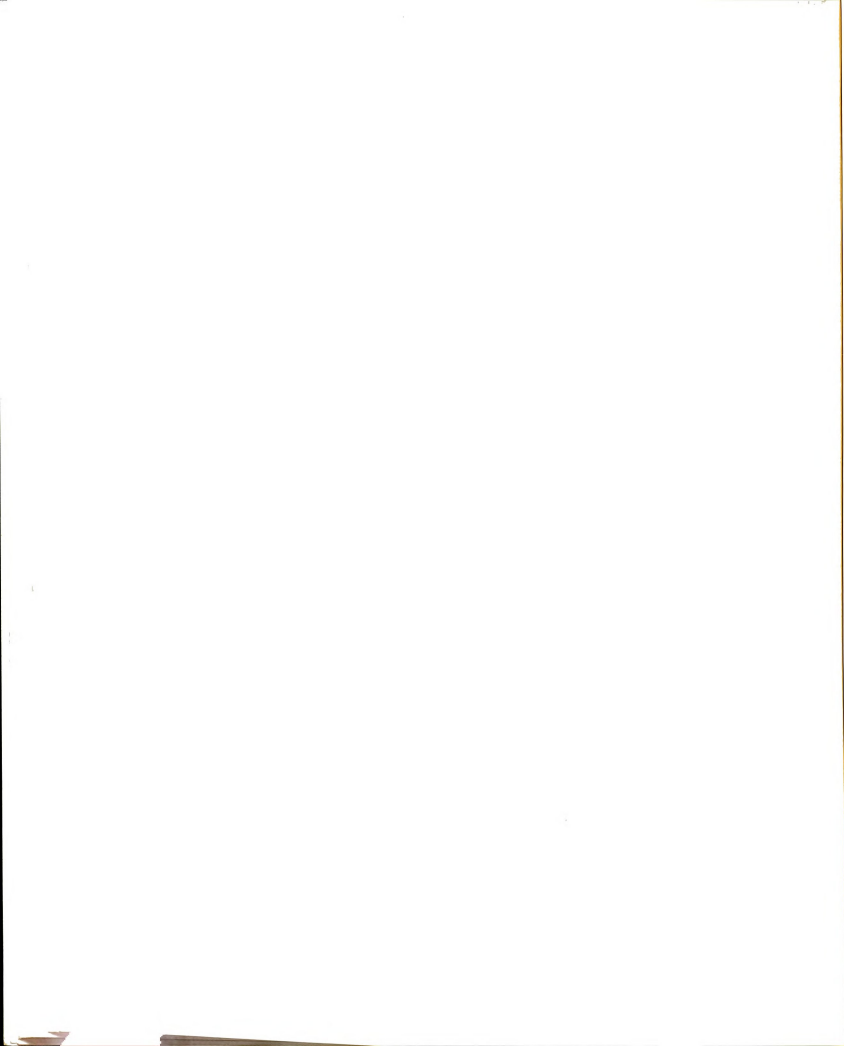
Factors related to the organizational structure of international markets are also quite important in the identification of export requirements and coordination potential among commodities. These include the



TABLE 2.4. MARKET ECONOMY TRADE IN ASSORTED AGRICULTURAL COMMODITIES - 1976

| Three Digit SITC Class | Commodity | U.S. Share Exports- 1976 | U.S. Rank | Top 4 Exporters (cum%) | Top 4 Importers (cum%) |
|------------------------|------------------------------------|--------------------------|-----------|---|--|
| 011 | Meat, fresh, chilled, frozen | 9.84 | 3 | Netherlands } Australia } 46.64 U.S. } New Zealand } | Fr. Germany } Italy } 52.90 France } Japan } |
| 041 | Wheat, unmilled | 43.1 | 1 | U.S. } Canada } 87.61 France } Australia } | India } Japan } 40.45 U.K. } Brazil } |
| 042 | Rice | 30.9 | 1 | U.S. } Pakistan } 70.77 Thailand } Burma } | Indonesia } Saudi Arabia } 34.00 Hong Kong } Bangladesh } |
| 044 | Corn | 70.92 | 1 | U.S. } Netherlands } 85.47 Argentina } France } | Japan } Netherlands } 52.43 Italy } Fr. Germany } |
| 051 | Fresh Fruit, Nuts | 12.56 | 2 | Italy } U.S. } 41.48 Spain } France } | Fr. Germany } France } 49.58 U.K. } U.S. } |
| 052 | Dry Fruit | 22.8 | 1 | U.S. } Greece } 65.89 Turkey } Iran } | U.K. } Fr. Germany } 41.55 Canada } France } |
| 053 | Fruit, Preserved and Prepared | 13.44 | 1 | U.S. } Italy } 36.13 South Africa } Netherlands } | Fr. Germany } U.K. } 51.07 U.S. } France } |
| 081 | Animal Feed Stuff | 23.63 | 1 | U.S. } Brazil } 52.60 Netherlands } Fr. Germany } | Netherlands } Fr. Germany } 47.92 France } Belgium/Luxembourg } |
| 221 | Oilseeds, Nuts, kernels | 62.18 | 1 | U.S. } Brazil } 83.84 Canada } Philippines } | Japan } Fr. Germany } 57.74 Netherlands } Spain } |
| 263 | Cotton | 25.49 | 1 | U.S. } Turkey } 52.41 Egypt } Mexico } | Japan } Fr. Germany } 44.85 Italy } France } |
| 411 | Animal Oils & Fats | 42.91 | 1 | U.S. } Australia } 62.06 Norway } Peru } | U.K. } Fr. Germany } 44.85 Netherlands } Japan } |
| 054 | Vegetables, fresh | 10.03 | 2 | Netherlands } U.S. } 53.18 Thailand } Italy } | Fr. Germany } France } 52.40 U.K. } Netherlands } |
| 055 | Vegetables, Preserved and Prepared | 8.48 | 5 | Spain } Netherlands } 48.40 France } Italy } | Fr. Germany } U.S. } 55.97 U.K. } France } |

Derived From: U.N. Yearbook of International Trade Statistics, (New York: United Nations, 1977, pp. 496-636.



structural characteristics of firms involved in international trade, and structural characteristics of import markets. Where substantial concentration exists, coordination among cooperative exporters may permit them to compete more effectively.

In the grain trade five multinational firms handle 75-86 percent of U.S. exports of wheat, coarse grains, and soybeans.¹ The same five firms also control 90 percent of European Community trade in wheat and corn, 90 percent of Canadian barley exports; 80 percent of Argentina wheat exports, and 90 percent of Australian sorghum exports.²

While data on concentration in world trade of other commodities are not available, there is no evidence to suggest that concentration approaches such levels in trade of fruits, nuts, vegetables and animal products. There is, however, considerable activity by state traders and marketing boards as well as large multinational firms in international markets for such commodities.

State trading is extremely important in food grain imports. It accounts for 90 percent of the wheat imports by the top eight wheat importing nations. State trading is far less important among importers of soybeans³ (see Table 2.5). In evaluating potential coordination in exporting, it is useful to recognize that even where a state trading company has responsibility for a wide range of products, there is often

¹Cargill, Continental, Louis Dreyfus, Bunge and Garnac; Thurston, et al., 1976, pp. 16-18.

²Dan Morgan, Merchants of Grain (New York: Viking, 1979), p. 234.

³Michael L. Cook, Ronald L. Knutson and Thomas L. Sporleder, "Multinational Cooperatives: Their Potential Role in the International Grain Marketing System" (Technical Article 3, College Station: Department of Agricultural Economics, Texas A&M University, 1979), p. 3.

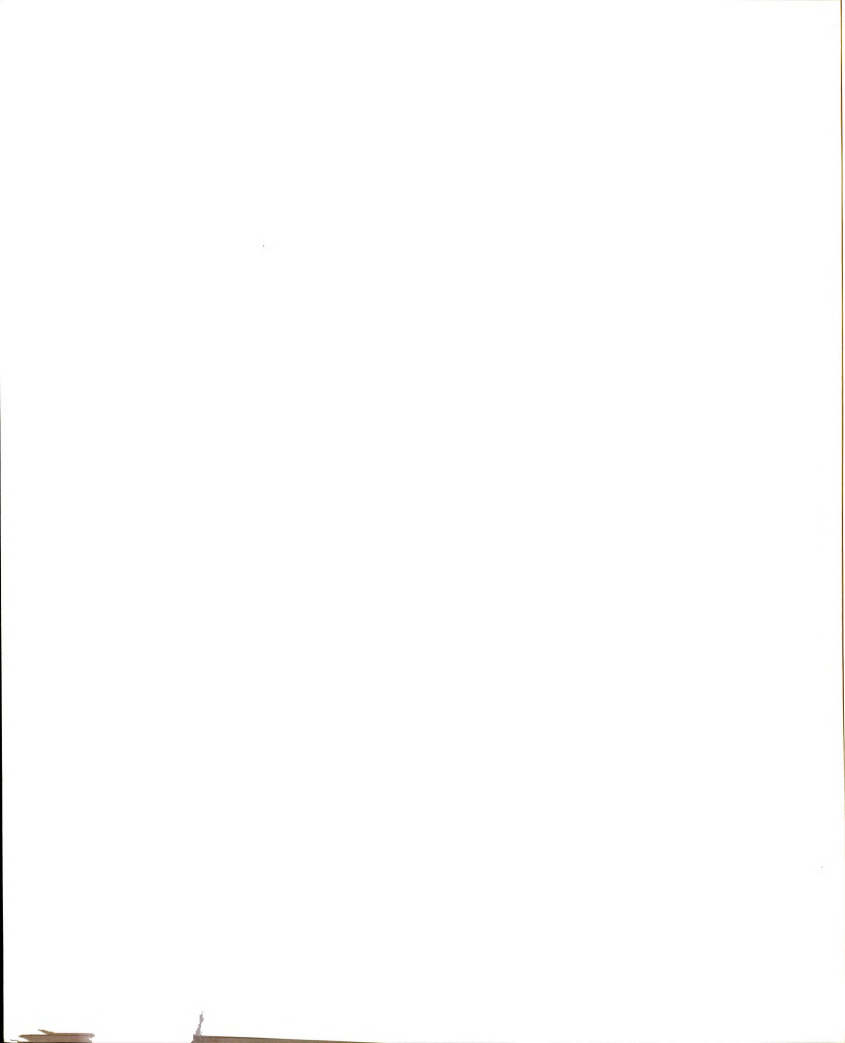


TABLE 2.5. COMPARISON OF GRAIN IMPORTING AND EXPORTING COUNTRY CONCENTRATION RATIOS BY COMMODITY AND BY PROPRIETARY, COOPERATIVE AND STATE TRADING MARKET SHARES FOR THE LARGEST EIGHT EXPORTING AND IMPORTING COUNTRIES, 1977-78

| | Soybeans and meal | Coarse Grain | Wheat |
|----------------------------------|----------------------|-----------------|-------|
| | Percent | | |
| <u>Exporting Countries</u> | | | |
| 4 country share | 100 | 88 | 85 |
| 8 country share | 100 | 96 | 91 |
| <hr/> | | | |
| State trading share ¹ | 0 | 9 | 31 |
| Proprietary trade share | 92 | 80 | 61 |
| Cooperative share | 8 | 11 | 8 |
| <hr/> | | | |
| <u>Importing Countries</u> | | | |
| 4 country share | 46 | 47 | 36 |
| 8 country share | 72 | 72 | 51 |
| <hr/> | | | |
| State trading share | 7 | 10 | 90 |
| Proprietary trade share | 71 | 73 | 10 |
| Cooperative share | 22 | 17 | 0 |

¹ State trading, proprietary or cooperative share is the estimated percent of the total volume of direct grain exports or imports by state traders, proprietary firms, or cooperatives for the eight largest exporting or importing countries.

Source: Cook, Knutson and Sporleder, 1979, p. 3.

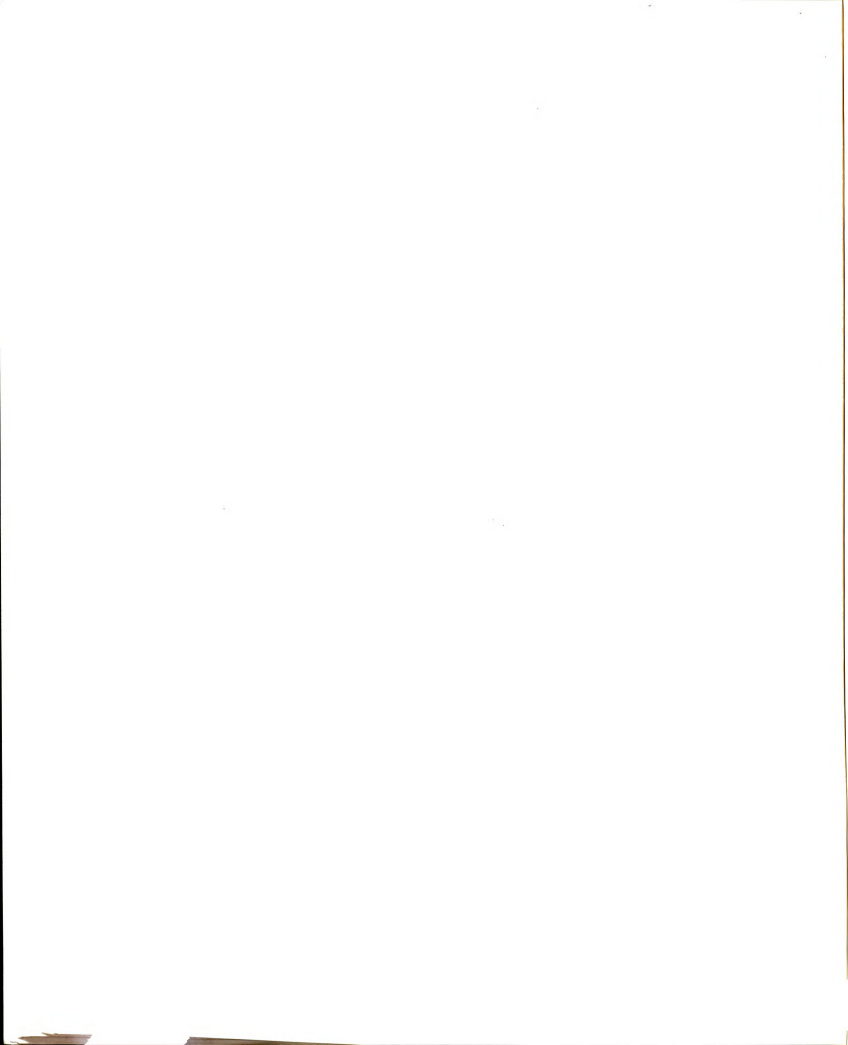
separation among sub-agencies handling food grains, feed grains and oilseeds; fibers, such as cotton; and consumer goods, such as fruits, nuts, vegetables and animal products. This may limit the potential range of commodities over which economies of joint representation may be achieved.

The organizational structure of international markets for individual commodity groups can be expected to influence the requirements for cooperatives or other market participants to become successful competitive exporters. Structural elements will also influence the potential gains which may be achieved through coordination of export marketing activities. This will be discussed in more detail in Chapters V and VI.

2.4 Policy Issues Affecting the Competitive Position of U.S. Agricultural Exports

The competitive position of U.S. commodities in foreign markets is an important consideration in developing an export marketing strategy. Economic theory suggests that comparative advantage and national factor endowments will be the governing basis for the commodity composition of trade among nations under free trade and a number of other assumptions. The purposes of the current research do not necessitate a complete exposition of the international economic theory here.¹ It is more important to point out that a variety of national self-sufficiency

¹For more detailed discussions of comparative advantage and the Heckscher-Ohlin factor endowment theory see: Richard E. Caves and Harry G. Johnson, eds., Readings in International Economics (Homewood, Illinois: Richard D. Irwin, Inc. for the American Economic Association, 1968); Herbert G. Grubel, International Economics (Homewood, Illinois: Richard D. Irwin, Inc., 1977); Mordechai E. Kreinin, International Economics: A Policy Approach, third edition (New York: Harcourt Brace Jovanovich, Inc., 1978); Vernon L. Sorenson, International Trade Policy: Agriculture and Development (East Lansing: Michigan State University Graduate School of Business Administration, 1975).



policies, tariffs, and nontariff regulatory actions by governments throughout the world also shape the flow of international commerce in a world of less than free trade.

While these factors will not be discussed here in detail, it is useful to recognize that the competitive position of U.S. agricultural commodities in foreign markets is affected directly and indirectly by tariffs, quotas, subsidies, and other measures taken abroad or in the U.S. A foreign tariff or quota may make American agricultural products less competitive in the market to which it applies. Likewise, the memory of a U.S. trade embargo may make other nations hesitant to rely upon the U.S. as a source of supply.

Agreements reached through the recent Tokyo round of multilateral trade negotiations conducted under the General Agreement on Tariffs and Trade (GATT) will have a variable impact on the international competitive position of different U.S. agricultural commodities. One source estimates that the direct result of concessions obtained will be a \$400 million annual increase in agricultural exports by 1987.¹ The largest gains are expected for beef, tobacco, soybeans and products and citrus (see Table 2.6).

As a result of some major success in tariff reductions under the GATT, the importance of nontariff barriers is gaining increased recognition.² Quotas and import licensing arrangements are commonly recognized

¹U.S., Congress, Senate, Committee on Finance, Subcommittee on International Trade MTN Studies, Vol. 1: Results for U.S. Agriculture, 96th Congress, First Session (Washington, D.C.: Government Printing Office, 1979).

²For discussion see: Jimmie Hillman, Nontariff Agricultural Trade Barriers (Lincoln: University of Nebraska Press, 1978).

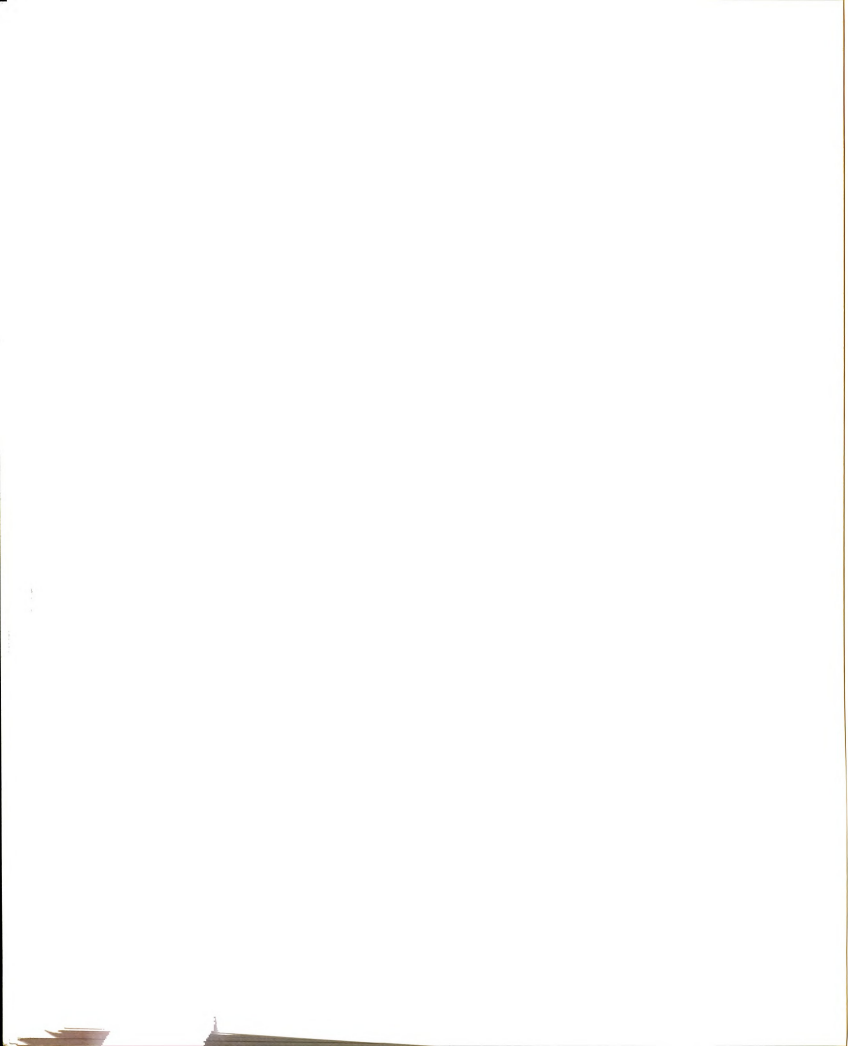


TABLE 2.6. AGRICULTURAL TRADE GAINS IN THE MTN, BY COMMODITY

| U.S. Exports for Which Concessions were Sought | Export Value, 1976 | | Annual Increase in Trade By 1987 Due to Concessions | |
|--|--------------------|--------------------------------|--|---------|
| | Total | On Which Concessions Sought | Value | Percent |
| Million Dollars | | | | |
| Almonds | 109.1 | 85.8 | 4.8 | 1.2 |
| Beef | 211.5 | 137.1 | 190.3 | 46.7 |
| Canned Peaches and Fruit Cocktail | 47.6 | 17.8 | 2.5 | 0.6 |
| Citrus | 357.0 | 195.8 | 43.2 | 10.6 |
| Poultry | 181.0 | 84.0 | 28.3 | 6.9 |
| Rice | 628.7 | 78.5 | 3.2 | 0.7 |
| Soybeans and Products | 4,419.0 | 872.4 | 55.8 | 13.7 |
| Tobacco | 940.4 | 454.8 | 78.6 | 19.3 |
| Vegetables Protein Concentrates and Isolates ¹ | 39.3 | 17.1 | 1.4 | 0.3 |
| Wine | 5.7 | 3.8 | - | - |
| Total | 6,939.3 | 1,947.1 | 408.1 | 100.0 |
| Total U.S. Agricultural Exports | 22,996 | | | |

Source: U.S., Congress, Senate, MTN Studies, 1979, p. 18.

¹1978 export value

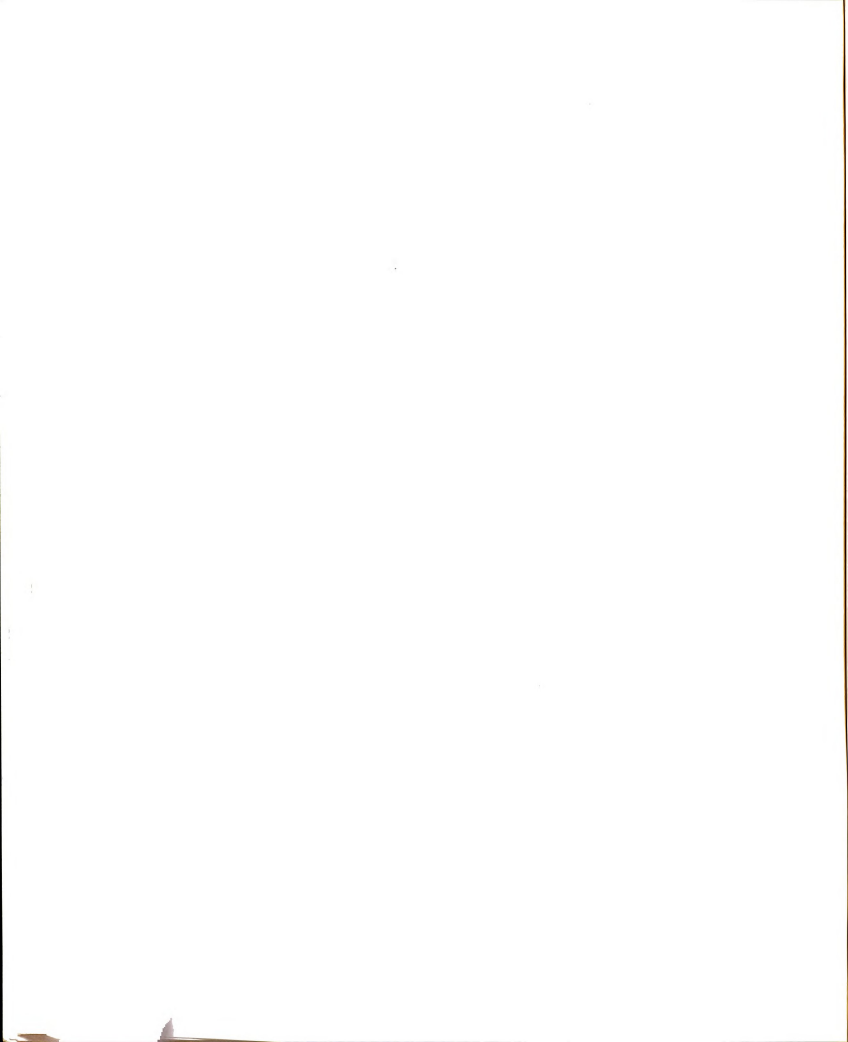


to be nontariff barriers. There are also subtler forms of nontariff barriers such as discriminatory tax policies, and health, labeling, inspection or quarantine standards. Regardless of the validity of the reasons for their existence, nontariff barriers influence the competitive position of U.S. agricultural exports. They also may be amenable to some modification through collective action by cooperative exporters.

In addition to policies specifically directed at international trade, domestic agricultural policies affect exports and vice versa. The effects and costs of price and income policies and their implementation through target prices, loan rates, set-asides and market orders are all intimately linked with export marketing. Without demand from foreign markets, maintenance of current price and income levels in the U.S. agricultural sector would be difficult. The implementation of a deficiency payment system has helped to make U.S. exports more competitive. Additionally, market orders have been used to encourage export market development in some cases. These are only a few of the factors which indicate the increasing interdependence between U.S. agriculture and the world economy.

Another export related policy area concerns the role of public and private participants in export marketing of agricultural products. The importance of five family-held multinational corporations in the world grain trade has received increasing attention since "the great grain robbery" of 1972.¹ This in turn has led to public consideration of a

¹Morgan, 1979; James Trager, The Great Grain Robbery (New York: Ballentine Books, 1975); "The Incredible Empire of Michel Fribourg," Business Week, March 11, 1972.



range of alternatives to such control. One option emphasizes an increasingly important role for cooperatives as effective competitors in the world grain trade.¹ Another alternative being considered by Congress would create a National Grain Board which would be the seller or marketing agent for all U.S. export sales of wheat, coarse grains and soybeans.² This study does not attempt to evaluate the relative merits of public and private participation in export marketing.³ Instead, the central thrust is toward identifying factors conducive to improving the competitive position of U.S. farmer cooperatives in export marketing through collective action. The policy variables mentioned here form part of the environment within which this issue must be evaluated. Furthermore, they are indicative of factors which will influence the competitive position of individual U.S. produced commodities in the years ahead.

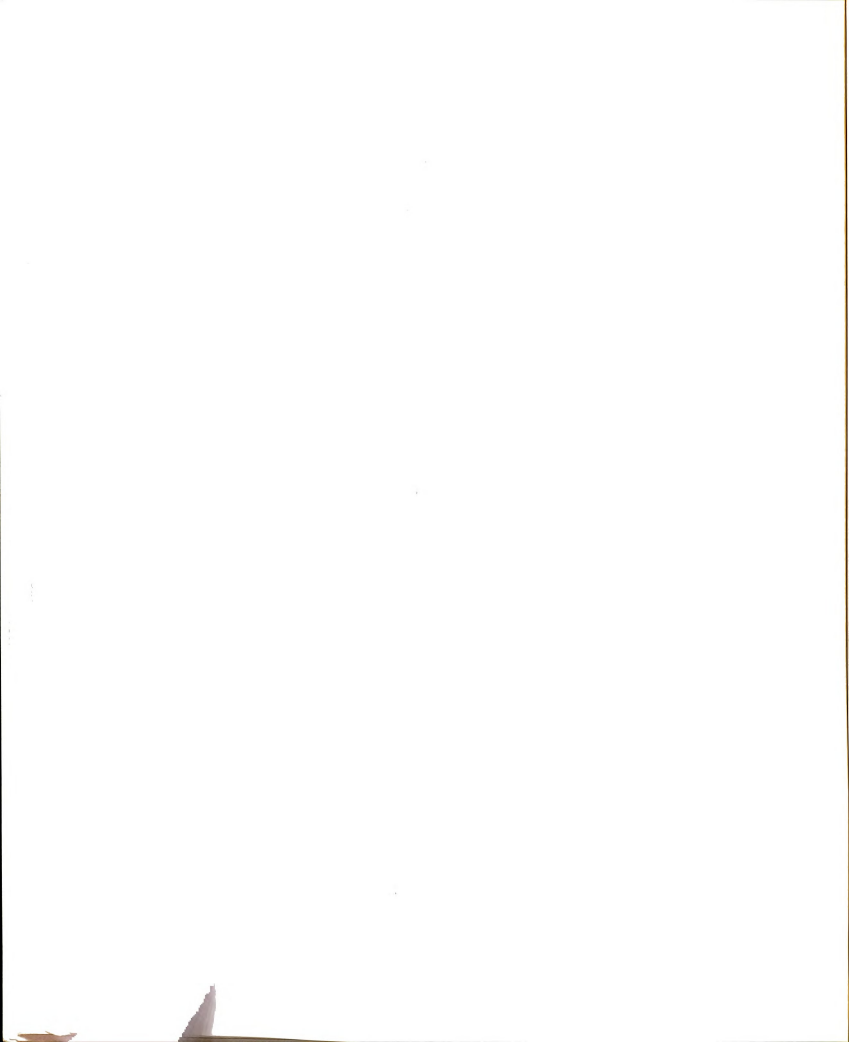
2.5 Projections of Future U.S. Agricultural Exports

This research has not made new projections of demand for U.S. agricultural commodities abroad. However, it may be useful to briefly consider some results of projections made by others.

¹Thurston, et al., 1976.

²HR. 3042, U.S., Congress, House, 96th Cong. First Sess., 1979.

³For discussion of some of the issues involved, see A.F. McCalla, "Strategies in International Agricultural Marketing: Public vs. Private Sector" (Giannini Foundation Paper No. 466; Davis: University of California, revised July 1977).

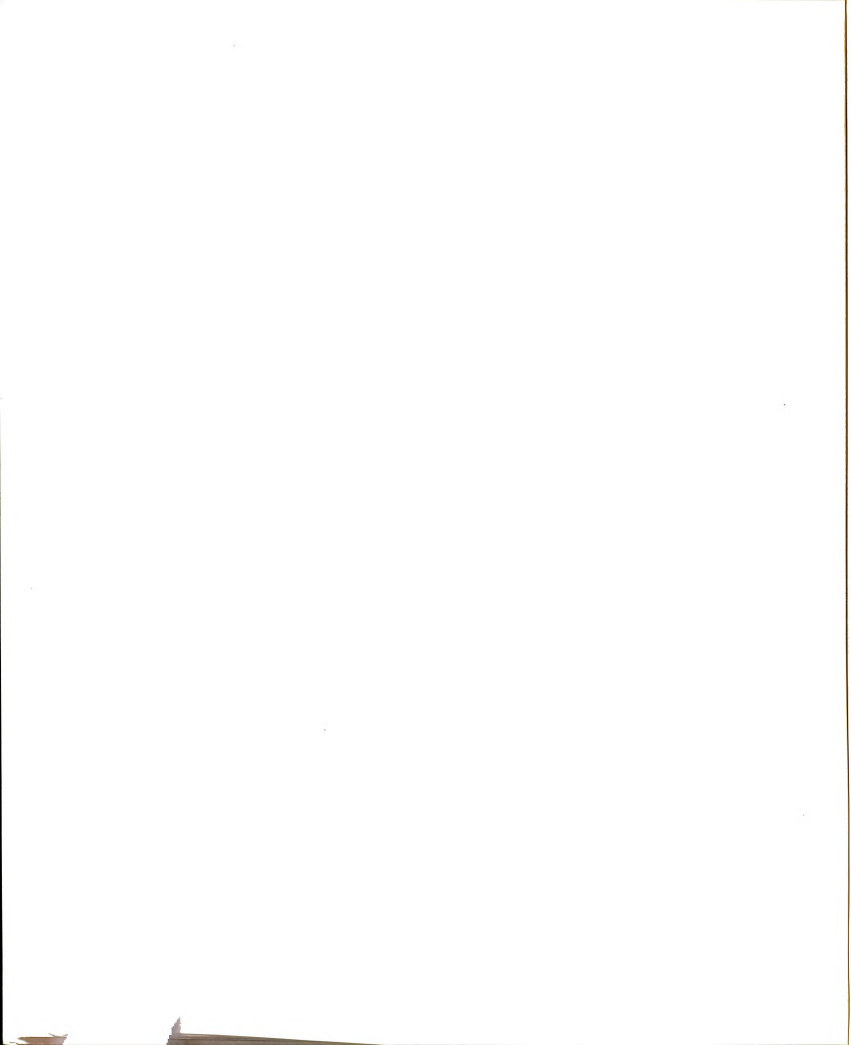


The USDA has made projections of U.S. trade in 1985 using a mathematical grain-oilseeds-livestock (GOL) model.¹ The model is designed to test the impact of different economic and policy assumptions on quantities and values traded. The results range from projections of exports of 77 million tons of wheat, coarse grains and rice under assumptions that current policies continue to projections of grain exports of 116 million tons under assumptions of policies conducive to high import demand. The latter alternative would result in growth of corn exports to Western Europe of 62 million tons under liberalized trade policies and growth of wheat exports to 50 million tons, primarily as a result of growth in exports to low income developing nations. The primary shortcoming of the model and projections for purposes of this research is its limited commodity focus.

Another modeling effort which has attempted to project trade flows was conducted by the U.S. Department of Commerce Maritime Administration (MarAd).² While suffering from limitations of commodity aggregation as well as those which normally accompany simplistic projections, the study

¹Anthony Rojko, Donald Regier, Patrick O'Brien, Arthur Coffing and Linda Bailey, Alternative Futures for World Food in 1985 (Washington, D.C.: USDA, 1978).

²U.S., Department of Commerce, Maritime Administration, Office of Policy and Plans, Division of Economic and Operational Analysis (MarAd) A Long-Term Forecast of U.S. Waterborne Foreign Trade, 1976-2000, 3 volumes (Washington, D.C.: Government Printing Office, November 1977). The MarAd predictions are based upon forecasts of 43 independent variables to 1990 using the Data Resources Incorporated long-term model, "TRENDLONG" and 82 micro models of foreign trade commodity groups. The 82 commodity forecasts were disaggregated to 354 projections of three-digit schedule B, commodity projections based upon the historical composition of each major commodity group. These three-digit forecasts were then allocated to 19 world regions on the basis of historical trade shares, and then to 65 maritime trade routes. The results were checked against forecasts by USDA, and others. For discussion of assumptions and the more detailed model results, the reader is referred to the original source.



attempts to predict rates of growth of waterborne export tonnage for a number of commodities. The results for agricultural products are presented in Table 2.7. The MarAd study projects increased export tonnages between 1975 and 2000 for all agricultural commodities on a highly aggregated basis. It forecasts a growth rate of export tonnages of animal feeds and animal and vegetable oils and fats which exceeds the growth rates of those commodities during 1967 to 1975. For other agricultural commodities, the study predicts a slower rate of growth in tonnage. This, of course, does not necessarily imply a slower rate of growth in the value of exports of other agricultural commodities.

It is important to note that any long-term projection of trade flows must be based upon highly simplified models of export growth. For the individual exporter of a specific commodity, the value of such projections is extremely limited. Factors discussed earlier in this chapter will have a major impact on the future competitive position of U.S. agricultural commodities in foreign markets. Additionally, functional and organization factors which form the central focus of this research will influence the position of U.S. cooperative exporters in foreign markets.

2.6 Summary

Agricultural exports contribute significantly to the economic well-being of U.S. agriculture. The European Community, Japan and Canada received almost one-half of all U.S. agricultural exports during 1974-1978. Evaluation of aggregate trade flow data will provide some insights into the level of experience of all U.S. exporters. However, in order to begin to identify opportunities for potentially advantageous

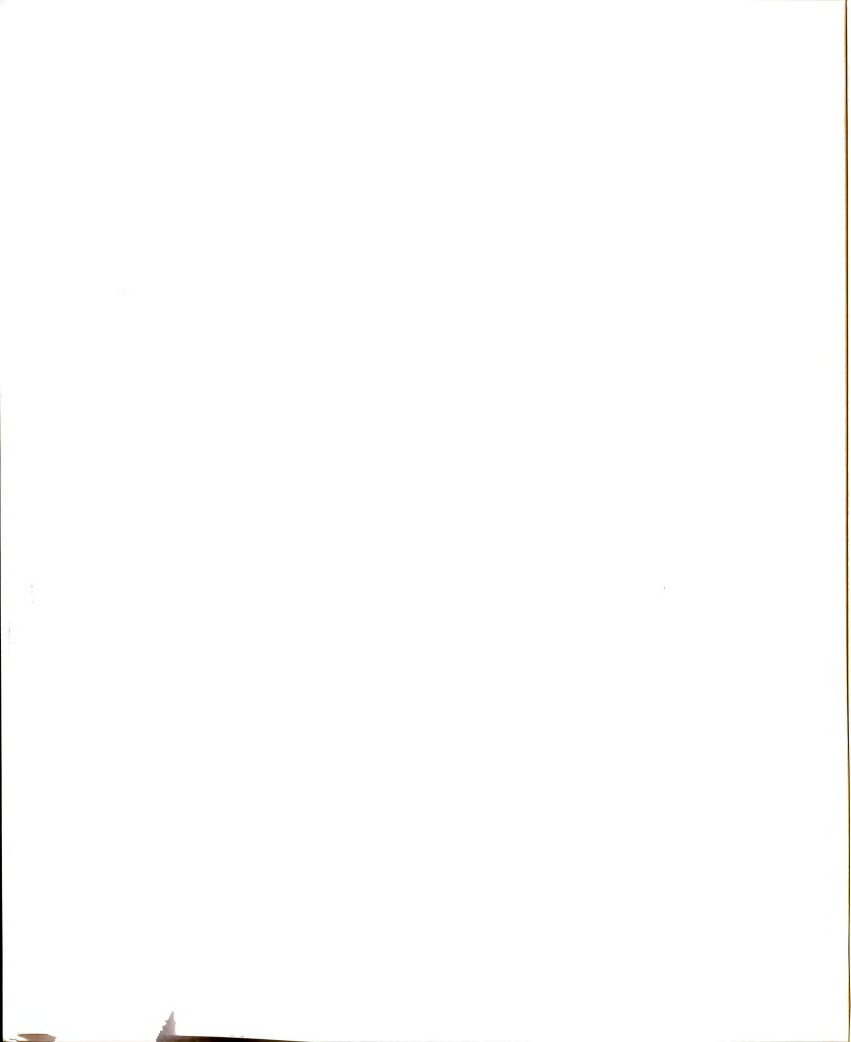
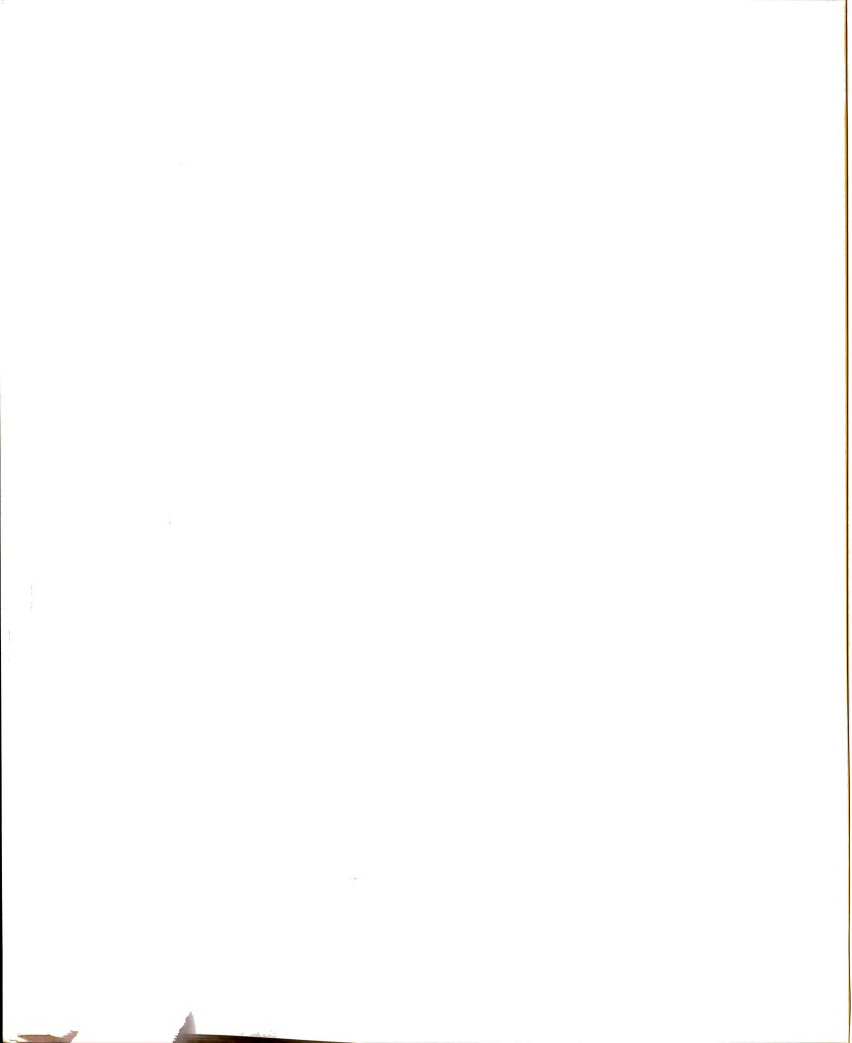


TABLE 2.7. U.S. WATERBORNE TRADE FORECAST EXPORT GROUPS 1975-2000

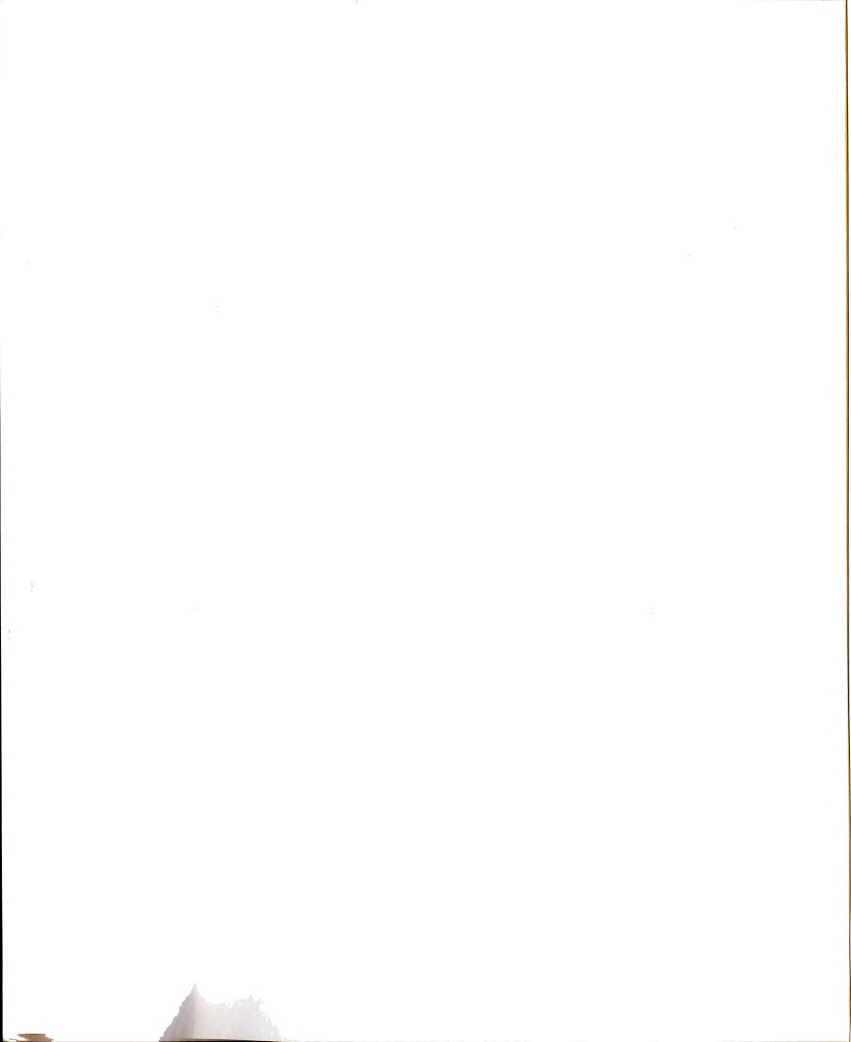
| Export Group | Actual | | Forecast | | | Annual % Growth | |
|--|-----------------|--------|-------------------------------|--------|--------|------------------|------------------|
| | Percent in 1975 | 1975 | 1980 | 1990 | 2000 | | |
| | <u>%</u> | | <u>Thousands of Long Tons</u> | | | <u>1967-1975</u> | <u>1975-2000</u> |
| Grains | 29.9 | 71747 | 82448 | 109684 | 145916 | 6.7 | 2.9 |
| Animal Feeds | 2.4 | 5678 | 8923 | 16198 | 29401 | 6.3 | 6.8 |
| All Other Foods | 1.0 | 2512 | 2792 | 3534 | 4474 | 2.4 | 2.3 |
| Beverages | 0.0 | 89 | 153 | 276 | 500 | 15.9 | 7.1 |
| Tobacco | 0.2 | 369 | 423 | 539 | 687 | 1.0 | 2.5 |
| Oilseeds and Nuts | 5.3 | 12799 | 15068 | 21742 | 31372 | 6.3 | 3.7 |
| Natural Fibers | 0.5 | 1127 | 1498 | 1575 | 1656 | 0.3 | 1.6 |
| Animal and Vegetable Oils and Fats | 0.7 | 1685 | 2134 | 2999 | 4215 | 0.5 | 3.7 |
| Total Agricultural Exports | 40.0 | | | | | | |
| Total Agricultural and Nonagricultural Commodities | 100.0 | 240332 | 285581 | 409851 | 603093 | 4.1 | 3.7 |

Source: MarAd, vol. I, p. II-6.



coordination of export marketing activities by individual exporters, analysis of more disaggregated trade flow data and structural characteristics of international markets is required.

Complementarity in regional export interest or experience among exporters of different commodities may contribute to the development of collaborative exporting arrangements. Additionally, control of large market shares by few sellers or buyers will influence the potential competitive advantages to, or necessities for, coordination among relatively small exporters.



CHAPTER III
COOPERATIVES IN U.S. AGRICULTURE
AND INTERNATIONAL TRADE

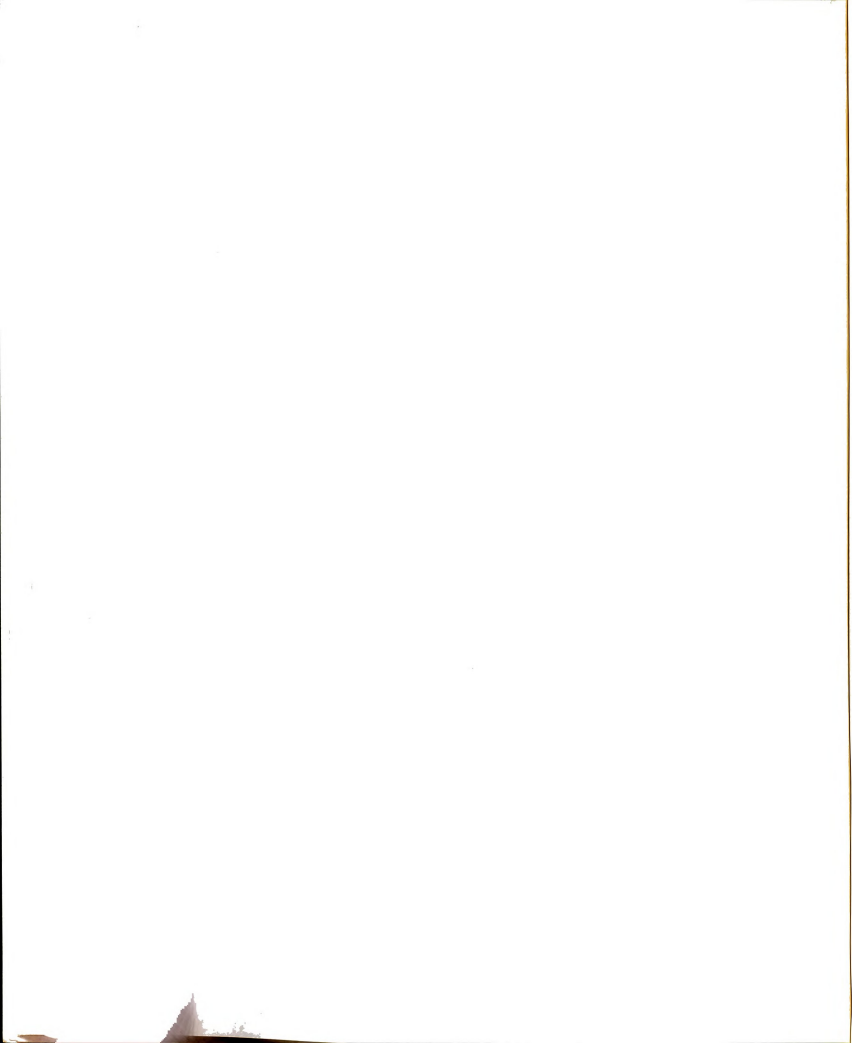
3.1 U.S. Farmer Cooperatives: Historical
and Legal Foundations

This research analyzes the advantages and disadvantages of coordination of export marketing activities by farmer cooperatives. Historically, cooperatives have played a unique role in U.S. agriculture, and they continue to do so. A review of both the reasons for development of cooperatives and the legal basis for marketing coordination through farmer cooperatives can contribute to an understanding of coordination issues considered in this research. Evaluation of the economics of coordinated export marketing activity among cooperatives must reflect the legal environment within which they function.

Cooperatives are a critical component of the structure of U.S. agriculture. For farmers, cooperatives provide an alternative for product marketing and a source of supplies and services. Simply stated, cooperative organization is based upon principles of ownership and control by member-users, operations provided at cost, and a limited return on member capital.¹

In the process of evaluating the potential for cooperatives to coordinate their export marketing activities, it is useful to briefly

¹More detailed discussions are presented in: M.A. Abrahamsen, Cooperative Business Enterprise (New York: McGraw-Hill, 1976); and E.P. Roy, Cooperatives: Development, Principles and Management (Danville, Illinois: Interstate Printers, 1976).

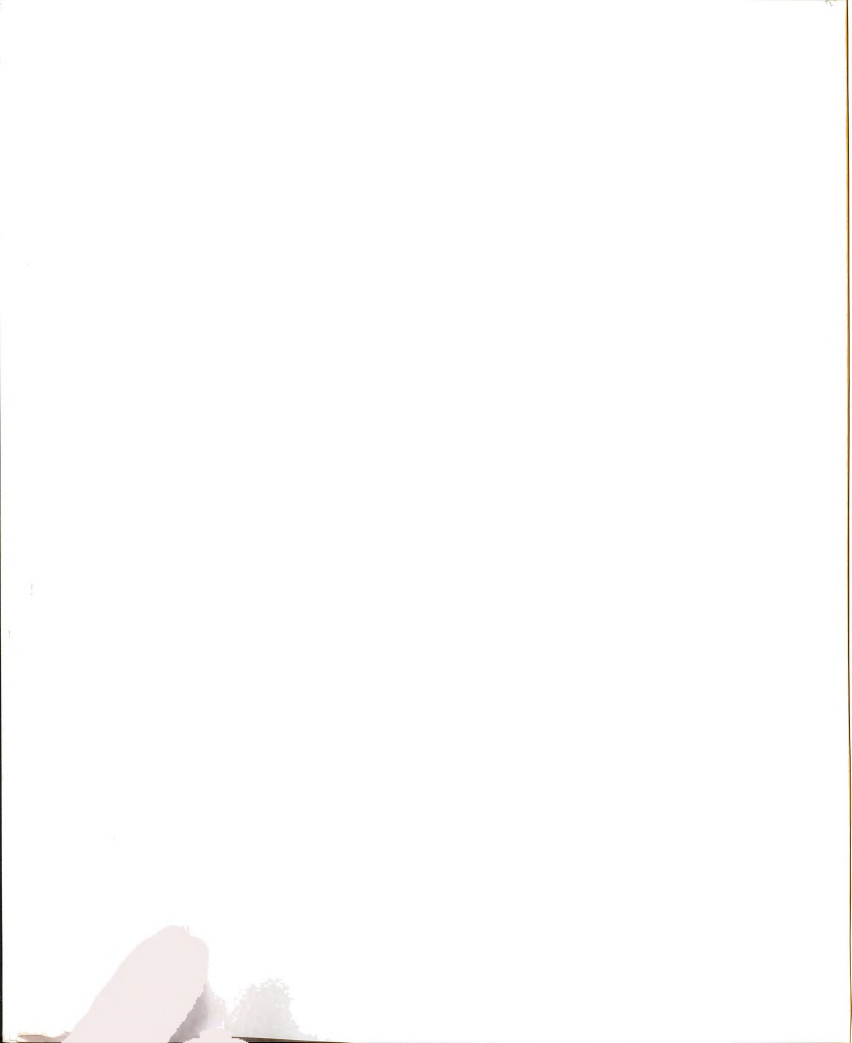


survey the process by which cooperatives developed in the U.S., the legal foundations for their current coordination role in the agricultural economy and current issues related to that role.

Cooperative organization permits producers to develop countervailing power without the legal requirement that they merge their respective enterprises. The need for cooperatives grew out of the competitive nature of agricultural production and the problems confronting individual producers in dealing with powerful interests in both input and output markets.

Faced with restricted access to market information, the inability to adjust output in the short-run, the necessity of a long-term resource commitment prior to production, the perishability of many commodities, and substantial uncertainty with respect to both prices and the ability to cover production costs, individual agricultural producers were at a disadvantage in dealing with local oligopolists or oligopsonists. Consequently, buyers, handlers and sellers were able to exert considerable pressure on individual producers. In response to their plight, 19th century agricultural producers began banding together into cooperative associations as a means to countervail such pressure. At the same time, public sentiment against economic concentration and powerful interests gave rise to antitrust legislation and to the eventual enactment of the Sherman Act of 1890.

Cooperatives did not fare well under the new antitrust legislation. Soon after the passage of the Sherman Act, it became evident that the mere formation of a cooperative represented restraint of trade under Section 1 of the Act. The Sherman Act made no distinction between combinations of farmers or laborers facing monopsonistic buyers and combinations of businesses.



State laws exempting cooperatives from antitrust regulations were enacted, but in 1902 the Supreme Court declared one such state law unconstitutional, stating that,

If combinations of capital . . . are hurtful to the public interests and should be suppressed, it is impossible to perceive why like combinations in respect of agricultural products and livestock are not also hurtful.¹

The Court's refusal to recognize a distinction between combinations of farmers and others continued for some time.²

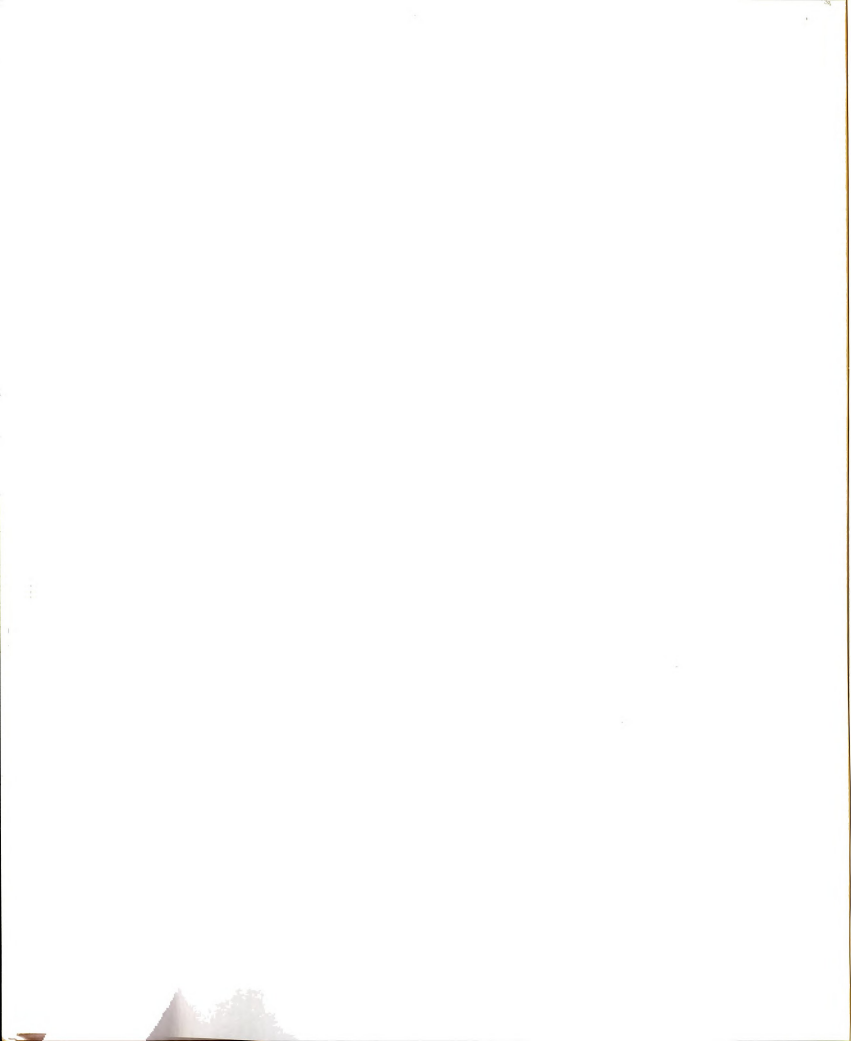
Congress attempted to remedy various weaknesses and abuses of the Sherman Act with the Clayton Act of 1914. By that time, cooperative numbers had grown and, according to E.G. Nourse, there was much interest in obtaining language which would protect farmers' associations ". . . from a statute designed primarily to curb the monopolistic tendencies of the industrial trust."³ The result was Section 6 of the Clayton Act, which provided an exemption from the antitrust laws for non-stock cooperative associations.

The status of cooperatives organized with capital stock was clarified with the passage of the Capper-Volstead Act of 1922. This act

¹Union Sewer Pipe Company versus Connolly, 184 U.S. 540, 563-544 (1902) cited in Willard F. Mueller, "The Economics and Law of Full-Supply Contracts as used by Agricultural Cooperatives" in Proceedings of the National Symposium on Cooperatives and the Law (Madison: University of Wisconsin, 1974), p. 121.

²Reeves versus Decorah Farmers' Cooperative Society, 160 Iowa 1940, 140, N.W. 844 (1913).

³E.G. Nourse, The Legal Status of Agricultural Co-operation (New York: The MacMillan Company, 1928), p. 246.



also spelled out various functions that cooperatives could undertake without running afoul of the antitrust statutes. Section 1 of the act provided that persons engaged

. . . in the production of agricultural products . . . may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. Such associations may have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes.¹

Section 2 of the act made provisions for regulation of cooperatives. It

. . . authorized the Secretary of Agriculture, if and when he found that farm cooperatives had unduly enhanced prices, to order them to cease and desist from enforcing such prices and if they neglected to obey such order an action at law should be instituted by the Attorney General requesting the court to enforce such order.²

While the statute prohibits undue price enhancement, it does not prohibit lessening of competition per se. In discussing Senate Judiciary Committee amendments to the bill, Congressman Volstead stated:

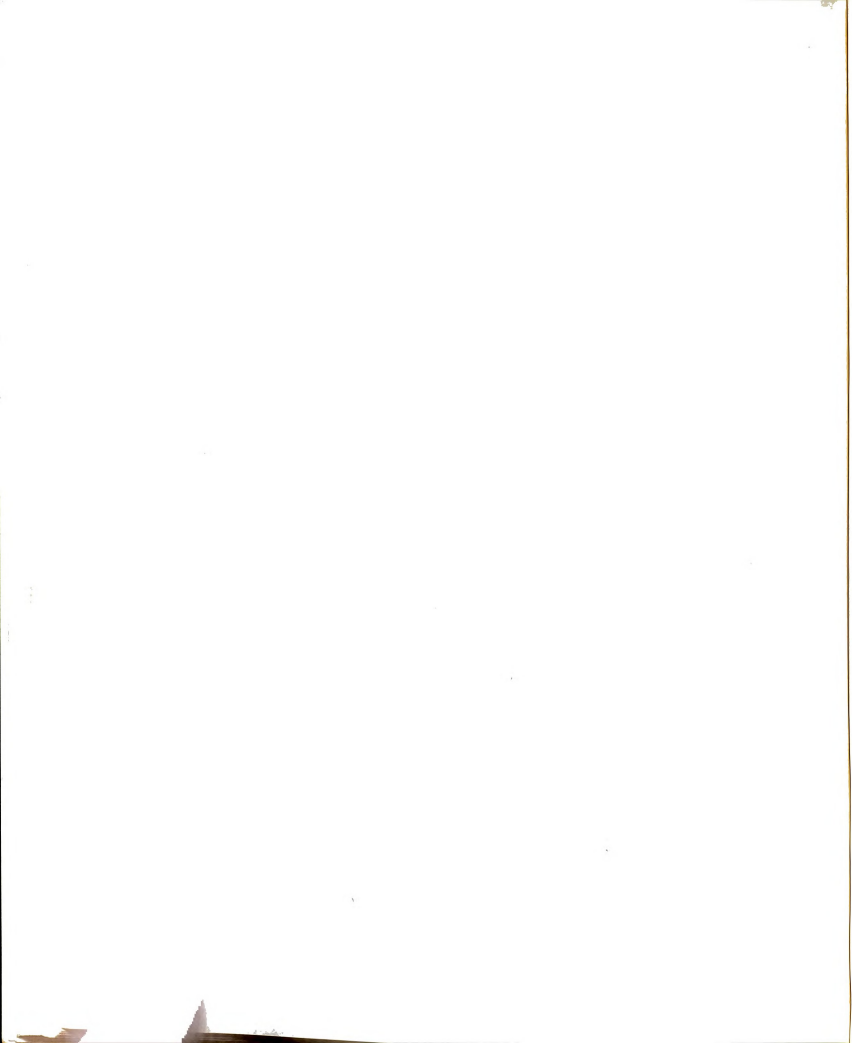
The natural and inevitable effect of cooperative farm associations is and always must be to lessen competition among farmers in the sale of their products, and to do that they must control the sale of a certain amount of such products.³

In addition to the Clayton and Capper-Volstead Acts, The Cooperative Marketing Act of 1926 provides that producers acting in associations may

¹ 7 U.S.C. Sec. 291-292.

² Ibid.

³ Cited by Joseph G. Knapp, Capper-Volstead Impact on Cooperative Structure (FCS Information 97; Washington, D.C.: USDA, 1975), p. 9.



. . . acquire, exchange, interpret, and disseminate past, present and prospective crop, market, statistical, economic and other similar information by direct exchange between such persons and/or such associations or federations thereof, and/or by and through a common marketing agent selected by them.¹

This act is important in modifying the applicability of antitrust laws with respect to exchange of market related information among cooperatives, regardless of whether it refers to domestic or foreign markets.

The structural extent of coordination among producers through cooperatives has been found to be less important than their conduct. The courts have long held that agricultural cooperatives may lawfully possess even 100 percent of a market so long as such power was acquired as a result of activities authorized under the Capper-Volstead Act.²

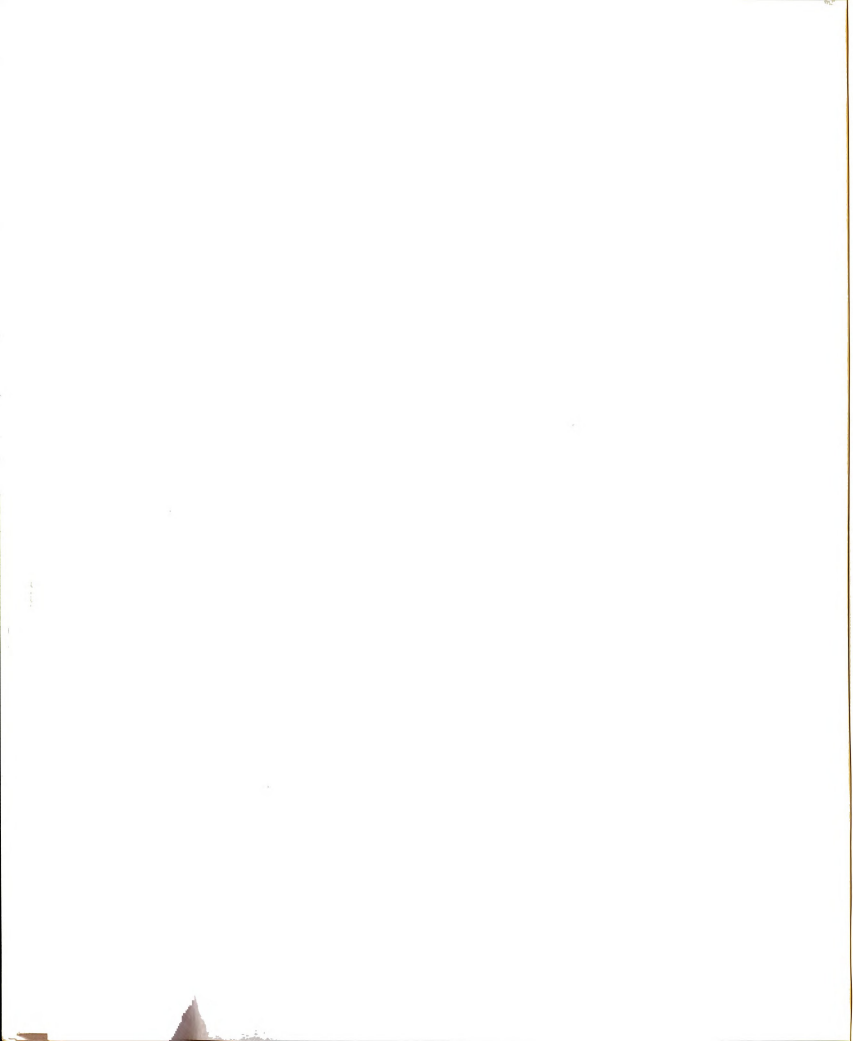
Even the recent report of the National Commission for the Review of Antitrust Laws and Procedures acknowledges that due to the special nature of cooperatives ". . . per se standards of illegality under the Sherman Act should not apply to ordinary intercooperative agreements."³ Thus, conduct is the central issue in judging permissible coordination.

The courts have provided some guidelines with respect to prohibited conduct in domestic marketing. These can be summarized as follows:

¹ 7 U.S.C. Sec. 451-457.

² Treasure Valley Potato Bargaining Association versus Ore-Ida Foods, Inc., 497 F.2d. 203, 216 n.11 (9th Cir., 1974) cert. denied, 419 U.S. 999 (1974); Cape Cod Food Products, Inc. versus National Cranberry Association, 119 F. Supp. 900, 906 (D. Mass., 1954).

³ Report to the President and the Attorney General of the National Commission for the Review of Antitrust Laws and Procedures (Washington, D.C.: Government Printing Office, 1979), p. 262.



1. Anti-competitive transactions and agreements between cooperatives and non-cooperatives are not permitted.¹
2. Coercive and predatory practices are not exempt from antitrust action.²
3. Boycotts and refusals to deal with those dealing with non-member producers are prohibited,³ as are unilateral refusals to sell.⁴
4. Interference with supply contracts between processors and non-affiliated producers are not permitted either.⁵

These general guidelines provide some important insights into the legal flexibility with which cooperatives may coordinate their marketing activities. Although they are directed at domestic marketing activity, they may be considered as generally applicable with respect to export marketing also. Other statutory provisions, such as the Webb-Pomerene Act, which permits coordination among cooperative and corporate exporters, may provide exporters with even greater legal flexibility. This is discussed in Chapter VI.

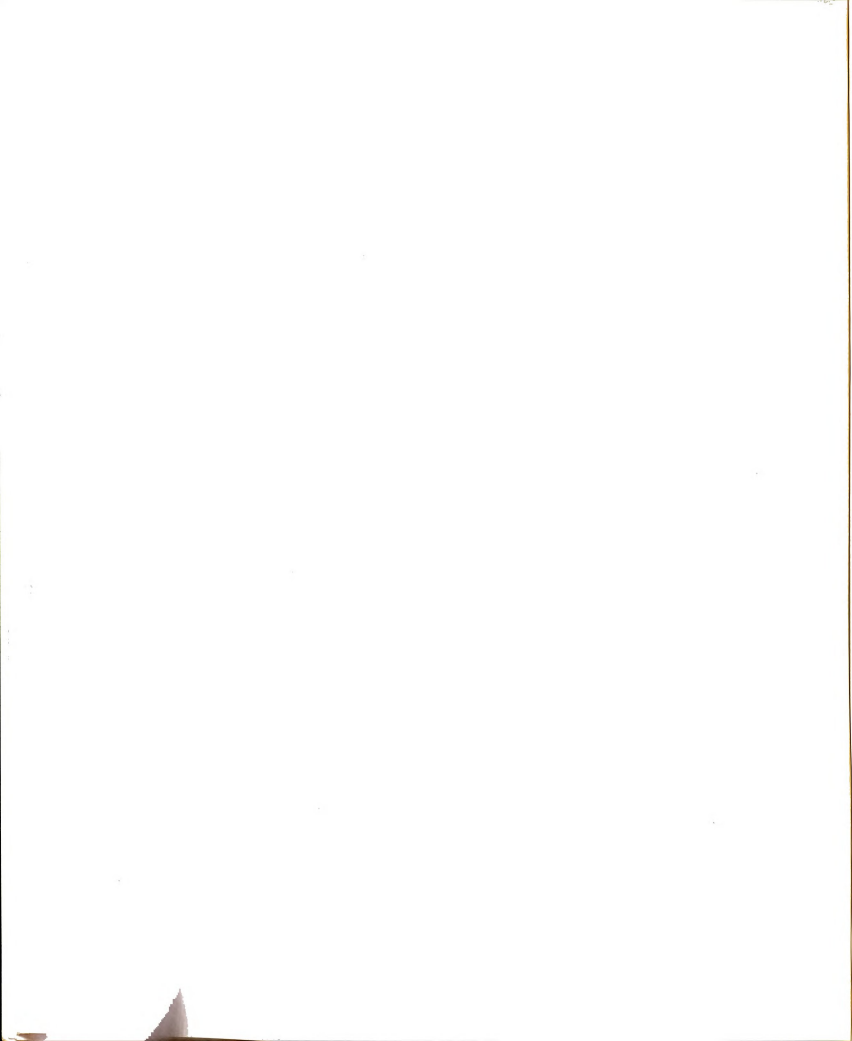
¹U.S. versus Borden Company, 308 U.S. 188 (1939).

²Maryland and Virginia Milk Producers Association versus U.S., 362, U.S. 458 (1960). April versus National Cranberry Association, 168 F. Supp. 919, 923 (D. Mass. 1958).

³Case Swayne Company versus Sunkist Growers, Inc. (9th Cir. 1967), reversed on other grounds.

⁴Sunkist Growers, Inc. versus Winckler & Smith (9th Cir. 1960), reversed on other grounds.

⁵Case Swayne Company versus Sunkist Growers, Inc., supra: North Texas Producers Association versus Metzger Dairies, 348 F. 2d. 189 (1965); Berjans Farm Dairy versus Sanitary Milk Producers, 241 F. Supp. 476, affirmed, 368 F. 2d. 679 (1966).



3.2 Cooperatives as Market Participants: Domestic Marketing

One of the objectives in undertaking this research is to produce a report which will be useful to members, management and boards of directors of regional and interregional cooperatives. In the pursuit of this goal, it is useful to identify and further describe the attributes of the target cooperatives.

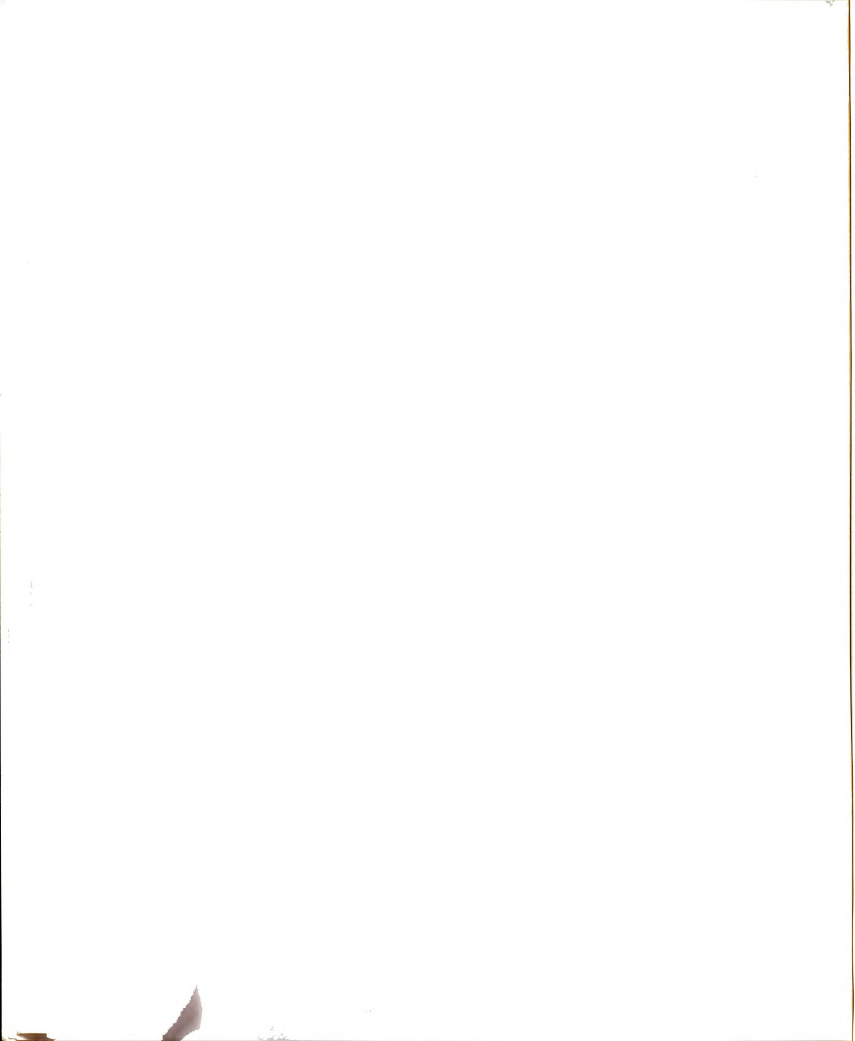
Published statistics ceased to distinguish between local and regional cooperatives after 1973-74, and CMPD was unable to provide more recent data. Thus, the description which follows combines USDA data from that period with statistics gleaned from other sources.

Data from 1973-74 indicate that there were 463 regional marketing cooperatives in the U.S. with 1.4 million members.¹ Regionals were reported to have handled \$15 billion of a total \$27 billion net cooperative marketing volume in 1973-74.² This compares to net marketing volume of \$29.8 billion handled by 4,840 cooperatives in 1975-76.³

¹Bruce L. Swanson and Jane H. Click, Statistics of Farmer Cooperatives, 1972-73, 1973-74 and 1974-75 (FCS Research Report 39: Washington, D.C.: USDA, 1977), p. 11. The membership figures may be somewhat misleading because many regionals are federated associations in which producers join local cooperatives which in turn become members of regionals. In 1973-74 there were almost 1.2 million members of local grain marketing cooperatives but less than 110,000 members of regionals.

²Ibid., p. 15.

³Ralph M. Richardson and Jane H. Click, Statistics of Farmer Cooperatives, 1975-76 (Farmer Cooperative Research Report 3; Washington, D.C.: USDA, March 1979).



Overall, cooperatives handled an average of 30 percent of total cash farm receipts from marketing in 1974-75.¹ A recent General Accounting Office (GAO) study reports that cooperatives handled an average of 28.9 of all agricultural products marketed during 1975-76.² The cooperative market shares for individual commodities are presented in Table 3.1. The range from a high of 68.4 percent of dairy products to a low of 8.3 percent of poultry and eggs marketed.

Regional cooperatives vary considerably in their size and sales volume. Data for 1971-72 indicate that while almost 52 percent of all regional cooperatives handled gross sales volumes of \$9.9 million or less, they accounted for less than five percent of total gross cooperative sales volume. Over 60 percent of total gross sales volume was handled by the ten percent of cooperatives with gross volumes of over \$100 million.³

Insights into the degree of commodity specialization and trends towards diversification among regional marketing cooperatives could also be useful in this analysis. Sporleder and Skinner, studying diversification of regional marketing cooperatives in 1973-74 and before, found that grain, fruit and vegetable, poultry, and bean and pea cooperatives were the most diversified in terms of products marketed, and at about the

¹Randall E. Torgerson, "An Overall Assessment of Cooperative Market Power," in Bruce Marion, editor, Agricultural Cooperatives and the Public Interest (North Central Regional Research Publication 256, Madison: University of Wisconsin, 1978), p. 269.

²U.S. General Accounting Office, Family Farmers Need Cooperatives--But Some Issues Need to be Resolved (Washington, D.C.: Government Printing Office, 1979), p. 68.

³John Schmelzer and Gerald Campbell, "An Overview of the Number, Size, Diversification and Market Shares, Agricultural Marketing Cooperatives in Various Commodity Subsectors," in Marion, editor, 1978.

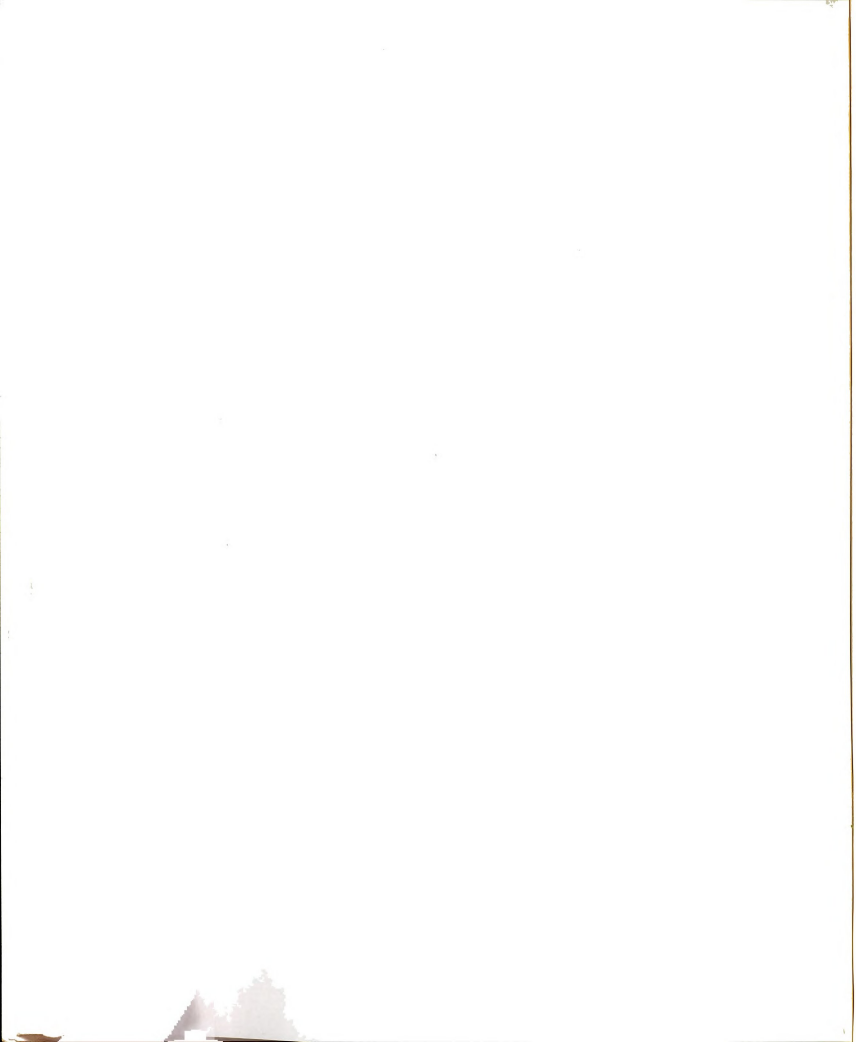
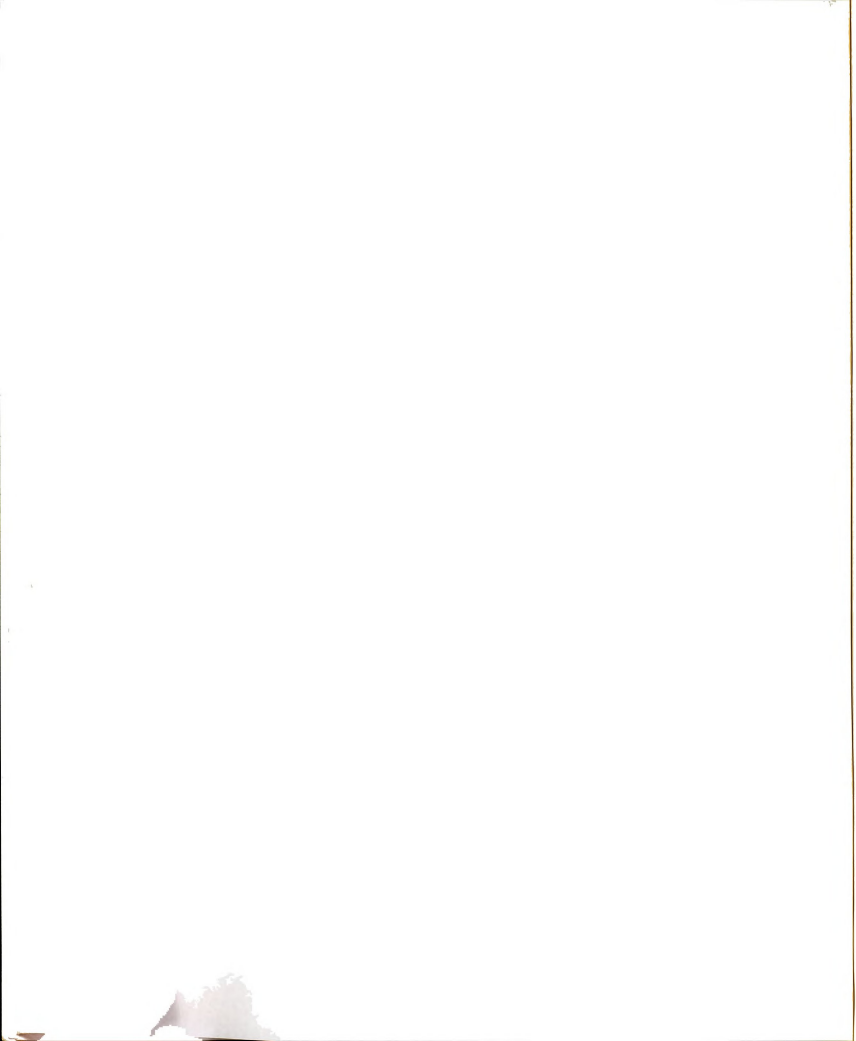


TABLE 3.1. COOPERATIVES' SHARE OF AGRICULTURAL PRODUCTS MARKETING
FOR CROP YEAR 1975-76

| Commodity | Cooperatives' Share |
|-----------------------|---------------------|
| | Percent |
| Grain and Soybeans | 40.2 |
| Rice | 54.2 |
| Dry Beans and Peas | 28.4 |
| Cotton and Cottonseed | 26.2 |
| Tobacco | 12.9 |
| Fruits and Vegetables | 25.9 |
| Peanuts and Tree Nuts | 43.2 |
| Sugar Crops | 57.2 |
| Dairy Products | 68.4 |
| Livestock Products | 9.6 |
| Wool and Mohair | 24.3 |
| Poultry and Eggs | 8.3 |
| Other Commodities | 12.6 |
| Total | 28.6 |

Source: GAO, 1979, p. 68.



same level.¹ The percentage of total cooperatives which were diversified was lowest in the dairy category. Another study, by Schmelzer and Campbell, calculated specialization ratios for regional marketing cooperatives in 1971-72.² The results were consistent with Sporleder and Skinner's findings in that while the level of specialization is high for all commodities, those that are diversified are in the same commodity categories. While neither analysis of specialization indicated which products tended to be combined through the diversification process, they do provide some indication of commodity groups in which cooperatives have exhibited a tendency toward marketing diversification. This may be indicative of a degree of willingness to coordinate marketing which might be extended to export marketing.

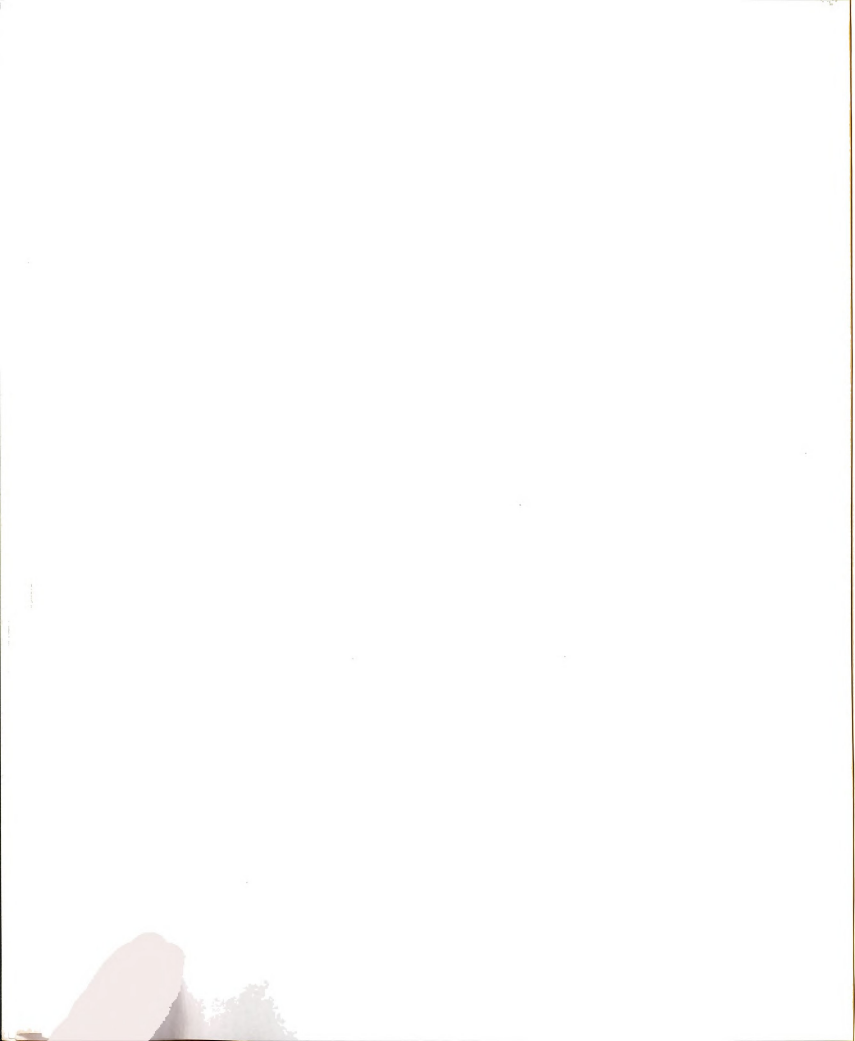
3.3 Cooperatives as Market Participants: Export Marketing

An evaluation of the potential for coordination of export marketing by cooperatives also requires an understanding of current export marketing volume, practices, procedures and interests. The role of cooperatives in international trade has been surveyed on two occasions. In a 1973 study, Bradford and Berberich obtained data from 98 cooperatives, mostly large-scale regional or federated cooperatives, on exports and imports for fiscal years 1968-70.³ (In the report, cooperative sales to U.S.

¹Thomas L. Sporleder and Robert A. Skinner, "Structural Aspects of Regional Marketing Cooperatives," in Marion, ed., 1978, pp. 109-110.

²Schmelzer and Campbell, pp. 78-80.

³Henry Bradford and Richard Berberich, Foreign Trade of Cooperatives (FCS Information 88; Washington, D.C.: USDA, 1973).



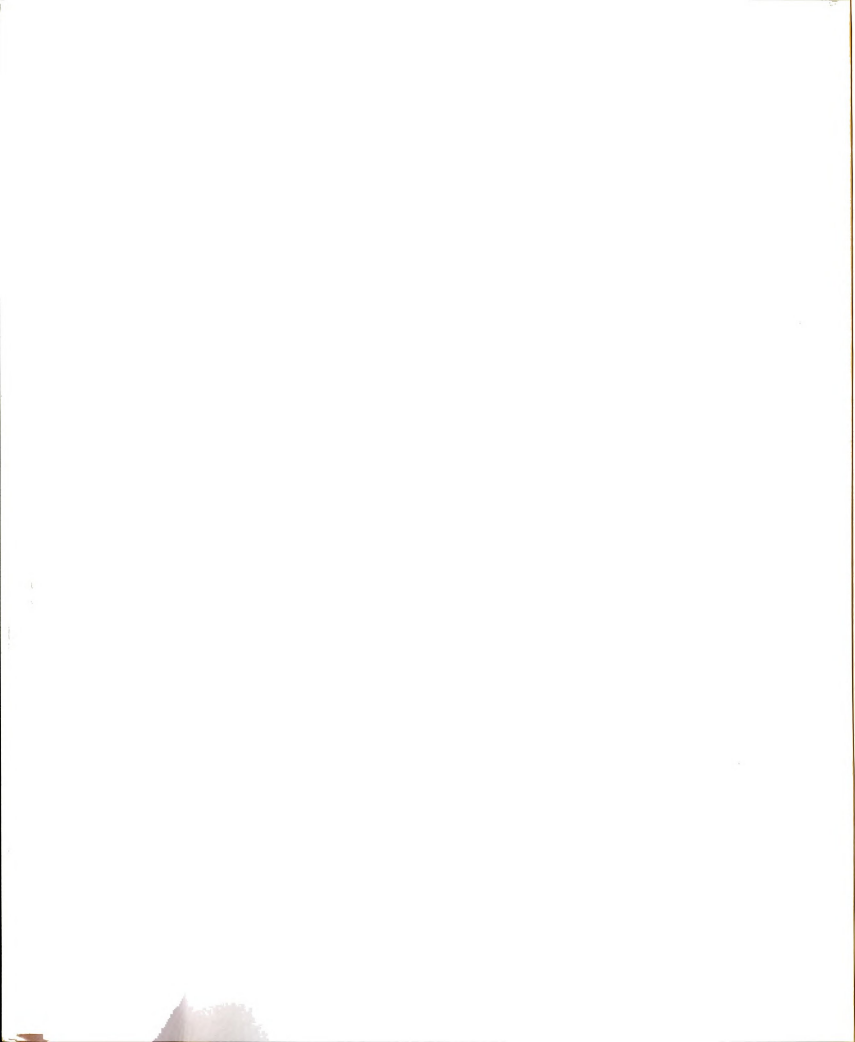
territorial positions--Guam, Puerto Rico and the Virgin Islands, were included as foreign trade.) It was found that 77 cooperatives exported agricultural commodities during FY 1970. Grains and preparations were the most important cooperative exports by value. However, cooperatives accounted for the largest share of U.S. exports of fruits and preparations. Overall, it was found that direct exports by cooperatives, valued at \$782 million, accounted for 14 percent of total U.S. agricultural exports. Bradford and Berberich concluded that coordination and intensification of efforts would be essential to increasing the cooperative export share. They noted that while some cooperatives have joined forces for entry into international trade, ". . . few associations have the necessary expertise, volume, financial resources and experience to adequately meet foreign competition."¹

A 1976 study by Hirsch examined the volume of cooperative exports and marketing channels, buyers and intermediaries used by cooperative exporters, as well as overseas destinations of those exports, Hirsch found that 73 cooperatives directly exported agricultural commodities valued at more than \$2 billion.² Direct exporting was defined as the process by which ". . . the cooperative deals directly, through its employees or foreign-based representatives, with a foreign buyer or his foreign-based agent."³ This was distinguished from indirect exporting where the cooperative dealt through an intermediary such as another U.S. firm, an international trading company or the U.S. agent of a foreign buyer.

¹Ibid., p. 14.

²Hirsch, 1979, p. 7.

³Ibid., p. 3.



Hirsch's findings were based on a mail survey and follow-up discussions involving 179 cooperatives thought to be direct exporters. The sample was developed from a reference file compiled by Hirsch; consultations with other commodity specialists in the Cooperatives Program, ESCS, USDA; use of the "Directory of Farmer Cooperatives" published by the National Council of Farmer Cooperatives; Trade Opportunity Referral Service (TORS) lists maintained by the Foreign Agricultural Service, USDA, working files for Bradford and Berberich's previously cited research project; and lists of cooperatives published by state agencies and the Central Bank for Cooperatives.

The results indicated that in addition to the 73 cooperatives studied which were direct exporters, 47 other cooperatives only exported indirectly. As shown in Table 3.2, the direct exports of the 73 cooperatives in the sample represented 9.2 percent of total U.S. agricultural exports in 1976.¹

Comparison with Table 3.1 indicates that cooperatives were more reliant upon U.S. market outlets than U.S. agricultural marketers as a group. Feed grains, wheat, soybeans and cotton accounted for 68 percent of cooperative exports. While the dollar volume for these commodities was large, the cooperative market share of total U.S. agricultural exports ranged from 8.2 percent for food grains to 22.1 percent of cotton.

Cooperative shares of the U.S. export market were greater in fruits and preparations (38 percent) and nuts and preparations

¹The apparent decline in cooperative direct exports as a percentage of total U.S. exports may be in part the result of methodological differences. See: Hirsch, 1979, pp. 76-77.

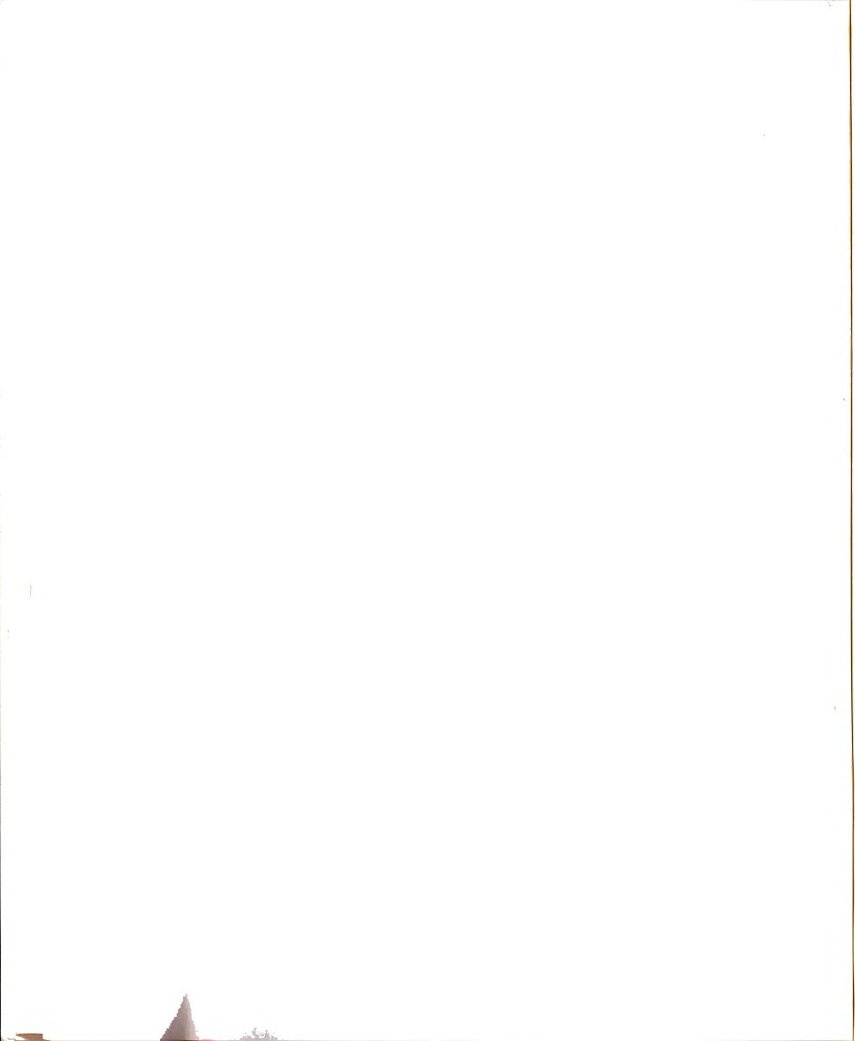
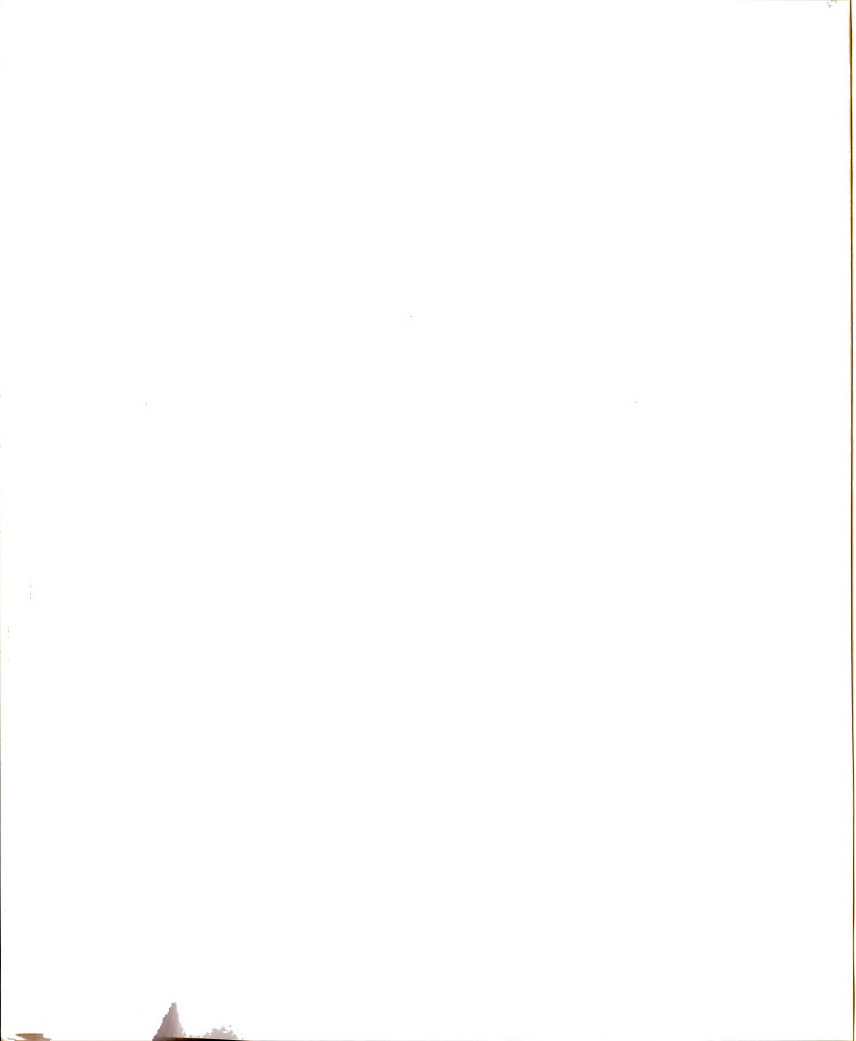


TABLE 3.2. DIRECT EXPORTS BY COOPERATIVES COMPARED WITH TOTAL UNITED STATES EXPORTS, 1976

| Commodity group ¹ | Total U.S. | Cooperatives | | |
|--|---------------|-----------------|-----------|-----------------------|
| | | Associations | Value | Percent of Total U.S. |
| | \$,000 | Number | | |
| Animals and animal products | 2,379,563 | 14 | \$1,000 | |
| Grains and preparations | 10,875,277 | 11 | 34,175 | 1.4 |
| Fruits and preparations | 770,079 | 27 | 931,549 | 8.6 |
| Nuts and preparations ² | 198,249 | 3 | 292,704 | 38.0 |
| Vegetables and preparations | 674,060 | 12 | 79,479 | 40.1 |
| Feeds and fodders | 448,752 | 6 | 18,360 | 2.7 |
| Oilseeds, oilnuts, and products ³ | 5,070,368 | 11 | 10,093 | 2.3 |
| Cotton, raw, excluding linters | 1,048,669 | 4 | 427,157 | 8.4 |
| All other | 591,081 | 7 | 231,664 | 22.1 |
| | | | 5,464 | 0.9 |
| Total | 22,056,098 | 73 ⁴ | 2,030,645 | 9.2 |

¹Excluding tobacco.²Excluding peanuts and products.³Including cottonseeds, flaxseeds, peanuts, peanut oil, corn oil, and other vegetable oils.⁴Some associations export commodities from more than one group.

Source: Hirsch, 1979, p. 10.

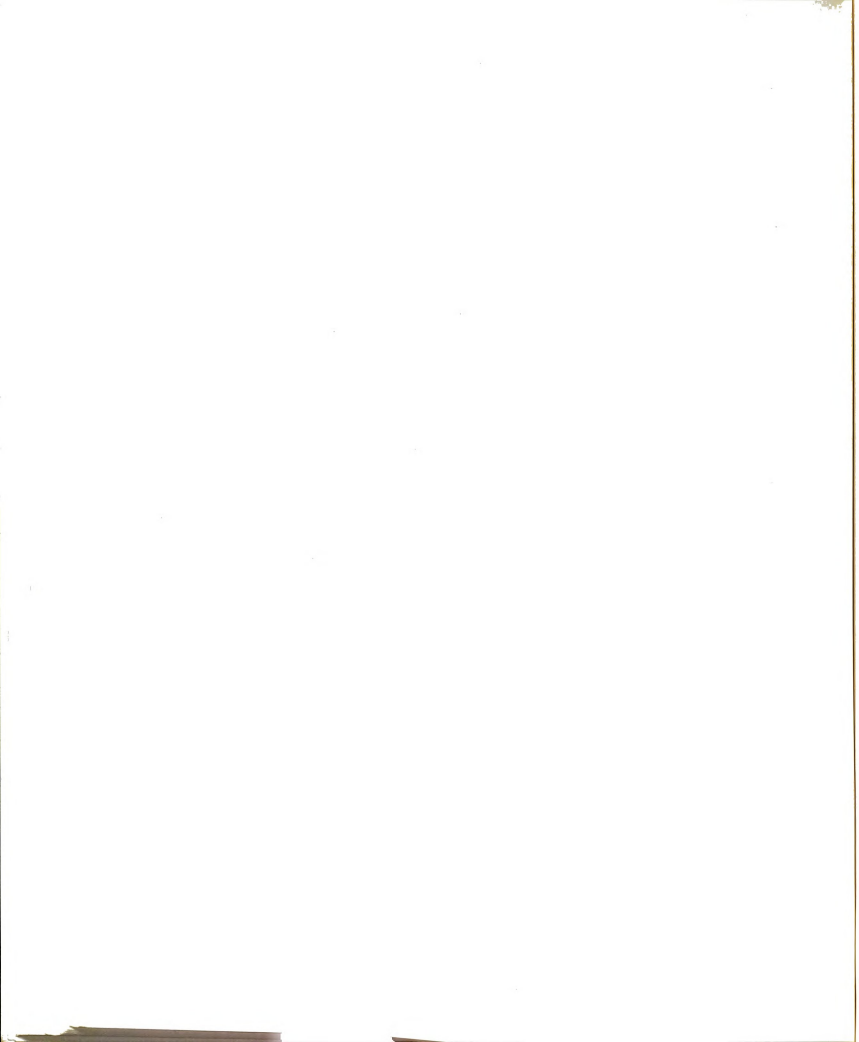


(40.1 percent). Hirsch, therefore, concluded that cooperatives are ". . . relatively strong in exports of branded, packaged commodities, and less important in exports of commodities sold in bulk and in large quantities."¹ However, he pointed out that in the export of processed vegetables, cooperatives handled less than one percent of the U.S. total in 1976.

A list of the cooperative direct exporters identified in Hirsch's study and stratified by export sales volume was made available to this researcher in September 1979. While all of the interviews for this study had been completed by that date, the list made it possible to conduct an ex post comparison of the cooperatives interviewed in the present study and the population of direct exporting cooperatives in 1976, stratified by the value of their direct exports in 1976. While some cooperatives interviewed in this study were not among the 1976 exporters, the results of comparison, shown in Table 1.2 indicate that more than 35 percent of the participants in the 1976 survey were interviewed during this study. The percentage interviewed ranges from 16 percent of those cooperatives with direct exports of less than \$1 million in 1976 to a minimum of 50 percent of all those with direct exports of \$10 million or more.

Hirsch found that 94 percent of the direct export volume of the 73 cooperatives in his sample was conducted by the 18 largest direct exporters, those with sales of \$10 million or more in 1976. Thus, from

¹Donald E. Hirsch, "Cooperatives Directly Export \$2 Billion in Farm Products," Farmer Cooperatives, May 1978, p. 8.



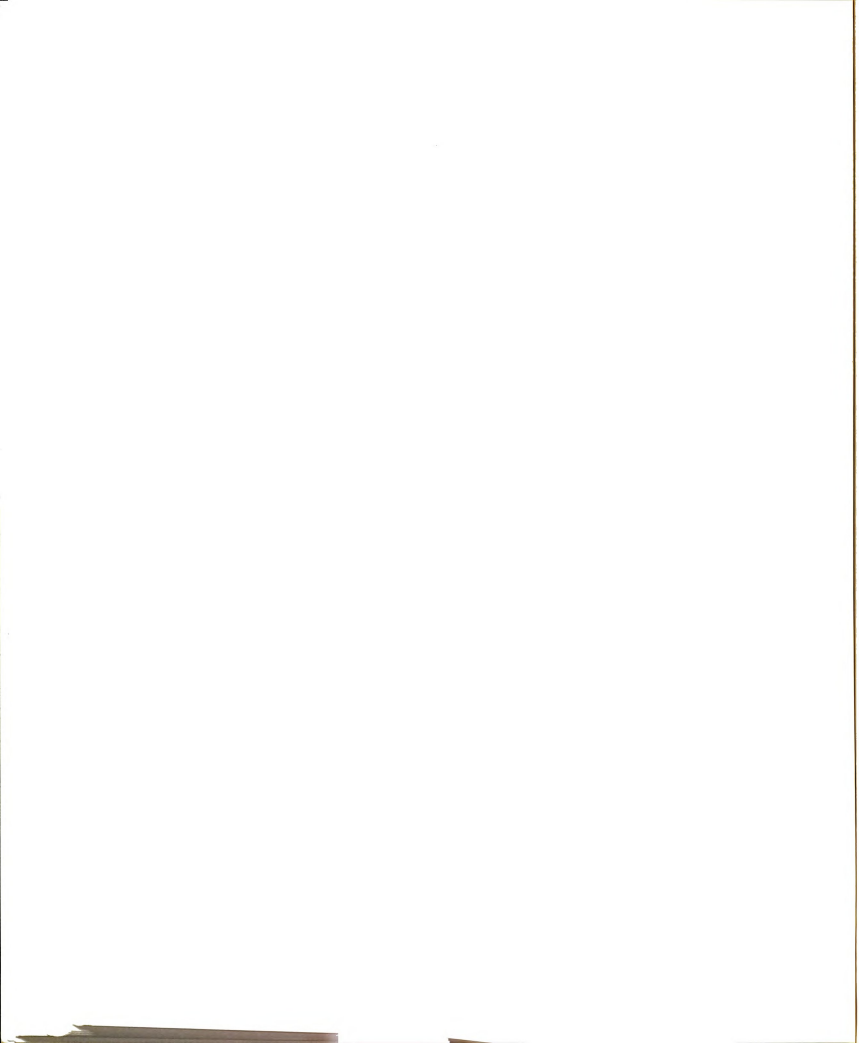
the perspective of cooperative experience in direct exporting, it can be concluded that a substantial proportion of the total 1976 cooperative direct exporting experience was considered in this study.

Another important criterion for the evaluation of potential for cooperative export marketing coordination is interest in and potential for exporting among cooperatives. The terms of the agreement under which this research was conducted specified that, ". . . CMPD will make available information on . . . potential for exports by farmer cooperatives."¹ As such information was not supplied, the researcher was forced to seek to identify potential and interest in the course of the interview process. The major handicaps imposed by this approach are that potential and interest could neither be used in identification of interview subjects, nor evaluated for those cooperatives which were not interviewed or studied through secondary sources. With these constraints presented as caveats to evaluators of the overall study results, we proceed to briefly consider additional research on cooperatives and international trade as it relates to this project.

3.4 Other Related Research

The discussion above has focused upon descriptive studies of the role of U.S. farmer cooperatives in international trade. It is useful to survey other past and on-going research which is directly related to this project. Because of the breadth of the topic under study, much relevant research will be cited throughout the text. The primary

¹Research Agreement: ESCS/DAC/CMPD and Department of Agricultural Economics, Michigan State University, p. 3.



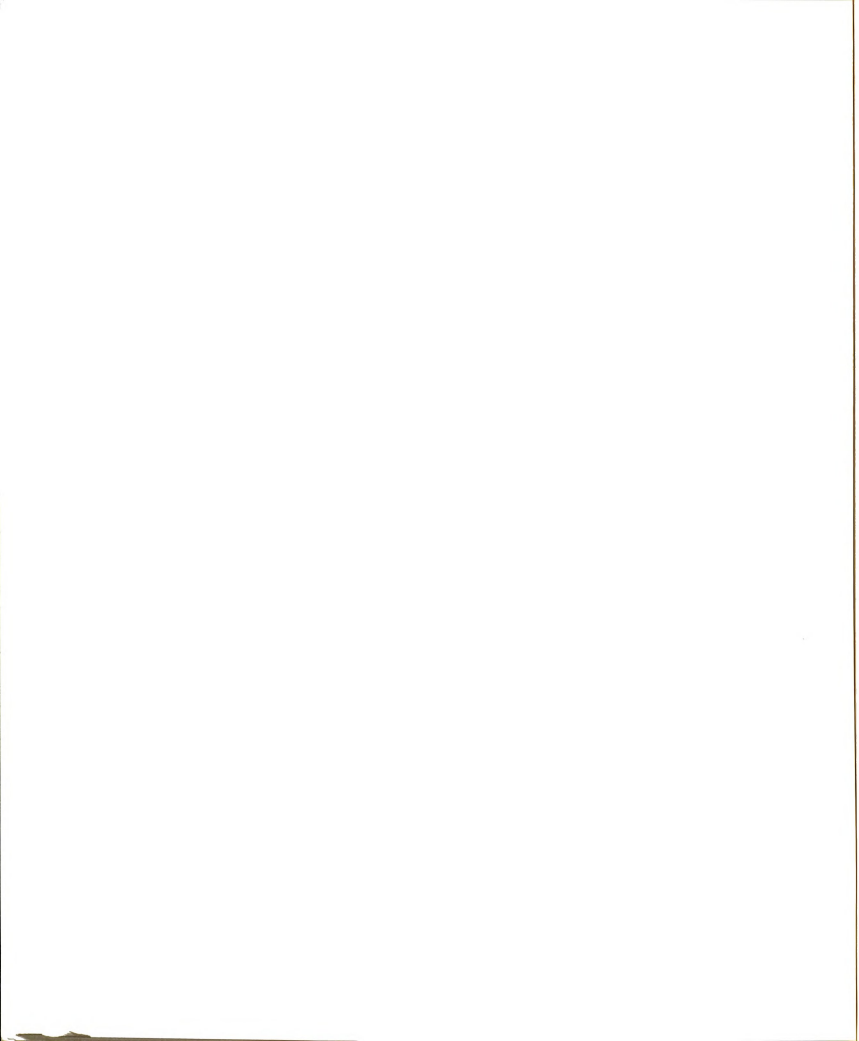
emphasis in this section is on work directed specifically at increasing the role of cooperatives as exporters.

Improving the Export Capability of Grain Cooperatives by Thurston, Phillips, Haskell and Volkin is the principal work which explicitly seeks to identify opportunities for increased exporting by cooperatives. The report surveys markets for wheat, feed grains and soybeans. It suggests that barriers to increasing cooperative market share at the expense of the major grain exporters include: diversification of the major exporters, their multinational character and ability to procure grain from multiple sources, cross-subsidization among products and operations by the grain companies, their worldwide market intelligence systems, and the fact that all are closely held corporations which are not required to disclose information about their operations.

Thurston, et al., made recommendations in four areas: sales strategy, organizational structure, facilities and transportation, and commitment and financing. They proposed a single federated grain export cooperative which would emphasize personalized service, high product quality and uniform and efficient loading. They further suggested increased flexibility in delivery terms and strengthened sales to foreign cooperatives.

In order to achieve these goals, emphasis was placed upon increased market intelligence and economic analysis capabilities, added port facilities and improving product commitment through the establishment of a seasonal export pool.

Other research currently in progress is also relevant to the evaluation of increased export opportunities for farmer cooperatives.



A study being conducted by Knutson, Cook and Sporleder of Texas A&M University examines the potential benefits of international coordination among cooperatives in the world grain trade.¹ That study has included interviews with cooperative leaders around the world. It evaluates the possibilities for International Trade Agreements, International Marketing Agencies in Common and Multinational Cooperative Enterprises. These options are being evaluated in terms of their ability to enhance pricing and operational efficiency, assure market supplies and outlets, and enhance grain prices.

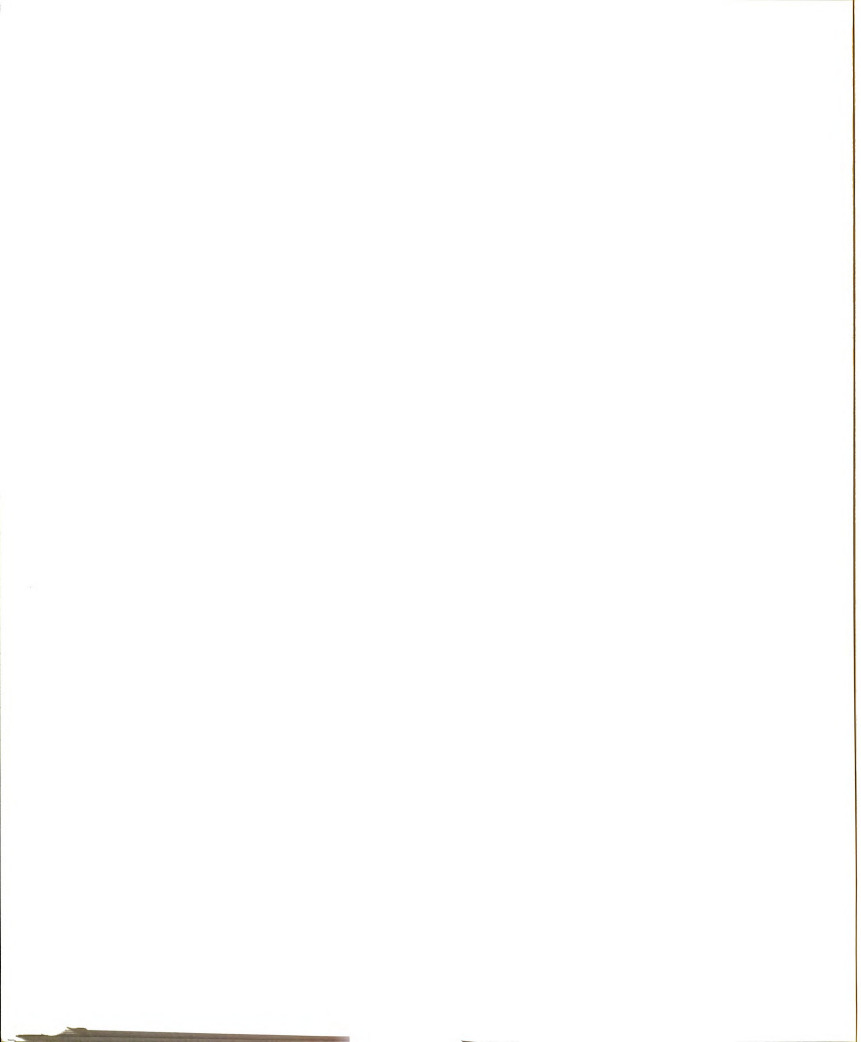
Another research project being conducted by Hirsch of CMPD examines the potential for cooperative involvement in ocean freight chartering.²

These are the primary studies which deal directly with the role of cooperatives in international trade. Other literature deals specifically with the mechanics of exporting³ and such topics as: the functioning of

¹Knutson, Cook and Sporleder, 1978.

²Hirsch, forthcoming.

³Donald E. Hirsch, Export Techniques of Grain Cooperatives (FCS Information 104; Washington, D.C.: USDA, 1976); Claude M. Jonnard, Exporter's Financial and Marketing Handbook (Park Ridge, New Jersey: Noyes Data Corp., 1973); Richard Posthumus, George Stachwick, Donald Ricks, Glynn McBride and Vernon Sorenson, How to Develop Export Markets for U.S. Foods and Agricultural Products (East Lansing: Marketing Program, Cooperative Extension Service, Michigan State University, 1973); Daleen Richmond, "Mechanics of Export Commodity Marketing: A Study of Produce, Processed Product, Hide and Grain Exporters' Marketing Channels and Practices" (M.S. thesis, Cornell University, 1977); Small Business Administration, Export Marketing for Smaller Firms, third edition (Washington, D.C.: Government Printing Office, 1971); and U.S. Department of Commerce, A Basic Guide to Exporting (Washington, D.C.: Government Printing Office, 1979).



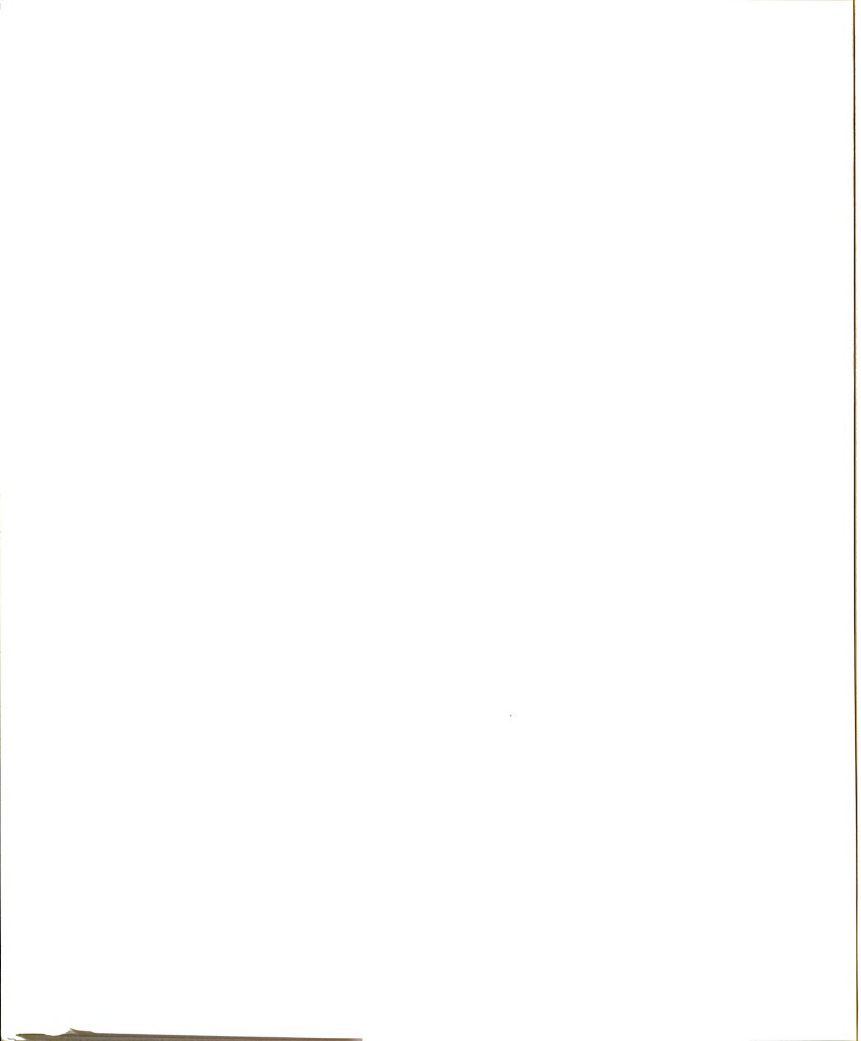
the grain industry,¹ multinational enterprise in international markets,² and food markets and marketing in various countries.³

Conspicuous by its apparent absence is literature which specifically evaluates the potential for functional coordination in export marketing. It is the motivating premise of this research that such an analysis can provide useful information for the further development of cooperative exports.

¹Richard E. Caves, "Organization, Scale and Performance of the Grain Trade," Food Research Institute Studies 16 (1977-1978); Richard G. Heifner, James L. Driscoll, John W. Helmuth, Mack N. Leath, Floyd F. Niernberger and Bruce H. Wright, The U.S. Cash Grain Trade in 1974: Participants, Transactions and Information Sources (Agricultural Economics Report 386; Washington, D.C.: USDA/ERS, 1977); Monte E. Juillerat and Paul L. Farris, Grain Export Industry Organization and Facilities in the United States (Research Progress Report 390; Lafayette: Purdue University Agricultural Experiment Station, 1971); and Morgan, 1979.

²Thomas Horst, At Home Abroad: A Study of the Domestic and Foreign Operations of the American Food-Processing Industry (Cambridge, Massachusetts: Ballenger Publishing Co., 1974).

³A few examples are: Neil Lawrance, Scandinavian Markets for Fresh and Processed Fruits and Vegetables (Washington, D.C.: USDA/FAS, 1978); Norris T. Pritchard, W. Scott Steele, and William P. Huth, Food Marketing in West Germany: Developments, Prospects for 1980; Significance for U.S. Exports (Foreign Agricultural Economic Report 76; Washington, D.C.: USDA/ERS-FAS, 1972); and Donald J. Ricks, "Overview of the European Blueberry Market Potential" (Agricultural Economics Staff Paper 75-8; East Lansing: Michigan State University, 1975).



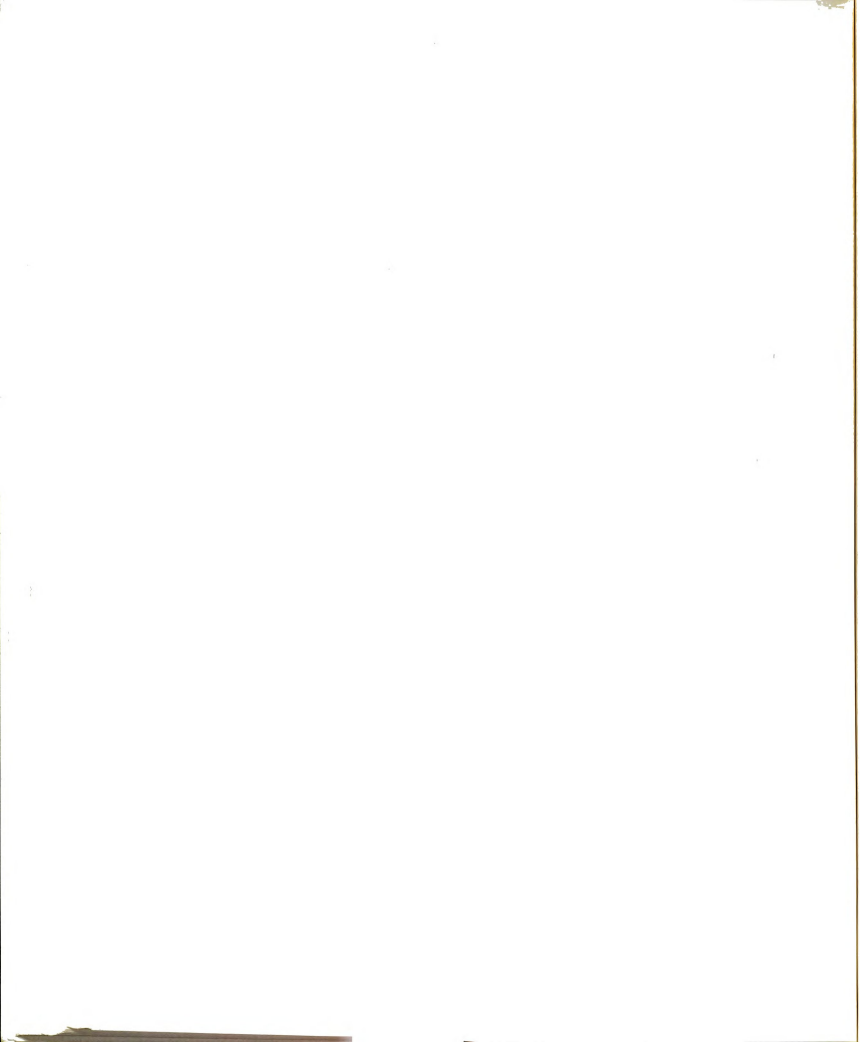
CHAPTER IV
EXPORT COORDINATION: A FRAMEWORK
FOR ANALYSIS

Export coordination is the process by which individual firms or market participants combine to perform, or contract for, certain functions in the export process. This chapter examines conceptual issues related to: types of coordination of export marketing activities which may be undertaken; the environment within which export coordination potential must be evaluated; and functional components of the export marketing process in which coordination opportunities may exist. The framework developed here provides the background for an economic analysis of functional components of the export marketing process in Chapter V.

The export coordination potential of cooperatives must be examined within the larger context of the entire market opportunity set facing the cooperative manager and indirectly, the farmer. Two key issues are:

1. the manner in which the potential benefits from sales in foreign markets can serve to complement sales to domestic customers, and
2. how export coordination by cooperatives can serve to enhance that complementarity.

The development of this framework is aimed at providing the tools for analysis of these issues. It is also directed at facilitating evaluation of the potential of alternative organizational arrangements for export coordination.



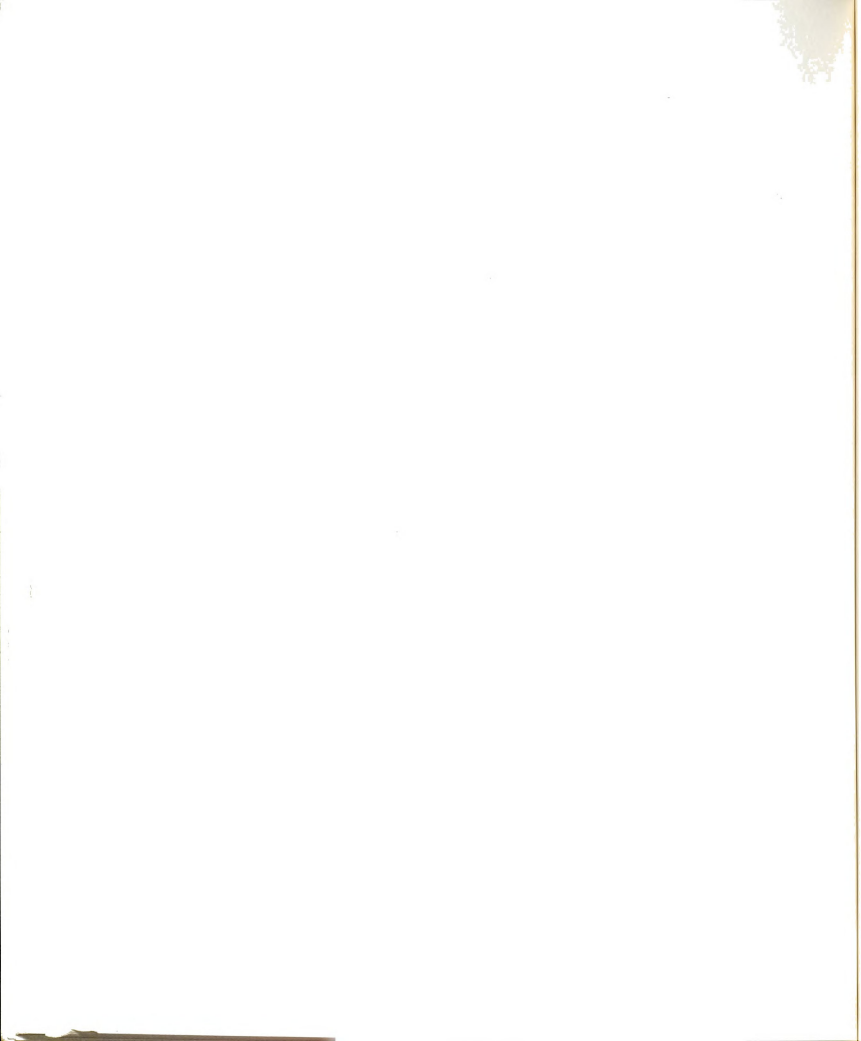
This research focuses upon evaluation of coordination potential among cooperative exporters as an alternative to analysis of potential commodity combinations in exporting. This approach permits direct analysis of the component functions of the export marketing process and opportunities for advantageous collaboration in the performance of those functions. As a result, indicative conclusions can be derived which will be of value to exporters of a wide range of commodities. It is through the identification of similarities in interest and requirements, as well as potential economies of coordination, that individual cooperatives can begin to examine opportunities for specific collaborative undertakings in export marketing. The range of options which can be considered is underscored by considering different types of coordination.

4.1 Types of Export Coordination

Four types of export coordination can be considered by cooperatives: horizontal, vertical, product extension and conglomerate.

1. Horizontal coordination involves emphasis on control or combination of a larger portion of the total supply of a given commodity or product.
2. Vertical coordination involves synchronization of successive steps of the functional marketing process.
3. Product extension involves combination of a range of complementary commodities.
4. Conglomerate coordination is based on factors flowing from size, name recognition, internal availability of funds, etc.

A distinction among types of coordination is useful in evaluating the prospects for both coordination of export marketing activities in

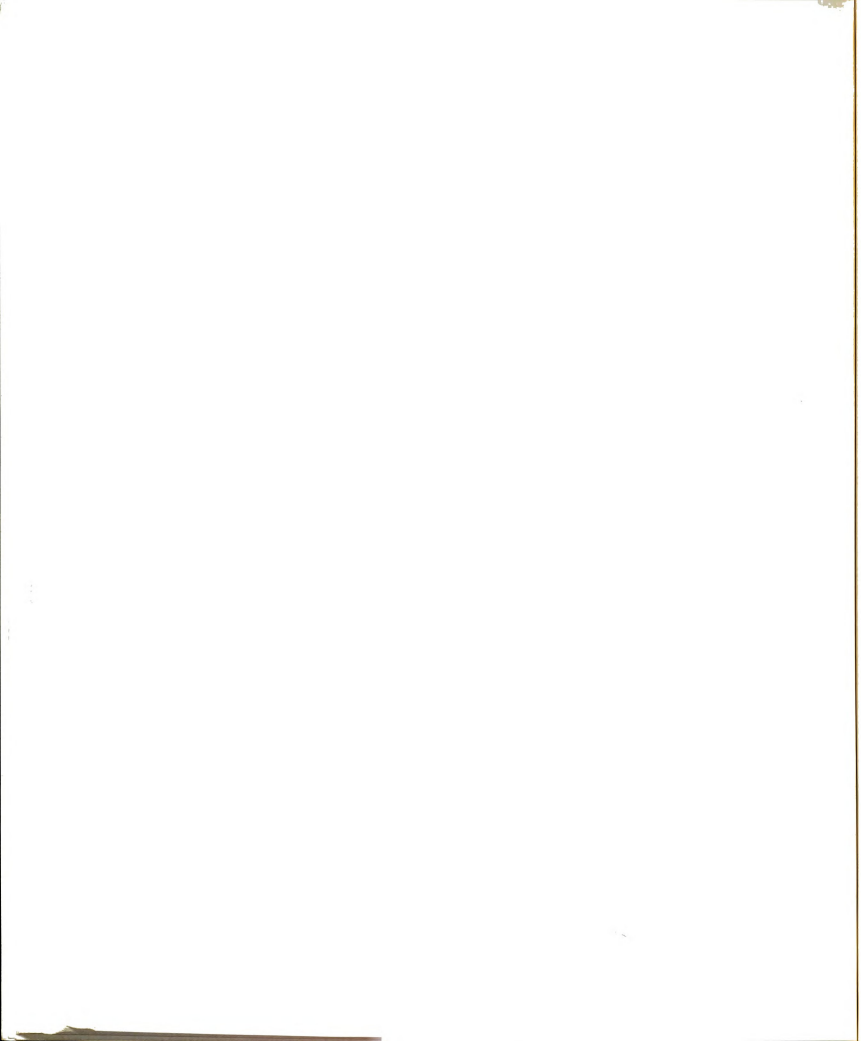


general and more specific organizational arrangements. Similarities and differences in participant objectives and performance criteria will influence the types of coordination which can be profitably undertaken by any group of cooperative exporters. An organization attempting to draw together a larger share of total corn exports (horizontal coordination) could be expected to face somewhat different opportunities and constraints than a similar organization which combined corn and other bulk grains (product extension) or bulk grains and tart cherries (conglomerate). It is in recognition of these differences that a distinction among types of coordination is made.

4.2 Bases for Export Coordination

In addition to recognizing the types of coordination which can be undertaken, it is useful to acknowledge that different rationales can exist for the development of coordinated marketing arrangements. For purposes of classification, three bases for export coordination may be considered: functional, supply related and demand related.

1. Functional bases for coordination arise from similarity or complementarity in the requirements for marketing different products. This may include such factors as the ability to employ specialized personnel if a large enough sales volume is achieved through export coordination. Also, there may be advantages to size in terms of the ability to contract for services and influence their quality and price. Where transportation shortages arise, for example, a large regular customer may receive higher priority than a smaller or irregular shipper. However, even where a cooperative may be



large enough to market efficiently in domestic markets, its export volume may be small enough to warrant collaboration with others in the performance of specialized export marketing functions.

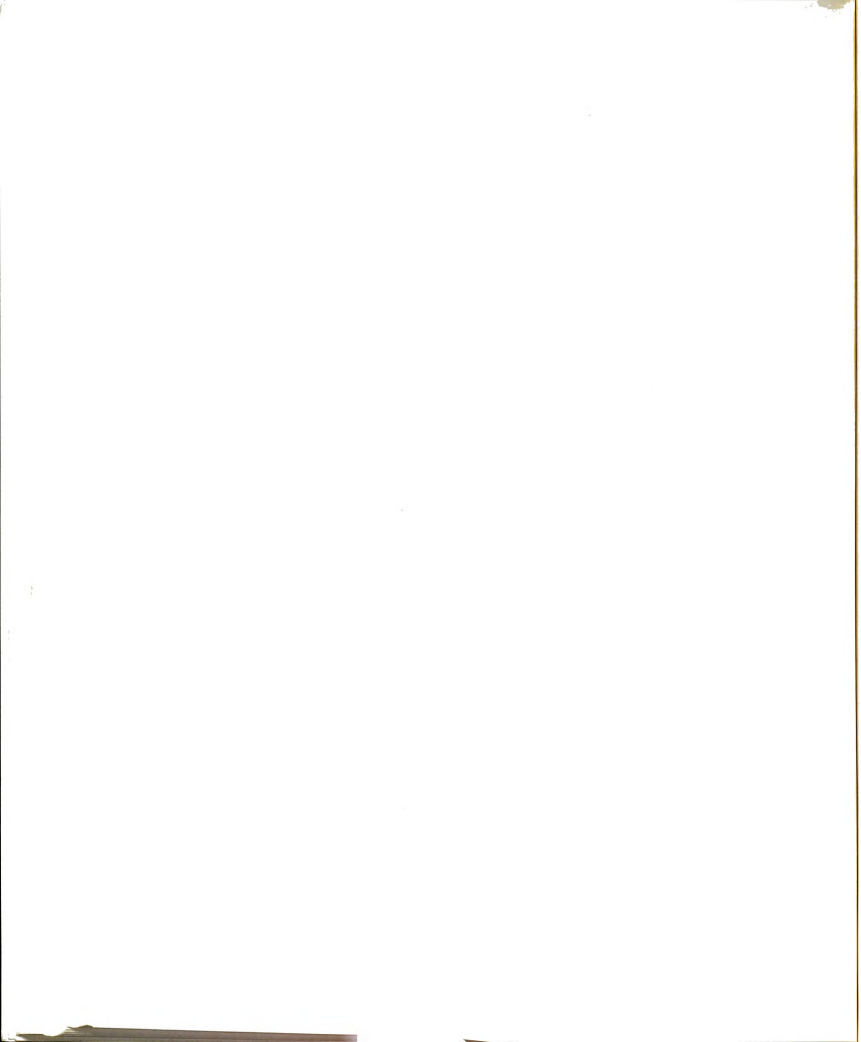
2. Supply related bases for coordination may result from: the production of different products in the same region; the nature of the production process and presence of joint products; the staggering of the production cycle in different geographic regions such that personnel, facilities and contacts could be better used, and markets more fully served, through coordination; or similarities in necessary handling and/or processing facilities which may be conducive to coordination.

3. Demand related coordination potential develops from similarities in destinations and buyers, or complementarity of products.

Where foreign buyers or distributors are the same for a number of products, coordination on the supply side may result in economies for all involved in terms of the costs of business transactions. The ability to decrease the number of contacts which a foreign buyer must make in order to supply a broad range of needs as well as other reductions in transactions costs to buyers resulting from coordination among sellers may serve as an incentive to increased overall purchase volumes.

4.3 Factors Influencing Coordination Opportunities and Desirability

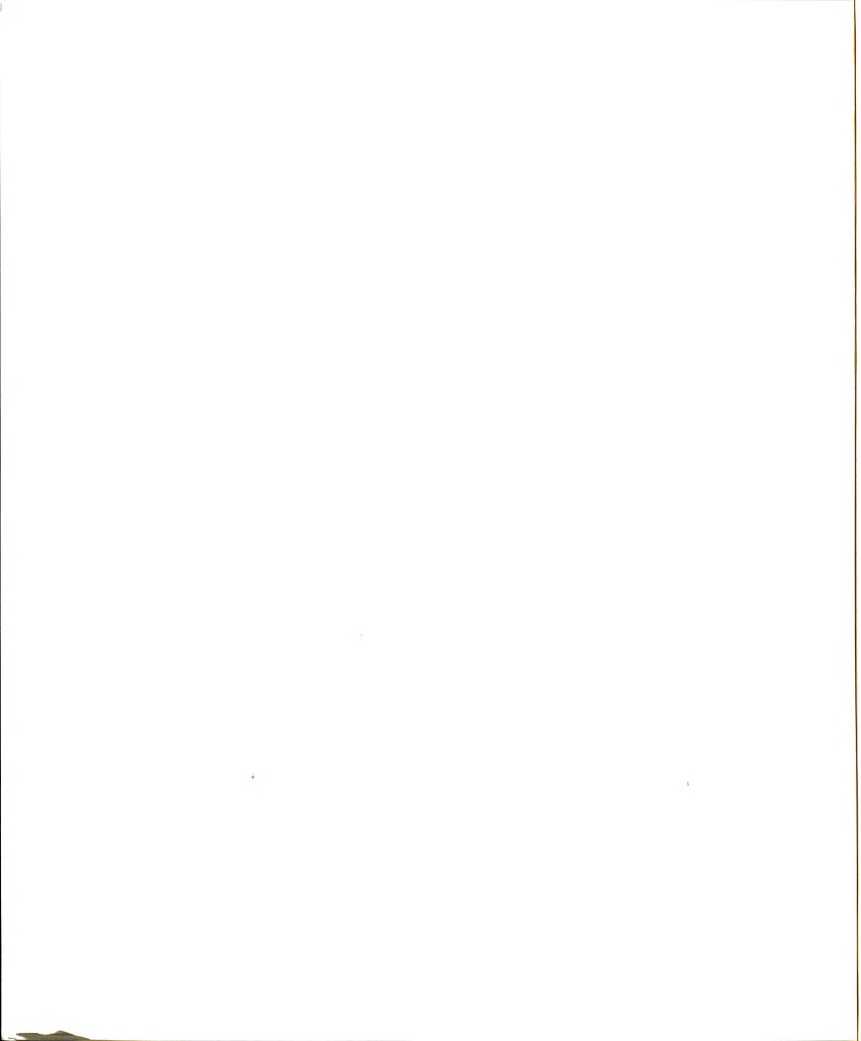
Having established that there can be different types of coordination and different bases for the development of collaborative arrangements,



it is necessary to evaluate the reasons for even considering the possibility of coordination of export marketing activities among cooperatives.

If cooperatives functioned in a world conforming to the assumptions of the perfectly competitive economic model, the "invisible hand" of the market mechanism could be counted on to perform the coordination function. In such a world, perfect knowledge, perfect information flows, and the absence of transportation costs or other transaction costs would permit buyers to select from alternative sources of supply, solely on the basis of price. For the individual firm, demand could be expected to be infinitely elastic. Furthermore, under assumptions of free trade, this scenario would be expected to hold true for exchange among countries as well as within countries. When transportation costs are admitted, *ceteris paribus*, the theory suggests that they alone will determine price differences between producing and consuming regions. This line of logic leads to the eventual conclusion that under free trade, resources will be optimally allocated in the world's producing and consuming regions automatically. In such a world, many "marketing" functions would be unnecessary. An individual firm could concentrate on maximizing profit by equating marginal production cost with a price dictated by "the market."

In the real world, individual transactions occur in an environment which is much more complex. Domestic and international markets are characterized by imperfect information flows and high transaction costs which give rise to considerable risk and uncertainty. Product differentiation, bounded rationality, variations in market structure and the distribution of power among market participants all influence the opportunity



sets of individual handlers of agricultural commodities. As a result, individual firms operate in markets which are less than perfectly competitive. Firms face demand that is less than perfectly elastic; and international trade is not "free." These factors all contribute to the importance of the coordination issue.

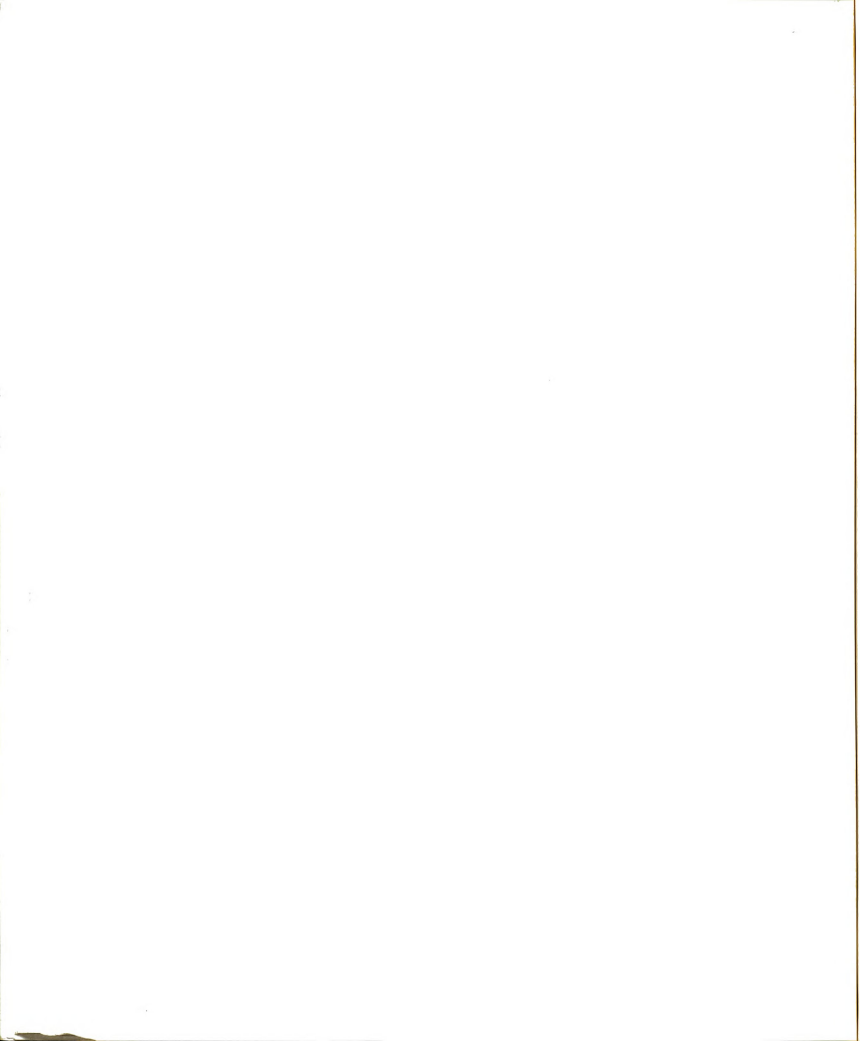
4.3.1 Bounded Rationality

For the cooperative attempting to increase returns to its members, it is important to develop some understanding of constraints on its own behavior and that of potential customers. Economic theory indicates that buyers, being rational, will choose among alternative sources of supply on the basis of price in order to maximize profits and satisfaction. However, as Simon and others have pointed out, objectives are more diverse than profit maximization and, in any event, rationality is bounded by a number of factors which oblige satisficing behavior when individuals "do not have the wits to maximize."¹ Simon suggests that rationality is bounded by at least three limits:

- 1) the skills, habits and reflexes of the individual market participant,
- 2) values and the individual's conception of purpose, and
- 3) the extent of knowledge which an individual can accumulate and apply, both technical knowledge for decision making (e.g., knowing how to charter ocean freight) and the information required to make a decision appropriate to a given situation (e.g., knowing when to charter ocean freight).²

¹Herbert A. Simon, Administrative Behavior (second edition; New York: The Free Press, 1957), p. XXIV.

²Ibid., pp. 40-41.



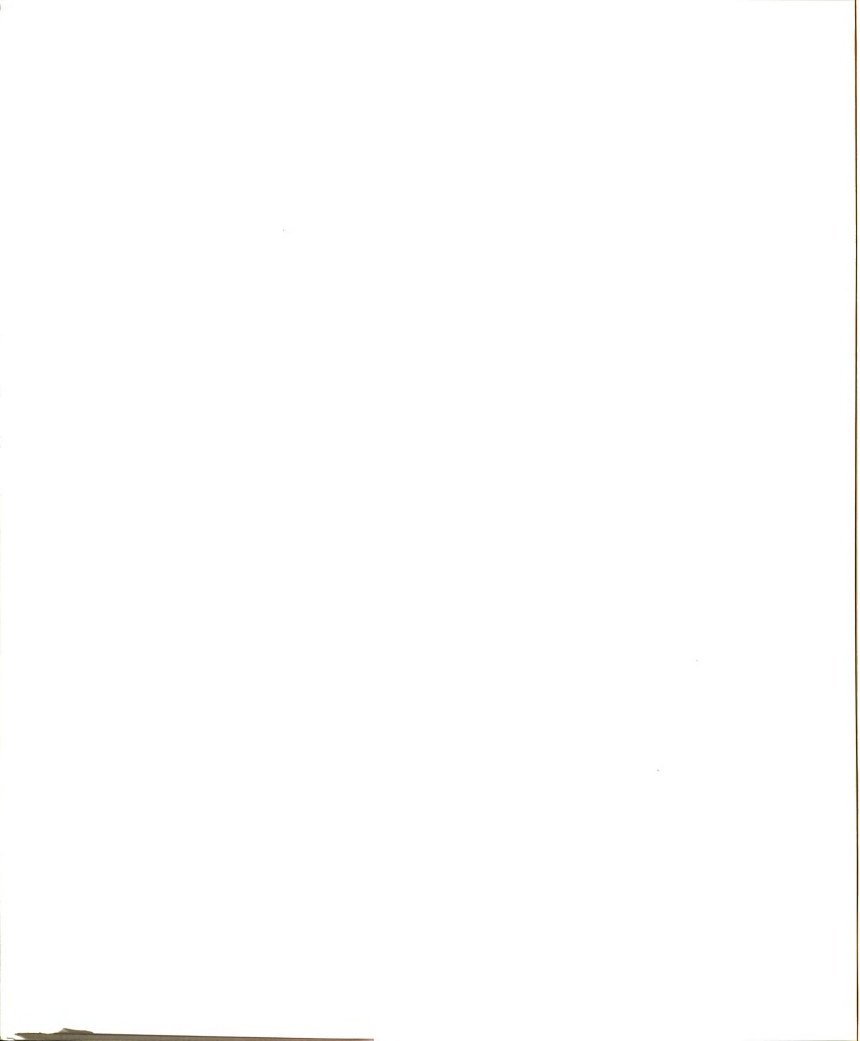
Such bounds must be recognized by both management of cooperatives in the pursuit of their own marketing goals and economic analysts seeking to provide useful policy prescriptions. The potential for cooperatives to loosen the constraint of the above bounds on their performance through the coordination of export activities is of particular interest in this study.

4.3.2 Market Power

An additional factor which may influence the competitive position of individual cooperatives in exporting is "market power." The importance of market power to cooperatives is nothing new. The justification for the Capper-Volstead Act is rooted in the belief that individual producers should be permitted to join together for purposes of countervailing market power of buyers, input suppliers and others. More recently, some cooperatives have come under attack for allegedly wielding too much market power.¹

Economic theory posits different decision criteria for production and pricing decisions by firms with varying degrees of market power. The theory of the firm under perfect competition, monopolistic competition, oligopoly and monopoly is the subject of an immense literature which need not be repeated here. For this analysis it is more important to recognize the potential effects of market power and some of its sources.

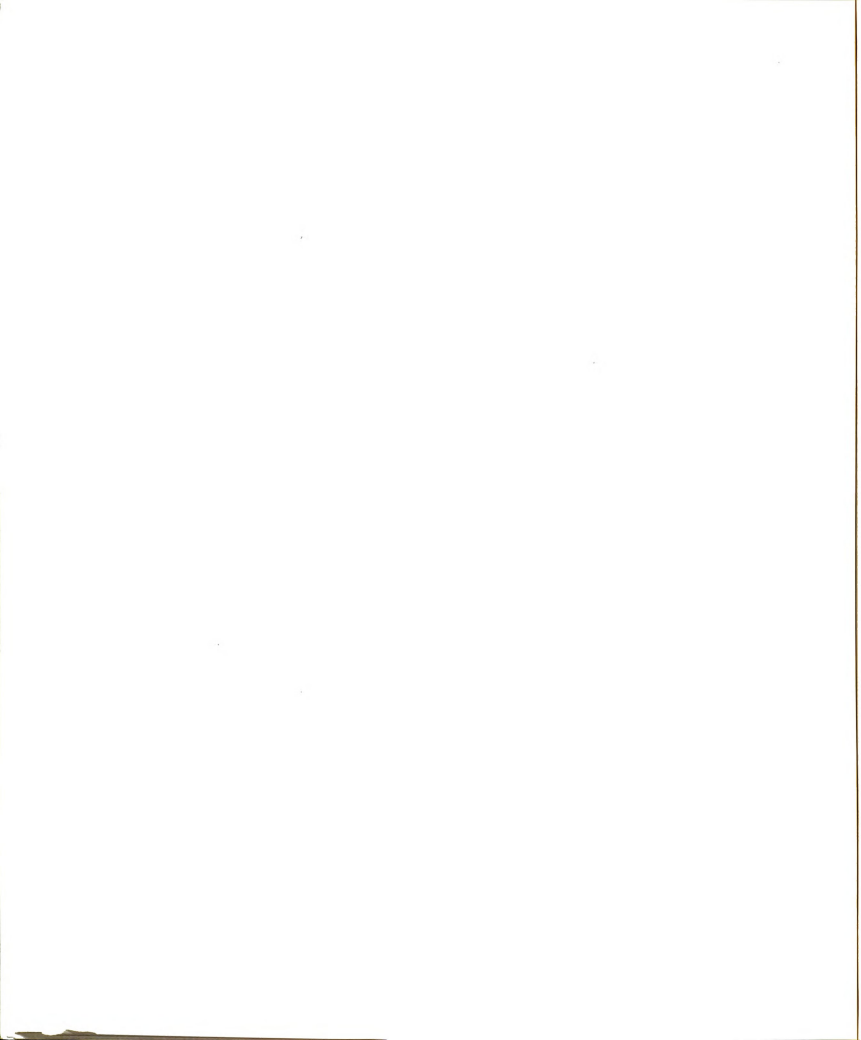
¹ Federal Trade Commission Staff Report on Agricultural Cooperatives (Washington: Government Printing Office, 1975); Complaint, In the Matter of Sunkist Growers, Inc., Docket No. 9100, Federal Trade Commission, May 31, 1977; "The Billion Dollar Farm Co-ops Nobody Knows," Business Week, February 7, 1977.



One rationale for coordination among market participants is as a means to countervail market power. In exporting, market power takes a number of forms. Cooperatives compete with huge multi-national firms with the ability to originate products from multiple sources and with substantial investments in the means to sell those products and deliver them to their destinations. These firms may have the financial resources necessary to outspend and out lose any competitor if such action is necessary in order to maintain an important market share. Cooperatives also compete with state trading companies or sell to state procurement agencies, some of which are insulated from market forces when making pricing or procurement decisions.

Market power may arise from a number of sources. Economies of size and scale may serve as effective entry barriers to additional competitors, as in the development of worldwide market intelligence networks. Control of scarce resources, whether capital, facilities or product related may give rise to market power. Control of technology as through patent-protected innovations, may yield advantages of market power. Government policies such as those related to import or export licensing or the establishment of tariff or nontariff barriers can confer benefits and power to individual market participants. Finally, random events, including natural disasters, strikes, wars, etc., may confer power on firms and individuals.

As a means to countervail market power in procurement, supply-side coordination presents the opportunity to improve bargaining effectiveness of individual suppliers. While economic theory posits that surpluses



can be extracted by the possessor of one-sided market power, theoretical solutions to cases of bilateral market power are indeterminate.¹

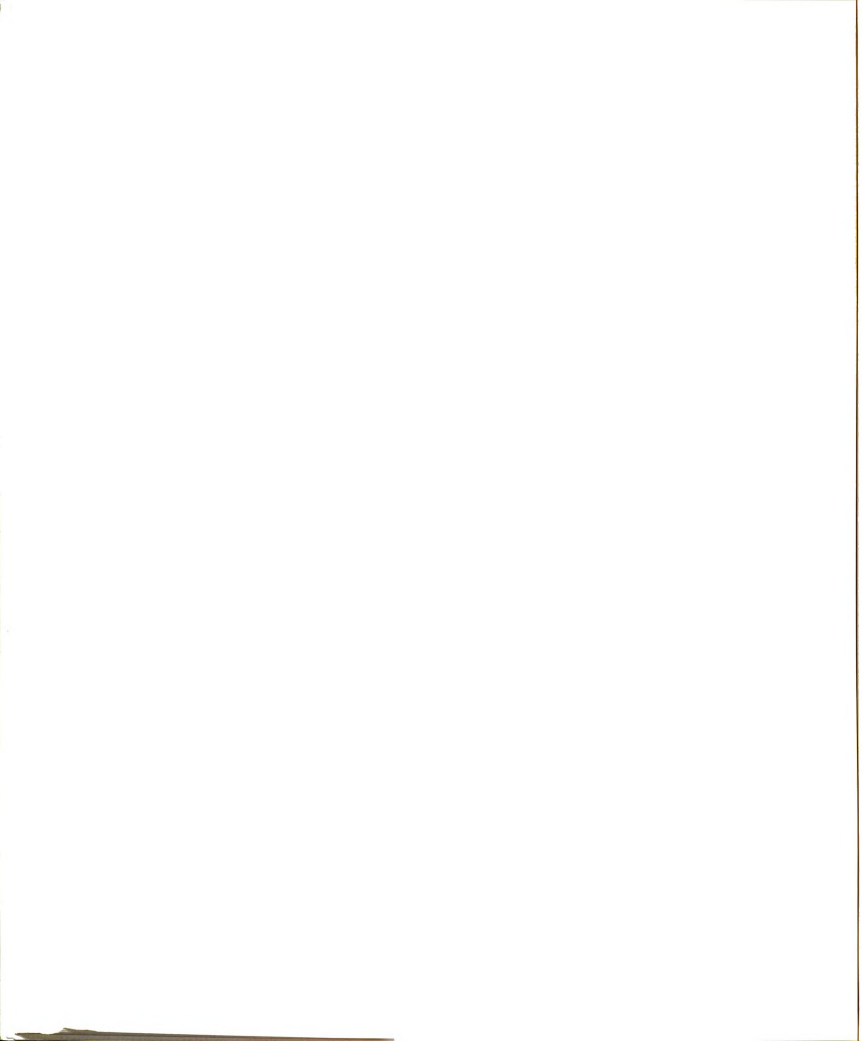
Where market power is concentrated among a few suppliers, coordination of activities among smaller suppliers may increase the competitive position of the latter and improve overall competition in a market.

Malmgren looks at this issue from the basic question, "Why do multi-person, multi-process firms exist in a competitive economy?"² He points out that while transactions between firms reflect activities of the market, within firms, the entrepreneur performs planning and coordinating functions. If the market operated in a "perfect" sense, there would be no reason for individuals to tie themselves together in firms through long-term contracts. Rather, Adams Smith's "higgling and haggling" could be used daily to arrange for performance of the tasks essential to production of the firm's output. Thus, firms exist in part because of transactions costs inherent in using the price mechanism.

By the same logic, firms may find it advantageous to coordinate their activities. The traditional explanation for coordination or integration of activities has been the existence of technological economies of size or scale and/or changes in market size which result in larger optimum firm size and combination of enterprises. Marion

¹For discussion of the indeterminacy of solutions to bilateral market power see Walter Nicholson, Microeconomic Theory: Basic Principles and Extension (Hinsdale, Illinois: The Dryden Press, 1972), p. 360; W.J. Baumol, Economic Theory and Operations Analysis (third edition; Englewood Cliffs: Prentice-Hall, Inc., 1972), pp. 349-351.

²H.B. Malmgren, "Information, Expectations and the Theory of the Firm," Quarterly Journal of Economics, 75 (August 1961), p. 399.



calls this the "technological determinism conceptual framework." It views intra-firm economics as the key to vertical organization and coordination.¹

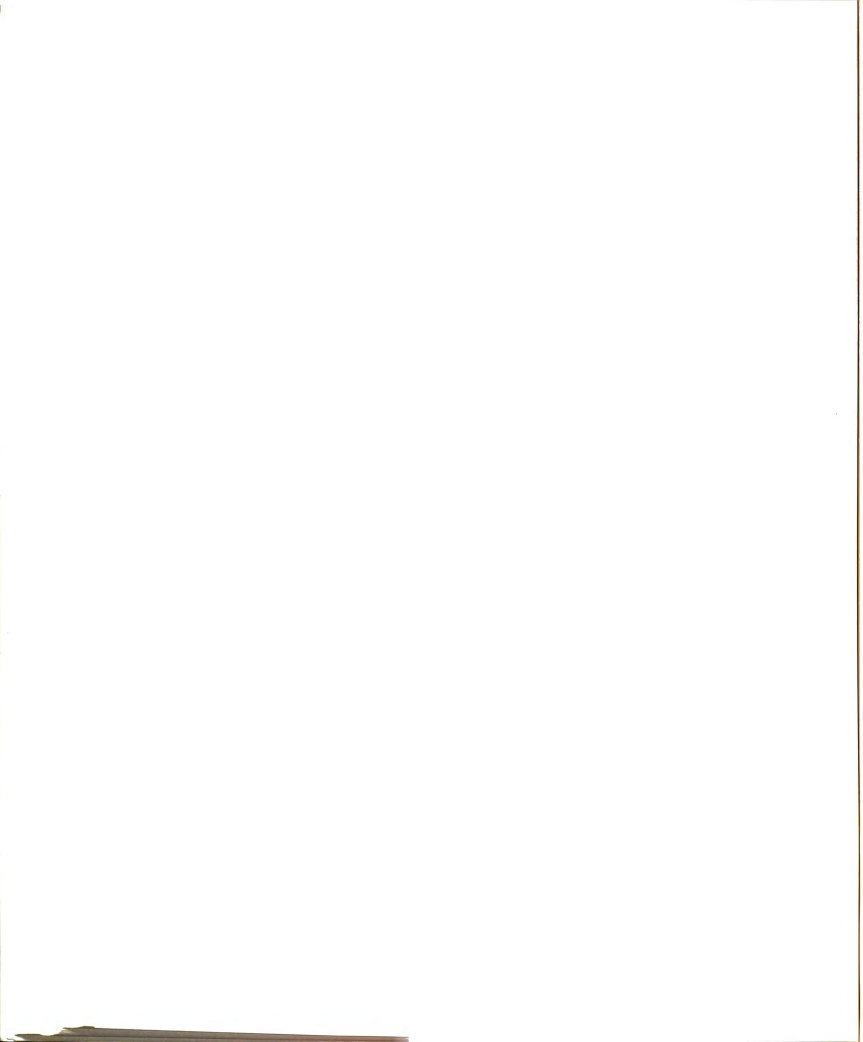
A second set of perspectives for understanding coordination, which Marion calls a "behavioral conceptual framework," places considerable emphasis on the problems of inter-firm relationships in the functioning of a system.² Williamson, for example, argues that the substitution of internal organization for market exchange is often attractive less because of technological economies associated with production than because of "transactional failures" which affect the responsiveness of market operations for intermediate goods.³ He states that through substitution of internal organization for the market mechanism, the sensitivity of incentive and control systems can be increased, information economies can be achieved and inherent structural advantages realized. In evaluating coordination potential in export marketing, both "technological" and "behavioral" views are important.

Analysis of the export process necessitates identification of its component functions and costs associated with them. Furthermore, the potential impacts of size and sales volume on the costs and performance quality of individual export functions must be evaluated. While technological factors will be important in this evaluation, reflection upon

¹Bruce W. Marion, "Vertical Coordination and Exchange Arrangements: Concepts and Hypotheses," in Coordination and Exchange in Agricultural Subsectors, Marion, editor (North Central Regional Research Publication 228, Madison: University of Wisconsin, 1976), pp. 185-186.

²Ibid.

³Oliver E. Williamson, "The Vertical Integration of Production: Market Failure Considerations," American Economic Review (May 1971) and Idem., Markets and Hierarchies: Analysis and Antitrust Implications (New York: The Freedom Press, 1975).



individual functions as part of an interdependent system will help to underscore the importance of "transactional failures" and other behavioral considerations. Performance of one function at the lowest possible cost becomes less important if costs and risks associated with another function are increased in the process.

4.4 The Costs of Exporting

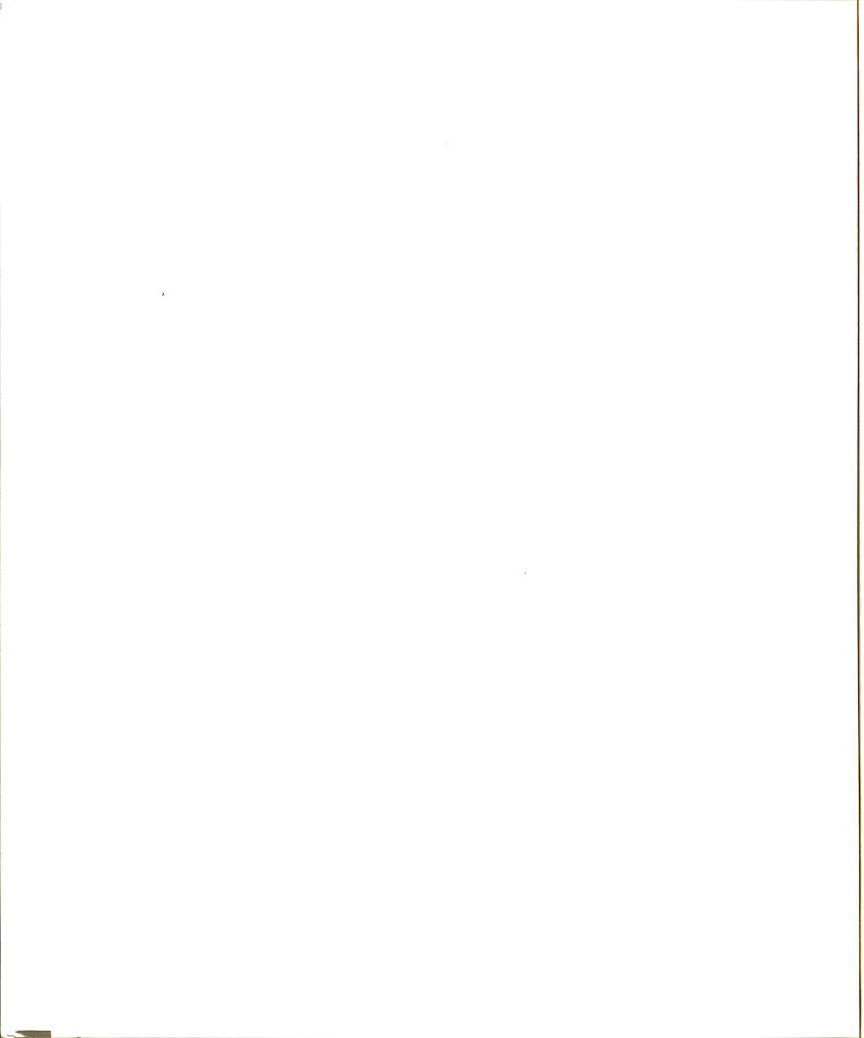
In evaluating the economics of the export process and potential advantages to coordination of export marketing activities, it is useful to have a conceptual view of the costs involved.

Development of an understanding of the costs of exporting is a rather complex process. Seemingly straightforward accounting practices often mask the somewhat arbitrary manner in which decisions in the allocation of fixed costs, valuation of inventories and a range of other factors must be made.

In analyzing costs, the distinction between fixed and variable costs is useful. Fixed costs, often described as "overhead" costs, include such factors as physical facilities, maintenance and management costs which remain constant over a certain range regardless of the volume handled. Variable costs, including those associated with inputs, some labor expenses and sales costs, vary directly with the level of volume.

4.4.1 Technical and Non-Technical Cost Elements

The determination of costs is influenced by both technical and non-technical elements. Technical cost elements may be examined from somewhat of an engineering perspective. These involve valuation of the factors involved in a physical input-output relationship. Non-technical

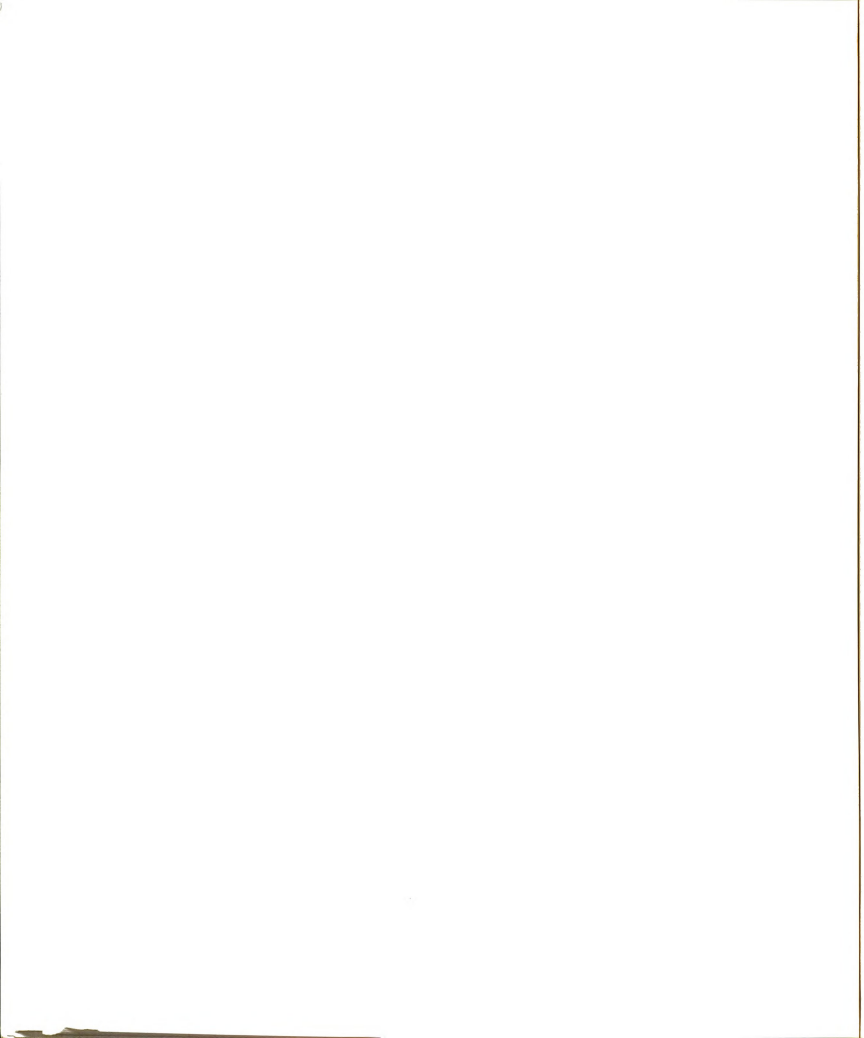


cost elements, sometimes referred to as "pecuniary factors," are less influenced by physical resource use or conservation. These are more responsive to risks and power relationships in the market place.

The cost of performing an individual export related functions, transportation, for example, would begin with the technical costs associated with moving a shipment between two points. Additionally, fees and commissions paid to those handling various arrangements for services, as well as costs of the shipper's own staff resources involved in arranging or performing services, would be included. To these would be added such non-technical cost elements as a risk premium to cover the cost of correcting problems if services were not performed satisfactorily and a factor reflecting market power and bargaining advantages which could influence costs.

The distinction between technical and non-technical cost elements is sometimes clouded by their interaction in a given situation. For example, the ability of a large marketer to obtain lower prices than his competitors from service suppliers may reflect both lower technical costs associated with the provision of large volumes of service and non-technical factors relating to the importance of the marketer as a major customer of the service suppliers. These may permit the marketer to obtain price reductions which exceed the value of decreased technical costs.

The interests of the current research include the identification of both technical and non-technical elements of export marketing costs. These form the background for analysis of the potential for development of scale or size economies in the exporting marketing process through the coordination of export activities by farmer cooperatives.



4.4.2 Economies of Size or Scale

A large body of literature on the theory of scale or size economies exists, although empirical analyses of such economies in export marketing are rare. The subject under study essentially involves the production of export marketing services and much of the analysis of economies of scale in the production of physical output can be used as a theoretical base. In general, the potential for development of economies of scale or size in production are considered to arise from:

- 1) specialization benefits,
- 2) economies of massed reserves, and
- 3) physical economics generated by size in plant and equipment.¹

In addition, economies associated with market power must be recognized.

Specialization, or the "division of labor" as Adam Smith said, "...occasions, in every act, a proportionable increase of the productive powers of labour."² Smith attributed this to

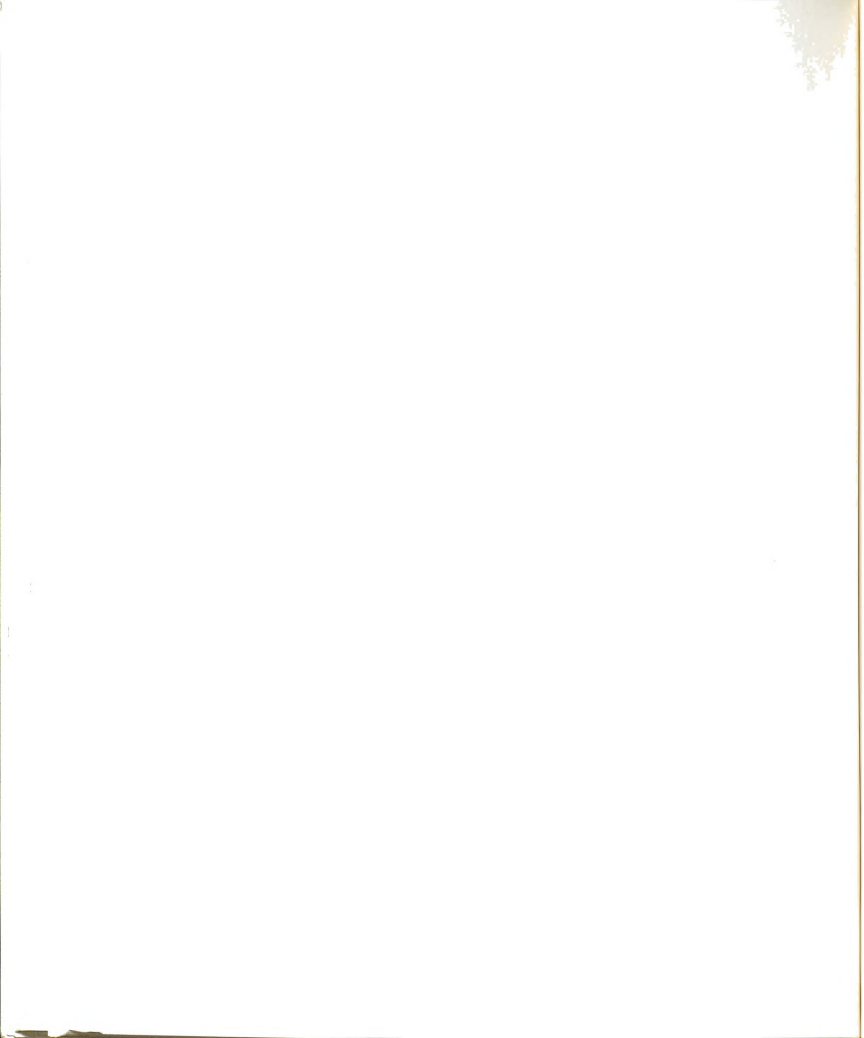
...the increase of dexterity in every particular workman; ...the saving of the time which is commonly lost in passing from one species of work to another; and lastly, to the invention of a great number of machines which facilitate and abridge labour and enable one man to do the work of many.³

In evaluating export marketing functions, it is useful to identify the existence of economics achievable through specialization and some

¹F.M. Scherer, Industrial Market Structure and Economic Performance (Chicago: Rand McNally & Co., 1970), pp. 72-103.

²Adam Smith, The Wealth of Nations (New York: The Modern Library, Random House, 1937), p. 5.

³Ibid., p. 7.



opportunities for cooperative exporters to gain access to them through coordinated marketing activities.

"Economies of massed reserves" are presented by E.A.G. Robinson as the advantages of a large organization in being able to manage the risk of breakdown of plant or demand peaks through inventories or reserve equipment with a "less proportionate reserve of machinery or of stocks to meet possible emergencies" than required for a small firm.¹

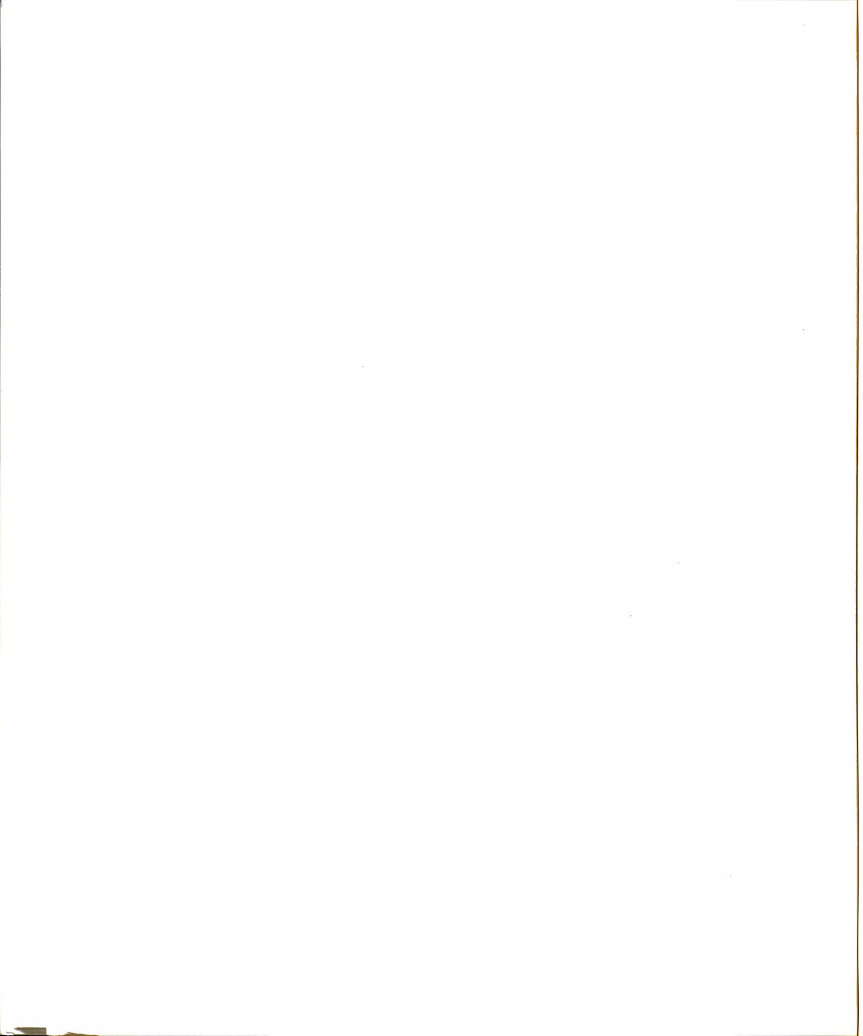
The third source of scale economies, technological advantages of size is discussed by Scherer, who notes that in processing industries, engineers generally consider that up to a certain point doubling of plant output will require only a two-thirds increase in materials and fabrication effort.² This latter point is of interest in the current study in that export markets offer one option for the sale of additional production which may result from the development of scale economies in production and processing of agricultural products.

The above sources of scale economies could all be classified as related to technical cost elements. They all imply an allocation of resources such that physical output from a given level of inputs is increased so that cost per unit of output decreases. Other, non-technical cost elements, such as market power, discussed above, also influence the potential for achievement of scale or size economies.

Another major concern in evaluating the costs of exporting is the potential for development of diseconomies of size or scale. This may

¹E.A.G. Robinson, The Structure of Competitive Industry (Chicago: University of Chicago Press, 1958), pp. 26-27.

²Scherer, p. 73.



occur when any potential coordinational advantages resulting from specialization and other factors are outweighed by increased costs of coordination and management. Such factors must also be considered in the evaluation of potential economic advantages to collaboration in performing the functions which make up the export process.

4.5 Component Functions of the Export Process

Essential to evaluation of the economic potential for coordination of export marketing activities of cooperatives is a view of the export process. In developing a view of the functional requirements of export marketing it is important to recognize that, to a large extent, domestic and international marketing are similar. The provision of a physical product to consumers in a form wanted and at the time and place desired remains essential to a workable marketing system. Kohls' view of a market involving groups of exchange, physical and facilitating functions can be applied to domestic and export marketing.¹ There are, however, differences in the component activities of those functions as well as differences in market participants and preferences and the way information, goods and payment are transferred.

The export process can be described as involving nine component functions:

1. procurement
2. processing
3. transportation and physical distribution
4. market information

¹Richard L. Kohls and Joseph N. Uhl, Marketing of Agricultural Products (fifth edition; New York: Macmillan Publishing Co., 1980), p. 24.



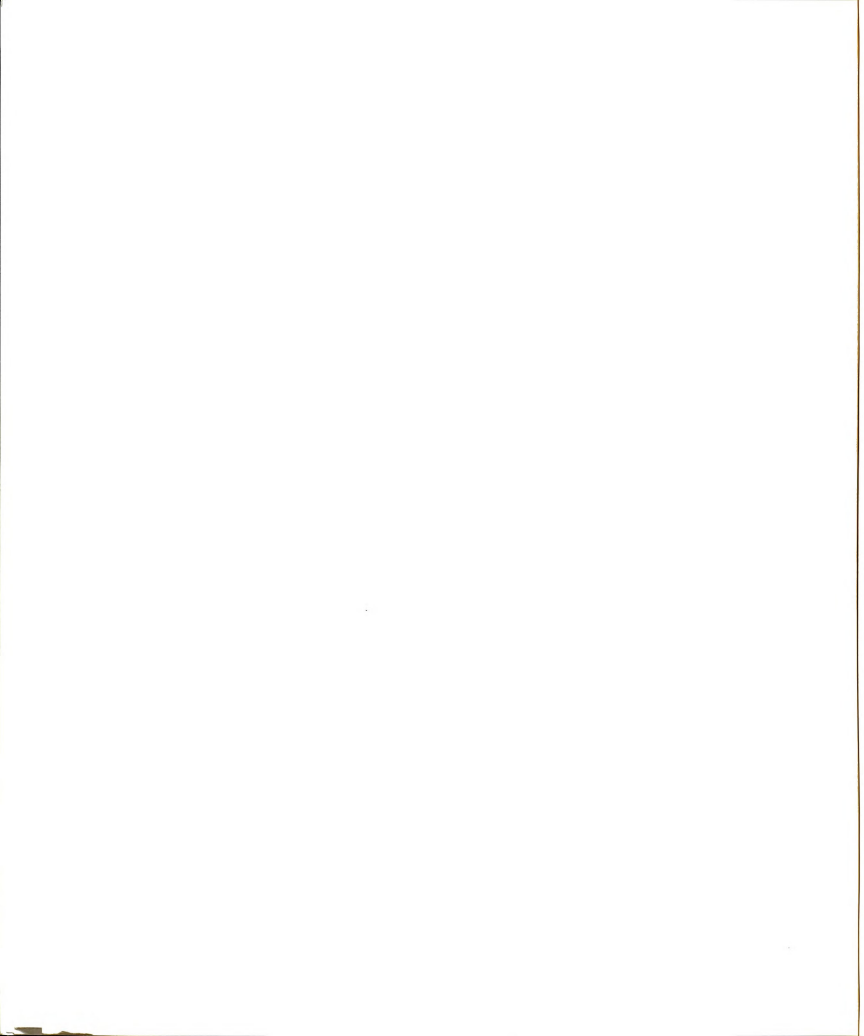
5. sales
6. financial
7. documentation
8. risk management
9. regulatory

The activities making up each function vary somewhat according to the participants in trade, the commodities traded and the form in which they are traded. Nonetheless, these nine functions are generally components of the export process. They will form the basis for evaluation of the economics of the export process in Chapter V. The central issues to be considered with respect to each function are listed in Figure 4.1.

4.6 Selection of a "Functional Approach"

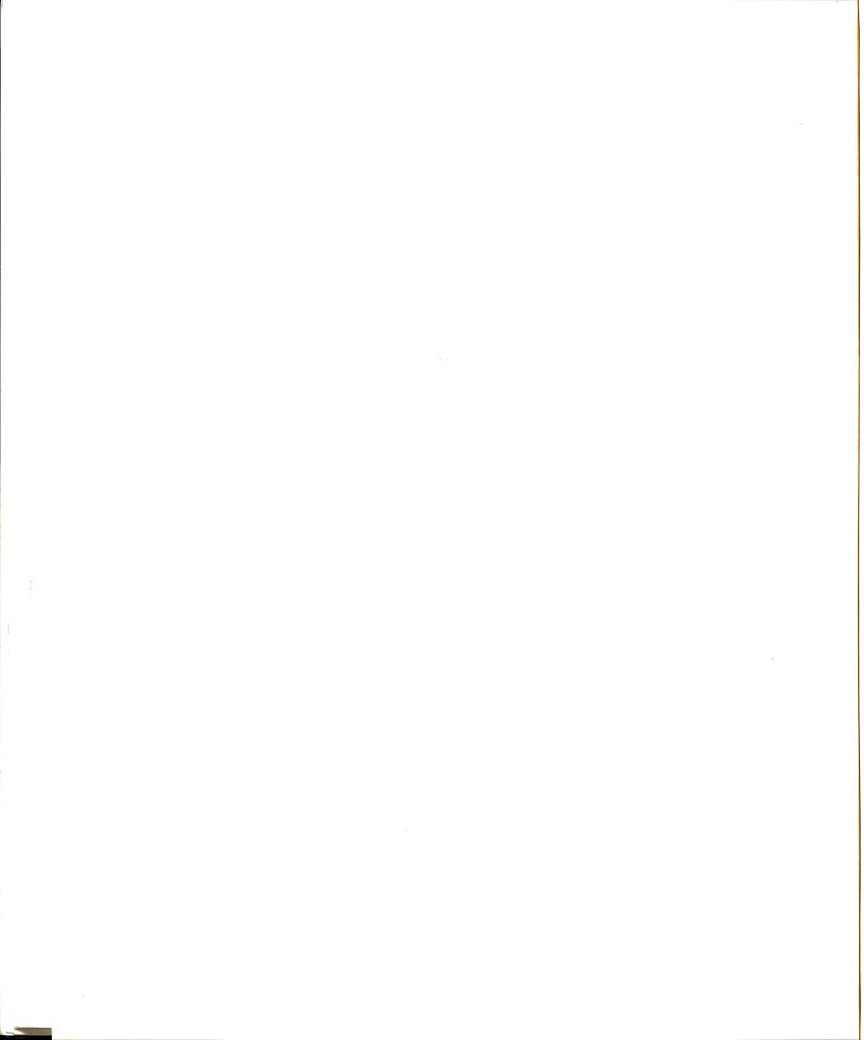
Prior to the adoption of a "functional" approach to analysis of the potential for cooperatives to benefit from coordinated export marketing activities, significant attention was devoted to consideration of an alternative "matrix" approach to the problem. The "functional" approach adopted emphasizes the identification and evaluation of opportunities for coordination of activities required for the performance of individual export marketing functions. The "matrix" approach would focus on commodity-related attributes affecting export marketing requirements which would be conducive to collaboration among exporters. The objective of such an approach would be the ranking of various groups of commodities according to the opportunities and possibilities for joint exporting.

The simplicity of a research product which would permit the identification of export coordination opportunities solely upon the basis of the



- 1. PROCUREMENT
 - * PRODUCT COMMITMENT
 - * MARKETING STRATEGY BASED ON AVERAGE RETURN
 - * ALLOCATION BETWEEN DOMESTIC AND EXPORT MARKETS
 - * MARKET DEVELOPMENT
 - * SPORADIC SALES
- 2. PROCESSING
 - * COMPLEMENTARITY IN FACILITIES REQUIREMENTS
 - * PRODUCT STANDARDIZATION - PRODUCT DIFFERENTIATION
 - * ABILITY TO RESPOND TO FOREIGN TASTES AND PREFERENCES
- 3. TRANSPORTATION AND PHYSICAL DISTRIBUTION
 - * DOMESTIC - INTERNATIONAL LINKAGES
 - * TWO TYPES OF SHIPMENT
 - * BULK
 - * GENERAL CARGO
- 4. MARKET INFORMATION
 - * TWO INFORMATION CATEGORIES
 - * RESOURCES OF KNOWLEDGE
 - * MARKET INTELLIGENCE
 - * MAJOR FIXED COSTS
 - * EXPORTER vs. TRADER - ARBITRAGEUR
 - * IMPORTANCE OF TRADING PRESENCE
 - * VERTICAL COORDINATION AND BARGAINING ADVANTAGE
- 5. SALES
 - * REPRESENTATION
 - * PROMOTION
 - * PRICING
 - * SERVICING
- 6. FINANCIAL
 - * PAYMENT AND COLLECTIONS
 - * INVENTORIES AND RECEIVABLES
 - * FOREIGN CURRENCY EXCHANGE
- 7. DOCUMENTATION
 - * TRANSFER OF GOODS AND PAYMENT
 - * REGULATORY COMPLIANCE
- 8. RISK MANAGEMENT
 - * PRICING RISKS
 - * COMMERCIAL RISKS
 - * FOREIGN EXCHANGE RISKS
 - * POLITICAL RISKS
 - * PHYSICAL RISKS
- 9. REGULATORY
 - * TARIFFS, QUOTAS, SUBSIDIES ...
 - * HEALTH AND SAFETY STANDARDS, LABELLING REQUIREMENTS
 - * CHANGING "THE RULES OF THE GAME"

FIGURE 4.1. FUNCTIONAL ISSUES IN EXPORT MARKETING



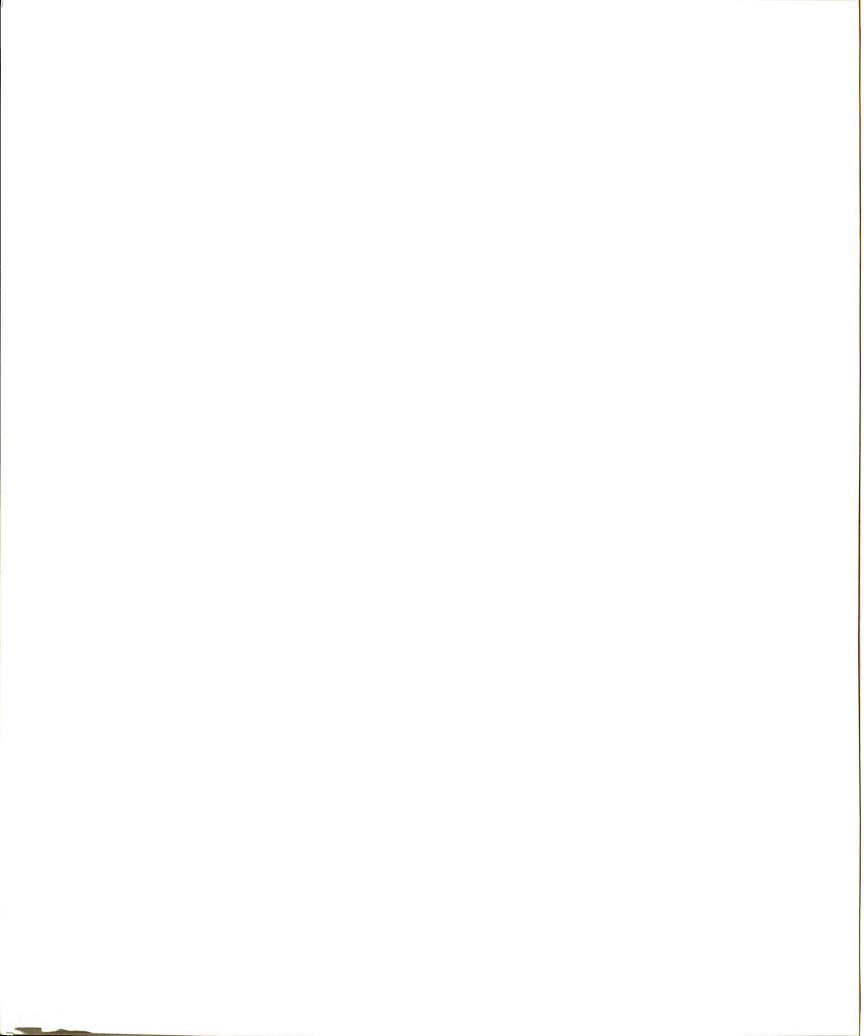
commodity attributes makes a "matrix" approach intuitively appealing. Unfortunately, the complexity of the issues involved is not conducive to such a mode of analysis. It is not sufficient to note that a single exporter has diversified its product line to combine food and feed grains with salt. Neither is it particularly useful to attempt to develop organizational principles based on the observation that producers of citrus and automobiles have coordinated certain international trade-related activities. In each case mentioned, analysis of the economics of export functions, particularly transportation, can, in fact, provide some insights into the process of development of opportunities for successful coordination.

In adopting the "functional" approach, it was decided that evaluation of economic issues related to the performance of the component functions of the export process could be useful to a wide range of cooperative exporters handling diverse product lines and with significantly different export marketing volumes and objectives. Furthermore, it was felt that such an approach could make use of the considerable experience which cooperatives already have in export marketing, and recognize the essential role that individual cooperative managers and other personnel have played in the acquisition of that experience.

4.7 Summary

Export coordination is the process by which individual firms or market participants combine to perform, or contract for, certain functions in the export process.

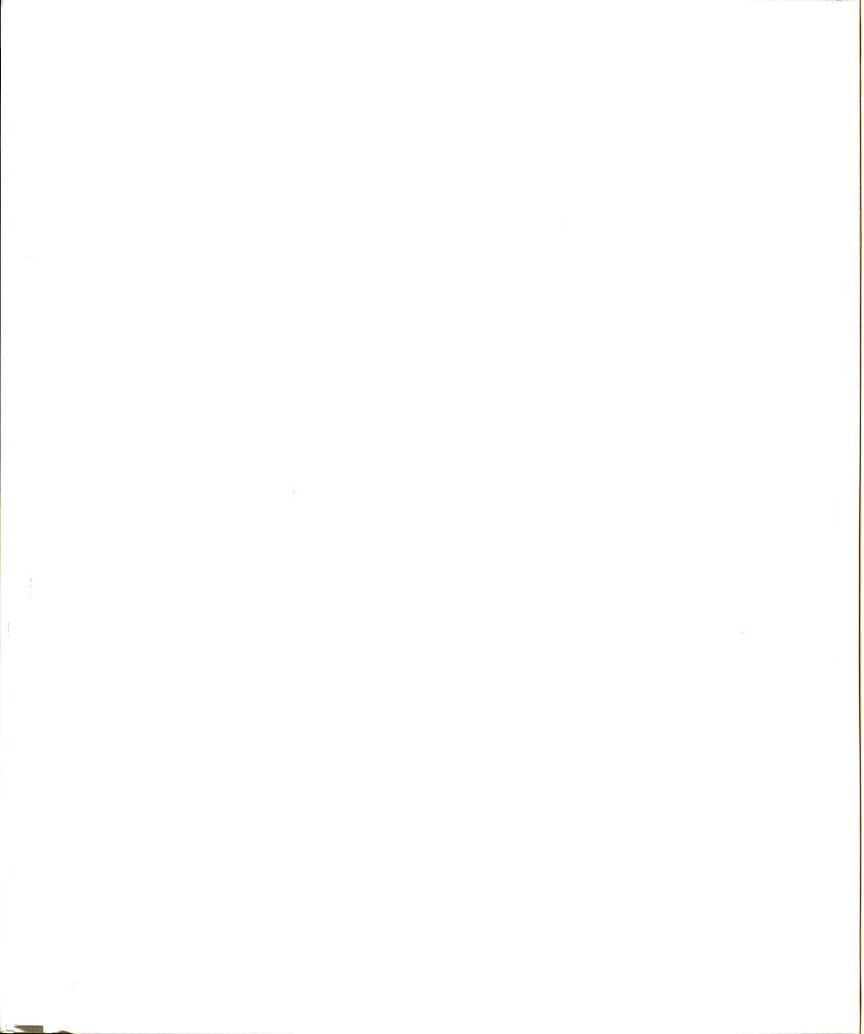
A distinction among four types of coordination: horizontal, vertical, product extension, and conglomerate, is useful in evaluating



the prospects for coordination of export marketing activities in general and more specific organizational arrangements. Coordination may be based on functional, supply related, and/or demand related factors.

Deviations of real world circumstances from the functioning of the perfectly competitive economic model make consideration of coordination opportunities and desirability important. Economies of size and scale, bounded rationality, and variations in market structure and the power of market participants all contribute to the significance of coordination as a mechanism to influence the efficiency and competitive positions of cooperative exporters.

A functional approach to analysis of component functions of the export process is proposed as a vehicle for examination of the above factors. This is the subject of the following chapter.



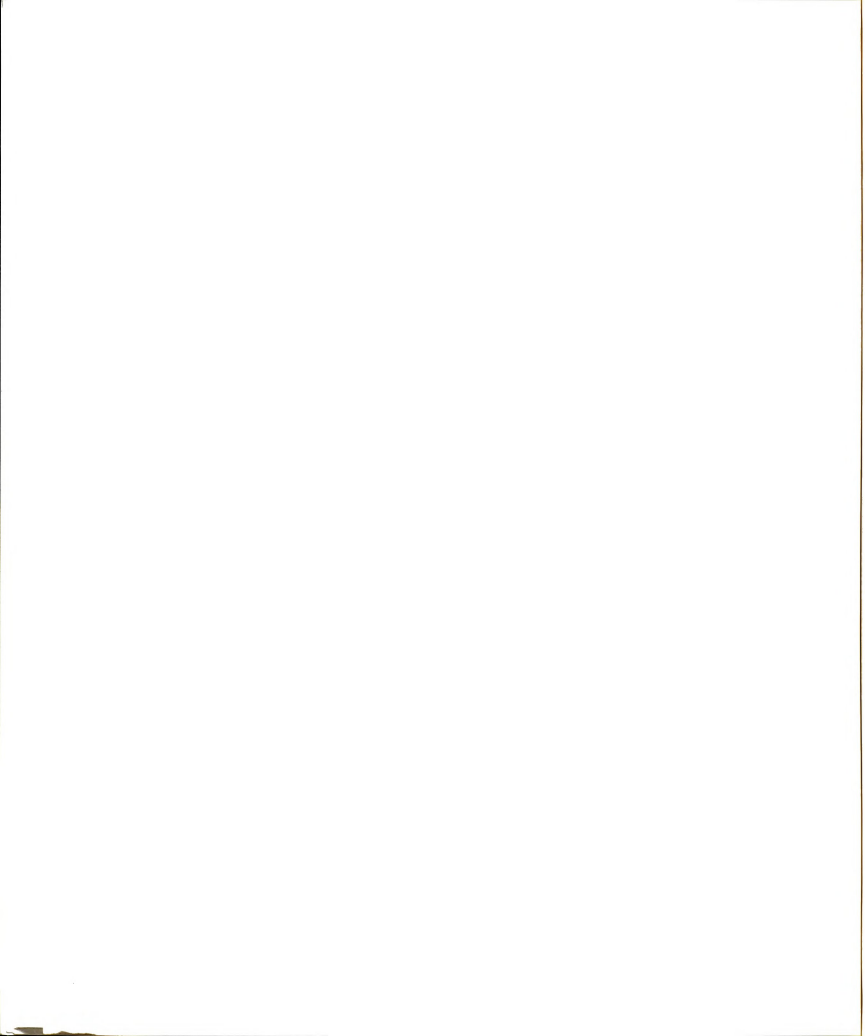
CHAPTER V

FUNCTIONAL COMPONENTS OF THE EXPORT PROCESS: AN ECONOMIC ANALYSIS

The conceptual issues discussed in the last chapter provide useful guidelines for evaluating the economics of the export process. Such an analysis will contribute to understanding the potential for cooperatives to benefit from coordinated export marketing activities. This chapter draws upon data collected in the interview process, as well as secondary source materials, to consider economic and related factors significant to each of the functions which must be performed in export marketing. While the intent is not to provide a functional exposition on the mechanics of exporting, an attempt has been made to include sufficient descriptive material and references to permit the non-specialist to understand the issues involved. Where possible, the potential for achievement of economies of size or scale in the performance of individual functions is evaluated, as are issues related to coordination opportunities. Although analysis is facilitated by treatment of individual functions separately, it is essential to recognize that as components of a process, considerable interdependence among functions exists.

5.1 Procurement

Procurement is the process by which the right to sell a commodity is obtained and the physical product is assembled. While procurement for export and domestic sales sometimes involves different grades of



product and separate arrangements, the mechanics of the procurement function for a given commodity are quite similar, regardless of the ultimate destination involved.

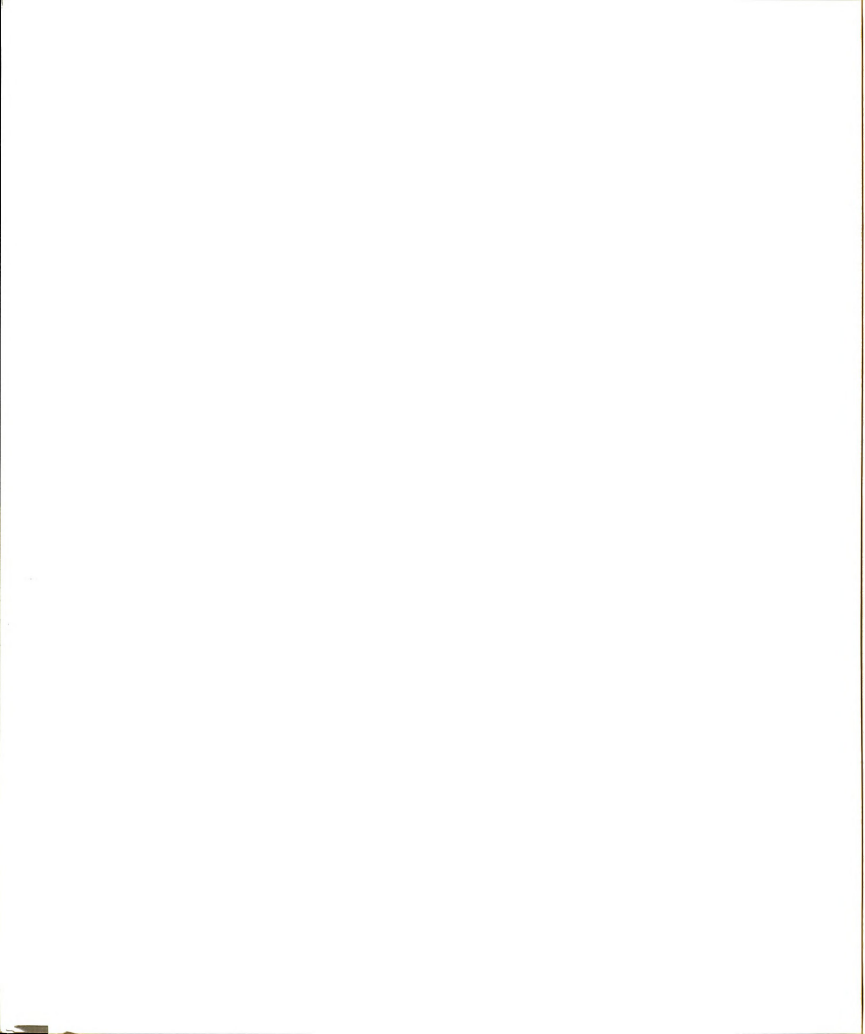
There are three central concerns relative to procurement for export: 1) arrangements for product procurement, i.e., whether the cooperative is the exclusive marketing agent for its members, has annual commitment contracts or must bid for its members' production; 2) the basis for allocation of available supplies among domestic and foreign customers and potential customers; and 3) the basis for transfer pricing among domestic and export marketing programs.

5.1.1 Product Commitment

Arrangements for product procurement are crucial to a cooperative's ability to plan investment in market development and to make forward sales. A large number of cooperatives handling fruits, nuts and vegetables, serve as the exclusive marketing agents for their members. As such, they are responsible for the sale of all of their members' production and must concern themselves with the average overall return on the members' total production.¹ This serves as an incentive to market diversification, as well as product differentiation and new product development.

A diverse set of market outlets offers the potential for decreased variability in the total demand for a commodity. The development of export markets is one means to accomplish such diversification.

¹For a discussion of exclusive marketing arrangements in a general context, see James D. Shaffer and Randall E. Torgerson, "Exclusive Agency Bargaining" in Marketing Alternatives for Agriculture (Ithaca: New York State College of Agriculture and Life Sciences, Cornell University, 1976).

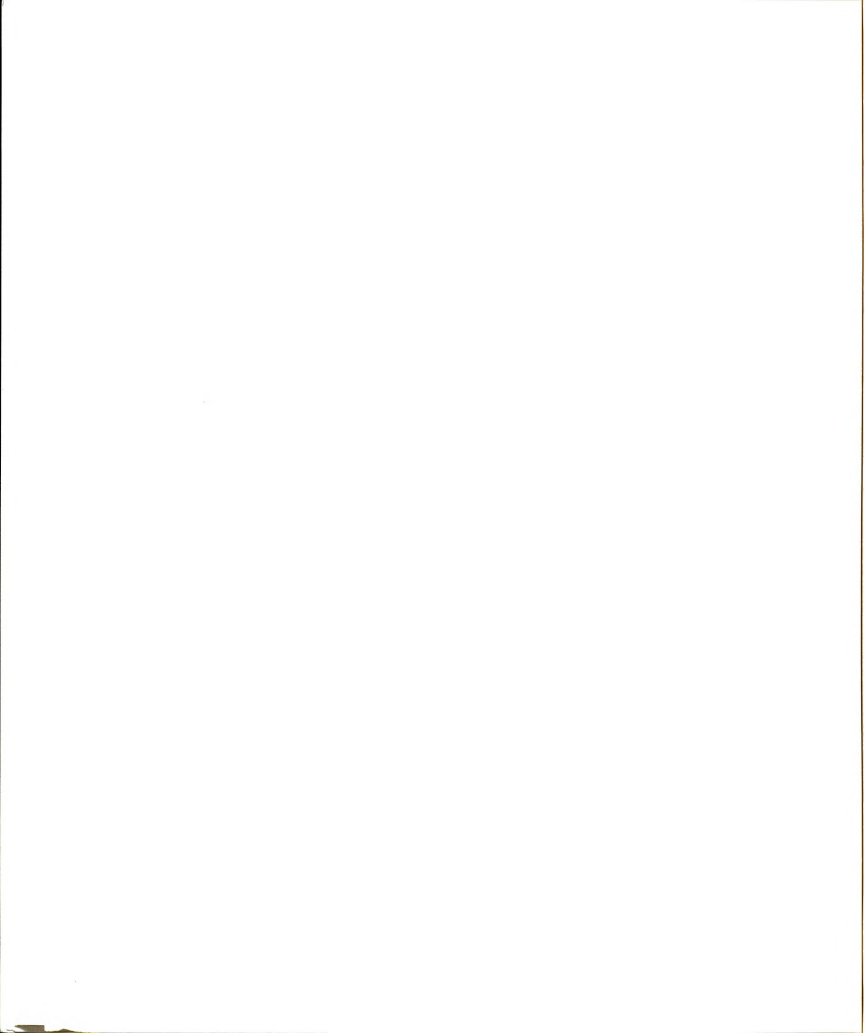


The importance of a marketing strategy which emphasizes maximization of the average return to total production is often overlooked by producers. Cooperatives must often compete with private handlers who are able to pay a price higher than the average return earned by the cooperative, but who only purchase a fraction of the farmers' total production. Membership agreements which commit producers to sell all of their output through their cooperatives decrease the cooperative marketer's uncertainty as to what he must sell. This also permits the cooperative to make the sales and capital commitments necessary to maximize the average return to the growers total production.

In conjunction with membership agreements, many cooperatives use pooling as a mechanism to combine the non-priced volumes of many producers under a specialized marketing staff. Each producer then receives the average price received by the pool for the quantity of each specified quality that he delivers.

Pools vary in the manner in which they differentiate among product uses and destinations, as well as their procedures for allocation of overhead costs.¹ In some cases, pools for exported products have been separated from those sold in domestic markets. Where the quantity of production sold in export markets affects the amount available domestically, it may also affect the domestic price. In recognition of this interdependence, some cooperatives do not distinguish between returns in export and domestic sales.

¹For a discussion of pooling and case studies in its effectiveness see: T.M. Hammonds, Cooperative Market Pooling (Circular of Information 657; Corvallis: Oregon State University Agricultural Experiment Station, 1976).

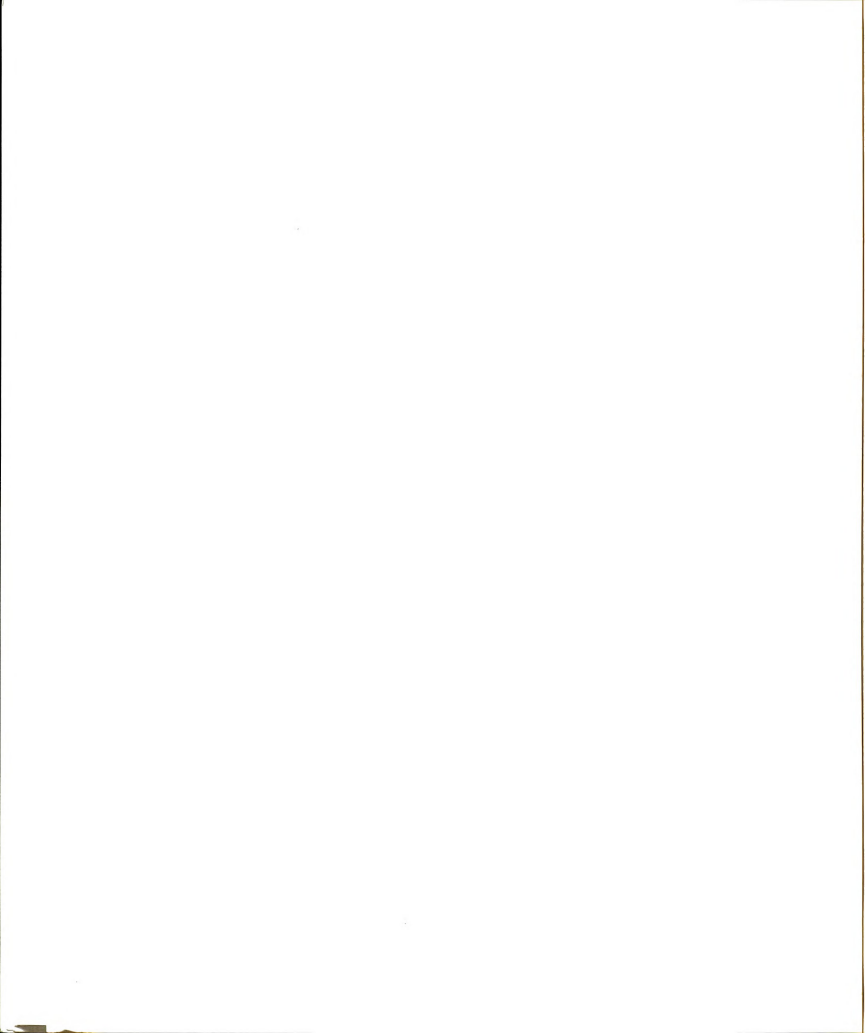


While pooling and exclusive marketing agreements are quite common in the procurement of fruits, nuts, vegetables, cotton and rice, cash markets prevail for wheat, feed grains and oilseeds.

Several grain cooperatives have attempted to operate pools. Far-Mar-Co, for example, has developed Promark, a wheat pooling program which it hopes will provide an advantage in marketing. However, as Gordon Leith of Far-Mar-Co's parent Farmland Industries notes, a pool "locks in" the commodity supply to the cooperative, but it still has to be sold.¹ Procurement is only one part of the marketing process which leads to sales in domestic and foreign markets.

In the absence of an exclusive marketing agreement with members or some sort of product commitment, cooperatives are forced to either purchase the commodity prior to resale or speculate on their ability to place a hedge and purchase later. Farmer's Export Company (FEC), an interregional grain exporting cooperative, operates without formal commitment from its members to provide it with grain for sale. When it finds the opportunity for an export sale, it can provide its members with the first opportunity to meet sales commitment for grain or oilseeds, but that failing, FEC must go to non-members in order to satisfy its sales obligations. While the percentage of member product sold by FEC has been on the increase, accounting for 70 percent in 1978, the ability to plan sales is constrained by knowledge of availability of product. James Layton, FEC president, continually stresses the importance

¹Interview with Gordon Leith, Corporate Vice President, Farmland Industries, April 27, 1979.



of a marketing strategy based upon maximizing average prices of total production and "offering a continuous supply of quality grains" as major steps in export market development.¹ These goals might be facilitated through firmer membership agreements.

5.1.2 Product Allocation

The second major concern in procurement is the basis for allocation of available supplies among domestic and foreign customers.² In periods of above average production, producers and their cooperatives are concerned primarily with finding buyers for their output. For periods of shorter supply, contingency plans for procurement and allocation must be considered.

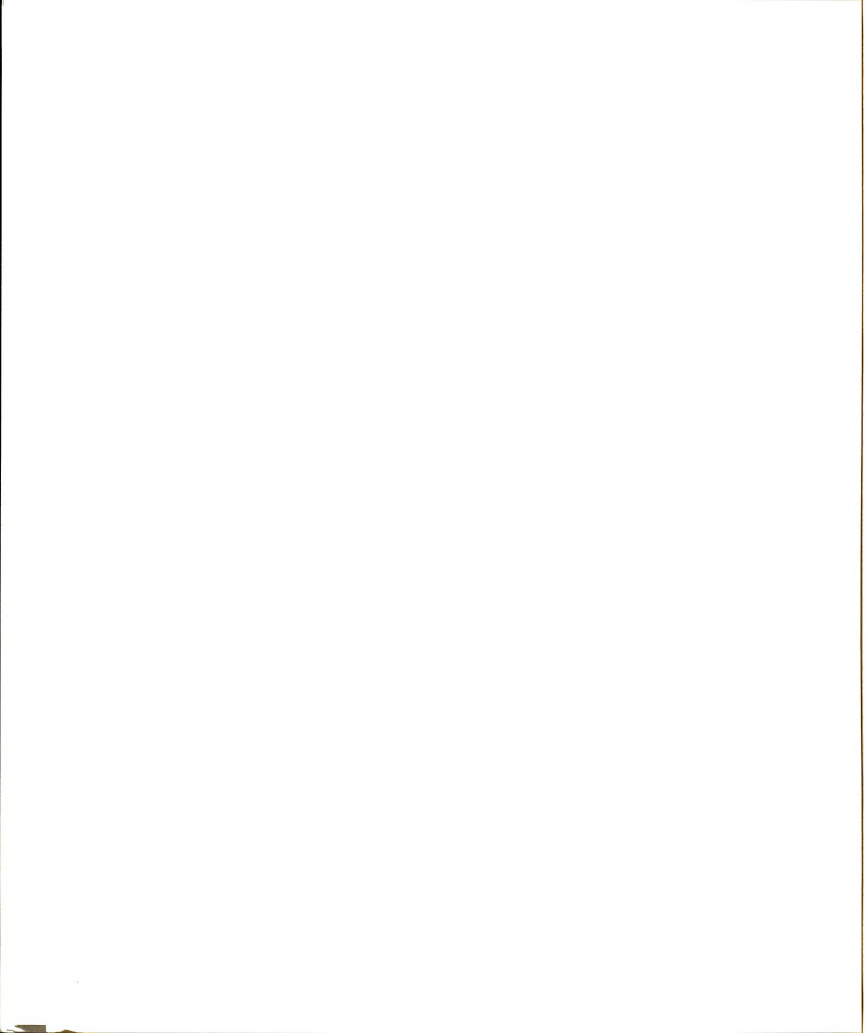
These plans will determine whether export marketing is to be approached as 1) a market development activity, or 2) an outlet for sporadic sales of surpluses. While the latter approach has often been the norm for U.S. producers, increasing international competition, as well as awareness of the potential impacts of surplus disposal on foreign producers, make reliance on such a strategy increasingly tenuous.

Many cooperatives continue to treat export markets as an outlet for sporadic sales. Poultry exports are treated as such in part because of the difficulty of competing with subsidized European exports.³ Export marketing for many fruits and nuts began on a sporadic sales basis, but

¹Quoted by Alan Krob, "Grain Importers Seek Steady Prices, Supplies," FarmLand News, February 15, 1979.

²With some commodities, grade and size demands of domestic and export markets are complementary, so that allocation is concerned with joint products. This section refers to cases where a given commodity can be processed for sale in either domestic or export markets.

³Waldo W. Rowan, "EC Poultry and Egg Policies Hamper U.S. Trade with EC-9" Foreign Agriculture, Supplement, April 17, 1978.



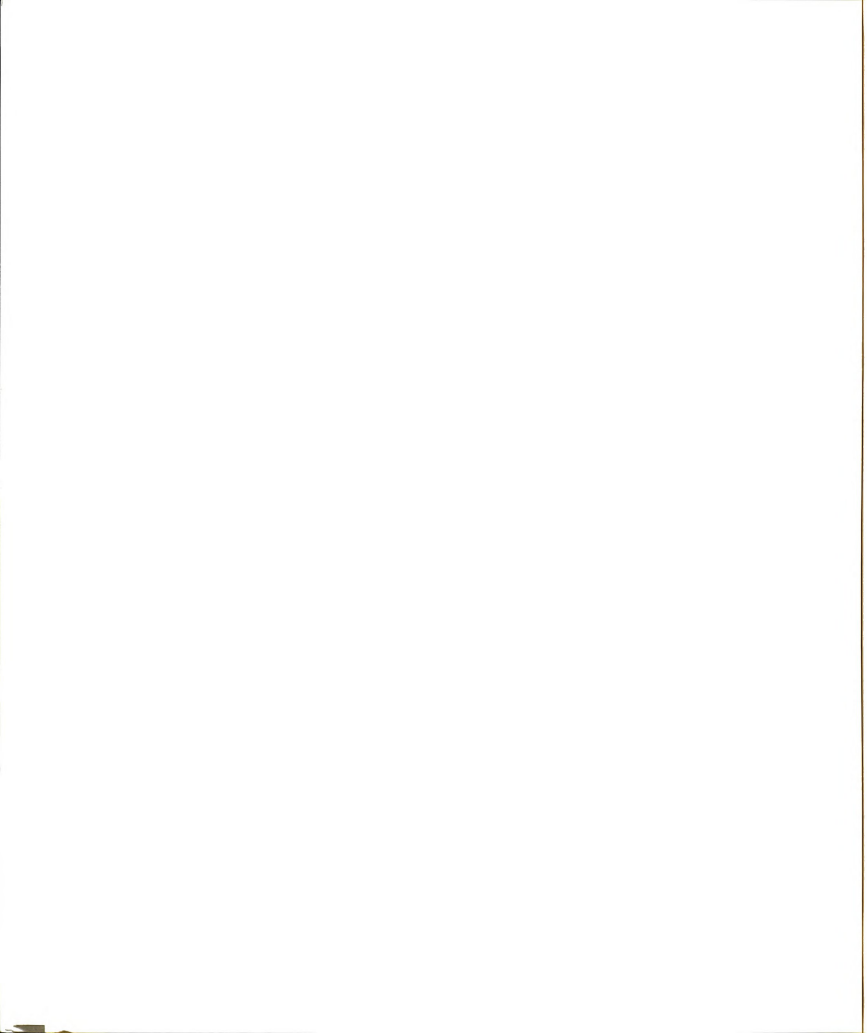
has since been transformed into full scale market development activities. In the case of almonds, exclusive agency arrangements, combined with expectations of major production increases, have provided the impetus for major initiatives in development of both new products and broadened export markets.¹

This research emphasizes exporting as a market development activity. Stochastic factors in the production process will always result in some variability in supplies to both export and domestic markets. Storage provisions under some marketing orders, such as those for almonds and raisins, are one mechanism for stabilizing supply over time in a manner consistent with market development.² Where storage is not possible, a critical issue is whether the burden of adjustment to supply fluctuations will be shared among markets or allocated entirely to export markets. If investment in export market development is to be an economically feasible proposition, then some provision for procurement must be made.

Cooperative exporters handle this situation in four different ways: 1) they sign annual membership agreements and establish allocation rules among markets; 2) they take member production, but arrange for additional non-member sources of product when required to satisfy demand; 3) they sign marketing agreements to sell specified quantities of non-member production during the marketing year; or 4) they ignore procurement and

¹Interview with Jack Axer, California Almond Growers Exchange, August 9, 1979.

²For discussion, see: National Commission on Food Marketing, Organization and Competition in the Fruit and Vegetable Industry (Technical Study No. 4; Washington, D.C.: Government Printing Office, 1966), pp. 307-312.



allocation issues and complain about the costs of exporting and their inability to capture returns sufficient to pay for any investments made in foreign promotion.

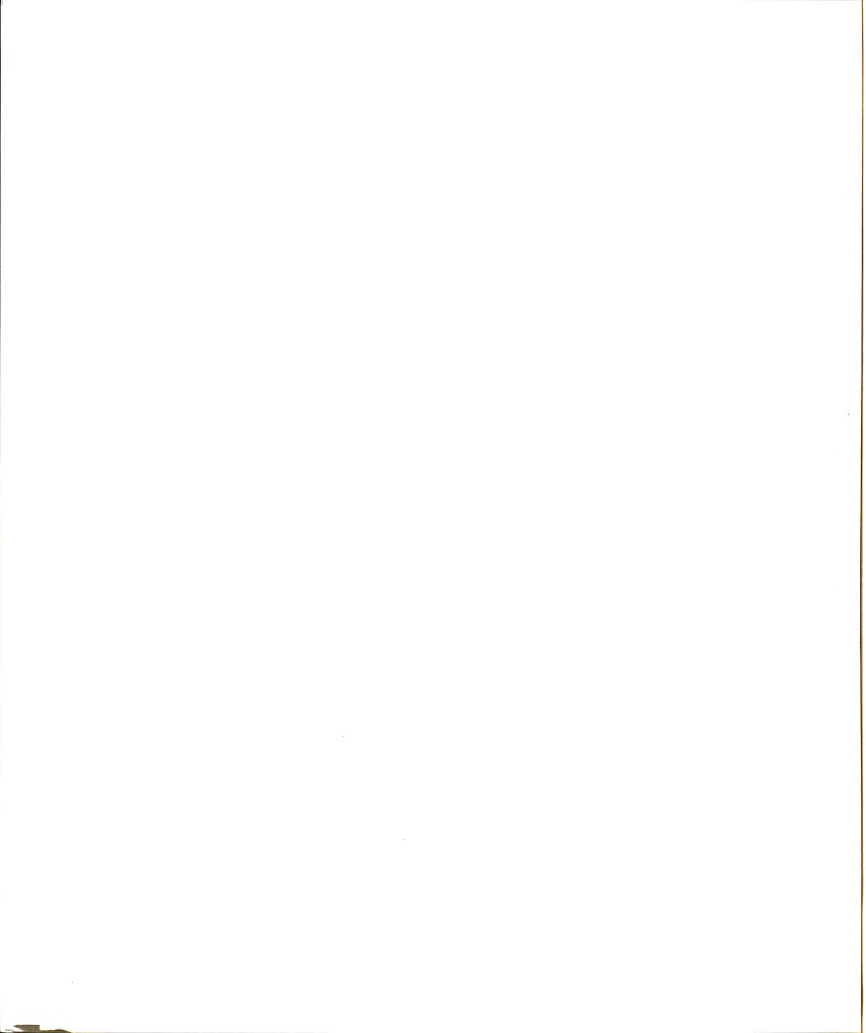
Each of the above approaches has some advantages and disadvantages and the managers adopting them often face different constraints in terms of member priorities and market opportunities. In evaluating the potential for coordination of export activities, product procurement related factors merit consideration.

5.1.3 Transfer Pricing

While the procurement function is similar whether the ultimate consumer is domestic or foreign, it is useful to recognize a distinction between procurement for the cooperative in general and procurement for export sales. A final procurement issue to be considered is internal transfer pricing for domestic and export sales.

As cooperatives get larger and involved in more diverse activities, they often develop a multidivisional structure with individual divisions treated as profit centers. This offers certain advantages in facilitating evaluation of the performance of individual activities and perhaps deciding whether some activities can best be handled outside of the organization.

At the same time, the divisional quest for "margins" or profit offers potential interference with the ultimate organizational goal of maximizing the average return to the producer. Export activities are particularly vulnerable in this respect. A basic concern is the procedure for evaluating the profitability of an export marketing division.

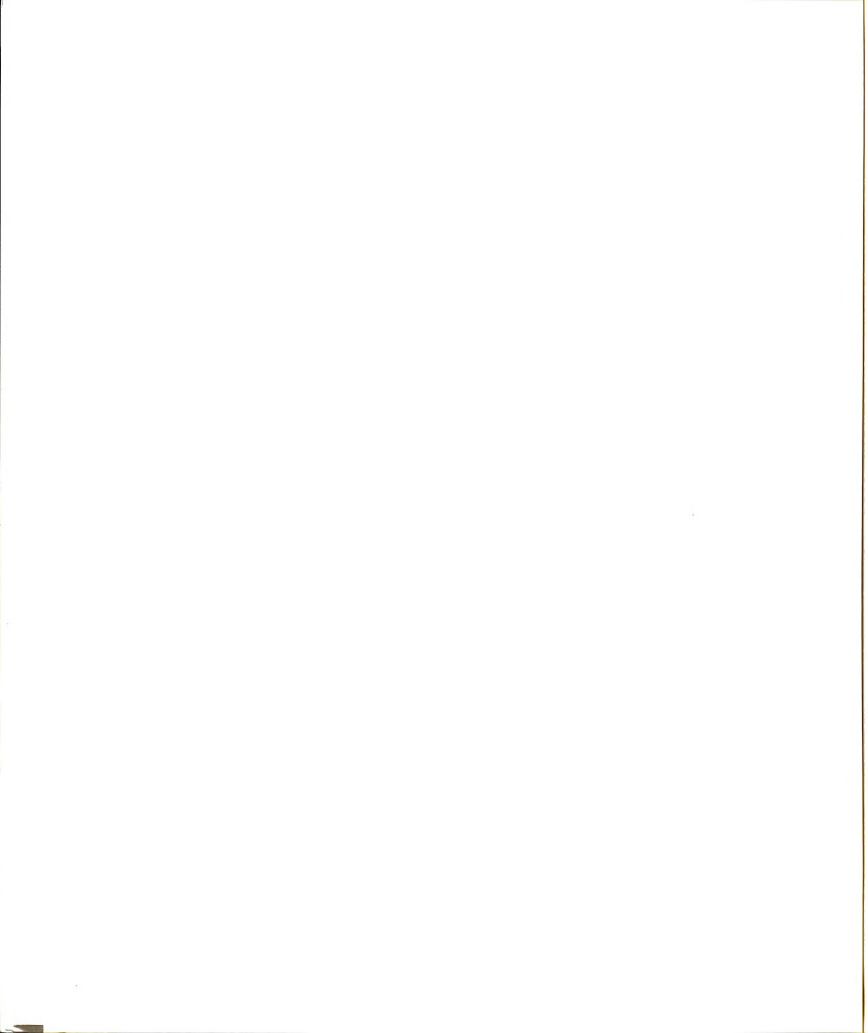


Where export market development amounts to market segmentation, economic theory tells us that total revenue can be maximized through price discrimination. If this is the goal, then evaluation of export market profitability on its own may be misleading in terms of the contribution of exports to overall profitability. Furthermore, the profit center concept may lead to performance which is contrary to the overall organizational objectives if profits built into each stage of the procurement process combined with requirements for profitability in the export division, detract from the competitive position of the product. This is not to say that exports need not be profitable. Rather, it is an observation that evaluations of divisional performance must go beyond simple comparison of "bottom lines" to consider the impact of divisional strategies on overall organizational performance.

5.1.4 Economies of Size in Procurement

While there may be some size advantages in terms of potential to employ specialized field representatives for procurement, and the ability to spread the fixed costs of contract development, or systems for analysis of inventory, etc., these factors are not unique to procurement for export sales.

For the current research, the interest in size advantages concerns potential economies which might arise from multicommodity coordination. In the case of procurement, there might be some advantages to coordination where the sets of producers of multiple commodities intersect substantially. Given the nature of specialization in U.S. agriculture, such overlap would be expected to relate to limited groups of commodities, such as corn and soybeans or apples and pears. The advantage to coordination would appear greater in procurement for both domestic and export



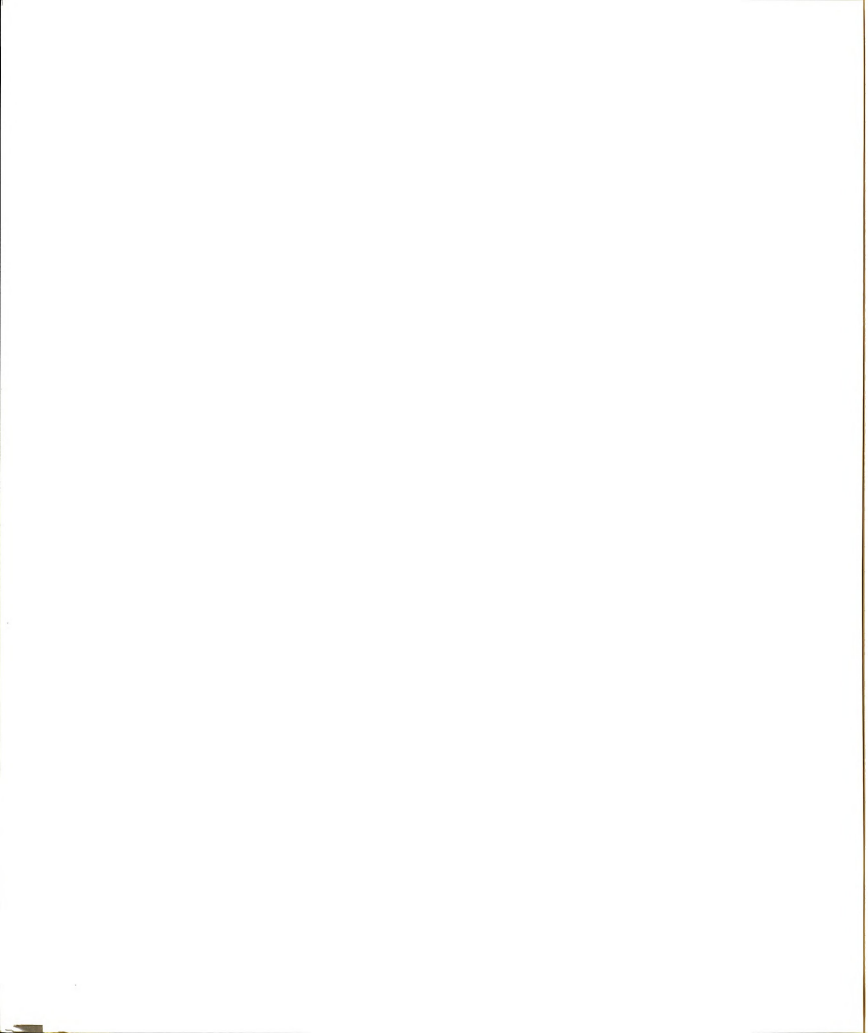
markets of the same products, as is currently done by many local and regional cooperatives, rather than to farm level procurement of a wide range of commodities for export. An examination of the former set of economies is obviously beyond the scope of the current research.

5.1.5 Summary

The procurement function is important to the evaluation of potential for cooperative export coordination in three major respects. First, the degree of member product commitment to cooperatives varies considerably. The marketing task of cooperatives which are the exclusive agent for their members' products differs from those which are but one alternative outlet for their members. Fruits, nuts, vegetables, poultry, and dairy products fall into the former category, while grains and oilseeds generally fall into the latter group.

Secondly, the basis for allocation of available supplies among domestic and export markets permits classification of cooperatives as exporters interested in market development or sporadic sales. This distinction is useful in identifying the potential for investment in export market development as well as any commonality of interest or marketing orientation which would be conducive to coordination of export marketing activity.

Finally, transfer pricing strategies can be critical factors in influencing the success or failure of any attempt at coordination of exports which requires procurement of products from a number of cooperatives. Such strategies must be evaluated in the development of performance criteria for any collaborative effort.



5.2 Processing

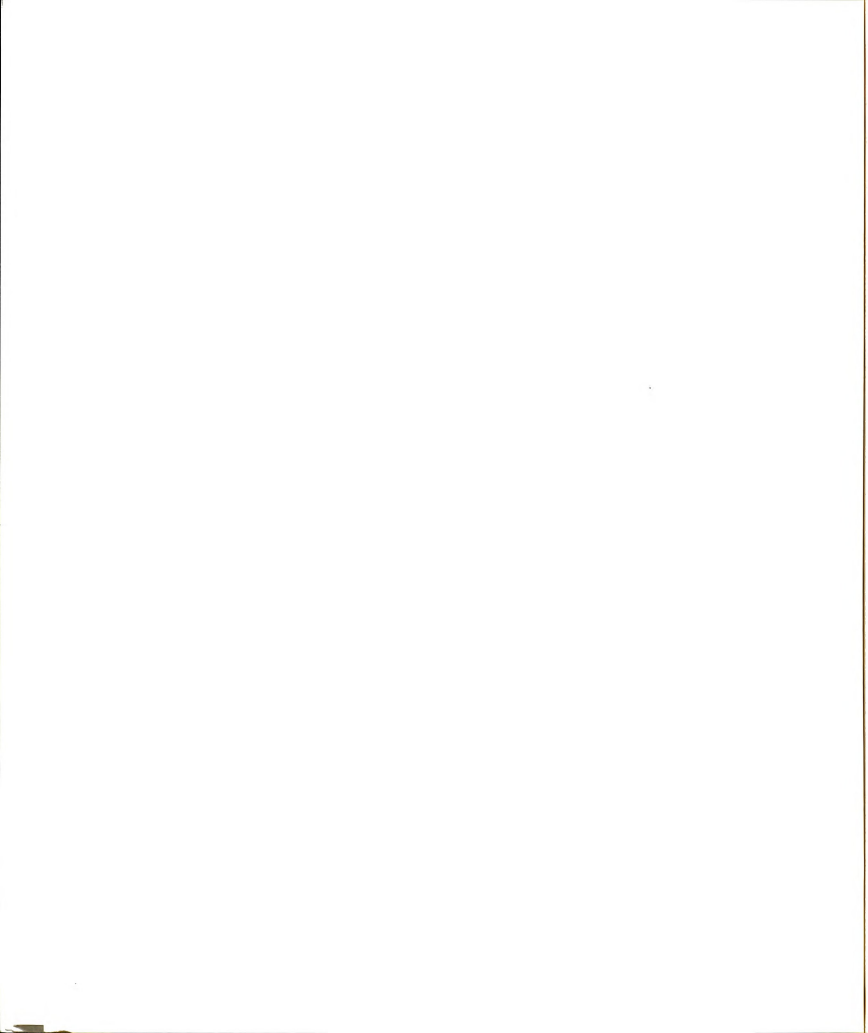
The processing function contributes to product form, and thus modifies product utility. Processing affects the ultimate salability of a product as well as flexibility among market outlets.

"Processing" is a term of broad meaning, and the processing function differs markedly among commodities. For grains and oilseeds, processing begins with cleaning, grading and blending and eventually leads to milling or crushing and transformation into a broad range of products. For fruits and vegetables, processing may include washing, grading, sizing and packing, but little more; or, it may involve canning, freezing, drying or use as an ingredient in some other product.

In the current research, interest in the processing function centers on its influence upon the ability of cooperatives to export profitably and the potential economies which might be obtainable through collaborative effort among cooperatives handling diverse commodities. The analysis which follows considers: 1) complementary processing facilities requirements as they relate to export; 2) processing as a means for product standardization and/or differentiation; and 3) tastes and regulations which influence processing requirements for different commodities in individual foreign markets.

5.2.1 Complementarity in Facilities Requirements

Special processing facilities requirements for export range from port elevation for grains and oilseeds to foreign government inspected fumigation rooms for fresh fruit exports to specific markets. Processing for export does not always require special facilities, however.



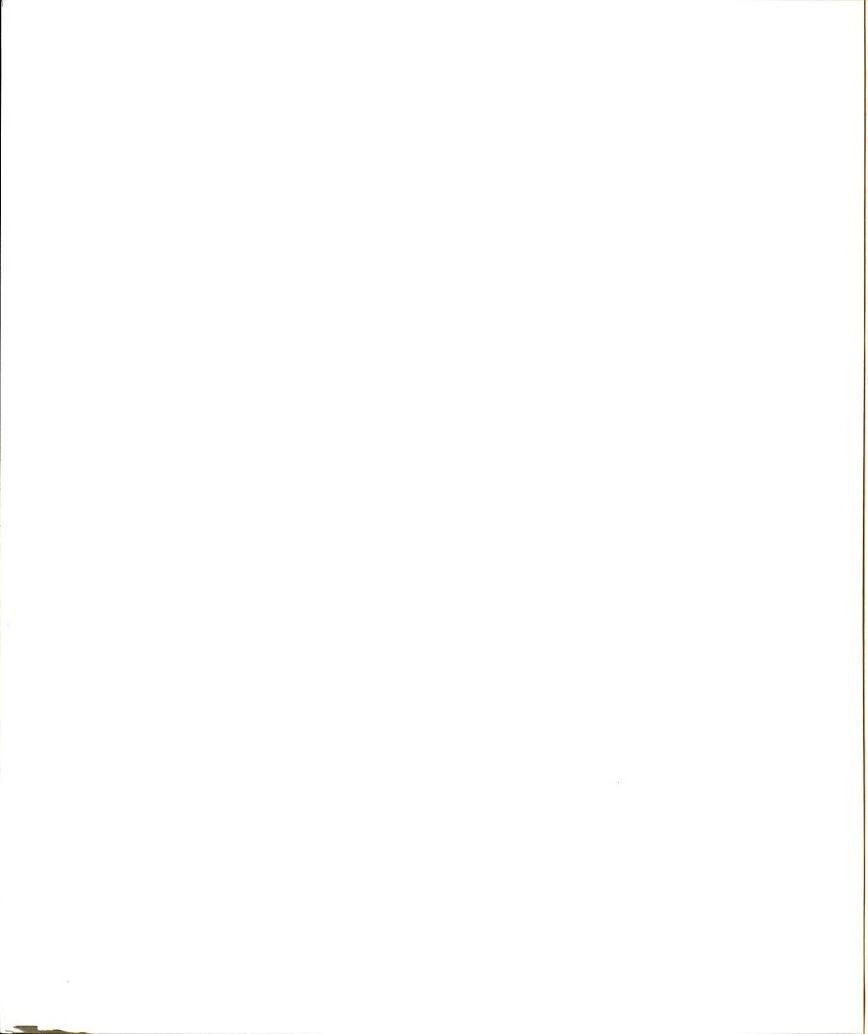
A distinction can be made among commodities based upon complementarity of need for processing facilities. Grains and soybeans, which are a subset of the bulk commodities group, can all be handled through similar port elevation facilities. While these commodities can be physically loaded and unloaded without elevation, there are substantial economies, such as speed in handling and precision in blending and vessel loading, which are made possible through the use of elevation. Grain in export elevators is generally out of position for profitable sale on domestic markets, so complementarity would be expected to extend only among export destined commodities. Such complementarity may be further influenced by domestic transportation economics and similarities among buyers.

An elevator may be operated most efficiently in a technical sense through handling a single commodity. However, economies related to supply and satisfaction of buyer demand often result in handling of several commodities through an elevator. On the Gulf Coast, one rule of thumb suggested was that a maximum of four commodities, spring and soft wheats, soybeans and corn, be handled through Louisiana Gulf locations, with hard winter wheat and sorghum left to Texas elevators.¹

For fruits and vegetables, there may be special inspection requirements for sales to specific foreign markets. For example, fresh cherries shipped to Japan must be fumigated under Japanese inspection.² A group of Washington and Oregon cherry marketers, cooperative and non-cooperative,

¹ Interview with Joe Zeman, Vice President, Marketing Administration, Farmers Export Company, April 26, 1979.

² Interview with Brian Lay, Manager, Fresh Fruit Sales, Diamond-Fruit Growers, August 2, 1979.



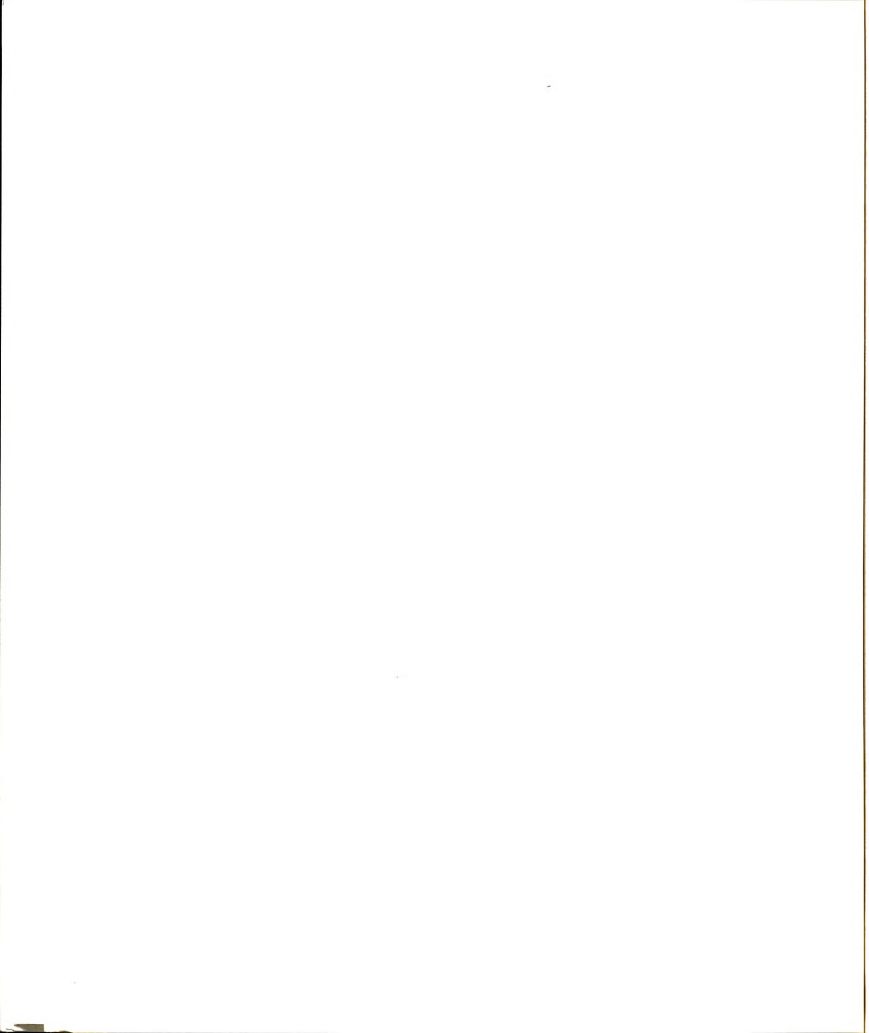
have formed Northwest Fruit Exporters, a Webb-Pomerene association which, among other activities, brings Japanese inspectors to Northwestern packinghouses.¹ This permits achievement of economies of volume in fumigation and inspection. Single packers might be unable to profitably bear such expense. This will be discussed further under the regulatory function.

The above examples are indicative of the types of complementarity of facilities requirements which may exist. In evaluating the potential for multicooperative collaboration in export marketing of a broad range of commodities, it is useful to consider the capital requirements for specialized processing facilities. Port elevation, for example, whether leased or purchased, is quite expensive.² Any multicooperative organization including commodities requiring port elevation faces the problems of allocation of capital costs and managerial effort. Cooperatives which handle only commodities which do not require elevation cannot justify tying up their members' capital in such facilities. In establishing a multicooperative organization, this accounting problem could be handled through prorating capital contributions according to potential or actual facilities used.

A more fundamental problem in such cases would be the difficulty confronted by management in providing equitable marketing attention to a broad range of commodities, when capital employment would be strongly

¹"Fresh Northwest Cherries on Way to Japan," The Goodfruit Grower, July 1, 1979, pp. 1-2, 10.

²Farmers Export Company reportedly paid \$37 million in its 1977 purchase of a Galveston, Texas export elevator from Cook Industries. "Farmers Export Company Passes \$1 Billion," Milling and Baking News, May 24, 1977, p. 7.



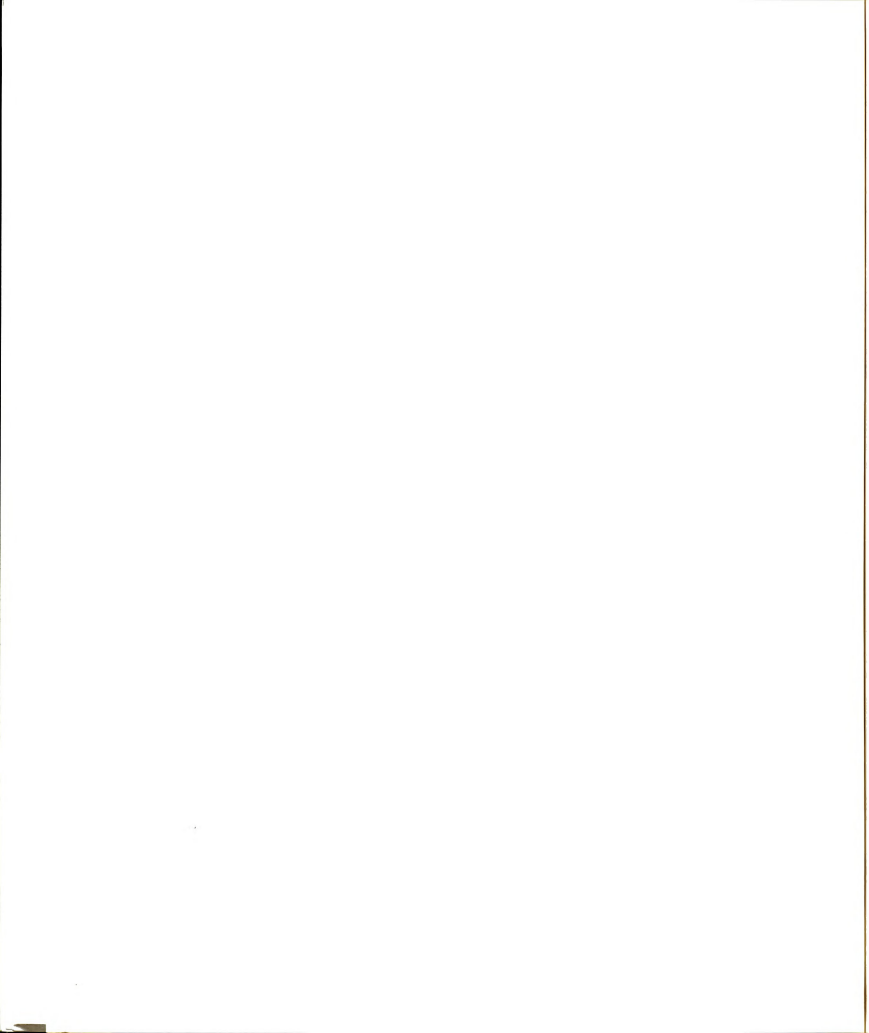
skewed toward grains. Under such conditions, merchandising priorities would indicate emphasis on grain sales, and producers of other commodities might fear that they would be shortchanged. While organizational and accounting procedures could be developed to cope with some of the above problems, overcoming fears of unequal treatment by producers of non-bulk commodities may necessitate short-term coordination initiatives including commodity subgroups which either share special requirements or face none.

5.2.2 Processing for Product Standardization or Differentiation

A distinction between processing for product standardization and differentiation is useful in evaluating the complementarity of export marketing strategies for different commodities. Product standardization permits buyers to choose among sources of supply without examination of the commodity. In such cases, price can be a very important variable in the choice among sources of supply.

In contrast, product differentiation expands the range of variables involved in choice among sources of supply. While price may remain an important factor for the purchaser, commodity attributes also enter the comparison process. Among differentiated products, price, promotion and positioning are all important marketing factors.

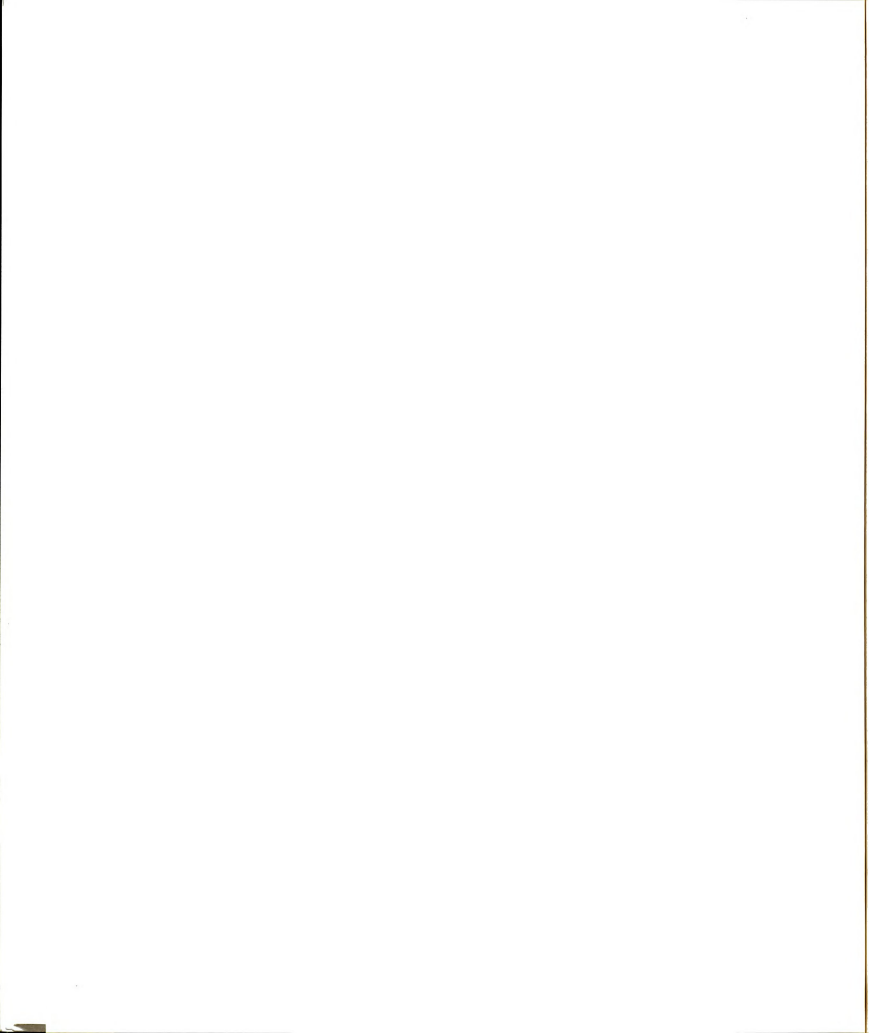
Trade in grains and oilseeds is largely a high volume, low margin business in standardized bulk commodities. In addition, there is a much smaller and higher margin trade in grains, oilseeds and products which are differentiated either through packaging, such as sale in bags, or identity preservation, as in the case of seed.



In the high volume, low margin grain trade, contracts are written for grades such as No. 2 soft red winter wheat or No. 3 yellow corn. U.S. farmer cooperatives have worked hard to develop a reputation for providing product which meets these quality standards. At the same time, cooperatives are often slightly underbid by multinational traders. In such cases, blending to provide the exact quality contracted for becomes an important factor. If cooperatives provide higher quality grain than they are paid for, they not only may adversely affect their ability to compete, they are also in effect giving away their members' margins.

Product differentiation may be accomplished through branding, or special grading standards, packaging, or services. Branding may serve to differentiate a product or line of products and establish them as achieving certain quality standards. This may be translated into a price premium in certain markets. Some cooperatives have successfully developed export markets for branded products, among them California Almond Growers Exchange's Blue Diamond Almonds, Gold Kist poultry, Sunkist and Seald-Sweet citrus, and Diamond Fruit Growers' apples and pears. The importance of promotion, the means through which a product may be differentiated in specific markets, will be discussed under the sales function.

Grading as a means of product differentiation may involve the establishment of standards which closely reflect product attributes of importance to prospective purchasers. This has the effect of decreasing buyer transactions costs. For example, American Rice, Inc. (ARI), has developed a grading system which permits buyers to purchase rough rice without need for buyer inspection. Since other rice requires such



inspection, the ARI grading system yields a substantial marketing advantage.¹

Special services which differentiate products range from sale of bagged grain, oilseeds or meal to special processing of fruit to reflect preferences in specific markets. In some export markets, for example, No. 2 1/2 cans of processed fruits are a preferred retail pack to the No. 303 can which is popular in the U.S.² Also, Japanese consumers are said to prefer canned fruits which are firmer than those consumed domestically.³ Special processing in response to demands of specific export customers presents marketing opportunities quite different from those in exporting standardized products. For the exporter with access to the facilities necessary to permit response to specialized demand, there are substantial export opportunities.

5.2.3 Responding to Foreign Tastes and Preferences

The ability to respond to foreign tastes and preferences includes: 1) the process of assessment of those preferences; and 2) processing requirements for their satisfaction.

Market research is one means of assessing tastes and preferences in specific markets, domestic or foreign. Complementarity in market research would be expected to reflect the organization of demand for commodities. Thus, there might be advantages to joint research on

¹Hammonds, p. 13.

²Interview with Percy Rideout, California Valley Exports, August 6, 1979.

³Interview with Ken Cain, Diamond Fruit Growers, retired, August 2, 1979.



preferences for a full line of retail packages of processed fruits and vegetables. Likewise, complementarity would be expected to extend among such commodities in identification and response to peculiar processing requirements such as ingredients, canning practices and labelling.

These factors will be reflected in later discussion of market information, sales and regulatory functions.

5.2.4 Summary

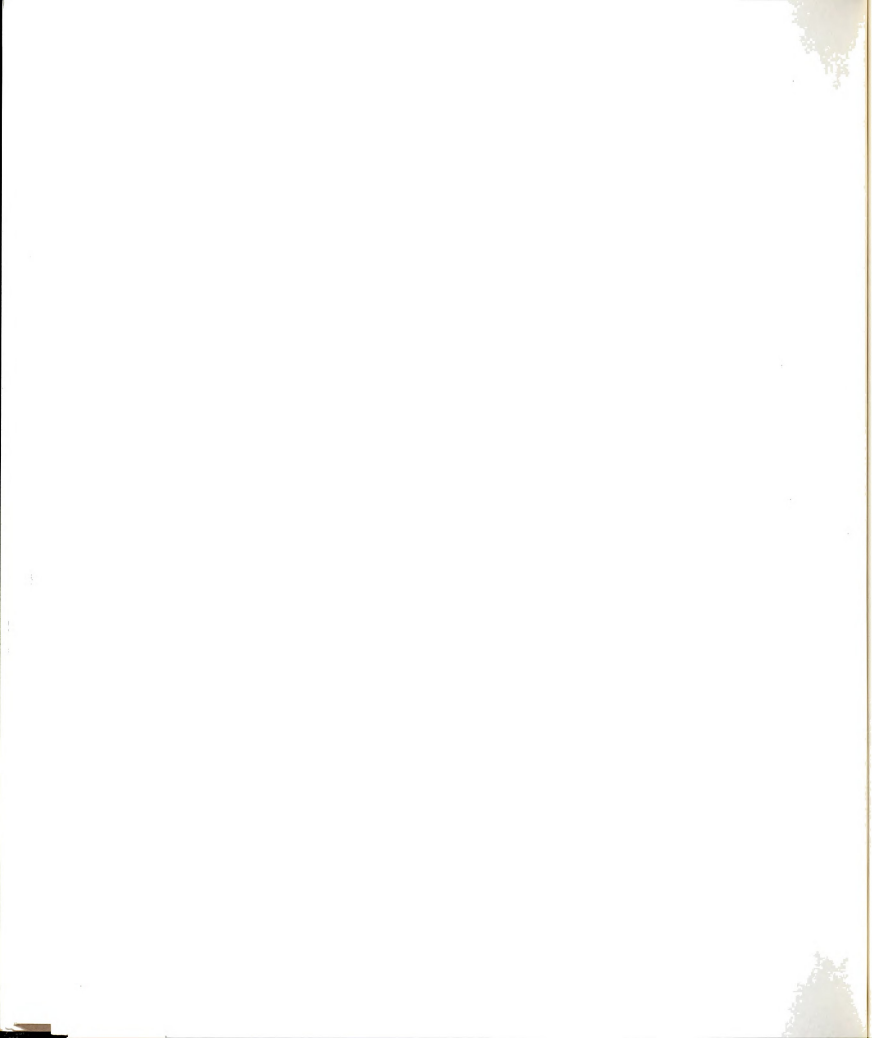
In evaluating the potential for coordination in processing for export, the greatest opportunities appear to lie in the areas of horizontal coordination and product extension. Complementarity in facilities usage is greatest in these areas.

As with many other functions, a distinction between bulk commodities, especially those handled through elevator facilities, and other commodities appears relevant. Further distinctions among fresh and processed products are important.

A distinction between processing for product standardization and for product differentiation is useful. Marketing strategies for standardized products may be expected to require larger volumes and yield lower margins than strategies for differentiated products.

Differentiated products may respond to tastes and/or regulations of specific foreign markets. In such cases, their sales flexibility may be limited. This makes market development activity, as opposed to sporadic sales, crucial.

In understanding and responding to foreign tastes, advantages of coordination may accrue to complementary products facing similar marketing channels and organization of demand.



5.3 Transportation and Physical Distribution

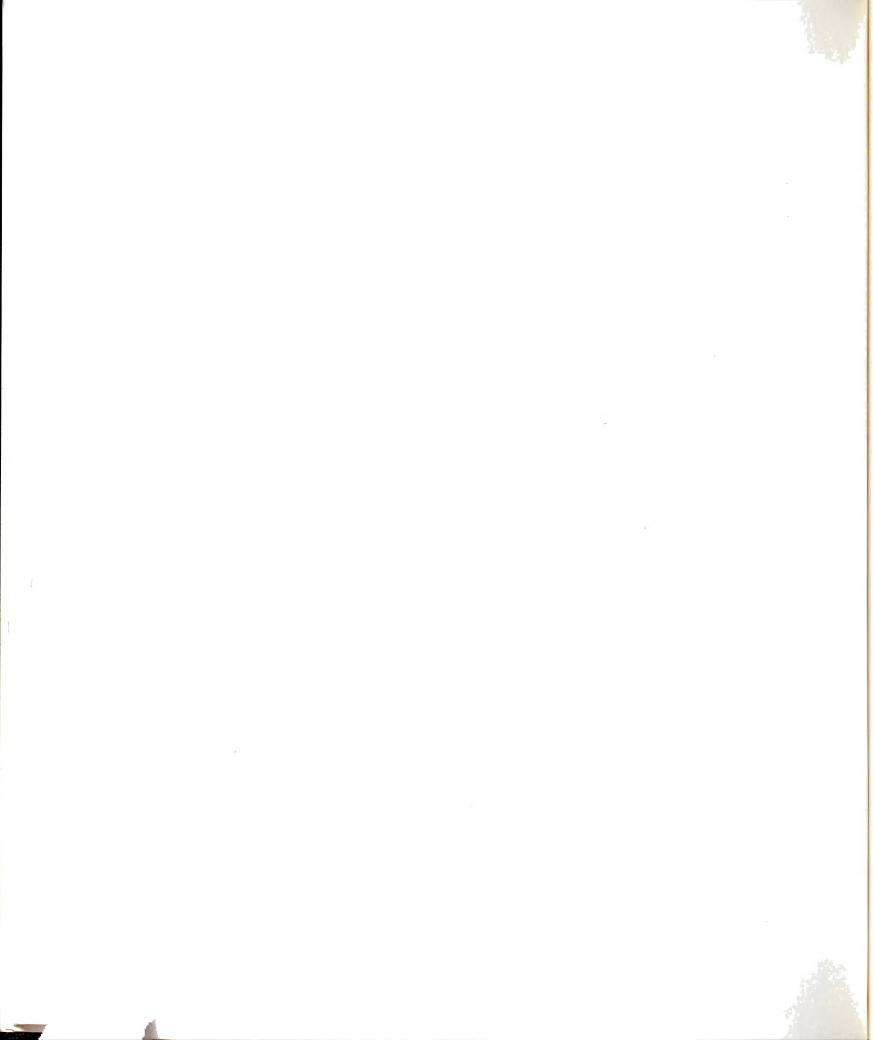
The transportation and physical distribution function is an essential component of the export marketing process regardless of whether it is arranged by buyer or seller. This section reviews the economics of domestic and international transportation related to the coordinated exportation of multiple commodities. It also discusses some economic issues pertaining to the process of freight arrangement and other physical distribution. In each case, advantages of size and the potential for achieving economies through multicommodity coordination are assessed.

5.3.1 Domestic Transportation for Export

The modes of transportation through which commodities destined for export reach their ports of exit are influenced by: the origin and destination of the commodities, the types of commodities being shipped, the costs associated with alternative transportation modes, and, access to them. Domestic transport of agricultural commodities destined for export is generally provided by rail, motor carrier, or barge. Though air transport is sometimes used, it is of such limited importance that it will not be discussed here.¹

Domestic transportation by common carriers is regulated by the Interstate Commerce Commission (ICC). However, rate regulation does not extend to trucks classified as exempt agricultural haulers, owner-operators, or private carriers. Where rates are regulated, they

¹ Air transportation is involved in less than 0.5 percent of the domestic movement of food and live animals. Source: U.S. Department of Commerce, Bureau of the Census (DOC), Domestic and International Transportation of U.S. Foreign Trade (Washington, D.C.: Government Printing Office, 1976).



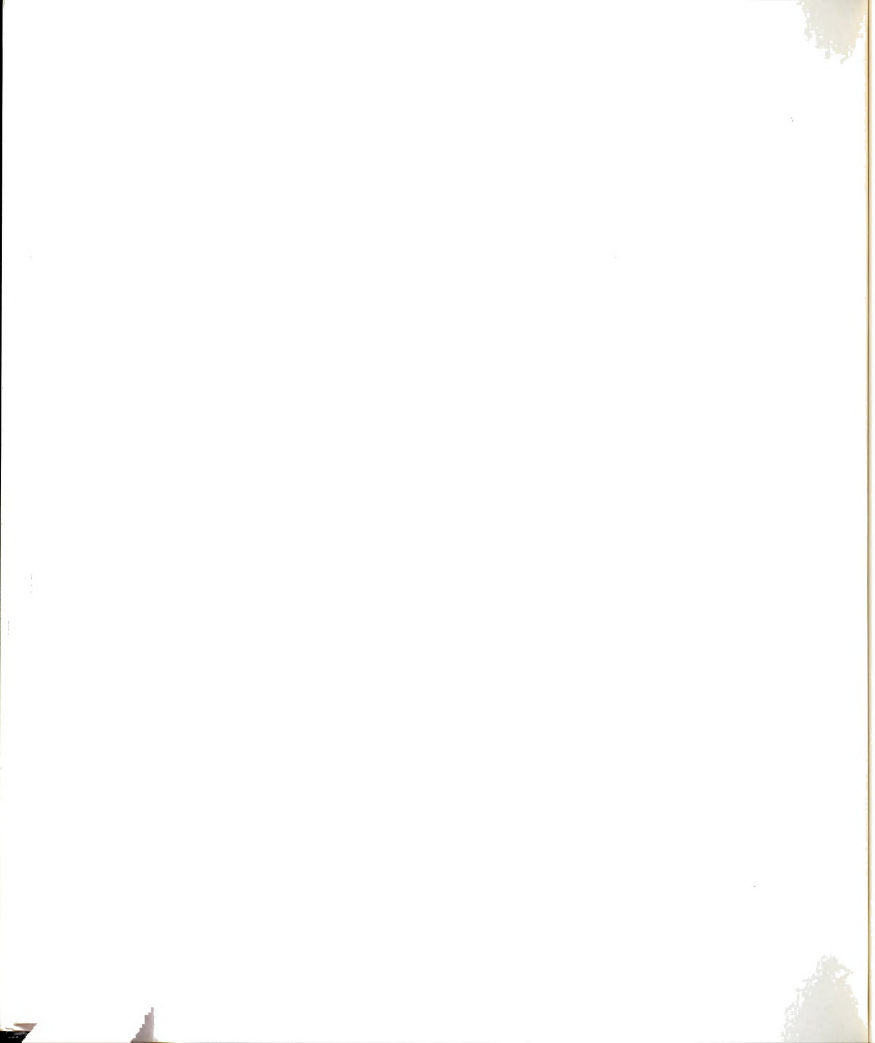
fall into two categories: class tariffs and commodity tariffs.¹ Class tariffs are supposed to reflect the basic cost of shipping all kinds of freight to similar destinations. Commodity tariffs are generally established for products which move in large quantities between specific points; they are generally lower than class tariffs.

Rates may be based on the quantities shipped, particular routing characteristics, shipper-carrier agreements or factors such as cubic space occupied or piggyback service. In cases where freight is destined for export, there are sometimes rates lower than those applicable to similar domestic traffic. In some cases, rates are structured to equalize the advantages of individual ports or seacoasts.²

While there are economic advantages to be obtained from volume shipments of all commodities destined for export, the nature of transportation and facilities requirements are such that complementarities are enhanced through the recognition of two sub-groups: bulk commodities and general cargo. The bulk commodities group includes both dry cargo, such as grains, soybeans, oilseeds, meals and other products; and bulk liquids, such as soybean and cottonseed oils. The general cargo group includes ordinary dry packaged cargo and fresh and frozen cargo requiring special devices such as refrigeration or controlled atmosphere facilities.

¹Roy J. Sampson and Martin T. Farris, Domestic Transportation: Practice, Theory and Policy, fourth edition (Boston: Houghton Mifflin Co., 1979), pp. 174-176.

²Interstate Commerce Commission, Rail Service Planning Office (ICC), Rail Rate Equalization to and from Ports: Preliminary Report (Washington, D.C.: Government Printing Office, 1978), pp. 35-37.



The choice of mode of transportation and port of exit is in part conditioned by the commodity being exported. Bulk commodities such as grains and soybeans require specialized port elevator facilities. This considerably limits the flexibility of exporters in changing ports of exit in the short run. Additionally, refrigerated general cargo is somewhat limited in flexibility among ports of exit due to facilities requirements.

There are major differences in the modes of transport used by general cargo and bulk commodities.¹ In large part, this difference can be attributed to variation in cost structures, and indeed, the transportation environment, facing shippers of the two groups of commodities.

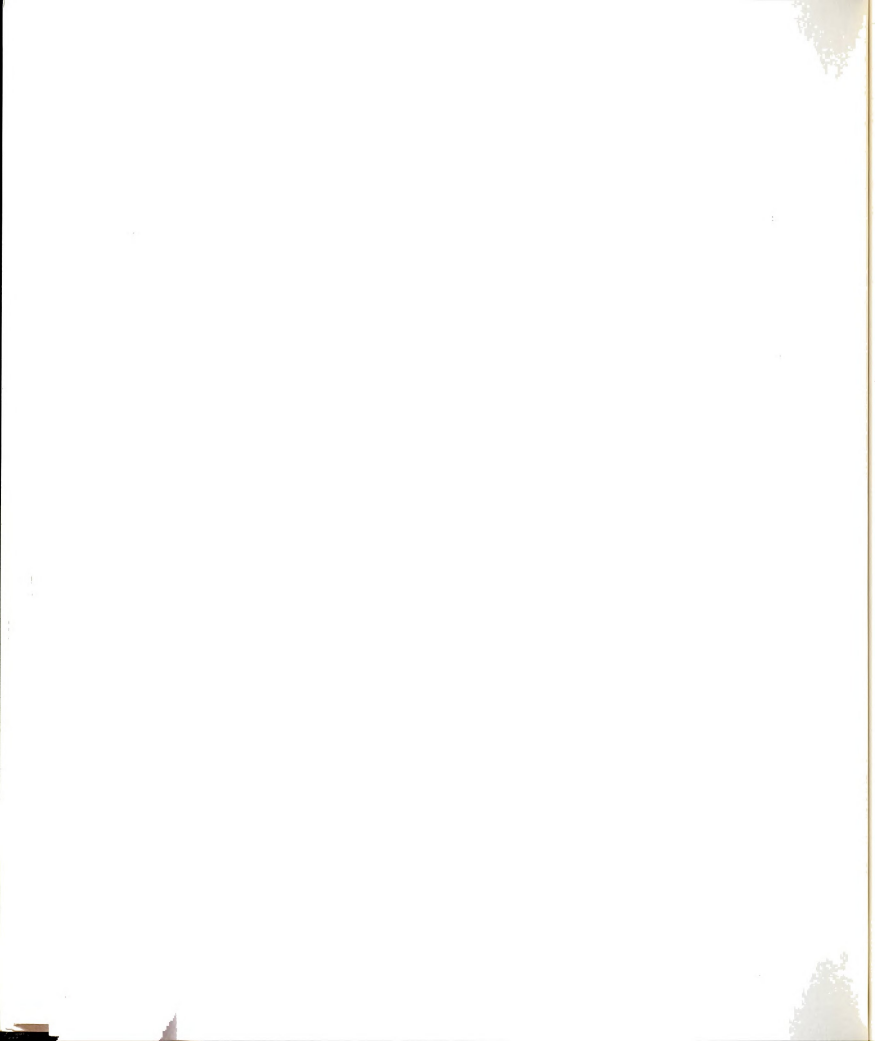
5.3.1.1 Bulk Commodities

Grain moving on railroads travels in either covered hopper cars or boxcars. While the former are preferred, regular annual shortages result in continued use of boxcars. Covered hoppers can be used for corn, soybeans, wheat and other grains, as well as products such as soybean meal. In order to deal with the problems of freight car shortages, cooperatives have bought or leased about 9,000 rail cars, mostly covered hoppers.² The issue of freight car availability affects both the ability to get grain to port and the cost of doing so.³

¹Ibid., pp. 35-36; and DOC, p. 30.

²Eldon E. Brooks and Robert J. Byrne, Cooperative Transportation and Distribution (Cooperative Information Report 1, Section 12; Washington, D.C.: USDA, 1978), p. 3; Thurston, 1979, p. 5.

³For a discussion of the freight car allocation problem and alternative proposals for solution, see: John Richard Felton, The Economics of Freight Car Supply (Lincoln: University of Nebraska Press, 1978).



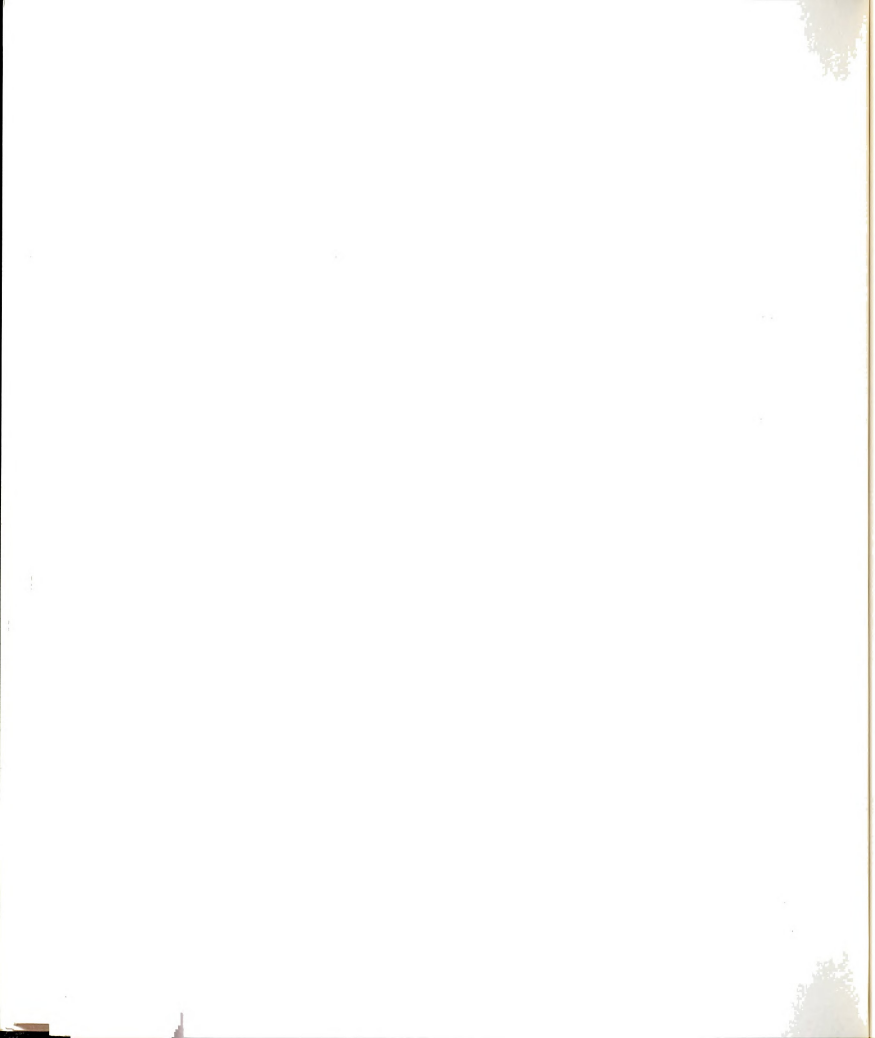
The ability to assemble grain to take advantage of volume rates can improve the competitive position of an individual supplier, whether it be a local or regional cooperative, or a major grain company such as Cargill or Continental. This ability is a function of facility capacity, procurement practices and access to rail cars. Unit-train and rent-a-train rates provide decreasing cost rail transportation to shippers who are able to move grain in 10, 25, 50, 75, or 115 car trains, or who are able to achieve volumes of 5, 10, 15, 25, 35, 45, 52, or 60 trips per year.¹ The cost of transporting a bushel of corn to port on a 75 car unit-train car may be more than 25 percent less than at single car rates.²

In order to load volume shipments, access to both commodity and rail cars is necessary. Thus, the allocation of rail cars by the railroads or the ICC can have a significant impact on transportation costs. A recent district court decision held that a shipper was entitled to unit-train rates even though the rail cars that he requested were not delivered at one time as specified in the tariff and he waited for them to arrive.³ Nonetheless, timing is critical in intermodal transport linkages. Users have a certain number of days of free time to load or

¹George Birdsong, "Transportation Logistics in Grain Marketing," paper presented to NC-139 at Cargill, Inc., November 16, 1978.

²Derived from figures presented in Robert N. Wisner, C. Phillip Baumel and John A. Wallize, "Why Does \$2.20 per bushel corn from Iowa Suddenly Become Worth \$6 in Rotterdam?" Iowa Farm Bureau Spokesman, July 22, 1978, p. 3.

³Norfolk and Western Railway Company versus B.I. Holser and Company, 466, F. Supp. 885 (N.D. Ind., 1979), discussed by James Baarda "Railway Siding Rate Draws Ruling," Farmer Cooperatives, August 1979, p. 8.



unload hopper cars, barges and ocean vessels. After this time, demurrage is charged. On a hopper car this amounts to \$10-\$30 per day. If the hopper car is holding up a 30,000 ton ship, this may cost \$6,000 per day in demurrage.¹ The costs of delays add up quickly, so that savings in one area may merely lead to more than offsetting cost increases in another.

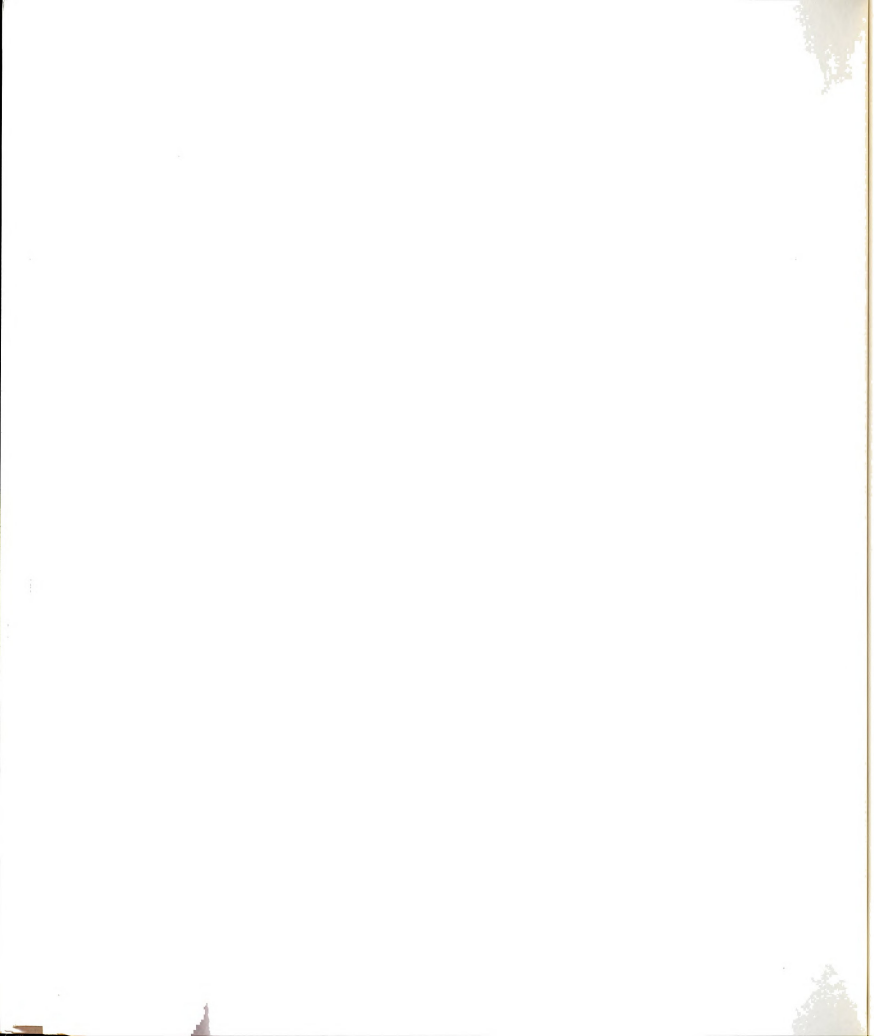
Barges are also an important means for transportation of grain to ports. Barges, too, have problems which can lead to delays. They may be backed up at locks, delayed by fog, or prevented from moving by unexpected ice. Also, barge rates are not regulated and may fluctuate as much as \$10.00 per ton.² Some regional cooperatives are able to hedge against this variation through their ownership in Agri-Trans, a cooperative barge line. The cost of barge transport is generally lower per ton mile than for rail. However, the value of this comparison is lessened by the less direct nature of river routes and by less than full-cost pricing by railroads for shipments from origins near waterways.

The third alternative for transporting grain is the use of motor carriers. Martin and Dahl found that while the cost of providing truck transportation for wheat and barley in the upper midwest far exceeded the cost of rail transport, rail rate regulations more than double the distance within which trucks remain competitive.³ If their cost conclusions hold true throughout a larger geographic area, and there are

¹Figures from Birdsong; and Krob, January 31, 1979.

²Birdsong.

³Michael V. Martin and Reynold P. Dahl, Social Costs of Regulating Railroad Grain Rates in the Upper Midwest (Technical Bulletin 319; St. Paul: University of Minnesota Agricultural Experiment Station, 1979), pp. 13, 17, 22.



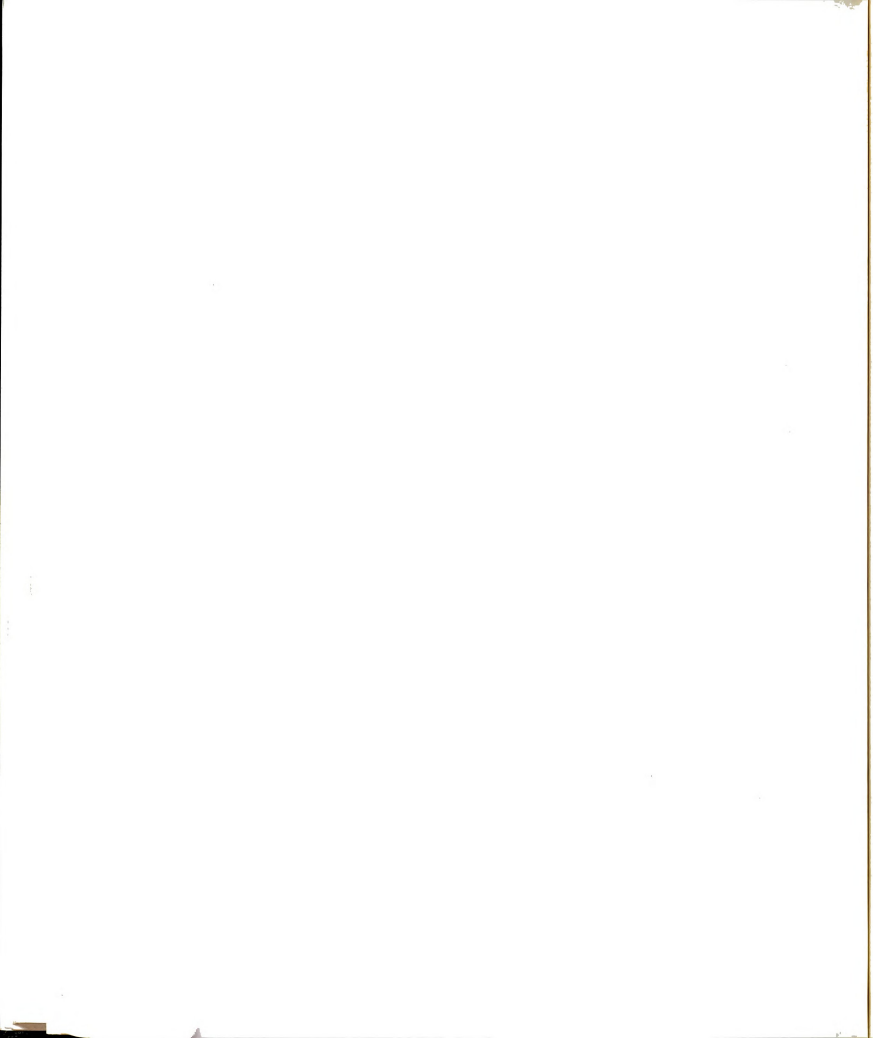
continued trends toward greater numbers of reduced rail rate arrangements for large volume shipments, one would expect that trucks will become less important in the long distance transport of bulk commodities, but more important in the collection function to rail loading points.

5.3.1.2 General Cargo

In contrast to bulk commodities, motor carriers have been gaining a larger share of total domestic traffic in general commodities destined for export. This may be attributed in part to the rapid growth of containerized shipping. Containers are essentially truck trailers of 20, 35, or 40 foot length, with removable chassis. Ocean shipment of containers between the U.S. east coast and Europe began in 1966. Since that time, the containers have been rapidly replacing break-bulk rail cars across the U.S. At the ports of New York and Boston, for example, 75 to 80 percent of general commodity tonnage is now containerized.¹

Container shipments can be transported by rail, motor carrier, barge, or some combination. The railroads have published domestic piggyback rates in an attempt to combat rate competition from motor carriers. These are generally identified as trailer on flat car (TOFC) or container on flat car (COFC) rates for intercity movements. While there are no specific export/import rates published, some rates require prior or subsequent movement by water. While some specific commodity rates are published, most tariffs are set on a FAK (freight-all-kinds) basis. Volume rates for 10, 30 and 60 trailers or containers are sometimes available.

¹ICC, pp. 39-40.



While rates are usually on a mileage basis, volume rates for shipments from some origins to certain port cities have been equalized. Thus, multitrailer rates from Chicago to Baltimore, Philadelphia and points in New York and New Jersey are the same even though the distances traveled may differ by more than 100 miles. An ICC study attributes this to the bargaining power of large shippers such as steamship lines and freight forwarders, and competition for traffic among competing rail lines.¹

Two other rate arrangements which permit cost savings on domestic transportation of goods destined for export and also offer potential savings from coordination of shipments are "Mini-Bridge" and "Micro-Bridge." These are described by the ICC as

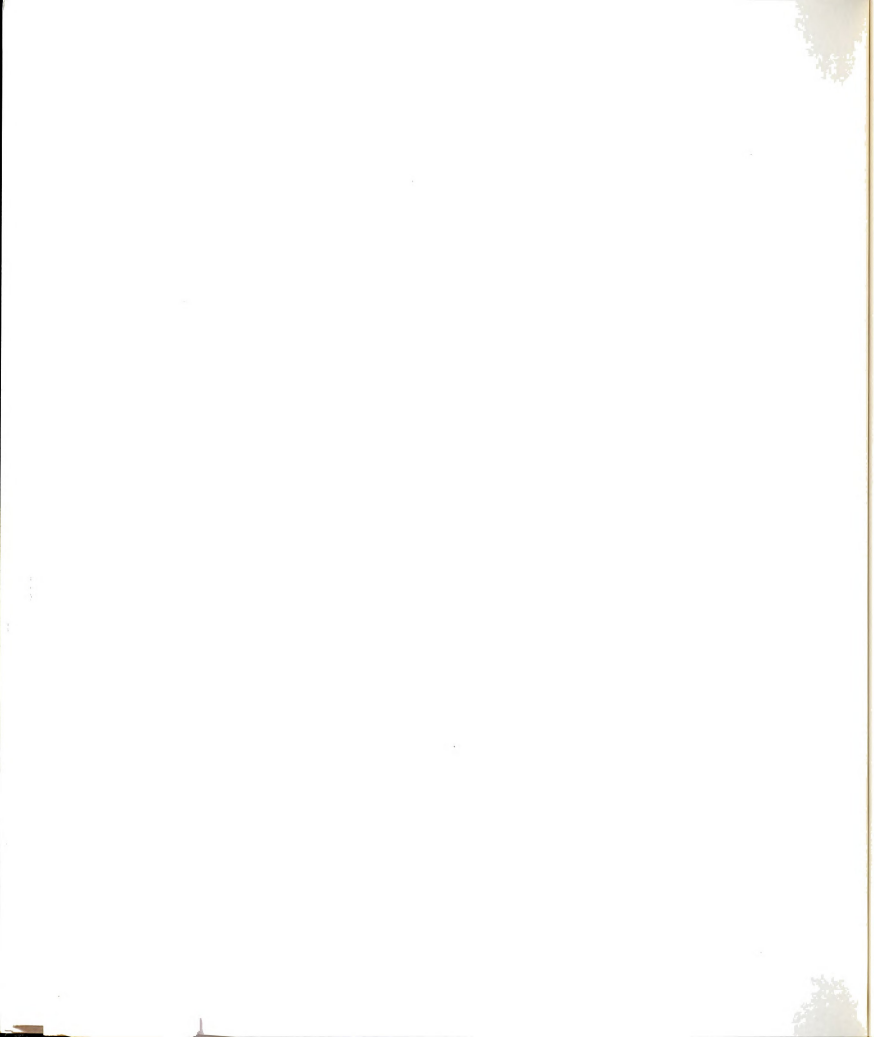
an intermodel sea/land transport system under a single bill of lading at a single rate under a joint through service tariff using United States railroads connecting United States east, Gulf, or west coast ports.²

Mini-bridge service involves the substitution of rail for water service between two U.S. port cities. (For example, shipment of goods by rail from Seattle to New York and then to Europe, rather than shipping through the Panama Canal.) Substantial economies are available when large mini-bridge shipments are put together. On shipments between west coast ports and selected east coast ports, per container savings of about 20 percent may be realized on shipments of more than 60 containers compared to shipments of 1-20 containers.³

¹Ibid., pp. 70-71.

²Ibid., p. 48.

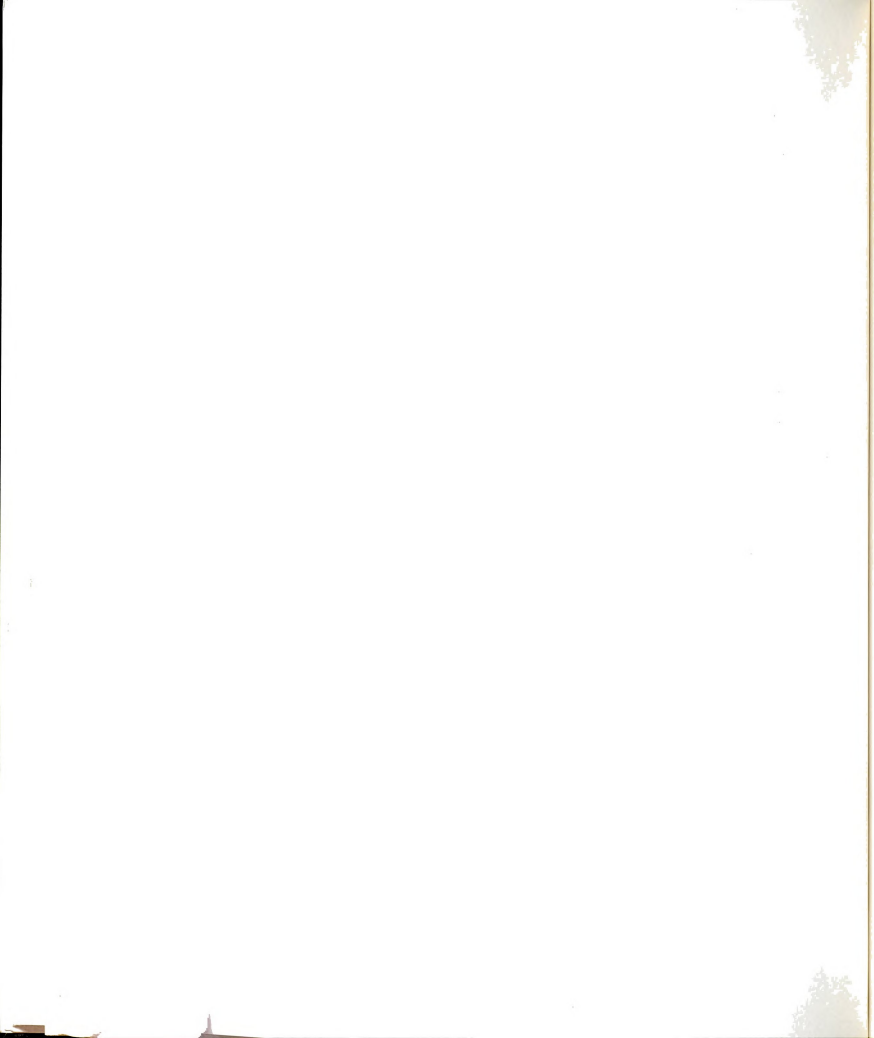
³Calculated from rates presented in *ibid.*, p. 79.



Micro-bridge shipments follow the same general principle as mini-bridge except that they originate at an inland rail terminal instead of a rail terminal in a seaport city. Thus, under micro-bridge, a shipment from Chicago to the Far East could go by rail to Long Beach and then by ship to the Far East. In order to qualify for mini-bridge rates the shipment would have to go first from Chicago to an east coast port such as Baltimore and then return to Long Beach, from there it would be shipped to the Far East. Under mini-bridge, the latter voyage would cost about the same as an all water voyage, but save seven days transit time. Micro-bridge rates would provide both lower costs and a greater reduction in transit time.¹

Mini-bridge and micro-bridge arrangements are advantageous to shipping companies because they permit better use of available space and vessels as well as saving costs of tolls in the Panama Canal. For shippers, they are advantageous because they often result in lower transportation costs as well as decreased transit times. An additional advantage conferred by access to these arrangements is that shippers are given greater potential leverage in dealing with shipping conferences for ocean transport. For example, the Pacific Agricultural Cooperative for Export (PACE) is an association of west coast shippers who conduct a substantial trade volume between California and Europe. Prior to the availability of mini-bridge rates, the individual shippers were unable to prevail upon ocean freight carriers in the Pacific Coast-European Conference to consider the impact of alternative shipping rates on the

¹Ibid., p. 82.

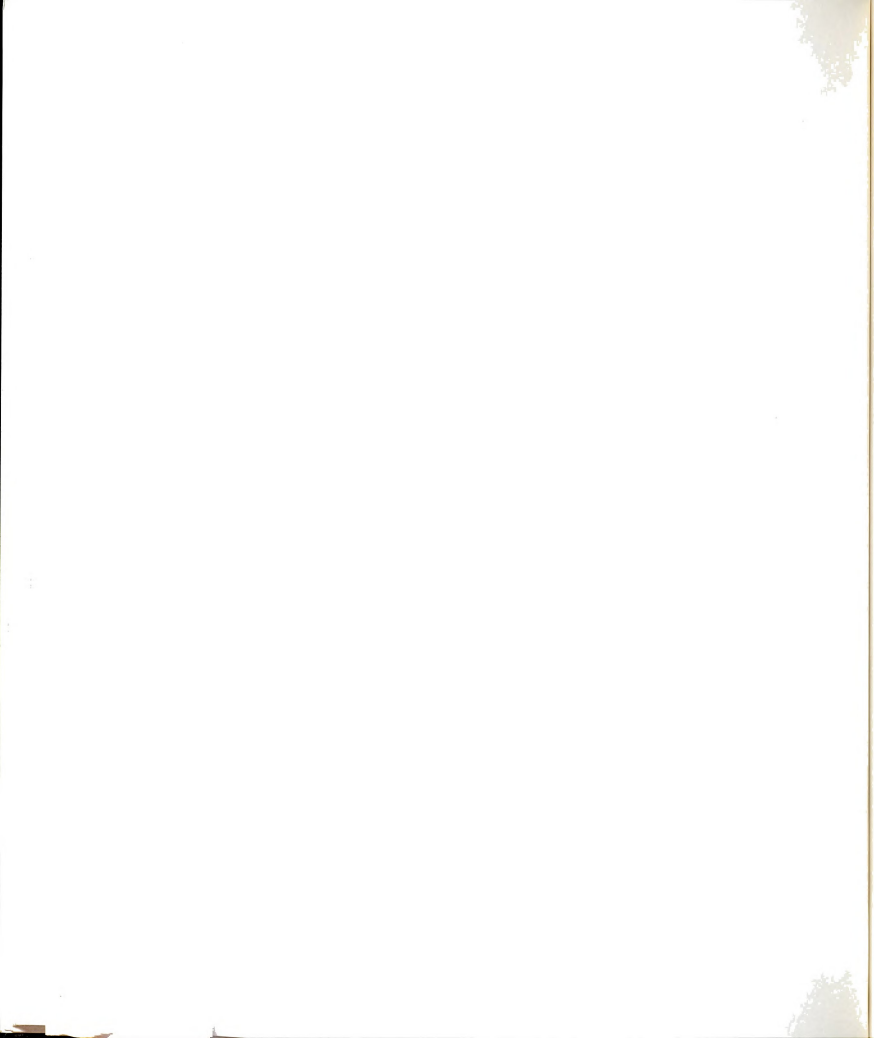


competitive positions of California-produced agricultural products in European markets. The shippers had no economically feasible transportation alternative, and the shipping conference members were able to take advantage of the power that resulted. With the development of a mini-bridge alternative using Gulf ports, California shippers were able to improve their bargaining position vis-a-vis the ocean freight conference. Substantial rate reductions and cost savings have been achieved by PACE members as a result.¹

In sum, economic advantages which can be achieved through coordinated arrangements for domestic transportation of commodities destined for export fall into two categories. First, economies of volume, whereby lower per unit shipping costs can be achieved through larger shipment size. This would seem to indicate that where similar transportation modes are employed and assembly costs do not outweigh potential transportation economies, shippers may be able to benefit from coordinated domestic freight arrangements.

Secondly, bargaining power obtainable through coordination among shippers can be important both in influencing domestic transportation options and costs. This will have implications for both domestic and international transportation alternatives. While an analysis of the organization of regulated transportation in the U.S. is beyond the scope of this research, it is useful to note that innovative transportation services and pricing structures often appear to develop only under severe competitive pressures. To the extent that coordination

¹Interview with Murray Fox, Executive Secretary, PACE, September 6, 1978.



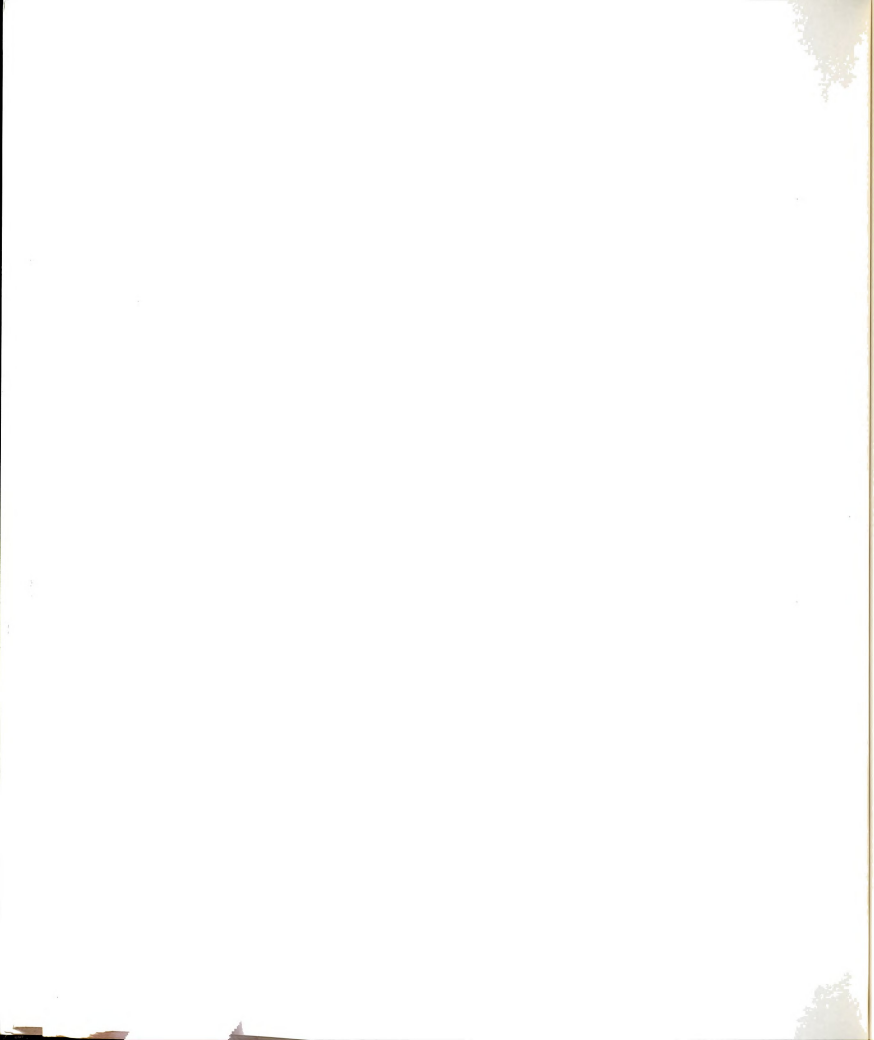
among shippers can increase the responsiveness of the regulated transportation system to the needs of users, this may be considered an advantage. In the example of PACE, cited earlier, a group of shippers worked with the Southern Pacific Railroad to stimulate the establishment of Southern Pacific Maritime Transport, a non-vessel owning common carrier which provided west coast shippers with an option to make shipments to Europe via Gulf Coast ports.¹ This resulted in the development of bargaining power in dealing with the Pacific Coast-European Ocean Freight Conference, and ultimately led to lower freight rates and improved competitive positions for the exporters. The importance of bargaining power in international shipping will be discussed further below.

5.3.2 International Transportation

Where a cooperative provides price quotations on a f.o.b. or f.a.s. basis, it can export while dealing primarily with the domestic transportation system. Such practice permits the cooperative to avoid the risks inherent in direct involvement in international transportation. However, the burden is placed upon the potential customer to convert a f.a.s. or f.o.b. price into a delivered price at a cost which will maintain a competitive edge for the cooperative's products. This, too, involves risk for the exporter. There are, therefore, advantages to evaluating international transportation options.

The movement of cargo from the U.S. to foreign destinations can be accomplished by ocean transport, air, or, for shipments to our contiguous

¹Ibid.



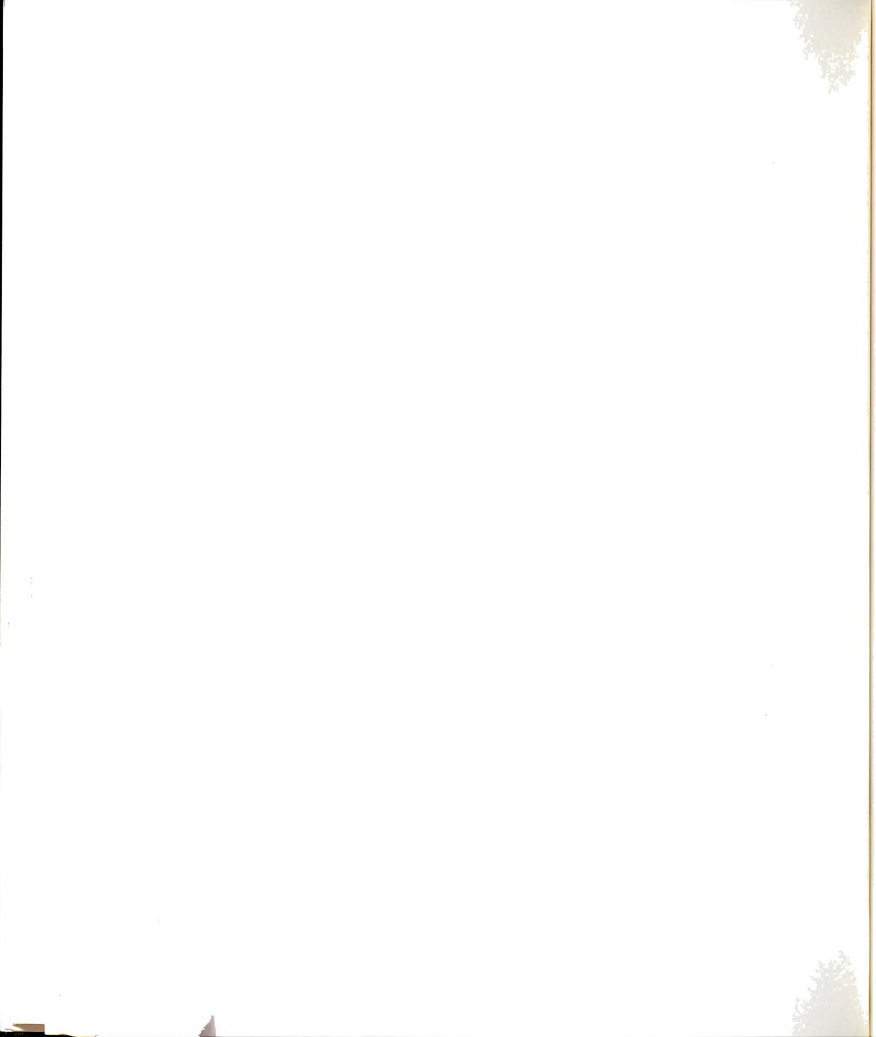
neighbors, rail or motor transport. When a shipment destined for export moves domestically, it can often be handled by a shipper's domestic traffic department. With delivery to a port, or even contemplation of a choice of port, additional expertise may be required. A cooperative planning increased exports may meet this shortcoming through training and experience, hiring of new personnel, or making use of a freight forwarder experienced in international shipments.

The following evaluates some of the similarities in the ocean transportation requirements for various commodities and assesses potential economies achievable through coordination. Additionally, some general background on ocean freight shipping is provided.

5.3.2.1 Ocean Freight Alternatives

Ocean transportation can be acquired through vessel ownership, chartering of an entire vessel or booking space on a vessel. The discussion here will focus on the latter two options.

Chartering is of two basic types: time charters, where a vessel is chartered for a fixed period of time, ranging from days to several months or years; and, voyage charters, where the vessel services are obtained for single or multiple trips between ports. Both time and voyage charters offer the potential to lower average shipping costs, relative to merely booking cargo space on a vessel. However, in highly volatile freight markets, chartering also introduces the risk of locking in a higher freight cost than competitors, thereby imposing a competitive disadvantage.

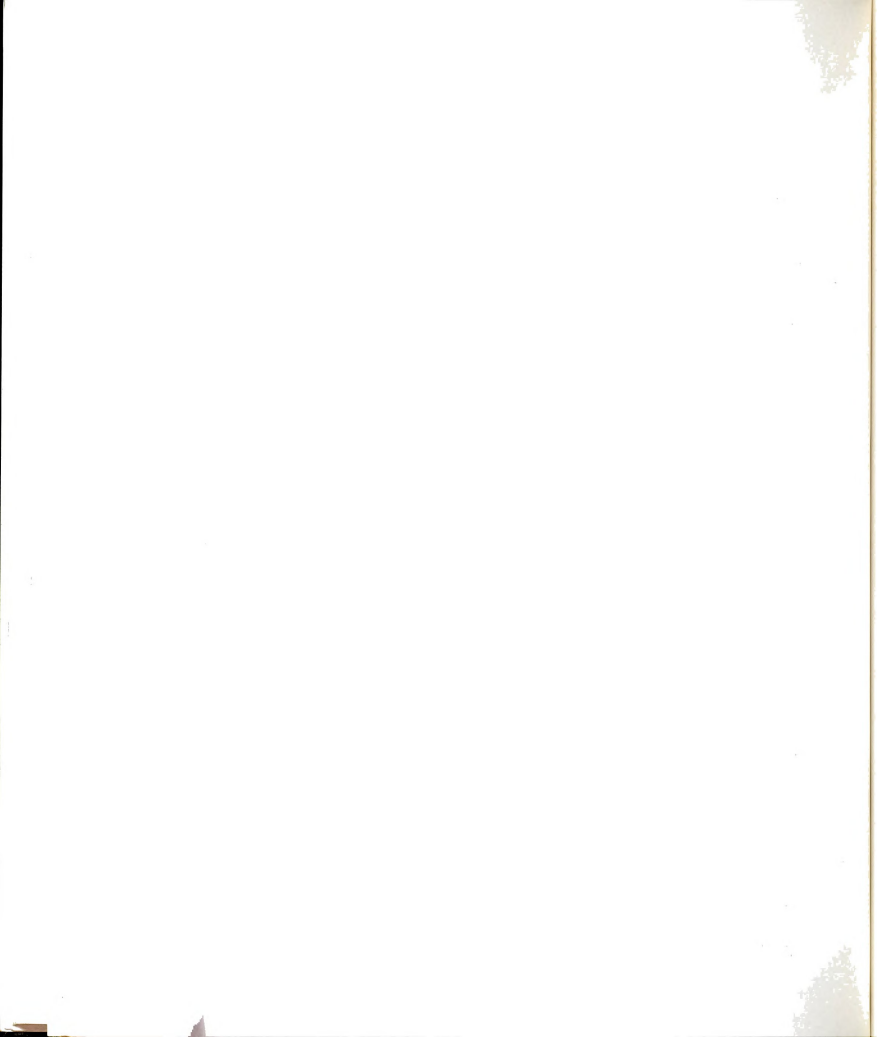


The type of vessel to be chartered is often a function of the requirements of the commodities shipped. Grains generally move in bulk on vessels with capacities ranging from 30 to 100,000 m.t. In contrast, citrus shippers require smaller vessels with refrigerated hold capacity into which break-bulk or palletized cargo or refrigerated van containers are loaded.

While time charters may offer the opportunity for lower average costs per unit shipped than voyage charters, as with owned vessels, this is in part dependent upon the avoidance of empty cargo space and the ability to obtain backhaul cargo. Cooperatives have recognized this problem domestically and sought to decrease average costs of operating 320 barges owned by Agri-Trans Corporation through coordination of Gulf-bound grain shipments with backhauls of fertilizer. In international shipping, Seald-Sweet International has an arrangement whereby it ships 300,000 case lots of Florida grapefruit to Japan on a ship, the Sunbelt Dixie, which returns laden with Toyota automobiles. Although Seald-Sweet does not charter the vessel involved, this example demonstrates the potential breadth of products for which coordination in exporting offers possible benefits.

Vessels providing ocean freight transportation can be divided into three categories: liners, tramps, and private carriers. Liners are members of shipping conferences.¹ They provide regularly scheduled

¹Under the Shipping Act of 1916, as amended (46 USC 801), ocean carriers are permitted to combine in conferences for the purposes of rate agreements with immunity from antitrust laws provided that their rates are filed with and approved by the Federal Maritime Commission. This act applies only to common carriers. Thus, private carriers, which carry proprietary cargo, are excluded. Tramps are excluded by statutory definition [1, 46 USC 801 (1970)].



service along specific routes, at tariffs common to all members of a conference. Tramps provide irregular service, with rates open to negotiation. Private carriers generally handle proprietary cargo, though they sometimes take on cargo as tramps do.

Tramps sail according to the availability of cargo. Some are bulk product carriers, handling grain and other bulk products, while others are general cargo ships, handling break-bulk, separately packaged, products. Tramps often carry commodities which move in sufficient volume to make it worthwhile to charter an entire ship, though sometimes loads may be topped off with small consignments.

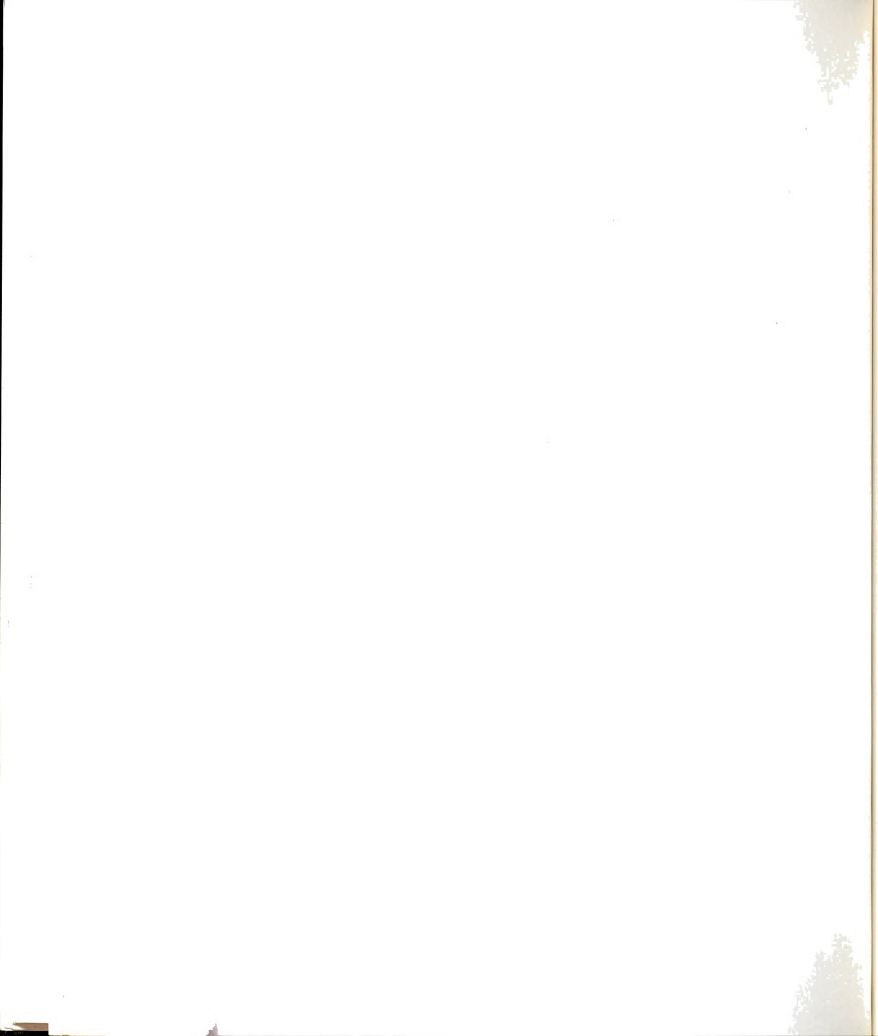
Where competition from tramps is quite strong, such as in bulk commodities and those moving in large-sized shipments, conferences often have an "open" rate which permits their members to negotiate with shippers.

For other commodities, shippers who agree to use only conference vessels on a given route are often granted a preferential rate on that route. For example, on a 1979 shipment of one container of canned cherries from New York to Hong Kong, the conference rate was \$157 per metric ton or cubic meter, while the non-conference rate was \$180.55.¹ Thus, the shipper who agreed to use conference vessels exclusively on the New York-Hong Kong route would save about 13 percent.

This "dual rate system" is also provided for under the Shipping Act of 1916.² Under that Act, any conference may charge rates up to

¹Rates quoted March 1979, source: interview with Mary Mueller, F.X. Coughlin Freight Forwarder, Inc., Detroit, Michigan, March 23, 1979.

²14b, 46 USC 801 (1961).



15 percent lower to shippers making such exclusive usage agreements.¹

In the event that a shipper breaches this contract and ships on a non-conference carrier on the conference route, he must pay damages equivalent to the amount which he would have paid if the goods had moved by conference carrier, as well as paying the shipping charges to the independent.²

The dual rate contract must be offered to all shippers, except that it does not apply to bulk commodities other than liquids in less than shipload lots. Either shipper or conference can withdraw from, cancel or amend the dual rate system on 90 days notice. A dual rate system may be cancelled by the Federal Maritime Commission (FMC) on finding that it is "detrimental to the commerce of the United States or contrary to the public interest."³

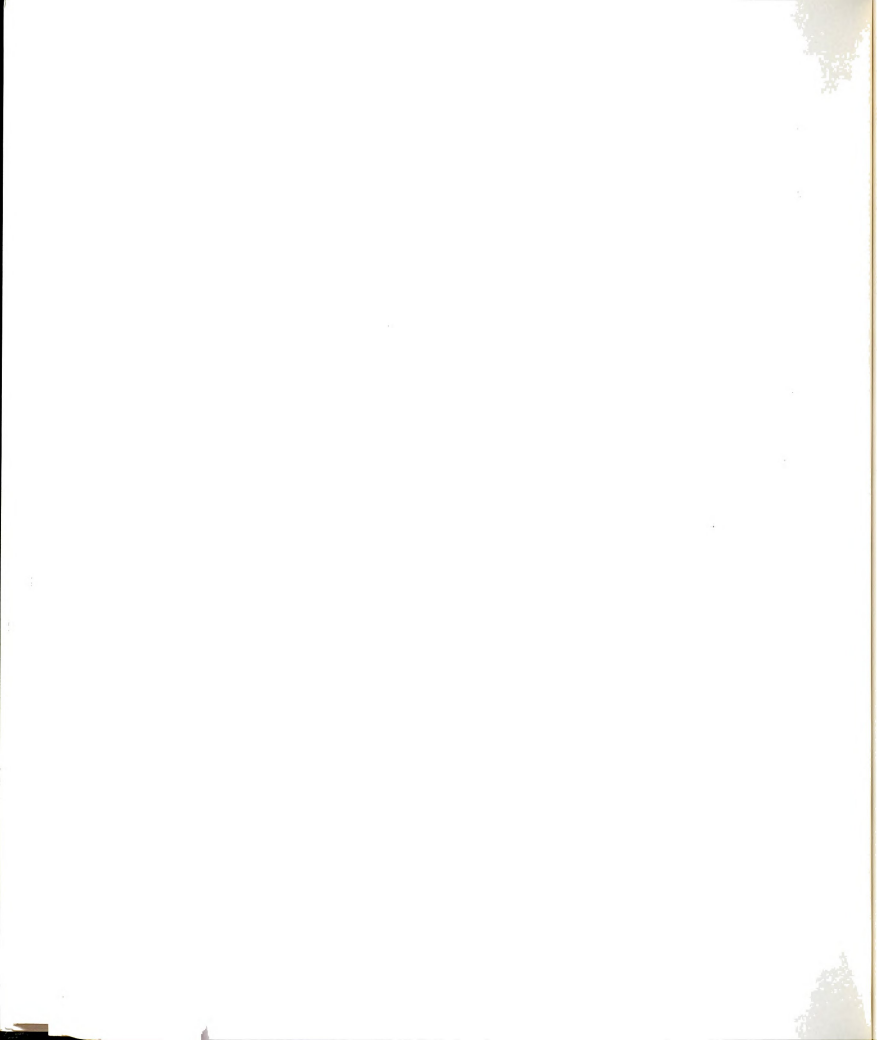
Within conferences, except for the case of open rates mentioned previously, carriers have no freedom to change rates. They may, however, withdraw from a conference on 30 days notice or be expelled for failure to adhere to rates agreed upon.

The rates charged by conference carriers are generally set on a commodity-by-commodity basis. A 1976 study by the U.S. Department of Justice concluded that rates are based on elasticities of demand for shipping an individual commodity. In other words, "what the traffic

¹Senate Bill S1463 96th Congress, First Session would amend 14b to change the legal rate spread permitted under dual rate contracts.

²Department of Justice, Antitrust Division (DOJ), Study of the Regulated Ocean Shipping Industry (Washington, D.C.: Government Printing Office, 1976), p. 30.

³46 USC 813a (1970), *ibid*, states that this power has been exercised only twice, and "in short, there has been no refinement of this power in normal circumstances," p. 31.

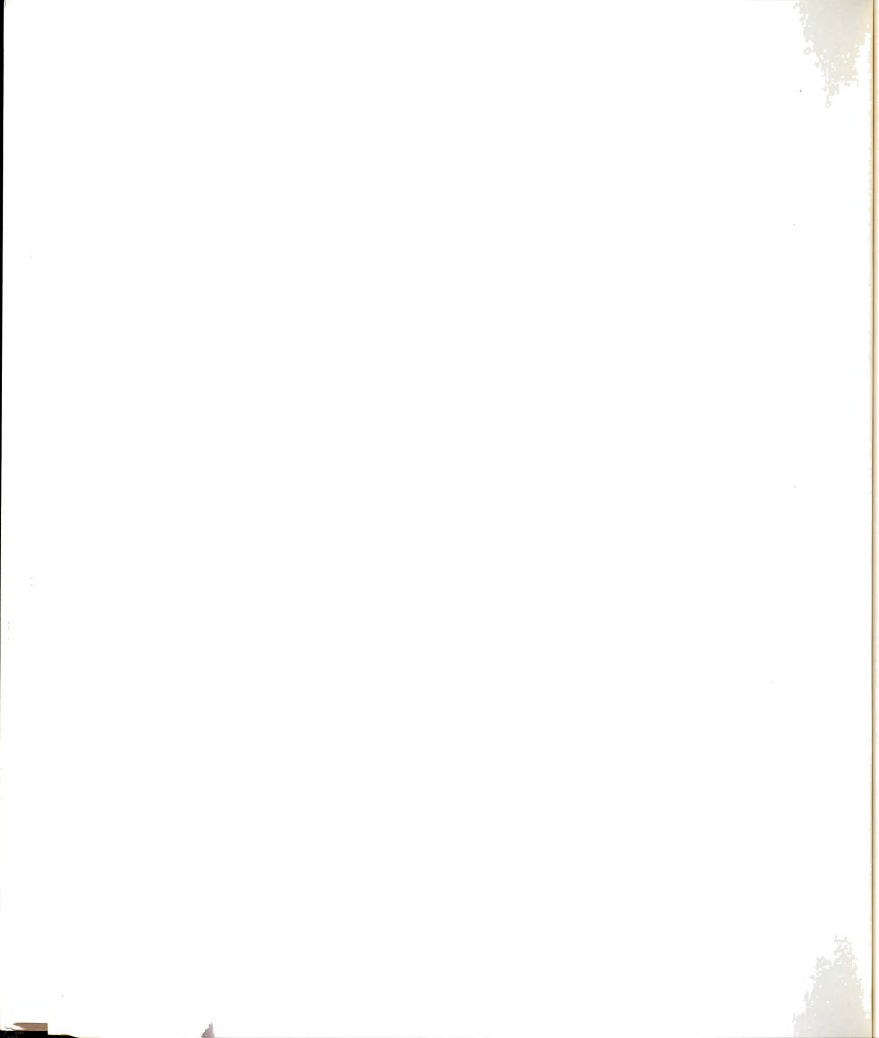


will bear." The study cited an example of shipping two commodities, motorcycles and electronic goods, between Japan and the U.S. Pacific coast. While the cost to the carrier of transporting a container of electronic goods was ten percent greater than for transporting a container of motorcycles, the rates charged for transporting electronic goods were more than double those for the relatively lower valued product. This same phenomenon was verified by several west coast shippers of agricultural commodities. The general observation was that rates reflect the value of service, rather than the cost of providing that service. Thus, two containers of identical weights, one carrying high valued almonds, and the other carrying lesser valued canned corn, or dry beans would be likely to pay very different rates for transportation between the same two points.

In a few instances, large freight volumes generated by agricultural exporters have made it possible to influence the rates charged for transportation of individual commodities by ocean shipping conference members. PACE, the association of California shippers discussed earlier, claims to have achieved conference rate reductions of as much as 50 percent in some cases.¹ It has not been successful in achieving uniform rates for freight of all kinds (FAK) as exist in domestic transport, however.

Additional opportunities for cost savings in ocean freight transportation may be found through use of non-conference vessels (tramps). The rates charged by tramps are more subject to the forces of competition

¹Interview with Fox.



than those of conference carriers. In order to be competitive with dual rate systems, non-conference vessels must either offer rates so low that they compensate the shipper for occasionally having to pay high non-contract rates on conference vessels, or offer service comparable to that of conference vessels in quality and frequency so that shippers will not need the services of conference carriers.

Non-conference carriers appear to fall into two categories: small companies with slower, older break-bulk ships, and larger carriers which are attempting to develop market share.

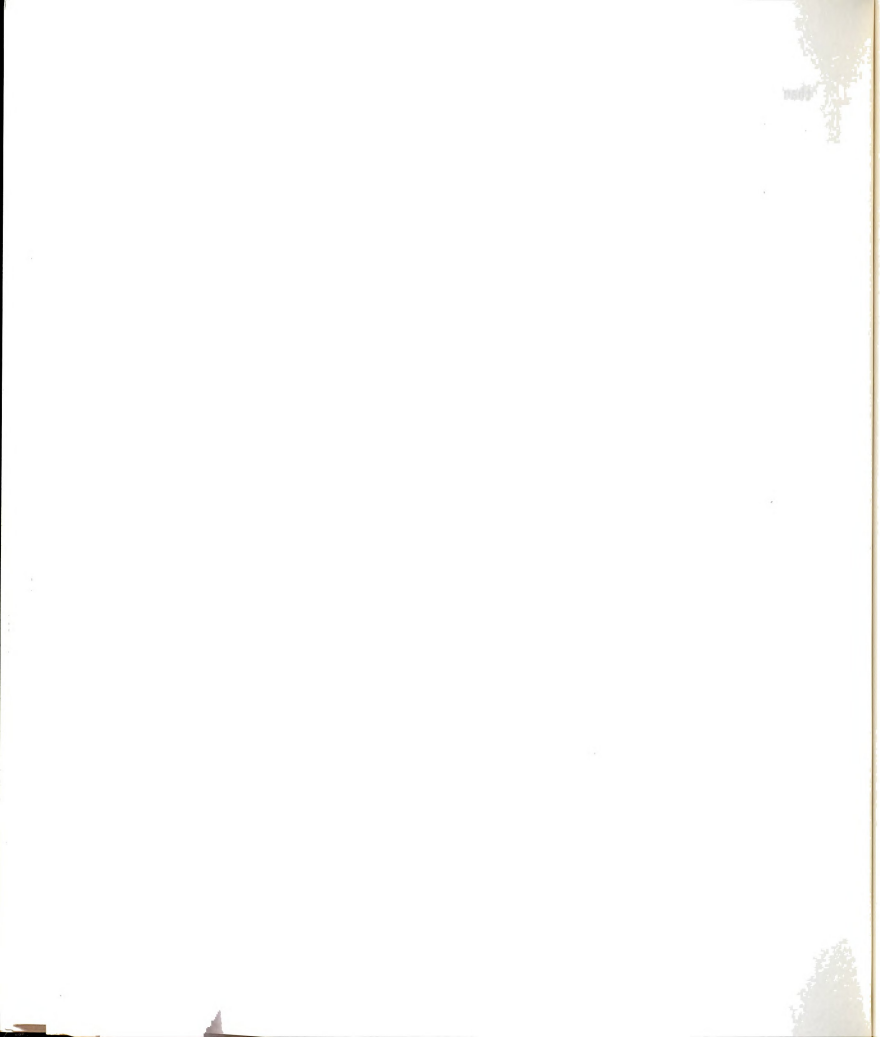
In the former category, rates may be 10-15 percent below the conference rates, but schedules may be irregular and the risks associated with overage ships may sometimes raise insurance costs enough to outweigh any freight cost savings.

The latter category of non-conference carriers increasingly includes service offered by Soviet and other COMECON member vessels. In some cases these carriers are reported to cut conference rates by as much as 40 to 60 percent in order to get business and foreign exchange.¹

Many of the shippers interviewed stated that non-conference service was equal in quality to that of conference carriers. Some west coast shippers stated that on European routes, tramp rates were generally 15 percent less than the conference rate, while on Far Eastern routes, tramp rates are more volatile and no "rule of thumb" applies.

Non-conference shipping options can be important to cooperative exporters and other shippers both as transportation choices in their

¹"COMECON Shipping" European Community, July-August 1978, pp. 51-52; and "Shipping: EC Nations Fight Communist Tactics," Business Week, December 12, 1977, pp. 69-70.



own right and as alternatives to conference carriers which will enhance the ability to bargain with conferences.¹ Without such alternatives, the ability of shippers to influence carrier rate making will be severely constrained. This, in turn, will influence the competitive position of agricultural products abroad.

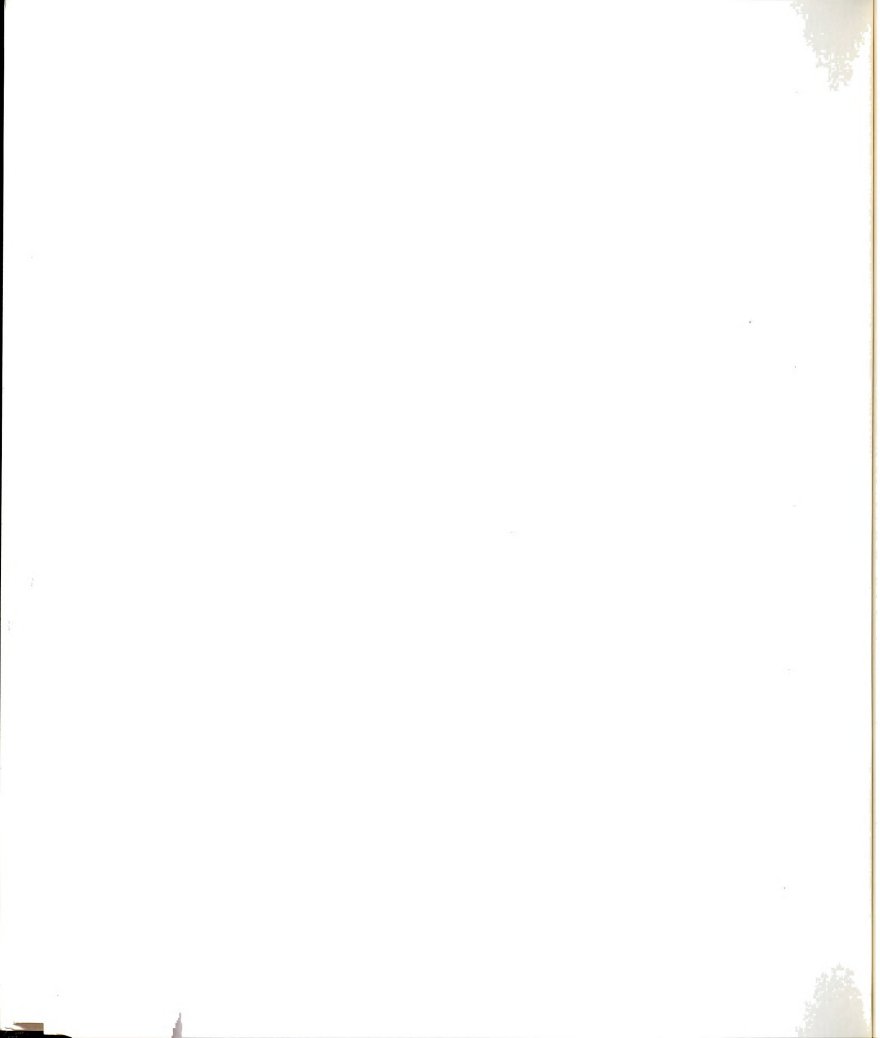
5.3.2.2 Physical Handling

In addition to differences in ocean freight conference membership which affect rate flexibility, there are significant physical handling differences among commodities which influence the type of vessel used for individual ocean freight shipments and the costs involved. As with domestic shipments, ocean transportation requirements permit a distinction between commodities based upon whether they are handled in bulk or as general cargo.

Bulk commodities include both dry cargo, such as grains, soybeans and products; and bulk liquids, including oils and petroleum. Bulk liquids move in tankers. They will not be discussed here because of the limited range of agricultural commodities involved. Oilseed meals, other feed ingredients and some culled beans also move in bulk. Dry bulk commodities can be mixed in shiploads subject to the availability of separate holds.

General cargo can be divided into that requiring ordinary stowage, mostly dry packaged cargo, and that requiring special devices, usually

¹It should be noted that legally there can be no bargaining between shippers and conferences. The shippers present their case to the conference and then must leave without discussion. It is in being able to influence the weight given to shipper opinion by a conference that the term bargaining is used here. There is currently discussion in Congress of permitting "shippers' councils," which would be allowed to bargain directly with ocean freight conferences.

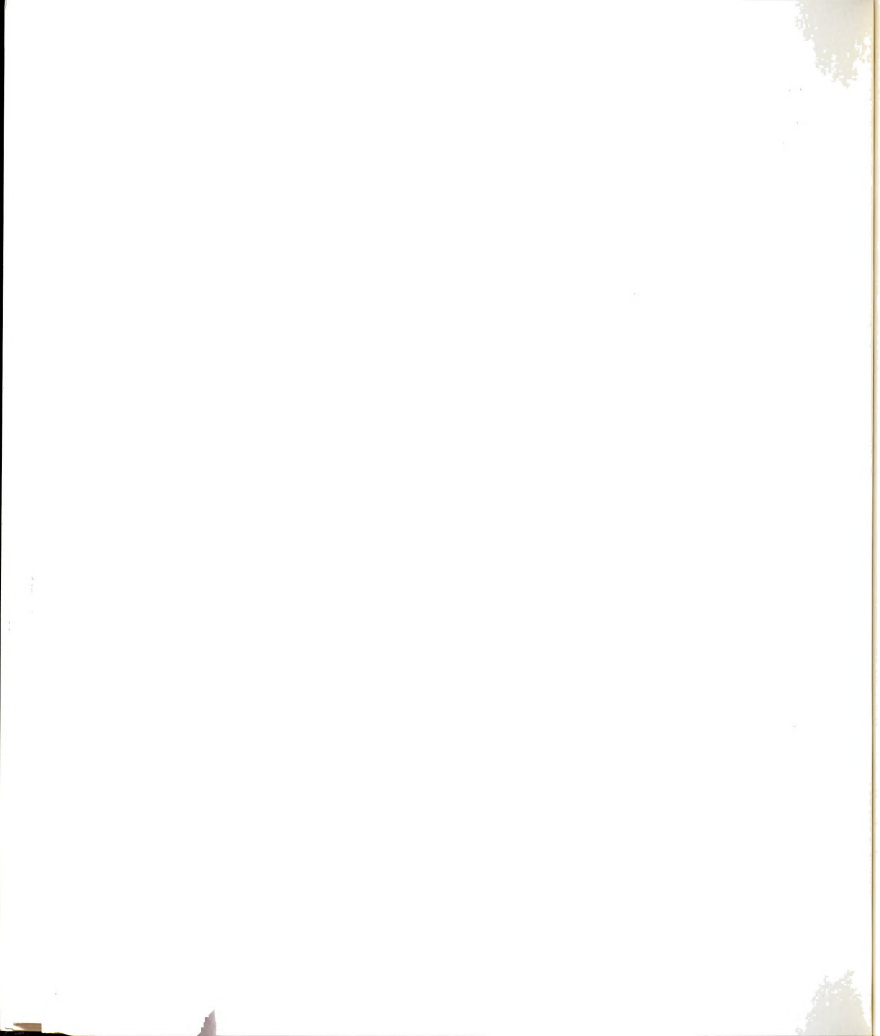


refrigeration. While there are some constraints on the availability of refrigerated cargo space and additional monitoring costs and risks involved, arrangement for either type of general cargo space is similar.

General cargo moves either as break-bulk freight or in containerized shipments. Break-bulk cargo is used for a wide variety of commodities shipped in sacks, drums, crates, boxes or other packaging. Most commodities, agricultural and otherwise, can be shipped in this fashion subject to constraints of susceptibility to odors, spoilage, cross-contamination in mixed loads, breakage and pilferage.

Containerization, as mentioned earlier, involves movement of commodities in sealed 20 foot or 35 to 40 foot length boxes which are essentially semi-trailers with or without removable chassis. Containerization is becoming increasingly popular in both domestic and international transportation. In 1978 there were 1.8 to 2 million 20 foot equivalent container units in the world, an increase from only 250,000 ten years earlier.¹ Each 20 foot unit can carry a gross weight of about 20 tons. Although containerization necessitates relatively major capital investments in containers, loading facilities and specialized vessels, it permits combinations of many different commodities on a single vessel. It also reduces labor handling cost, pilferage, damage, spoilage, and loss, as well as transit times. Additionally, decreased loss claims result in lower insurance costs.

¹Patrick Finlay, editor, Jane's Freight Containers, 1978 (New York: Franklin Watts, Inc., 1978), p. 31.



Containers can be transported on roll on/roll off (ro/ro) vessels where containers on a chassis or semi-trailer are moved by wheeled vehicles; or lift on/lift off (lo/lo) vessels, where gantry cranes are used for loading and unloading. A container vessel can be loaded and unloaded in about 20 percent of the time required for a similar break-bulk freighter.¹

Modern container ships are also both faster and larger than traditional break-bulk vessels. In the early 1960s, a vessel at 10,000 gross registered ton (Grt) was considered large. Now container ships may be as large as 55,000 Grt with a capacity to carry up to 2,000 20 foot equivalents and move at speeds of up to 33 knots.²

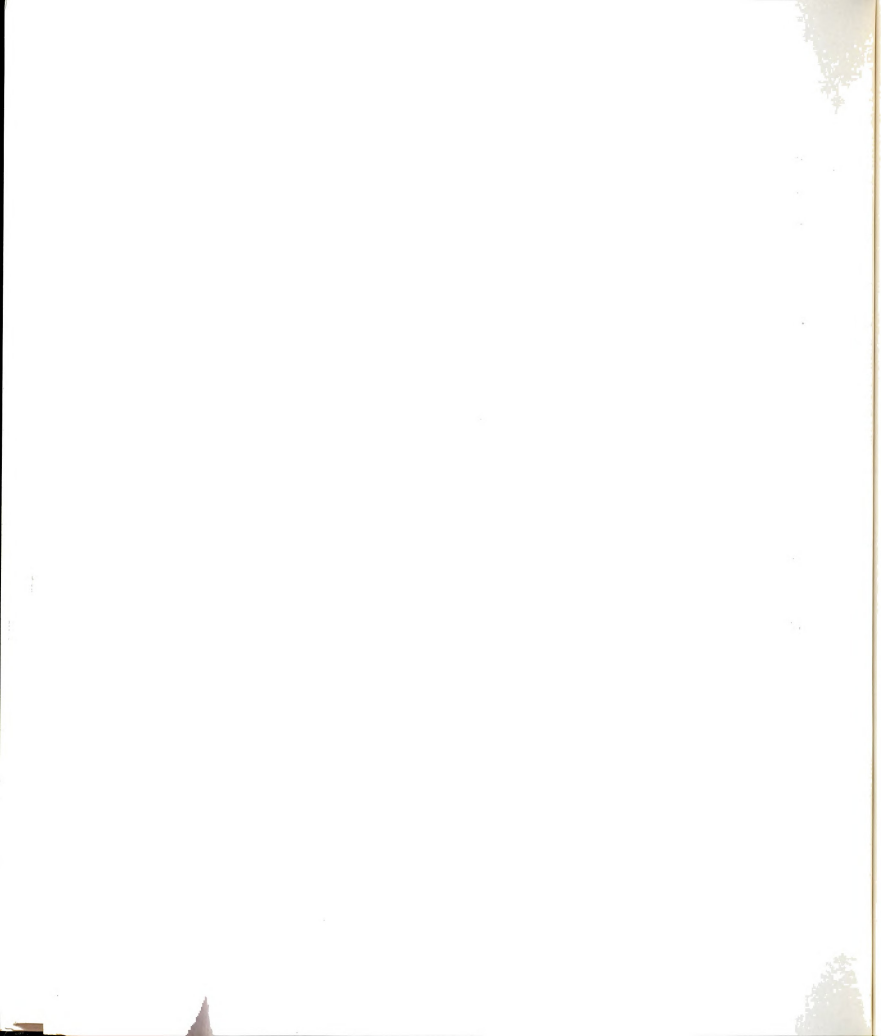
Containers with refrigeration capacity and controlled atmosphere (c/a) are available as well as regular dry containers. This permits container shipment of a wide variety of fresh and processed fruits and vegetables, meats and products, dry beans, rice, and cotton.

While almost all commodities can be shipped in containers, the per ton cost relative to large bulk shipments of commodities such as grains make their shipment by container prohibitive except where the bulk commodity has high value such as seed, where sales tend to be smaller and bulk handling would present high risks of quality deterioration.

Thus, cooperative shippers can be subdivided into two categories according to whether the primary mode of ocean freight handling required may be classified as bulk or general cargo. This distinction reflects

¹ICC, p. 39.

²Ibid., p. 41.



differences in: the types of vessels used for ocean freight, the organization of freight markets, and the risks involved in assumption of responsibility for freight arrangements. These factors will be discussed further in evaluating potential economies of coordinated international transportation.

5.3.2.3 Potential Economies of Coordinated International Transportation

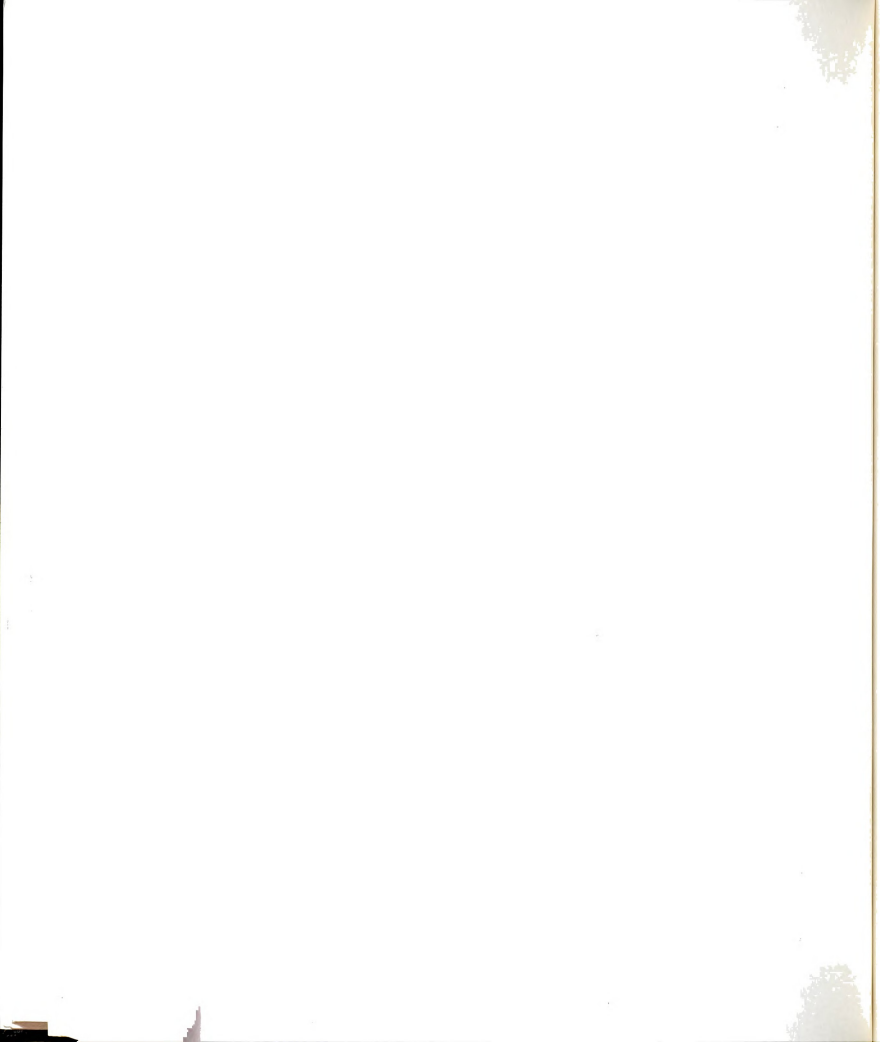
In evaluating opportunities for advantageous coordination in arrangement for ocean freight transportation, three distinct levels offering potential economies were identified:

- 1) chartering whole vessels,
- 2) regular, large volume general cargo movements, and
- 3) consolidation of small shipments.

5.3.2.3.1 Vessel Chartering

Chartering of vessels on either a time or voyage charter basis offers the opportunity to lower average shipping costs. It also requires the assumption of considerable risk when dealing in volatile freight markets. As noted previously, this includes the potential to lock in higher freight costs than competitors.

As an example of the volatility of freight markets, one cooperative exporter related the experience of making an offer to sell a large volume of grain to Algeria at a price based on a shipping cost of \$23 per metric ton between the head of the Great Lakes and his destination. Overnight the news hit the trade that Algeria was making major grain purchases and the freight rate shot to \$48 per metric ton. Naturally, the exporter had not built a \$25 per ton margin into his price, and the



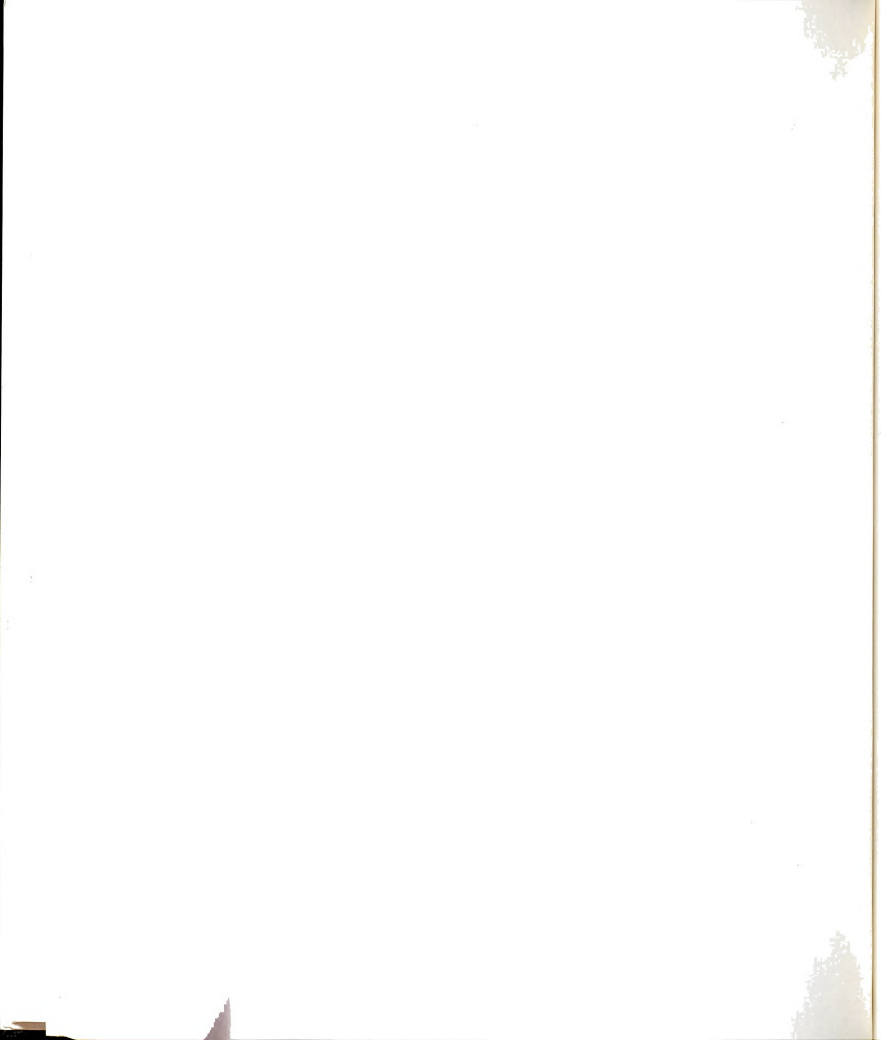
potential losses were quite great. Fortunately, in this case, arrangement of a time charter permitted achievement of a cost close to that originally budgeted for.¹ Nonetheless, this demonstrates the risks of volatile freight markets. Further evidence can be found through reference to the quarterly rates from the U.S. gulf to northern Europe and Japan, presented in Figure 5.1.

Because of the volatility of freight markets, many cooperatives hesitate to take freight positions prior to finalization of a sale. Several managers interviewed commented that cooperatives were not meant to be speculators. This seems to ignore the fact that having an open bid which, if accepted, would require the acquisition of services from a volatile freight market, is also a form of speculation. Where sales are sporadic and volume low, the risks of speculation, either through taking a freight position or offering on a c.i.f. or c. & f. basis without a position are increased. This has been recognized by the management of Farmers' Export Company (FEC), an interregional cooperative which handles exports for 12 member cooperatives. FEC, while still selling a large portion of its exports on a f.o.b. or f.a.s. basis, is gradually gaining experience in voyage chartering and even some multiple voyage charters.²

In addition to the risks of price variability, another risk in locking in freight space through charters is that the product will not be ready to load when the ship is. Demurrage charges on ocean freight

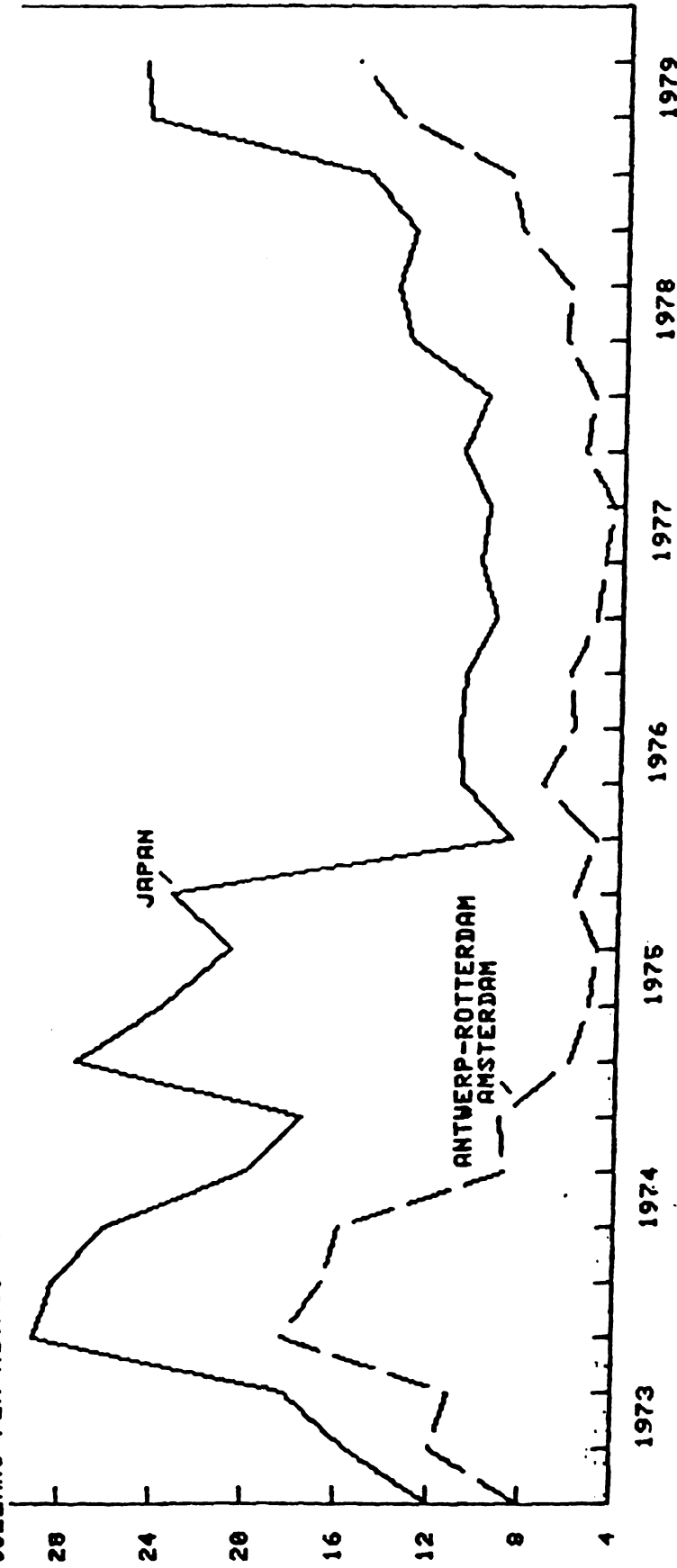
¹Interview with Robert L. Boothe, Vice President, Business Development, Producers Grain Corporation, April 23, 1979.

²Interview with Zeman.



OCEAN FREIGHT RATES FROM U.S. GULF TO NORTHERN EUROPE AND JAPAN, 1973-79 1/

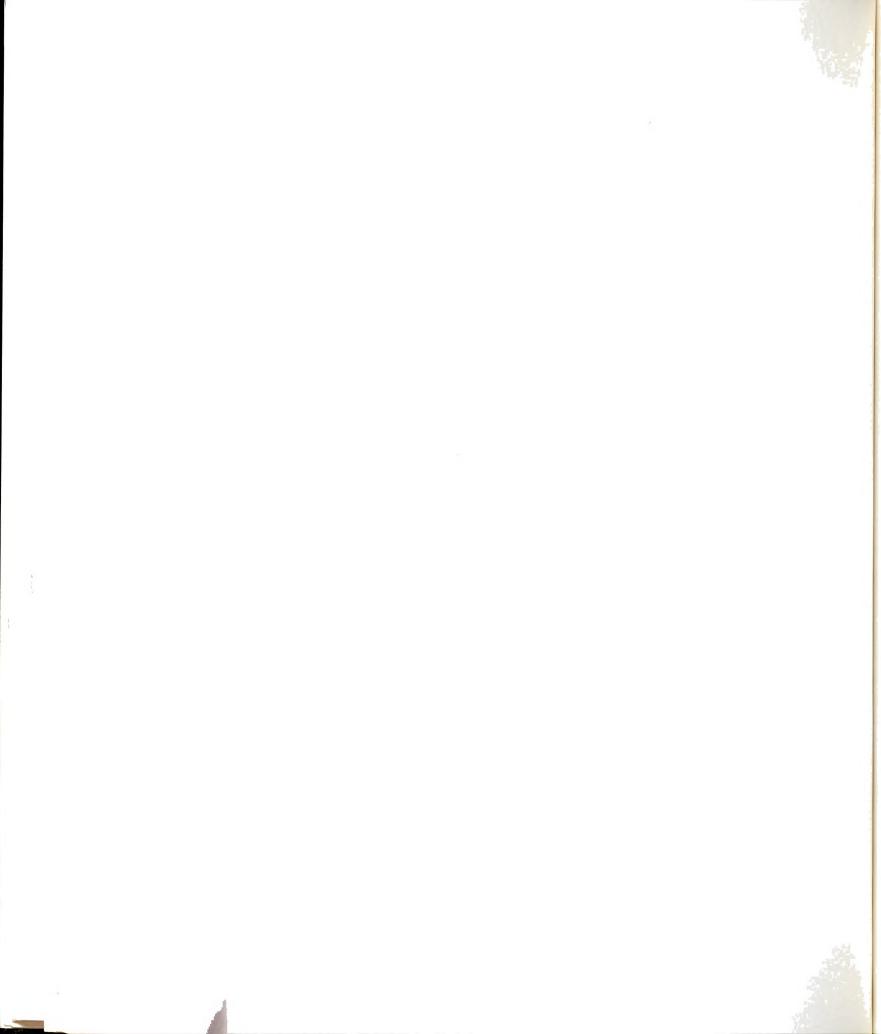
DOLLARS PER METRIC TON



1/ OCEAN FREIGHT RATES ARE QUARTERLY AVERAGES BASED ON REPORTED SHIPPING CONTRACTS FOR GRAIN. HOWEVER, BECAUSE SOME GRAIN SHIPMENTS ARE NOT COVERED, AVERAGE RATES SHOULD NOT BE CONSIDERED PRECISE ESTIMATES.

FIGURE 5.1.

Source: Mary Darhanian and Floyd D. Gaibler, "Ocean Freight Rates for Major Agricultural Exports," Foreign Agricultural Trade of the United States (FATUS), November 1979, p. 64.



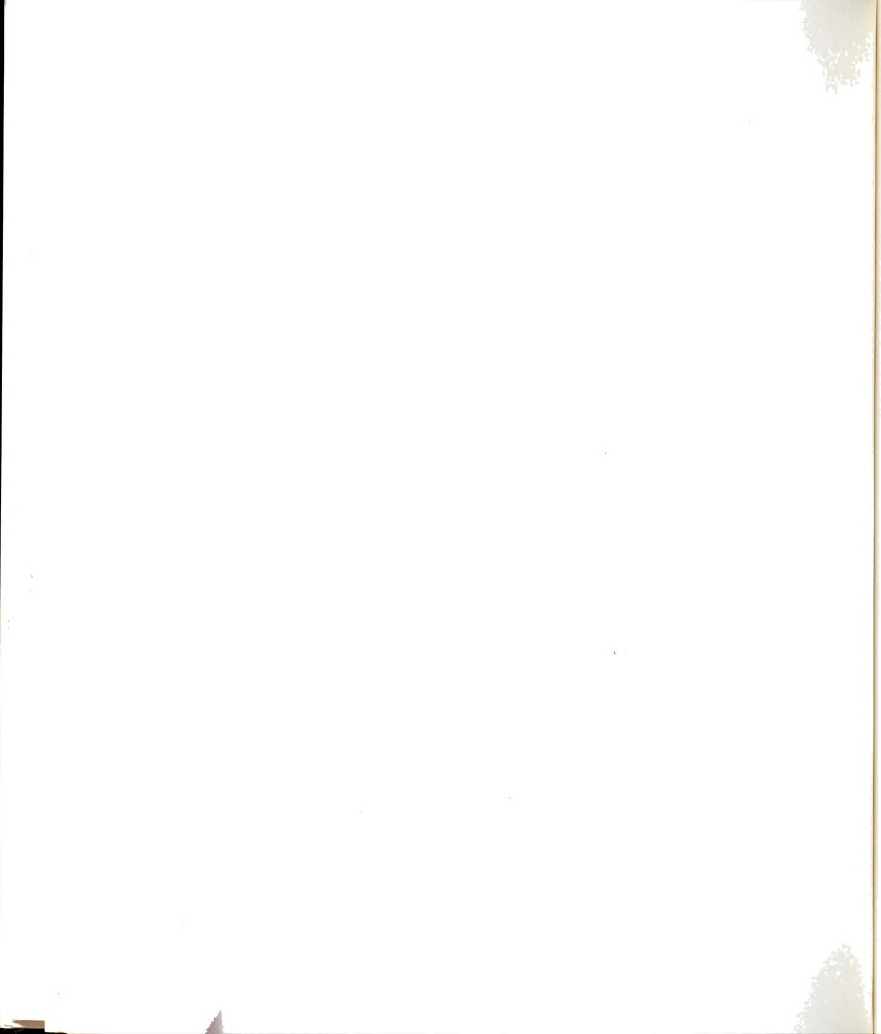
may run \$6000 per day on a 30,000 ton vessel, so that transportation bottlenecks such as rail car shortages and slow unloading can have major costs attached.

Besides problems with railroads, barges and trucks, a shipper may fail to have the product ready as he expected when arrangements for a vessel were made. This was the case mentioned by several citrus shippers. If they do not fill the holds, they pay for unused freight space.

While freight rates are quite volatile, the competition in world grain markets is such that the difference between high and low bids on many large contracts and public tenders is often only \$2/metric ton.¹ Thus, freight rates can be a critical factor influencing cooperative export sales and member returns. The opportunity for large profits exists, but so does the potential for large losses. Cooperatives can best evaluate these issues as part of an overall risk management strategy. This will be discussed further in Section 5.8.

Among cooperatives handling general cargo commodities, the opportunities to benefit from ocean freight chartering also exist. For example, Sunkist Growers, Inc., has a major ocean freight voyage chartering program for shipments of fresh citrus to markets around the world. The vessels involved are both smaller than those carrying grain, and refrigerated. While differences in the type of vessels chartered would seem to preclude advantageous coordination in transportation

¹Interview with Charles Pence, USDA/OGSM, October 20, 1978.



among shippers of bulk commodities and those requiring refrigerated general cargo space, opportunities for coordination among shippers of commodities requiring similar stowage requirements could be developed.

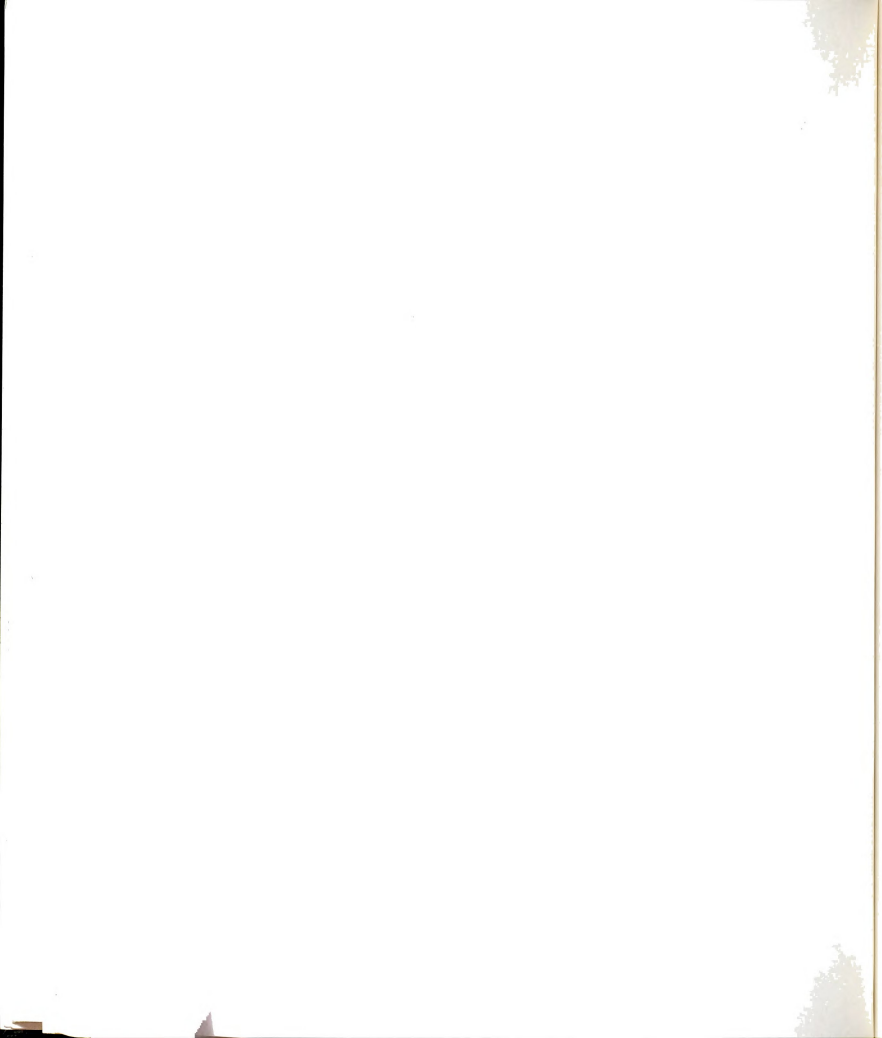
In addition to the type of handling and cargo space, several other factors may be considered in evaluating potential transportation economies and coordination possibilities. These include the size, regularity and destinations of export sales and shipments.

In voyage chartering a large amount of cargo space on a regular basis, cooperatives have successfully developed satisfactory agreements with non-conference lines to achieve high quality service at lower cost. In one such case, a cooperative leader noted that this also resulted in a reduction of conference rates for the cooperatives' competition.¹ The overall effect in this case is to make U.S. products in general more competitive in foreign markets.

5.3.2.3.2 Large-Volume General Cargo Movements

In other cases of larger volume general cargo movements, economies have also been obtained without chartering entire vessels. As noted previously, through PACE, large-scale shippers with regular commitments along the same freight routes have been able to realize cost savings through their ability, in concert, to influence conference rates. In 1973, PACE claimed an average cost reduction of \$6 per ton. More recently, a PACE member claims to have saved \$3 million on transportation

¹Interview with Russell L. Hanlin, President, Sunkist Growers, Inc., August 15, 1979.



in two years. Although not all members enjoyed such large savings, this serves to underscore the potential to bargain when those doing the bargaining are important customers to the carriers involved and have alternative means of transportation.

5.3.2.3.3 Consolidation of Small Shipments

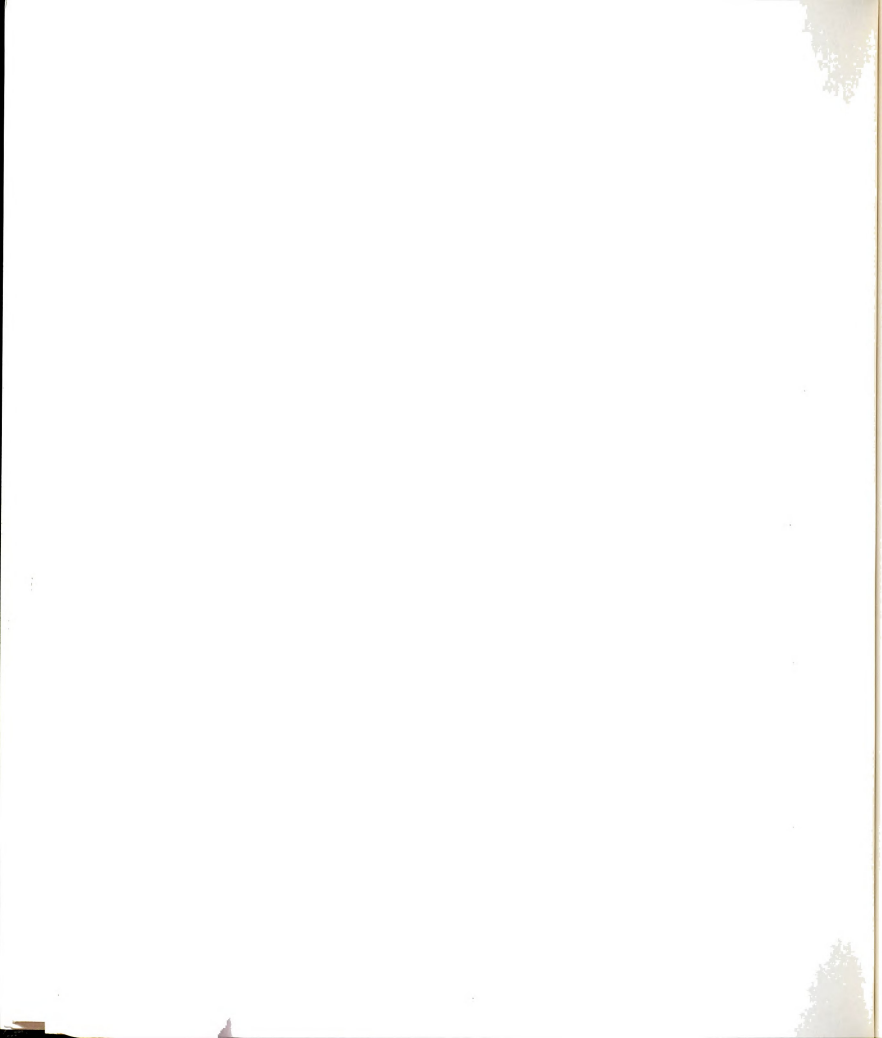
Not all cooperatives have the resources or the volition to enter export markets as large exporters. The pursuit of economies in coordination of smaller scale exports may help to improve the competitive position of smaller exporters, eventually permitting them to develop larger export programs.

One area for potential economies is the consolidation of less than container load (LCL) shipments. Where shipments are destined from a common port to a common foreign buyer or destination, consolidation may permit savings on costs of freight, documentation and any consular arrangements.¹

If a number of small shipments to a single foreign buyer are combined on a single bill of lading, the shippers could not only avoid payment of multiple forwarding fees, but also multiple minimum freight charges and multiple charges for the consular invoices required on exports to some countries.

For example, 450 cases of canned cherries, weighing about 20,000 pounds, will fill approximately one-half of a 20 foot container. If

¹It is important to consider whether these savings are offset by increased domestic assembly costs.

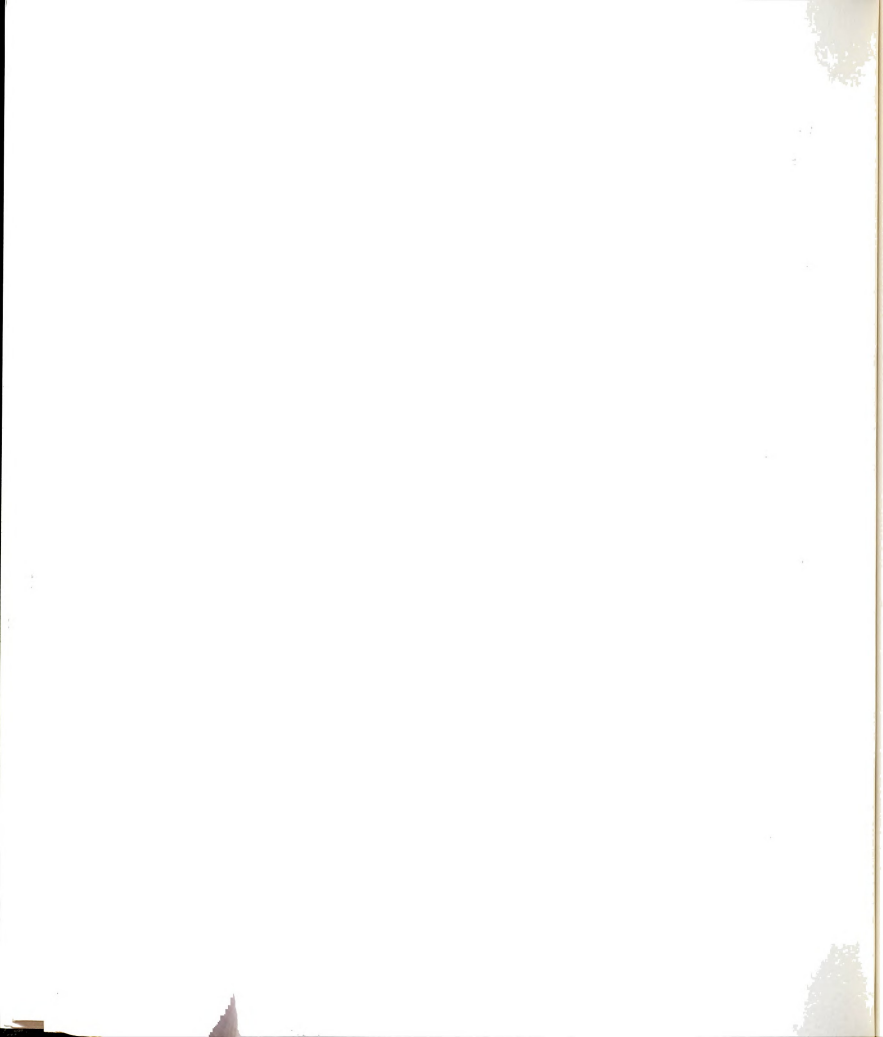


shipped by container, the shipper would have to pay a minimum charge which would approximate the cost of shipping a full container. One alternative is for the shipper to seek cargo space on a break-bulk vessel. The break-bulk rate would often prove less expensive than paying the minimum charge for a container, but the shipper might face trade-offs in terms of speed of shipment and risk of product damage and pilferage which would lead him to prefer container shipment. Independently, a cooperative shipping canned blueberries might be facing the same situation. If the two could get together to consolidate shipments, either through joint agreements or through arrangement by a freight forwarder, both could potentially achieve lower freight costs.

The advantages of a freight forwarder in this situation would stem from the wide range of shipments which he or she would be handling daily. This would increase the probability of matching shipments between ports and destinations for consolidation purposes.

However, if our analysis moves to the context of the export marketing process as a whole, with a 450 case cherry sale in hand, a joint sales office might be able to use the potential savings on freight consolidation to either sell a buyer blueberries, or more cherries; or sell another product to the same buyer or one in close geographic proximity. This would permit cost savings on transportation as well as serving to further develop export markets.

In order to better understand other potential savings mentioned above, it is useful to discuss freight arrangements and, more specifically, international freight forwarding.



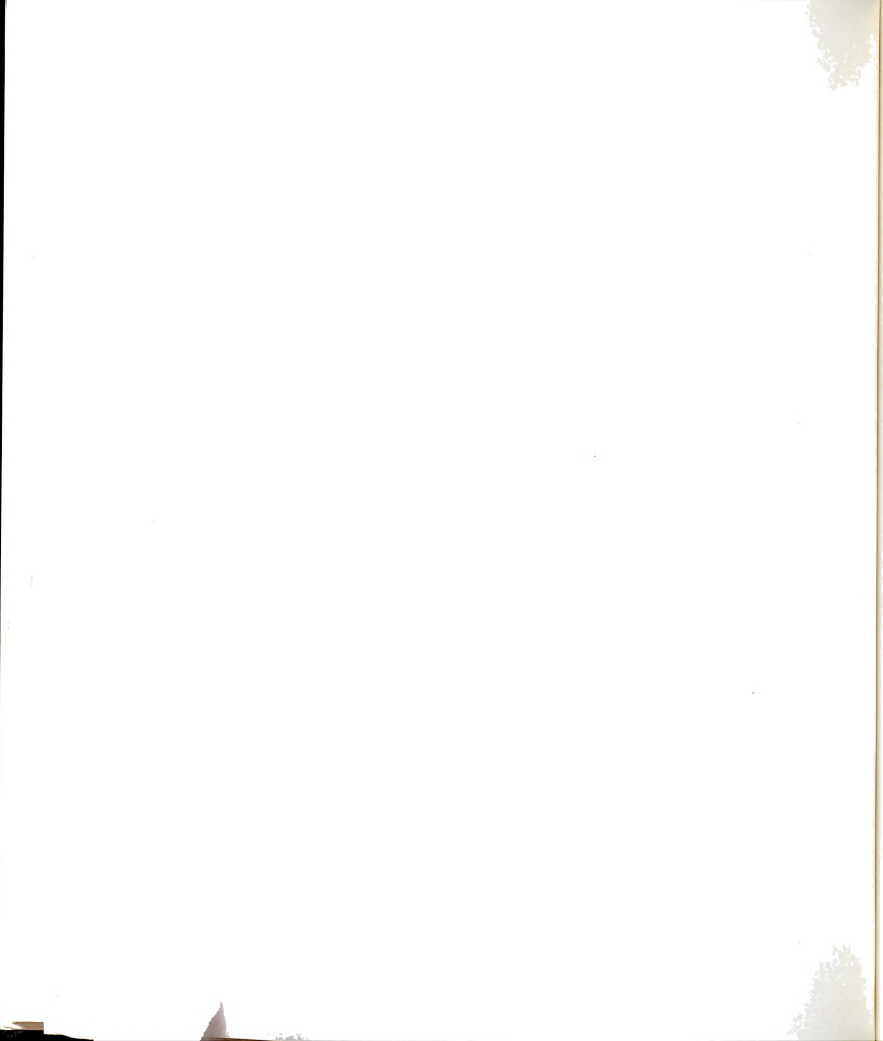
5.3.3 Freight Arrangements

For the exporter facing a vast array of domestic and international transportation alternatives and the need to make both choices and arrangements, a number of options exist. Some exporters maintain international traffic departments, others use the services of international freight forwarders.

In addition to arranging for and booking space on ocean vessels, freight forwarders perform a number of additional tasks. Among other things, they provide advice on shipping and market conditions, arrange land transportation to the most favorable port, arrange for proper packing, marking, invoicing and other procedures to comply with buyer and foreign government requirements, trace goods if necessary, to assure vessel connections, arrange to transfer goods to the vessel when they arrive at the port, consolidate shipments from different suppliers to a single buyer, arrange U.S. customs clearance, insurance coverage, preparation of consular invoices to meet customs regulations at the destination, and prepare banking and collection papers.¹

The forwarder receives a forwarding fee from the shipper and a brokerage fee or commission on the ocean freight bill from the carrier. Brokerage fees range from one and a quarter to six percent of shipping cost. Some forwarders charge a lump sum fee for their services so that forwarding a LCL shipment would cost the same as forwarding 1000 containers. One forwarder who follows this practice charges \$25 per bill of lading. According to Murr, others charge separate fees for different activities:

¹For a more detailed discussion of the role of forwarders, see Alfred Murr, Export/Import Traffic Management and Forwarding, fifth edition (Cambridge, Maryland: Cornell Maritime Press, Inc., 1977).



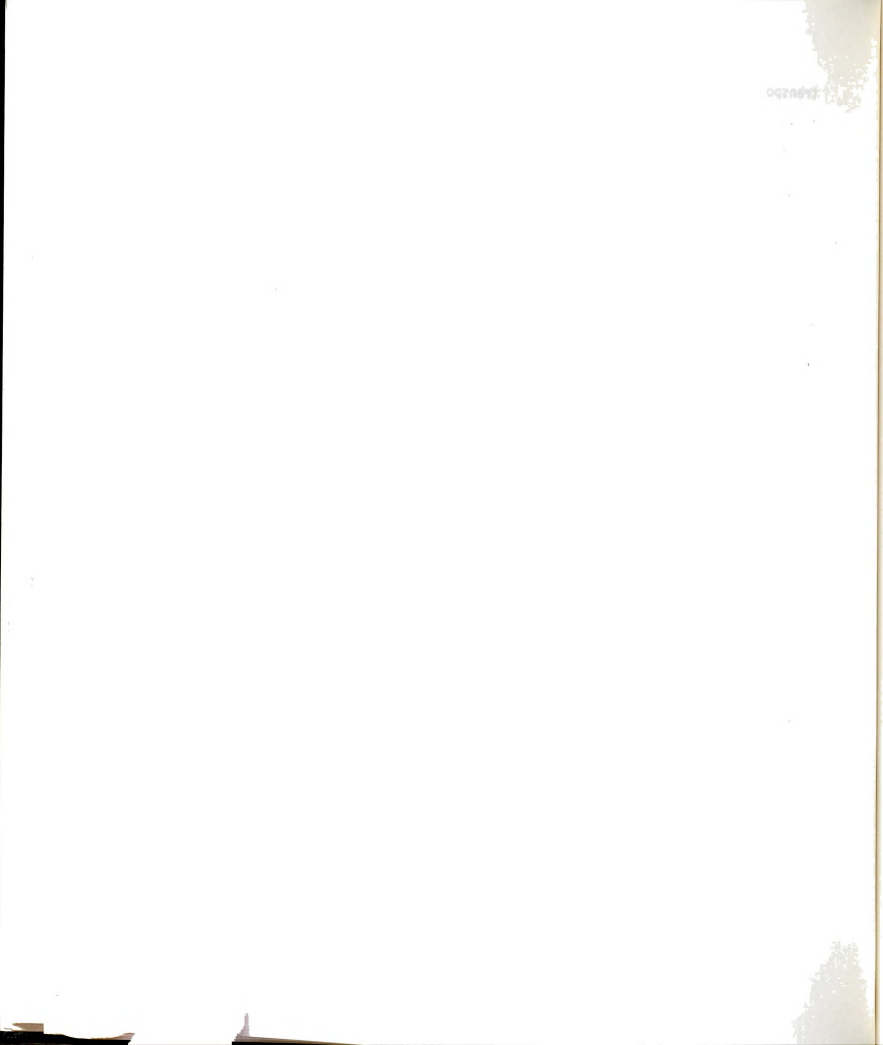
transportation arrangements and preparation and handling of a bill of lading (\$7.50 to \$50.00), preparation of a customs invoice and/or certificate of origin (\$2.50 to \$7.50), customs clearance, verification of an export license (\$2.50 to \$5.00), and banking services such as draft attendance or collection of a letter of credit (\$3.50 to \$10.00).¹

In considering the costs associated with transportation arrangements, it is intuitively appealing to think of saving on forwarding fees and commissions on ocean freight and brokerage through an internal international freight department. The analysis of advantages and disadvantages of such an approach can begin with a look at the size and timing of an exporter's demand for forwarding services. If there is extreme variability in that demand, there may be a problem of peak loading, accompanied by the need to pay employees full time in order to have them available for periods of peak demand. Freight forwarders may be specialists, but they generally handle a broad enough range of commodities so that variable personnel demands balance out.

Forwarders perform a number of services, which can be performed by an internal freight department. The critical issue becomes one of identifying the conditions under which these functions can be performed internally on a cost-effective basis. Some cooperative exporters have found this to be possible, others have not. In one instance, a freight forwarder has placed his own employee in a cooperative's office.² This permits provision of the personal service required by the account while

¹Ibid.

²Interview with Rideout.



maintaining the advantages of the forwarder's own network of international offices and trade connections. In this case, the cooperative pays the forwarder fees, but no salary or retainer. Shipping rates are negotiated by the cooperative as part of PACE, so the forwarder is primarily concerned with freight arrangements.

The particular cooperative under discussion is actually a joint exporting venture of two other cooperatives. In addition to rate reductions achieved through PACE, the traffic volume generated through the joint venture is sufficient to merit the individualized service provided by the freight forwarder. This is another example of a potential advantage of export coordination.

5.3.4 Warehousing and Distribution

As we have seen, there are economies associated with large volume and regularity of shipments in the acquisition of transportation services.

Ocean vessel chartering offers great potential economies, but also involves a concomitant increase in risks. Freight rates may decrease after a charter party is signed. If cargo space has been chartered, but commodity is out of position, or unavailable, the shipper may have to pay for dead freight space. Or, commodities may have to be "sold afloat" if freight and commodity are ready to move before a buyer has been found.

Where high product perishability is not a problem, the availability of warehousing and distribution facilities in or near export markets offers the potential for holding inventories and thus mitigating somewhat the risks associated with "locking in" transportation services. It may

also facilitate achievement of economies of large volume transportation while permitting more economical distribution to smaller volume customers. Additional benefits in terms of the ability to better service customers are also a possibility.

Cargill, Inc., owns grain storage facilities in Western Europe which permit it to achieve transportation economies as well as merchandising flexibility.¹

For processed food products, some cooperative personnel suggest that cooperatives might benefit from a joint warehousing and distribution facility to service various European markets.² Hirsch suggests that such an arrangement might be viable in the Middle East.³

A number of cooperatives have experience with such a venture domestically through Agfoods, Inc. The organization seeks to strengthen member marketing through the provision of warehousing and distribution for dry, cold storage and frozen food products. Agfoods is credited with reducing forward inventory and shipping costs through consolidation, permitting improved customer service, and facilitating promotional programs and entry into new markets through assurance of inventory coverage under uncertain demand and supply conditions.⁴

The potential for coordination of distribution activities is once again constrained by the distinction between bulk commodities and

¹Interview with N. Leonard Alderson, Senior Vice President, Tradax, March 27, 1979.

²Interview with Charles Riley, Group Vice President, General Services, Agway, April 4, 1979; and interview with Leonard Sletten, Export Sales Manager, Diamond/Sunsweet, July 16, 1979.

³Hirsch, 1979.

⁴Brooks and Byrne, pp. 16-17.

packaged goods. While advantages may accrue to both groups through coordinated foreign distribution systems, differences in facilities requirements and potential customers would seem conducive to the development of separate distribution networks.

5.3.5 Summary

In summary, commodities exported by U.S. farmer cooperatives fall into two general categories: bulk and general cargo.

Bulk commodities include both dry cargo, such as most grains, soybeans, and oilseed meals, and bulk liquids, including oils. Dry bulk commodities can be mixed in shiploads subject to the availability of separate holds.

Most other commodities are handled as general cargo. There are, however, differences in general cargo according to whether it requires ordinary stowage, as with most dry packaged cargo, or special devices, such as refrigeration or controlled atmosphere. While there are some constraints on the availability of refrigerated cargo space, and additional monitoring costs and risks are involved, arrangement for either type of general cargo space is similar. Most general cargo is either transported as break-bulk freight or in containerized shipments, with the latter gaining rapidly in popularity.

Domestic transportation of exports of most commodities is quite similar to domestic transportation of the same commodities destined for export markets, with cost savings accruing to volume shipments. There are, however, some rate categories which apply only to imports and exports. Consolidation of shipments to take advantage of economies in those rates could be beneficial where assembly costs do not outweigh the overall transportation savings.

Economies of size and coordination in ocean transportation are attainable at three levels:

- 1) through chartering of vessels,
- 2) through regular, large volume shipments, whether break-bulk or containerized, and
- 3) through consolidation of small shipments of less than container-load lots.

The alternative of private vessel ownership was not discussed.

In analysis of the potential advantages of coordination of export related transportation and distribution activities of cooperatives, several important points bear repetition. First, advantages of coordination may arise from: similarity of domestic origin, use of the same services, same ports of exit and destination, and identical or similar customers. The advantages here are not limited to transportation coordination. Secondly, the bargaining power of coordinated action by shippers in dealing with ocean freight conferences has been demonstrated. Thirdly, differences in the transportation requirements and objectives of shippers of bulk and general cargo commodities may limit coordination possibilities with respect to the transportation function. Finally, dissimilarity among the needs of shippers handling large and small volumes may preclude similarities of interest necessary to successful coordination.

5.4 Market Information

The market information function involves acquisition and validation of data and analysis from short, medium and long term perspectives. The information needs of the exporter vary with respect to the commodities, markets and length of run being considered. They also vary based upon

whether the exporter is interested in arbitrage, market development, or sporadic sales.

The fixed costs involved in the market information function are a major proportion of the total costs. In other words, once a market information system is in place and functioning, the marginal costs of an additional bit of information is relatively low. This gives rise to size advantages as increasingly large sales volumes which cover variable information costs will lower average total costs.

For the marketer, information acquires value through its impact upon sales and revenues. In evaluating the costs and benefits of investments in information, it is useful to differentiate between 1) resources of knowledge, which are not expended through their use, and 2) market intelligence, which retains most of its value in trading for only a short period of time.

The resources of knowledge include such factors as knowledge and understanding of: market participants and their standard operating procedures, global and country specific markets for different commodities, and the language and customs of trade in individual markets.

Market intelligence, while contributing to the resources of knowledge, may be of value per se only in presenting the opportunity to trade. This may involve identification of sales leads, forthcoming tenders or arbitrage opportunities, or predictions of changes in freight or foreign exchange rates or availability. These are cases where the potential exists to obtain what Williamson calls "nontrivial first-mover advantages."¹

¹Williamson, 1971, p. 116.

The above distinction may be useful in differentiating information which can be of value for a broad range of commodities or situations from that which has more time and situation specific importance.

Caves suggests that economies of scale in the employment of information as a productive asset contribute to the advantage of large scale traders.¹ One objective of the current research is to evaluate the degree to which such scale economies can be obtained by farmer cooperatives through multicommodity coordination in exporting. This analysis will proceed by reviewing Caves' conclusions with respect to informational economies among large grain merchants and comparing them with the view of cooperative objectives and operations as gleaned through the interview process.

Caves' view of economies of information can be summarized in four points:²

1. There are increasing returns to satisfaction of information requirements.
2. Awareness of trade possibilities between centers requires information with respect to market conditions at each center. However, acquisition of information about conditions at a center n , provides information about possibilities for $n-1$ additional trades.

¹Caves, 1977-78, pp. 115. Caves also suggests that scale economies, in coordination of information and physical facilities, together with large transaction size, may force grain traders to become large in order to pool risks.

²Ibid., pp. 115-117.

3. Information is perishable, and extra start up costs arise if the trader is not continuously involved in making a market or receiving bids. In order to realize informational economies, a trader must incur both the costs of information and the costs of a trading presence in a given market.

4. Through vertical integration, information about physical facilities usage can be transformed into a bargaining advantage where there are economies of size in operating facilities at close to their short run capacities.

5.4.1 Fixed Costs of Information

There are a number of sources of information for the exporter, including: foreign offices, agents, and representatives; buyers; market news and wire services; U.S. and foreign government publications and announcements; reports in domestic and foreign trade publications and other news media. These sources provide data and information of varying usefulness in diverse forms and at different costs.

5.4.1.1 Foreign Offices

Where an exporter has developed a system of foreign offices staffed by its own personnel, it will often be possible to provide information on an additional commodity from that office at less than the cost of opening a new office, or system of offices. Factors influencing such potential include: slack in employment of physical facilities and personnel, complementarity in the marketing channels for individual commodities, and seasonable variability in demand for services by individual suppliers. Evaluation of the costs involved is complicated

by the difficulty in allocating costs to an information function, when that function is only one of many performed in an office, and those other functions contribute to the value of the information function. We can, however, begin our analysis under the assumption that an office is used exclusively for information purposes. Office costs vary considerably according to the country of location, staffing patterns, travel and communications requirements and entertainment expenses. The standard operating procedures for trade in different commodities vary, as do regional customs and requirements. These factors affect the cost of doing business abroad. For example, although a grain trader might be able to perform all essential technical functions in an office in Japan for \$100,000 to \$250,000 a year, the necessities of demonstrating his stature and potential reliability may result in a more lavish operation, costing \$500,000 to \$1 million per year, being found desirable and, indirectly, profitable. If such is the case, one advantage of coordination extending beyond technical economies in personnel and facilities usage might be potential economies in obtaining status.

The nature of demand for individual commodities and the relevant markets for commodity groups differ significantly. For example, while wheat is largely sold for milling and feed uses and the purchasers are often state organizations, processed fruits and vegetables are sold for consumer, institutional and industrial uses with a wide range of buyers. Even where sellers of fruits and vegetables deal with state traders, the personnel or even the organizations are often different from those handling wheat.¹

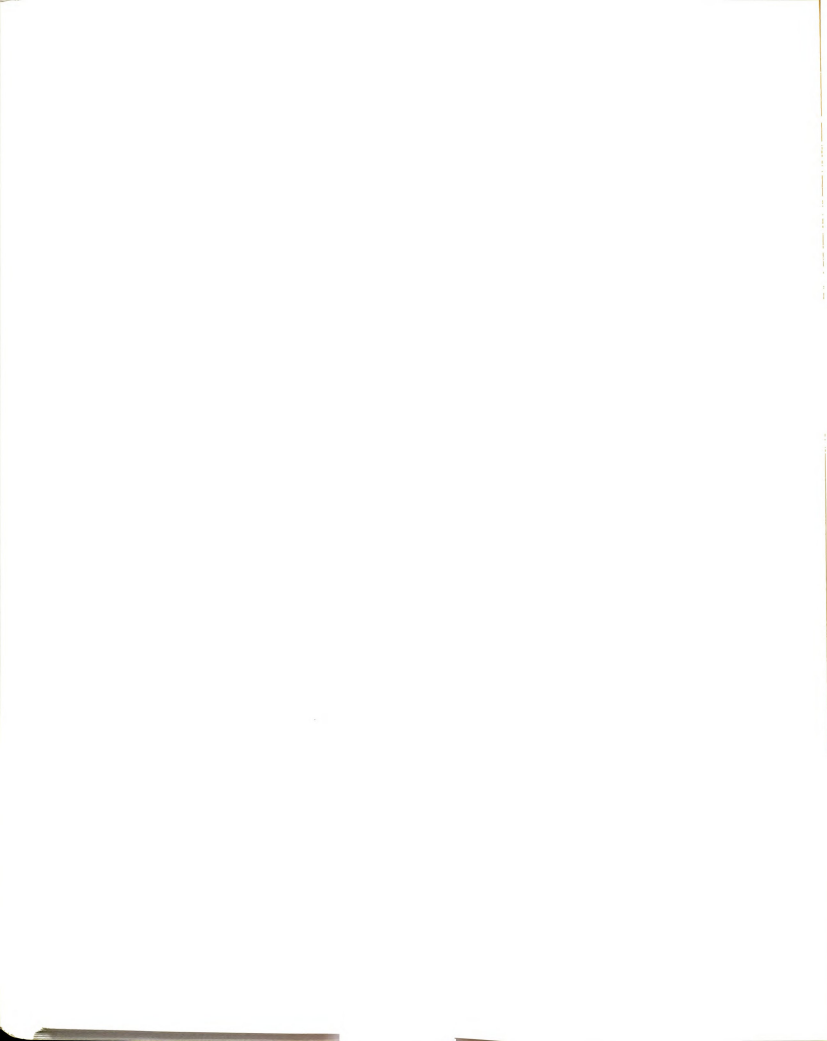
¹This is apparently not always the case. One source stated that CEROILFOOD in the People's Republic of China has greater emphasis on geographic origin than commodity.

Thus, while sources of political, economic and climatological information relevant to the two commodity groups might be similar, additional contacts would be required to provide market intelligence and trade leads relevant to sellers of the two commodity groups. For example, a trader handling feed ingredients would, in the course of his daily activities, be exposed to data on market factors affecting a range of feed grains, meals, and substitutes. His information could be useful to a number of suppliers of sometimes competing commodities. There would be less advantage in having him provide regular information on the market for fruit cocktail, however.

One cooperative exporter with a primary interest in the sale of bulk grains reports occasional arrangements for container load sales of items such as canned corn and corn flakes.¹ In these cases, the information system is able to produce leads which facilitate sporadic sales of disparate commodities. However, if producers of the latter products wished to develop comprehensive export market development programs, other approaches could be more effective.

Where personnel appear to be underutilized, it may be possible to achieve economies in operation by increasing the breadth of their commodity coverage. In many instances, marketing seasonality and worker indivisibility may necessitate periods of excess capacity in order to ensure adequate staffing for periods of peak demand. Any economies to be obtained through improved use of slack must avoid

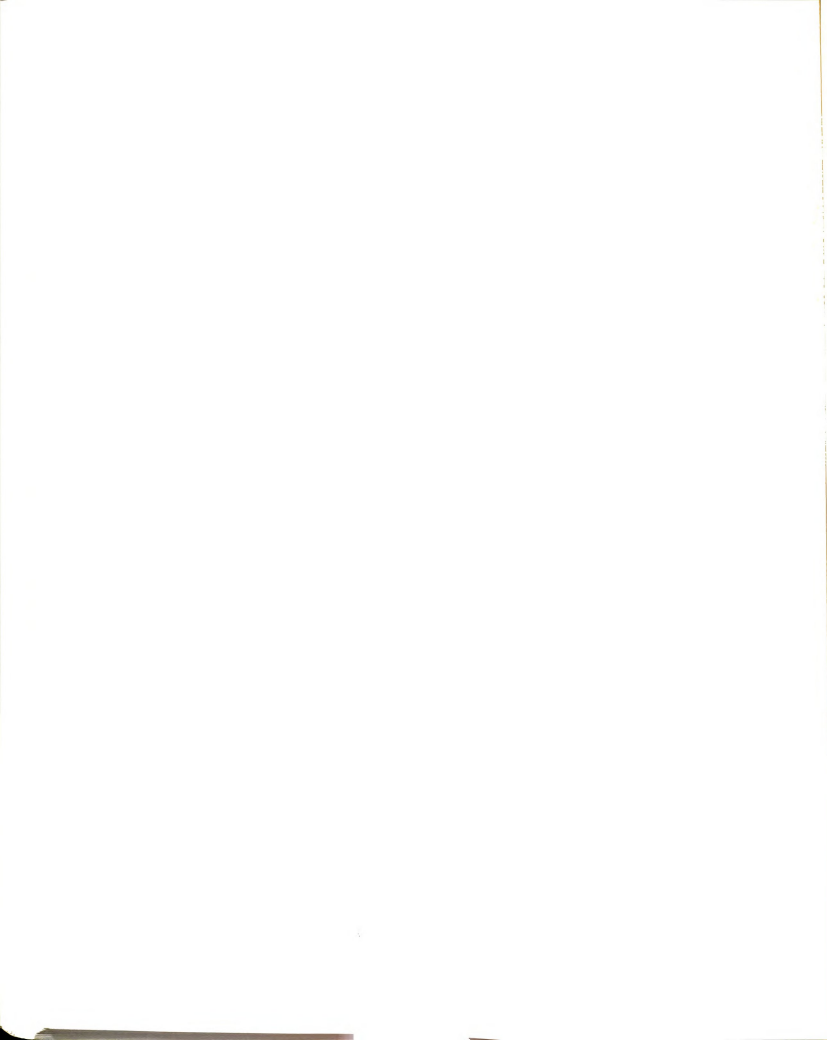
¹Interview with Boothe.



competition during peak demand periods. In analyzing the potential for combining commodities covered by an information network, comparison should be made with the costs of using agents for dissimilar commodities, as well as the costs of combining commodities in a cooperative's own overseas offices. It is essential to recognize the importance of commodity specific technical competence in guiding data collection and providing the analysis necessary to obtain useful information.

There are potential economies in use of facilities, such as telex, telephone, secretarial services, etc. The research indicated that it is unlikely that these alone would provide sufficient incentive for regular coordination of information networks for unrelated commodities. In some cases, however, these fixed costs could be used to provide an occasional service function at a low marginal cost. This type of arrangement might permit sporadic sales of assorted commodities, as several cooperatives do currently.

Other types of arrangements also have some promise. For instance, the location of offices specializing in feed ingredients may permit them to occasionally arrange for verification of arrival quality of fresh produce or other cargo when a dispute arises. The value of this service to the exporters of other commodities would be somewhere between the potential loss from the damage claim and the cost of sending someone from its own offices. Such arrangements could decrease the risk of fraudulent damage claims, reducing insurance costs and further freeing resources with which to pay for the service.



5.4.1.2 Agents or Representatives

Another area of fixed costs is arrangement for agents or representatives in markets around the world. While most agents work on a commission basis, the selection of an agent and development of a mutually satisfactory working relationship involves considerable transactions costs. The agent generally serves as an exporter's information source and sales representative in a specific market.

Development of a workable system of 50 to 60 agents around the globe is a major undertaking. It requires investment in careful monitoring and evaluation of information supplied, though it may be less capital intensive than a system of a similar number of offices. Cooperatives handling dried fruits, nuts, and processed fruits and vegetables have undertaken various sorts of arrangements to increase product flow through such systems, thus reducing the average portion of fixed costs which must be supported with each dollar of sales volume. In some instances, this has been accomplished through joint marketing departments; in others, there are intercooperative agreements to market for a fee.¹ The potential advantages of coordination of agents will be discussed further under sales representation (5.5.1).

5.4.2 Arbitrage and Information Costs

For a trader, or arbitrageur, whose interest is in moving commodities between areas of supply and demand at a profit, the addition of another information center opens the opportunity for trades between that center and all others in which he has sources of information.

¹The latter form of arrangement must be evaluated in terms of legal constraints on non-member volume which can be handled by an agricultural cooperative.

In contrast, an exporter interested in selling goods from a single origin gains only one more potential trade opportunity through the addition of another information center.

If we simplify our analysis through assumptions that only one commodity is being exported, and that costs of arrangement of transactions and transportation between markets is constant, we can see that the trader's costs of information from an additional office, n , can be allocated over trades between $n-2$ more centers than can those of the single source exporter. In other words, if the trader's average sales volume between centers is greater than only $1/(n-2)$ of the exporter's average, then the trader realizes lower average information costs. In order to remain competitive, the exporter must realize economies elsewhere.

Cooperatives have adopted several approaches to dealing with the informational disadvantages inherent in being single source exporters. Several cooperatives handling fruits and vegetables have diversified their product lines and/or made limited ventures into trading from multiple sources. Also, a group of cooperatives with major grain and feed ingredients interests have purchased a share of an international trading company, A.C. Toepfer International.¹

Some cooperative leaders argue that trading non-U.S. origin and/or non-member produced commodities is inconsistent with the interests of their members. Others suggest that those activities can be part of an aggressive marketing strategy which provides growers with both high returns and low cost marketing services. These issues will be discussed further under sales.

¹For further discussion of A.C. Toepfer International, see Chapter VI.



5.4.3 Information Perishability

The critical linkage between a trading presence and access to market information is a reflection of both the perishability of information and the importance of supplier reliability. In the sale of grains to some commercial buyers and state trading organizations, a traditional supplier may get the option of first refusal on a bid.¹ Given the importance of volume to the trade, such information can be quite valuable and an incentive to stay in the market. Some traders accomplish this by submitting high priced offers on business that they really do not want.² Others, like Cargill, may sell because they are asked to, even though doing so may not be profitable in the short run.³

In trade in other commodities, a reputation as a reliable supplier is also important. Procurement strategies of domestic industry are indicative of the importance of risk to both buyers and sellers. To the extent that out of stock situations are undesirable and costly, it is in the interest of foreign purchasers to assure themselves of reliable sources of supply. In addition, a buyer can decrease transactions costs associated with seeking out a source of supply through the development of ongoing supply arrangements, whether formal or informal. Where a supplier makes product available on an irregular basis, and there are risks of supply shortages, the potential buyer may be reluctant to leave a regular supplier, or at least add a risk premium to any offer from the irregular supplier. Since he becomes ranked as a lower priority

¹Jim Lepine, Vice President, New Market Development, Farmers Export Company, cited by Krob, February 15, 1979.

²Interview with Pence.

³Interview with Alderson.

source, market intelligence costs to the irregular supplier may be higher than those of his competitors.

5.4.4 Information, Management and Diversification Strategy

Diversification of commodity lines marketed requires knowledge of specific commodity market operations. In considering diversification, it is necessary to recognize the relevant market over which economies of scale in management of information can be obtained. Furthermore, given resource constraints, diversification cannot seek to achieve all possible economies with respect to all commodities. Priorities must be established.

One cooperative leader pointed out the trade-offs of broad line diversification as: taking a manager with a great deal of expertise with respect to the marketing of one type of commodity and diverting his time to an area he knows little or nothing about.¹ Where there is substantial room for market development within the area of the manager's expertise, there may be diseconomies to diversification due to the high fixed costs of information in marketing relatively unrelated commodities.

This raises the important issue of commodity categorization. A primary distinction between bulk commodities and others appears relevant. Further distinctions in the latter group can be based upon product complementarity and the organization of demand. Fresh fruits and vegetables, traded at auction in some markets, require somewhat different information management than their processed, and therefore less perishable counterparts.

¹Interview with Leith.



Evaluation of diversification potential requires analysis of commodity marketing similarities which offer potential size economies in management and information use.

For example, the recent entry of Phillip Brothers Division of Engelhard Minerals and Chemicals Company into the grain trade builds on a \$7.3 billion 1977 sales volume in trading bulk commodities. In discussing the move, David Tendler, Phillip Brothers' President said,

Our intention is to build on our financial strength, our presence in practically all the developed nations and in many of the developing countries, our network of offices and our wide-ranging information sources to create a team that can be a significant participant in the world grain trade.¹

Phillip Brothers markets almost 150 bulk commodities through its network of about 50 offices around the world.

In addition to having advantages in procurement of commodity information, Phillip Brothers is one of the largest arrangers of ship time charters in the world.² Time chartering fixes facilities just as leasing or ownership of an elevator does. To the extent that bulk carriers can handle grain as well as other commodities, diversification permits Phillip Brothers to spread the fixed costs of transportation information, and use information on shadow prices of fixed facilities to enhance its bargaining ability.

We can compare the factors conducive to Phillip Brothers' diversification with the environment facing cooperatives. In the export marketing of bulk commodities, cooperatives have undertaken a joint initiative in

¹"Major New Entry into Grain Exporting," Milling and Baking News, December 19, 1978, pp. 49, 52.

²*Ibid.*, p. 54.

Farmers Export Company, and most recently, the acquisition of an interest in the Alfred Toepfer Trading Organization. Additionally, cooperatives have the experience of Producers Export Company, a joint effort of 19 regionals, which functioned between 1958 and 1969.¹ Farmers Export Company (FEC) is gradually developing a global information network, using agents and opening foreign offices. It is also beginning an involvement in ocean freight voyage chartering. Its management team, which has been in control less than a year, is moving aggressively to diversify geographic market and commodity emphasis. An explosion at FEC's Galveston elevator in 1977 was a serious setback to this process, but rebuilding will be completed in early 1980. In addition, FEC has added several new regional members and leased port elevation at Philadelphia. With rapid growth and potential for further growth in the bulk commodities area, management has chosen to build on and further develop expertise in the sale of grains and soybeans. FEC faces a disadvantage relative to Phillip Brothers in terms of the size of its foreign information network. The addition of non-bulk commodities to the FEC marketing program would not improve this situation, however.

In contrast to the relatively modest information network being set up by FEC stand the massive intelligence networks of Cargill, Continental, and others. As one source described it:

Continental is plugged into virtually every major foreign government. Its listening network is like a vast news agency that never publishes a word . . .

¹For a more detailed discussion, see Bruce Reynolds, Producers Export Company: The Beginnings of Cooperative Grain Exporting (Washington, D.C.: USDA/ESCS, 1980).

Continental boasts an integrated worldwide communications system that feeds 5,000 messages each day into and out of the New York headquarters. Much of it comes from the Paris office where messages pour in from other offices and listening posts in Europe, Africa, Latin America, and the Middle East, reporting bids and offers for grain, crop and weather conditions, political and economic trends--anything that affects the grain business, which is just about everything.¹

In discussing Cargill's trading and information system, operated through the headquarters of Tradax in Geneva, Cargill spokesmen are quoted as claiming enough flexibility "to market a shipload of wine from Chile and precious metals from Africa."²

It is intuitively appealing to argue that cooperatives should be seeking to develop information networks such as those of the major bulk commodity traders. Though major costs would be involved, exclusive and timely access to information is one of the necessary requirements for cooperatives to be strong competitors in the export of their members' products. A fundamental issue lies in the distinction made earlier between arbitrageurs and exporters. The business of Cargill's Tradax is, "buying commodities anywhere in the world where they are in surplus, selling in deficit areas and assuming the risks."³ The informational economies of multimarket arbitrage relative to single source exporting were discussed earlier.

For FEC, or any other cooperative exporter, to achieve parity in information supply and costs with its arbitrageur competition would require either substantial increases in export sales volume or becoming

¹"The Incredible Empire of Michel Fribourg," Business Week, March 11, 1972, p. 85.

²Thurston, et al., 1976, p. 17.

³Interview with Alderson.

a multi-origin trader, too.¹ But, if a cooperative becomes an arbitrageur like its competition, will it sacrifice some of the attributes which contribute to the uniqueness of farmer cooperatives? Some say yes. Others argue that such multi-origin business would permit the cooperative to become a more effective marketer for its members' production, and is thus consistent with cooperative goals.

Such issues must be evaluated within the context of the entire set of risks and benefits which would accompany a transition from exporter to arbitrageur. In so doing, it is important to recognize that an information system cannot be fail-safe. Raw data may be incorrect or incomplete, or analysts may misjudge their implications. Morgan cites the example of a July 1975 sale of 4.5 million tons of corn by Continental to the USSR which went unhedged. An unpredicted price rise of \$33.60 per ton by August 20 left Continental faced with the potential for a \$151 million loss.² One study of the potential for farmer cooperatives in the grain trade reportedly indicated risk of losses as high as \$50 to \$100 million per year. This not only points out the importance of risk management, it indicates the potential value of good information in planning a management strategy.

5.4.5 Summary

Economies in the performance of the information function may arise through: spreading of fixed costs over a larger transactions volume,

¹This does not mean that cooperatives cannot compensate for higher information costs through lower cost performance of other export functions or specialization with respect to markets. The essential point is that an arbitrageur has certain inherent information cost advantages vis a vis a single source exporter.

²Morgan, 1979, p. 326.

increased numbers of market information centers, a regular trading presence, and the ability to shadow price facilities and gain bargaining advantages thereby.

There is evidence of substantial potential for the development of informational economies through coordination among cooperative exporters. This potential is bounded by such factors as complementarity of products and market channels employed, whether information requirements are based upon a desire to develop a regular export marketing program, and the temporal profile of activity in marketing the cooperatives' products. Once again, these factors appear to indicate a distinction between bulk and other commodities. In the export of bulk commodities, competition with extremely large arbitrageurs places single source exporting cooperatives at an information cost disadvantage which can only be partially compensated for through increased volume and broadened commodity coverage.

5.5 Sales

The sales function involves matching of supply and demand. For the cooperative approaching a potential market, demand is not completely exogenously determined, however. While comparative advantage may be the fundamental basis for international trade, under conditions of imperfect information and high transactions costs, factors such as representation, promotion and servicing, as well as price, influence demand. The export sales function is thus both complex and critical to the overall marketing process. This section will begin with an overview, followed by discussion of representation, promotion, pricing and servicing.

In considering the potential for coordination among cooperatives in the performance of the export sales function, it is useful to distinguish among the sales requirements for standardized and differentiated products as well as the necessary functional organization for sales in industrial, institutional and retail markets. For the cooperative selling wheat or feedgrains, the trade makes use of internationally recognized standards which, though they may be imperfect guides to the usefulness of the commodities to the purchaser, result in sales based in large part on the price at which a standardized product is offered.¹ In other words, two potential sources of supply of equal ratings for reliability and service will be perfect substitutes as suppliers of U.S. No. 3 yellow corn.

At the other extreme in terms of sales requirements, are those branded and differentiated products which are sold in retail markets. Grades and standards also exist for such commodities and may serve to facilitate unbranded and private label sales. Branded commodities, however, often rely upon the perception of non-price product attributes, as well as price, in the generation of sales. For the cooperative which markets branded or otherwise differentiated products, issues such as proper positioning, access to shelf space and overall promotional strategy are of greater importance than to the marketer of a standardized product.

Commodities which are generally sold on a standardized basis are sometimes differentiated through special services, such as bagging of

¹Deficiencies in grades and standards as a guide to attributes of grains and oilseeds which are of value to purchasers are discussed in Lowell D. Hill, "The Role of Grades and Standards in Market Performance," paper presented at a seminar, Department of Agricultural Economics, Michigan State University, East Lansing, Michigan, October 15, 1979.

grain or oilseed meal. These services may permit an exporter to avoid cut-throat price competition through the development of expertise in areas where competing suppliers do not aggressively pursue the business.

Understanding of potential coordinational economies in export sales of different commodities thus requires evaluation of types of markets into which the individual commodities are sold. This includes assessment of the standard procurement procedures of potential export customers. Where price is the primary decision factor, the expenses involved in a sales strategy based upon development of an image of superior product quality may merely detract from product competitiveness.¹ Thus, cost of the sales function becomes a critical factor. Where product quality is of equal or greater importance than price as a determinant of procurement decisions, the most efficient or cost effective organization of the sales function will differ from organization for a "price" market.

The structure of international markets for individual commodities will also influence the incentives for coordination of export marketing by cooperatives. Where the world market is oligopolistic and dominated by a small number of closely held trading companies, the necessities for effectively competitive marketing will differ markedly from those required for participation in markets where power is less concentrated. The presence of state traders in export markets will also affect the role of coordination as a mechanism to countervail market power.

¹The ability to cross-subsidize in the short run might prevent these strategies from being incompatible.

Another important coordinational consideration is the geographic orientation of exports. Cooperative exporters can attempt to gain new or increased shares of existing export markets, and/or they can emphasize development of markets which, though relatively unimportant as a percentage of total U.S. trade, offer considerable market development opportunity. The largest U.S. market is not necessarily the best export market for the individual cooperative exporter. Japan, Canada, and Western Europe are major markets for many agricultural commodities, but markets in other areas are growing or can be developed.

U.S. exporters often have a transportation advantage in export sales to Canada, Central and South America and the Caribbean area. Many cooperative exporters treat Canada as part of their domestic market in terms of sales organization. It is, nonetheless, a major export market.

Much of the discussion of coordination potential for cooperatives has emphasized its importance as a means to countervail market power. Coordination also presents the opportunity to share the costs of new market exploration and development, especially for commodities which flow through similar marketing channels. Any attempt to make export sales requires market research. This involves development of the resources of knowledge discussed under the information function. This is essential in order to be able to identify the overall sales potential and best positioning of a product in a given geographic or political market area.

Few cooperatives could afford to maintain a sales organization for a single product in every market in which it might be sold. Coordination



may offer opportunities to improve the exposure of a product to potential customers throughout the world. In evaluating such opportunities, it is necessary for cooperative management to consider both domestic and international components of its marketing strategy, as well as interests in the short, medium and longer run. It is quite easy to conclude that the short run returns to a sales trip to Cedar Rapids will be greater than one to Shanghai, especially if the salesman has never visited Shanghai before.¹ The longer term interests of the cooperative members may be best served by investment in the trip to Shanghai, however. Furthermore, coordination may offer the opportunity to reap such benefits at lower cost.

The problem can best be viewed through further analysis of four sales subfunctions: representation, promotion, pricing and servicing.

5.5.1 Representation

The representation subfunction is the mechanism through which information flows between potential buyers and sellers. Those charged with sales representation will generally play a major market information and intelligence role, including monitoring marketing opportunities, competitive conditions, and individual customer needs, interests, and overall satisfaction. In some cases, foreign buyers deal directly with the U.S. offices of a cooperative supplier. More often, it is advantageous to have representatives more easily accessible to foreign customers. This may be accomplished through commission agency arrangements,

¹As John St. John, General Manager, Citrus Central, points out, limited sales resources may dictate the assignment of priority to Cedar Rapids. Interview, May 16, 1979.

foreign distributorships or overseas offices staffed by the cooperatives' own personnel. In indirect sales, brokers or export managers often handle representation.

While there are significant costs associated with representation regardless of the manner in which it is performed, the relative importance of individual components of the bill will reflect the form of representation adopted. In the following discussion, costs of representation through agents and foreign offices are compared and an attempt is made to identify opportunities for coordination of representation among cooperative exporters.

An exporter without foreign representation may limit his export sales efforts to response to inquiries from abroad; or, he may take a more aggressive approach involving telexed and written inquiries to follow up leads provided by private and government trade information services or contacts resulting from participation in trade shows, advertising in domestic and foreign trade publications, or a reputation as a reputable supplier. Whether this turns out to be an acceptable means of doing business will depend largely upon the amount of export business being conducted, the marketing objectives of the exporter, and the interests of foreign customers.

Geographic markets vary significantly in their organization and standard business procedures, just as markets for different commodities do. The requirements for effective representation in a foreign market may be influenced by social norms and cultural values as much as by the sales volume involved. Several cooperative leaders interviewed indicated that while a sale in one country will require continued personal contact

regardless of its size, in another country all sales are handled quite mechanically. Thus, representation must be tailored to the particular practices of a given market.

In many countries, personal visits from home office personnel of significant suppliers are expected, even where foreign agents or offices handle most of the business arrangements. Where visits to foreign markets are to be made by U.S. office personnel, foreign market contacts can be critical in introducing the visitor to language, culture and customs, facilitating appointments and even avoiding such seemingly simple acts as visits which coincide with foreign business holidays. This is one set of functions which foreign representatives can perform. Where an exporter makes foreign visits without a contact in the foreign market, he can expect to incur higher transaction costs in terms of both time spent in making arrangements and effectiveness in seeing the right people in customer organizations.

Foreign representatives can often allow the exporter to provide better service to export customers as a result of both their accessibility and their potential for familiarity with the customer's business and requirements. Before considering coordination potential in performance of foreign representation, it is useful to evaluate some of the costs and benefits of alternative forms of representation.

5.5.1.1 Export Agents

Export agents generally work on a commission basis. This permits the exporter to gain access to foreign representation without locking in major fixed costs. Although some agents are paid a retainer or guarantee

against commissions, the general advantage of a commission agent to the exporter is that his costs are related to the amount he sells through the agent.

Commissions vary substantially by commodity, size of sale, average annual sales volume, market structure, services performed and what the market will bear. Interviews with cooperative managers indicated that some agents receive commissions which average less than 0.1 percent on substantial oilseed sales, while on small sales of specialty products, the commission may amount to ten percent. This comparison overstates the range of commissions in that the latter figure includes some domestic services associated with export marketing, while the former apparently reflects a fee for services involved in the foreign end of the transaction only.

As can be seen from Table 5.1, agent commissions for exports of assorted processed fruits, nuts and vegetables fall in the two to four percent range, while commissions on sales of bulk grains and oilseeds are generally 0.5 percent or less. The meaning of direct comparisons of commission rates is significantly obscured by differences in the quality of service provided as well as the services performed by an agent. An agent may or may not represent one exporter exclusively for each of the products he handles. This is a matter to be agreed upon between exporter and agent. While many U.S. exporters talk about the importance of having agents who will not handle competitors' products, the commitment to supply export agents on the same basis as domestic ones is not always as strong.

TABLE 5.1. COMMISSION COSTS FOR EXPORT SALES AND
REPRESENTATION: EXAMPLES FOR SELECTED
AGRICULTURAL COMMODITIES

| Commodity | Representative Commission Costs | Total Selling Costs (Including Representation) |
|---|---------------------------------------|--|
| | Percentage Rate | Percentage Rate |
| Feed Grains | 0.15 - 0.5 | |
| Rice | 0.5 | |
| Oilseeds | 0.06 - 0.2 | |
| Citrus Feed Ingredients | | 1.5 |
| Canned Fruits and Vegetables | 2 - 2.5 | 4 - 4.5 |
| Dried Fruits | 2.5 | 4 |
| Nuts: wholesale/retail | 2 | 4.5 |
| Nuts: institutional | 3 - 4 | |
| Fresh Citrus | | 5 - 10 |
| Processed Food Products (sold through export management firm) | | 10 |

Derived from data collected during interviews.

In evaluating an agent, one criterion emphasized by some cooperative leaders is the importance of the exporter to the agent. Where an agent handles products for a number of suppliers, even if the products are complementary, he will often devote the greatest attention to his largest sources of income. Cooperatives handling complementary commodities might find that coordination on the supply side could help them to increase their importance to a given agent. For example, several U.S. cooperatives independently market processed fruits and vegetables through the same agent in at least one European market. In acting as individual entities, they may be less important to the agent, and command lesser attention, than would be possible if they collaborated on the supply side, either to provide a fuller product line or a common marketing position.

A cooperative with a relatively small export volume is faced with the choice between concentration of exports in the territory of one agent in order to be somewhat significant in terms of the agent's total business; or, diversification of market outlets at the risk of being relatively unimportant to individual agents marketing its products. This is another area where either horizontal or product extension types of coordination may be advantageous. In combining with domestic competitors, or in combining with suppliers of complementary products, the opportunity to be a more important client for a given agent is increased.

Agents and representatives vary in both the types of customers with whom they deal and the range of commodities which they handle. In some cases, it is possible for a cooperative exporter to make use of the same agents for sales to retail, institutional and industrial customers. In

others, separate agents are used for one or more groups. Both the types of customers dealt with by an agent and the range of commodities handled will vary somewhat according to the organization of individual geographic and product markets. It may be possible to induce an agent or representative to make some modification in his customer orientation or product line, but much must be accepted as given. Where the choice among agents is unsatisfactorily limited, the attractiveness of establishing an overseas office may be enhanced by default.

This research did not include direct contacts with foreign importers and export agents. Nonetheless, some indication of the range of commodities handled by individual importers and agents has been drawn from interviews with U.S. exporters and others involved in the provision of auxiliary services. Many multinational trading companies and state procurement agencies are extremely diversified in the range of agricultural products handled. However, there is apparently considerable internal specialization of procurement activities. This would tend to limit the advantages of broad based multicommodity coordination on the supply side. For example, those charged with procurement for a Japanese trading company may be specialized according to whether they handle beef or pork with little or no interaction between them.¹

Some foreign agents and representatives are less specialized than their counterparts in multinational trading companies, but this will not always be the case. Agent contacts depend upon the organization of

¹Interview with W. Frank Page, Vice President, Chicago-Tokyo Bank, March 28, 1979.

marketing activities in the areas in which they do business. Some may specialize in a line of feed ingredients, others may handle a full range of processed fruits, nuts and vegetables destined for retail or institutional use. Meats and animal products may be handled differently, especially where the market is more institutionally oriented, as with beef, or industrially oriented, as with tallow.

Fresh fruits and vegetables often are handled through a separate set of agents. This organization will vary considerably by country and market area. Thus, identification of specific opportunities for collaboration in the use of export agents will require market specific research.

5.5.1.2 Overseas Offices

One alternative to the use of foreign country agents is to establish overseas offices staffed by the exporter's own personnel. A foreign sales office has the advantage of being engaged exclusively in the pursuit of the exporter's objectives. It may permit increased attention to the exporter's products, provide better service to customers and even contribute to the exporter's vanity. It does, however, lock in major fixed costs which necessitate a significant sales volume. Table 5.2 presents estimates of the range of annual expenses in maintaining an overseas office. These expenses will vary markedly by office location, staffing, type of services provided, market area covered and the image which the exporter seeks to project. Office rental in Tokyo would exceed the cost of a similar office in Algiers. A regional office would be expected to have higher travel expenses than an office serving a small market area, etc. Nonetheless, these figures give some insight into the costs involved in an overseas office and, thus, facilitate comparison between offices and agents in development of a representation strategy.

TABLE 5.2. ANNUAL OVERSEAS OFFICE EXPENSES:
INDICATIVE ESTIMATES

| | Cost in Dollars |
|---|--|
| <u>Office</u> | |
| Rental | 10,000-100,000 |
| Furnishings (non-recurrent cost) | 30,000 |
| Utilities | 1,500-2,000 |
| Telephone, Telex, TWX, etc. | 10,000-20,000 |
| Miscellaneous supplies and services (including janitorial and messenger services) | 5,000-15,000 |
| <u>Staff</u> | |
| U.S. Director \$30,000-\$40,000 base salary plus fringe benefits, foreign taxes, education and housing allowances | 60,000-100,000 |
| Secretary | 8,000-20,000 |
| Bookkeeper | 8,000-20,000 |
| <u>Travel</u> | Dependent upon type of operation and geographic coverage |
| <u>Entertainment</u> | |
| TOTAL | 100,000-300,000+ |

Based on FAS estimates and data collected during interviews.

5.5.1.3 Evaluating Representation Alternatives

In evaluating requirements in terms of number and location of agents, foreign sales offices or some combination of these, it is important to take note of factors which limit the market coverage of a representative. These include:¹

- 1) national boundaries
- 2) geographical accessibility
- 3) linguistic unity
- 4) physical size of an area and travel time
- 5) regional differences in taste or tradition
- 6) local media coverage
- 7) the range of individual representative contacts
- 8) the location of facilities, offices, etc.
- 9) the commodity organization of the importing country marketing system

These factors all influence the configuration of a representation network which will best serve the interests of an exporter or group of exporters. In the final analysis, as McMilan and Paulden point out:

The only yardstick against which to measure an agent's territory is his proven ability to maintain a satisfactory sales pressure over the whole of it, in terms of the numbers of times per annum his salesmen can call on the clients in the area, the ability to speedily arrange or make deliveries, provide service, inventories, etc., and the degree to which promotional resources can penetrate the market.²

¹Based in part on: Colin McMilan and Sydney Paulden, Export Agents: A Complete Guide to Their Selection and Control, second edition (London: Gower Press, 1974).

²Ibid., p. 140.

For cooperatives evaluating export representation alternatives, coordination of activities with other exporters may broaden the range of feasible options available.

As noted previously, agents generally work on a commission basis. In principle, this might result in access to representation services at a constant cost per unit sold. However, the reality of such arrangements involves considerable variation in both cost of representation services and the quality of service provided. Evaluation of many of the qualitative trade-offs between agents and offices is difficult. It is evident, however, that the formal control over a foreign office is greater than that over an agent. This permits the exporter to have greater influence over the allocation of time among those charged with sales in a given market. At the same time, the foreign agent may have market specific expertise which the exporter can acquire for his foreign office only through experience over time or hiring of experienced personnel.

One major factor influencing the choice between agent and office will be the expected changes in costs and sales which might result. Where an agent would receive a 2.5 percent commission for his foreign market activities, this would amount to \$100,000 per year if sales volume were \$4 million in the market covered by the agent. This would make the exporter a substantial customer for many agents. On the other hand, it would pay for only the most limited foreign office in many areas of the world, especially if the office staff included a U.S. national.

It must be remembered that this comparison refers only to a single geographic market. Broad product exposure will require representation

in many markets. Thus, it may often be advantageous to make use of an agent, where a good one is available, rather than assuming the fixed costs of a foreign office.

5.5.1.4 Coordination Economies in Representation

Coordination of representation for exporters of different agricultural commodities can be advantageous if the benefits in terms of decreased representation cost per unit sold are more important than the diseconomies resulting from diffusion of focus on the part of representatives.

Where the commodities being combined are sold through similar channels and purchased by the same people, a number of advantages to coordination can be identified. For the buyer, contact with a full-time supplier or agent can yield decreased transaction costs in satisfying procurement needs. They may lead to first refusal options on provision of a number of commodities.

Furthermore, the costs involved in making a sales contact for a supplier of two commodities will generally be substantially less than twice the cost of a contact if the supplier had only one commodity to sell. Additionally, the probability of making a sale which will cover the costs of a sales visit will rise, within limits, as does the number of products handled for which the prospective customer is a user. At some point, however, a salesman cannot maintain sufficient commodity expertise to be able to effectively handle an additional commodity. The determination of that point will vary according to the individual involved and commodities handled.

Also, the organization of demand will generally be such that the range of products for which representation can advantageously be combined will parallel those for which a single individual or organization would be likely to handle procurement. This type of combination could be broadened on an occasional basis to reflect sporadic demands for additional commodities or representation services.

Another factor which may influence the range of commodities for which representation activities can be advantageously combined is the seasonality of marketing activities for individual commodities. Where marketing of a commodity is seasonal and sales representatives desire an income on an annual basis, diversification may reduce seasonal slack and lower per unit sales costs. Of course, once diversification is begun, it will be necessary to staff to reflect the requirements for effective marketing of each additional commodity. Thus, seasonal labor requirements may again produce periods of slack activity or peak loading.

One criticism of diversification voiced by some cooperative representatives is that it will result in decreased marketing attention for the member commodities which were initially marketed.¹ While this is a legitimate concern, some cooperative marketing experience indicates that changing staffing patterns to handle a more diverse product mix may actually result in increased attention to the marketing of member commodities where products with seasonal marketing requirements are effectively combined. For example, Diamond/Sunsweet has found that in marketing both walnuts and prunes, commodities with somewhat staggered

¹Interview with Stephen Heinrichs, Field Manager, California Almond Growers Exchange, August 9, 1979.

marketing seasons, the fixed costs of marketing are shared and the combined organization has more personnel selling in more markets, with more sales contacts and more potential sales opportunities than could be supported at similar cost by independent marketing organizations for each commodity.¹

Other cooperatives have also added members handling commodities with different seasonal marketing requirements. One citrus cooperative, Seald-Sweet, Inc., markets peaches and apples at the end of the citrus season.² This permits the employment of personnel and facilities during a period of low citrus marketing activity.

In summary, there are many opportunities for the achievement of economies through the coordination of export representation activities. They include both potential cost savings and potential service improvements. Evaluation of specific collaborative arrangements will require consideration of both these advantages and any sacrifices entailed in diffusion of focus on the part of representatives. In all cases, the importance of commodity specific expertise must be remembered. Also, the range of available representation opportunities must be evaluated in the context of the individual market area under consideration.

5.5.2 Promotion

Another important component of the sales function is promotion. Promotion is the means through which demand is developed or reinforced.

¹Interview with John Huber, International Marketing Director, Diamond/Sunsweet, Inc., August 9, 1979.

²Interview with Donald M. Lins, Executive Vice President and General Manager, Seald-Sweet Growers, Inc., May 17, 1979.

Promotion can have effects at three levels:

- 1) in influencing the use of a commodity regardless of origin;
- 2) in development of demand for that commodity in a specific country, region or other limited geographic areas; and
- 3) in affecting demand for individual brands or products from specific sources of supply.

Decomposition of promotion impacts in this manner can be a useful tool in evaluating coordination potential. Additionally, distinctions made previously between standardized and differentiated products contribute to the analysis. Recognition of a difference between market development and sporadic sales is also of value.

For a marketer of a standardized product, capturing the benefits of promotion may be more difficult than is the case with promotion of a differentiated product. Promotion of standardized products opens up opportunities for the "free rider," a market participant who does not contribute to the costs of promotion, but who enjoys access to its benefits. Because of these problems, promotion of standardized products is often undertaken only by groups representing interests which are large enough to capture a substantial portion of the promotional benefits or smaller groups which attempt to differentiate their product in some manner.

Without product differentiation or horizontal coordination among suppliers of a standardized product, a classic social trap may arise. If a single supplier bears the cost of winning over the potential customer, he must then compete with rival suppliers who can underbid his price because they do not need to cover the costs of promotion. As

a result, absent other cost economies, the promotional job would not get done, and fewer sales would be made. In order to solve this problem, promotion for U.S. produced standardized commodities abroad is often handled by trade associations, in cooperation with the USDA Foreign Agricultural Service (FAS). FAS works with 46 such groups, referred to as "market development cooperators," in promotion of demand for U.S. produced commodities, some traded as standardized commodities and others differentiated. Cooperators include such groups as: U.S. Feedgrains Council, American Soybean Association, Great Plains Wheat, Inc., Northwest Horticultural Council, and others.¹

With a generic promotion program aimed at creation of demand for standardized commodities from a specific origin, U.S. feed grains, for example, a successful program can be expected to increase demand for feed grains from other origins as well as the U.S. Thus, incentives for generic promotion exist in cases where the U.S. share of potential world trade in a commodity or group of commodities is large enough to capture a significant portion of the total benefits of the promotional activity.

Furthermore, the distribution of benefits from such promotion among individual suppliers of feed grains will be affected by the capability of those suppliers to take advantage of demand. This requires representation, market information, availability of the commodity and the ability to deliver it at a competitive price.

¹For a complete listing see "Home Offices of U.S. Market Development Cooperators" (Washington, D.C.: USDA/FAS, 1979).

As a result, with a standardized commodity, horizontal coordination in promotion may be expected to be an advantageous means of limiting free rider problems. While the direct benefits of promotion will flow to those with the marketing apparatus necessary to make sales, the impact on overall supply and demand will be more far reaching. The objective of the FAS Cooperator Program, for example, is to enhance demand for U.S. produced commodities without promoting specific suppliers of those commodities.¹ This is justified by the belief that export sale of U.S. produced commodities will generate benefits to the balance of trade, agricultural producers, and the overall domestic economy.

In light of the linkage between a market presence and the benefits of promotion, the distinction between market development and sporadic sales orientations is an important one. Where a cooperative exporter seeks to develop foreign markets, it can hope to capture benefits accruing from investment in promotion. On a sporadic sales basis, this will be more difficult.

There are a number of mechanisms used to promote export sales and to develop foreign markets. These include participation in trade shows, trade fairs, and exhibits, trade team visits to prospective foreign buyers and advertising.²

Some economies in participation in fairs, trade shows, and trade team visits may be achieved through sharing of the costs of joint

¹Interview with Vernon Harness, USDA/FAS, May 1979.

²These are discussed in greater detail in David A. McKinna, Agricultural Export Marketing Development Procedures and Practices with Special Emphasis on U.S. Government Sponsored Programs (Ph.D. dissertation, Cornell University, 1978).

representation. While this might permit wider exposure for exporters on a limited budget, its effectiveness would be restricted to the ability of the joint representative to effectively represent multiple interests and make contacts necessary to effectively promote diverse products. For complementary products, this could work quite well, for others, it might not.

Of course, participation in trade shows, etc., is insufficient to effectively develop foreign markets by itself. Follow-up activities and contacts are essential. As one cooperative manager pointed out, the business contacts made outside of the formal programs of trade teams and trade shows are also important.¹ Such events can serve as an opportunity to use foreign market representatives to arrange contacts with both potential and established customers. This must be considered in evaluating the potential costs and benefits of joint promotional representation at trade fairs and similar events.

Promotion through advertising is becoming increasingly important throughout the world. Advertising serves as a mechanism for decreasing potential buyer information costs as well as for the modification of consumer tastes and preferences.

Studies of advertising in the United States have found that its maximum effectiveness is achieved only at certain saturation levels. Advertising has a cumulative impact, so that each additional dollar spent may build upon expenditures incurred earlier. Furthermore, there are economies in the procurement of advertising.² A full page advertisement

¹Interview with F. Dale Kuenzli, Manager, Valley Marketing Cooperative, Inc., February 2, 1979.

²Scherer.

generally costs less per square inch than a quarter page. Large volume advertisers also often pay less per unit of time or area.¹ Additional economies in advertising are obtainable through combination of multiple complementary products in a single promotion. This opens up possibilities for cross-subsidization in the introduction of new products to an already recognized line.

For cooperative exporters considering joint promotion, the issue of branding is quite important. Some joint endeavors maintain separate brands for individual commodities, such as Diamond walnuts and Sunsweet prunes. The preservation of individual brands may limit the breadth or number of commodities which can be successfully promoted through coordinated advertising. However, there are a myriad issues surrounding the choice and use of a joint brand or trademark by multiple cooperative exporters which must be resolved. Many cooperatives have considerable goodwill invested in their own brands and would be reluctant to give them up for a joint arrangement. Nonetheless, there could be significant advantages to coordination of promotional activities.

In a study of the food processing industry, Horst found that economies of scale in advertising were obtainable at much larger sizes than required for efficient processing plant scale.² Coordination may be one means for exporters to attain the size necessary for achievement of promotional economies. The recognition of different size requirements for enterprises to exhaust economies in marketing is, after all,

¹Some rates are available from International Standard Rate and Data, Skokie, Illinois.

²Horst, pp. 124-126.

at the foundation of the cooperative movement. Just as efficient producers band together to obtain economies in domestic marketing, domestic marketers may benefit from combination of limited export volumes in arrangement for export sales promotion.

5.5.3 Pricing

The exporter's objective in performance of the pricing subfunction is to avoid needlessly giving away profit opportunities while remaining competitive. In developing a pricing strategy consistent with this goal, a number of issues must be dealt with. Sales can be made on a number of terms: f.a.s., f.o.b., c.&f., and c.i.f. are the most common. Each involves different marketing services and risks. A sale or contract can reflect a flat price, or, for some commodities, it can be priced on the basis. In some cases the actual price may be set at some later date. Furthermore, the currency of sale will affect the final prices paid and received. This latter point will be discussed under the financial function.

Much discussion of pricing in the international marketing literature focuses on marginal cost pricing and the allocation of domestic marketing expenses to export sales. Such issues are of interest to this research primarily as they affect transfer pricing between domestic and export marketing activities. This was discussed under the procurement function.

An export pricing strategy must also reflect domestic supply and demand conditions, competition in specific foreign markets and the procurement priorities of buyers in those markets. The marketer has to constantly reflect upon the fact that his total revenue is a function

of both price and quantity sold and that his profit depends upon both total revenue and total costs. Therefore, both short and longer term repercussions of decisions must be considered in developing a pricing strategy for exports.

It is generally accepted that the costs of gaining entry to a new market outlet are greater than those involved in retaining an established client. Thus, flexible pricing, cross-subsidization in the allocation of overhead expenses, is an important tool in both market development and market retention.¹

Pricing strategy will also depend upon competition in individual foreign markets and economic factors such as elasticities of demand and the availability of substitute products and suppliers. In some foreign markets, U.S. exporters compete against each other and also against state trading agencies and marketing boards which have tremendous pricing flexibility in the development and maintenance of market shares. In such cases, coordination among U.S. suppliers may offer the opportunity to compete more effectively with such state traders. Webb-Pomerene Associations, discussed in Chapter VI, are one mechanism for such arrangements.

Another pricing strategy consideration concerns the procurement priorities of buyers. Buyers in some foreign markets are reputed to emphasize price to the exclusion of quality in their procurement practices. In other markets, price is important, but quality considerations

¹For discussion of the increased replacement of formula pricing by more flexible approaches, see: "Flexible Pricing: Industry's New Strategy to Hold Market Share Changes the Rules for Economic Decision-Making," Business Week, December 12, 1977, pp. 78-88.

and risks result in substantially larger thresholds over which price variations will not alter procurement decisions. For the exporter, there is significant value in information related to the identification of procurement priorities of individual foreign buyers. This is just one area where coordination potential is evident.

Informational economies which may be achieved through coordination among exporters can also permit greater precision in the estimation of export marketing costs. This may result in greater flexibility in pricing terms as well as a decrease in the risk premium necessary to cover pricing errors. In other words, pricing accuracy can be expected to improve as accuracy of expected cost data improves. If coordination among cooperative exporters enhances the access to specialized and competent personnel for the performance of the information function, this can be expected to yield advantages in pricing accuracy also.

Similarly, collaboration in the collection and analysis of market intelligence may permit the development of broader market knowledge as well as market specific information consistent with the goal of competitive pricing without unnecessary loss of profit opportunity.

In sum, while any effort at coordination in pricing would still require commodity specific market information and knowledge, informational economies as well as economies of specialization would be consistent with improved pricing accuracy and decreased uncertainty regarding the cost of marketing services.

5.5.4 Servicing

Service is also an important component of the sales function.

In many cases, potential purchasers of U.S. agricultural commodities

require technical assistance in their use. They may also want assurance of timely and continued access to supplies. As export sales expand and new markets are developed, the importance of service to sales can be expected to increase. This will include such activities as teaching foreign grain millers to use U.S. wheats, instructing foreign textile mills in the use of U.S. cotton and instructing foreign food processors and consumers on the uses of U.S. produced fruits and nuts. There are already significant activities in this sphere being undertaken by trade associations as part of the FAS Cooperator Program. These involve broad-based horizontal coordination which permit the costs of such services to be shared by those in the industries which benefit.

Other service related factors also merit discussion. These include: the advantages of size and massed reserves, flexibility in packaging, quality control services, and flexibility in delivery and payment terms. In each case there are some opportunities for advantageous coordination among cooperative exporters.

The problems of inventories are somewhat different for agricultural products than for durable goods. Nonetheless, the concept of economies of massed reserves, whereby a large sales volume can be backed up by proportionally smaller inventories than a smaller sales volume, is useful in understanding potential coordinational advantages. A larger sales volume will facilitate the diversion of shipments from one market to another when necessities of marketing, such as delays, catastrophes or economic forces make such action advantageous.

Larger sales volumes may also permit the justification of foreign location of inventories. This could be accomplished through joint

warehousing and distribution arrangements, similar to AgFoods, Inc., on the domestic scene. Some of the potential transportation cost advantages of such action were discussed in Section 5.3. Additional servicing advantages would include the ability to provide rapid deliveries and avoidance of out-of-stock situations. Additionally, foreign facilities may serve as a risk management tool in dealing with variable levies, tariffs, embargoes and other barriers. They also increase seller flexibility in dealing with foreign customers. The potential for coordination in foreign warehousing would be limited by both physical storage requirements of individual commodities and products and the organization of demand. Horizontal and product extension coordination would probably offer the greatest potential.

Other servicing factors, knowledge of foreign consumer tastes and foreign packaging requirements and flexibility in packaging involve both information and processing functions discussed previously. There are considerable opportunities for shared achievement of informational economies in identification of tastes and packaging requirements. These, as well as processing economies would be conducive to horizontal or product extension coordination.

In the control of arrival quality of export shipments, some joint efforts have already been attempted, such as Pure Gold's participation in Citrus Shippers United, which arranges for personnel to meet arriving citrus shipments in Western Europe. This protects the reputation of the supplier, as well as inhibiting fraudulent damage claims. Sunkist has similar arrangements, but its sales volume is sufficient to support quality control operations independently. Cooperatives with lesser sales volumes might benefit from collaborative effort.

In addition to simple quality control through monitoring, the development of more precise grades and standards which reflect buyer priorities are another area in which service can contribute to the sales function. As mentioned previously, American Rice, Inc., has developed standards for rice grading which permit buyers to purchase rice on grade rather than by examination. This decreases both information costs and uncertainty for purchasers and results in increased returns for members of the cooperative. In this area, benefits could be increased through horizontal coordination in both domestic and export marketing.

Willingness to provide commodities delivered where the buyer wants them and on flexible payment terms is another factor conducive to increased sales. The ability to provide such service without undue risk exposure is important for the marketer. Increased sales volume is one means to support access to improved information and mitigate risks. These factors will be discussed further under the financial and risk management functions.

5.5.5 Summary

The sales function brings together sources of supply and demand. The ability to achieve economies in both cost and quality of performance of the sales function is closely linked to the information and risk management functions. The potential for coordinational economies in sales may be evaluated in the areas of representation, promotion, pricing and servicing.

Coordination among cooperatives in foreign representation may take the form of common use of agents or representatives; or joint offices

overseas. In each case, the importance of an exporter to a foreign representative will affect the quality of service obtainable as well as the per unit cost of export market representation. Collaboration among cooperatives in export representation offers the opportunity to expand and diversify export market exposure as well as becoming part of a more important clientele group in individual markets. These advantages will be restricted somewhat according to commodities with some distinction among mutual sales interests in industrial, institutional and related markets.

Promotional economies will also be limited to commodity groups with mutual market interests which result in the use of similar promotional media. Substantial economies in coordination of promotion among complementary products may be realized. The development of "full-line" cooperative suppliers would best reflect the organization of demand and procurement in individual foreign markets in order to achieve maximum promotional economies in these markets.

Economies in pricing may result from improved market information and intelligence. These can contribute to increased pricing accuracy and reduction of the pricing risks which must be covered in the development of a pricing strategy. Intelligence on foreign market conditions and competitive suppliers can facilitate competitive pricing and the unnecessary loss of profit opportunities. Additional considerations related to transfer pricing were discussed under the procurement function.

Servicing economies may also be achieved through coordination of exports. These may take the form of flexibility in physical positioning of inventories, knowledge of and capacity to provide special packaging

and processing for individual markets, ability to support effective quality control, and flexibility in delivery and payment terms.

Potential for advantageous sales coordination among cooperatives marketing different commodities will be largely dependent upon the organization of demand in individual export markets.

In exporting to some state trading nations there may be opportunities for achievement of economies through collaboration among an extremely broad range of agricultural commodities. In other countries, the organization of markets will be conducive to much more limited sales coordination. In all cases, however, commodity specific expertise will be essential to successful performance of the sales function.

5.6 Financial

The financial function is critical to the flow of goods in international trade.¹ It includes payment and collection of accounts, financing inventories and receivables, handling foreign currency exchange, and various other activities such as checking foreign customer credit and arranging to pay for foreign offices, facilities and employees.

5.6.1 Payment Terms

Payment for export shipments can be handled through letters of credit, sight or time drafts, or on the basis of cash against documents, open account or consignment. These are listed in order of increasing

¹Mechanics of financing exports are explained in publications such as Donald Hirsch, Export Marketing Guide for Cooperatives (FCS Marketing Research Report 1074, Washington, D.C.: USDA, 1977); Morgan Guaranty Trust Company, The Financing of Exports and Imports: A Guide to Procedures (New York: Morgan Guaranty Trust Company, 1977); and U.S. Department of Commerce, A Guide to Financing Exports (Washington, D.C.: Government Printing Office, 1978).

risk to the exporter. If payment is made through a letter of credit which is issued irrevocably by a bank in the buyer's country and confirmed by an American bank, the seller assumes almost no risk. If the shipment is made in accordance with the requirements of the letter of credit, the seller is assured that he will receive payment upon presentation of the necessary documents through his bank or to the confirming U.S. bank. The buyer is also protected, since payment will not be made without compliance with the terms of the letter of credit. There are costs involved, however. As can be seen from Table 5.3, the confirming bank may charge one-twentieth percent for guaranteeing the letter of credit. Additionally, the issuing bank imposes charges. In the example, the cost would be a \$20 minimum or one-eighth percent of the value of the letter of credit. There are additional costs in seller and buyer personnel time required to negotiate and comply with the letter of credit terms. Furthermore, depending upon the relationship between buyer and seller, requirement of a letter of credit may be considered insulting to the buyer's credit-worthiness or at least an unnecessary bother when other suppliers are willing to make sales on a less restrictive basis.

A survey of financial requirements of cooperative exporters by the Bank for Cooperatives (BC) system concluded that some cooperatives sell only on a letter of credit basis because they are unable to adequately evaluate the credit ratings of foreign customers and find this the simplest means to eliminate risk of non-payment. The study concluded

TABLE 5.3. COMMISSION COSTS ASSOCIATED WITH INTERNATIONAL
FINANCIAL SERVICES

| | |
|--|--------------|
| Collections - $1/8$ % - minimum \$15 | Maximum \$25 |
| Letter of Credit Negotiation - $1/8$ % - minimum \$20 | |
| Acceptance Commission (time drafts) - $1/2$ % | |
| Remittances (open account) - \$5 per item | |
| Confirmation or Advising Commission (letters of credit) - $1/20$ % | |

Source: Banks for Cooperatives, "Report of the Banks for Cooperatives System Export Services Study Group," Denver, 1976, exhibit E.

that such terms limit overall potential export growth as well as growth in new markets.¹

Where the exporter feels that the protection of a letter of credit is not required by the commercial or political risks involved, he may agree to payment on a draft basis. An export draft is a financial document drawn by the seller which instructs the buyer to pay the amount of the draft on receipt (sight draft) or at an agreed upon future date (time draft). Time drafts usually require payment 30, 60, 90, 120 or 180 days after presentation (sight) or after the date of the draft.

Most cooperative exporters have drafts collected through a U.S. bank. The exporter sends required documentation and collection instructions along with the draft to either his U.S. bank or directly to the collecting bank. On a sight draft, the shipping documents are released to the foreign buyer or his bank upon payment. On a time draft, documents are released against acceptance of the draft by the importer.

One advantage of export drafts is that they cost less than a letter of credit, especially sight drafts. Often there is a flat \$15 to \$25 collection fee charged by the bank, whereas the minimum charge on a letter of credit would be \$20. As a result, the cost to the potential buyer is decreased, and the exporter's goods may be made more competitive.

Open-account transactions, involving an arrangement between buyer and seller for payment at some specified future date, are an even simpler method of payment than those mentioned above. In addition, bank costs and involvement are even lower. However, since there is no

¹Banks for Cooperatives (BC), "Report of the Banks for Cooperatives System Export Services Study Group," Denver, 1976, pp. 10-11.

negotiable financial instrument involved, there may be complicated legal procedures in obtaining payment of a dishonored open account transaction. Thus, export sales on open account generally involve trade with established customers and in markets where political risks are minimal.

Among other payment terms, cash against documents, which Hirsch found to be quite common in indirect export sales,¹ is essentially an informal sight draft, where the buyer or his bank pays upon receipt of documents. The risks are somewhat greater than with an official financial document, but the bank charges are further reduced.

Consignment sales involve an even greater degree of risk. These are quite common in European fresh produce markets, especially where exporters do not have the reputation for constant quality standards. Some cooperatives, such as Sunkist, which have both the reputation for quality and the foreign quality control systems to protect it, almost never sell on consignment, even though their competitors from Israel and South Africa do so regularly.

The obvious conclusion from this discussion is that there are trade-offs between banking service costs associated with collection of payment for export sales and the risks associated with the payment terms under which the sale is made.² The degree of trade-off involved is largely dependent upon the credit-worthiness of both supplier and his foreign customer. The ability to assess risks involved is thus largely

¹Hirsch, 1979, p. 24, and personal communication.

²Insurance for commercial and political risks will be discussed under Section 5.8, Risk Management.

dependent upon knowledge of specific foreign markets and access to information on the credit ratings of firms which operate in them. Such information is essential to the meaningful evaluation of the costs and risks associated with collections and banking services for transactions involving different payment terms.

5.6.2 Foreign Credit Information

A cooperative manager is charged with the responsibility to obtain the highest possible average return to his producer-members. If a sale is arranged at a high price, but the buyer defaults on payment, the sales price becomes meaningless. Likewise, if a sale is not made to a credit-worthy customer because the cooperative manager is unable to evaluate the risks involved, a profit opportunity is needlessly foregone. For one familiar only with credit information sources for domestic markets, the mere thought of far-away markets and potential collection difficulties may result in establishment of a strict policy of exclusive letter of credit export sales. While seemingly simple, this policy may not be in the best longer term interest of the cooperative exporter. Foreign credit information can be obtained and used to evaluate the appropriate terms for a specific export customer.

Information on the financial positions of prospective foreign customers may be obtained through experience, the exporter's foreign offices or agents, other traders, banks, and a number of governmental and private services. Governmental sources, such as USDA and the U.S. Department of Commerce, generally provide only limited information, such as bank references. Private services such as Dunn and Bradstreet International and Chase World Information Corporation provide financial

data on international businesses and credit terms granted for shipments to various markets.¹

Banks constitute a major source of foreign credit information for their customers. Their ability to obtain valid and useful information depends upon their foreign subsidiaries or correspondent relationships with other banks in foreign countries. Their willingness to treat inquiries by a specific exporter as a high priority may depend upon the importance of the exporter as a customer. The same condition might apply to treatment of inquiries by an agent in a foreign market.

A cooperative exporter providing a commodity with a small and highly specialized set of foreign customers may find acquisition of financial information through trade contacts and foreign country agents less difficult than an exporter of commodities for which foreign importers easily and regularly enter and exit the market.

In any event, there appear to be opportunities for potential coordination economies in obtaining credit information. With greater volume and a wider range of foreign customers, the opportunities for access to information through trade contacts increases, as does the importance of the exporter to foreign agents. In addition, banks appear to be more responsive to larger customers as well as providing them preferential rates for both facilitating services and credit.²

¹Dunn and Bradstreet, Principal International Businesses (New York: Dunn and Bradstreet International, 1977); Chase Export Credit Reports (New York: Chase World Information Corporation, n.d.).

²BC, "Export Services Study Group."

5.6.3 Credit

Both the cost of credit for export related activities of cooperatives and the availability of credit to finance export sales are important financial concerns. Cooperative exporters need credit to finance inventories and receivables as well as export related domestic and foreign facilities.

The advantages of size and good credit rating in obtaining commercial credit are well documented. Commercial bank loans at the prime lending rate are generally reserved to "better" customers, while smaller customers pay more. Large size, name recognition, and good credit ratings also permit some cooperatives to issue commercial paper with high ratings, gaining them access to capital at one to 1.25 percent below the prime interest rate.¹

Many cooperatives make use of the Banks for Cooperatives for credit to finance export related inventories and domestic facilities. The BC system is often able to provide credit to cooperative borrowers at 1.5 to 2.5 percent below rates charged by commercial banks.² In some cases, they will also finance a larger percentage of inventories.³ However, since cooperative borrowers must also invest in their regional Banks for Cooperatives, it is difficult to state unequivocally that the cost of BC capital is actually less than from commercial sources. Nonetheless, cooperative borrowers do a major part of their financial business with

¹Sunkist Growers, Inc., 1978 Annual Report, p. 10.

²Interview with Glade Nelson, Vice President, St. Paul Bank for Cooperatives, March 26, 1979.

³Interview with Cain.

the BC system. Cooperatives which deal almost exclusively with the Banks for Cooperatives have in some cases encountered difficulty in obtaining satisfactory servicing of their export related financial requirements by the commercial banking sector. A number of cooperatives maintain lines of credit with commercial banks in order to facilitate better treatment.

Legislation currently before the U.S. Senate would amend the Farm Credit Act of 1971 to permit the BC system to expand its participation in the international trade related activities of U.S. Cooperatives.¹ The BC system is attempting to improve its ability to provide export related financial services by setting up an international banking facility. A study of the potential for a BC international facility concluded that both cooperatives and the BC system could benefit from more attentive and rapid service as well as through reduced costs more conducive to increased export activity by cooperatives and hence to increases in BC lending.²

Summarizing, advantages in export related credit availability and cost may be obtained through coordination of activities through the commercial banking system and commercial money markets, through expanded BC activity, or some combination of these. Coordinated use of the commercial banking system would probably require more formal arrangements than would the use of a BC international banking facility.

Issues related to credit for export financing are quite important to the competitive positions of U.S. agricultural exports in many

¹U.S., Congress, Senate, S.1465, 96th Congress, First Session, 1979.

²BC, "Export Services Study Group."

markets of the world. However, because they are of relevance more as a general concern than as a potential avenue for coordination among cooperative exporters, they have received relatively minor emphasis in this research. Some of the issues include: the availability of medium term (more than three years) credit to foreign purchasers of U.S. agricultural commodities through the Commodity Credit Corporation (CCC), the availability of CCC credits to nonmarket economy countries,¹ and the availability and terms of credit for agricultural exports through the Export-Import Bank and commercial sources.²

5.6.4 Foreign Exchange

Very few cooperatives contacted made any export sales priced in foreign currency. By contrast, many proprietary and corporate exporters and traders stand ready to provide goods priced in any currency, with duties paid, anywhere in the world that a buyer seeks to have them delivered.

Since August 1971 when the U.S. announced that it would no longer accept foreign dollars for conversion into gold, the commitment to exchange rate parities among major world currencies has been replaced by a system of managed but flexible exchange rates among currencies, often referred to as "dirty floats." One result is that much less

¹For discussion see U.S., Congress, Senate, Committee on Banking, Housing and Urban Affairs, Sub-committee on International Finance, Hearing: Agricultural Export Policies, March 30, 1978, 95th Congress, Second Session (Washington, D.C.: Government Printing Office, 1978).

²See also Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the U.S., semi-annual, cited in: ibid.

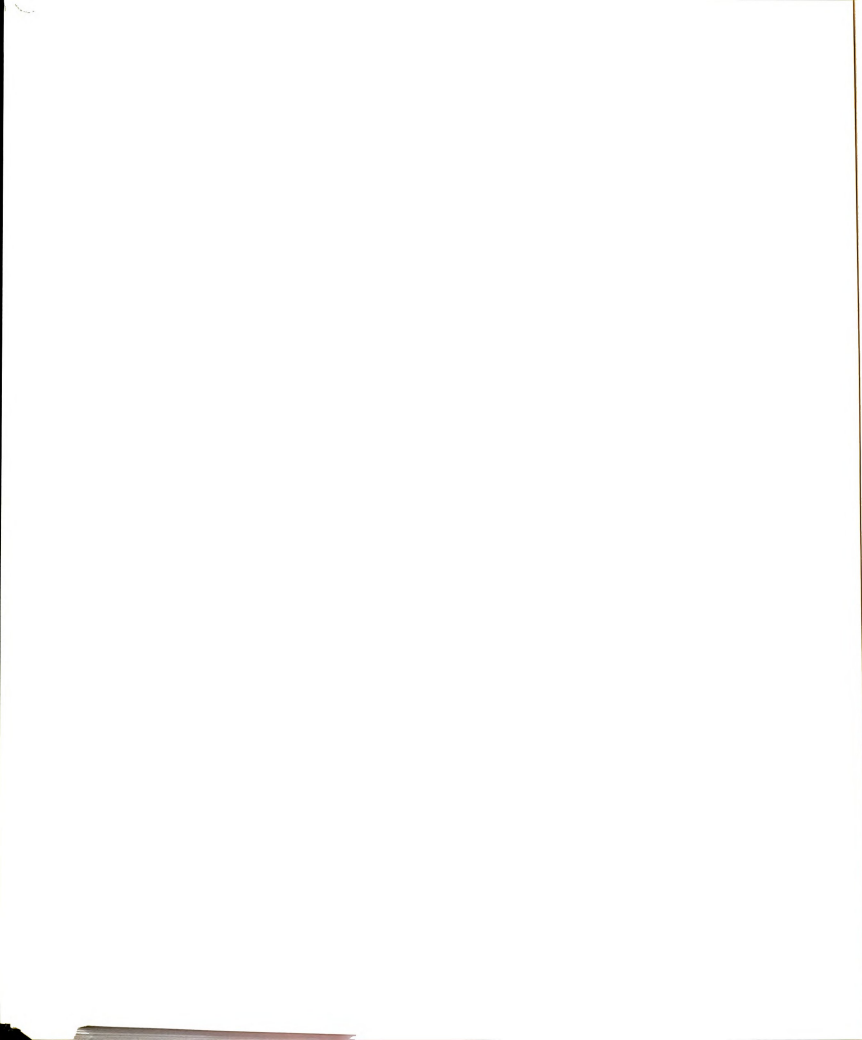
certainty exists that the relationships among currencies in buying and selling nations will remain stable between the time a sale is arranged and the delivery of the commodity. This gives rise to foreign exchange risk.

Many U.S. exporters assume that it is easier for their foreign customers to make purchases based on quotations in U.S. dollars than for them to provide price quotations and make sales in foreign currencies. In reality, the ability to make export sales in foreign currencies may improve the competitive position of the U.S. exporter vis a vis other suppliers of foreign markets. It may also permit cooperative exporters to increase returns to members through avoidance of unnecessary loss of profit opportunity.

Unless a foreign buyer happens to have dollars available through Eurodollar account balances or lines of credit in dollars at U.S. banks, currency exchange will have to occur at some point as a result of an export transaction. Furthermore, unless the foreign buyer will either resell the product for dollars or make use of it in the production of an output which will be valued in dollars, some conversion of the value of the imported goods from dollar to foreign currency terms will have to occur.

Thus, the issue is not whether a price of U.S. commodities in foreign currency terms will have to be calculated, but rather when and by whom it will be calculated and how foreign exchange risks will be handled.

When a U.S. cooperative offers goods on dollar terms, the foreign buyer has to calculate a price in his own currency terms and evaluate



the potential for change in exchange rates before payment will fall due. Where close substitutes are available from other sources, he compares prices. If the prices are close, but another exporter is willing to provide a firm price in the importing country currency, the tendency to accept the competitor's offer and avoid dealing with exchange risk may be a rational one. For the cooperative, the result may be a lost sale. In other words, the ability to deal in foreign currencies is important to export market development just as is the ability to arrange for ocean freight transportation.

As noted above, there is risk in dealing in foreign exchange. If the value of \$1 drops from \$1 = 2.5 German marks (DM) to \$1 = 2 DM, then a sale of U.S. commodities priced in dollars will cost the German importer 20 percent less in DM terms. However, for the cooperative exporter, it is important to know whether that 20 percent savings is a windfall gain to the importer. If goods valued at \$100 were attractive to the importer for 250 DM, then a fluctuation in exchange rates which permits the buyer to pay only 200 DM represents the unnecessary loss of an opportunity for a 25 percent greater return for the cooperative and its members.

It is important to recognize that exchange rate fluctuations can also impart windfall losses. While the magnitude of the fluctuation in the above example may be considered atypical, it does demonstrate that understanding and foreign currency markets can have a major impact on the profitability of export marketing. Such knowledge may be obtained by the exporter directly, or through use of the services of banks and currency traders.

One cooperative manager mentioned the example of a sale to a customer in the United Kingdom which was priced in pounds sterling. The manager sought the advice of his banker and hedged the payment through a forward sale of pounds for dollars. As the vagaries of the market would have it, the value of the pound fell relative to the dollar before the cooperative collected its payments. If the manager had not hedged his transaction, he would have lost \$25,000 for the cooperative.¹

Having considered some of the important components of the financial function in exporting, it is useful to proceed to consideration of potential for coordinational economies in their performance.

5.6.5 Potential Coordinational Economies

The financial function is one part of the export process in which most economies are obtainable across commodity lines. The international banking system functions in such a fashion that explicit compliance with documentary terms is more important than the actual commodity handled. Thus, the same banking personnel may be involved in performing financial services required for export sales of any number of different commodities, but, for example, they may be reluctant to accept a bill of lading for "no. 3 yellow corn" as complying with the terms of a letter of credit for "corn, yellow, no. 3."

In evaluating potential coordination economies, it is useful to recognize that these may be reflected in both improved service and more favorable commission charges which may be secured as a result of greater

¹Interview with Kuenzli.

size and regularity of volume. Some of these advantages may be more readily obtainable with the establishment of an international facility in the Bank for Cooperatives system.

One area with potential for achievement of economies is in the development of experience and expertise in foreign markets. Because of similarities in the financial processes involved in the sale of a wide range of commodities, financial system contacts and credit information sources will be useful to cooperatives exporting a variety of commodities.

Furthermore, a foreign market presence for the export of one commodity could usefully serve as a source of financial information and assistance for others. One reason that many U.S. exporters are hesitant to make export sales on less restrictive payment terms, such as open account or even cash against documents, is that there would be substantial costs and distances involved in the resolution of any difficulties which might occur. While the banking system may provide assistance in obtaining credit information through foreign correspondents, the fledgling exporter may be faced with the problem of being a relatively unimportant client at the outset. While collections and credit information would probably not be sufficiently important by themselves to lead to the establishment of a joint overseas office, this is one function which could quite easily be shared across commodity lines.

Another area of importance to exporters is the speed with which payment can be received. The speed of documentation flow is one critical factor in determining the speed with which payment is received and the costs of financing commodities which are already sold. With short term interest rates now above 15 percent, increasing the speed of

collections by only one day on a \$1 million sale can result in over \$4,000 savings in interest. Such increased speed may be achieved through better service from the banking system, use of courier service to deliver documents, better training for cooperative personnel, or other factors which might be achieved through joint action. Savings in financing costs may permit more competitive pricing and increased sales volume, both of which may contribute to export profitability.

The Bank for Cooperatives hopes to be able to contribute to more rapid payment through its new international facility. However, the logistics of the facility remain to be worked out. Coordination among cooperative exporters may be another means to obtain better rates and service from the international departments of commercial banks.

Another possibility for achievement of economies may be in the establishment of a federated cooperative for foreign exchange transactions. This might be similar to the Illinois Commodity Futures Trading Cooperative which provides low cost hedging operations to member cooperatives through coordinated trading in futures markets. Such a federated arrangement would permit cooperatives to share the costs and specialized expertise of international financial market analysts and foreign currency traders. This would increase the flexibility of terms under which cooperatives could offer commodities in export markets while providing the means to manage the risks involved. Additionally, combination of trading volumes could yield more favorable costs of foreign exchange

itself.¹ As a result of these factors, cooperatives would be better equipped to compete effectively with corporate rivals as well as foreign state traders.

5.6.6 Summary

Export sales can be made on a variety of payment terms. Evaluation of trade-offs between risk and cost associated with individual terms requires access to credit information with respect to foreign markets and firms, and the ability to analyze it. Without such capacity, terms must, of necessity, be restrictive. This may inhibit growth of exports and new market development, contributing to unnecessary loss of profit opportunity for the cooperative and its members.

The ability to make sales in foreign currency also contributes to exporter flexibility. Similarities in the international financial requirements of exporters handling diverse commodities result in broad opportunities for coordination with respect to the financial function. The Bank for Cooperatives System intends to assist in this area. Additional opportunities for multicooperative coordination, such as a federated foreign exchange trading cooperative might also be developed.

5.7 Documentation

The documentation function facilitates the flow of goods and payment between buyers and sellers. While a seemingly simple task, the average

¹ There are economies in the sale and purchase of foreign exchange as well as in the development and use of an analytical system for information on international money markets. One recent article pointed out that there is often a difference of more than three percent in the exchange rates received by larger customers.

Gene C. Marcial, "Currency Trading in Volatile Times No Trouble for Deak," Wall Street Journal, 28 November 1979, p. 7.

international shipment involves 46 separate documents.¹ Furthermore, the economic significance of the documentation function far exceeds the costs of preparation and processing of documents. This can best be demonstrated through an example.

Assume that Cooperative A ships a container load of canned cherries to Company B overseas. The payment terms are cash against documents, meaning that when a signed on-board bill of lading arrives at B's bank or another designated agent, B must pay for the merchandise in order to get the documents with which he can collect his shipment when it arrives.

If the signed bill of lading is not mailed to the collection agent or bank rapidly, then the goods may arrive at the foreign port and remain unclaimable until B has the bill of lading. After a certain amount of time, there will be storage charges which must be paid. Furthermore, every day that the documents are not in transit, A is financing the cost of his shipment. In this case, he may be paying interest on \$50,000. For larger shipments, the amount financed may be millions of dollars. These potential costs must be built into the price quotation that A gives B, and will affect B's decision whether to purchase from A or some other supplier. In summary, the documentation function is important to both buyers and sellers.

Many exporters make use of international freight forwarders to handle the documentation function. Some cooperative exporters, claiming that each additional intermediary in the documentary flow merely provides an additional place for the documents to get slowed down, handle

¹Unz and Co., The "How to" Guide for Importers and Exporters (Jersey City, New Jersey: Unz and Co., 1979), p. 31.

documentation themselves.¹ Nonetheless, freight forwarders who have networks of offices and contacts between the point of origin of goods and their destinations are able to expedite documents when a hang-up occurs. The freight forwarder also has resources for finding out which documents are required for an individual shipment. Some cooperatives also handle all aspects of the documentation function. They type the export declaration and use courier services and foreign offices or agents to expedite documentary flows after the shipment is on board an ocean vessel and the bill of lading signed.

It has been estimated that documentation costs make seven and one-half percent of the value of total U.S. export and import shipments.² This may not include the costs of inventory financing when documents move less rapidly than the shipments themselves. Hutchinson reports cases of perishables arriving in Europe a full week before the arrival of the documents required to clear customs.³

Throughout the world there is considerable variation in the documentary requirements among importing countries and for different commodities. The speed with which shipments and documents are handled also varies. In tests involving frozen poultry shipments conducted by

¹Interview with Kuenzli.

²Committee on International Trade Documentation and U.S. Department of Transportation, Paperwork or Profits in International Trade (New York, 1971). Cited in Constantine J. Nicholas and Philip Breakiron, Intermodal Transport of Frozen Poultry Products to Overseas Markets (ARS Marketing Research Report 1025, Washington, D.C.: USDA, 1974), p. 16.

³T.Q. Hutchinson, L.A. Hoffman and R.L. Parlett, Improving the Export Distribution System for Fresh Fruits and Vegetables (ERS Marketing Research Report 1027, Washington, D.C.: USDA, 1974), p. 27.

USDA, it was found that while the free port of Hong Kong required only two documents for customs clearance, ten were required in Italy. Customs clearance of poultry shipments in those tests took time ranging from two to six hours in Germany to two to three days in Italy.¹ This demonstrates some of the variability associated with the documentation function.

In evaluating coordination potential in the documentation function, it is useful to consider economies achievable in its performance. These can be divided into: cost savings through more rapid documentary flow, advantages of specialization in document preparation and processing, and economies obtainable through consolidation of shipments.

5.7.1 Speeding Documentation Flows

Costs and time involved in the flow of goods and documents can be decreased through knowledge and understanding of the standard operating procedures of participants in the process and the ability to make contact with and influence those participants. As noted previously, banks are said to be more responsive to the needs and requests of their more important clients.² Additionally, messenger services, foreign agents and representatives can all be involved in checking on and speeding up the flow of documents. The value of even one day decrease in the time required to collect accounts was discussed in Section 5.6.

Economies in the facilitation of document flows may be realized through increased volume. A messenger service or other personnel

¹Nicholas and Breakiron, p. 14.

²B.C., "Export Services Study Group."

charged with carrying bills of lading from ship to bank or forwarder can easily combine several sets of documents in one trip at a far lower cost per document set than moving each individually. Freight forwarders recognize this fact, and in some ports share messenger services.¹ Where shippers share common use of a port or common foreign destination, the potential for collaboration in arranging for export service can be developed.

5.7.2 Savings on Documentation Costs

The second area of potential coordination is in the actual preparation and processing of documents. This includes efforts to reduce the number of documents prepared and consolidation of shipments to save on documentation costs.

While the costs of documentation are difficult to estimate, some researchers have attempted to do so. An A.T. Kearney and Company estimate, published in 1968, was that documentation costs per export shipment averaged \$163.² These costs are broken down in Table 5.4.

A more recent study estimates that 19 export documents most frequently used for exports originating in the U.S. have an average preparation cost of \$94.52 and an average processing cost of \$281.25 for an average documentation cost of \$375.77 per shipment.³

In addition, there are 33 additional documents which can be required, but are less frequently used, and 43 special documents which

¹Interview with Mueller.

²A.T. Kearney and Company for National Committee on International Trade Documentation, Score Line Traffic Executive Newsletter, January 1968, cited in Nicholas and Breakiron, 1974, p. 14.

³Hutchinson, pp. 26-27. Based largely on Committee on International Trade Documentation and U.S. Department of Transportation, pp. 125-126.

TABLE 5.4. ESTIMATED AVERAGE COST OF DOCUMENTATION FOR AN EXPORT SHIPMENT, 1968

| | |
|-----------------------|---------------------------|
| Exporter | \$ 43 per order processed |
| Domestic Carrier | 3 per waybill |
| Freight Forwarder | 25 per shipment |
| International Carrier | 10 per bill of lading |
| Opening Bank | 27 per line charge |
| Paying Bank | 27 per line charge |
| Insurance Underwriter | 3 per certificate |
| Customhouse Broker | 25 per shipment |
| Total | <hr/> \$163 |

Source: A. T. Kearney and Co., For National or International Trade Documentation, Score Line Traffic Executive Newsletter, January, 1968, cited in Nicholas and Breakiron, 1974, p. 14.

are used infrequently. Of the 33 less frequently used documents, 32 can be required for ocean shipments and 30 for air shipments. The cost of preparation and processing of these documents is said to add as much as \$641.18 to ocean shipment costs or \$623.77 to costs of air shipments.¹

The cost of documentation preparation and processing can be decreased somewhat through changes in methods of preparation. A form entitled "U.S. Standard Master" makes it possible to produce 16 documents in a single typing, eliminating much repetitive transfer of the same data among forms.² It has been estimated that substitution of the Standard Master for nine of the most commonly used forms could save \$151.89 per shipment in preparation and processing costs. Further savings of \$185.54 per shipment were estimated to be possible through use of the Standard Master in place of 20 less frequently used documents.²

It would be inappropriate to conclude that such savings could be achieved by all exporters through the use of a different document form. Nonetheless, the figures are indicative of the magnitude of potential variation in documentation costs which will be influenced by the specialized expertise of those charged with handling documentation for the exporter. A freight forwarder may provide this service. Alternatively, a group of exporters, coordinating their activities, could also generate the volume necessary to support the fixed costs of maintaining both specialized internal expertise and contacts throughout the system through which documents must flow. In considering such a move,

¹Ibid.

²Unz and Co., p. 31.

³Hutchinson.

it is important to evaluate the temporal demands of potential collaborators on any joint arrangement. Freight forwarders often handle transport and documentation arrangements for an extremely broad commodity mix. While many forwarders have specialists in the movement of agricultural commodities on their staffs, the seasonal variation in flow patterns of different commodities helps to even out demand for staff resources. This helps to avoid some of the problems of highly variable staffing needs. Cooperatives considering coordination in this area must also evaluate the potential staffing costs and service capacity requirements which accompany the temporal marketing patterns of different combinations of commodities.

5.7.3 Economies Through Consolidation

The third area for achievement of economies in performance of the documentation function is through consolidation of shipments. Some of the potential advantages of consolidation of shipments were discussed in Section 5.3, where special emphasis was placed on transportation economies. The above discussion demonstrates the substantial impact of documentation costs on the competitive position of U.S. goods in foreign markets. Regardless of the terms of a sale, documentation costs influence the final cost of a shipment to a foreign buyer. If the costs of assembly of single shipments are less than the resultant economies in transportation and documentation, the competitive positions of the individual suppliers will be improved. The costs of documentation are, in fact, quite similar, regardless of the size of a shipment. In any case, the change in documentation costs resulting from a doubling of shipment size would be less than double the original documentation cost.

As a result, exporters who use similar ports and ship to similar destinations may be able to benefit from consolidation of shipments. Also, single or groups of exporters may save on documentation costs by making larger shipments and physically positioning inventories close to foreign markets. This was noted previously with respect to transportation and physical distribution savings.

5.7.4 Summary

In summary, there are potential economies of coordination which may be achieved through increased speed of document flow and through decreased costs of document preparation and processing. The latter may include benefits of specialization in preparation and processing, and those gained through consolidation of shipments. The documentation function, as the linking mechanism between product and payment, is an essential factor in determining the profitability of exports.

5.8 Risk Management

The risk management function involves evaluation and balancing of the trade-offs between risks and the costs of covering them. Risk management requires assessment of risks associated with individual transactions as well as the impact of such risks on overall risk exposure. Five types of risks associated with export transactions include: physical risk, pricing risk, commercial risk, foreign exchange risk, and political risk.

The risk management function is highly interdependent with all other export marketing functions. Many of the trade-offs involved in managing risks have been discussed in earlier sections of this chapter.

This section draws together the analysis of individual risk elements in the export process. It will then evaluate the potential for either mitigating risks directly or decreasing the cost of risk coverage through coordination and risk pooling among cooperative exporters.

5.8.1 The Problems of Risk

A manager, faced with varying degrees of certainty as to the range and distribution of potential outcomes from individual activities, is forced to make decisions which impose risk upon those whose interests are being managed. While many risks can be covered, the cost at which coverage can be obtained is often so great that either the activity must be foregone or the exposure to risk only partially covered. In marketing, the costs imposed by both risk coverage and risk exposure contribute to the price at which products can be profitably offered for sale and, thus, affect the competitive position of the marketer. Faced with a seeming conflict between costs of risk coverage and the ability to be competitive in a given market, one apparent solution may be to seek out markets where such conflicts are less problematic. While such a risk avoidance strategy may provide the most satisfactory short run solution to the risk management problem, longer term overall risk exposure in a dynamic environment may actually be increased.

Farmer cooperatives are often accused of being overly risk averse. Critics point out instances where cooperatives have withdrawn from activities after a loss on a single transaction while it is believed that private or proprietary firms would have continued in spite of the short term setback. Such behavior on the part of cooperatives may be explained in part by differences in responsibility bearing between

cooperative and proprietary enterprises. Cooperative activities are more open to public, and especially member, scrutiny than are those of a private firm. The owner/manager of a closely held multinational grain company may be willing to accept a major loss on a single sale without looking for a new management team. Some of the cooperative managers interviewed indicated that they were vulnerable to replacement as the result of much smaller, short term losses than would be permitted their corporate counterparts. While this may sometimes result in short term strategies which are not consistent with the maximum longer term welfare of cooperative members, it would be wrong to conclude that all cooperative activities are, or will be, characterized by risk aversion. For example, cooperatives involved in petroleum refining have recognized that without their own sources of crude oil supply, they would be exposed to greater risk than through assumption of the burden of risk involved in oil exploration and drilling. This involves risks of over one million dollars per dry hole.¹

In grain marketing, members of interregional cooperatives, such as Farmers Export Company, have begun to recognize both the importance of evaluating trade-offs between short and longer term risk exposure, and to develop the sales volume and activities necessary to permit more effective management of risks. The issue of ocean freight chartering provides a useful illustration. Many cooperatives have developed satisfactory arrangements with foreign buyers which permit the cooperatives to avoid the risks of ocean freight chartering. An important consideration

¹Interview with William A. Hiller, Group Vice President, Distribution Services, Agway, Inc., April 4, 1979.

is the extent to which the short term avoidance of risks in ocean freight markets will merely result in exposure to greater risks in terms of future market outlet alternatives. If a large percentage of the total sales of a cooperative are to the limited number of foreign buyers who are willing to make arrangements for ocean freight, the members may be exposed to considerable risks in the event that a single customer wishes to alter the arrangement or extract price concessions.

The problem may be evaluated in the larger context of the risks associated with limited market diversification. Where export sales are concentrated in a limited number of markets, the risks of economic injury resulting from impediments to trade, such as the breaking of diplomatic relations, embargoes, wars or import restrictions are greater than where markets are more diversified. Hirsch found that in 1976 cooperatives were more reliant upon markets in the European Community and Japan than were exporters of U.S. agricultural commodities in general. Cooperatives made 66 percent of their direct export sales in those two market areas, compared to 44.5 percent of all U.S. agricultural exports which were sold there.¹ Of course, each of these geographical market areas includes a large number of independent buyers, but many risks are common among them, particularly political risks.

One experienced manager suggested that a rule of thumb for market outlet diversification is that no more than 20 percent of sales should be made to a single outlet.² While this rule is drawn partially from

¹Hirsch, 1979, p. 13.

²Interview with Cain.

experience in domestic marketing, it reflects the fact that changes in personnel, firm acquisitions, credit problems or bankruptcy, as well as political factors may interrupt the marketing relationship between a supplier and his customers. Market outlet diversification is one means for the seller to guard against the risk of catastrophic effects from such problems. With general problems of risk placed in perspective, it is useful to consider specific types of export-related risks and methods for their coverage.

5.8.2 Physical Risk

Physical risk reflects probabilities of loss or damage to the merchandise being sold. This is the most commonly recognized risk in international trade, and is usually covered by marine or cargo insurance.¹ Marine insurance may cover many risks, among them loss, theft, pilferage, breakage, and damage from fire, fermentation, humidity, leakage, odors, sweat, taint and/or vermin. The type of available coverage ranges from "all risks" coverage, which covers physical loss or damage, but not that caused by war, riots or strikes (these may be covered separately), to loss of vessel only (T.L.V.O.) coverage. The latter is less expensive, but covers only total loss of cargo resulting from total loss of the vessel. A more commonly used minimum coverage, free of particular average (F.P.A.), covers total and general average losses as well as some partial losses. Most export shipments are insured against some

¹For specific discussion of the terms of marine insurance see: Posthumus, Stachwick, Ricks, McBride and Sorenson; Dunn and Bradstreet, Exporters' Encyclopedia (annual), Richmond, and Mark R. Greene; Risk and Insurance, third edition (Cincinnati: South-Western Publishing Co., 1973).

form of physical risks. If sales are made on a c.i.f. basis, the shipper makes arrangements for insurance. On other sales terms, such as f.o.b. and c.& f., the buyer is responsible for insurance arrangements. However, if the exporter continues to hold a financial interest in the merchandise being shipped, it is in his interest to ensure that the shipment is protected against physical perils. Additionally, if the shipper can provide such coverage at lower cost than the buyer, his competitive position is improved.

Significant economies are obtainable through insurance of large sales volumes and large numbers of shipments. Marine insurance policies can cover a single shipment, or they may be written on a blanket basis to cover all shipments made during a given time period. The latter coverage is less expensive because the insurer's risk is spread over a number of different shipments. Freight forwarders often have open insurance policies which permit them to cover individual shipments at a lower cost than would be obtainable through policies written on a single shipment basis.

Cooperatives also have experience in obtaining economies in insurance coverage. Many cooperatives have their own or joint insurance companies which provide services to members as well as coverage for physical risks of domestic shipments.¹ Gold Kist, Inc., a cooperative with significant (\$175 million) annual export sales volume in peanuts, soybeans and products, poultry and several other products, has a blanket marine insurance policy which was negotiated through its domestic

¹Several of the cooperatives with interests in insurance companies include: Agway, Inc., Michigan Farm Bureau Services, Gold Kist, Inc., and Seald Sweet, Inc.

insurance department. As a result of the large and diversified volume covered, Gold Kist has sometimes found that it can provide insurance coverage for 50 percent or less of the cost at which prospective customers can obtain similar all risk coverage. This improves its ability to compete as well as providing better service to customers.¹

Size and diversification both contribute to economies in insurance. It becomes possible to more precisely estimate the probability of an occurrence as the number of observations sampled increases. In other words, for a large sample, the probability increases that the sample mean will more closely approximate the population mean. The precision with which estimates of loss probabilities can be made will increase with the number of shipments of similar size and with relatively homogeneous risk characteristics. Thus, combining coverage for shipload quantities of grain with containerload quantities of canned cherries would yield fewer advantages than would combining shipload quantities of bulk commodities subject to similar physical risks and then forming another pool combining containerized commodities with similar physical risk potential. This would permit the cost of coverage to more closely reflect the physical risks involved.

In assessing the advantages of coordination in physical risk bearing, it is useful to recognize potential economies in information and risk coverage. Experience in exporting contributes to the development of knowledge with respect to the probabilities of various physical risks.

¹Interview with Michael A. Stimpert, Manager, International Marketing Division, Agricommodities Group, Gold Kist, Inc., October 1978.

Experience with individual shipping companies and with individual ports also contributes to that knowledge. This is one of the reasons that many exporters rely upon freight forwarders to handle export transportation and insurance arrangements. They get access to such knowledge at a relatively low cost.

Economies in knowledge related risk factors, such as the ability to monitor the arrival quality of commodities shipped in order to maintain quality standards and prevent fraudulent loss claims, are not as readily accessible through commercial sources. In fresh fruit shipments, it was noted previously that large cooperatives such as Sunkist, have adequate volume to support the costs of having a paid representative present during the discharge of fruit from vessels. For smaller shippers, collaborative action may be the basis for economies in foreign inspection. For example, Citrus Shippers United (CSU), an association of cooperative and proprietary packers and marketers of California and Arizona citrus, arranged for a paid representative to monitor arrival of fruit exported to Europe during 1978.¹ CSU has also established a self-insurance program to cover fruit decay. This permits individual shippers to benefit from the reduced costs obtainable through insurance of large volumes. Additionally, since the program is set up as a mutual, any premiums which are not used to pay claims are distributed among the shippers.² This also provides an incentive to prevent decay problems.

¹Interview with James W. Neu, President, Pure Gold, Inc., August 14, 1979; and "Citrus Shippers United European Marketing Policy" (Redlands, California, 1978, mimeographed), p. 2. For further discussion of Citrus Shippers United see Chapter 6.

²"Citrus Shippers United Policy," pp. 5-8.

Self-insurance is often quite appealing as a means to cut costs of physical risk coverage. However, it is essential to recognize that self-insurance should not be viewed as an alternative for those who cannot afford commercial insurance. One source estimates that, in general, insurer expenses amount to 30 to 40 percent of the total premiums collected.¹ This indicates opportunities for major cost savings through self-insurance, if the conditions for a successful program can be met. Greene suggests that for successful self-insurance, a firm must: (1) have sufficient numbers of objects to insure so that they are not subject to simultaneous destruction and that are sufficiently homogeneous in nature and value to permit accurate calculation of probable losses within narrow limits, (2) set aside a fund for large or unusual losses and/or use self-insurance in conjunction with large deductibles in commercial insurance, (3) maintain accurate records in order to estimate expected losses, and (4) provide for careful administration and planning including specialized personnel to handle investment of funds, payment of claims, inspections, loss prevention, record keeping and other related duties.²

These are all factors which could be achieved through multicooperative coordination. To the extent that cooperatives' export sales can be considered relatively homogeneous risk-units, the potential for advantages of joint insurance exist. For cooperatives making large and frequent export sales, the inclusion of risk for smaller, irregular sales

¹Greene, p. 85.

²Ibid., pp. 84-85.

could yield economies for the latter. However, assumption of the risks of large sales by small exporters would not yield similar advantages. This implies that either the initiative for broad-based coordination in insurance of physical risk would have to come from those with large sales and large volume or that separate arrangements would have to develop according to the size of the physical risks involved. The former option would offer greater opportunity to achieve economies of administration.

5.8.3 Pricing Risk

Pricing risk accompanies variation in the price of the commodity being marketed as well as the costs associated with marketing functions for which the exporter bears responsibility, such as transportation. Pricing risk includes both exposure to losses and unrealized profit opportunities. The process of pricing was discussed previously under the procurement and sales functions.

Pricing risk associated with procurement exists regardless of whether the commodity is priced immediately or at some later point. Some critics of cooperatives argue that pooling eliminates the pricing risk for cooperative managers, giving them an unfair advantage over corporate competitors. Pooling does limit the managers' short run risk that sales price will result in a paper loss. However, in the longer run, producers will not participate in a pool which does not provide a competitive return. Thus, pricing risk is continually present.

For a number of commodities, futures markets provide a means to mitigate some of the pricing risks of export sales. Many export sales are priced on the basis. They involve agreement on a certain price

under or over a designated futures contract price.¹ This still involves risk because the basis cannot be directly hedged. Furthermore, not all sales can be effectively hedged through the futures market. A variety of political and economic news events such as embargoes, rumors of a major transaction, or increased trading in a contract may alter price relationships before a sale can be hedged.

With commodities for which there are no futures contracts to permit hedging, devices such as forward contracts or holding of inventories can decrease risk exposure somewhat. However, some risk must simply be borne as part of the marketing process.

In addition to the pricing risks associated with the commodity being exported, there are significant pricing risks associated with the costs of marketing and transportation, especially ocean freight. Cargill officials have stated that risk associated with ocean freight rate fluctuations is even greater than that associated with commodity prices.² These risks can be hedged partially through vessel charters or ownership, both requiring substantial sales volume, expertise and capital. This was discussed in Section 5.3 above and is the subject of ongoing research by Hirsch.³ The risk of ocean freight rate variation is greater for those involved in vessel chartering and large bulk shipments than for those shipping smaller break-bulk or containerized quantities. While the latter rates are generally less volatile because

¹For discussion of basis pricing see Neilson Conklin, Gerhard Wilbert and Reynold Dahl, "Pricing of Grain Exports and the Role of Futures Markets," Minnesota Agricultural Economist, 614 (December 1979).

²Interview with Melvin Middents, Vice President, Commodity Marketing Division, Cargill, Inc., March 27, 1979.

³Hirsch, forthcoming.

of the conference system, the level of rates per unit of weight or volume is usually much higher.

Where the price of services such as ocean shipping is quite volatile, irregular participation in the market results in uneven probabilities of windfall gains or losses. Thus, pricing risk is increased by volatility in prices and costs of both the commodity being marketed and the services necessary to market them.

Size and volume contribute to advantages in managing this risk. There will always be some variation in returns to individual export transactions. However, as the number of transactions increases, the expected variance of returns can be decreased. Where the size of transactions is large, as in the grain trade, the volume of sales over which risk is to be pooled must be quite large in order to gain any appreciable reduction of the expected variance of returns. Caves suggests that such requirements for risk bearing may contribute to the need for major grain trading companies to be quite large.¹

For cooperative exporters the potential coordinational advantages in managing pricing risk are largely dependent upon similarities in functional export marketing requirements. Where commodities are traded on futures markets, cooperatives can and do benefit from joint action, as is done with Illinois Commodity Futures Trading Cooperative. Collaboration in performing transportation, information and sales functions, discussed above, all open up opportunities to reduce pricing risks through improved pricing accuracy.

¹Caves, 1977-78, p. 116.

5.8.4 Commercial Risk

Export-related commercial risks include both credit risk and risk associated with dependence upon a limited number of market outlets.

Commercial credit risk may be insured through commercial underwriters and limited through the payment terms under which a specific sale is made. The latter were discussed in detail under the financial function. While risk associated with receipt of payment can be virtually eliminated through requirements of payment through confirmed, irrevocable letters of credit, it was noted previously that such a requirement may diminish the competitive position of the exporter. Commercial credit insurance covering insolvency or deliberate default on payment is one alternate means of covering the exporters' risk exposure.

Additionally, market knowledge and contacts are essential components of a strategy designed to evaluate commercial credit risks associated with individual transactions. This includes access to credit reports on potential foreign customers, the ability to analyze them, and the ability to follow up if difficulties in the receipt of payment arise. These factors are closely related to representation under the information and sales functions, discussed earlier.

Coverage for both commercial and political risks is available through the Foreign Credit Insurance Association (FCIA). According to Robert A. Keenan, Chief Executive Officer of FCIA, the organization was set up in 1961, ". . . to insure U.S. exporters against credit losses, and in the process, give them a competitive edge (against) exporters in

other nations."¹ In 1977, FCIA membership included 53 major private insurance companies and it insured about \$5.2 billion worth of U.S. exports.² Under the FCIA program normal commercial credit risks are covered by the private insurers and the Export-Import Bank of the United States assumes liability for political risks.

Most agricultural exports would be insured under a short term policy with payment expected within 180 days. In providing coverage, FCIA generally requires that all short term receivables be covered with the exception of those where an irrevocable letter of credit has been issued or where sales are to buyers in Canada. In some cases, a reasonable geographic spread of receivables will be covered instead of the total volume.³ On short term policies, FCIA will cover up to 95 percent of the political risk and 90 percent or less of the commercial risk involved in sales. Thus, exporters maintain a continuing interest in each transaction as they must carry the uninsured percentage for their own accounts.

Exporters can elect FCIA protection against commercial and political risks or political risks only. Cost of coverage under a blanket short term policy ranges from 0.25 percent to 0.5 percent, or 25 to 50 cents per \$100 of gross value. One cooperative manager found this cost prohibitive, given the low margins on many agricultural export sales and

¹"Before you sell abroad, check your insurance," Nations Business, April 1979, pp. 103-194.

²Ibid.

³Morgan Guaranty Trust Company, p. 30.

the requirement that the entire turnover be insured, and not just exports to selected markets.¹

In addition to economies obtainable through collaboration in collection and analysis of credit data on prospective export customers, cooperatives might also be able to beneficially coordinate arrangements for commercial credit insurance. Where sufficient volume and market diversification can be obtained, it may be possible to seek coverage for a geographically spread risk exposure which would satisfy FCIA without necessitating coverage for all export markets.

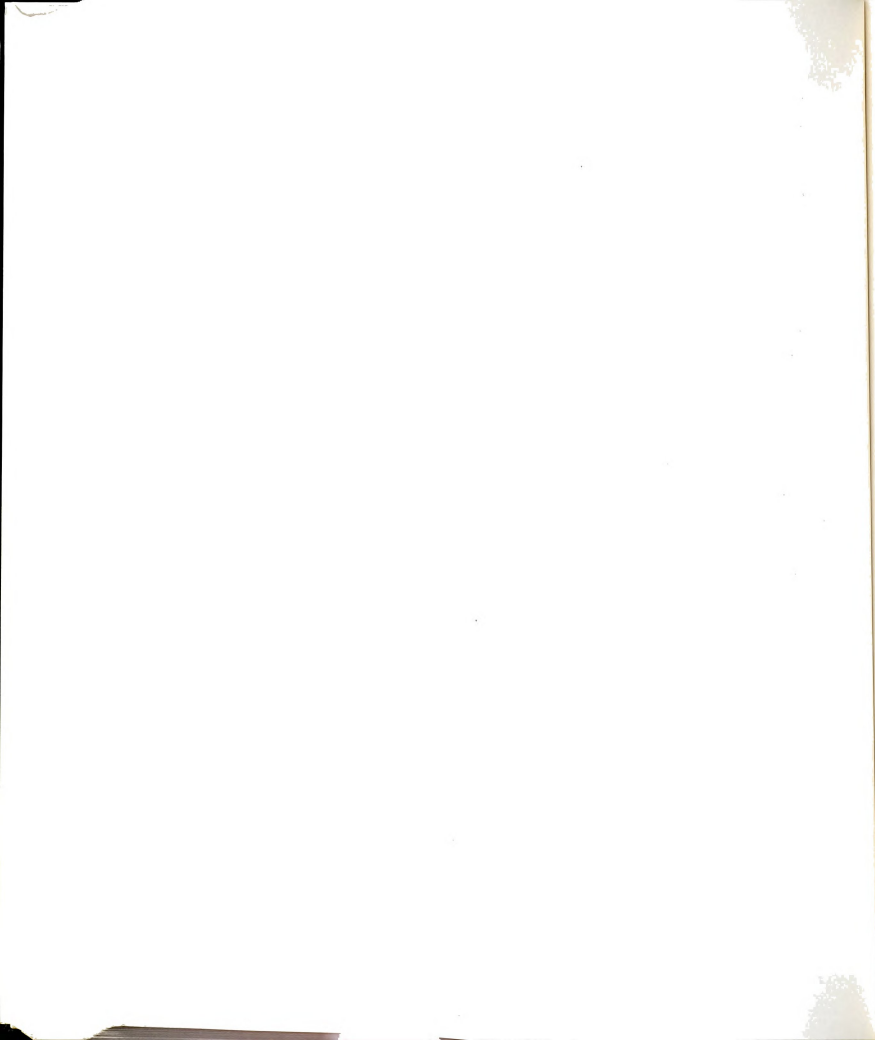
The discussion of commercial risks has thus far concentrated upon risks to exporters. Other commercial risks accrue to the customer who seeks guarantees that exporters can and will deliver products or services as agreed when they submit bids. This risk is increasingly covered through requirements of Bid/Performance Bonds.² These bonds usually take the form of letters of credit for 12 to 15 percent of the value of the commodity to be exported. This can pose a financial burden for even financially viable and scrupulous exporters. Small exporters are sometimes required to post 100 percent non-interest bearing cash collateral with the bank issuing the bond.³ The cost of providing a bid/performance bond may range from two to ten percent of the value of the bond, depending upon the reliability and experience of the exporter.⁴ As a result, size, experience, and sales volume can

¹Interview with Stimpert, May 18, 1979.

²For discussion, see Robert Scholle, "Bid/Performance Bonds: How They Affect the Small Exporter," Foreign Agriculture, January 22, 1979, pp. 5, 6, 12.

³Ibid., p. 6.

⁴Krob, February 15, 1979.



yield advantages in the cost of doing business. This is another area where collaboration may permit an improvement in the competitive position of cooperative exporters.

5.8.5 Foreign Exchange Risk

The issue of foreign exchange risk was discussed in detail under the financial function. It includes variability in the rate of exchange among currencies and the potential for significant profits and losses which results.

As was noted previously, foreign exchange risks cross all commodity lines and provide potentially significant opportunities for coordination among cooperative exporters in managing foreign exchange risk.

5.8.6 Political Risk

A number of politically related factors may affect the ability of an exporter to collect payment of his commodities. These include: currency inconvertibility or exchange transfer delay, war or other hostilities, expropriation, confiscation, import restrictions, regulations, governmental actions such as unforeseen withdrawal or non-renewal of licenses to export or import. These are referred to as political or noncommercial risks.

Exporters of agricultural commodities may obtain coverage for political risks through FCIA, discussed earlier, or, in some cases, under the U.S. government Commodity Credit Corporation Noncommercial Risk Assurance Program (GSM-101). While FCIA usually provides political risk coverage on agricultural commodities for up to 180 days, the GSM-101 program will cover periods of up to 36 months. This permits

longer term financing through private banks with insurance for political risks provided by CCC. The cost of coverage varies by market, but is generally less than one percent of the financed value. The U.S. Department of Agriculture determines the amount of coverage which will be made available for shipments of all commodities to specific countries.¹

The potential for economies in dealing with political risk are similar to those associated with other types of risk. Information is essential in evaluating the probability of political risks and market diversification is important in limiting exposure to such risks. While exporters of some commodities may be more exposed to political risk because of the volume of their export sales and the markets in which they deal, most such risks can be evaluated with wide ranging interest to exporters of different commodities. Such interest is not limited to cooperative exporters, however.

5.8.7 Summary

Economies of risk management in exporting may be developed in the areas of information and risk coverage. Informational economies are achievable in identification of the actual risk exposure associated with a particular transaction and alternatives for its coverage. Risk coverage economies may be developed through increases in volume and diversification of commodities and/or markets where these yield increased numbers of relatively homogeneous risk exposure units.

¹"U.S. Farm Export GSM-101 Program Covers Noncommercial Risks," Foreign Agriculture, January 1, 1979, p. 5.

Exporters must deal with five types of risk: physical risk, pricing risk, commercial risk, foreign exchange risk, and political risk. In each case, commercial and/or public sources of insurance are available. However, the cost and terms of coverage are not always compatible with the competitive necessities of marketing.

There are a number of opportunities for advantageous joint cooperative action in the performance of the risk management function. As with the information and sales functions, a coordinated presence in foreign markets can yield economies in representation costs as well as influencing the quality of information and representation obtained. This is a function of the overall importance of members of any joint organization to representatives or information sources.

Furthermore, there are potential advantages to combining similar risk exposures in order to achieve lower cost coverage. In dealing with physical risk, the possibilities for joint "self-insurance" arrangements can be explored. However, current volumes of cooperative exports would probably be more conducive to use of self-insurance in conjunction with commercial insurance as a deductible, rather than the internal provision of all-risk maritime insurance coverage by a cooperative insurer. Economies in the joint negotiation of blanket coverage by commercial insurers might also yield some economies in physical risk coverage.

Where the size and type of physical risk exposure differs markedly, as between shipload quantities of bulk commodities and single container shipments of packaged products, the similarity of interest conducive to joint insurance would be difficult to realize. While bulk shippers

could assume the risk of a single container shipper, the latter would be unlikely to willingly share in the larger risks of the former.

Pricing risk exposure includes commodity procurement price risk and associated marketing and transportation cost risks. Procurement risks were discussed previously. In dealing with transportation cost risks, there is already joint cooperative ownership of a barge line, Agri-Trans. Ocean freight cost risks have long been avoided through f.a.s. and f.o.b. sales. This limits market outlet alternatives and imposes commercial risks. Ocean freight cost risks fall primarily in bulk commodities, since other rates are not as volatile. Major grain companies and other shippers limit their risk exposure in ocean freight through chartering and vessel ownership.

Commercial risks include credit risks associated with the receipt of payment for individual export transactions as well as vulnerability of exporters associated with reliance upon a limited number of market outlets. Coordination can yield economies in assessment of the credit risks associated with individual transactions as well as presenting the opportunity to diversify the markets served by sales and information functions.

Foreign exchange risks, discussed under the financial function, are an area with the potential for wide-ranging collaboration among cooperative exporters, regardless of the commodities handled.

Assessment and coverage of political risks is also an area with far-reaching potential for collaboration. Cooperatives which are hesitant to export because of political risks may be able to take advantage of political risk coverage obtainable through FCIA. Because of the

FCIA requirement for coverage of all shipments or a balanced portfolio, coordination among cooperatives might permit development of economies in the insurance of political risks.

5.9 Regulatory

There are two types of problems encompassed in the regulatory function. The first involves access to, and analysis of, regulatory information and compliance with regulations. The second involves influencing the regulatory environment in which the exporter must function, i.e., changing the rules of the game.

It is useful to consider two groups of regulatory factors which affect the flow of goods in international trade:

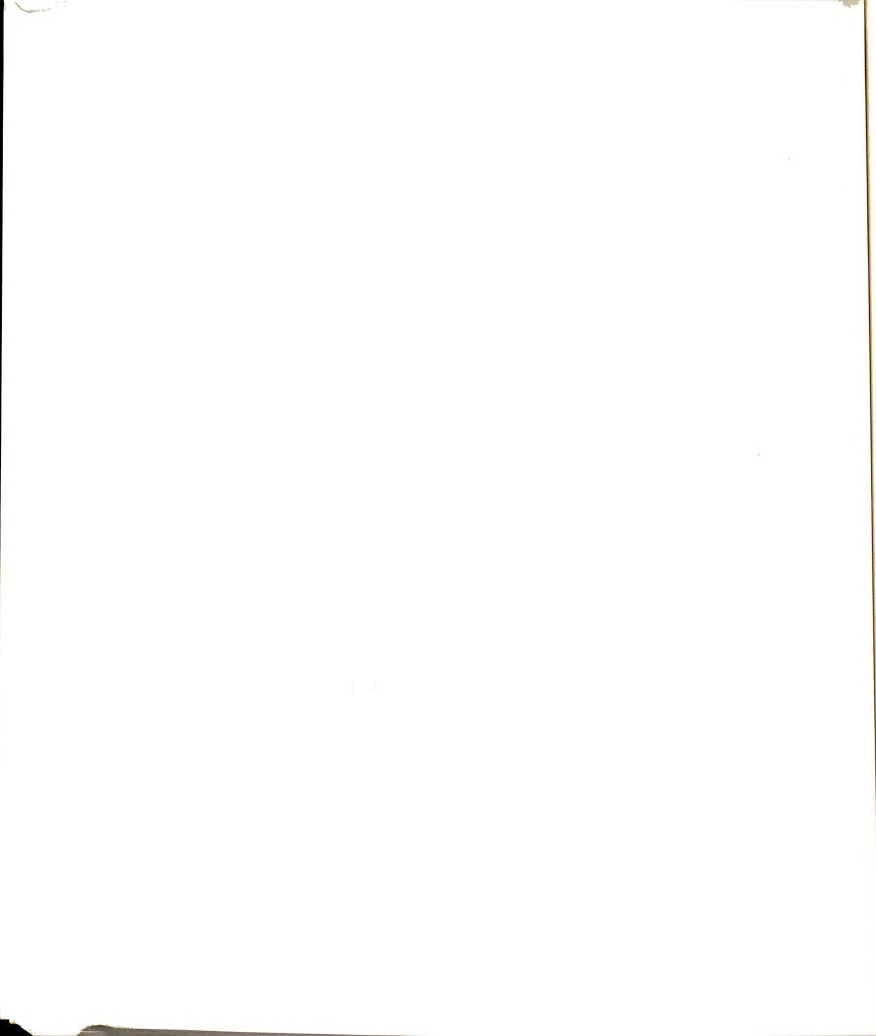
- 1) tariffs, quotas, subsidies and the other non-tariff barriers, and
- 2) health and safety standards, labeling requirements, quarantines and other regulations of chemical residues, food additives, etc.

In some cases, regulations falling into the second group may be de facto non-tariff barriers. However, given the wide variation in decision criteria deemed acceptable for the establishment of health and safety hazards, it is useful to distinguish between the two groups of factors.

This section will evaluate the potential for economies of coordination in dealing with both types of regulatory problems and discuss some experiences of cooperative involvement in the regulatory function.

5.9.1 Regulatory Information and Compliance

Regulations are imposed upon market participants and their conduct by governments, social custom and market participants. They are directed



at influencing the distribution of economic, political, health and safety benefits and costs in the regulated area.

For the exporter, compliance with regulations in foreign markets begins as an information problem. It is necessary to determine whether a product now available for export can be sold in a given foreign market. This involves identification of restrictions on food additives, chemical residues, labeling requirements and other factors which may affect the admissibility of the product into the foreign market. Some of this information is available in published form from the USDA, foreign country embassies, consulates and trade offices, and other sources.¹ FAS attempts to keep abreast of foreign regulations affecting the use of pesticides and food additives, as well as labeling requirements.² FAS also has a "New Products Testing Service" which will clear the wording and ingredients on food labels with foreign governments for a fee of \$5.00 per label per country.

Information on tariff and non-tariff barriers which may affect the competitive position of the exporters' goods in a foreign market are available from similar sources and from agricultural attache offices and foreign governments.

The information and compliance process is complicated by the dynamic nature of regulation. The registration of certain chemicals or additives

¹For example, see Food Sanitation Law: Food Additives in Japan, revised sixth edition (Tokyo); Japan's Import and Marketing Regulation Selected Agricultural and Marine Products, JETRO Marketing Series 12 (Tokyo: Japan External Trade Organization, n.d.); Commission of the European Community, Exporting to the European Community: Information for Foreign Exporters (Brussels: EC, 1977).

²Interview with Tom O'Connell, USDA/FAS, February 28, 1979.

for use on or in specific commodities may be revoked or modified by foreign governments, just as they may be domestically. Thus, the exporter must remain abreast of regulatory changes and proposals which may affect his future marketing prospects.

In the U.S., there can be significant economies in monitoring regulatory proposals which may affect a number of different agricultural products. Similarly, in foreign markets, the potential for economies in regulatory monitoring can be expected to mirror the organization of the regulatory institutions which may affect individual commodities. Where all agricultural commodities are regulated by a common agency, the opportunity for broad-based coordination would exist.

To be useful, regulatory monitoring must be accompanied by an analytical capability for assessing the potential impact of proposed regulatory change. It is through such evaluation that the costs and benefits of possible action to influence foreign regulatory processes can be appraised. While a rule change might impose significant damage on the export program of a single exporter, the costs involved might be insufficient to justify investment in attempting to influence foreign decision makers to reconsider a ruling. In such a case, coordinated analysis of potential impacts on different exporters could serve as the basis for coordinated action to influence the "rules of the game."

5.9.2 Influencing the Regulatory Environment

Where multiple exporters may be affected by a regulatory modification in a foreign market, they may find it advantageous to coordinate efforts in order to influence the foreign regulatory process. This may

take the form of a joint effort to change tariff or non-tariff barriers, or combined efforts to influence requirements for labeling or chemical use.

Modifications of the rules of the marketing process have the characteristics of "joint-impact goods." Schmid defines these as goods which enter the utility functions of multiple market participants "irreducibly," so that the marginal cost of another user is equal to zero.¹ This is important because it introduces the opportunity for free rider problems. If a group of exporters jointly finances a program to alter foreign regulations in a manner conducive to its interest, its competitors may be able to take advantage of the rule change without sharing the costs involved. If a fear of this situation prevents action from being taken, the result is a "social trap," with the welfare of all of the concerned exporters adversely affected. An alternative may take the form of coordinated arrangements whereby a large percentage of those potentially affected by rule changes share in the costs of influencing them. At a minimum, this would entail horizontal coordination, including both cooperative and corporate handlers of exports of affected commodities. In all likelihood, the impacts of rule changes would not be limited to single commodities. Thus, broader-based coalitions might be possible with respect to specific issues. One approach would be to coordinate action along commodity lines through groups such as trade associations and FAS cooperators. The role of farmer cooperatives in such arrangements would depend upon the position

¹A. Allan Schmid, Property, Power and Public Choice (New York: Praeger, 1978).

of cooperatives in the industry being organized. In some cases, cooperatives or cooperative coalitions could be expected to take the organizational lead because of their important market positions. In other cases, cooperatives might be active participants in coordinated negotiating activity involving cooperative and corporate competitors with similar export interests. This would require recognition of the interrelationship between market power and the ability to bargain effectively.

The potential for cooperative exporters to influence their regulatory environment, as well as possibilities for coordination among exporters, are best illustrated through two examples:

- 1) the recent activity by Diamond/Sunsweet, Inc., in attempting to influence the modification of tariffs and non-tariff barriers affecting U.S. exports of walnuts to the European Community, and
- 2) the role of Northwest Fruit Exporters in influencing quotas and fumigation standards for exports of fresh cherries to Japan.

5.9.3 Influencing Tariff and Non-Tariff Barriers: Walnut Exports to the European Community

Increases in tariff or non-tariff barriers may seriously impede sales in export markets which are already quite important to cooperative exporters. For example, after a large harvest of small sized walnuts in France during 1978, U.S. walnut exporters increased their sales of larger sized walnuts in West Germany. Faced with large inventories, the French called upon their fellow members of the European Community

to establish licensing requirements for imports, minimum import prices and the right to stop imports if deemed necessary to safeguard European producers of walnuts, almonds and hazelnuts (filberts). For members of Diamond/Sunsweet, Inc. (D/S), a growers' cooperative marketing association, sales of Diamond walnuts to the nine members of the European Community and Greece, Spain and Portugal, which are expected to join the EC, amounted to 80 percent of walnut exports during 1978-79. These sales were valued at almost \$20 million, so change would have been devastating to the D/S marketing program. The need to attempt to influence the "rules of the game" was self-evident. The D/S reaction was swift. Representatives of the D/S international marketing department contacted U.S. agricultural attaches in Europe to enlist their support. Furthermore, recognizing the importance of the move to all U.S. walnut producers, Diamond/Sunsweet, Inc.'s president and other representatives of the Walnut Marketing Board met with the EC Commission and key representatives of Belgium, the Netherlands, England and West Germany in an effort to counter the proposals.¹

While the final results of this action are not known, several important implications can be identified. First, it is critical for the exporter to have access to information on changes and proposals for change on the regulatory environment in which he functions abroad. If a cooperative or others are to invest in the development of foreign markets, they cannot afford to be uninformed as to potential rule

¹"French Farmers Insist on Economic Protection," Diamond/Sunsweet News, June 1979, pp. 7, 49.

changes which may adversely affect those investments. Given access to such information, the exporter must also be able to evaluate its potential impact. In the above case, the maximum possible effect would be quite large. Other rule changes may be less clear in their impact.

The ability to influence the process of regulation must also be considered. In the above example, the market and industry involved were large enough to justify investment in contesting the proposed rule changes. Additionally, the involvement of the Walnut Marketing Board, representing walnut production in California, Oregon and Washington, amounted to de facto horizontal coordination in performance of the regulatory function. This avoided free rider problems in that the board is financed by all walnut producers, and not just the cooperative members.

It is important to further consider the reasons that those contacted by Diamond/Sunsweet and the Walnut Marketing Board should respond to their declaration of interest. The U.S. walnut industry can hardly be considered an important constituent of the EC Commission, or the ministries of agriculture in EC member countries. However, the U.S. is an important trading partner for the EC. The importance of organized opposition by U.S. walnut growers to the French proposal is largely based upon the importance of the U.S. market for European exports. If the organized U.S. walnut growers have "clout" within the U.S. domestic political system, then they may constitute a threat to European exporters to the U.S. in terms of their ability to stimulate retaliatory action. In this respect, the U.S. walnut growers are important to the EC Commission, and may be listened to.

More broadly based coordination efforts through national agricultural organizations representing greater domestic political influence might be even more effective in promoting the walnut grower case, although competing commodity interests in such groups would have to accept some trade-offs in return for greater influence. Additionally, to the extent that information on proposed changes in regulations affecting all agricultural commodities flows through similar channels, broad-based coordination in the identification of proposals for regulatory change would also be advantageous.

In contrast to the defensive strategy mentioned above, an offensive approach to the modification of tariff and non-tariff barriers may take the form of input into multilateral trade negotiations, such as the recent Tokyo round of the General Agreement on Tariffs and Trade (GATT). This presents the opportunity for coordinated action to put reduction of specific barriers on the negotiating agenda. In the recent negotiations, cooperatives marketing almonds and citrus were some of the many organizations which provided active input into the negotiating process, and reaped positive results.

5.9.4 Influencing Health and Safety Standards: Cherry Exports to Japan

Another example of coordinated activity to influence the regulatory environment in a foreign market is the experience of Northwest Fruit Exporters (NFE), a Webb-Pomerene Association involving 25 cooperative and proprietary cherry shippers in Washington and Oregon.¹ Cherry

¹For further discussion of NFE see Section 6.7.5.3 below.

growers in the northwestern U.S. had been effectively barred from exports to the Japanese market by a prohibition on the importation of any agricultural commodity which may carry coddling moth. It is claimed that Japanese agriculture is completely free of this insect, and Japanese import regulations are designed to prevent their introduction. Thus, cherries, peaches, plums, apples and other fresh fruit, as well as unhusked walnuts have been barred from the Japanese market.¹

A number of northwest shippers were convinced that through effective fumigation they could export coddling moth-free cherries. They established a joint organization which negotiates with the Japanese government and has been successful in demonstrating the effectiveness of fumigation as a means to eliminate the risk of introduction of the coddling moth into Japan on fresh cherries. Since exports have begun, the organization has continued to conduct tests and negotiate in an effort to demonstrate that fumigation can be effective in eliminating coddling moth without requiring that the fruit flesh temperature be at least 70° F. as is now required by the Japanese inspectors. Success in this effort will permit improvement in quality and prolongation of the sales life of exported fresh cherries. This is expected to further encourage exports.

The NFE experience is indicative of the potential for coordinated effort to bring about changes in health and safety standards which regulate the sale of U.S. agricultural products in foreign markets. NFE does not include all cherry shippers in the northwest. However,

¹Japan's Import and Marketing Regulations, p. 26.

the opportunities for free riders has been limited by the recognition of NFE as an industry marketer by the Japanese government. Shippers who did not initially participate in NFE are permitted to join, but with reduced quotas in the total NFE marketing program.¹

The above example demonstrates that joint efforts to show that exports of specific commodities will not conflict with health and safety objectives of foreign governments can sometimes be effective. In some cases, there are bona fide disagreements over the precautions necessary to protect health and safety. In other cases, health and safety standards are merely politically motivated devices to inhibit competition with producers in the affected countries. This must also be considered in the development of a coordinated strategy to influence the rules of trade.

5.9.5 Summary

The regulatory function involves both compliance with rules governing the flow of goods in international trade and the process of attempting to modify those rules.

There are potentially significant economies of size in:

- 1) obtaining the information necessary for compliance with foreign market regulations;
- 2) recognition of the potential impact of changes in regulations, and
- 3) attempting to influence the "rules of the game."

¹ Interview with Lay; and The Goodfruit Grower, July 1, 1979.

Actions to modify regulations have the characteristics of joint-impact goods. The benefits of a general rule change achieved by one exporter cannot be captured exclusively by that individual unless he has a monopoly. Thus, the problem of free riders develops. In rules affecting only one specific commodity, horizontal coordination offers the potential to distribute costs and benefits in a fashion conducive to advantageous action. In efforts to influence rules with broader commodity implications, coordination of more diverse agricultural interests may be desirable. This might take the form of activity by farm organizations or government. In any event, the inability to capture benefits may inhibit the development of coordinated arrangements limited exclusively to farmer cooperatives.

5.10 Overview

The above discussion considered nine component functions of the export process: 1) procurement, 2) processing, 3) transportation and physical distribution, 4) market information, 5) sales, 6) financial, 7) documentation, 8) risk management, and 9) regulatory. Each of these functions will always have a bearing upon an individual export transaction. However, the allocation of costs and returns from the performance of specific functions is significantly influenced by both the identities of the market participants who perform them and the manner in which they are performed. While the above analysis was simplified through separate treatment of individual functions, it is important to understand export marketing as a process characterized by functional interdependence. As a result, optimization of the performance of individual export marketing functions will not necessarily yield an optimum overall

result. Economies in the performance of one function may, in fact, result in diseconomies in the performance of another. For example, in some instances, achievement of international transportation economies will entail increased procurement and domestic transportation costs. Assessment of the trade-offs involved in individual situations is beyond the scope of this research. Nonetheless, such trade-offs should be evaluated in considering various export coordination options.

Economic and related factors which are most significant to each export marketing function have been summarized with each section of the current chapter and will not be repeated here. This section concentrates on: 1) distinctions noted above among export requirements of different commodity groups, 2) the importance of the time frame being considered in assessing coordination potential. Evidence of potential functional economies identified in the above analysis will be expanded upon in Chapter VII.

Analysis of similarities and differences in the functional requirements for export marketing of a broad range of agricultural commodities has confirmed the usefulness of a distinction between 1) bulk commodities, and 2) perishable, processed or branded products. Exports of commodities in these two general groups exhibit sufficient differences to merit separate attention in the development of any multicommodity export coordination arrangement. Although there are significant differences in the functional requirements for exporting commodities in each of the above groups, it does not follow that it is possible to rank individual commodities or commodity groups with respect to coordination potential. Functional complementarity across commodity lines can contribute to

possible benefits derivable through coordinated exporting. Organizational factors related to the objectives and constraints of individual cooperatives will also affect coordination potential.

The range of commodities for which some export marketing activities can be combined is very broad, although, over the next five to ten years, practical difficulties can be expected to limit the variety of commodities for which cooperatives will coordinate export marketing activities. There may be some long term advantages to the existence of a cooperative sales agency handling a wide range of commodities produced by U.S. cooperatives. However, control issues and constraints on the ability of managers to successfully organize extremely broad-based groups of cooperatives with divergent interests can be expected to inhibit the development of an all-inclusive multicommodity cooperative exporting arrangement without the prior development of successful collaborative ventures within each of the commodity areas identified above. In the short and medium term, this implies that, in most cases, the greatest benefits to cooperatives can be achieved through the development of separate coordination efforts emphasizing dry bulk commodities, such as grains, soybeans and other feed ingredients; and perishable, processed or branded products, including fruits, nuts, vegetables and some animal products. While there are currently collaborative endeavors underway within each commodity grouping, substantial opportunities exist to broaden the scope and improve the performance of export coordination activities through such arrangements.

CHAPTER VI
ORGANIZATIONAL ARRANGEMENTS FOR
COOPERATIVE EXPORT COORDINATION

One objective of this research was to identify and analyze organizational arrangements which might serve the needs of U.S. cooperative exporters. Six types of arrangements were identified for evaluation through the interview process. These included:

1. Cooperative trade information service--providing trade leads to cooperatives from foreign buyers interested in dealing directly with farmer cooperatives;
2. Cooperative brokerage organization--putting buyers and sellers together without taking title to any commodities;
3. Cooperative export manager--one cooperative taking the lead and serving as the export department for other cooperatives;
4. Multicommodity federated export cooperatives--with individual member cooperatives providing commodities to a federated association which would take title and marketing responsibility;
5. Joint venture arrangements--multiple cooperative or cooperative-corporate partnerships in export marketing;
6. Webb-Pomerene associations--permitting a variety of collaborative export arrangements without reliance on the limited anti-trust immunities of the Capper-Volstead Act.

6.1 Evaluation Issues

6.1.1 Control

Each of the above organizational arrangements implies a different balance of decision-making control among participants. Many cooperative boards of directors, managers and members are quite hesitant to delegate control to larger organizations to which the cooperative may belong. This applies to relationships such as those between local and regional cooperatives for domestic marketing as well as to export coordination. There are tradeoffs between the maintenance of tight control over commodities by producers, local cooperatives and regional personnel involved in domestic operations and the ability of those charged with exports to develop an effective export marketing program. This point was discussed with respect to product commitment in sections 5.1 and 5.3 above. Recognition of the importance of control to managers can be helpful in designing institutional arrangements which respond to their perceived needs and constraints. Economic analysis which ignores control issues may in effect be assuming away a critical part of the coordination problem.

6.1.2 Potential Types of Coordination and Bases for Development of Organizational Arrangements

As discussed in preceding chapters, coordination of export marketing can be of horizontal, vertical, product extension and conglomerate types. In examining the potential of various organizational arrangements it is useful to consider both the types of coordination which might be accomplished through individual organizational forms as well as the bases for establishing specific arrangements. The primary types of coordination which could be accomplished through individual organizational forms are compared in Figure 6.1. From this comparison, it is

| Organizational Arrangements | Types of Coordination | | | |
|---|--------------------------|----------|----------------------|--------------|
| | Horizontal | Vertical | Product Extension | Conglomerate |
| Cooperative Trade Information Service | | | | * |
| Cooperative Brokerage Organization | | | | * |
| Cooperative Export Manager | * | | * | * |
| Multicommodity Federated Export Cooperative | * | * | * | * |
| Joint Venture | * | * | * | |
| Webb-Pomerene Association | * | * | * | |

FIGURE 6.1. TYPE OF COORDINATION WITH SIGNIFICANT POTENTIAL: *

evident that there is considerable breadth in the range of objectives which could be pursued through the six organizational forms to be discussed. This breadth may be further clarified through comparison of the bases upon which specific arrangements might be developed, as presented in Figures 6.2 and 6.3. These factors will be discussed in further detail in the analysis below.

6.1.3 Overall Marketing Objectives

This analysis is intended to provide a general assessment of mechanisms for export coordination. It is hoped that this will serve as background for further study by individual cooperatives or groups of cooperatives interested in additional consideration of these types of arrangements. There is no single correct or best approach to export marketing. The individual cooperative must evaluate potential advantages obtainable from alternative organizational arrangements from the perspective of its overall marketing objectives for both domestic and export sales.

One of the first steps toward development of an effective export marketing program must include an assessment of overall marketing objectives and constraints for the short, medium and longer term. These are essential to the development of policies toward coordination which are consistent with member needs and interests.

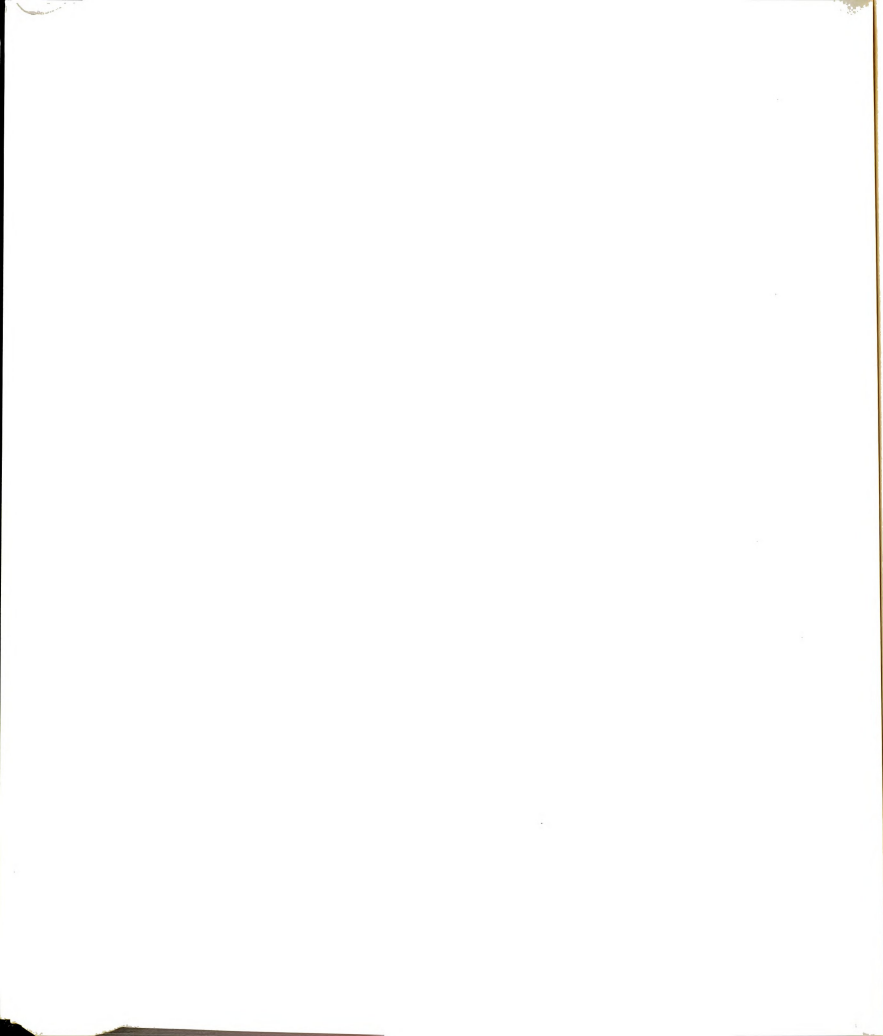
The distinction between market development and sporadic sales orientations, discussed throughout this study, is an important factor influencing both the potential contribution of the cooperative to any organizational arrangement and potential benefit which the cooperative might derive from such undertakings.

| Organizational Arrangements | Bases for Coordination | | |
|---|---------------------------|-------------------|-------------------|
| | Functional | Supply Related | Demand Related |
| Cooperative Trade Information Service (CTIS) | * | | * |
| Cooperative Brokerage Organization (CBO) | * | * | |
| Cooperative Export Manager (CEM) | * | * | * |
| Multicommodity Federated Export Cooperative (MFEC) | * | * | * |
| Joint Venture | * | * | * |
| Webb-Pomerene Association | * | * | * |

FIGURE 6.2. BASIS FOR COORDINATION WITH SIGNIFICANT POTENTIAL: *

| Organizational Arrangements | Functions | Procurement | Processing | Transportation & Distribution | Market Information | Sales | Documentation | Risk Management | Financial | Regulatory |
|---|-----------|-------------|------------|-------------------------------|--------------------|-------|---------------|-----------------|-----------|------------|
| | | | | | | | | | | |
| Cooperative Trade Information Service (CTIS) | | | | | * | | | | | |
| Cooperative Brokerage Organization (CBO) | | | | | * | * | | | | |
| Cooperative Export Manager (CEM) | | | | * | * | * | | * | * | |
| Multicommodity Federated Export Cooperative (M FEC) | * | | * | * | * | * | * | * | * | * |
| Joint Venture | * | | * | * | * | * | * | * | * | * |
| Webb-Pomerene Association | | | * | * | * | * | * | * | * | * |

FIGURE 6.3. FUNCTIONAL BASIS FOR COORDINATION WITH SIGNIFICANT POTENTIAL: *



The advantages of export coordination are not reserved exclusively for cooperatives willing to commit themselves to market development. However, to the extent that any organizational arrangement will involve some fixed costs, it is necessary to develop arrangements with an awareness of the requirements and capabilities of the individual members. For example, where cyclical production patterns often lead to sporadic export sales, horizontal coordination may offer the opportunity to prevent domestic competitors from bidding prices in export markets to such lows that variable production costs are not covered. Where the objective is solely the avoidance of cut-throat competition, coordination might be limited exclusively to maintenance of a mechanism for collaboration in the pricing component of the sales function. This would be quite different from the broader coordinational arrangements through which market development might be pursued.

6.1.4 Evaluating Performance Potential

In order to evaluate organizational alternatives it is necessary to have a set of criteria for performance or potential performance. Since some of the arrangements being evaluated do not exist, their evaluation entails hypothetical analysis. Even where there are examples of individual organizational arrangements, it is difficult to generalize to other commodity groups or other cooperatives based on an incomplete understanding of the objectives and constraints facing extant organizations and their members. In spite of these limitations, we proceed on the premise that useful analysis can be performed based upon case study evidence and the application of inductive logic. Evaluation of

organizational arrangements will consider their potential contribution to competitiveness and responsiveness.

The competitiveness criterion includes examination of the potential for an arrangement to permit improvement of the competitive position of participants through changes in the cost, quality or availability of services to them as individual entities.

The responsiveness criterion includes evaluation of the potential of the organizational arrangement to facilitate response to the needs and objectives of cooperative members and management as well as users and consumers of their products.

6.2 A Cooperative Trade Information Service (CTIS)

The idea of a cooperative trade information service to provide trade leads and market information to cooperatives as well as providing potential foreign customers with information on U.S. cooperative suppliers is initially quite appealing. While general market knowledge may be obtainable through such an approach, its fundamental shortcoming lies in the need to validate market intelligence and the importance of a selling presence in being able to do so.

Trade leads and market information are currently available to cooperatives through agents, brokers, foreign customers and competitors and trade associations as well as the trade press and various government agencies. A CTIS would have to offer better service and/or lower cost to attract membership. Provision of "better service" would necessitate broader sources of information or a superior means of validation, neither of which could be expected to develop without a closely related sales function.

The services of a CTIS might be embellished through provision for credit checks on potential customers and even a willingness to assist in collections or insurance claim settlements. While there is potential value to such activities, it can only be realized through sales. If duplicate costs were required in order to perform the sales function, there would be little incentive for investment in a CTIS in the first place. The fundamental problem appears to be that the greatest beneficiary of a CTIS would be a new entrant into an export market with an interest but no marketing contacts. These would also be the market participants with the smallest volumes with which to support such a service. Furthermore, a new exporter would eventually have need of some arrangement through which to make sales and would face the duplication of services problem.

A useful illustration is provided by the Trade Opportunity Referral Service (TORS) of the USDA Foreign Agricultural Service Export Trade Services Division.¹ Through TORS, over 6,000 U.S. suppliers of agricultural products receive trade leads obtained by U.S. agricultural attaches abroad. These are transmitted through computerized mailgrams and compiled weekly in a bulletin, "Export Briefs." Additionally, U.S. firms are offered an opportunity to announce their products to foreign buyers through listings in a monthly bulletin, "Contracts for U.S. Food Products," which is distributed through U.S. agricultural attaches abroad.

The TORS system does not assess the reliability of foreign importers or U.S. suppliers. The quality of trade leads supplied is apparently

¹Interviews with William F. Dobbins, Director, and Lloyd R. Williams, TORS Coordinator, USDA/FAS/Export Trade Services Division, October 1978.

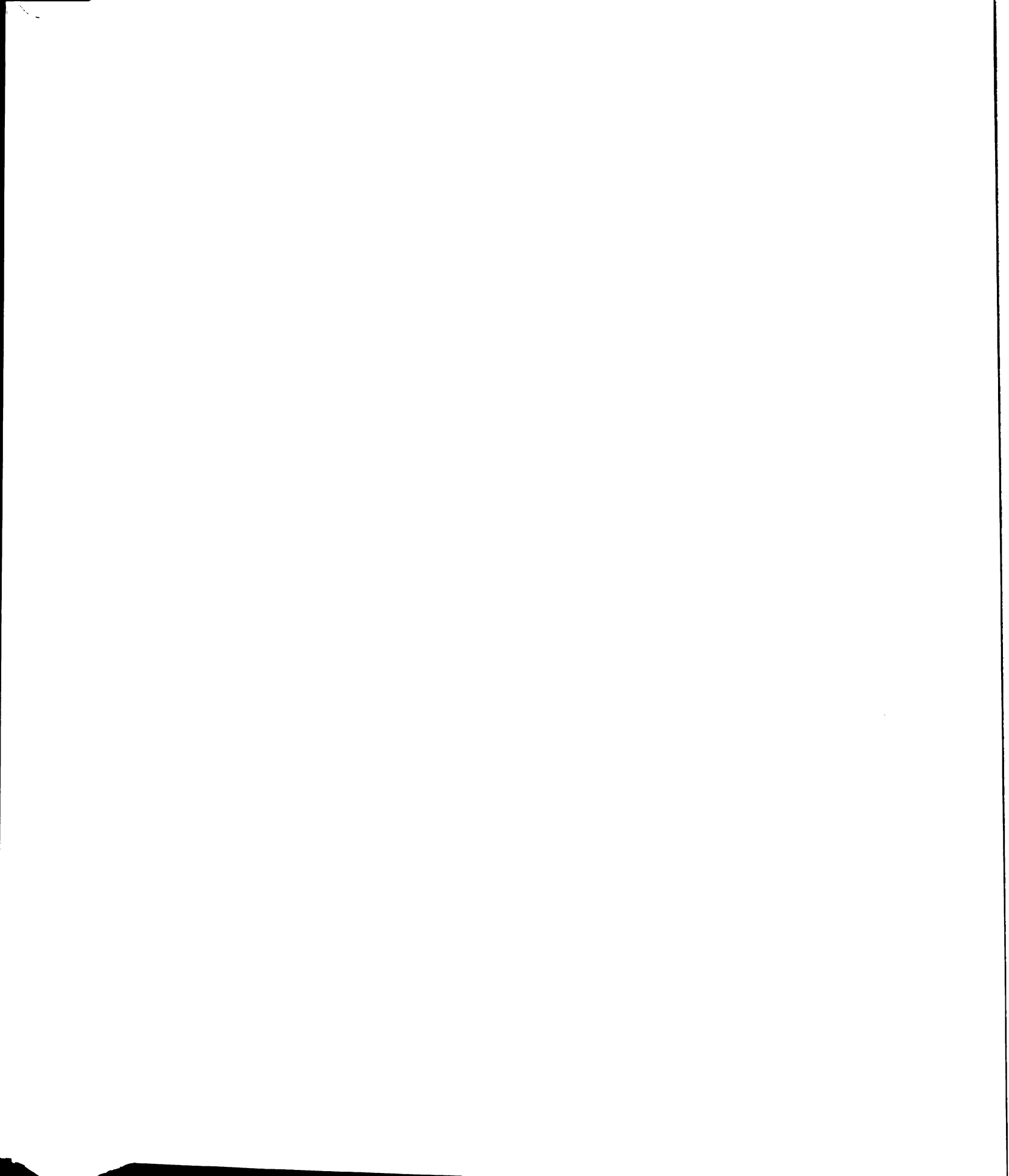
quite variable. TORS can supply lists of importers' commodity interests, business size and bank references in about 50 major markets. It cannot indicate the motivation behind an inquiry: whether the market is just being tested or a bona fide supply source is sought.

Many of the exporters who were interviewed indicated that they regularly investigate TORS leads, either directly, or through agents. Some acknowledged making sales as a result of those leads.¹ Often, however, they found that inquiries were from individuals hoping to act as intermediaries, or firms which had already made purchases and wanted to compare prices. Several cooperative leaders expressed interest in a service which could verify the credibility of inquiries. The costs of providing such services would be expected to decrease with familiarity with a specific geographic and commodity market. A broadly based CTIS might find it difficult to perform any better than the agricultural attaches involved in TORS if it were not actively involved in the trade for a given commodity.

One appeal of a cooperative information service appears to be that the power to control sales would remain with the domestic operation. This may also be the primary factor limiting effectiveness potential for such an arrangement.

The authority to make sales and arrange other activity, such as promotion, would put the staff of a trade information service in regular contact with the buying and selling activity of market participants. This appears to be quite important in the acquisition and validation of market intelligence, including trade leads.

¹FAS reports that in 1976, follow-up on 20 percent of the trade inquiries indicated that sales of \$36 million were made. "Fact Sheet: Trade Opportunity Referral Service," USDA/FAS, July 12, 1978.

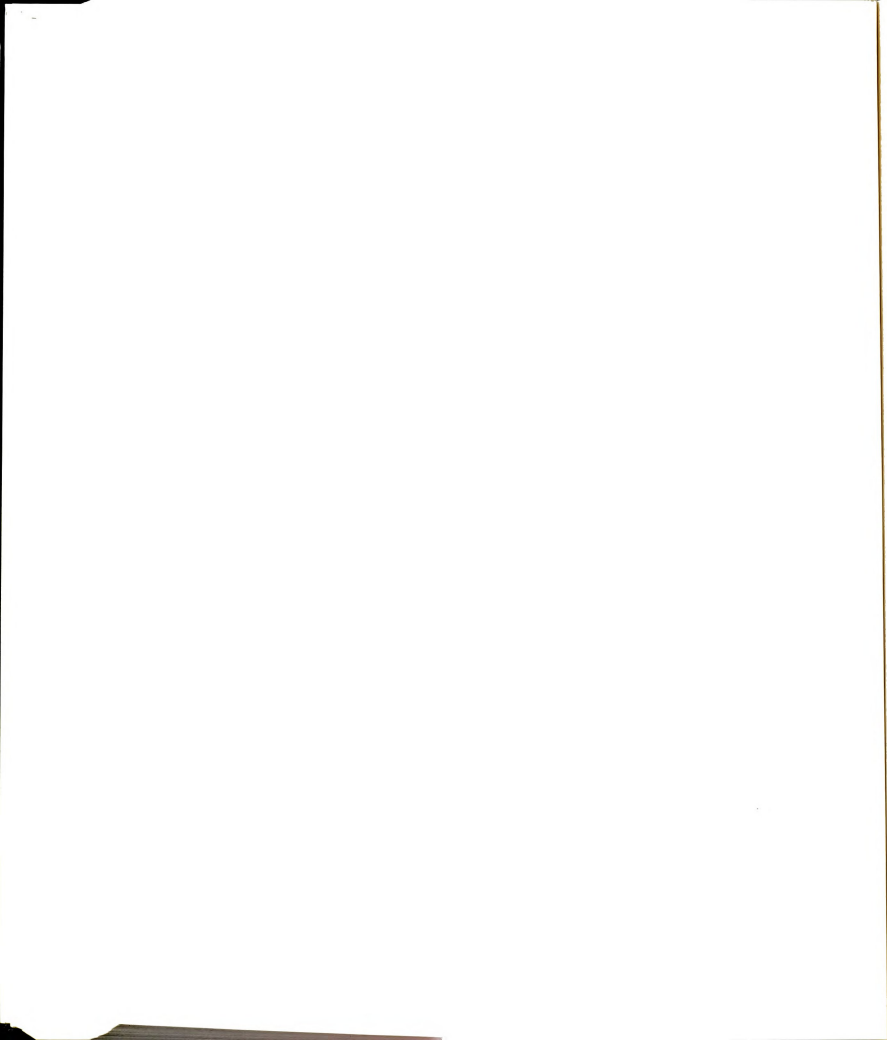


Alternatives to a CTIS include: use of agents or representatives to perform the market information function; purchasing access to the market information network of another exporter; or the establishment of foreign sales offices combining market information and sales functions, perhaps through some of the organizational arrangements which follow. In sum, the interdependence of sales and information functions limits the promise of a CTIS as a major opportunity for export coordination by cooperatives.

6.3 Cooperative Brokerage Organization (CBO)

A cooperative brokerage organization would put buyers and cooperative sellers together without taking title to any commodities. This option was judged unsatisfactory early in the research process. There are significant numbers of brokers currently trading all agricultural commodities. They engage in arbitrage between any sources of excess supply and demand. A cooperative broker would be forced to rely upon an ideological commitment on the part of buyers to secure commodities only from cooperatives. In the absence of evidence of such commitment, a CBO would be entering a competitive market at a competitive disadvantage in terms of ability to match demand with a wide range of potential supply sources.

Furthermore, a brokerage organization would not be involved in market development for the cooperatives involved. It would merely be another intermediary sharing in the final return to producers. Because there is no indication of potential advantages to buyers or sellers from a CBO, the option can be disregarded.



6.4 Cooperative Export Manager (CEM)

A cooperative export manager arrangement would involve one cooperative taking the lead and acting as the export department for other cooperatives' products. The arrangements would involve provision of marketing services for a fee. In some instances, the lead cooperative might provide patronage refunds to those making use of its services. In such cases, the distinction between a CEM and a multicommodity federated export cooperative (MFEC) would be that through the CEM, short term control would be vested in the lead cooperative while the MFEC would have more diffused control.

6.4.1 Sunland Marketing

An example of a cooperative serving as an export manager for another cooperative is provided by Sunland Marketing, Inc., a wholly owned subsidiary of SunMaid Growers of California. In addition to member produced raisins and apricots, Sunland handles domestic and export marketing of all of the production of Valley Fig Growers on a contract basis.¹ The arrangement gives Valley members access to a sales network which includes agents in 50 countries around the world without the need to support the fixed costs of its own marketing organization.

Sunland has a strong commitment to export market development and emphasizes the importance of being a reliable supplier to export customers. In order to assure allocation of supply among all customers on a fair basis it prefers to assume total domestic and export marketing responsibility for any new commodities it adds to its line.

¹Interview with Don Soetart, Executive Vice President, Sunland Marketing, Inc., August 6, 1979.

Expansion of the line of products marketed by Sunland has been limited to dried fruits and nuts. While some diversification has been the result of supplier interest, agent and sales representative demand has also provided the impetus to seek non-member produced commodities.¹

In the Sunland case, the CEM relationship provides a means for Sunland to cover some of its fixed costs with the commissions from sales of Valley products. It may also make Sunland a more important supplier through a fuller line of dried fruits and nuts. Furthermore, it reduces the marketing costs to SunMaid members.

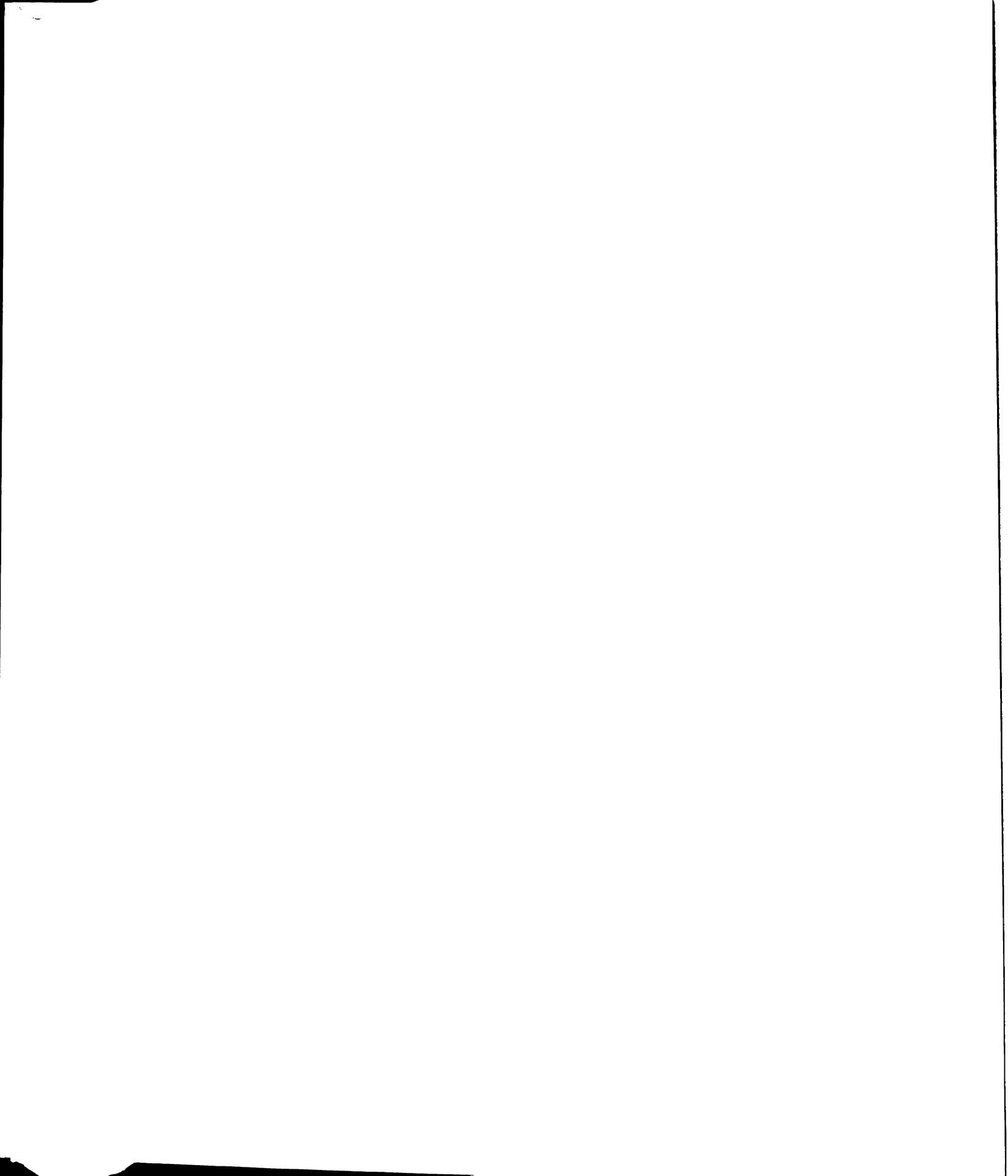
For Valley members, the CEM arrangement provides them access to a broader sales network than might otherwise be accessible given their size, and relieves them of the burden of investment in a marketing system. In exchange for these advantages, they pay commissions and give up some control over the marketing of their products.

6.4.2 CEM Compared to an Export Management Firm: A.E. Chew International

Useful parallels can be drawn between a CEM arrangement and traditional export management firms (EMF).² An export management firm will serve as a company's export department, performing a full range of functions, including market information, sales and financial arrangements in the name of the domestic company. In some cases, the EMF handles marketing world wide, in others it may handle exports to a single region.

¹ Interview with Mr. Koenig, Export Manager, Sunland Marketing, Inc., July 13, 1979.

² Some literature refers to export management firms (EMF) as Export Management Companies (EMC) or Combination Export Managers (CEM). These should not be confused with Cooperative Export Managers for which the abbreviation CEM is used here.



One such firm, A.E. Chew International, handles agricultural products, ranging from beans and popcorn to Tobasco sauce. Chew serves as Tobasco's export department. Invoices are prepared in the name of "Tobasco International" and collections are received and forwarded by Chew, acting as "Tobasco International." In other cases, Chew pays for goods in 30 days and takes over collections on its own account.¹

The ideal role of the export management firm would have it serving as the export department for a small number of companies with complementary, but non-competitive products. In reality, export management firms often diversify and handle a broad range of products from many supply sources and even trade for their own accounts. From the perspective of an EMF, complete dependence upon business from a limited number of accounts involves a sizeable risk burden. While new accounts often sign a six month to one year contract with an EMF, older accounts may cancel on 60-90 days' notice. Chew, for example, now does 70 percent of its business in trading for its own account.² This reduces the risk associated with loss of an individual client, but consequently it may decrease the incentives to be responsive to the needs of individual clients.³

6.4.3 Calavo Growers of California

Unlike the EMF, which maintains a distinct identity as the export department for each individual client, the CEM may be viewed as a means

¹Interview with Jerry Fonda, Regional Manager, A.E. Chew, International Group, April 19, 1979.

²Ibid.

³This is intended as a general comment and does not reflect any perceived behavior on the part of the firm used in the example.

to pull together client products in a single line. This can be illustrated through reference to the domestic marketing program of Calavo Growers of California. Calavo members are avocado producers, but the cooperative also markets a range of other commodities.¹ Calavo acts as the exclusive U.S. marketing agent for Alcot Farms Cooperative, a producer of kiwi fruit. This arrangement contributes to the ability of Calavo salesmen to offer buyers a line of 10-12 commodities on a truck. Economies in transportation and sales are achieved by Calavo. Commissions on kiwi fruit help to defray the marketing costs of avocados, and Alcot Farms gets access to a large and effective marketing network for a short season product at a relatively low cost. The marketing agreement between Calavo and Alcot Farms specifies a certain minimum volume to be marketed by Calavo. If production exceeds this minimum, Calavo agrees to try to market it, but is not required to do so.² This is one area where the potential disadvantages of loss of control of marketing may surface. Alcot Farms' members must evaluate benefits and potential costs in deciding to market through Calavo.

6.4.4 Producers International

Another type of arrangement between a lead cooperative and others could involve a CEM handling sporadic export sales for other cooperatives. The closest example to such an arrangement may be the experience of Producers International (PI), a domestic international sales

¹Calavo has separate marketing divisions for perishable commodities, dry fruit and frozen products.

²Interview with Eugene Royle, Vice President, Marketing, Calavo Growers of California, August 15, 1979.

corporation ("DISC") subsidiary of Producers Grain Corporation.¹ PI has had considerable involvement in the provision of technical assistance to the government of Algeria. As a result, it has had an office in Algeria, run by a PI employee, since 1974. This office has been used to make sales of sorghum (milo) and hard red winter wheat for PI. The contacts with state purchasing agencies have also opened up opportunities to sell durum wheat, dry edible beans and packaged consumer goods, such as breakfast cereal and canned vegetables. In this case, demand has provided the impetus for combining commodities, and PI has acted as more of an agent than a manager. Nonetheless, this type of arrangement might also be developed from the supply side, with potential users contracting for occasional representation through the sales organization of another cooperative.

In another case, PI has brokered occasional exports for a cooperative which handles some of the same commodities that PGC does. While not a regular arrangement, the user cooperative has chosen to become a member of PGC in order to receive patronage refunds on the business so handled.

While the previously mentioned caveats on the problems of sporadic export sales still apply, the CEM arrangement offers some potential for the novice exporter to test the profitability of export sales with limited commitment. It offers the lead cooperative an opportunity to cover some fixed costs as well. For the sporadic user of such a service, some comparison must be made with services available through foreign

¹Interview with Robert L. Boothe, Vice President of Business Development, Producers Grain Corporation; Senior Vice President, Producers International, April 23, 1979.

agents specializing in its commodities. They may be able to offer similar or better service at a similar cost.

6.4.5 The CEM Evaluated

The above examples indicate that cooperatives can participate in a CEM arrangement as leaders or users. For the leaders, a CEM presents the opportunity to make better use of an existing export marketing system and/or further develop it. For the user of a CEM, the potential advantage can be seen as presenting rapid access to a functioning export marketing system. The user has less control over export marketing, but the costs and risks associated with use of a CEM may be less than those involved in putting together an effective single product export program, especially for a smaller cooperative.

In assessing the desirability of participation in a CEM arrangement, it is useful to consider the potential commission costs involved. For an EMF, commissions on processed food products are generally about 10 percent of f.o.b. price. Where single sales are large, in the \$1 million range, or markets extremely competitive, EMF commissions may be reduced to the three percent range.¹ Under the assumption that a CEM would charge a ten percent commission, a potential exporter can project expected export sales in order to come up with an idea of potential costs of use of a CEM. This can be compared to the costs of development of an internal export department or participation in other export arrangements in order to get a first approximation of the export marketing opportunity set. On \$100,000 in annual export sales, ten percent

¹Interview with Fonda. It should be noted that the EMF pays commissions to foreign agents or representatives from its fee.

would provide a very limited budget with which to develop an export program. In contrast, with \$1 million in annual export sales, \$100,000 in commissions could support a limited export program. In the latter case, investigation of alternatives to a CEM would be warranted.

In evaluating the bases for coordination through a CEM, it is useful to recognize: 1) the potential for economies in the performance of export functions, especially market information, sales and transportation; 2) the potential to make use of a CEM for export marketing on a limited regional basis, even where other export arrangements exist; 3) the potential for the leader in a CEM to benefit from horizontal coordination where market opportunities exceed the leader's supply potential; and 4) the potential advantages to all participants from marketing a full product line (product extension coordination).

6.5 Multicommodity Federated Export Cooperatives (MFEC)

The specialized federated regional or interregional cooperative has become an increasingly important means for cooperatives to achieve maximum size economies in the performance of specific manufacturing or marketing functions. This section evaluates the potential for use of federated structures in coordinating export marketing. Types of coordination which can be achieved through a MFEC are discussed, as are the bases upon which such organizations could be developed. Cooperative experiences in the development and use of federated arrangements are used as case studies for evaluating MFEC potential.

The primary characteristic of a federated cooperative is that producers belong to associations which in turn belong to the federation. The management of a federated cooperative is guided by a board of

directors which is selected by representatives of producers, rather than producers themselves. This process has the advantage of being extremely open to producer input. The primary disadvantage is that diffused power can result in limitations on short term management flexibility. In domestic marketing, some cooperatives avoid this problem through a definition of roles which leaves the board of directors with responsibility for broad policy choices and the management with considerable autonomy in the pursuit of those policies. In discussing the cooperative manager's role with many managers, in the course of this research, views ranged from the role of the manager solely as an instrument for implementing board policies, to the manager as "czar," providing the board with his evaluation of desirable policy for its approval.

Despite considerable variability in the autonomy with which cooperative managers may make short term decisions, it can be generally stated that all members of a federated cooperative would have at least slightly greater opportunity to influence or control policies than they would as users of a CEM, mentioned previously. At the same time, a fundamental requirement for any successful business arrangement is that opportunities be provided for feedback and adjustment.

Export marketing involves risks and requires short term decision-making flexibility, just as domestic marketing does. The differences in the nature of those risks and decisions and the environment in which they must be made provides the impetus for the development of federated marketing arrangements specifically devoted to export marketing.

6.5.1 Possible Activities of a MFEC

A federated arrangement presents the opportunity for all four forms of coordination discussed previously.

Horizontal coordination in oligopolistic markets may provide the opportunity for smaller cooperatives to gain a large enough collective market share to improve competition in the market. In the grain trade, for example, Farmers Export Company is pursuing the position of third or fourth largest U.S. exporter not because this is necessarily the maximum size obtainable, but because its management feels that this will permit it to effectively compete with Cargill and Continental.¹

Vertical coordination through a federated cooperative is a means to develop the volume necessary to retain specialists to handle all export marketing functions. While commodity specialists are essential to any effective export sales organization, as was pointed out in Chapter 5, many functions are similar for a range of commodities.

A cooperative with limited volume or commodity mix may be able to find an individual who is capable of handling all of its marketing arrangements for domestic and export sales. Specialization might permit such an individual to concentrate his energies on those tasks where his comparative advantage lies, permitting achievement of even better service and higher returns to producers. Membership in a federated cooperative is one means of access to the volume necessary to support such specialization.

Product extension by a federated cooperative may generate the volume necessary for specialization through coordinated marketing of complementary commodities. Buyer transactions costs necessary to obtain a full line of related products can also be decreased as a result, thus

¹Interview with Jim Lepine, Vice President, Market Development, Farmers Export Company, April 26, 1979. (FEC is also engaged in coordination through product extension.)

making the MFEC a more attractive supplier. This might take the form of providing a full line of food grains, oilseeds, or feed ingredients; full lines of processed fruits, vegetables and other foods for retail, institutional or industrial markets; or other groups of related commodities.

Conglomerate coordination through a federated cooperative has the intuitive appeal of providing "one stop cooperative shopping" for foreign customers. The fundamental issue is whether such an orientation can be compatible with the MFEC members' individual overall marketing objectives. Conglomerate coordination may take the form of sporadic sales of unrelated commodities through an export marketing system or linkages among market development efforts for seemingly unrelated commodities on the basis of cross-subsidization, tie-in sales, use of internally generated capital and other sources of conglomerate power. Success at cross-subsidization among cooperatives would be made difficult by nature of their diffused internal power structures. The potential of joint sporadic sales efforts will be tied to the broader marketing goals of the individual cooperatives involved.

From this brief overview, some of the opportunities for various forms of coordination through a federated cooperative can be identified. It is also useful to survey the bases upon which individual federated arrangements might be set up. Cooperatives can probably expect little success with the latter by nature of their diffused internal power structures. Potential at the former will be tied to broader marketing goals. Federations formed on the basis of function may involve completely joint export marketing, or they may be developed only for the purpose of obtaining economies in the performance of individual or groups

of functions, such as representation, promotion, servicing, information, transportation and distribution, etc. Such arrangements are quite common in domestic marketing.

Supply based associations may develop as a result of region specific factors, such as use of a common port, or participation in regional promotion efforts. They may also develop based upon commodity related factors, such as seasonal marketing cycles, product line attributes and physical production factors such as the existence of joint products. It can be seen that there is some overlap here with functionally based factors.

Federated export cooperatives may also be developed on the basis of demand related factors. This may arise from similarity in geographical markets, buyer structure or organization. A federation established in order to deal with state traders would probably differ in commodity focus, organization and activities from another with sales targeted for retail customers.

6.5.2 Experience with MFEC Arrangements

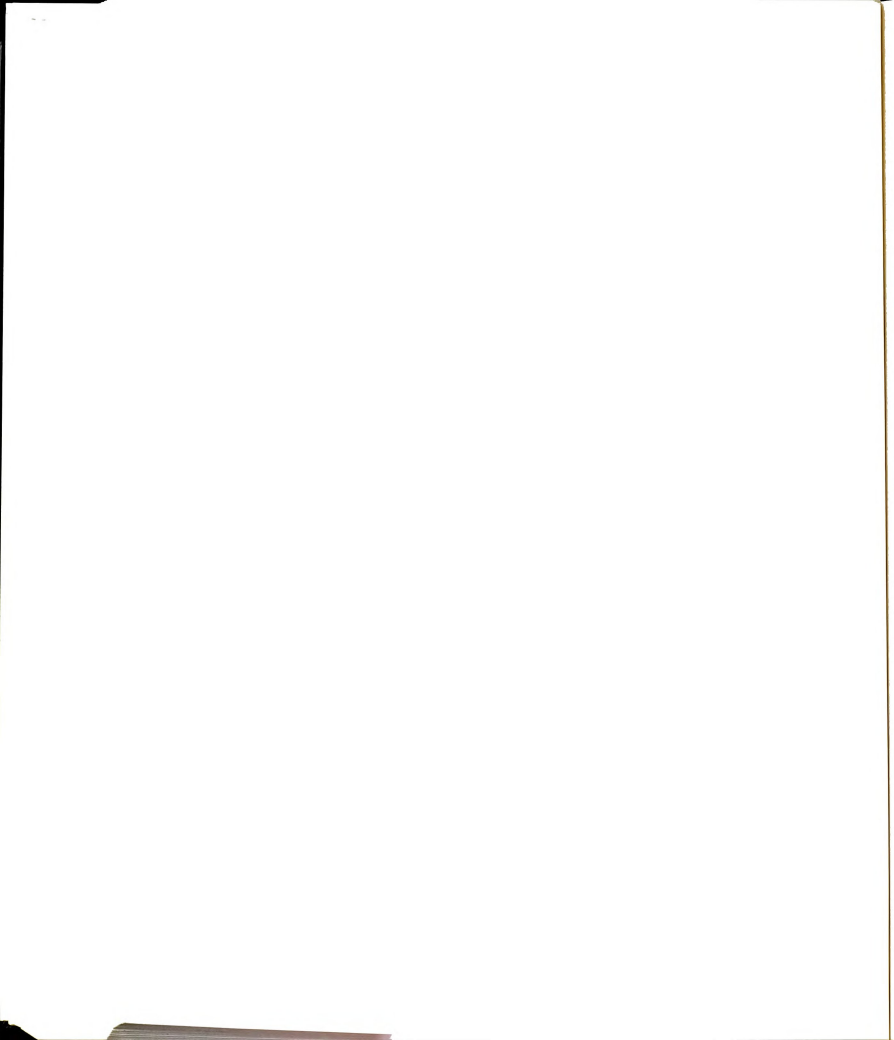
The above factors can be clarified through discussion of several cases in which cooperatives have developed MFEC arrangements. In the export of grains and oilseeds, there is over 20 years of experience with federated export cooperatives. In fruits and vegetables, there have been some limited attempts at MFEC creation, but none with the size and breadth of membership found in the following examples.

6.5.2.1 Producers Export Company¹

Producers Export Company (PEC) was established in 1958 by 19 regional cooperatives handling soft and hard wheats, rice, corn, other feedgrains and oilseeds. According to Reynolds, PEC was set up with five main objectives: 1) the development of export markets for grains and soybeans handled by cooperatives; 2) increasing the sales volumes of its member regionals; 3) providing members with information on the workings of the international grain trade and some measure of the margins obtainable through exports; 4) improvement of the bargaining position of regionals in sales to multinational grain traders; and 5) assisting regionals in expanding their control of port elevators.

PEC hired a general manager, set up an office in New York and attempted to establish itself as a national cooperative marketing agency while minimizing its risk exposure. The organization's risk averse strategy was best accomplished through back-to-back sales in which PEC became a principal, but only between delivery to the elevator and the end of the loading spout. Transactions most compatible with this strategy were sales to state traders, who would purchase shipload quantities on a f.o.b. basis, and PL 480 sales where the U.S. government paid for the grain on a f.o.b. basis. A small percent of PEC sales during its early years of operation were foreign port delivered, some of which were consummated by chartering "Liberty" ships.

¹This example draws heavily on: Bruce J. Reynolds, Producers Export Company: The Beginnings of Cooperative Grain Exporting, Washington: USDA/ESCS, 1980; and an interview with James Jordan, Vice President, Kansas City Operations, Union Equity Cooperative Exchange, April 25, 1979.



As noted earlier, state trading is involved in a larger percentage of procurement of wheat than for other grains.¹ PL 480 sales involved largely wheat, some feedgrains, but no soybeans. The importance of PL 480 sales ranged from 50 percent to 60 percent of PEC's total during 1958 to 1965, but fell to 43 percent in 1966.²

PEC never succeeded in providing competitive bids to all of its members' needs and commodities. In light of its operating methods, it is not surprising that cooperatives handling wheat accounted for a major share of the PEC sales volume. However, three cooperatives, Union Equity Cooperative Exchange, Producers Grain Corporation and North Pacific Grain Growers, accounted for most PEC volume, ranging from 80 percent in the first few years to 99 percent in 1967 and 1968.³

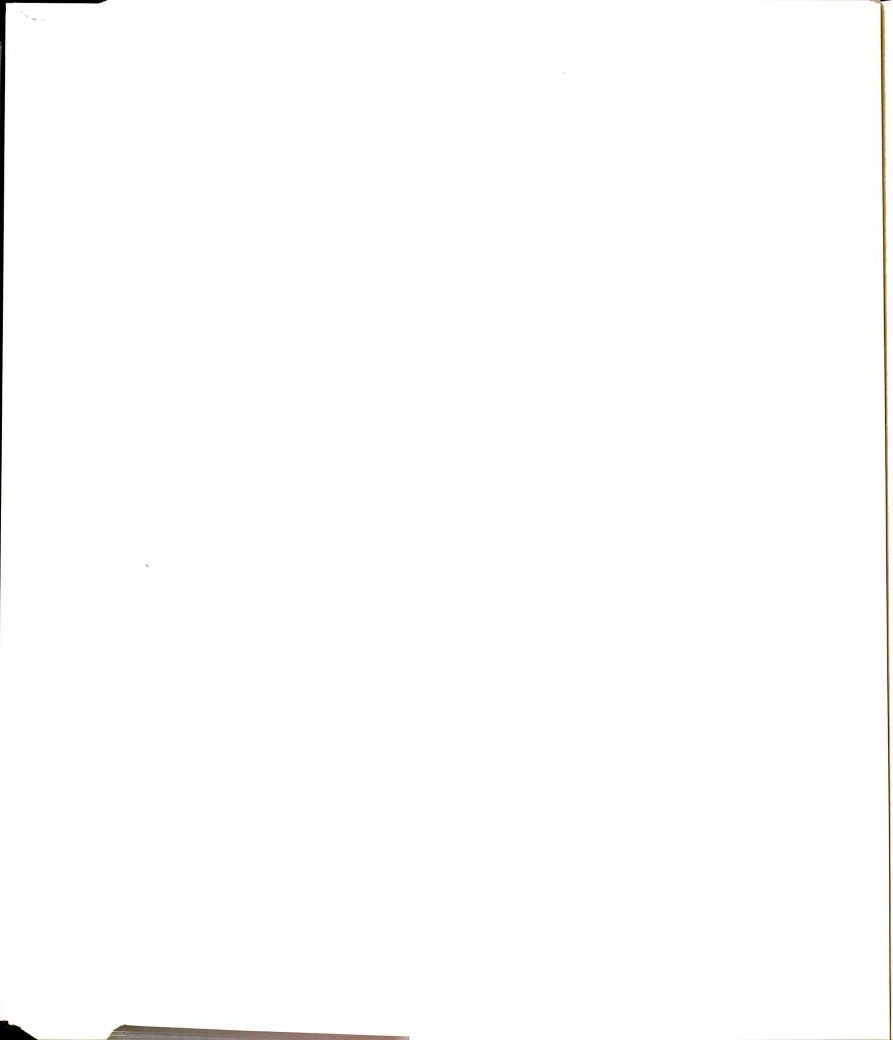
The importance of access to elevator facilities in the export of bulk grains and oilseeds was discussed in Chapter 5. Reliance on competitors for port elevators can result in substantial demurrage costs as well as limiting the ability to blend to minimum contract specifications. PEC had several short term leasing and throughput arrangements. Additionally, there were two attempts at joint participation in port elevator construction projects among (or by) PEC members.

In 1961, Union Equity tried to organize an interregional cooperative to jointly build an elevator at the Port of Houston. While meetings were held, other regionals from Nebraska, Kansas, Missouri,

¹In 1977-78, 90 percent of wheat procurement involved state trading, compared to 10 percent of coarse grain imports and seven percent of soybean and meal imports. Cook, et al., 1979. See Table 2.5.

²Reynolds.

³Ibid.



Oklahoma and Texas were unwilling to commit themselves to such a sizeable investment in light of their expected export volume to the Texas Gulf. Union Equity eventually build the facility alone.

In 1964, PEC formed a committee to study the feasibility of building an elevator on the Louisiana Gulf. In 1966, five PEC members and two non-members, Grain Terminal Association (GTA) and Tennessee Farmers Cooperative, formed a new interregional, Farmers Export Company (FEC) for the construction of an export facility at Ama, Louisiana, near New Orleans. The participating members did not want to rely on PEC as their sales agent. This led to the establishment of an independent export marketing organization for FEC. While PEC and FEC discussed merger for about a year (1968), they were unable to agree on centralized control of port elevators. In early 1969, FEC was dissolved.

Several implications for cooperative export coordination can be drawn from the PEC experience. First, the importance of avoiding significant differences in the level of attention to the interests of different members or groups of members should not be overlooked. PEC was set up with the intention of being a national cooperative export marketing agency. While it never achieved that goal, it could have been considered a success if it had been established to serve only the three cooperatives which it actually did serve. Where it is readily obvious that a new organization will be unable to serve the interests of members equally, it may be possible to establish different classes of membership which reflect such expectations. This could permit conditional membership subject to the attainment of certain medium or long term objectives by the federated organization.

Secondly, in attempting to coordinate major capital investments by cooperatives the examples cited above demonstrate the difficulties facing regionals in making commitments to projects for which their own members' potential use is uncertain. In both cases mentioned, an attempt was made to create a new interregional entity to participate in construction of port elevation. Other alternatives which might be considered are a lead cooperative making an investment in facilities while establishing long term contracts for their use with other cooperatives; or, a purchase-leaseback arrangement whereby one cooperative would own facilities, presumably for which its would be a major user, and then lease the facilities on a long term basis to a federated export cooperative of which is was part.

A third area, not discussed above, pertains to the linkage between product commitment and market information. PEC issued marketing reports to its member regionals detailing its export customers, intermediaries used in the performance of export functions and margins obtained. This information was a useful public relations tool for PEC and also for regional managers to use with their member locals. However, Reynolds points out that, "In some cases, the marketing reports may have even assisted some of the regionals in competing against PEC for export outlets"¹ (emphasis added). The above discussion indicated that PEC was incapable of being the exclusive export marketing outlet for its members. However, without some sort of product commitment or exclusive agency agreement with its members, any cooperative will be limited in the type of marketing program which it can successfully develop. An arrangement

¹Ibid.

based upon a first refusal option whereby members may proceed to compete with their joint organization invites the MFEC to bid away the margins required for the quality of its service to improve, or even stay the same.

6.5.2.2 Farmers Export Company¹

As mentioned in discussing PEC, Farmers Export Company (FEC) was formed in 1966 as a result of mutual interest among seven regional cooperatives in port elevator facilities on the Louisiana Gulf. It has since grown to include 12 regional and interregional cooperatives with the ability to originate a full line of grains and soybeans and arrangements for elevation on all U.S. seacoasts.²

In addition to its Ama, Louisiana facility, FEC is currently rebuilding an elevator at Galveston, Texas and remodeling an elevator at Philadelphia, Pennsylvania. When all are remodeled, rebuilt and functioning in 1980, FEC will have an annual shipping capacity of 14.5 million metric tons (550 million bushels), up from current capacity of 8.7 million metric tons (330 million bushels). Additionally, facilities are being leased on the West Coast.

FEC has its corporate headquarters in Overland Park, Kansas, a new office in Portland, Oregon, and an overseas sales office in Japan. Additionally, FEC has exclusive agency arrangements in 15 countries.

¹ Interviews with Lepine and Zeman.

² FEC members are: American Grain and Related Industries (Agri Industries); Far-Mar-Co, Inc.; Farmers Union Grain Terminal Association; Growmark, Inc.; MFC Services (AAL); Michigan Farm Bureau Services, Inc.; Missouri Farmers Association; Indiana Farm Bureau Cooperative Association, Inc.; Kansas City Terminal Elevator Company; Landmark, Inc.; Ohio Farmers Grain Corporation; and St. Louis Grain Corporation.

While a breakdown of FEC sales by commodity was not available, total figures indicate that grain marketed by FEC has increased from 4.2 million metric tons (157.8 million bushels) in 1972 to more than 14 million metric tons (531 million bushels) valued at \$2.4 billion in 1979.¹

FEC is developing expertise in the performance of most functions associated with the export process. FEC grain requirements are procured from members and others. Traditionally, members have had a first refusal option. In 1978, 70 percent of the grain handled by FEC was from its members. No statistics were available on the percentage of member export sales which were made through FEC.² While FEC President James Layton has been cited as underscoring the importance of a marketing strategy which considers average return more important than the return on individual sales, cooperatives handling wheat, feedgrains and soybeans have traditionally had much less formal supply relationships with their members than have cooperatives handling other commodities.

FEC makes sales to both multinational grain trading companies and a wide range of foreign buyers, including the USSR and China. Most FEC contracts are priced on the basis. Hedging decisions are made internally, with hedges placed through FEC members who are clearing members of the Kansas City and Minneapolis Boards of Trade, and through Illinois Commodity Futures Trading Cooperative on the Chicago Board of Trade.

¹Milling and Baking News, May 24, 1977; and "Farmers Export Volume Up 51% in 1979; More Growth Projected," Milling and Baking News, April 8, 1980, p. 52.

²In the 1977 prospectus for revenue bonds to finance the purchase of the Galveston Elevator by FEC, it was stated that, "The company's export terminal in Ama, Louisiana operated at full capacity for the last five years and management believes that during such period the Ama facility handled less than 50 percent of its members' exported grain." Milling and Baking News, May 24, 1977.

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Inland transportation arrangements are supervised by the FEC Traffic Director. Rail arrangements are made internally, although FEC owns no rail cars. Barge transport is handled by FEC members who are some of the owners of Agri-Trans, a cooperative barge company, or who otherwise negotiate for river transportation.

While three-fourths of FEC's 1978 sales from the Gulf and Philadelphia were f.o.b., there were increasing requests for c. & f. sales. Voyage charters of ocean freight are arranged by the FEC Vice President for Marketing Administration making use of a freight broker. Documentation is handled internally.

Arrangements for credit for sales other than those through CCC have been unnecessary. While FEC has been prepared to make arrangements for credit, interest rates in the U.S. have been higher than those in many importing countries, so that credit demand has not been particularly great.

Risk management includes both shorter term hedging and a longer term commitment of FEC management to market diversification. This strategy emphasizes increasing the number of markets dealt with rather than further broadened commodity focus.

FEC is pursuing a strategy directed at being an effective competitor in the high volume, standardized bulk grain trade. A part of that strategy is to improve its ability to have a commodity sales mix which more closely reflects the commodity mix handled by its members. FEC experienced a short term set-back in the pursuit of that goal when its Galveston Elevator was destroyed by an explosion in December 1977. Reconstruction in Galveston is expected to be completed in 1980, permitting

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FEC is a functioning example of a multicommodity federated export cooperative. Its growth exemplifies a commitment on the part of regional cooperatives to decrease their dependence upon multinational grain traders to market their members' products. The last three years have seen marked growth in FEC sales volume, facilities and membership. New management, headed by James Layton, has recruited personnel from private and public corporations and the grain trade, as well as cooperatives. FEC is expanding its expertise and developing experience in the performance of all export functions.

It is important to recognize that FEC did not reach its current position overnight. Its members have almost 14 years of experience in FEC as well as lessons learned in PEC to draw upon. Their learning and growing period is not over, and FEC management makes no pretense that it is. As increasingly sales are made on a c. & f. basis, the need for FEC to take a volume position in the freight market is expected to grow. This involves major risks, which can only be covered through increased volume.

One view from the FEC Board of Directors is that expansion should continue along the commodity lines currently handled.¹ To do otherwise, it is argued, would be a less than optimum allocation of the grain trading expertise and managerial talent which FEC is building. Thus, it appears that any more broadly based MFEC will have to arise elsewhere, at least in the near future.

¹ Interview with W. Gordon Leith, Member, FEC Board of Directors and Corporate Vice President, Farmland Industries, April 27, 1979.

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6.5.3 Future MFEC Potential

As the above examples indicate, an operational MFEC is currently developing among cooperatives handling grains and oilseeds. It does not include all cooperatives which handle commodities in that group and does not even handle all of the export volume of its members. Nonetheless, FEC is building its capacity to provide producers with a cooperative alternative through which to export grains and soybeans.

Among cooperatives handling other commodities, there is considerable opportunity for coordination through MFEC arrangements. There is already collaboration in promotion along commodity lines through the FAS cooperator program, and a number of export related joint ventures involving cooperatives handling processed fruits, nuts and vegetables which will be discussed in the next section. Several of these arrangements began as federated export cooperatives and evolved into smaller joint ventures. While explanations for such changes were not readily available, one reason given was that cooperatives with sharply different sales volumes have different marketing priorities which make collaboration through a federated sales organization difficult.

In developing a federated arrangement, control issues may influence the most advantageous size and membership. One cooperative leader suggested that limitation of the number of cooperatives in any federated or joint arrangement is important in order to be able to make decisions and move rapidly. Based on Agway's experience, six member cooperatives was suggested as an upper bound on membership which would preserve that flexibility.¹

¹Interview with Hiller.

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Thus, the MFEC may be best evaluated as an organizational form which could be used for the development of a number of federated export cooperatives. Such arrangements could arise based on functional, supply related or demand related factors. There might even be possibilities of further collaboration among MFECs where economies in the performance of functions, such as transportation, are obtainable at levels of volume which may exceed those necessary for economies in the performance of other functions.

6.6 Joint Ventures

A joint venture is defined by Hulse and Phillips as, "an association of two or more participants (persons, partnerships, corporations, or cooperatives) to carry on a specific economic operation, enterprise or venture, but with the identities of participants remaining apart from their co-ownership or co-participation in the venture."¹ Arrangements for sharing of expenses, profits, losses, risks and control are agreed upon by the participants. While many federated cooperatives would fall within this definition, the discussion here will focus on smaller multi-cooperative or cooperative-corporate partnerships and their potential as a mechanism for export marketing coordination.

The institution of joint ventures with corporations is quite important to cooperatives in domestic markets, particularly in food processing. Arrangements involving vertical coordination often permit one (usually the corporate) partner to take advantage of decreased procurement uncertainties while giving the other a share of returns on

¹Fred E. Hulse and Michael J. Phillips, Joint Ventures Involving Cooperatives in Food Marketing. (Marketing Research Report 1040; Washington: USDA, 1975, p. 2.)

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value added through processing, thus somewhat limiting the price and income risk of production.¹

6.6.1 Possible Joint Venture Activities

Joint ventures present the greatest potential for vertical coordination and product extension. To the extent that they can assist domestic competitors to become more effective overseas marketers, there is also some horizontal coordination potential.

Vertical coordination through joint ventures may permit cooperatives to obtain access to a functioning international marketing system on a more rapid and profitable basis than through development of such a system individually.

Product extension may present the opportunity for partners in a joint venture to become a more important collective source of supply than they would be individually. Additionally, economies of volume in the performance of many export functions may be achievable through product extension.

Horizontal coordination among domestic competitors in export marketing may offer access to export marketing economies as well as permitting development of the power to countervail oligopsonistic and monopsonistic procurement agencies, state traders and other importers.

Thus, the joint venture offers much of the same potential for coordination as a multicommodity federated export cooperative. In fact, the MFEC may be considered a subset of the class of joint ventures.

¹Domestic partnerships between cooperatives and corporations have been the subject of several studies, including: Ray A. Goldberg, "Profitable Partnerships--Industry and Farmer Co-ops," Harvard Business Review (March-April 1972): 108-121; and Hulse and Phillips.

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As noted above, they have been separated in this analysis so that discussion of joint ventures can focus on smaller cooperative partnerships and cooperative-corporate arrangements.

The principal bases upon which joint ventures may be established advantageously are functional or demand related. Functionally, the range of bases for coordination is the same as for a MFEC, and reflects the conclusions of Chapter 5 with respect to potential economies. Demand based ventures may take advantage of similarity in the organization of foreign demand, complementarity of demand for commodities handled, or the need to avoid being played-off against other suppliers by those possessing market power abroad. Supply based coordination also presents some opportunities for coordination of procurement and other functions.

6.6.2 Cooperative Experience in Joint Ventures

In evaluating joint venture prospects, it is useful to discuss the experience of two cooperative partnerships, California Valley Exports and Diamond/Sunsweet. Additionally, the recent development of a cooperative-corporate partnership in Toepfer International may be instructive.

6.6.2.1 California Valley Exports¹

California Valley Exports (CVE) is a joint venture export sales company established in 1970 by Tri/Valley Growers and California Cannery and Growers, two major West Coast cooperatives. CVE handles export sales of processed fruits and vegetables to retail, institutional and industrial buyers throughout the world.

¹Interview with Rideout; and interview with William Allewelt, Jr., President, Tri/Valley Growers, August 6, 1979.

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CVE was developed in order to countervail buyers' ability to play its two owners off against each other in West European markets. Prior to the formation of CVE, each cooperative maintained its own agents and representatives in Europe. Facing destructive competition against each other in those markets, but desirous of remaining competitors domestically, a joint venture offered the opportunity to compete profitably abroad.

As their markets developed throughout the world, Tri/Valley and Cal-Can found themselves again positioned against each other in the Japanese markets. In 1976, CVE was expanded from its regional focus and given responsibility for marketing throughout the world.

Each year, the management of CVE prepares a marketing plan and submits it to its parent cooperatives. Each cooperative assesses its capability to supply 50 percent of the volume necessary to fulfill that plan. It decides to make a commitment to supply a certain percentage of the plan, but may re-evaluate that commitment during the packing season. Where CVE's owners are unable to fill its marketing needs, it goes to other cooperative and proprietary processors to supply them. CVE is limited in the amount of non-member business which it can conduct by the need to retain its tax exempt cooperative status, however.

CVE sells to about 250 customers, both directly and through a system of 10 agents, most of whom handle retail, institutional and industrial markets. One European agent works exclusively with industrial customers. While export sales make up only 5 to 8 percent of the total sales volume for each of the owners of CVE, that amounts to \$20 to \$30 million annually.

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This permits supporting an office staff of 8 to 10 export specialists who perform most functions associated with the export process. CVE is a member of PACE, which negotiates freight rates with ocean shipping conferences. Most CVE sales are priced on a c. & f. basis in order to take advantage of economies in freight procurement. Because of the volume shipped by CVE, a commercial freight forwarder has located a representative in the CVE offices. This results in personalized service as well as access to the forwarder's own network of worldwide contacts.

Market information is obtained through agents, visits to customers one or two times annually and industry connections. USDA reports are received, but many in the industry are of the opinion that they are distributed too slowly to be useful in trading.

At one time, another cooperative, Pacific Coast Producers, also participated in CVE. It was much smaller than the other owners and had different marketing needs. CVE management found the disadvantages of dissimilar interests to outweigh the advantages of the increased volume contributed by the third participant. Thus, that arrangement was terminated.

Nonetheless, there is considerable interest in diversification and further development by CVE. A major portion of CVE volume has been fruit cocktail and canned cling peaches. Increased product diversification is seen as a means to increase volumes and even out product flows in order to make better use of personnel. It would be more conducive to achieving greater transportation and informational economies. Tri/Valley President William Allewelt, Jr., has suggested that ideally, CVE could serve as a central agency for exports of California cooperatives' agricultural commodities and speciality products. While noting that this

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goes against an industry tradition of exporting independently and selling on a f.o.b. basis, Allewelt comments that such a move would yield even greater exporting economies.

CVE customers are extremely large purchasers of canned goods who would benefit by dealing with a single source of supply for a full line of canned fruits and vegetables. In terms of a diversification path for CVE, Manager Percy Sideout suggests that canned fruits and vegetables are quite compatible. Dried fruits are closely aligned with canned in case size and handling, while frozen fruits and vegetables tend to differ from canned and dried in the departments handling them, the buyers involved and specialized shipping requirements. Much frozen volume is shipped in bulk quantities and repackaged abroad.

CVE activities include both horizontal and product extension coordination. While the original basis for its development was horizontal coordination to avoid destructive export competition, the achievement of economies in export marketing has provided the impetus for product extension. Further extension into dry fruits and tree nuts may further complement this process.

An interesting development which may affect the future activities of CVE is the 1978 acquisition of S&W Fine Foods by Tri/Valley. S&W has an annual export volume of about \$15 million and sells a branded commodity with considerable good will developed for its brand name. It is expected that S&W will benefit from shipping cost advantages of CVE, but the export marketing functions have remained separate.

The issue of brands and trademarks is somewhat complicating in a joint venture where members have their own brands and have invested in their promotion overseas. Because of economies in promotion, it would

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appear to be advantageous for a joint arrangement to export a common brand or a full line under a common brand (although exports are often packed under private labels). Nonetheless, agreement on the choice of a common brand; whether it is irrevocably assigned to the joint venture; and contingencies in the event of dissolution, must all be dealt with. CVE has not yet resolved these issues. In light of the availability of government incentives for branded promotion overseas through the FAS Export Incentive Program, it may be forgoing some possible advantages as a result.

6.6.2.2 Diamond/Sunsweet¹

Diamond/Sunsweet is a cooperative marketing association which was formed in 1975 to handle domestic and export marketing for Diamond Walnut Growers association, Inc. and Sunsweet Growers, Inc.

Through this arrangement, the two cooperatives share overhead costs on facilities, pools, etc. Exports account for about 25 percent of Diamond/Sunsweet's total sales volume, or about \$50 million annually. Export sales are handled by an internal staff of three full-time exporters who work through a system of 60 foreign agents distributors, brokers and manufacturers representatives as well as making sales directly to foreign customers. Internal personnel also arrange transportation and documentation.

The products handled by Diamond/Sunsweet include: walnuts, prunes and assorted dried fruits, some of which are marketed for another cooperative.

¹Interviews with: George H. Funk, Senior Vice President, Marketing and Sales; John F. Huber, International Marketing Director, August 9, 1979 and Leonard Sletten, Export Sales Manager, July 16, 1979, Diamond/Sunsweet, Inc.

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Export market development has been quite important to both Diamond and Sunsweet because production is increasing, but domestic usage of walnuts and prunes has been rather static.

The joint marketing arrangement permits producers of both commodities to get greater sales attention on a seasonal basis than would be justifiable by their individual sales volumes. The joint marketing and distribution arrangement also permits customers to contact a single supply source and receive all products on a single invoice. Diamond and Sunsweet growers have achieved higher returns and pay lower sales costs on a per ton basis as well. In addition to sharing agents and sales personnel, costs for services such as data processing are also shared.

Overseas promotion activities jointly promote both Diamond and Sunsweet brands. This is supported in part by the FAS Export Incentive Program. Brands are found to be important in retail markets, but price is a larger factor in sales to industrial importers.

The future development of Diamond/Sunsweet in export marketing is expected to include further broadening of its product line. International Marketing Director John Huber feels that a single salesman can handle at least four or five complementary commodities with equal or greater success, and at a lower cost per ton than he could a single commodity. He further points out that while marketing of mainly "branded grocery products" can be combined advantageously, it is essential to provide adequate staffing and commodity expertise to be able to obtain those advantages. Finally, he notes that an effective marketer must have control over product supply. Diamond/Sunsweet, for example, is the exclusive marketing agency for its members' production, and thus is able to make

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6.6.2.3 Alfred C. Toepfer International

Six American cooperatives announced an agreement to set up a joint venture with four European cooperatives and Alfred C. Toepfer Verwaltung-G.m.b.H. of Hamburg, West Germany¹ in mid 1979. The cooperatives have agreed to purchase a 50 percent interest in the commodity trading portion of the Toepfer organization for about \$40 million.

While this organization is also an example of international cooperative coordination, a subject which is currently under study in a project at Texas A&M University,² it is useful to mention it here as an example of potential cooperative-corporate partnerships in exporting.

The Toepfer organization has been involved in the trade of grains, oilseeds and products and major feed ingredients since 1919. It now operates in every major grain exporting nation and most major importing nations. In the year ended July 31, 1976, the Toepfer organization volume was \$5.5 billion with 17.4 million tons of grains, oilseeds and feed ingredients handled, and after tax profits of \$17.8 million. While the joint venture with cooperatives is confined to commodity trading interests, the Toepfer organization includes feed mills, ocean vessel

¹The American cooperatives involved are Gold Kist, Inc.; Agway, Inc.; Citrus World, Inc.; Land O'Lakes, Inc.; Landmark, Inc.; and Indiana Farm Bureau. The European cooperatives are Cebeco-Handelstaad (Rotterdam, The Netherlands); Deutsche Raiffeisen-Warenzentrale-G.m.b.H. (Duisburg, W. Germany); and Union Nationale Des Cooperative Agricoles De Crex Cereales (Paris, France). Feedstuffs, June 18, 1979.

²Knutson, et al., forthcoming.

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ownership, an ocean freight chartering business, a grain elevator in Hamburg, a private banking firm and farming interests.¹

The joint venture links Toepfer with U.S. sources of supply for grains, oilseeds and feed ingredients, while giving the cooperatives access to an international trading network with offices, experienced personnel and the ability to provide data and information on market conditions and trade possibilities around the world.

While all of the U.S. cooperatives which are participating in the organization have some interest in grains, oilseeds and/or feed ingredients, three members, Land O'Lakes, Agway and Citrus World, all have considerable interests which would benefit from any expansion of activities into processed and branded commodities. Current plans are for the commodity orientation to remain limited to trade in bulk ingredients for the next several years, however.

The available information on plans for Toepfer International is limited. Participants were reluctant to discuss the venture during most of the period during which this research was being conducted. At one point, an option was discussed whereby cooperatives would be able to participate in Toepfer International on either an equity or conditional basis, with the latter status subject to conversion to an equity status if the venture were successful in further broadening its commodity focus. It is not known whether or not the final agreement includes participation on one or both bases.

¹"Toepfer 'Builds Bridges Through Trade'," Milling and Baking News, June 7, 1977, pp. 1, 68-78.

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In any event, this joint venture has given cooperatives a share in a functioning international trading system with the ability to source commodities from anywhere in the world. Membership includes both exporting and importing cooperatives, as well as the Toepfer traders who are interested in arbitrage, but whose importing country base gives them somewhat of a procurement focus. This may be a good complement to U.S. cooperatives' origination capacity.

While there may be economies in purchasing a share of a functioning trading organization as opposed to trying to build one from the ground up, there are deep philosophical disagreements among cooperatives as to the advantages of each choice of strategy. Some members of FEC, discussed earlier, are committed to building from the ground up. They feel that control of an organization will be more firmly in their hands through such an approach, even if there is some sacrifice in the rate at which their volume and net margins grow.

The participants in Toepfer International have decided that the most attractive approach to entering the world grain trade is to acquire a going concern. U.S. cooperatives involved in trade in bulk commodities have been extremely hesitant to expose themselves to the risks of c.i.f. sales and handling commodities of non-U.S. origin. Through acquisition of a part of Toepfer, they can share those risks with experienced personnel while gaining access to a network capable of supplying commodities from multiple sources and working in international markets.

Toepfer International has not been in existence long enough to permit evaluation of its success. Also, it is premature to further speculate on its future. This discussion should be adequate to indicate that cooperative-corporate joint ventures offer one means of gaining access

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to an export marketing system on a relatively rapid basis. There are trade-offs in terms of the ability to control objectives, policies and the direction of growth which must be dealt with. However, the ultimate goal of seeking means to increase the average return to producer members of cooperatives over the longer term must not be lost sight of in evaluating the potential of options which were not built entirely by the cooperative itself.

6.6.3 Joint Venture Prospects

The above examples indicate some of the opportunities for use of joint ventures to develop the critical mass necessary to take advantage of functional economies in the export process, particularly in transportation, information, sales, financial factors, risk bearing and management.

Cooperative partnerships offer much promise as do cooperative-corporate arrangements. Potential collaboration with corporate marketers has not received much attention in export sales of processed food products. Many major concerns have substantial sales overseas. Some also have significant overseas investment in production and processing. To the extent that such investments reduce emphasis on increasing U.S. produced exports, there may be a fundamental conflict of objectives which could prevent satisfactory development of export related joint ventures. Thus, a corporation such as Del Monte may be ambivalent toward reducing transportation costs to Europe from California if it also has sources of supply for substitute products from South Africa, Italy or Greece.¹ The

¹Even more so if its conglomerate parent also owns a shipping line, as is the case with R.J. Reynolds ownerships of both Del Monte and SeaLand.

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potential for corporate-cooperative collaboration may exist, but similarity of interest must be carefully examined.

Joint ventures present the opportunity for coordination where mutual interests are compatible, whether partners are cooperative or corporate. A useful mechanism in establishing such arrangements for export is the Webb-Pomerene Act, which will be discussed next.

6.7 Webb-Pomerene Associations

Under the Webb-Pomerene Act¹ U.S. firms are permitted to form export trade associations which agree upon export prices and allocate foreign markets with limited antitrust immunity, provided that they do not interfere with domestic competition. This mechanism for coordination of export marketing appears to be somewhat less familiar to many cooperative managers than arrangements discussed above. This section presents an overview of the act, its rationale and use, with special emphasis on permissible conduct and cases of cooperative participation in Webb-Pomerene Associations. This will contribute to an assessment of the potential usefulness of such associations in cooperative export coordination.

In reviewing the legislative background of the Webb-Pomerene Act, Supreme Court Justice Thurgood Marshall wrote that, "Congress...thought it could increase American exports by depriving foreigners of the benefits of competition among American firms, without in any significant way injuring American consumers."²

A Federal Trade Commission (FTC) staff report described Congressional intent as primarily directed at helping small firms which would be

¹Export Trade Act of 1918, 40 Stat 516, as amended; 15 U.S.C. 61-66.

²U.S. versus Concentrated Phosphate Export Association, Inc., et al. 393 U.S. 208 (1968).

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financially unable to conduct individual export programs and exporters facing foreign cartels.¹

The concern in this research is with the extent to which the act can be used by cooperatives as an export coordination mechanism. Such analysis requires an overview of permissible and prohibited conduct under the act as well as a brief review of past performance.

6.7.1 Permissible Activities

Normal activities permitted under the Webb-Pomerene Act were listed by Judge Wyzanski in his decision of a case involving Durex Abrasives Corporation, a Webb-Pomerene Association.² These included:

1. recruiting four-fifths of the firms in an industry into one association;
2. assignment of stock in an association according to quotas or member production;
3. commitment of members to use the association as their exclusive foreign outlet;
4. refusal of the association to handle the exports of American competitors;
5. determination of quotas and prices at which each member should supply products to the association;
6. fixing resale prices for foreign distributors; and
7. limiting foreign distributors to handling only member products.

¹Federal Trade Commission (FTC), Webb-Pomerene Associations: A 50-Year Review (Washington, D.C.: Government Printing Office, 1967), p. 4.

²U.S. versus Minnesota Mining and Manufacturing Company, et al., 92 F Supp, 965 (1950).

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6.7.2 Restricted Activities

Under the terms of the act, Webb-Pomerene Associations are not permitted to: 1) restrain trade in the U.S.; 2) restrain the foreign trade of any domestic competitor of the association; or 3) artificially or intentionally influence prices within the U.S.¹

In a decision involving the Alkali Export Association, the court held that this latter prohibition made it illegal for producers to use the export association to stabilize domestic prices through removal of its members' surplus production from the domestic market.²

However, the inevitable restraint which may accompany a successful association was held to be permissible in the Durex Abrasives case.

Judge Wyzanski stated:

Now it may very well be that every successful export company does inevitably affect the foreign commerce of those not in the joint enterprise and does bring the members of the enterprise so closely together as to affect adversely the members' competition in domestic commerce. Thus every export company may be a restraint. But if there are only these inevitable consequences, an export association is not an unlawful restraint. The Webb-Pomerene Act is an expression of Congressional will that such restraint shall be permitted. And the courts are required to give as ungrudging support to the policy of the Webb-Pomerene as to the policy of the Sherman Act. Statutory eclecticism is not a proper judicial function.³

Judicial interpretation has indicated several other forms of restricted conduct. In the Durex case, it was held that while members could agree to export only through an association, they could not use the association to halt exports to market areas which members could

¹15 U.S.C. 62.

²U.S. versus United States Alkali Export Association, et al., 86 F. Supp. 59 (1949).

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supply more profitably from foreign production facilities.¹ Price fixing in conjunction with foreign competitors was ruled unlawful in the Alkali Export Association case.²

Furthermore, the court held that while agreements not to withdraw from an association or at least not to export independently could be made in the interest of stability, reasonable provision for withdrawal must be provided. In Durex, the court suggested one to two years as a reasonable period for written notice of withdrawal based on the longevity of that association.³

Court interpretation has prohibited the use of Webb-Pomerene Associations in the transactions "initiated, controlled and financed by the United States Government (even where)... a foreign government is the nominal 'purchaser.'"⁴ This, in effect, prevents associations from being used to bid on U.S. foreign assistance procurement. The justification is that such sales are not exports, since "the burden of non-competitive pricing (falls), not on the foreign purchaser, but on the American taxpayer..."⁵ Use of Webb-Pomerene Associations in bidding on PL 480 contracts is also precluded.

¹Ibid.

²86 F. Supp. 59 (1944).

³92 F. Supp. 966.

⁴United States versus Concentrated Phosphate Export Association, Inc., et al., 393 U.S. 199 (1968).

⁵Ibid.

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6.7.3 Use of Webb-Pomerene

Having set forth some of the legal limitations on conduct by Webb-Pomerene Associations, it is useful to briefly consider the use of this coordination mechanism during the 62 years since passage of the act. A 1978 FTC staff study found that only 1.5 percent of total U.S. exports sales, \$1.725 billion, were assisted by Webb-Pomerene Associations in 1976. This compared with 2.3 percent, or \$499 million, in 1962.¹

In 1978, there were 32 associations registered with the FTC, compared with 46 associations in existence for some or all of the period 1958 to 1962, and treated in an earlier FTC survey.² Associations are not limited to handling agricultural commodities. In 1958-62, 13 associations dealt in farm products.³ It appears that nine of the 32 associations registered in 1978 handled agricultural commodities.⁴ Only three of the more recent group of agricultural exporters were registered during the earlier survey.

Past hesitancy to use Webb-Pomerene Associations apparently stems in part from ambiguity in the roles of the Federal Trade Commission and Department of Justice with respect to the antitrust exemption of the act.⁵ A 1973 Government Accounting Office study concluded that,

¹Federal Trade Commission, "Webb-Pomerene Associations: Ten Years Later: A Staff Analysis," (mimeographed), November 1978, p. 15.

²FTC, 1967.

³Derived from FTC, 1978, Appendix C.

⁴David A. Larson, "An Economic Analysis of the Webb-Pomerene Act," Journal of Law and Economics 13 (1970): 465.

⁵In *U.S. versus U.S. Alkali Export Association, Inc.*, 58 F. Supp. 785 (S.D.N.Y. 1944) the court held that the powers conferred by Section 5 of Webb-Pomerene are merely auxiliary and thus did not interfere with Department of Justice action.

Justice's authority to pursue criminal prosecution under the antitrust laws regardless of whether FTC has first made an investigation and recommended, as provided for in the act, that the association adjust its practices, creates in U.S. business a fear of antitrust prosecutions and thus acts as an impediment to formation of export trade associations.¹

6.7.4 Association Activities

As the act was initially interpreted, only joint sales associations were considered to qualify for Webb-Pomerene exemptions. However, in 1924, the FTC issued the "Silver letter" which considerably expanded the scope of activities for which an association could be established. The letter stated that "the test of legality lies in result in most instances rather than in form or method pursued."²

Economic analysts have not always recognized the potential benefits obtainable through use of Webb-Pomerene Associations for activities other than joint sales. Larson, for example, purported to test factors associated with association success, defined as establishment of a joint sales agency with association exports exceeding those of any single member. He found that industry concentration and product homogeneity were significantly associated with his definition of success.³ While this ignores factors associated with the achievement of other benefits through Webb-Pomerene Associations, it is useful if interpreted as factors associated with success in establishing joint sales arrangements.

Webb-Pomerene Associations' activities can range from joint export marketing to collaboration in the arrangement for or performance of

¹U.S. General Accounting Office, "Clarifying Webb-Pomerene Act Needed to Help Increase U.S. Exports," (Washington, D.C.: Government Printing Office, 1973), p. 10.

²Federal Trade Commission, "Letter to the Silver Producer's Committee," July 31, 1924, cited in FTC, 1967, pp. 15-16.

³Larson, op. cit., pp. 468-469, 479-480.

individual export marketing functions discussed in Chapter 5. In 1978, the FTC collected data on activities performed by 26 associations during 1976. Table 6.1 indicates the number of associations performing individual activities. Each activity is classified according to the functional breakdown presented above. Many associations perform multiple functions. This information presented is indicative of the types of activities which members find useful, but does not reflect qualitative differences in the functions performed by different associations.

Among the associations polled in 1976, 14 conducted exports in their joint name. Eleven engaged in negotiation of shipping arrangements; this included freight consolidation, rate negotiation and ship chartering, both for individual association member exports and in the association's name. Eleven other associations shared export market research and analysis.¹

An improved understanding of the potential for use of Webb-Pomerene Associations for functional coordination can be gained through a look at some of the associations in which farmer cooperatives participate.

6.7.5 Cooperative Participation in Webb-Pomerene Associations

Cooperatives participate in a number of export trade associations. This section presents brief sketches of the activities of some of these associations.

6.7.5.1 California Avocado Export Association²

California Avocado Export Association (CAEA) has five members including Calavo Growers of California, a cooperative. In addition to

¹FTC, 1978, p. 11.

²Interview with Eugene Royle, Vice Chairman, CAEA and Vice President, Marketing, Calavo Growers of California, August 15, 1979.

TABLE 6.1. FUNCTIONS PERFORMED BY WEBB-POMERENE ASSOCIATIONS - 1976

| Function | Activity | Number of Associations Performing |
|--|---|-----------------------------------|
| Transportation and Physical Distribution | Freight consolidation / rate negotiation / ship chartering | 11 |
| | Foreign storage or distribution facilities | 2 |
| Market Information | Market research; analysis of export markets | 11 |
| | Statistical services | 8 |
| Sales | Exports in name of association | 14 |
| | Sales agent from offices within U.S. | 8 |
| | Sales agent from foreign sales offices or through foreign sales agents | 6 |
| | Cooperative bids or negotiation of sales with foreign governments / international organizations | 5 |
| | Sales to U.S. for delivery outside the U.S. | 0 |
| | Allocating business among members | 3 |
| | Setting prices | 8 |
| Financial | Credit information and collection facilities | 8 |
| Documentation | Uniform rules, terms of sale, or contracts | 6 |
| Regulatory | Monitoring U.S. legislation and regulatory activities | 4 |
| | Monitoring foreign legislation and regulation | 3 |

Based on: FTC, 1978, p. 12.

being a Webb-Pomerene Association, CAEA is a non-exempt federated farm cooperative. The association functions as a joint market development and sales agency for members' exports to Japan and Hong Kong. Members use a common export brand, AVOCAL, and coordinate market information, promotion, pricing, sales and shipping. The manager is a hired employee of the association. He makes sales for members, preparing c.i.f. price quotations based upon members' agreement on a monthly f.o.b. packing house price. Sales are allocated by the manager on the basis of availability of product.

Association members benefit from marketing economies in information, promotion, sales and transportation. At the same time, they avoid cut-throat competition and disorderly marketing, both of which could be particularly destructive to marketers of fresh produce. One purpose of the association is to develop market outlets for production from increasing California avocado acreage. While members of CAEA handle other commodities, the organization currently deals only in avocados. Trials to test the physical compatibility of avocados and citrus in shipments to the Far East have been conducted by CAEA. These may eventually lead to some coordination with marketers of other commodities.

Some members also coordinate marketing in Western Europe, but the primary objective of CAEA is to jointly market in Japan and Hong Kong. This is an example of the use of Webb-Pomerene as a mechanism for joint market development. Where promotion is directed at encouraging consumption of a standard grade of California avocado, individual shippers would find it difficult to capture the benefits of such activity. Joint action by those handling a major market share provides the incentive to develop markets by decreasing the potential for "free riders."

6.7.5.2 Citrus Shippers United¹

Citrus Shippers United (CSU) is an association of 29 cooperatives and corporations which coordinates marketing of members' fresh citrus in Western Europe.

Most sales in European fresh fruit markets are made on a consignment basis. As a result, the European market is more risky, and often less profitable for California citrus producers than are some other export markets. The risks are compounded by: 1) high transportation costs; 2) competition from state marketing agencies which can maintain themselves in a market at prices below production costs; and 3) bad planning and lack of coordination among U.S. shippers which have sometimes led to extreme buyer bargaining advantage when five or six vessels carrying California citrus arrive in a port simultaneously.

In an effort to make sales to Western Europe more profitable, CSU was formed in 1977. CSU is set up to perform a full array of export marketing functions, with Pure Gold, Inc., a cooperative, and Riverbend Farms, Inc., dividing administrative responsibilities. The overall objective of CSU is to provide for orderly and profitable marketing of California citrus in Europe.

Achievement of coordination economies is seen as a benefit to growers, shippers and consumers. Transportation economies are achieved through vessel chartering and coordinated container shipments. Economies in sales are sought through common use of a panel of European marketing representatives and a joint brand label. Physical risk bearing is handled through common insurance standards and a self-insurance scheme

¹Interview with Neu.

to cover fruit decay. CSU has a paid representative who meets shipments in Europe to monitor the quality of fruit on arrival. This helps to assure that quality standards are upheld as well as preventing fraudulent damage claims which increase costs of risk coverage. Documentation and financial functions are also coordinated through CSU. Smaller shippers get access to marketing expertise which would be too costly on an individual basis.

CSU was established to handle marketing activity in only one region of the world. Its members also have considerable trade with the Far East. The Far East market has been more profitable on a per carton basis than Europe has been in past years. CSU was, in effect, set up to increase the profitability of the marginal market. Heavy frost damage to California's citrus crop in 1978-79 resulted in severe curtailment of total production. As the least profitable market, sales to Europe have been severely reduced by all California producers. This makes the future of CSU quite uncertain.

Nonetheless, CSU exemplifies the potential use of a Webb-Pomerene Association as a vehicle for reducing export marketing costs to cooperatives which do not handle a majority share of total U.S. production. It should be noted that in trying to develop a low margin market, total withdrawal during small crop years may necessitate substantial organizational rebuilding costs in order to re-establish former ties and market position in the next normal production season.

6.7.5.3 Northwest Fruit Exporters¹

Northwest Fruit Exporters (NFE) is an association of 25 Washington and Oregon cherry shippers which is developing exports to Japan. As

¹Interview with Lay; and "Fresh Northwest Cherries on Way to Japan," The Goodfruit Grower, July 1, 1979, pp. 1-2, 10.

noted in Section 5.9.4, the group was formed to serve as an organized negotiating medium recognized by Japan. Prior to 1978, no fresh Pacific Northwest cherries had been permitted to enter Japan due to fear of infestation by coddling moths. NFE successfully demonstrated that fumigation with methyl bromide is effective in eliminating danger to the Japanese industry from coddling moths and the Western cherry fruit fly, and exports began in July 1978. The association is making progress in market development. Its exports to Japan grew from 140,000, 20 pound cartons in 1978 to 225,000 cartons in 1979.

NFE acts as a sales agency, setting prices and assigning quotas to members. It collects a 50 cent per box assessment which, among other things, pays for the costs involved in having a Japanese inspector present for fumigation and packing. This would be too costly for all but the largest individual shippers.

In addition to further negotiation with the Japanese government to permit lower fumigation temperatures, NFE is working with USDA and Washington State University researchers in evaluating export transportation and handling methods and their impact on product quality and sales life.¹

This is an example of an association which has gone beyond sales and marketing to change the regulatory environment in which it must function. Many cooperatives face tariff and non-tariff barriers in foreign markets which they would not find advantageous to attempt to change individually. A Webb-Pomerene Association may serve to bring

¹ Gilbert E. Yost, James B. Fountain and Charles Pierson, "Shipping Fresh Cherries into Japan Involved Careful Industry Monitoring," The Goodfruit Grower, June 1, 1979, pp. 6-7.

together cooperatives and corporations which stand to benefit from the use of collective action to bring change.

6.7.5.4 Pacific Agricultural Cooperative for Export,
Inc. (PACE)¹

PACE is a 14 member association which seeks to "assist and promote the export of a raw or processed agricultural, food or other products of its members."² The primary emphasis of PACE activity has been reduction of the cost of export transportation for its members.

As discussed under 5.3 above, PACE has successfully negotiated rate reductions with ocean freight conferences. These have been as high as \$55-\$60 per ton on one product. It has also explored non-conference shipping options and worked with the Southern Pacific Railway in the development of options to ship member products destined for Europe to Gulf ports by rail and then by ocean vessel.

PACE membership includes six U.S. farmer cooperatives. It retains an executive secretary to handle administrative affairs, act as a spokesman, evaluate new trends in shipping and suggest strategy. One advantage of an independent administrator is that he can be concerned with the overall view of group problems and solutions. Some associations have not succeeded in part because individual members handled administrative duties and were unable to resolve conflicts between the welfare of their individual businesses and that of the overall association.³

¹Interview with Fox.

²"Statement of Purposes and Objectives of PACE, Inc.," September 1, 1973 (mimeographed).

³Interview with Thomas M. Poerstel, Chief, International Transportation Services Branch, Office of Transportation, USDA, July 11, 1979.

PACE is an example of the use of the Webb-Pomerene law to coordinate activities with respect to a single export function. Some members interviewed voiced interest in expansion of those functions. Others felt that restriction of activities to a single function facilitated advantageous collaboration among exporters with such divergent marketing interests that they would be unwilling to collaborate on a broader basis.

6.7.5.5 California Rice Export Corporation¹

California Rice Export Corporation (CREC) is an association of four California rice marketers, two of them farmer cooperatives.

The association was established to permit export coordination in sales to Okinawa rice importers. CREC served as a common agency for discussions with importers and a mechanism for sharing sales greater than 500,000 tons.

Most CREC business was financed under PL 480. Thus, when the Supreme Court decided in 1968 that PL 480 sales were not "exports" as protected under Webb-Pomerene, the association's usefulness decreased markedly. It has remained registered, but inactive, since that time.

In spite of its current inactivity, CREC is indicative of one type of arrangement which could permit individual cooperatives to participate in business involving orders larger than they could fill alone. In the rice case, orders which previously were handled by CREC are now handled by a major rice company which then acts as a broker and arranges for purchases from smaller cooperatives and companies.

These examples each present a somewhat different dimension of the potential for cooperatives to use Webb-Pomerene for export coordination.

¹Interview with Robert W. Freeland, Executive Vice President, Rice Growers Association of California, August 8, 1979.

Also present are glimpses of potential problems which can arise in the functioning of associations.

6.7.6 Reasons for Inactivity or Dissolution

As part of the evaluation process, it is useful to identify some of the reasons that registered associations became inactive or dissolved. Between 1918 and 1965, 26 percent of all registered associations never became active and an additional 37 percent functioned for five years or less.¹ Of the 32 registered associations in 1978, only six were in existence during the 1958 to 1962 period.² FTC staff investigation revealed three major reasons for dissolution and inactivity during the 1958 to 1962 period:

1. Many associations applied for registration before assessing export market opportunities. Some found none.
2. In some cases, members were unable to agree on prices, market shares or other aspects of association activities.
3. In some cases, associations failed because members' products were too diverse to be marketed through a single agency.³

The latter point is of special interest in this research. Soon after the passage of the act, one diverse association, NAMUSA Corporation, was set up by members of the National Association of Manufacturers. It was supposed to handle the export business of various companies and even

¹FTC, 1967, pp. 23-26. One hundred seventy-six associations were registered at some time during the period 1918-1965. Of these, 46 (26.1 percent) were never active; 65 (36.9 percent) were active 1-5 years; 20 (11.4 percent) were active for 6-10 years; and 45 (25.6 percent) were active 11 or more years.

²FTC, 1978, p. 6.

³FTC, 1967, p. 24.

whole industries, but was disbanded after three years of attempting to initiate export programs. It has been followed by similar attempts which met with similar fates.¹

Historically, Webb-Pomerene successes have involved horizontal coordination in concentrated industries. This may be a reflection of the problems of control involved in coordinating large groups to the satisfaction of all members. Broader based coordination efforts have succeeded where similar interests were evident with regard to the performance of specific export functions, but apparently not in overall joint export marketing.

6.7.7 Recent Actions ... and Future Prospects

The Webb-Pomerene Act has been included in recent reviews of all antitrust exemptions by the Department of Justice and the National Commission for the Review of Antitrust Laws and Procedures (NCRALP). It is also the focus of legislation presently before the Senate.

The Department of Justice concluded that economic impacts of the Webb-Pomerene exemption were insufficient to justify detailed consideration of possible modifications.²

The NCRALP concluded that if the Webb-Pomerene exemption is retained, it should be made contingent on demonstration of "a particularized need."³

¹Ibid. Other diverse associations listed as not becoming active were the Mississippi Valley Trading and Navigation Company; the Pan-American Trading Company; and two American Producers Export Corporations.

²Department of Justice, Antitrust Division, Report of the Task Group on Antitrust Immunities, (Washington, D.C.: Government Printing Office, 1977), pp. 21-22.

³National Commission for the Review of Antitrust Laws and Procedures, Report to the President and the Attorney General, (Washington, D.C.: Government Printing Office, 1979), pp. 295-306.

Senate Bill S. 864, currently under consideration by the 96th Congress, would establish an office in the Department of Commerce "to promote and encourage the formation and utilization of export trade associations" as well as broadening Webb-Pomerene coverage to include exporters of services.

This is part of a renewed interest in exports, exporters and exporting. It seems reasonable to assume that the current political and economic importance of exports will lead to a reaffirmation of support for the Webb-Pomerene Act as a vehicle for use by exporters. Under such conditions, cooperatives and other agribusinesses can make broad use of the act as a basis for coordination. The Webb-Pomerene mechanism can complement some of the organizational arrangements mentioned previously. The act's antitrust exemption can complement cooperatives' Capper-Volstead protections at a time when they, too, are receiving increased attention.

Webb-Pomerene Associations can perform a broad range of functional coordination activities. The extreme of a joint sales agency which sets price and established quotas among members, as provided for in the act, is exemplified by the California Avocado Export Association. Where cooperatives and others are able to cooperate, this level of coordination offers access to economies throughout the export marketing process. Limits can be expected on the ability to coordinate widely divergent commodities, but a wide range of product extension opportunities may be developed.

Some associations limit their activities to negotiation for the performance of specific functional services, as PACE does in ocean transportation. Such arrangements present the opportunity to coordinate activities of cooperatives and others handling diverse products which

share similar requirements with respect to specific functions. By limiting the scope of activities of an association, it may be possible to bring together significantly larger numbers of participants. This can increase the potential to countervail, or directly influence, those who control a specific function, such as ocean freight conferences.

Supply based coordination may take the form of associations formed to permit members to jointly bid on contracts which would be too large for them to bid on as individuals. This is the type of activity in which the California Rice Export Association has participated.

Demand based coordination through associations may take the form of joint market research or promotion as well as joint negotiation with foreign governments on licensing, import quotas or other regulations as is done by the Northwest Fruit Exporters. In each case mentioned, the interdependence of export marketing functions must be recognized. A cooperative with limited expertise in the performance of all export marketing functions may be unable to reap the benefits of economies of coordination with respect to a single function. The examples of export coordination through Webb-Pomerene Associations draws together cooperatives with other agribusinesses. The link is either through similarity in commodities handled or similarity in export marketing services used. For the cooperative which feels that its export marketing success is at least as closely tied to corporate competitors as to other cooperatives, the Webb-Pomerene Act presents a means to coordinate exports with them. At the same time, the criteria for membership in an association can be established in such a fashion that only cooperatives would be eligible for membership.

6.8 Summary and Comparisons

Cooperatives seeking to coordinate their export marketing activities have access to a wide range of potentially useful organizational arrangements and mechanisms. The choice among arrangements should be influenced by: the relative and absolute importance of exports in the overall marketing strategy of the cooperative; the functional requirements for exporting the commodities handled; the management styles of potential participants; and areas of similarity of objectives and requirements among prospective participants.

Evaluation of six types of arrangements indicated that the greatest potential advantages to coordination of export marketing may be obtainable through: federated export cooperatives; export management cooperatives; joint ventures; and Webb-Pomerene Associations. Organizational arrangements with the least promise were a cooperative trade information service and a cooperative brokerage organization.

Each of the organizational options judged to be promising can serve as a vehicle through which cooperatives can improve their competitive positions in exporting. Achievement of economies in the performance of the export marketing functions evaluated in Chapter 5 often requires a critical mass of sales volume and experience. The result of coordination of export marketing activities can be both reduction of costs and improvement of the quality of the services performed.

Distinctions among the four types of arrangements found to have potential as coordination mechanisms for cooperative exporters are most evident with respect to their potential responsiveness to the diverse needs and objectives of individual cooperatives. Differences are

primarily based upon: the distribution of control among participants; size; and the opportunity for participation by non-cooperatives.

The lead cooperative, or Cooperative Export Manager, maintains control over the export organization and provides export services on a fee basis. Where cooperatives of vastly different sales volumes are potential collaborators, a CEM arrangement may be the only means through which a large and successful cooperative exporter can be induced to participate in coordinated export marketing activity.

The Multicommodity Federated Export Cooperative presents the opportunity for cooperatives to participate with co-equal status in decision-making on export marketing strategy and objectives. The MFEC may take the form of a joint export marketing agency, or have a more restricted emphasis, such as export transportation, distribution, sales, etc. Coordination may be horizontal, vertical and/or product extension. Conglomerate coordination may have some longer term potential through a MFEC. In the short and medium terms, the most advantageous organizational groupings may be expected to be based upon similarities in the organization and geographic location of demand and supply; and similarities in functional export requirements.

The joint venture presents a means for more restricted groups of cooperatives to coordinate export activities and for the development of cooperative-corporate partnerships in export marketing. The potential here is similar to that of a MFEC. The complementarity of objectives in cooperative-corporate ventures must be given even more careful scrutiny in order to assure that it is consistent with the overall marketing objectives of the cooperative and its members.

Webb-Pomerene Associations are yet another mechanism for collaboration in exporting which may include cooperative and/or corporate participants. The Webb-Pomerene Act provides explicit antitrust protections for collaboration among domestic competitors in export marketing. As such, it may usefully complement any of the above forms and the immunities of the Capper-Volstead Act.

The conclusion that two organizational types offer relatively limited promise was based on their restricted potential contributions to improving the competitive positions of individual cooperative exporters. A Cooperative Trade Information Service could provide general market information, but would be constrained in its ability to validate market intelligence without a selling presence in foreign markets. A Cooperative Brokerage Organization would offer services similar to those currently available through private and corporate brokers. However, if a CBO dealt exclusively in commodities originated by farmer cooperatives, it would have an inherent competitive disadvantage relative to rivals handling products from any source of supply.

All of the above arrangements have been presented in a somewhat general form, due to the breadth of commodity coverage of this research. They introduce some general alternatives for the development of coordinated export marketing. For the cooperative manager faced with member pressure to increase exports, coordination opportunities may permit the establishment of an export marketing program which profitably complements domestic sales. The choice among organizational arrangements, compared to independent export marketing, or complete rejection of export marketing, must be made in the context of the cooperative's own situation.

CHAPTER VII

CONCLUSIONS, IMPLICATIONS, SUGGESTIONS FOR FURTHER STUDY

Exports are becoming increasingly important to the United States agricultural economy. In the last decade, the physical volume of U.S. agricultural exports has more than doubled and their value has increased more than four-fold. On the average, the production from almost one out of every three acres harvested is exported.

As farmer cooperatives attempt to increase exports in order to improve their effectiveness as a marketing alternative for producers, they often face certain obstacles. Limited export sales volume and experience, limited financial strength and limited product lines all increase the risks of international trade while making it difficult for some cooperatives to compete effectively with many of the large, multinational corporations and state trading firms which operate in international markets. The current research has been directed at the identification and evaluation of opportunities and methods for cooperatives to improve their competitive positions in international markets through multicooperative and multicommodity arrangements.

An analytical framework based upon disaggregation of the export marketing process into nine functional components was developed and used to evaluate coordination potential. Additionally, six organizational arrangements through which cooperatives might coordinate their export marketing activities were identified and analyzed.

Conclusions with respect to both functional and organizational research questions have been drawn on the basis of personal and telephone interviews with 130 people during the period from September 1978 through August 1979. Those interviewed included: cooperative management and export staff, corporate exporters, management and staff of financial institutions, freight forwarders, export management firms, university researchers, personnel of the USDA and other government agencies.

Research results suggest that for individual cooperatives, the coordination options which offer promise range from collaboration in the performance of a single export marketing function to participation in a joint export sales organization. In order for individual cooperatives to evaluate opportunities for advantageous coordination of export marketing, three sets of issues must be considered. First, potential participants in any coordinated effort must analyze their overall marketing objectives and strategies with respect to domestic and international markets. Secondly, evaluation of functional components of the export process can serve as a guide to opportunities for advantageous coordination. Finally, organizational options should be considered in light of the objectives of potential participants and constraints facing them.

7.1 Cooperative Export Strategy and Objectives

7.1.1 Overall Long Term Marketing Strategy

The evaluation of possibilities for cooperatives to successfully and advantageously join together in the performance of export marketing activities should begin with an assessment of both short and long term

marketing objectives of each potential participant. Domestic and export marketing activities must be viewed as interdependent. If the resources of the cooperative are inadequate to permit it to service current domestic customers, its problems will only be compounded by entry into export markets. On the other hand, an effective domestic marketing program may be complemented by development of foreign customers.

A long term outlook is important in evaluating the approach that an individual cooperative should take toward exporting. The expectation that members will need and be able to supply foreign customers at some future date can justify investment in the development of export markets. If it is unlikely that foreign customers can be supplied over a long period of time, such investment will be less likely to be economically justifiable.

Through evaluation of its overall marketing strategy, a cooperative can begin to establish a range of possible scenarios with respect to its export marketing objectives and prospects. This is an important prerequisite to appraisal of specific coordination arrangements.

7.1.2 Export Marketing Objectives: Market Development versus Sporadic Sales

The ability of an individual cooperative to contribute to any coordinated export marketing arrangement will be strongly influenced by its objectives in export marketing. Exporting cooperatives vary considerably in their objectives. Their approaches to exporting vary from continuous and aggressive export market development to being a passive and sporadic export supplier (see Figure 7.1).

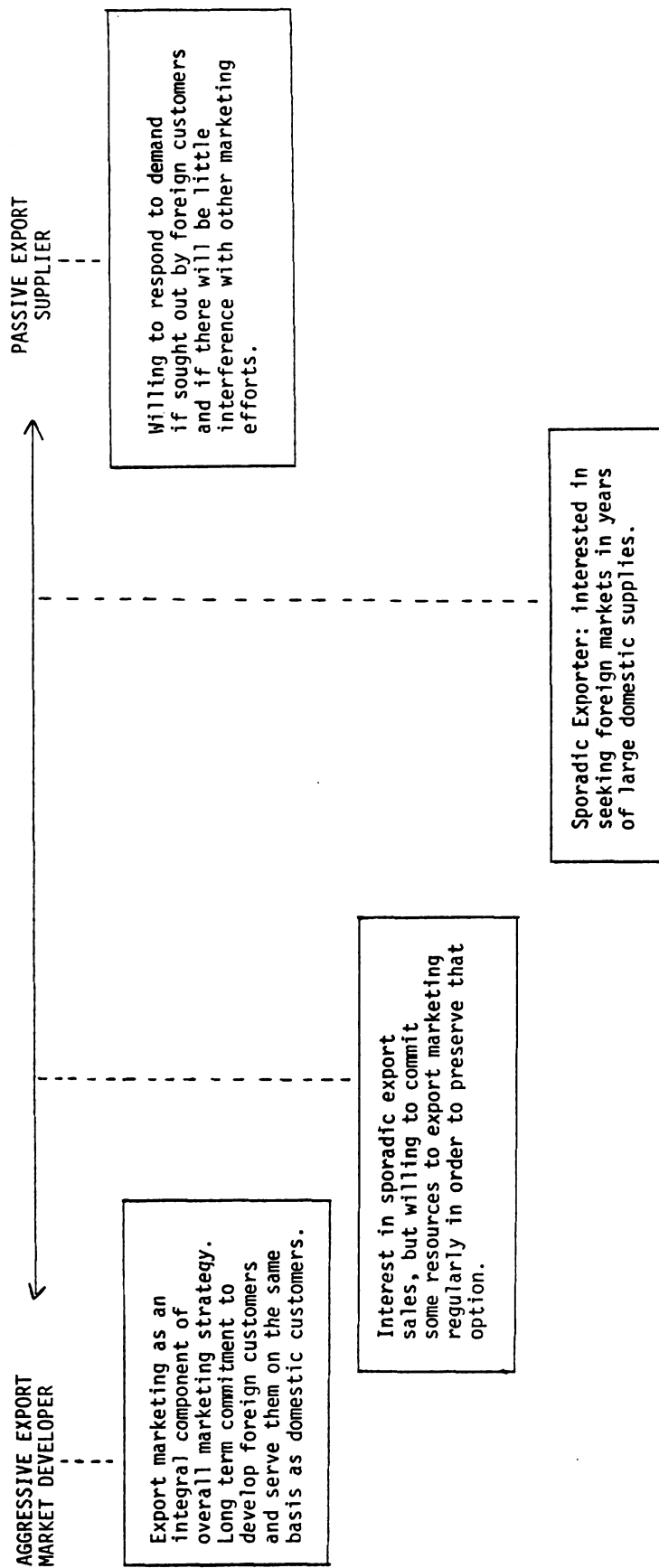


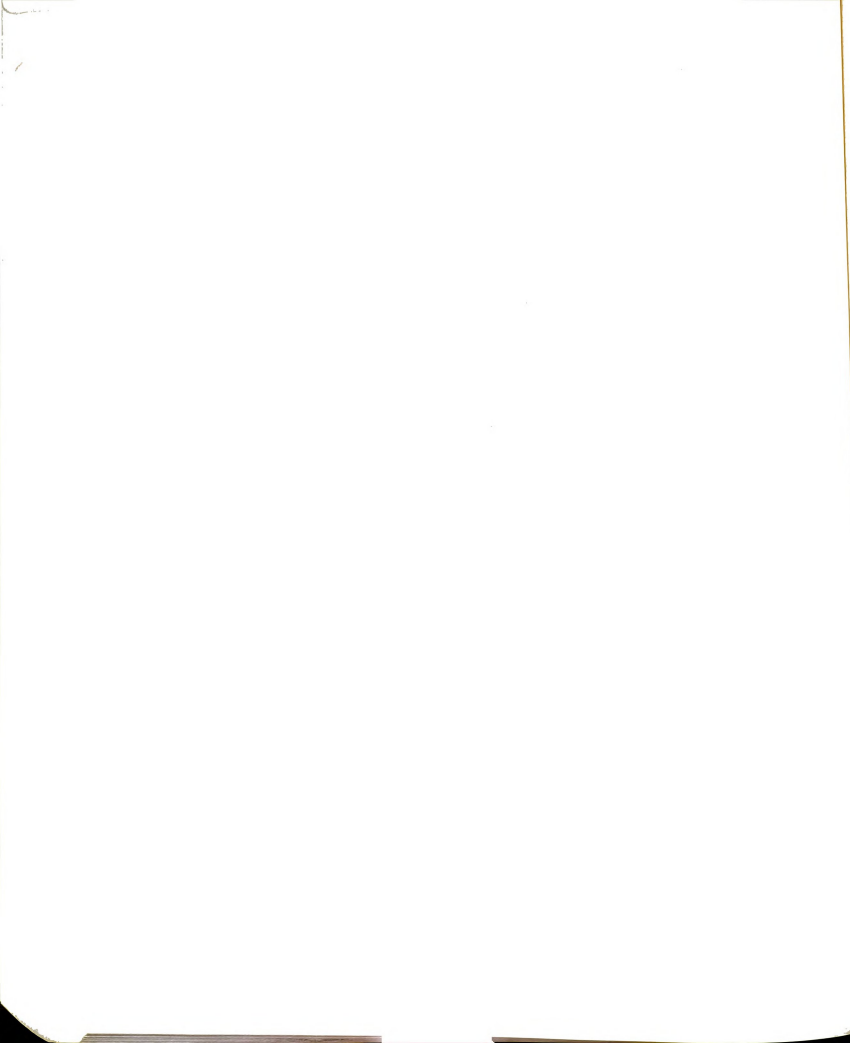
FIGURE 7.1. COOPERATIVE EXPORTERS: Strategy and Commitment



For an aggressive export market developer willing and able to serve both foreign and domestic customers on the same basis, there are strong incentives to invest in becoming an efficient and effective exporter. A cooperative with interest in exporting only as a means to get rid of periodic domestic surpluses will face different incentives. A cooperative with interest in sporadic sales and/or surplus disposal may be willing to commit resources to export marketing on a regular basis in order to have access to foreign markets when needed. However, the level of such commitment and ability to contribute a reliable supply will influence both its export options and its ability to contribute to collaborative arrangements.

Among exporters the other extreme case is a "passive exporter" who is willing to respond to foreign demand, but hesitant to take much initiative to export. Such a posture may result where management views exporting as unnecessarily complicated and generally unprofitable or simply as a lower priority than serving the domestic market. Where joint export marketing arrangements permit access to the specialized expertise required to reduce complexities and improve profitability, the passive exporter may find it advantageous to become more active. However, a distinction between interest in sporadic export sales and a commitment to foreign market development will be important both in the identification of objectives of individual cooperatives in any coordinated export marketing arrangement and the ability of each cooperative to contribute to such an arrangement.

Some cooperatives which take a generally passive approach toward exporting will be willing to make a limited investment in a joint



exporting arrangement on the basis of its public and member relations potential. Care should be taken to avoid confusing such an objective with a genuine commitment to export marketing. Cooperatives with each type of objective will differ significantly in their potential contribution to the achievement of functional economies through regular, large volume exporting.

7.1.3 Export Volume, Similarity of Interest, and Coordination Potential

An examination of the experience of cooperatives in joint arrangements indicates that those which were dissolved often involved cooperatives with significant differences in sales volumes. Conflicting marketing requirements and interests on the part of different sized participants apparently interfered with effective coordination. Where arrangements involved a relatively equal sharing of decision making power among cooperatives with markedly differing sales volumes, the tendency toward dissolution appears particularly strong. Managers of such arrangements have indicated that in some instances the complexity of the educational task of dealing with an additional board of directors has more than outweighed the marketing economies achieved as a result of the increment in sales volume which accompanies an additional participant.

One alternative to such control problems has been the development of a "fee for service" provision in the operation of a joint exporting arrangement. In such an arrangement, smaller cooperatives trade off certain control prerogatives for access to economies of size in export marketing. It appears that some loss of autonomy may be required in cases where smaller cooperatives seek to retain their identities while gaining access to more efficient means to market their members' production.

It should also be noted that the importance of similarity of size among organizational participants, and the range over which volumes may be considered to be "similar" varies among individual export marketing functions and the commodities being handled. A cooperative handling less than container load export shipments of processed fruits will face significantly different transportation problems than a grain exporter contemplating ocean vessel chartering alternatives. Nonetheless, both may face similar problems with respect to trading in foreign currencies and increasing the speed of documentation flows.

Individual cooperatives can begin to assess coordination opportunities through identification of their own overall marketing objectives, export interest, volume and experience. This can serve as the basis for evaluating opportunities offered by functional economies in exporting and various organizational options for taking advantage of them.

7.2 Functional Economics of the Export Process: Implications for Coordinated Export Marketing

An analytical framework based upon nine functional components of the export marketing process was developed in this research. The framework was used to evaluate potential advantages and disadvantages to coordination in the performance of individual functions.

Based on evidence collected through interviews and from secondary sources, it has been concluded that similarities in functional export marketing requirements for different commodities and cooperatives can permit the achievement of coordinational economies. In many cases, the range of commodities for which similarities exist varies by function.

Where economies in the performance of individual functions increase with sales volume over an extended range, there may be some advantages to the development of single function collaborative arrangements. In such cases, however, the advantages in terms of economies related to a single function must be judged against the trade-offs in satisfying the overall export marketing requirements of individual cooperatives. It is important to recognize that the export marketing process involves interdependent functions. Thus, economies obtainable through coordinated arrangements to perform one function may prove unrealizable if other functions cannot be performed effectively and efficiently.

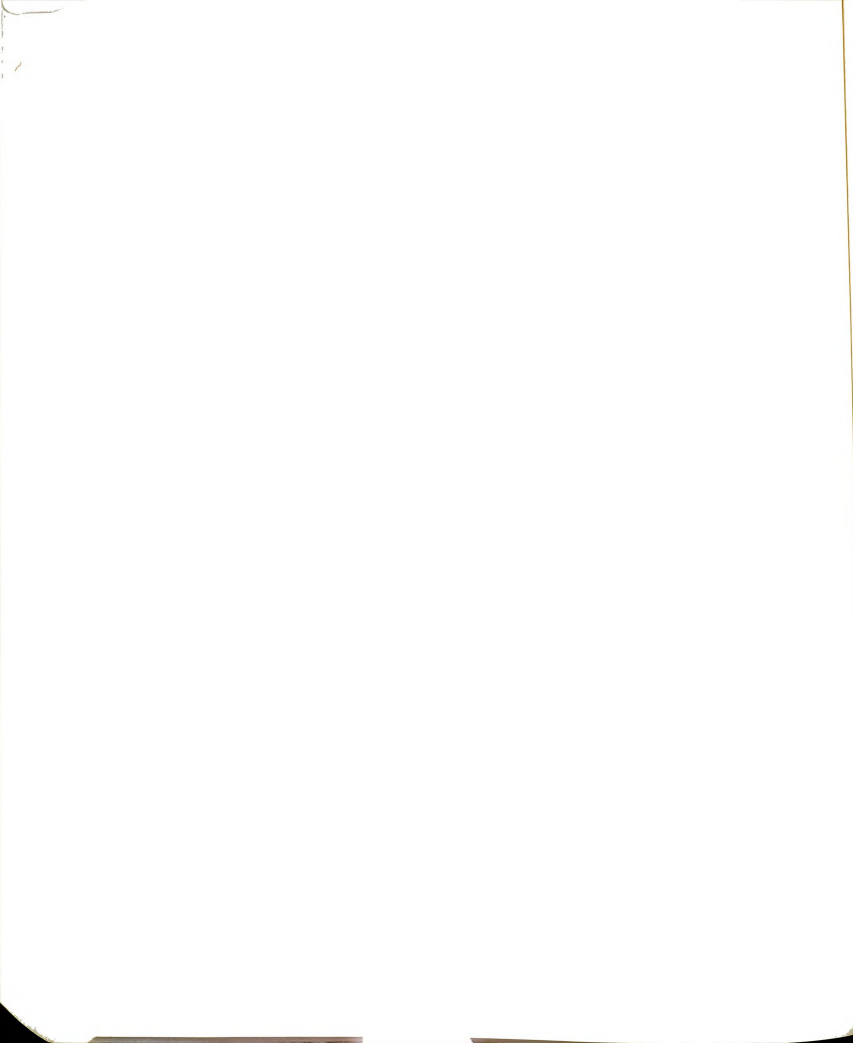
Advantages of coordinated export marketing activities may be achieved through increased sales volume, product extension, diversification of geographic markets, and harmonization of successive steps in the marketing process. Cooperative experience indicates that, in the establishment of collaborative export arrangements, significant initial gains can be obtained through combination of commodities which pass through the same or similar channels on the demand side. (For example, products used by feed compounders.) Access to functional economies in sales, market information, transportation, financial arrangements, documentation and regulatory compliance are all often available to exporters of commodities with similar handling characteristics and similar geographic destinations.

An initial hypothesis of this study was that in assessing coordination potential, commodities could be subdivided into two major categories: (1) bulk commodities, and (2) perishable, processed or branded products. This distinction has been borne out by the research findings.

Additionally, some further subdivisions have been suggested. Different handling requirements and size of sales indicate a useful distinction between dry bulk commodities and bulk liquids. Also, the unique channels followed by fresh fruits and vegetables indicate that they should be distinguished from those involved in trade in canned, dried and frozen fruits and vegetables. The distinction between handlers of fresh fruits and those handling processed fruits and products is so great that some cooperatives, Sunkist for example, have completely separate marketing divisions handling the fresh and processed forms of the same commodities. While this distinction is important, interdependence of fresh and processing markets for many commodities prevents their complete separation in analysis.

Significant differences in the functional export requirements of commodities falling into two major groups have been identified. However, these alone will not permit ranking of individual commodities or groups of commodities with respect to coordination potential. In some cases, differences in product attributes and handling requirements can serve as barriers to advantageous coordination. Where complementarity exists, such attributes can also serve as sources of synergism in export marketing. This can best be understood through a review of conclusions with respect to functional issues related to export coordination potential.

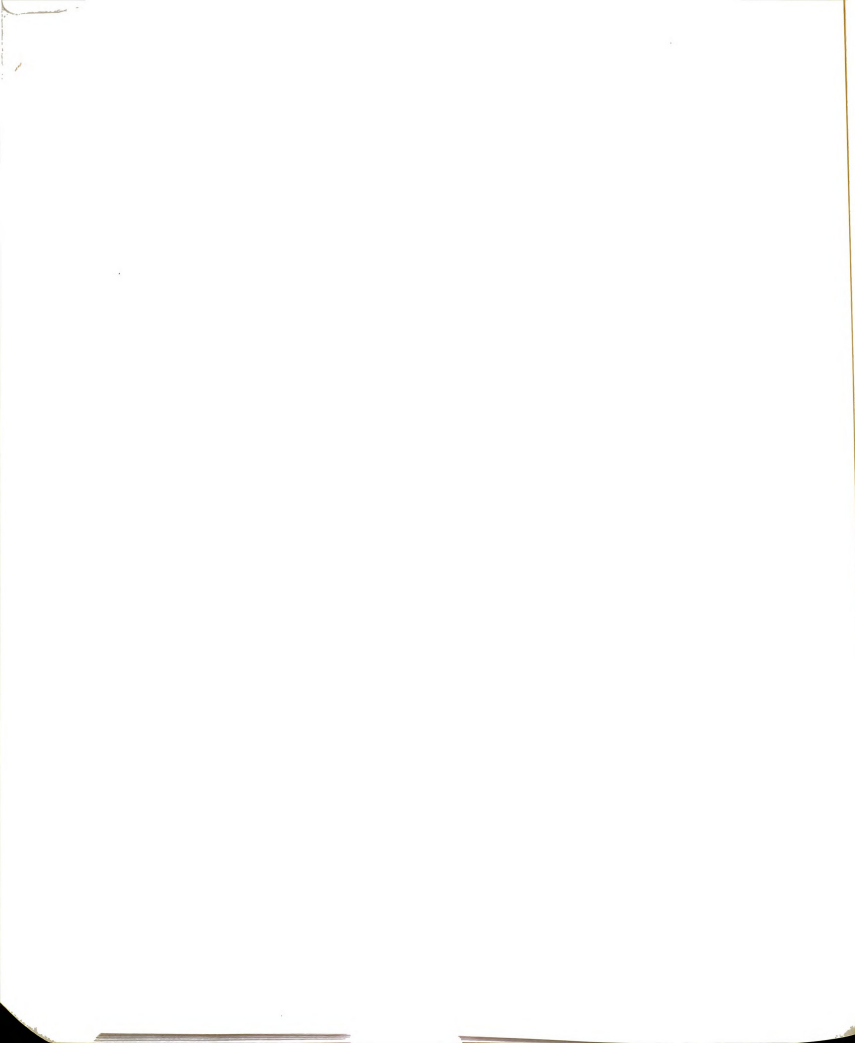
In evaluating the procurement function, significant differences were identified in product commitment among cooperatives handling different commodities. Members of cooperatives handling grains and oilseeds often treat their cooperatives as only one alternative product outlet among many. Producers of fruits, nuts, vegetables, poultry and



dairy products are more likely to have exclusive agency arrangements with their cooperatives. This latter approach provides marketers with greater flexibility through assurance of supply, but also often entails an obligation to market all that is produced. Differences in procurement practices influence the marketing task and objectives of cooperatives handling different commodities. This will have some impact on coordination potential in export marketing.

Another important procurement consideration is the basis for transfer pricing in allocating products between participants and a joint export marketing organism. Any collaborative export sales arrangement must either establish uniform transfer pricing practices or develop alternatives to the comparison of margins as a yardstick to its performance.

Similarities in processing facility requirements can be conducive to horizontal or product extension coordination among exporters. Port elevators can handle a wide range of grains and soybeans. Canning and freezing facilities can handle diverse fruits and vegetables. A distinction between processing for product standardization and for product differentiation is useful in identifying marketing objectives. Marketing strategies for standardized products can be expected to require larger volumes and yield lower margins than strategies for differentiated products. Additionally, product differentiation designed to respond to tastes or regulations in specific foreign markets will sometimes restrict sales flexibility for a given batch of products. This increases the importance of market development activity, as opposed to sporadic sales, in exporting differentiated products. Coordination among exporters can facilitate the identification of market specific preferences and regulations as well as response to them.



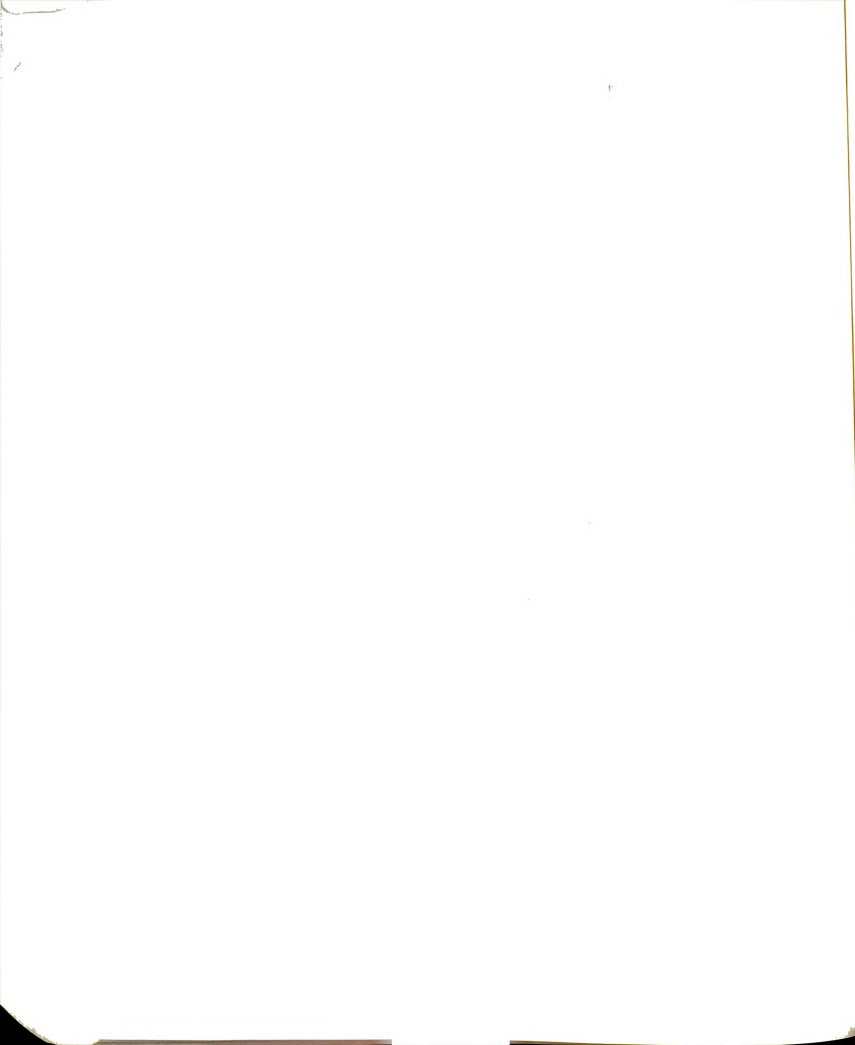
In transportation and physical distribution, significant economies may be obtained through collaboration among exporters at three levels: (1) chartering of ocean vessels, (2) regular, large volume general cargo shipments, whether break-bulk or containerized, and (3) through consolidation of small, less than container load shipments when assembly costs do not outweigh overall transportation savings. Cost savings may also be achieved through regular, large volume, domestic transportation usage. Transportation and distribution related coordinational advantages may arise from similarities in: domestic origin of commodities, use of services, ports of exit, foreign destinations, and customers. Also, in dealing with ocean freight conferences, the bargaining advantages of joint action by shippers have been demonstrated. The range of potentially advantageous coordination in transportation is limited by differences in objectives and requirements of shippers of bulk commodities and those shipping general cargo. Additionally, the needs of shippers handling large and small volumes differ significantly.

Economies in the performance of the market information function may be achieved through: (1) spreading of fixed costs over a larger transactions volumes, (2) a regular trading presence in foreign markets, and (3) the ability to accurately shadow price facilities (such as excess elevator capacity) and services, thereby gaining bargaining advantages. A distinction between broad-based market knowledge and commodity and time specific market intelligence is useful in delimiting the range of commodities for which potential information economies may develop through coordination. Market knowledge is generally of value to a broader range of commodities than market intelligence, but the latter

is essential to profitable exporting. The range of commodities and cooperatives for which there is significant potential for access to information economies through coordination is bounded by such factors as product complementarity, market channels employed, interest in development of a regular export marketing program, and the temporal profile of marketing activity for the commodities and cooperatives concerned. For cooperatives which are single-source exporters of bulk commodities, competition with large multinational trading companies which engage in arbitrage places them at an information cost disadvantage. This can only be partially compensated for through increased volume and broadened commodity coverage.

The potential to achieve economies of coordination in performing the sales function can be evaluated in four areas: representation, promotion, pricing, and servicing. Coordination among cooperatives in foreign representation may take the form of common use of agents or representatives, or joint offices overseas. In each case, the importance of an exporter to a foreign representative will affect the quality of service obtainable as well as the per unit cost of export market representation. Collaboration among cooperatives in export representation offers the opportunity to expand and diversify export market exposure as well as becoming part of a more important clientele group in individual markets. These advantages will be restricted somewhat according to commodities with some distinction among mutual sales interests in industrial, institutional and retail markets.

Promotional economies will be limited to commodity groups with mutual market interests which result in the use of similar promotional



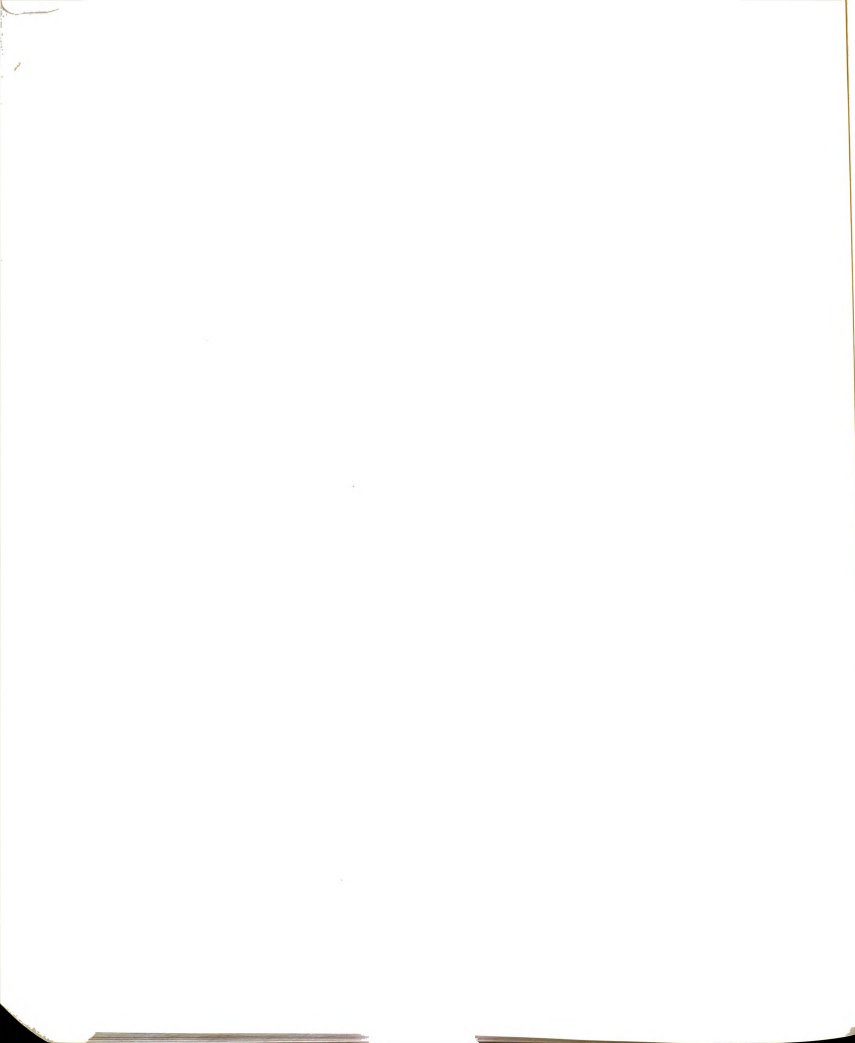
media. Substantial economies in coordination of promotion among complementary products may be realized. The development of "full-line" cooperative suppliers would best reflect the organization of demand and procurement in individual foreign markets in order to achieve maximum promotional economies in these markets.

Improved market information and intelligence can contribute to increased pricing accuracy and reduction of the pricing risks which must be covered in the development of a pricing strategy. Intelligence on foreign market conditions and competitive suppliers can facilitate competitive pricing and prevent unnecessary loss of profit opportunities.

Servicing economies may also be achieved through coordination of exports. These may take the form of flexibility in physical positioning of inventories, knowledge of and capacity to provide special packaging and processing for individual markets, ability to support effective quality control, and flexibility in delivery and payment terms.

Potential for advantageous sales coordination among cooperatives marketing different commodities will be largely dependent upon the organization of demand in individual export markets. In exporting to some state trading nations there may be opportunities for achievement of economies through collaboration among an extremely broad range of agricultural commodities. In other countries the organization of markets will be conducive to much more limited sales coordination. In all cases, however, commodity specific expertise will be essential to successful performance of the sales function.

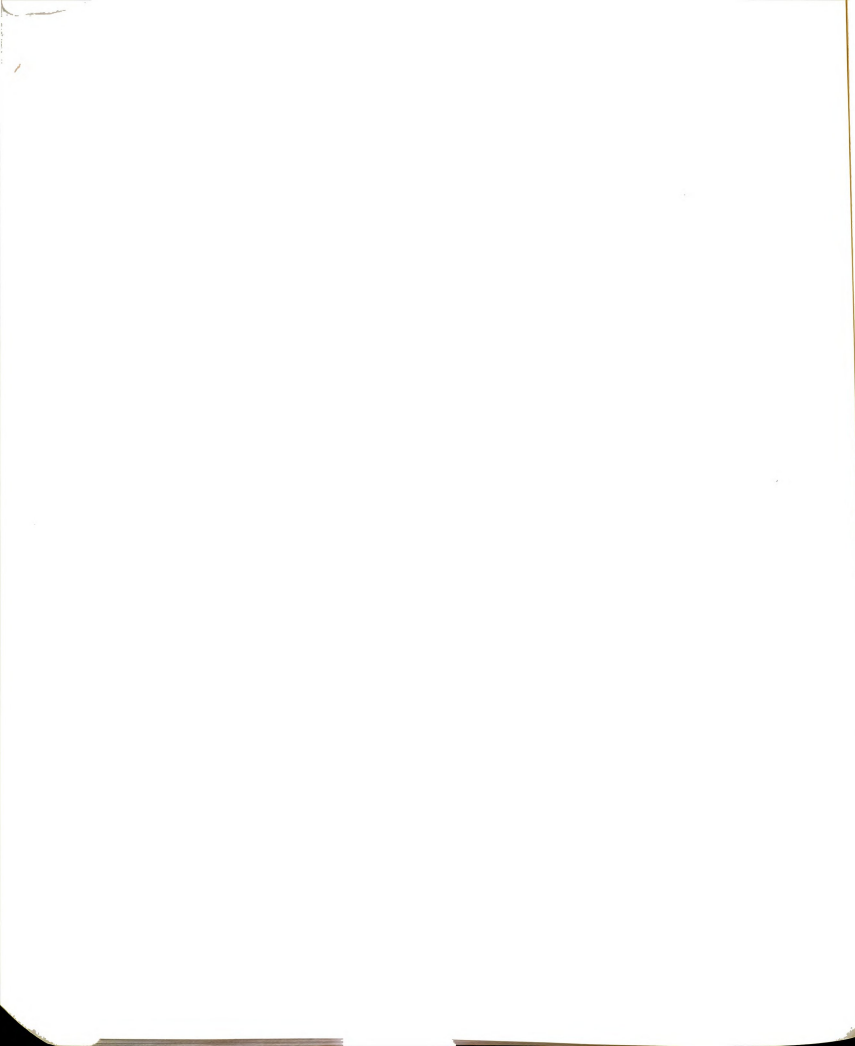
Coordination potential in the performance of the financial function crosses all commodity lines. The capacity to evaluate the trade-offs



between risk and costs associated with alternative payment terms (e.g., letter of credit versus open account) rests upon access to credit information on foreign markets and specific foreign firms. While some such information will be available from commodity specific trade sources, foreign banking systems can provide credit information as well as financial services. The Banks for Cooperatives system is in the process of increasing its ability to assist cooperatives with many export related financial services. Additionally, all cooperatives could benefit from coordinated access to foreign currency exchange information and trading capacity. These factors would all contribute to increased flexibility in the trade terms offered by exporting cooperatives.

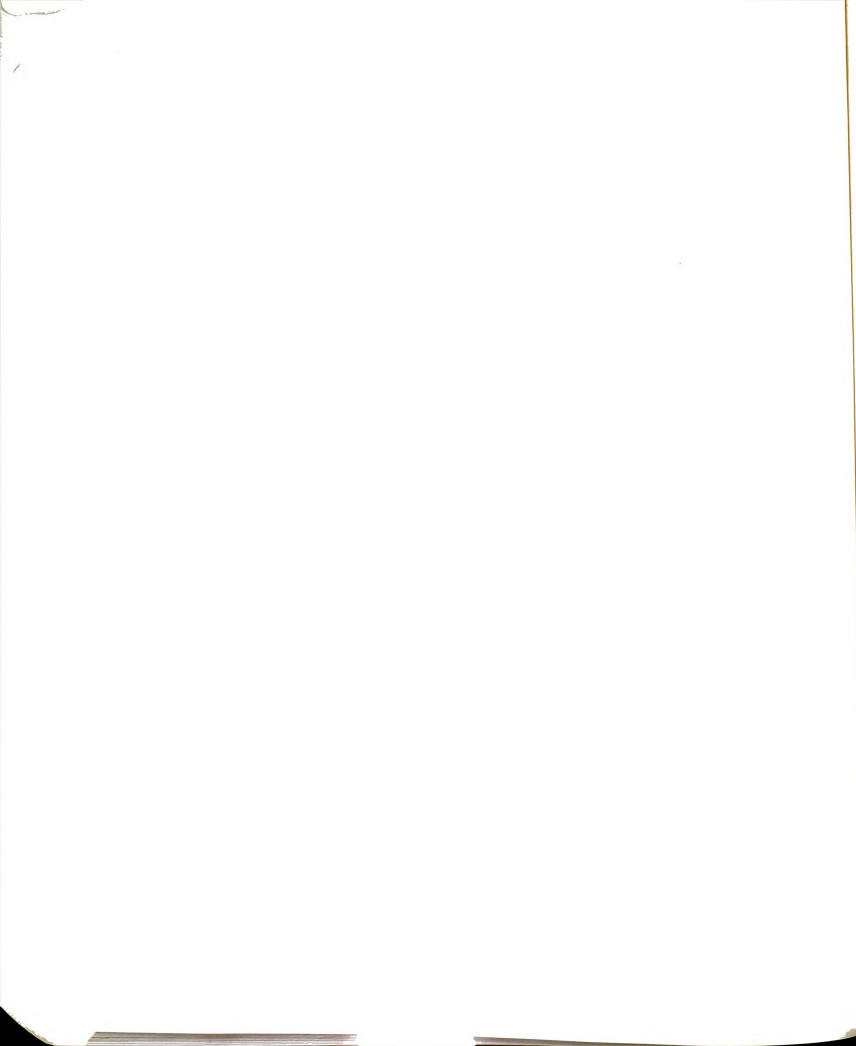
Coordination among cooperative exporters in the preparation and processing of documents also offers significant opportunities to decrease costs and improve service. Through increasing the speed of documentary flows, the costs of financing inventories and receivables can be decreased while improving service to customers abroad. The range of commodity interests involved in the coordinated performance of the documentation function will be of less importance than the range of geographic contacts and expertise involved.

There are a number of opportunities for advantageous cooperative joint action in the performance of the risk management function. Exporters must deal with five types of risk: physical risk, pricing risk, commercial risk, foreign exchange risk and political risk. While each can be covered through commercial or public sources of insurance, the costs and terms of coverage are not always compatible with the necessities of competitive pricing. There are potential advantages to



combining similar risk exposures in order to achieve lower cost coverage. In dealing with physical risk, the possibilities for joint "self-insurance" arrangements can be explored. However, current volumes of cooperative exports would probably be more conducive to use of self-insurance in conjunction with a large deductible on commercial insurance rather than the internal provision of all-risk maritime insurance coverage by a cooperative insurer. Joint negotiation of blanket coverage by commercial insurers could also yield some economies in physical risk coverage. Where the sizes and types of physical risk exposure differ markedly, as between shipload quantities of bulk commodities and single container shipments of packaged products, the similarity of interest conducive to joint insurance will be difficult to realize. While bulk shippers could assume the risks of a shipper of single container loads, the latter would be unlikely to willingly share in the larger risks of the former.

Pricing risk exposure includes commodity procurement price risk and associated marketing and transportation cost risks. Procurement price risks to the cooperative can be limited through pooling arrangements. However, some short term risk is shifted to the producer in the process. The short term price risks may be more than compensated for through longer term risk reduction, however, if a more effective marketing program develops. In dealing with transportation cost risks, ocean freight cost risks have long been avoided through f.a.s. and f.o.b. sales. This limits the range of potential buyers to those willing to bear freight cost risks, and imposes commercial risks on the sellers. Ocean freight cost risk falls primarily in bulk commodities,



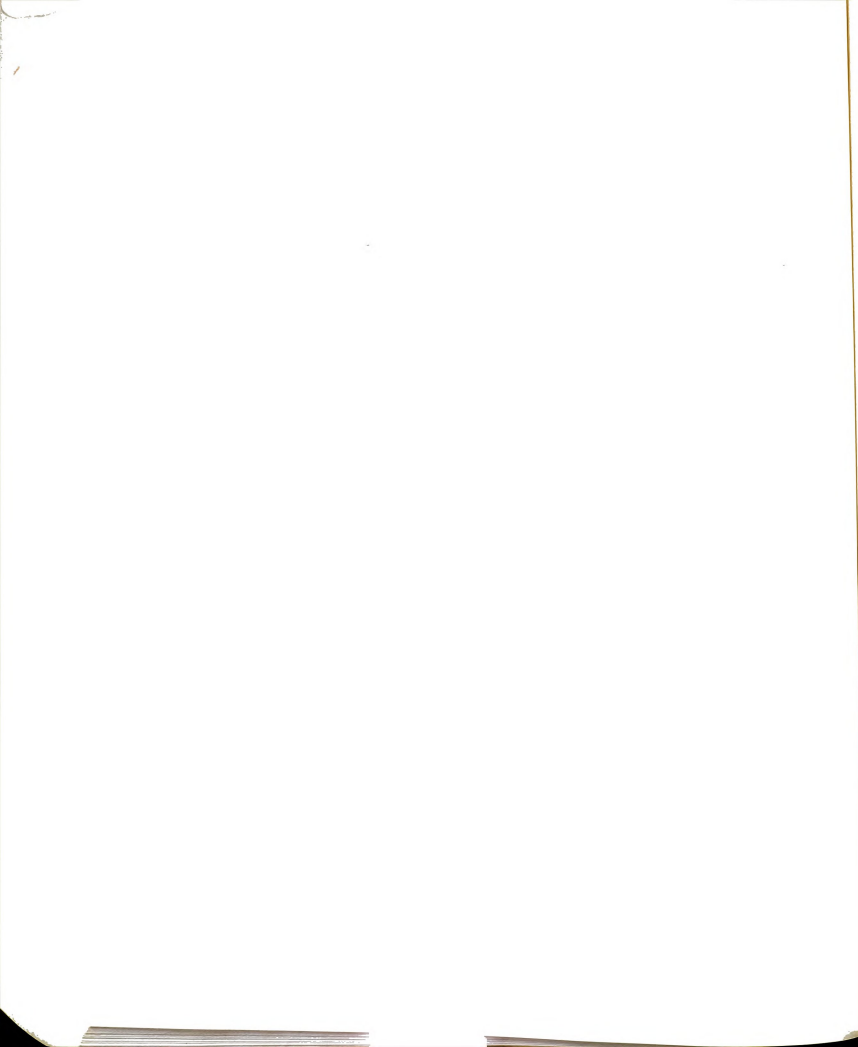
since other rates are not as volatile. Major grain companies and other shippers limit their risk exposure in ocean freight through chartering and vessel ownership.

Commercial risks include credit risks associated with the receipt of payment for individual export transactions as well as the exposure of exporters in reliance upon a limited number of market outlets. Coordination can yield economies in assessment of the credit risks associated with individual transactions as well as presenting the opportunity to diversify the markets served by sales and information functions.

Foreign exchange risks, discussed under the financial function, are an area with the potential for wide-ranging collaboration among cooperative exporters, regardless of the commodities handled.

Assessment and coverage of political risks is also an area with far reaching potential for collaboration. Cooperatives are often hesitant to export to many countries because of the political risks involved. The Foreign Credit Insurance Association (FCIA) will provide coverage for political risks. Because of the FCIA requirement that an exporter cover either all shipments or a balanced portfolio, coordination among cooperatives could permit development of economies in the insurance of political risks.

With respect to the regulatory function, significant coordinational economies which cross commodity lines may be achieved in: (1) obtaining the information necessary for compliance with foreign market regulations, (2) evaluating the potential impact of changes in regulations, and (3) attempting to influence the "rules of the game." Because it is



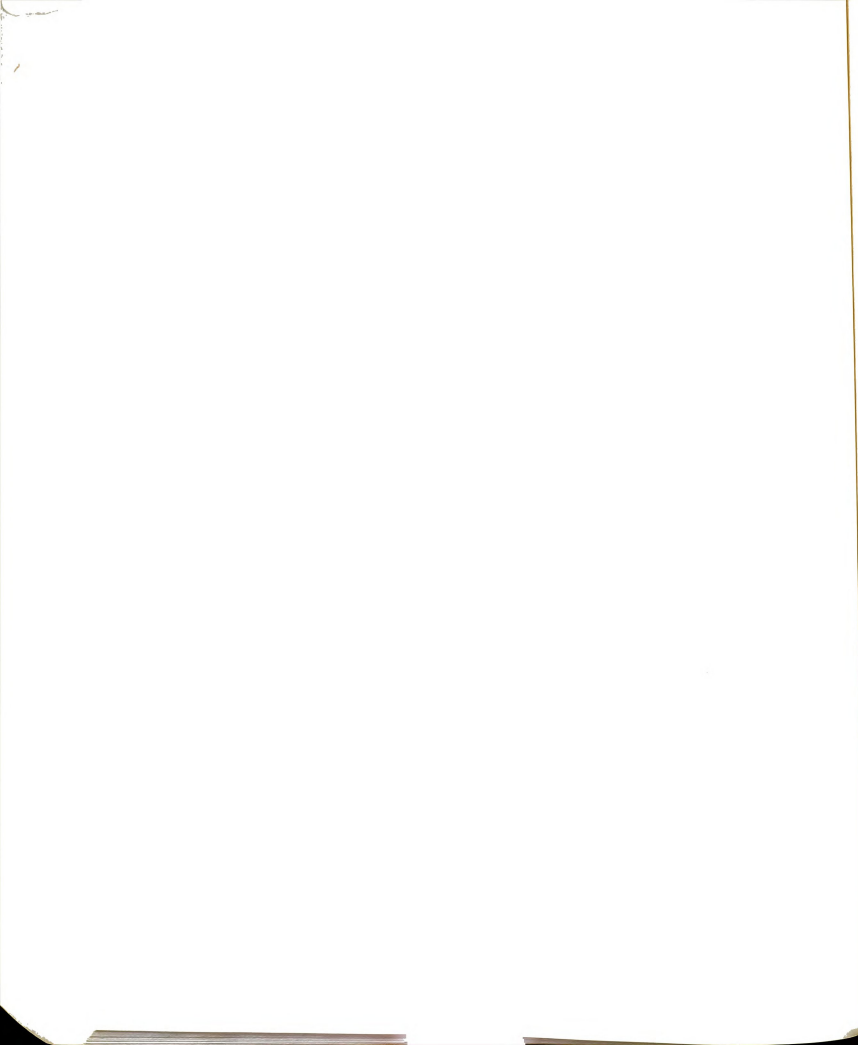
difficult for a single exporter to capture the benefits of rule changes without a significant market share, broadly-based coordination among potentially affected exporters can be justified as a means to avoid "free rider" problems. In some cases, this may require joint action through general farm organizations or public action in the interest of general U.S. welfare.

The above conclusions do not lead to rankings of groups of commodities according to coordination potential. Instead, they indicate significant factors which must be evaluated by individual cooperatives in assessing opportunities to benefit through coordinated export activity. Figure 7.2 summarizes areas of significant short and medium term functional coordination potential. The conclusions with respect to functional coordination potential permit consideration of organization options and inherent organizational complexities in the development of satisfactory collaborative arrangements involving cooperative exporters.

7.3 Organizational Options for Collaboration in Exporting

It has been demonstrated that fundamental economic factors influence the potential for achievement of coordinational economies in the performance of export functions. Additionally, organizational factors will affect the ability of individual cooperatives to gain access to such advantages.

In the course of this research, six types of organizational arrangements were evaluated. The analysis led to the conclusion that the greatest potential advantages to cooperatives in coordination of export marketing may be obtained through Cooperative Export Management (CEM)



| Function | Potential for Broad-based Coordination Among Exporters | Potential for Coordination Among Exporters of Bulk Commodities | Potential for Coordination among Exporters of Processed & Perishable Products |
|--|--|--|---|
| Procurement | * | ** | ** |
| Processing | ** | ** | ** |
| Transportation and Physical Distribution | *** | *** | *** |
| Market Information | ** | *** | *** |
| Sales | * | *** | *** |
| Financial | *** | ** | ** |
| Documentation | ** | ** | ** |
| Risk Management | ** | *** | *** |
| Regulatory | *** | ** | ** |

Rankings: *** greatest potential
 ** significant potential
 * limited potential

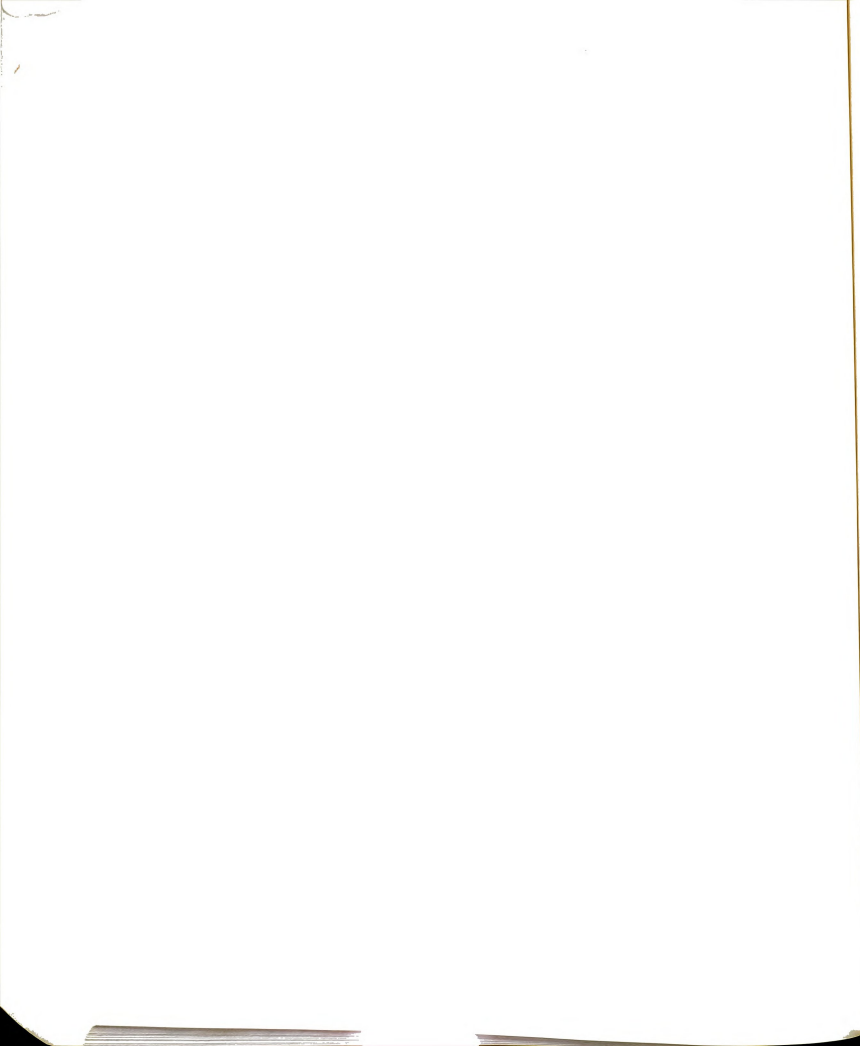
FIGURE 7.2. FUNCTIONAL COORDINATION POTENTIAL FOR EXPORTERS OF AGRICULTURAL COMMODITIES: Short and Medium Term

arrangements, Multicommodity Federated Export Cooperatives (MFEC), Joint-Ventures and Webb-Pomerene Associations. Two organizational arrangements found to have significantly less promise were a Cooperative Trade Information Service (CTIS), and a Cooperative Brokerage Organization (CBO).

The potential usefulness of each type of organizational arrangement as a mechanism through which a cooperative can gain access to size economies or other export marketing advantages on the basis of collaborative activity will be conditioned by a number of elements. Functional economic factors are important. They may be viewed as the necessary conditions for profitable coordination. Also, management styles and objectives of participants, the distribution of power and control in a proposed arrangement, participant size and sales volume, and the necessities imposed by the marketing environment in which each cooperative functions must be weighed in establishing sufficient conditions for a successful collaborative arrangement.

The range of coordination activities consistent with individual organizational types, and the implications for the distribution of control between members and the organization, are presented in Figure 7.3. A review of conclusions with respect to the potential of each type of organizational arrangement evaluated can contribute to an understanding of some of the trade-offs involved in coordinated export marketing.

In a cooperative export management arrangement (CEM), a lead cooperative would maintain control over a joint export organization while providing export services on a fee basis. Where cooperatives handling markedly different sales volumes are potential collaborators,



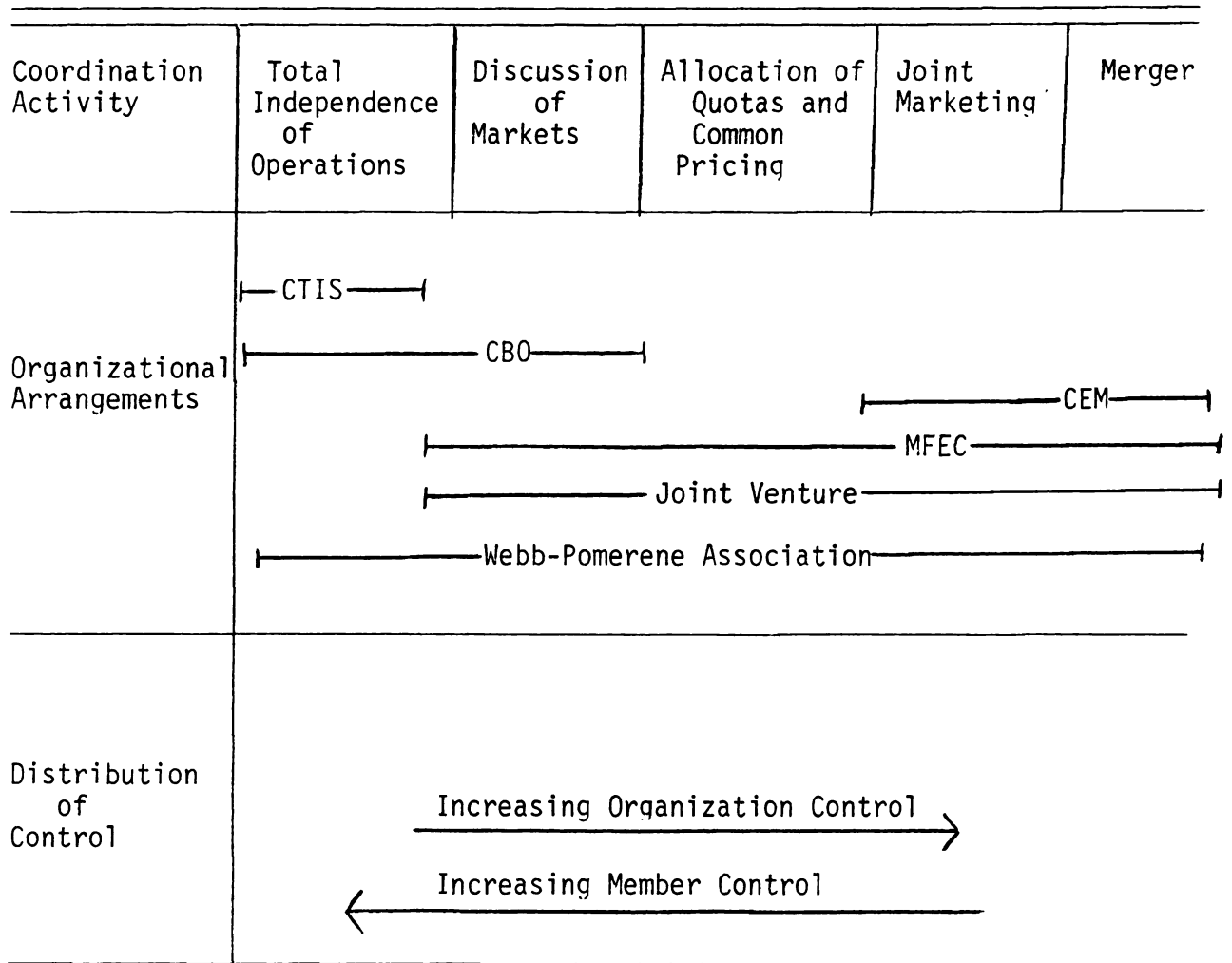
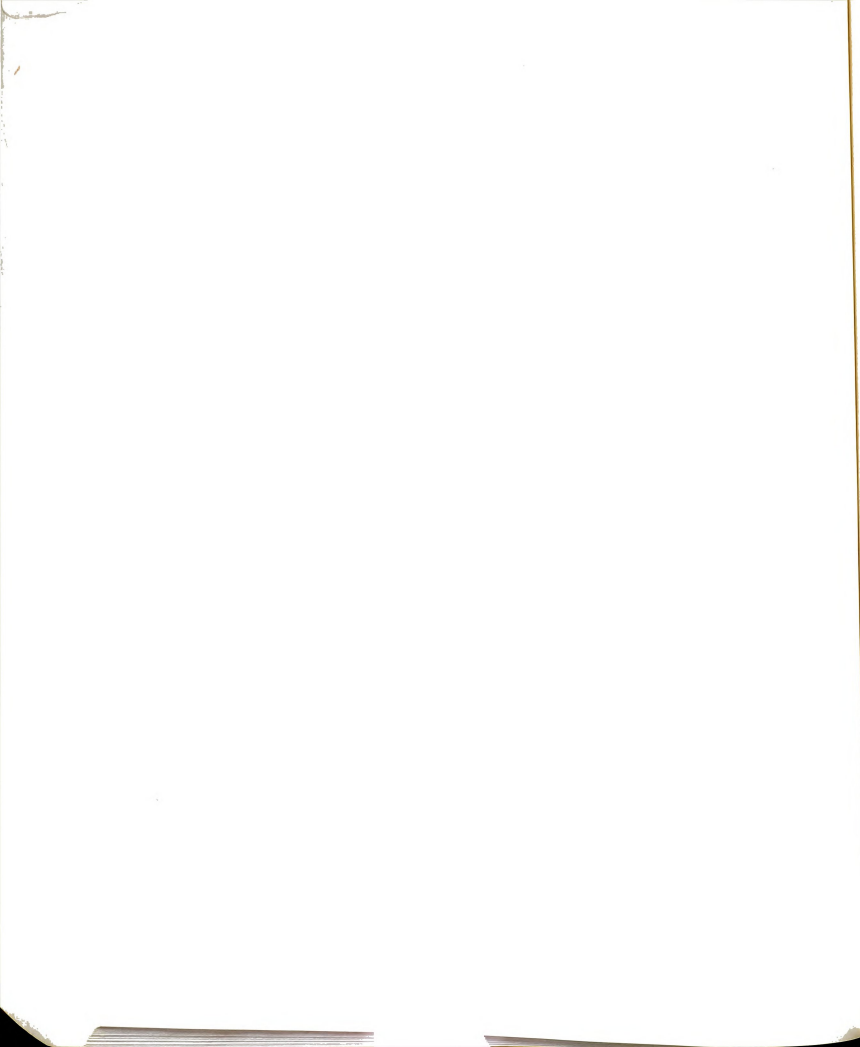


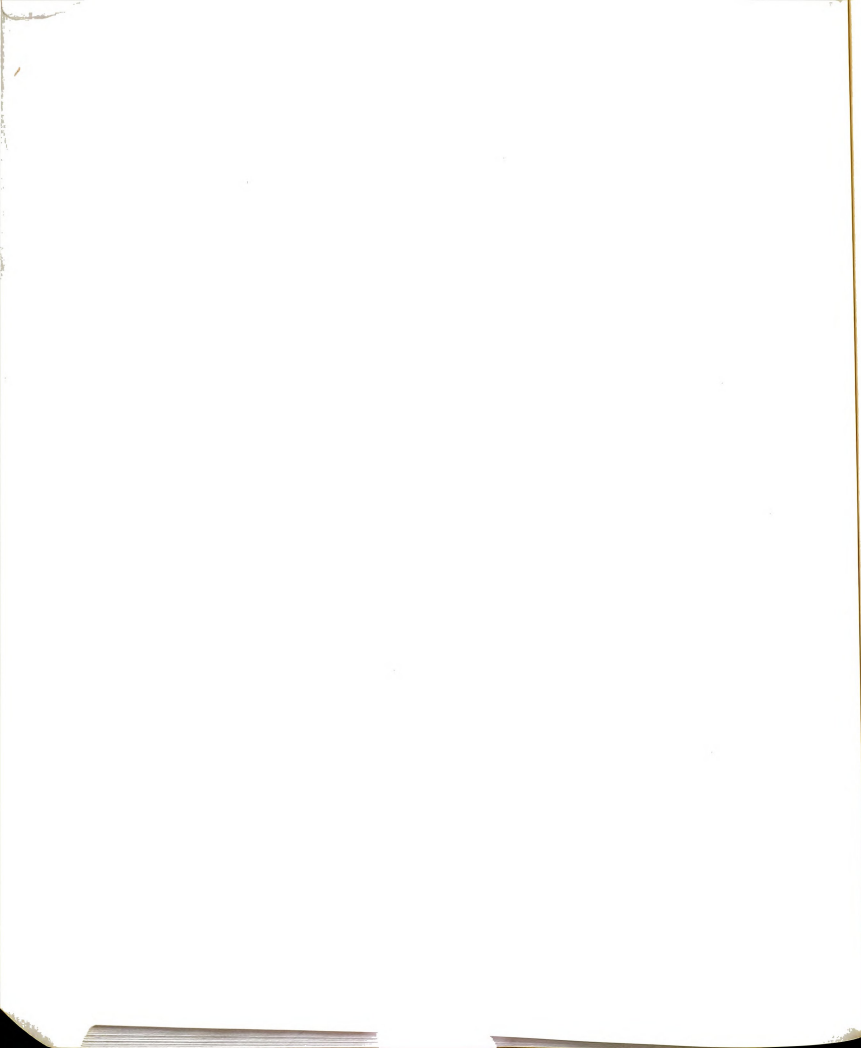
FIGURE 7.3. ORGANIZATIONAL ARRANGEMENTS FOR EXPORT COORDINATION: ACTIVITIES AND DISTRIBUTION OF CONTROL



a CEM arrangement may be one means to induce a large and successful cooperative exporter to participate in a joint marketing endeavor. If such an arrangement included provisions for patronage refunds, the most significant difference between a CEM and a MFEC would be in the allocation of control among users.

Multicommodity Federated Export Cooperatives present the opportunity for cooperatives to participate with co-equal status in decision making concerning export marketing strategy and objectives. The MFEC may take the form of a joint export marketing agency, or have a more restricted emphasis, such as export transportation, distribution, sales, foreign exchange trading, etc. Coordination may be horizontal, vertical, and/or product extension. Conglomerate coordination may have some longer term potential through a MFEC. In the short and medium term (i.e., the next decade), however, the most advantageous organizational groupings can be expected to be based upon similarities in the organization and geographic location of demand and supply and similarities in functional export requirements.

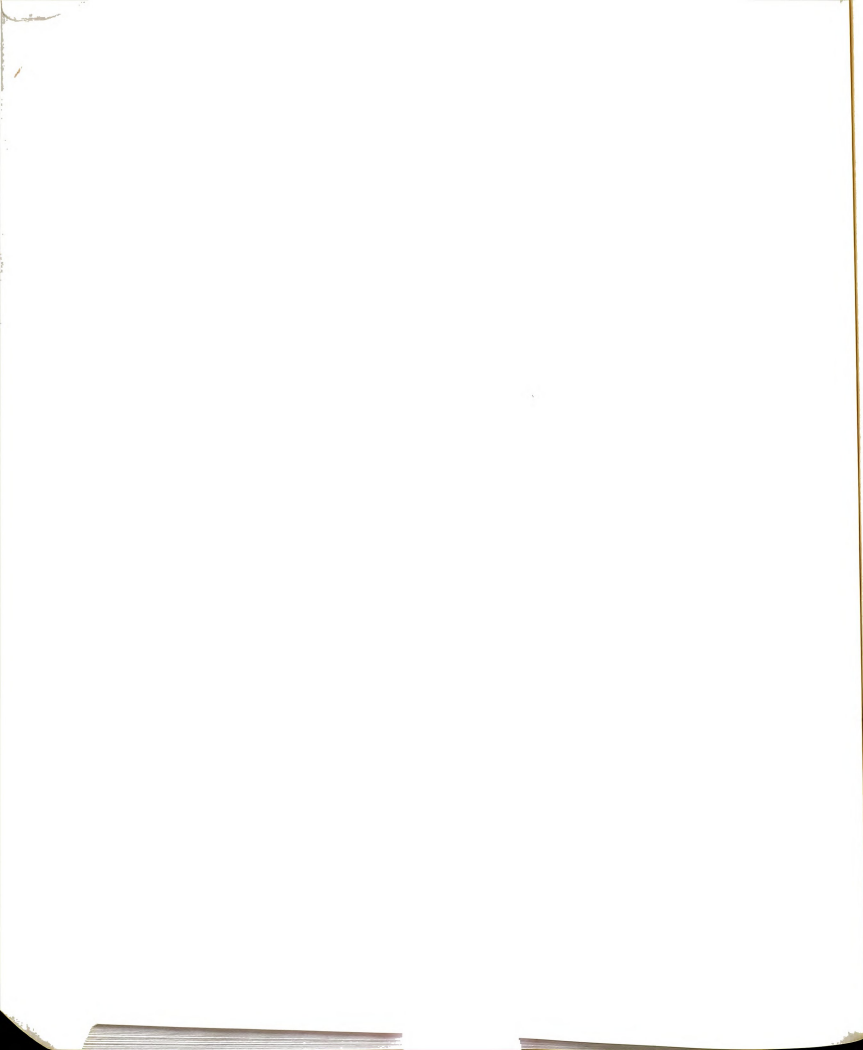
Joint ventures offer opportunities for restricted groups of cooperatives to coordinate export activities and for the development of cooperative-corporate partnerships in export marketing. The potential here is similar to that of a MFEC. Joint ventures may involve the combination of cooperative product origination capacity with corporate export marketing systems, the joint development of export marketing systems, or some combination of corporate capacity in the performance of individual export functions with a cooperative sales network. The complementarity of objectives in cooperative-corporate ventures must be



given particularly careful scrutiny in order to assure that it is consistent with the overall marketing objectives of the cooperative and its members.

Webb-Pomerene associations are another mechanism for collaboration in exporting which may include cooperative and/or corporate participants. The Webb-Pomerene Act provides explicit antitrust protection for collaboration among domestic competitors in export marketing. As such, it may usefully complement any of the above organizational forms and the immunities of the Capper-Volstead Act. Webb-Pomerene has been used to improve the bargaining advantages of shippers in the establishment of ocean freight rates. It has also aided groups of U.S. exporters in dealing more effectively with foreign governments and state traders both in gaining access to markets and replacing cut-throat competition with more orderly marketing.

Two organizational options were deemed to offer limited potential to cooperative exporters. For a Cooperative Trade Information Service to be of value, it would have to provide better and/or lower cost market information and intelligence to cooperative exporters than currently obtainable from other sources. However, the acquisition and validation of market intelligence in most cases requires a trading presence in a given market. Without linkage between market information and sales functions, it was concluded that the value of a CTIS would be extremely limited. A more viable alternative for cooperatives wishing to monitor foreign market conditions without a major commitment to exporting would be the use of a joint venture or MFEC to gain access to market intelligence collected by an active export marketer.

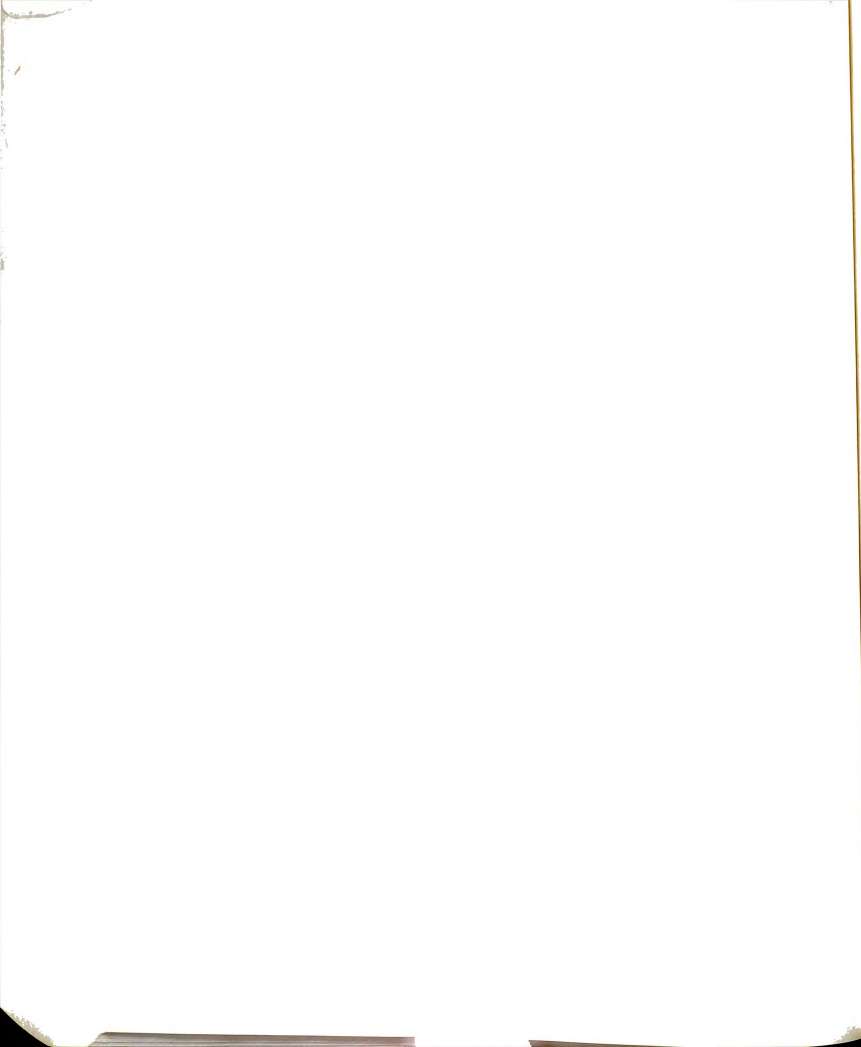


A Cooperative Brokerage Organization was discarded as a viable option early in the research process. There are significant numbers of brokers trading all agricultural commodities. They range in size from a telephone in a closet to substantial operations. A brokerage organization which limited its source of supply to farmer cooperatives would appear to be entering a highly competitive business at a competitive disadvantage. Thus, the option was rejected.

Both the CTIS and CBO arrangements may offer some appeal in that they would require minimal commitment by participants. This would also be a fundamental contribution to their ineffectiveness relative to the other organizational options considered above.

In conclusion, it is useful to note that the range of commodities for which some export marketing activities can be combined is virtually unlimited. Nonetheless, in the short and medium term, cooperatives can probably derive the greatest benefits through the development of separate efforts for (1) dry bulk commodities, such as grains, soybeans and other feed ingredients, and (2) perishable, processed or branded products, including fruits, nuts, vegetables, and some meat products. While there may be some long term advantages to the existence of a cooperative sales agency handling all U.S. produced agricultural commodities, constraints upon human organizational capacity and problems related to control appear to mitigate against the success of any attempt to combine all commodities in such an organization without the prior development of successful joint arrangement within both of the commodity areas identified above.

For individual cooperatives, the choice among export marketing options requires careful analysis of their particular marketing objectives



and alternatives. The current study has identified a wide range of factors which can contribute to such analyses. It has also uncovered a number of issues worthy of further investigation.

7.4 Suggestions for Further Study

This research has identified significant opportunities for the achievement of size economies in the performance of certain export marketing functions. It has also evaluated alternative organizational arrangements as mechanisms for collaboration among farmer cooperatives in export marketing. In this process several areas meriting further research have been identified. These include: (1) feasibility studies relative to specific combinations of commodities and/or cooperatives in exporting, (2) narrowly focused research within specific functional areas, and (3) further study of structural and organizational dimensions of foreign markets.

This research did not attempt to identify or evaluate the potential for specific groups of cooperatives to coordinate their export marketing activities. The need for feasibility studies directed at specific sets of cooperatives can be established based upon assessments of exporting marketing objectives, capabilities and requirements of possible participants. Such studies may consider the feasibility of fully coordinated export sales arrangements and/or the joint performance of individual export related functions. A foreign exchange trading cooperative, discussed earlier, is one example of the latter type of arrangement.

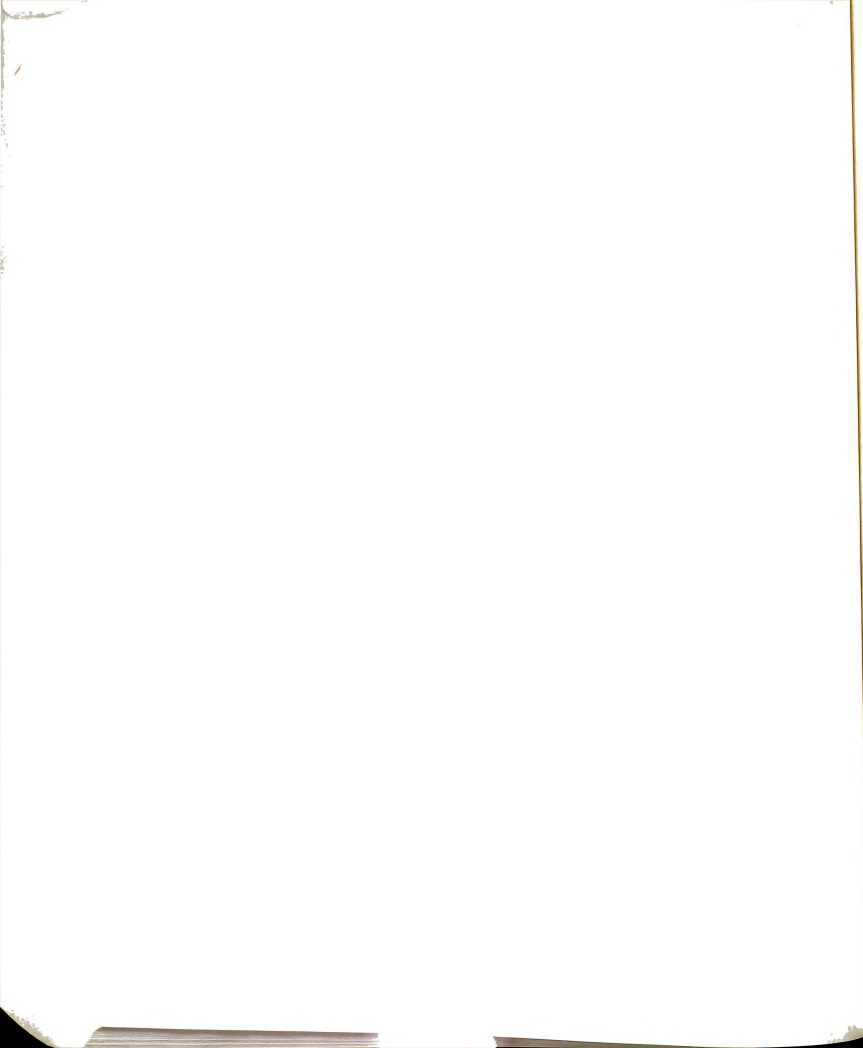
In the development of more narrowly focused research within specific functional areas, it would be useful to consider a number of interesting

and important issues related to: product commitment, branding, transportation and physical distribution, and, foreign market information and sales.

Product procurement arrangements such as pooling are often thought to result in merchandising flexibility which can be translated into higher average prices for cooperative owner/members. One cooperative leader has suggested that such arrangements actually lead to merchandising lethargy. Many others heartily disagree. This subject is of interest for domestic and export marketing. In light of the fact that this and a number of other studies have identified product commitment as a significant issue, further analysis would be useful. It has been noted that pooling is much less popular among bulk grain and soybean producers than among producers of fruits, nuts and vegetables. The success of some cooperatives handling rice in obtaining member product commitment while providing producers with a range of pricing alternatives merits further study as an option for grain cooperatives.

An additional procurement related topic which should be investigated is the competitive reaction of handlers who are not cooperatives to the establishment of cooperative pooling programs and other marketing agreements, particularly in the grains area. This may provide some insights into the constraints facing cooperatives as they attempt to develop innovative marketing strategies.

Additional study of the impact of branding of processed products on export marketing economies could be quite useful. Some joint venture participants export products under several different brand names. It would be expected that some economies could be achieved through the development of a common export brand, or set of brands, for use by

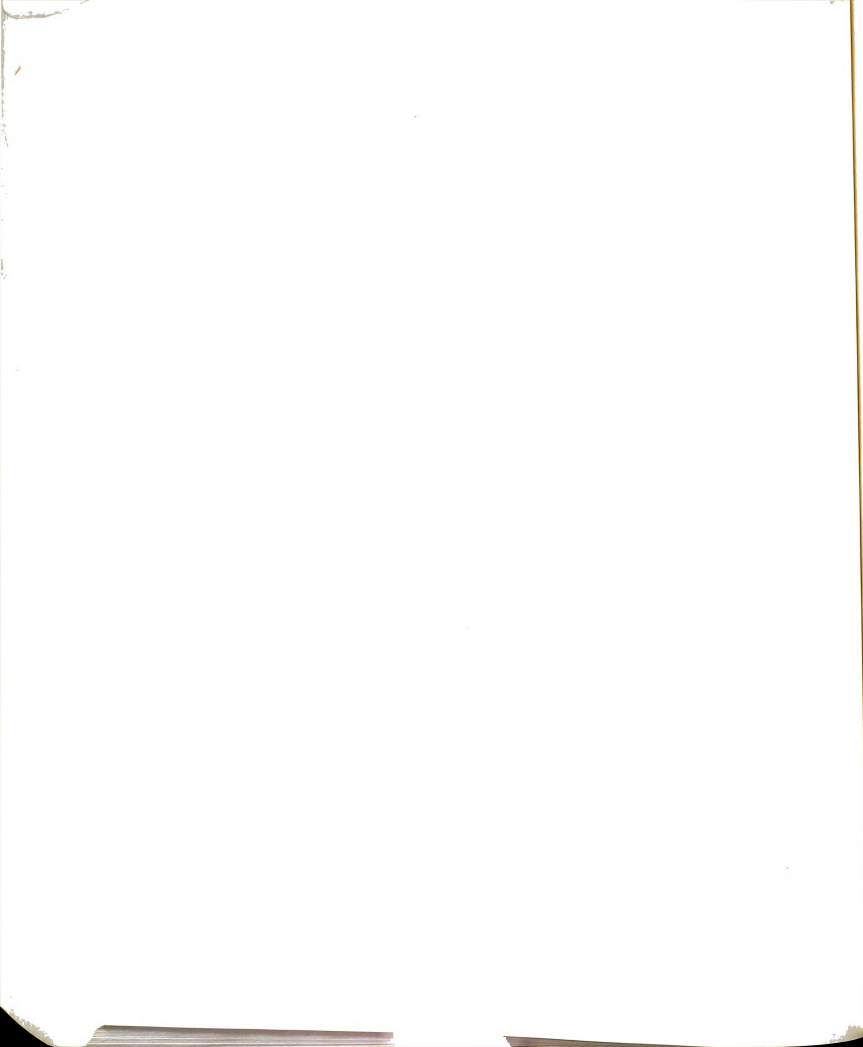


collaborating cooperatives. Significant complicating factors appear to inhibit the development of joint branding arrangements. Useful research could focus upon analysis of potential economies associated with joint branding and promotion in selected markets as well as means to overcome organizational impediments to such activity if it is indeed desirable.

Rising energy costs can be expected to have significant impacts upon international transportation and distribution costs. This will influence the competitive position of U.S. produced agricultural products abroad. Ship chartering, consolidation of shipments and joint warehousing arrangements all merit further study with respect to their potential impact on comparative advantage and the development of sales in specific foreign market areas.

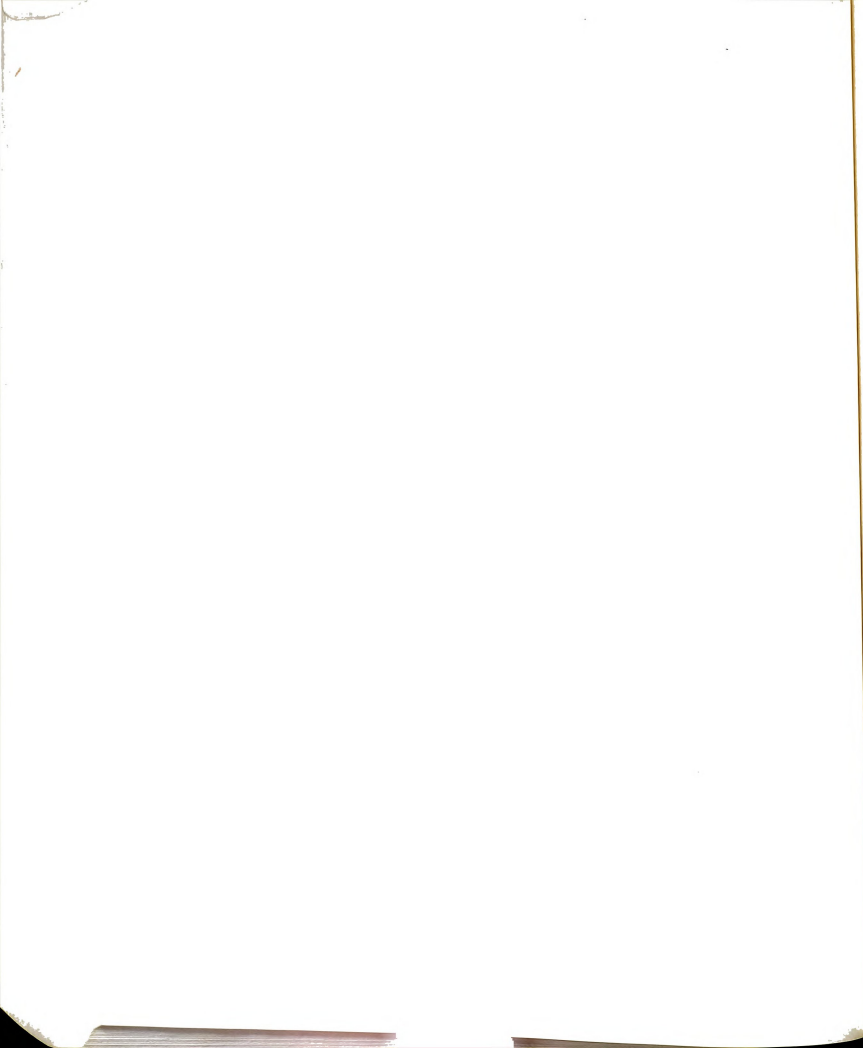
In evaluating the performance of the information function, further definition of the roles of public and private sources of data and information could be useful in considering both the effects of information on the competitive positions of individual market participants and the cost effectiveness of government trade-related information programs.

Opportunities for improved sales function performance may be identified through investigation of market organization in individual countries or groups of countries as well as further study of export agents and representatives. This can contribute to an understanding of the range of commodities which can be handled through coordinated marketing in specific geographic areas. Additionally, more precise estimates of the effect of sales volume on the quality of service rendered by agents to individual or groups of exporters could be developed through research with a limited commodity focus conducted in foreign markets.



Research focusing on the organization, functions and decision making processes of various multinational corporations and state trading institutions with which U.S. cooperative exporters compete and/or to whom they sell could also be of value if it could be carried out. Such studies could improve cooperative exporters' understanding of the export process and provide useful insights into specific areas where coordination in export marketing activities could be of value.

These subjects are indicative of some of the main areas in which further research could contribute profitably to improvement in the position of U.S. farmer cooperatives in export marketing. Cooperatives already have considerable experience in some of these areas. The usefulness of future research can be enhanced considerably through recognition and further assessment of that experience.



APPENDIX

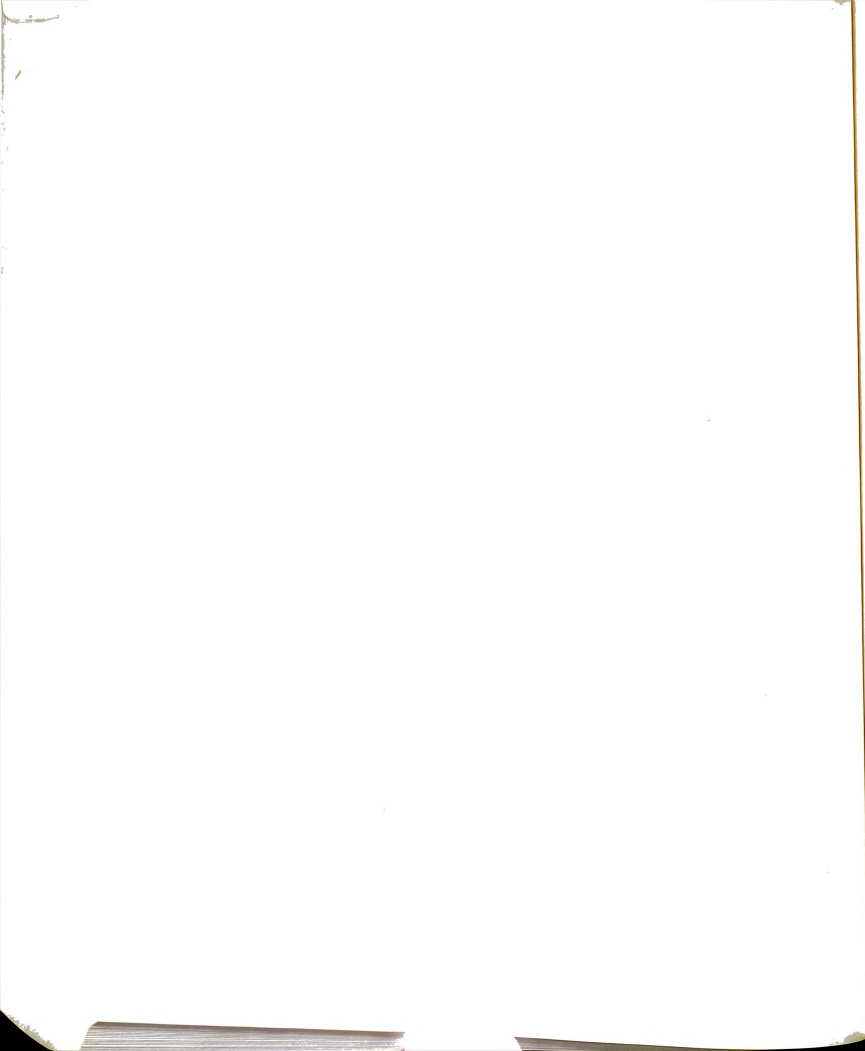
APPENDIX
ECONOMIC POTENTIAL OF MULTICOMMODITY
COOPERATIVE EXPORTS PROJECT
RESEARCH ISSUES OUTLINE

I. Physical Factors

- A. Commodities Exported
 - 1. Timing
 - 2. Variability of Supply and Demand
 - 3. Member Product Commitment
 - 4. Product Diversity and Quality
 - 5. Size of Sales
 - 6. Destinations
- B. Physical Handling
 - 1. Packing and Labelling
 - 2. Transportation - mode, cost, special requirements
 - a. Domestic
 - b. International
 - 3. Documentation

II. Institutional Factors

- A. Use of Agents, Brokers, Freight Forwarders, etc.
- B. Direct versus Indirect Sales--f.o.b., c.i.f., etc.
- C. Past and Present Competition or Cooperation in Export Marketing
- D. Use of Government Facilitating Programs, i.e. FAS Cooperator Promotional Funds, TORS
- E. Sources of Market Information and Analysis
- F. Price Quotations--offers and tenders, sources of requests, methods and frequency of preparation
- G. Financial Arrangements--payment, credit, insurance, foreign exchange
- H. Government Regulations and Barriers as a Factor Influencing Exports



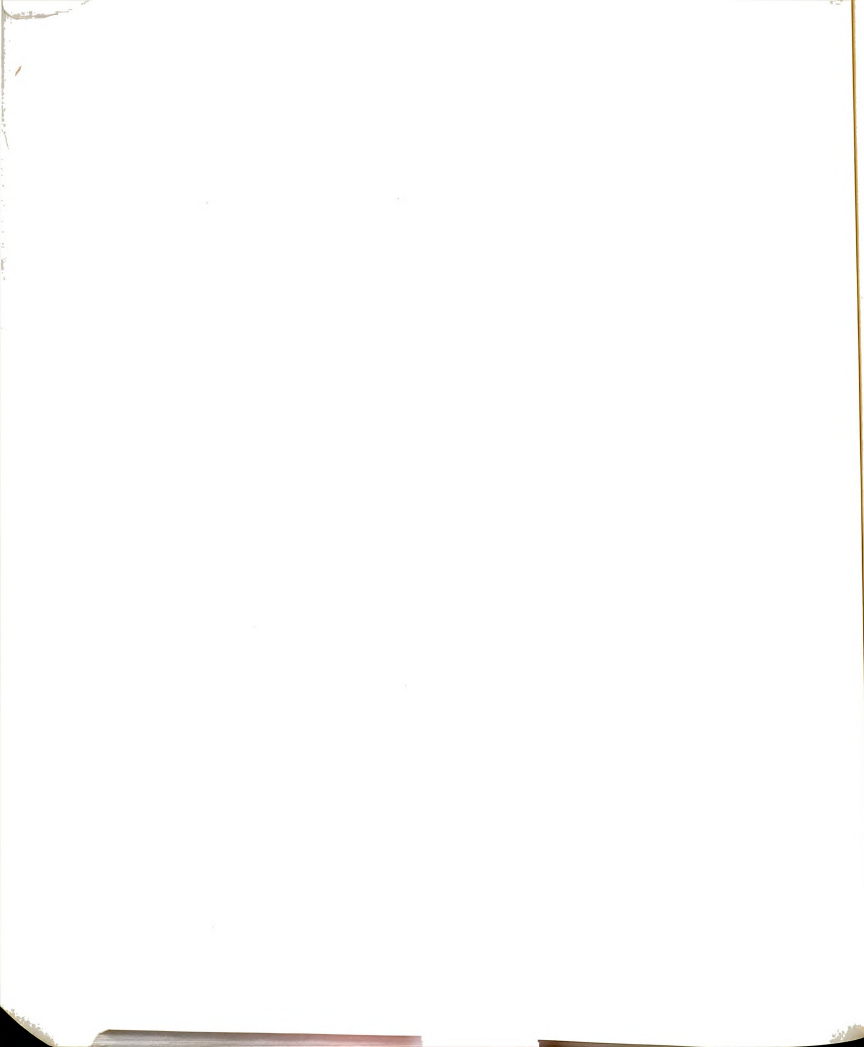
III. Long Range View of the Cooperative and Export Potential

IV. Organizational Arrangements for Cooperative Export Development

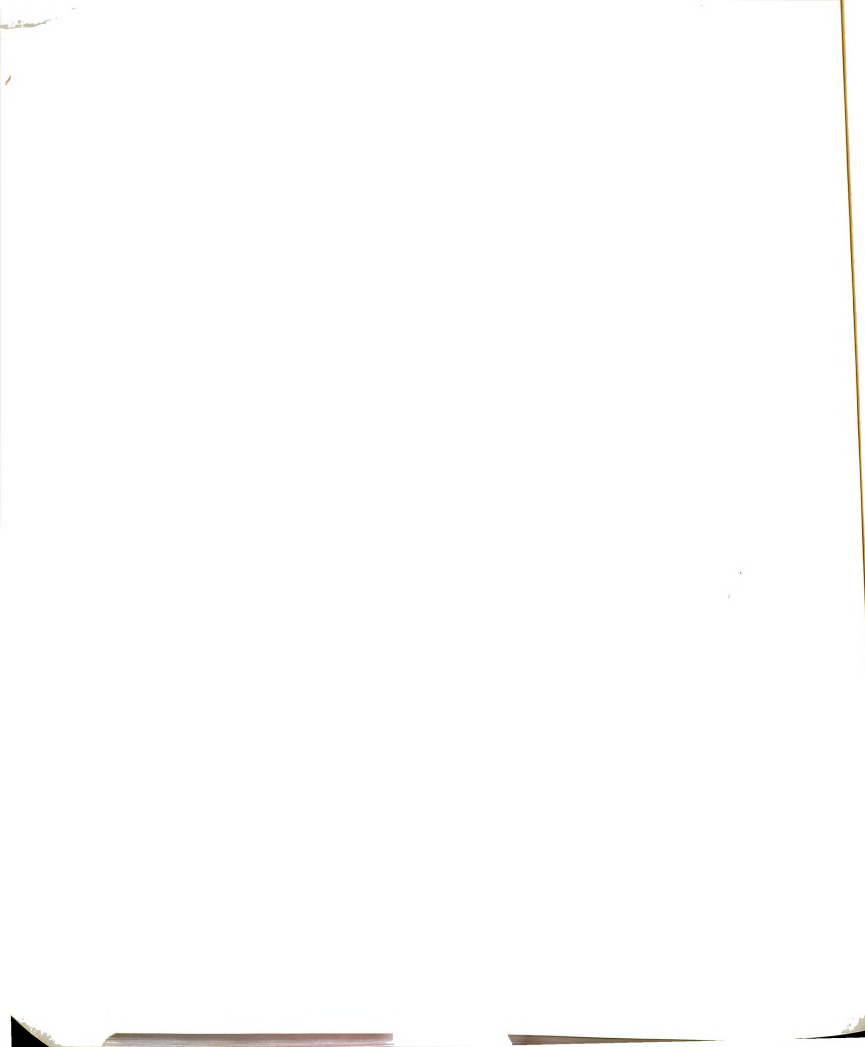
- A. Cooperative Trade Information Service
- B. Cooperative Brokerage Organization
- C. "Lead Cooperative" Providing Export Management Services
- D. Federated Multicommodity Export Cooperative
- E. Cooperative - Private Joint Venture
- F. Webb-Pomerene Association
- G. Other

V. Criteria for Evaluation of Organizational Alternatives

- A. Potential Benefits for Cooperatives and Their Members
- B. Potential Size or Scale Economies Through Multicommodity Coordination
- C. Potential for Spreading Risk
- D. Potential for Increasing Ability to be Competitive with Private and State Traders
- E. Potential Compatibility with U.S. Law Related to Agricultural Cooperatives and Export Development
- F. Additional Advantages and Disadvantages

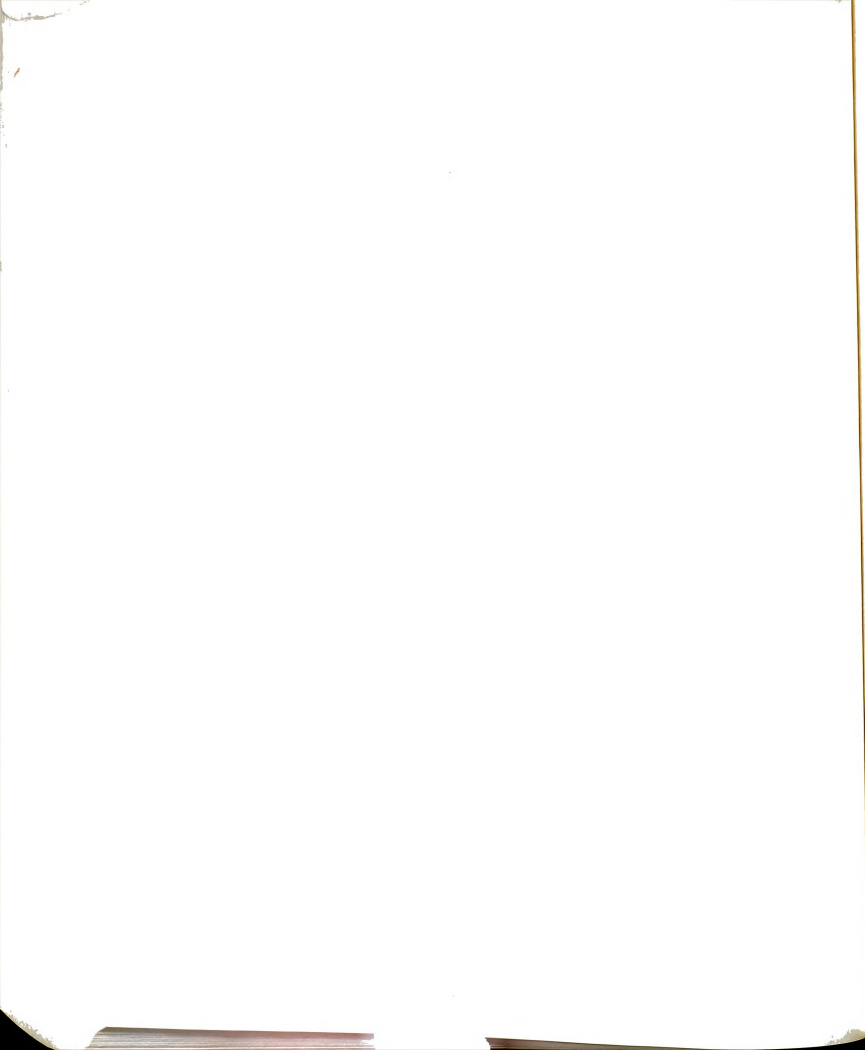


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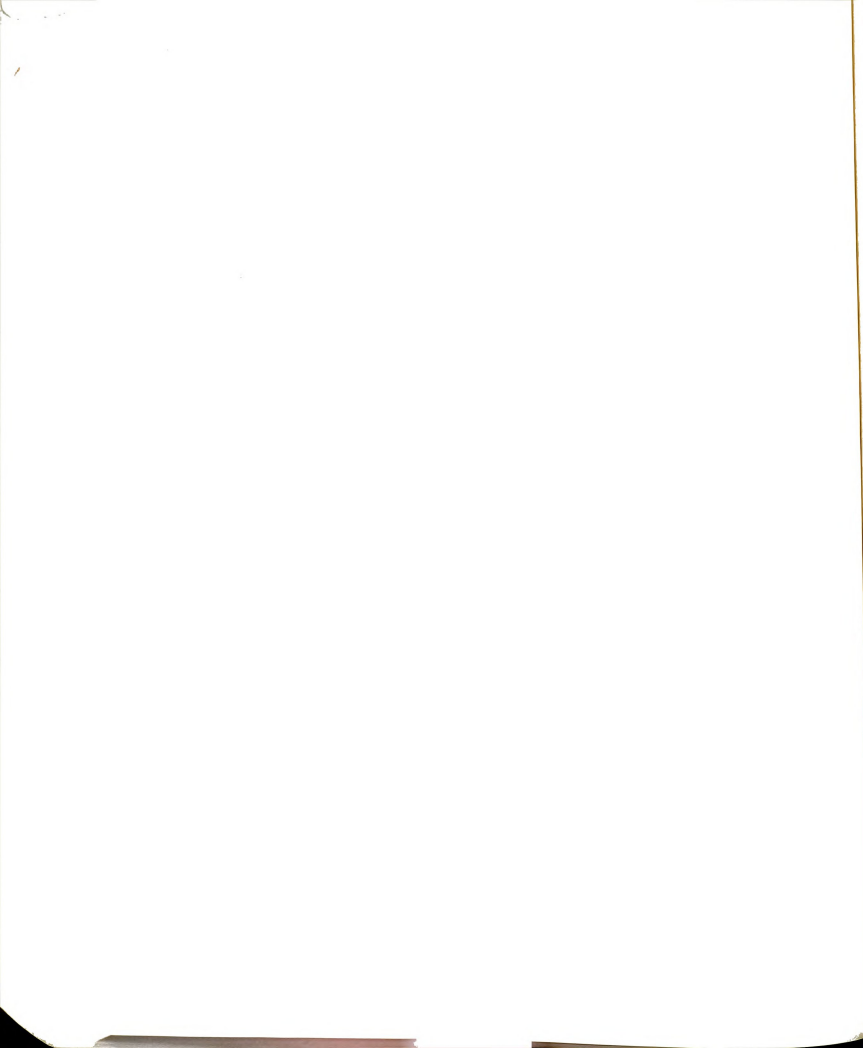


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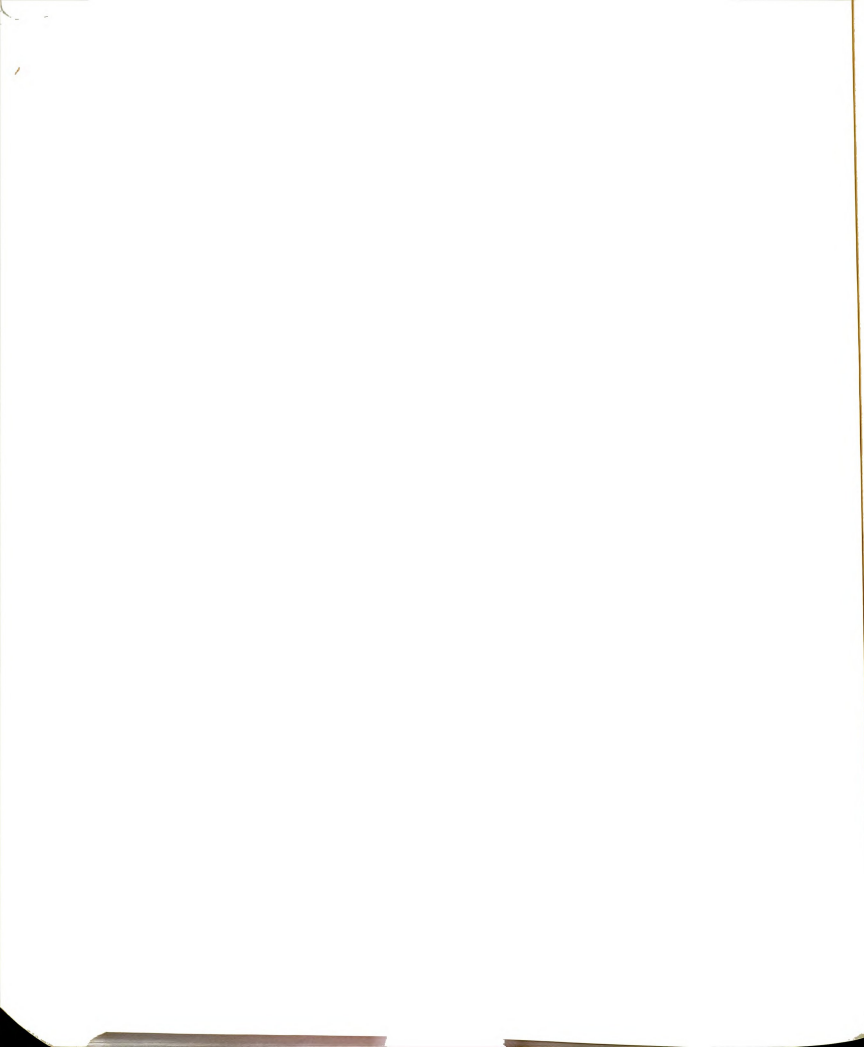
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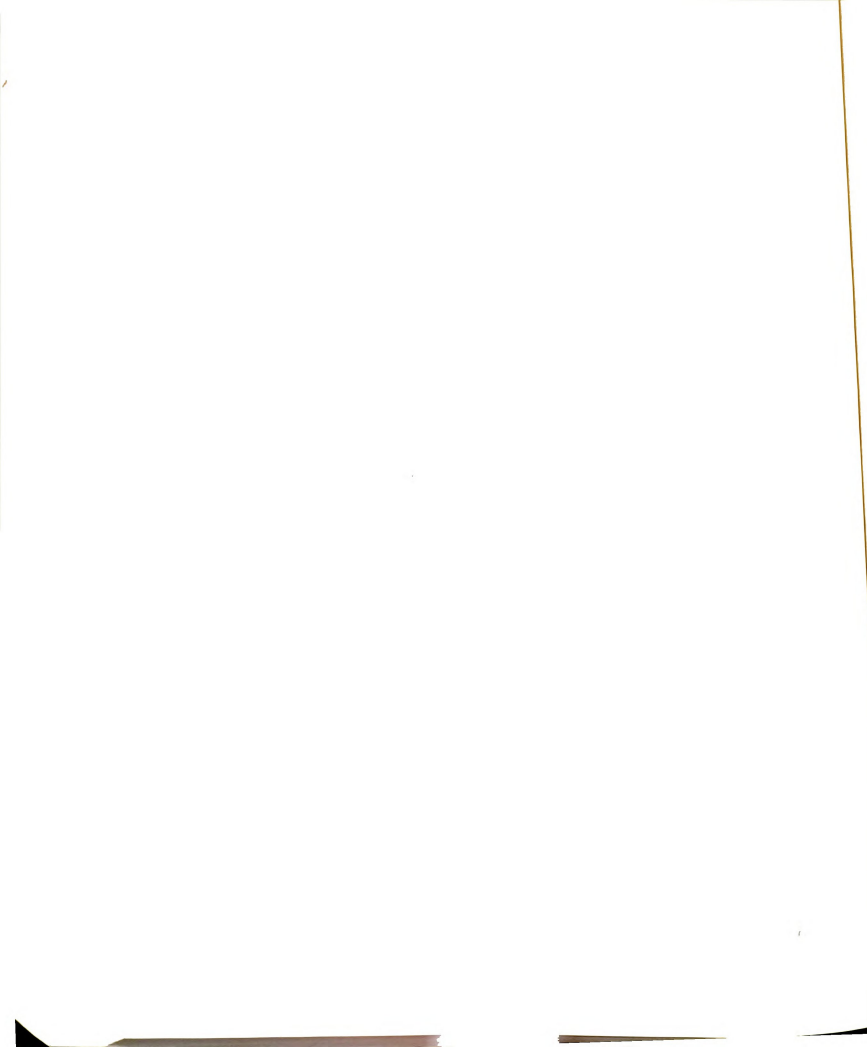


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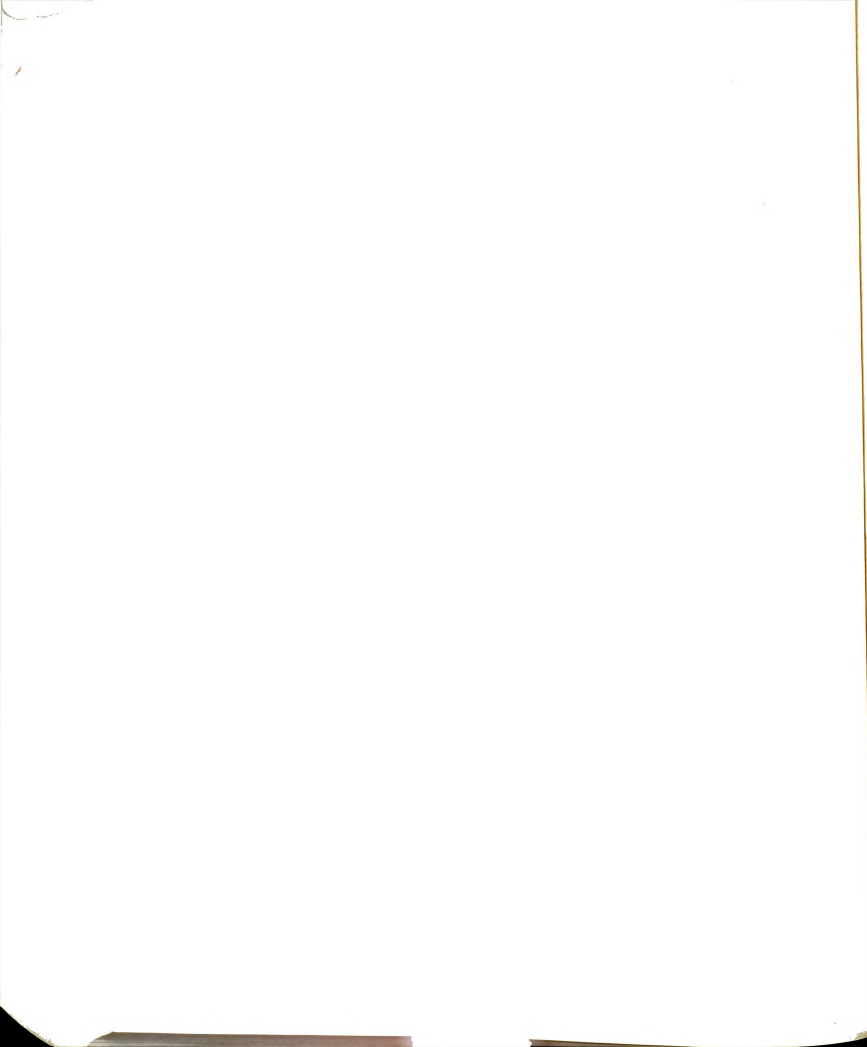


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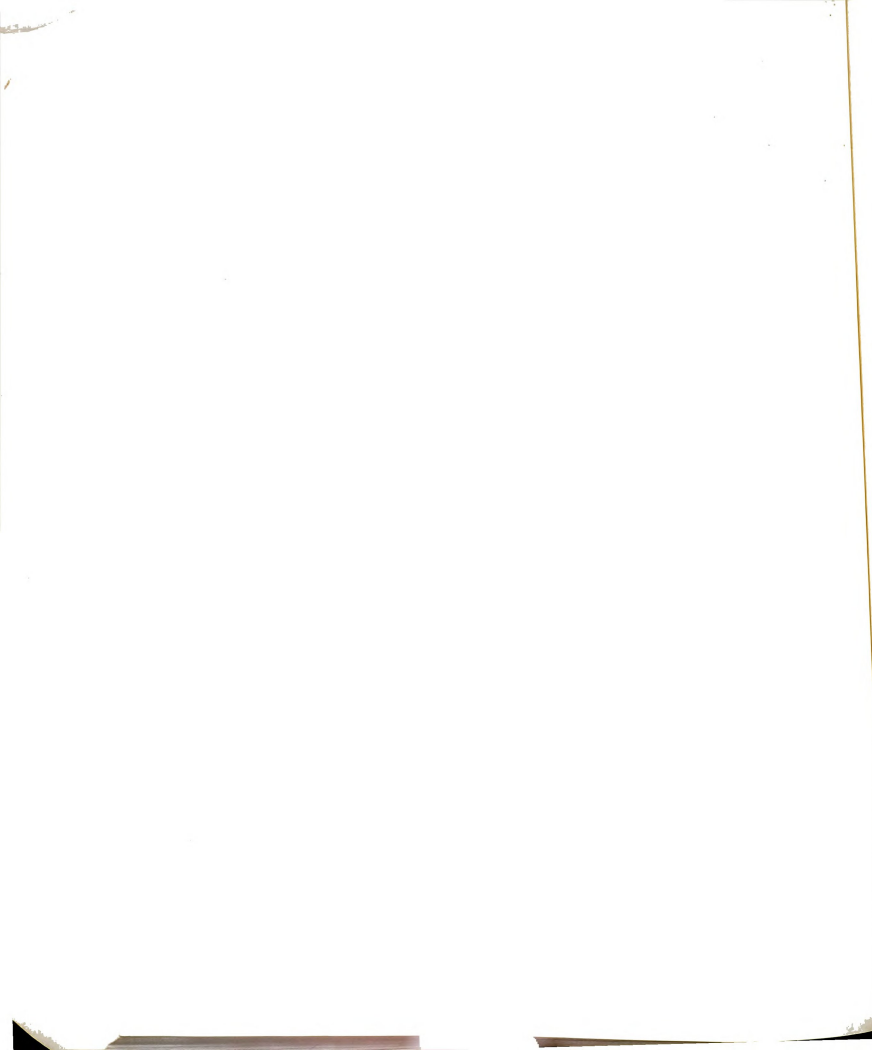


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