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Marketing Margins for Beef and Related Considerations

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Introduction

In an environment where inflation has become a way of life, rising prices are a natural accomplice. High prices are fine--for the seller. But those of us who wear the hat of the consumer (and that's all of us) greet escalating costs with a less than joyful attitude. The question is, Can consumers, longshoremen, producers, shippers, and the Russians find happiness together? In some respects the interests of the producer and the consumer may not be significantly different and could form the basis of an alliance in which marketing innovations could take place.

As prices advance, both producers and consumers claim that middlemen's profits are excessive. This contention has been under close scrutiny, especially since the spectacular rises of 1973. Efforts to closely monitor changes at various marketing levels have been made by the USDA and other agencies.

Whether or not middlemen's profits are "excessive" is a sociological problem that may not be completely answered by economics. What is excessive to one person may not be excessive to another, and it might be argued that a 20% return on investment is necessary to a growing concern. Economists can play a vital role in informing the public of trends, helping people understand relevant concepts, and generally serving as a facilitator of information. Thus as pervasive purveyors, we can increase awareness of pertinent facts and hopefully contribute to more knowledgeable decisions.

Definitions

Many terms are used in referring to marketing margins, costs, and price spreads.

- 1) Price spread is defined as the difference in the price of an equivalent quantity of a commodity at respective levels of the marketing system. The meat of this definition is "equivalent quantity." A \$0.45 per pound price at the live level is not directly comparable to a \$1.50 per pound retail price because about 2.28 pounds at the live level are required to yield one marketable pound at the retail level.

Prepared for Nineteenth Annual Cattle Feeders Day, October 31, 1975.

- 2) Marketing Margin - The difference between what a firm pays for a product (including service charges paid to other firms and/or individuals outside the firm) stated in per unit terms. The revenue received from the sale of the product or products is stated in the same per unit terms as in the initial cost. It may include the cost of many products and services added to the product by the firm.
- 3) Marketing bill is the total cost of marketing an entire quantity of a commodity. Consumer expenditures less farm value for beef would indicate the marketing bill for beef.
- 4) Market basket refers to the marketing bill for a group of products purchased by the average family. Meat currently comprises about a third of Mr., Mrs., and Ms. America's market basket.

Marketing Margins and Price Spreads

Various methods can be used to calculate price spreads. Generally, all approaches allow for a 1,000 pound live steer, 620 pound carcass, 440 pounds of beef sold at retail, by-product values, and loss due to shrinkage and other factors. By using these yields, it is possible to compute price spreads on a per head basis.

These computations are estimates for industry averages and, therefore, cannot be interpreted as indicative of a specific transaction. Also, assumptions regarding dressing percentage, cutout composition, and other items must be made to facilitate the estimation process. Although these assumptions are reasonable and useful, specific conditions in the short run may hamper the accuracy of computed spreads.

Total gross marketing spreads for beef include the farm-wholesale and wholesale-retail marketing spreads. The fact that this is a "gross" margin should be emphasized because the cost of beef is the only cost taken into consideration. Other costs must be included if a profit margin is to be computed.

Over the long term, marketing margins have tended to widen. One reason is the effect of inflation on costs which have been passed on to consumers. Another reason is the demand for additional services. As incomes and affluence have increased, the housewife has demanded foods which require less preparation in the home, are attractively packaged, etc.

In some respects the cattle industry has benefited from increasing marketing margins. A popular chant today refers to the necessity for properly merchandising beef. This may include various factors such as advertising, packaging, convenience, etc. which increase marketing costs. But at the same time they help move beef at the retail level. Therefore, by spending more money on aspects that increase marketing costs, movement at retail level may be enhanced and it could be possible to sell the same quantity as before at a higher price, i.e., an increase in demand.

QUARTERLY FARM TO RETAIL GROSS MARKETING MARGINS

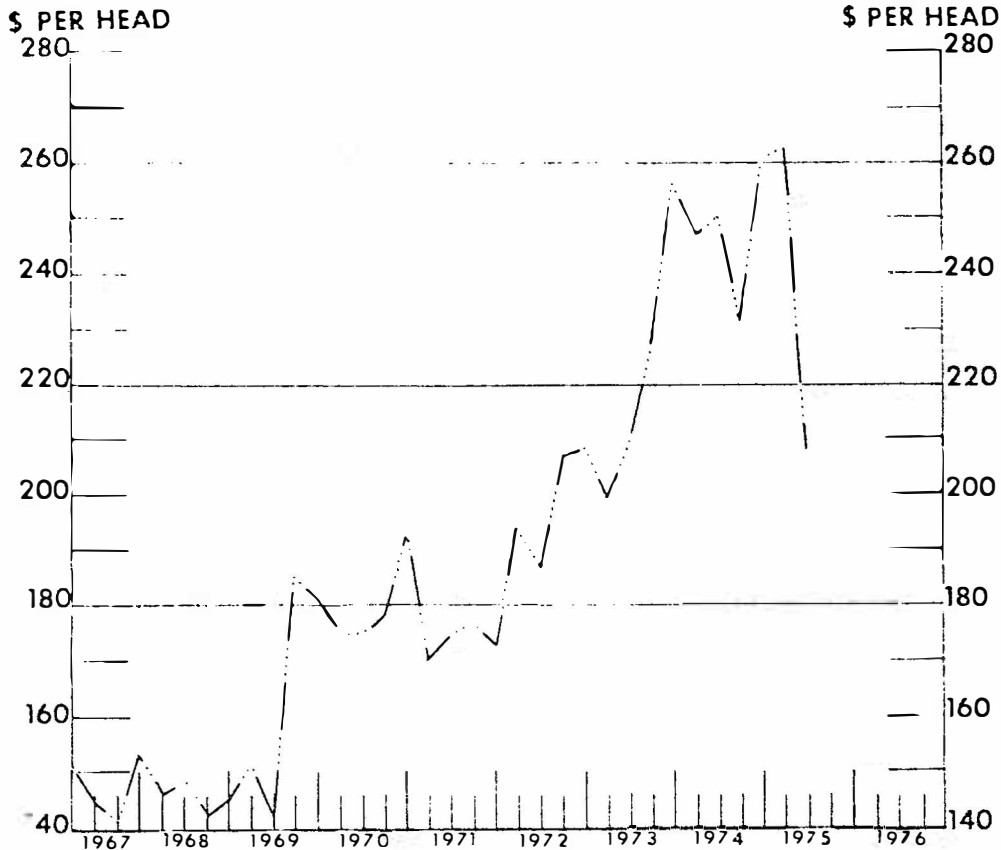


CHART 1

Marketing spreads have been more stable than farm values in the long run. This is because farm values are closely related to farm prices which are a function of supply and demand and can vary widely. On the other hand, costs of getting beef from the feedlot to the consumer do not generally fluctuate as much as farm prices. This has an impact on the relationship between the variation in marketing margins and farm prices.

In the short term, because marketing costs (margins) vary less than live prices, an increase in live prices will be accompanied by an increase in the farmer's share and vice versa. Said another way, as farm values increase, marketing margins from farm to the consumer are squeezed. This is exactly what took place when cattle prices advanced from February to June this year.

Note that in Table 1 the marketing spreads for beef are expressed on a per head basis and computed with Colorado live and wholesale prices. Prices at Colorado locations are used in an attempt to localize marketing spread data.

Table 1. Live-Wholesale-Retail Gross Marketing Spreads for Beef

	1	2	3	4	5	6	7	8	9	10
	Live prices ^a per cwt.	Value 1000 lb. steer per hd.	By-product value per hd.	Wholesale prices ^b per cwt.	Value of carcass ^c per hd.	Live to wholesale spread per hd.	Retail price ^d per lb. (cents)	Value of retail cuts ^e per hd.	Wholesale to retail spread per hd.	Percent marketing margins of total retail value
Annual										
1967	\$25.00	\$250.03	\$18.50	\$40.32	\$249.98	\$18.46	82.6	\$379.20	\$129.22	37.1
1968	27.03	270.27	18.50	42.90	265.99	14.23	86.6	397.27	131.28	35.7
1969	29.88	298.85	22.41	46.77	290.83	14.39	96.2	441.37	150.54	35.6
1970	29.49	294.90	22.79	46.36	287.41	15.30	98.6	452.38	164.97	37.9
1971	32.60	325.98	22.05	51.31	318.14	14.21	104.3	478.53	160.39	36.4
1972 ^f	35.79	357.85	34.96	54.38	337.15	14.26	113.8	522.11	184.96	35.8
1973 ^f	44.03	440.30	45.15	66.60	412.92	17.87	134.7	618.00	205.08	33.6
1974										
January	49.46	494.60	45.93	74.18	459.92	11.25	143.0	656.08	196.16	29.5
February	47.42	474.20	44.91	73.84	457.81	28.52	150.0	688.20	230.39	35.3
March	41.83	418.30	42.07	66.56	412.67	36.44	142.2	652.41	239.74	39.8
April	41.61	416.10	39.76	64.09	397.36	21.02	136.4	625.80	228.44	37.5
May	41.29	412.90	36.57	64.72	401.26	24.93	135.0	619.38	218.12	37.1
June	38.16	381.60	33.36	61.94	384.03	35.79	132.2	606.53	222.50	40.4
July	45.30	453.00	36.76	70.87	439.39	23.15	137.9	632.69	193.30	32.3
August	48.88	488.80	38.69	73.67	456.75	6.64	143.4	657.92	201.17	29.8
September	41.56	415.60	35.02	65.96	408.95	28.37	141.6	649.66	240.71	39.3
October	40.11	401.10	33.23	64.19	397.98	30.11	136.8	627.64	229.66	39.3
November	38.19	381.90	30.39	61.32	380.18	28.67	134.4	616.63	236.45	41.0
December	37.66	376.60	26.79	59.59	369.46	19.65	132.2	606.53	237.07	40.5
Average	42.62	426.20	36.96	66.74	413.81	24.55	138.8	636.62	222.81	36.7
1975										
January	36.65	366.50	25.50	61.70	382.54	41.54	132.8	609.29	226.75	42.3
February	34.52	345.20	24.55	58.34	361.71	41.06	129.0	591.85	230.14	44.0
March	36.21	362.10	27.29	59.06	366.17	31.36	127.0	582.68	216.51	40.6
April	43.95	439.50	32.50	69.11	428.48	21.48	133.9	614.33	185.85	32.1
May	51.35	513.50	33.49	80.26	497.61	17.60	147.8	678.11	180.50	27.8
June	53.86	538.60	35.17	85.77	531.77	28.34	157.8	723.99	192.22	29.1
July	50.98	509.80	36.74	83.07	515.03	41.97	161.0	738.67	223.64	34.3
August ^g	46.48	464.80	38.30	77.60	481.12	54.62	155.2	712.06	230.94	38.1

^aChoice steers in Colorado.^bChoice 600 to 700 lb. steer carcasses in Colorado.^cColumn 5 times 6.20.^dU. S. average composite price for Choice beef.^eColumn 7 times 458 pounds.^f11 month average.^gEstimated.

Regional differences in price spreads at various levels reflect the locational differences in live, wholesale, and retail prices. This results from no adjustment for regional differences in cutout yields. On a head basis, the assumption is a 1,000 pound Choice steer will yield 620 pounds of carcass and 400 pounds at retail in Denver, Los Angeles, or any other location. Therefore, the only variation in price spreads results from price differentials among specific locations.

Values from February to June advanced faster at the feedlot level than at packer and retail levels as increases were about \$190 at the feedlot level, \$170 at the packer level, and \$130 at the retail level.

This resulted in the farm share of the retail value increasing from 56% to 72%, while the middlemen's share (farm-retail margin) declined from 44 to 28%. However, as cattle prices peaked in June, wholesalers and retailers continued to pass previous price rises on to the consumers in an attempt to recoup losses incurred by their declining market share in the February to June period.

Fluctuating margins affect or are affected by other factors. For instance, prices rose in the spring as packers found it difficult to obtain higher quality cattle and were forced to turn to more abundant numbers of nonfed cattle to fill slaughter requirements. Also, feedlots were very current and packer buyers had to bid aggressively to purchase available supplies of Choice slaughter steers. Thus, traditional bargaining power shifted from the packer to the feedlot, a change that is common in periods of tight supplies. At the same time, farm-retail margins narrowed. Conversely, if abundant supplies are available, generally live cattle prices would be lower and marketing margins wider.

The close inverse correlation that has existed between live prices and the farm-retail marketing spreads is indicated in Chart 2. On a monthly basis, in the last two years each change in the direction of live prices has been accompanied by a change in the middlemen's share of the total retail value.

Now let's consider some items that relate to the margins story:

WHAT TYPE OF BEEF HAS BEEN MOVING THROUGH CHANNELS?

Substantial numbers of nonfed cattle are currently being slaughtered. However, estimated commercial slaughter and production by class show relatively more nonfed beef is available than indicated only by slaughter.

In the second quarter of 1974, nonfed beef production accounted for about 22% of total beef production; this year that portion almost doubled.

Estimates of ground and processed beef show that in the April-June period of 1975 about 17% more of this type of beef was available than at the same time last year. In other words, ground beef made up about 8% more of total beef production in the second quarter of 1975 than in 1974. A record cow slaughter has also contributed to these changes.

LIVE PRICES & FARM-RETAIL MARKETING MARGINS AS % OF TOTAL RETAIL VALUE

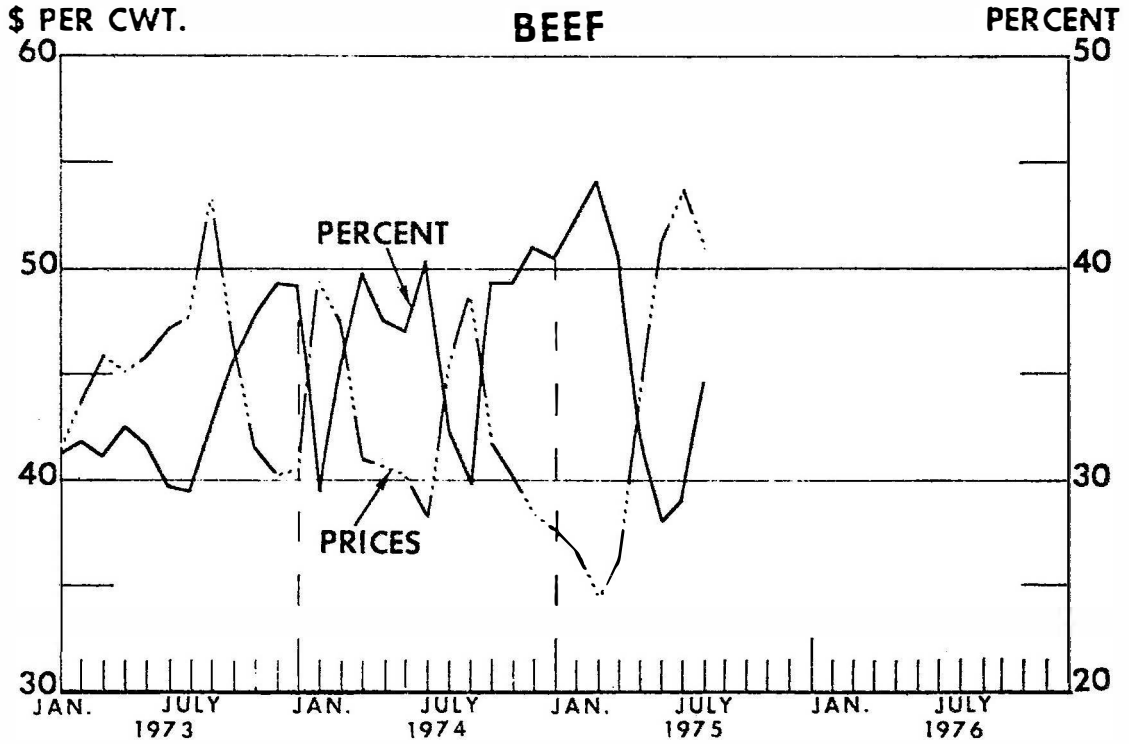


CHART 2

Historically, wide price differences between Good and Choice cattle, beef and different quality retail cuts have resulted from expanded nonfed and lessening fed cattle numbers. These price differentials are shown in Table 2.

Table 2. Price Differentials by Grade at Live,
Wholesale and Retail Levels

	Omaha		
	Slaughter steers 900-1100 lb. premium of Choice over Good \$ per cwt.	Carcass beef 600-700 lb. premium of Choice over Good \$ per cwt.	Retail prices United States premium sirloin steak over hamburger Cents per pound
1973			
1st quarter	3.04	3.39	82.1
2nd quarter	2.57	2.81	81.4
3rd quarter	2.70	3.79	81.6
4th quarter	1.82	2.99	71.6
1974			
1st quarter	2.68	3.62	74.1
2nd quarter	3.28	4.55	77.9
3rd quarter	4.39	5.36	91.0
4th quarter	2.41	4.40	88.1
1975			
January	3.25	3.84	89.6
February	3.29	4.52	89.9
March	3.15	3.34	87.4
April	3.88	3.63	92.8
May	5.48	3.88	104.7
June	5.97	5.75	121.3
July	6.87	7.77	121.3
August	7.26	8.99	132.9

Most marketing spreads are computed on the basis of Choice cattle and beef prices and a composite of retail cuts from a Choice carcass. Little or no data are available concerning cutout and what quantity of a specific cut is being sold. These factors may vary from operation to operation and can affect marketing margins.

WHAT ABOUT RETAIL PRICES?

Retail beef prices are collected by the Bureau of Labor Statistics and by the Economic Research Service (ERS). The retail price composite is a weighted average price of specific cuts of a Choice steer carcass. ERS makes adjustments for price specializing which obviously affects the price and quantity of beef sold.

Possibly other aspects could be taken into consideration when estimating retail prices and spreads. Farm and retail prices in a given week are used to calculate the spread. Time lags depicting the physical movement of beef might

enhance accuracy. Dressing percentages affect marketing margins and have varied more in recent months than in the past. Those estimating prices of various cuts should consider cutout composition. Increasing centralized fabrication in beef which could shift some cost components from retail to other levels and alter margins appears a predictable industry trend. The effects of most of these factors on prices and spreads are under study at this time.

WHAT ARE THE MIDDLEMEN'S PROFIT LEVELS?

As I mentioned before, economists may not actually be in the position to determine exorbitant profit levels; however, certain comparisons may be made. As shown in Table 3, over time packer and retail profits have been less than profits of all food manufacturing firms which in turn were lower than returns for all manufacturing firms.

Table 3. Average Profits After Taxes, 1964-74

	Meat packers	Retailers	All food manufacturing	All manufacturing
Percent return on equity	8.99	10.0	11.3	11.9
Percent return on sales	1.14	1.02	2.65	4.9

Note that retailers have the lowest profits when computed on the basis of return sales. Most retailers quote their profit margins as "only 1 cent out of \$1 for all goods sold"; this is correct. But consider the turnover at the retail level, it is enormous compared to many industries. Therefore, obviously anything as a percent of sales at the retail level may appear nominal.

The returns from total retail and meat sales may differ significantly. Usually the meat department accounts for about 25% of total sales and 35% of food sales. Studies indicate the consumer's image of the store may depend on the meat department. Therefore, more efforts may be made to make sure the meat department meets consumers' expectations; otherwise the shopper may be lost to competitors. Likewise, profits from meat sales may not be as great as profits on other items.

Comparing the four categories, the difference in profit levels is minimal. Adding another category, return to cow-calf operations which averaged 3 to 4% in 1964-74, we find significant profit differences. Perhaps middlemen's profits are not too high but cow-calf operators' returns are too low. Type of economic structure and subsequent degree of competitiveness found at the respective levels somewhat explains this difference. In essence, all categories except the cow-calf operator are able to pass most if not all of their cost increases on to consumers.

WHAT ARE THE MAJOR COSTS ENTAILED IN MARKETING FARM-FOOD PRODUCTS?

Recall that the marketing bill is an approximate cost of getting food from the farm to the consumer in a form demanded by the consumer. Therefore, the marketing bill is simply the difference in consumer expenditures and farm value. Chart 3 indicates all of these items have been rising.

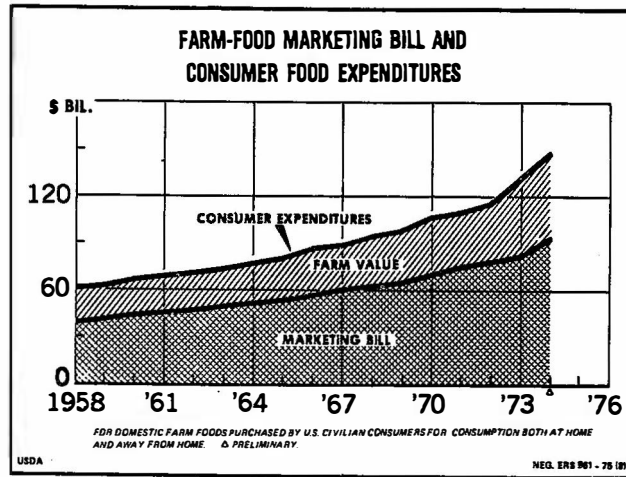


CHART 3

Last year consumer expenditures totaled \$147.5 billion, up 12% from 1973. Farm value was up 11% and the marketing bill was \$92 billion, up 12%. Meat products comprise the largest category of the marketing bill as they account for about one-fourth of the total (Table 4).

Table 4. Marketing Bill for Domestic Farm Foods, 1974

Item	Marketing bill (Mil. \$)	Percent of total
Meat products	23.3	25.2
Fruits, vegetables	23.1	25.1
Bakery products	11.9	13.0
Dairy products	11.9	12.9
Poultry, eggs	4.3	4.7
Grain mill products	3.9	4.3
Other	13.6	14.8
Total ^a	92.0	100.0

^aTotals may not add due to rounding.

The major cost component of the marketing bill is labor. In the last ten years, labor and packaging costs have doubled. Packaging costs (now 12% of the food marketing bill) have increased as consumers demanded attractive wrappers and as merchandising men found that an item sold better if it was dressed in a loud, eye-catching package instead of a plain brown paper bag. Who pays for this? Initially, the company must purchase the equipment to tie plastic bags and efficiently wrap the products, but eventually all the costs are passed on to the consumer.

What about rising labor costs? Not only have labor costs doubled since 1965, they now account for 51% of total marketing costs instead of the 43% prevalent in 1965.

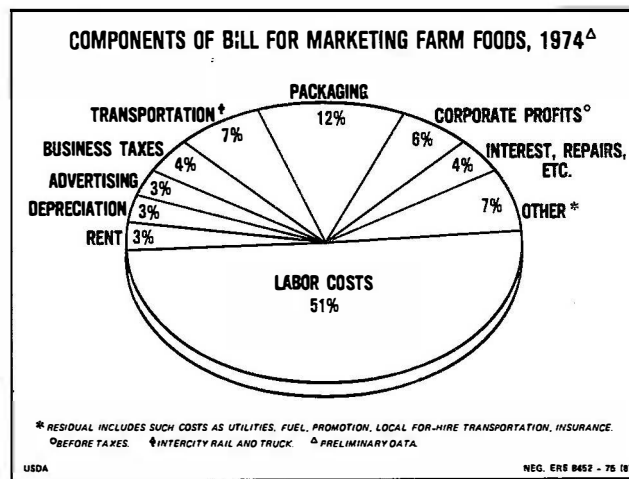


CHART 4

Today the cost of food to consumers includes much more than the cost and returns to farmers, especially in foods that require more processing. Sources of food cost escalation in many cases are related to what happens to the product after it leaves the farm. A 1,000 pound steer in a South Dakota feedlot is of little utility to a New York urbanite. But if that steer is dressed, transported to the consuming area, and partially stored (few people consume 400 pounds of beef in a short time period), then the utility to the consumer has increased. However, there are costs associated with these changes in utility and their escalation has accounted for much of the total increase in food costs.

WHAT HAS BEEN THE EFFECT OF WIDENING MARKETING MARGINS?

It is difficult, if not impossible, to assess the impact of changes in marketing margins on various facets of the system. However, changes can be noted and an attempt made to explain those changes based on available information and theoretical considerations.

Producer-consumer alliances have been mentioned. Actually, it may not be necessary for farm-retail marketing margins to be exorbitantly wide for such innovations to occur; if people only perceive margins are too wide, changes may take place.

Recently groups of feedlot operators have ventured into retailing. They opened outlets to sell directly from the feedlot after the beef has been broken down on the retail premises. Under this change, the feedlot is capturing some of the returns previously accruing to middlemen as the feedlot owners accept more risk and responsibility. Potential savings can be passed on to consumers; however, continued savings to consumers may or may not result.

Another innovation is the cooperative grocery store. Believing grocery chains were realizing excessive profits, some consumers have banded together to operate their own grocery stores. Again, it is probably too early to properly assess the success or failure of such operations. Only time will tell.

Perhaps somebody thought these changes would improve the system. If this judgment was correct, then hopefully the system was made more efficient by the changes, and the feedlot-owned retailer and the cooperative grocery store will benefit and grow. If the judgment was not correct, hopefully it was a mistake from which we can achieve better understanding.

Perhaps continued observation and evaluation of the results of change will contribute to a better understanding of the system. This could be beneficial to all concerned; and we are all concerned.