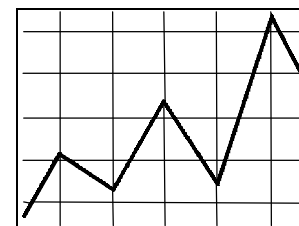


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WHY MOST SMALL AND MID-SIZED AGRIBUSINESSES AND COOPERATIVES DON'T EXPORT—IMPLICATIONS FOR THE U.S. DAIRY INDUSTRY

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Summary

Managers of small and mid-sized agribusinesses and cooperatives face a host of obstacles that discourage them from exporting. It is an apparent “article of faith” within the Foreign Agricultural Service of the USDA (FAS/USDA) that managers of many of these firms overestimate the difficulty of exporting. There is evidence suggesting that larger numbers of small and mid-sized agribusinesses and cooperatives could export profitably rather than battle over market share in domestic market segments that are often flat and fiercely competitive. From an industry perspective, the decision by many U.S. dairy firms to avoid exporting represents an implicit wager of sorts—a wager that assumes that expanded dairy exports will not be needed to maintain milk prices that are acceptable to U.S. dairy farmers. Exporting practices of successful small and mid-sized agribusinesses and cooperatives are described briefly in the paper, emphasizing practices of dairy exporters. Information needed by prospective agricultural exporters, and sources of that information, are discussed in the paper.

Introduction

The Federal Agricultural Improvement and Reform Act of 1996 (1996 Farm Bill) eliminated USDA farm price support programs that had existed for decades. For example, acreage set-aside programs (supply control measures), target prices, and deficiency payments for producers of corn, other feed grains, and wheat were eliminated by the 1996 Farm Bill and replaced by a schedule of declining payments to producers of these crops. In addition, the USDA’s dairy price support program—under which butter, cheese and nonfat dry milk are purchased to support farm milk prices—is scheduled to end after 1999 under the 1996 Farm Bill. Farm groups, the Congress, and Administration agreed to end certain major farm price support

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programs partly because they assumed (or hoped) that strong U.S. agricultural exports would support farm incomes, reducing the need for price supports. In 1998, the validity of this assumption is being called into question by weaknesses in Asian markets for U.S. farm exports and the strength of competing grain exporters—e.g., Argentine, Canadian, and Chinese grain exporters.

Relying upon agricultural exports to be the engine for growth in farm incomes is questionable for additional reasons, including one that is the subject of this paper: absence of most small and mid-sized agribusinesses and cooperatives from the exporting business is one reason that U.S. agricultural exports could fail to achieve their hoped for potential. Hence, the rationale for addressing the question: Why don't more small and mid-sized agribusinesses and cooperatives export?

The FAS/USDA is an agency which has as one of its main goals to “expand export opportunities for U.S. agricultural, fish and forestry products [5].” James Parker, Deputy Administrator for Commodity and Marketing Programs of the FAS/USDA, characterizes the problem addressed in this Marketing and Policy Briefing Paper as follows: The nearly \$60 billion of U.S. agricultural exports in fiscal 1996 were made by four to five percent of U.S. agribusiness firms. It appears that as many as 90 percent of U.S. agribusinesses do not wish to export agricultural products but an additional five or six percent do. An important task for FAS is to identify and help those that wish to export [8].

It is an apparent “article of faith” within the FAS/USDA that misconceptions exist in the minds of managers of many small and mid-sized agribusinesses and cooperatives that cause them to overestimate the difficulty of exporting. Parker, the FAS/USDA official, uses the Japanese market for value-added food products to support the agency's point. Parker, who worked in Japan for the FAS/USDA, claims that competitively priced U.S. differentiated food products can now be sold in Japan more readily than the conventional wisdom based on obsolete information suggests. Parker argues that small and mid-sized U.S. agribusinesses could secure more of this business. None of the private sector and university people interviewed by the author for the study challenged the validity of points associated with the FAS/USDA's “article of faith.” Therefore it is reasonable to believe that larger numbers of small and mid-sized U.S. agribusinesses and cooperatives could export profitably rather than battle over market shares in domestic market segments that are often mature and fiercely competitive.

Why Don't Many Small and Mid-Sized Agribusinesses Export?

Persons interviewed said that many small and mid-sized U.S. agribusinesses and cooperatives explain or rationalize decisions not to export for some of the following reasons: “Exporting is a big firm's game,” “We don't have the infrastructure needed for exporting,” “We are a small startup firm and have not yet taken advantage of all the good opportunities in the domestic market,” “The domestic market is familiar,” “Foreign markets are risky and we might not get paid for our products,” “We don't know how to obtain reliable information about opportunities in the export market,” “The red tape involved in exporting is a nightmare,” “The board of directors of our cooperative is

skeptical about the benefits from exporting,” and “Cooperatives are inherently short of capital, and we are reluctant to put available capital into a risky exporting venture.”

Parr Rosson, Extension Economist for International Trade at Texas A&M University, and his colleagues at several other universities surveyed 80 mostly small and mid-sized agribusiness firms in six states in 1997 and 1998 to identify the exporting and importing obstacles faced by the firms and assistance programs they desired. The main exporting and importing obstacles reported by the firms included the following:

- The lack of cost efficient transportation;
- Payment and collection problems relating to foreign firms;
- The difficulty of obtaining information on export markets;
- Dealing with U.S. Customs;
- Cultural and communication problems;
- Legal problems associated with forming joint ventures and strategic alliances in other countries;
- Identifying the “right” foreign business partner or customer; and
- Difficulty in completing the necessary international trade documentation.

In a 1995 survey, Cornell University’s Department of Agricultural, Resource, and Managerial Economics asked 1,500 U.S. agricultural exporters to rank the importance of 13 obstacles to exporting [1, p. 38]. Respondents named “meeting prices of foreign competitors” as the most important obstacle by a sizable margin. Next most important—and clustered with several obstacles of lesser importance—were “finding customers” and “obtaining country-specific and commodity-specific information.” Sixty percent or more of the respondents indicated that they were not aware of and have not used the USDA’s Trade Shows Office, Trade Assistance and Promotion Office, the (then) Market Promotion Program, or AgExport Connections [1, p. 41].

Thomas Suber, Executive Director of the U.S. Dairy Export Council, described why U.S. dairy cooperatives are not as heavily involved in dairy exporting as proprietary firms, as follows [6, p. 16]:

“We’ve seen a slightly greater interest on the side of proprietary processors – noncooperative, straight commercial processors whose primary goal is to make a profit—to develop the export market....On the cooperative side, they’re more focused on handling their producers’ milk, and therefore they’re dealing with surplus disposal concerns, more than they are concerned with marketing—generally. However, this is not universal, and that’s an important point. Cooperatives are now moving into the export arena as well. Cooperatives have a mandate to move as much milk as they’ve got—but no more than that. Then you have the processors who are way out there, pursuing export markets because that’s where their corporate future lies.

Wes Eckert, former CEO of Washington's Darigold Cooperative, characterized his cooperative's views and those of the U.S. dairy industry on dairy exporting, as follows [7, pp. 23-24]:

“We have a lot of technical assistance agreements overseas and have been very active in the Dairy Export Incentive Program. We (Darigold) are doing some exporting on the consumer products side with ice cream, sour cream and ultrapasteurized products. We've committed resources to really grow that business, not only in Asia but in Central and South America and Mexico.... Everybody is excited about exports, but we have to be competitive in the world market with the major players. We're kind of new to the international arena as an industry. The Europeans, Australians and New Zealanders have been at it actively since World War II. At this point we're not competitive, generally speaking, except for maybe a few small volume, value added products and specialty items. We have to drive ourselves to find ways to reduce costs both on the manufacturing end and on the farm, to continue to be more efficient.”

Clearly real and perceived barriers contribute to the obstacles to exporting reported by Parker, Suber, Eckert and by authors of the studies. If indeed, the major obstacle to exporting is “meeting the prices of foreign competitors” as reported in the Cornell University study, this is an important point. Such an obstacle will not be easily eliminated. When James Parker of the FAS/USDA was questioned on this point, he said that many small and mid-sized U.S. agribusinesses can beat prices of foreign competitors in the foreigner's own markets, but still don't export. It is unclear how many additional U.S. agribusinesses would be as price-competitive as the FAS/USDA official claimed. However, it is likely--given the importance of price as a barrier—that measures to increase the competitiveness of U.S. agribusinesses and cooperatives would carry a high payoff. Such measures include negotiating reductions in tariffs and reductions in non-tariff barriers that give foreign competitors a price advantage.

Implications of the Current Situation

Many observers assert that there is little to worry about in the current situation. They add that small and mid-sized agribusinesses and cooperatives stay away from exporting for good reasons—some of which were noted earlier. They also point out that the challenge of getting more firms to export is no worse in agriculture than in the rest of the U.S. economy, noting that [3, p. 6]:

“...in 1992, out of 690,000 manufacturing firms in the U.S., only six percent exported; only five percent of the nation's 770,000 wholesalers exported; and only one-third of one percent of all other types of U.S. companies—largely service-

A few point out that desirable “change is in the air “ with regard to dairy exporting by U.S. firms, agreeing generally with the following comment made by Dutrow of the FAS/USDA [4, p. 4]:

“Despite having the largest, and by all measures one of the most efficient and

progressive dairy production and processing industries in the world, U.S. dairy product exports have traditionally been small and have shown little growth. On a milk-equivalent basis, exports have generally accounted for only 2 to 3 percent of U.S. dairy production—a figure roughly balanced out by imports....But change is in the air; commercial, non-concessional (non-subsidized) U.S. dairy exports have risen steadily in recent years, so that in 1996 they surpassed the value of concessional exports.”

Anecdotal success stories have received wide circulation to suggest that even small and mid-sized U.S. firms and cooperatives are increasing exports of dairy products. Examples include the successes for Foremost Farms, Inc. of Baraboo, Wisconsin in exporting dried whey products to a score of countries; profits of Davisco in exporting dried whey products from Minnesota and Idaho plants; the savvy exhibited by Hilmar Cheese of California in tailoring cheese products for export to the Japanese market; Cabot Creamery’s sales of cheddar cheese to the U.K.; and successful exports of specialty cheeses into Mexico by a few small Upper Midwestern firms.

While the success stories are noteworthy, exports of dairy products by small U.S. agribusinesses and cooperatives remain limited. Many individual firms in the U.S. dairy industry opt not to export for reasons that can be readily understood. However, when viewed from the perspective of the industry as a whole, such decisions have sweeping implications. Indeed, the decision by many firms in the U.S. dairy industry not to export represents an implied bet of sorts—a wager that, among other things, assumes that expanded dairy exports will not be needed to maintain milk prices at levels that are acceptable to U.S. dairy farmers.

First, giving scant emphasis to exporting appears to represent a wager that the USDA’s dairy price support program will be restored if U.S. farm milk prices drop to low levels. Hence, according to this argument, there is no need to place lots of emphasis on getting more firms to export. This is a possible but not necessarily likely scenario. U.S. dairy industry groups have exhibited strong political power but it is unclear whether they would possess the clout needed to restore the dairy price support program once it is eliminated. Alternatively, it represents a bet that border protection for the U.S. dairy industry will remain strong for the foreseeable future. Implicit in this wager is a belief that border protection—e.g., restrictive tariff rate quotas--will keep prices for most U.S. manufactured dairy product prices above world price levels much of the time even in the absence of a domestic price support program. Again this is a possible but not necessarily likely scenario. The Uruguay Round GATT agreement put agricultural products on a track toward lower tariff protection—a track similar to one that industrial products have been on since the late 1940s. Industrial tariffs in most industrialized GATT/WTO signatory countries now average in the single digits. While “over quota” import tariffs for most U.S. dairy products under the existing tariff rate quota system will remain high for at least a few more years, experience with industrial tariffs suggests that the high tariffs for most dairy products entering the U.S. will not persist indefinitely.

Secondly, it represents a bet that dairy exports can be left to large firms without adverse impacts. After all, this argument claims, firms such as Cargill, Continental

Grain, ConAgra, and Kraft have demonstrated that they can export successfully huge quantities of many U.S. agricultural products. True, but such firms alone won't necessarily expand exports of value-added dairy and other agricultural products to the extent needed to keep farm prices at levels acceptable to U.S. farmers. Moreover, small and mid-sized firms and cooperatives represent a valuable addition to the exporting group because many are likely to be able to export differentiated, niche products competitively. Such niche products, in some cases, will not be of interest to large exporting firms. Finally, large exporters frequently obtain products from the cheapest country source—a practice they must follow to satisfy shareholders and other owners of the firms. But if Kraft, for example, sources dairy products for shipment to other countries from Australia, the impact on U.S. dairy product prices will not be the same as if those products were sourced from the U.S. As experience with grains and soybeans has shown, such sourcing practices can trigger supply response in nontraditional producing areas and depress world prices.

A persuasive argument for getting into exporting—an argument that applies to small and large firms--was made by Nestle, the giant Swiss food company, in the mid-1980s. Nestle's CEO described U.S. and European dairy and other food markets as being "flat and fiercely competitive [10]." To reduce the need to battle over market share in the U.S. and European markets, Nestle chose to pursue added sales through exports to, and foreign direct investment in, the "growth markets of Asia and Latin America." Nestle has profited for years from this strategy but now is seeing erosion of the company's profits in Asia. Over the longer-run, however, Nestle's Asia strategy is expected to be profitable. In general, Nestle's strategy indicates that battling over market share in mature markets—a condition which characterizes many U.S. markets for dairy products—may not be the optimal strategy.

Decisions relating to whether to export are not independent of timing issues. The New Zealand Dairy Board—the world's largest private dairy exporting firm—claims that important "first mover" advantages exist in dairy exporting. According to the Board, the first exporter to enter a new dairy export market gains about a 15 percent advantage over second entrants and larger advantages (third entrants break even and fourth and later entrants lose money) over later entrants. While it is unclear whether the relationship between profits and the sequence of entry into a market is as close as suggested the New Zealand Dairy Board, there are undoubtedly early mover advantages in exporting. Hence, a "better late than never" strategy may not be viable for U.S. dairy firms that think that they may eventually get around to export.

These points have implications for policy and collective action. If, as seems likely, the FAS/USDA's "article of faith" is valid, then additional small and mid-sized U.S. agribusiness and cooperatives could profit from dairy exporting. First mover advantages suggest that profits will be larger if additional firms get into dairy exporting sooner rather than later. These points suggest that there is merit in collective action which reduces risks involved in dairy exporting and other measures that would give additional qualified "export ready" firms incentives to export dairy products. Presumably therefore it is rational for U.S. dairy industry groups to support cost-effective industry,

state government, and federal government measures that provide export market information, reduce risks associated with exporting, and reduce tariff and non-tariff barriers to U.S. dairy exports.

What is Known About Exporting Practices of Successful Small and Mid-Sized Agribusinesses and Cooperatives?

Anecdotal information relating to this question is available from the FAS/USDA, experience of Washington State University's International Marketing Program for Agricultural Commodities and Trade (IMPACT) Center, Thomas Suber of the U.S. Dairy Export Council, Vermont-based Cabot Creamery, and others.

FAS/USDA Questionnaire: FAS/USDA has distributed a brief questionnaire entitled, "Is Exporting Right for You?" This questionnaire, which is attached as Appendix Document No. 1, "highlights characteristics common to successful exporters and is designed to help determine if exporting is right for your company." The questionnaire groups questions in the following four categories:

- Are your products competitive in foreign markets?
- Do you have an export marketing plan?
- Can you service foreign customers?
- Can you afford to export?

This questionnaire elicits valuable information about how ready a firm is to export successfully. The more positive responses a firm gives to the questions, the better its chances for succeeding in today's global markets. Several issues raised in the questionnaire are addressed below, by others who provide anecdotal information about successful agricultural exporters.

IMPACT Center: The IMPACT Center maintains case histories describing how Washington State firms with the Center's help have expanded exports of a host of agricultural products including cattle, apples, asparagus, onions, hay, Christmas trees, beans, and forest products. While the recipes for success varied by product, the general pointers noted below emerged from the experiences of successful small and mid-sized agricultural exporters:

- Unsolicited inquiries from foreign firms relating to possible purchases of a company's products often represent the first step toward exporting;
- Don't expect to get into exporting quickly. It often takes two to three years to make exports after the firm decides to export;
- Maintain a diversification strategy--continue to serve the domestic market effectively while engaging in exporting;
- Communication with foreign buyers is often difficult;
- Recognize the importance of cultural differences in foreign markets;
- Be willing to tailor products to the needs of importers;

- Recognize that success in exporting can expose the business to the problems associated with running a rapidly growing business; and
- Attention to detail is critically important in the entire export marketing process.

As suggested by several of the points, the IMPACT Center examples are probably as useful for identifying problems associated with running a small or startup business as for giving pointers to the new agricultural exporter.

Thomas Suber's Comments: Suber of the U.S. Dairy Export Council gives the following marketing and management pointers that relate specifically to exporting dairy products [9]:

- Exporting is not for everyone--a firm must have suitable management capabilities if it is to export successfully.
- Whether exporting makes sense for a firm is dependent upon how the firm plans to grow. A firm must think through its strategic plan for growth and assess how exporting fits into the plan. Exporting is one channel for growth and can be considered as an option.
- To carry out many exporting functions successfully, a firm probably needs a marketing and sales department. Some relatively large dairy cooperatives don't have sales departments for potentially exportable dairy products.
- If a dairy firm wishing to export does not have a marketing department, it often will employ a trading company to carry out certain exporting functions. However, the manufacturing firm must be involved in developing and cultivating the customer.
- Trading companies have a short association with a manufacturer. If a quality, high-demand product is involved in the export sales, the manufacturer often starts dealing directly with the end user.
- Once a sales relationship is established, the manufacturer needs to be in frequent contact with the end user. Travel by the manufacturer to work with the end user to tailor the product to the buyer's specifications becomes very important.
- Payment method is a competitive mechanism. New exporters often wish to obtain payment in cash in advance in U.S. dollars before shipping the product. While understandable, imposing such a requirement can limit export sales because importers often can obtain more favorable payment terms from other exporters.
- Freight charges are a big issue in dairy exporting--freight charges can represent 15 to 20 percent of the cost of landed dairy products in some Asian markets. Europeans frequently can ship cheese into Asian markets more cheaply than U.S. firms because they (a) get discounts based on a history of large volume exports of subsidized products, (b) avail themselves of backhaul opportunities, and (c) negotiate trading advantages based on a long history of exporting.

Cabot Creamery: Vermont-based Cabot Creamery's foray into exporting cheddar cheese to the U.K. has a complex history. It began in 1994 when Allan Crook, International Business Manager of Mendip Dairy Crest, Britain's largest cheese distributor, tasted Cabot cheddar on a visit to the U.S. Crook discovered that Cabot's cheese had the balance of creaminess and sharpness that the British palate expects [2].

Crook and Charles Green, Senior Vice President of Sales for Cabot Creamery, began an analysis of sales opportunities in the U.K. by asking the question: How much do consumers in the U.K. pay for a high quality aged cheddar cheese? Once that was determined, Crook and Green analyzed distribution, packaging, and shipping costs and impacts of the new lower tariffs negotiated under the Uruguay Round GATT agreement to determine whether Cabot could ship cheddar cheese to the U.K. at competitive prices. The answer was yes.

Cabot benefited from the low 10.5 cent per pound within quota tariff that applies to the first 7,800 metric tons of cheese imported into the U.K. and other EU member countries. Cabot officials note however that the licenses that grant the importer access to the lower tariffs were "extremely difficult to acquire [2, p. 22]." The licenses had to be requested well in advance from Brussels. With help from the Cabot's importer in the U.K., the firm was able to get cheese into Britain.

Developing a strategy that made the product stand out from the many cheddars offered in the U.K. market was a challenging task. Mendip Dairy Crest, which distributes Cabot products in the U.K., served as an important link in the marketing chain. Mendip was able to negotiate shelf space in Waitrose and Safeway, two large U.K. supermarket chains. In-store promotions, demonstrations, and point-of-sales displays, sponsored in part by the U.S. Dairy Export Council and the Eastern U.S. Agricultural and Food Export Council helped differentiate Cabot brand products from English cheddars.

A packaging makeover also was necessary to meet government packaging requirements and make the product more attractive to U.K. consumers. The basic product and production processes, however, were not altered for export. Cabot introduced a mature cheddar, aged 15 to 18 months, to the U.K. market.

Cabot's plans for expansion include two more supermarket chains: Sainsbury and Tesco. The expansion would allow Cabot to reach its 500,000 pound export sales goal. Cabot's "coals to Newcastle" experience shows that chance can be involved in successfully entering an export market. While the account is abbreviated, it also shows the complexities of the exporting process and that exporting proceeds in ways that are unique to the firm and destination market.

Tasks and Functions Involved in Exporting Agricultural Products

There are many different ways to export, each of which may involve performing different parts of the overall exporting job. Risk-reward tradeoffs are involved when the firm pays others to assume part of the export marketing task. Thus, using an agent or trading company to perform some exporting tasks can reduce risk but over the long-run

typically will carry with it reduced profits. It is beyond the scope of this brief paper to discuss a full range of different exporting arrangements for small and mid-sized agribusinesses and cooperatives. However, it is feasible to list certain important functions that must be carried out to export.

Key functions involved in exporting include those identified below in the curriculum for an “Export Management Specialist Program” offered by Oklahoma State University’s Center for International Trade Development:

- Determining export potential;
- Conducting market research;
- Understanding foreign trade data;
- Creating a marketing plan;
- Identifying/serving intermediaries;
- Export financing;
- Payments and collections;
- Export documentation;
- Export packing and shipping;
- Export regulations and licensing; and
- International legal issues.

If a firm has a good grasp of what is involved in carrying out these functions, it would likely be able to provide many positive responses to the FAS/USDA questionnaire included in the appendix. Knowledge of these basics of export management indicates the firm has a reasonably good start toward export preparedness. It would have insights about whether it should consider exporting and, if so, which of the export marketing functions it would have to farm out to others.

Where Can Small and Mid-Sized Agribusinesses and Cooperatives Obtain Needed Exporting Information?

Where would a small or mid-sized agribusiness firm or cooperative that decided that it wished to export find information on the subject? There are numerous sources of information on exporting of agricultural products. A few mid-sized agribusiness firms have found that it is most effective to obtain exporting information and expertise embodied in a person. M.E. Franks, a major exporter of bulk U.S. dairy products, at one time had as its CEO, Bruce Stuart, formerly an officer of New Zealand’s Dairy Board. M.E. Franks now has as its CEO a former FAS/USDA employee who gained exporting experience through work with the USDA’s Dairy Export Incentive Program. Persons who have gained experience with exporting of other agricultural products—e.g., meat products, grains, differentiated food products—where there is a lengthy history of exporting also may be sources of personnel.

Small and mid-sized agribusinesses that have successfully entered exporting in recent years strongly recommend that potential exporters become voracious readers of information about exporting and export markets that they have targeted for sales. Many

sources of information are available about export marketing, including those noted below:

- The FAS/USDA, including the agency's State Outreach offices. The agency's INTERNET site (<http://www.fas.usda.gov>) contains information about market trends, trade leads, trade shows, export credit programs, etc. that may be of interest to established and potential exporters. FAS/USDA's Ag Exporter magazine is a good source of general information on agricultural trade developments and the agency's programs. The FAS/USDA indicates that it can be most helpful to U.S. agribusinesses and cooperatives that are "export ready."
- The Agricultural Marketing Service of the USDA. Among other things, this agency has information about transportation and freight issues involved in exporting.
- State Departments of Agriculture. The Wisconsin Department of Agriculture, Trade and Consumer Protection, for example, provides information and assistance to new and experienced agricultural exporters.
- The Babcock Institute for International Dairy Research and Development at the University of Wisconsin-Madison provides information on trade policy, international marketing studies, other information relating to dairy exporting and other international dairy issues.

This obviously is not an exhaustive list of information sources. The previously mentioned Cornell University study indicates that trade associations and other exporters are often widely used sources of information for agribusinesses involved in exporting.

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