

Subsector Analysis and Vertical Coordination

Subsector Analysis

- ✓ What is a subsector?
- ✗ Shaffer: "The vertical set of activities in the production and distribution of a closely related set of commodities."
- ✓ Vertical view of industrial organization
- ✓ Catalyst: Rapid changes in vertical coordination for U.S. ag commodities

What is Subsector Organization?

- ✓ Vertical Coordination
 - ✗ The "harmonization" of the vertical *economic stages* of production and marketing in a subsector
- ✓ Economic Stage of Production
 - ✗ Williamson: Technologically separable production process
 - ✗ Any operating process capable of producing a saleable product or service (i.e. a value adding process)

Performance Questions

- ✓ What impact does alternative vertical organization of subsectors have on performance?
- ✓ Why one organizational form over another?
- ✓ How do changes in basic conditions lead to changes in subsector organization?

For Example.....

- ✓ Beef Subsector Organization
 - ✗ 1700's
 - ✗ 1900's
 - ✗ Present
- ✓ Grain/cereal production
 - ✗ Developed countries
 - ✗ Developing countries

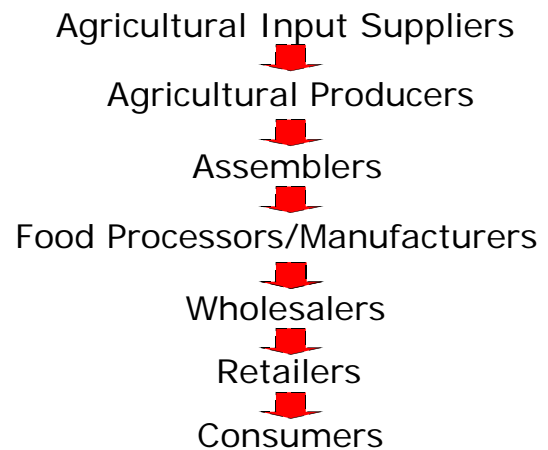
Why not the Spot Market?

- ✓ Biological production cycles
- ✓ Product Perishability
- ✓ Uncertainty
- ✓ Fixed investment

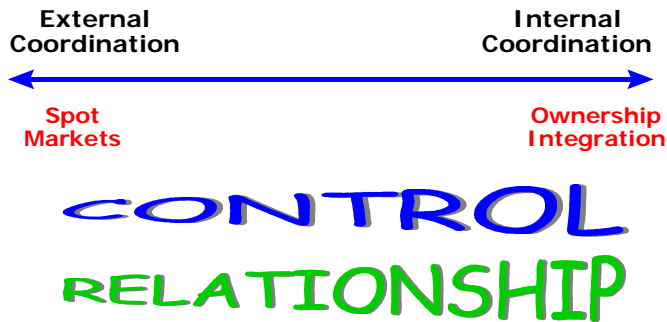
Subsector Performance Dimensions

- ✓ Resource Allocation
- ✓ Transaction Costs
- ✓ Dynamic Stability
- ✓ Equity
- ✓ Market and Information Accessibility

The Agri-Food System Marketing Channel



Continuum of Vertical Coordination



Barkema: *New Roles and Alliances in the U.S. Food System*

Price Discovery

- ✓ Process of finding a set of prices that clears the market at a given time
- ✓ Impacted by
 - ✗ Imperfect knowledge
 - ✗ Dynamic market
 - ✗ Choice of coordinating mechanisms
- ✓ Coordinating Mechanism
 - ✗ Set of institutions and arrangements used to accomplish harmonization of economic stages

Pricing Methods

- ✓ Auctions
- ✓ Private Treaty
- ✓ Administered pricing
- ✓ Formula pricing


External vs. Internal Vertical Coordination

- ✓ "Invisible hand"
- ✗ Exchange of information or goods between adjacent Agri-Food system stages occurs outside any single firm or economic entity
- ✗ The "cash" market (spot market)
- ✓ Exchange of information or goods between adjacent stages occurs within control of a single firm
- ✗ Ownership integration


Coordinating Mechanisms

- ✓ Terminal markets
 - ✓ Direct marketing
 - ✓ Electronic markets
 - ✓ Contract coordination
 - ✗ Market specification
 - ✗ Production management
 - ✗ Resource-providing
 - ✓ Cooperatives, Alliances, Networks
 - ✓ Integration
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Necessary Transaction Components

- ✓ Negotiating the deal
 - ✓ Transfer of ownership
 - ✓ Establishing a price
 - ✓ Physical delivery to the buyer
 - ✓ Monitoring and enforcement of contract terms
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Coordinating through "markets"....

- ✓ Terminal markets
 - ✗ Central assembly of buyers and sellers
 - ✓ Direct marketing
 - ✗ Direct negotiation between buyer and seller
 - ✓ Electronic markets
 - ✗ Electronic auction determines prices
 - ✗ Direct shipment from buyer to seller
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Contract Coordination

- ✓ Market Specification
 - ✗ Cattle
 - ✗ Potatoes
 - ✓ Production Management
 - ✗ Organic produce
 - ✗ Premium Beef
 - ✓ Resource Providing
 - ✗ Poultry
 - ✗ Hogs
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Strategic Alliances

- ✓ Mutuality in.....
 - ✗ Objective identification
 - ✗ Decision making processes
 - ✗ Sharing risks and benefits
 - ✓ Relationship focused
 - ✓ H.E.B.-Wegman's-Meijer Alliance
 - ✗ Strong Regional Grocery Retailers
 - ✗ Why ally?
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Formal Cooperation

- ✓ Presence of a formal organization that has a distinct identity from the parties involved
 - ✓ Requires equity commitment
 - ✓ Joint ventures, Cooperatives
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Policy Issues

- ✓ Protecting attributes through the system
 - ✗ Food safety
 - ✗ Quality attributes
 - ✓ Temporal coordination
 - ✗ Timing of supply and demand
 - ✗ Information's role
 - ✓ Thin markets
 - ✓ Market power
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