

1993 Cotton Management Economic Notes

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Four P's of a Marketing Mix

Although cotton producers are not directly involved with selling cotton to consumers, demand at the farm level is derived from the sum of domestic and foreign consumer's demand in the retail market. Thus, like other businesses, general marketing principles of 1) product, 2) price, 3) place, and 4) promotion apply to cotton producers and the industry. Managing the mix

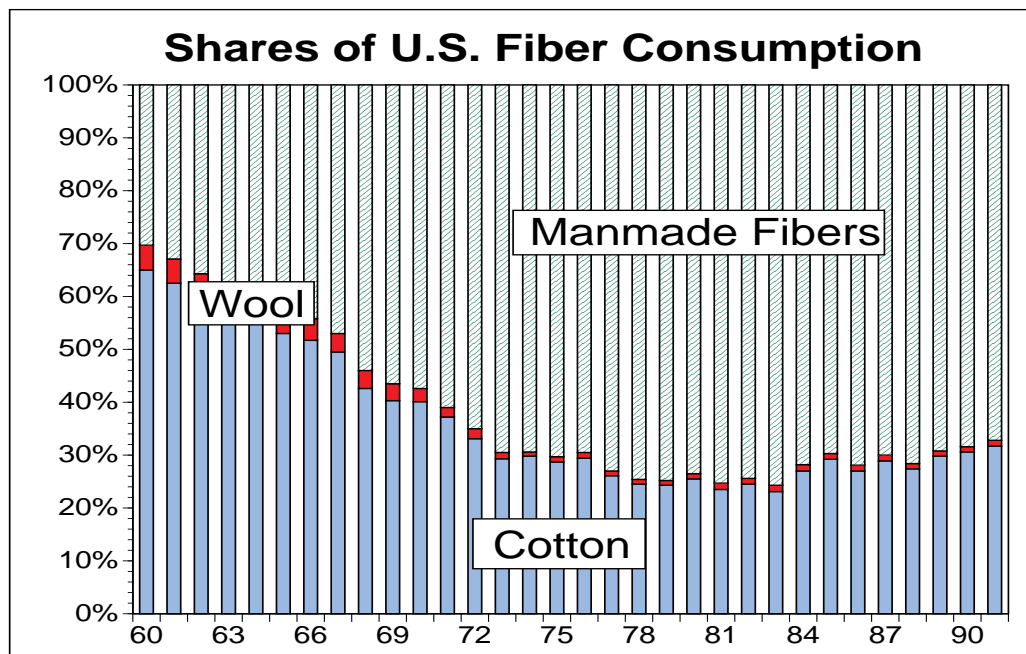
of these four P's to optimize the "livelihood" of an industry like cotton is very challenging because of "free-rider" problems and conflicting interests between regions.



Product

A "product" is a good that satisfies the wants or needs demanded by a consumer — not a good produced. Satisfying the demands of the consumers focuses on producing a product for the marketplace rather than just producing a product and looking for a market.

Consumers have needs for clothing, bedding and other products made from cotton, but these needs can be met by products made from non-cotton materials. The figure to the left shows the relative shares of cotton, wool, and man-made fibers consumed from 1960 through 1991.



Clearly, cotton is not a unique product for supplying the fabric demands of consumers.

Recent Prices	June 11, 1993	
	Upland (¢/lb)	Pima (ELS) (¢/lb)
Spot	53.32	90.50
Target Price	72.90	105.80
Loan Rate	51.15	88.15
Dec '93 Futures	57.92	

Note: Upland Spot for Desert SW grade 31, staple 35; Pima Spot for grade 03, staple 46, 5/28/93; Phoenix Loan Rates

Between 1960 and 1972 raw fiber equivalent prices for polyester dropped by about 70% while the fiber price of cotton remained virtually the same. As a result, cotton's share of US fiber consumption was cut in half. The international competitiveness of cotton has also increased during this time period. Between 1955 and 1959 the US supplied 40% of the world exports, but in recent years the US export share has slipped to around 30%. Australia, China, and the Ivory Coast have emerged as major exporting coun-

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tries in the last decade.

Price

Although individual cotton producers are “price takers” or have no ability to influence price, very few businesses or industries have the ability to always command a price that meets their average cost. Even some of the automobile and airline giants have reported annual losses, indicating that prices are primarily determined in accordance to foreign and domestic competition rather than average firm cost. Calculating a good average cost figure or break-even price is an invaluable reference point for finding where your operation sits in relation to the competition or prevailing market price.

The US government has taken extra steps in order for US cotton to remain competitive in the global marketplace. The 1990 Food, Agriculture, Conservation, and Trade Act gives the Secretary of Agriculture discretionary authority to effect the competitiveness of US cotton in one of three ways.

- ***If US average prices are above the A-Index price (average of the five lowest priced types of SLM 35 staple length cotton offered on the European market) and the Adjusted World Price is under 115% of the loan rate, the Secretary can lower the calculated original AWP. Lowering the AWP increases the Producer Option Payment or the differential between the loan rate and AWP, enticing sales to increase US competitiveness.***
- ***The Secretary can issue marketing certificates for domestic cotton users and exporters whenever US prices exceed the A-Index price by 1.25 cents/lb for more than four consecutive weeks. This makes the input price of cotton for US mills comparable to that paid by foreign mills, keeping US mills competitive. Certificate rates for the month of May were around 2 cents/lb.***
- ***As an insurance policy for keeping US mills competitive, an export quota would be created if US prices exceeded the A Index by 125 points for 10 consecutive weeks, after adjusting for certificate value.***

If a multi-lateral trade agreement for fiber was reached through the General Agreements on Tariff and Trade negotiations, US mills would feel the most impact from Asian competitors. The impact on farm returns would greatly hinge on how intact government programs in the US and foreign countries remained.

Place

On the surface location appears relatively unimportant for cotton since it is a very storable commodity and relatively inexpensive to transport. But these characteristics of cotton are the reason the US has been able to supply other countries clothing demands for decades and why countries like Australia and the Ivory Coast have emerged as major export competitors. The US pricing policy described earlier relieves the cotton industry from facing foreign competition head on, but pressures to reduce Federal budgetary expenditures make foreign competition more of a reality on the horizon. In recent years the AWP has been historically low in relation to US cotton prices.

Promotion

The Cotton Research and Promotion Act of 1966 provides a mechanism for state and federal agencies to assess mandatory check-offs to support generic promotional programs. In 1987, .28% of the value of cotton lint was spent on generic advertising. This figure was higher than the beef industry (.09%) and below the dairy industry (.37%). Advertising for generic products, like cotton is somewhat controversial. Generally, promotional efforts have been most successful for products that have brand recognition and many substitutes. Companies like McDonald's, and Pepsico confirm this inclination by reporting 6.1% and 7.4% advertising expenses as a percent of sales for 1987. In the future growers may be able to unite advertising expenditures more with manufactures of cotton products to benefit from brand recognition. Promotional and educational efforts about how cotton is a “natural” product and can enhance rather than degrade the environment may also yield favorable returns in the future.

Implications

Promotional efforts may improve cotton's position relative to man-made fibers but Arizona cotton will still have to compete directly with other US growers and foreign producers. The ability to supply favorable cotton quality at relatively low prices for export and domestic use is how cotton was established as a prominent industry in Arizona and this is the challenge for the future. Seeking out timely management information like that contained in the weekly cotton advisories is a step toward meeting this challenge.