2. Principal determinants of prices and costs in agrifood products

DETERMINANTS OF FOOD PRICES

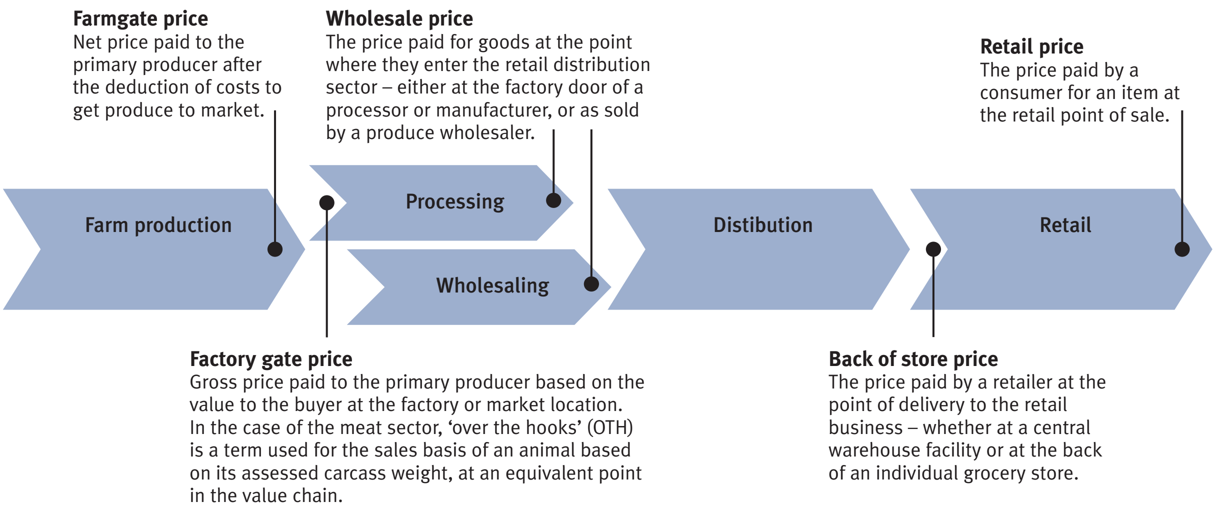
What is price?

The following page provides a summary of the respective price concepts that apply through the food value chain.

Whilst the concepts of price are reasonably straightforward closer to the farmgate, at the wholesale points of sale into the retail sector, price becomes more complex. The net price received by a fresh food supplier is at times net of selling commissions when a wholesaler assumes a role as agent.

The relevant price points at which a supplier makes a sale to a large retailer may vary between ‘back of store’, ‘delivered into central store’ or – in line with more recent innovations that are being rolled out at present – ‘factory gate’. Different treatments will apply to the costs of logistics which will see different cost recovery and net returns to the manufacturer.

Figure 3. **Food prices: Key concepts**



In addition to this, the wholesale price is rarely ever a list price which is offered by a supplier to a retailer. The price is adjusted by settlement terms, discounts or plans for specials, promotional plans and other price adjustments. Some of these apply to the individual product line, others apply across the supplier’s product range. In recent times, most suppliers have opted to accept rolled-up terms in dealing with supermarket buyers, whereby all price and terms adjustments are combined into a single percentage adjustment to list or gross price. This is preferred as it offers simplified administration for retailer and supplier in terms of accounting for transactions and volume or promotional adjustments.

The analysis that has been done in this report when assessing the sharing of retail selling price of individual products has been based upon a supplier’s estimate of **net** selling price after an allocation of appropriate adjustments to price.

Figure 4. **Major drivers of prices and costs in agrifood products**

Our analysis has identified seven groups of factors and influences that generically affect food pricing and costs across industries, regardless of the industry or product classification. The analysis of value chains in section 3 of this document will explain the specific impact of these items on each relevant food product sector.

1. Farm production factors

1.1 The volume and volatility of production.

1.2 Seasonality of production – where highly seasonal production creates variation in available supply and prices through the chain.

1.3 The perishability or shelf life of the product in raw material form strongly affects its value through the chain and the negotiability of returns.

2. Value-chain integration

2.1 The increasing vertical integration of activities through the chain.

2.2 Increasing scale efficiency of processing and manufacturing facilities.

2.3 Greater concentration of processing, manufacturing and brand ownership beyond the farmgate.

2.4 The changing and diverse nature of competition and concentration at points along the value chain.

3. The marketing approach

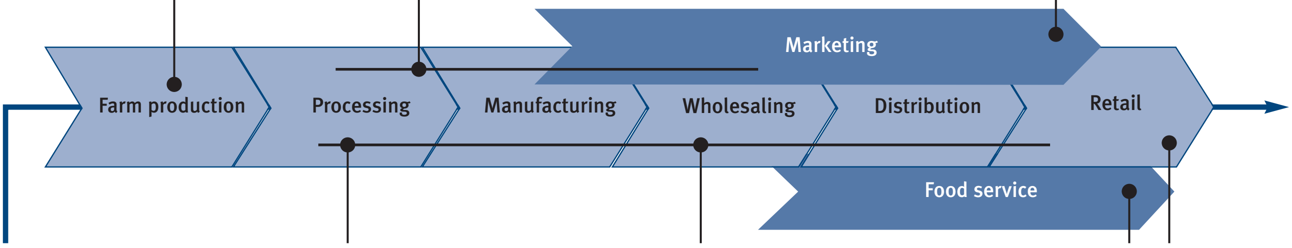
3.1 Increasing pressures on food manufacturers and marketers to provide differentiation in products across a variety of factors.

3.2 Globalisation of consumer brands.

3.3 The increasing strength of convenience markets.

3.4 A greater focus on specialisation and customisation of food products.

3.5 Differentiation of finished product in terms of quality.



4. Regulation and compliance

4.1 The increasing costs of business compliance with regulation.

4.2 The existence of barriers to greater value-chain profitability, generally in the form of restrictions on consolidation.

4.3 The increasing demands on value chains to meet ethical and product integrity demands, including environmental, welfare and food safety integrity.

5. Trade impacts

5.1 The extent to which primary and processed products are exported.

5.2 The extent and timing (including in seasonal terms) of imported products in primary, processed or finished goods form.

5.3 The influence of prevailing world commodity prices on the primary product, or in early stages of processing.

6. Technology and innovation

6.1 The increasing capital intensity in product transformation and manufacture.

6.2 The differing degrees of transparency in market prices and costs.

6.3 Greater investment in innovation to diversify core products and extract value from co-products.

7. Consumer and retail market dynamics

7.1 The growth of the private label in food products.

7.2 Greater demand for convenience and lifestyle solutions in meals and snacks.

7.3 Greater concentration in the retail sector – with increasing imposition of retail costs and margin pressure on suppliers.

MAJOR DRIVERS OF PRICES AND COSTS

These are generic factors that have common effect across industries. Their specific relevance or otherwise to specific products is discussed in section three.

Farm production factors

1.1 **The volume and volatility of farm production** – the year to year or season to season variation in total output from a primary production or supply industry.

1.2 **Seasonality of production within a production year** – highly seasonal production creates potential variation in the matching of available supply and demand and may create fluctuations in prices through the chain.

1.3 **The perishability or shelf life of the product** – in raw material form, this strongly influences the time needed for the product to reach the market or next-stage processing. This will influence the bargaining power of the producer and the value of the product downstream, depending on the extent to which supply matches available demand and whether the product is storable in processed or semi-processed form.

Value-chain integration

2.1 **Different degrees of vertical integration of activities through the chain** – the greater incidence of vertical ownership or alliances through the chain is reducing transaction costs, eliminating margins, increasing transparency to the integrator and providing for better matching of demand and supply.

2.2 **Increasing scale efficiency of processing and manufacturing facilities** – this is lowering the unit cost of production through better recovery of overhead costs and improved capacity to afford innovation and automation.

2.3 **Greater concentration of processing, manufacturing and brand ownership** – this improves the bargaining power of the owner, partly through a reduction in potential price competition in addition to the benefits in 2.2.

2.4 **The changing and diverse nature of competition at points along the value chain** – where, through changing innovation, globalisation of trade and shifting consumer preferences, the traditional forms of competition are replaced by new and emerging substitutes and pose direct threats to products in raw or processed form.

Marketing approach

3.1 **Increasing pressures on food manufacturers and marketers to provide differentiation in products across a variety of factors relevant to specific consumer market segments** – this reduces the commoditisation of products which offers diminishing real returns over time and reduces exposure to imported or substitute products.

3.2 **Globalisation of consumer brands** – this is seeing greater concentration of brands in the hands of fewer global brand managers, providing larger players with better ability to manage brand strategies and more leverage in dealings with retailers.

3.3 **The increasing strength of convenience markets** – the changing lifestyles and eating preferences of consumers is seeing a greater share of the stomach move away from home cooking to prepared foods in food service establishments, convenience formats in pre-prepared meals and products with a wider variety of retail points of sale.

3.4 **A greater focus on specialisation and customisation of food products** – eating preferences (specific food and cooking styles, tastes and health benefits) are influencing what is offered.

3.5 **Differentiation of finished product in terms of quality** – the scope for marketers to promote superior product quality to the end user.

Regulation and compliance

4.1 **The increasing costs of business compliance with regulation** – the greater cost burdens being placed on businesses to be accountable for their impacts on society.

4.2 **The existence of barriers to greater value-chain profitability** – generally in the form of restrictions on consolidation or other regulatory or commercial barriers which prevent enterprises through the chain from achieving better returns on investment.

4.3 **The increasing demands on value chains to meet ethical and product integrity demands** – this includes meeting regulatory and commercial requirements to account for impact on environmental conditions and adherence to food safety, welfare and other requirements of the consumer and community.

Trade impacts

5.1 **The extent and influence of primary and processed product exports** – returns from products with significant exports will generally strongly influence the pricing and returns to producers or processors of the domestic consumer product in question.

5.2 **The extent and timing of imported products in primary, processed or finished goods form** – greater access to domestic markets for imported products will have a stronger influence on the available prices that locally produced foods can achieve in domestic markets, depending upon timing, quality differentiation and price sensitivity of the later-stage processor or consumer.

5.3 **The greater influence of prevailing world commodity prices** – in the primary product or in early stages of processing, this influences the threat of imports, as well as the benchmark prices that producers seek in the domestic market for commodities.

Technology and innovation

6.1 **The increasing capital intensity in product transformation and manufacture** – which is changing cost structures to reduce a dependence on variable, globally uncompetitive labour costs towards greater associated fixed processing costs, requiring in turn greater consistency of production runs and limited downtime and product switching.

6.2 **The differing degrees of transparency in market conditions as to prices and costs** – whilst also a factor that relates to the integration in the value chain, the way in which knowledge is managed and shared through a value chain to create certainty of the commercial environment is strongly influencing outcomes between sectors.

6.3 **Greater investment in innovation to diversify core products and extract value from co-products** – as with 3.1, there is pressure to depart from a heavy reliance on commodity products but also to ensure that the greatest potential value is extracted from the raw product through by-product or co-product processes.

Consumer and retail market dynamics

7.1 **The growth of the private label in food products** – retailers in the Australian domestic market have generally placed private label products into discount categories which are reflected in generally lower buying prices from suppliers. The growth of the private label has been fuelled by strong price competition to provide the retailer with greater control of the category and better margins from the use of shelf space.

7.2 **Greater demand for convenience and lifestyle solutions in meals and snacks** – this is driving retailers and their suppliers to create more innovative options in convenience product form. There is less cooking being done in the home and less cooking from base ingredients. The concept of the meal is being redefined due to the nature of the busy city lifestyle. Changes in the way that people are eating meals is challenging the role of conventional foods and product forms.

7.3 **Greater concentration in the retail sector** – this is providing the chain retailer with far greater bargaining power in negotiations with suppliers who are faced with decreasing options in many categories due to the size of retail market share that the chain store offers. With greater bargaining power has come increasing imposition of the costs of retail (reflected in terms of trade) and margin pressure on suppliers who are competing for available shelf space.