A PERVERSE QUALITY-PRICE RELATIONSHIP

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ABSTRACT

Producers frequently get a lower price for better quality horticultural produce. One explanation is analysed.

INTRODUCTION

There are several reasons for believing that the horticultural marketing system in Britain and Ireland does not encourage growers to produce the product that consumers want, and is therefore inefficient.

(i) Retailers and consumers complain that they find it difficult to obtain produce of the quality they want, even if they are willing to pay extra for it (1, 2, 3).

(ii) Producers complain that they receive little or no premium for top-quality produce.

Producers I have interviewed in many cost-of-production surveys have produced records to show that this is frequently so.

(iii) Producers find that they get a higher average price if they split consignments between several wholesalers, though costs to producers, wholesalers and retailers are increased by this and bulk buyers are not interested in such small consignments (I, 2, 3).

(iv) In Ireland there is no apparent relationship between retail price and quality if a random sample of shops is taken, but there is if shops with similar purchasing power are compared (5).

Discounts

One explanation is as follows: If a retailer buys two or three packages in a wholesale market he will be charged the full wholesale price. When a retailer buys 500 packages he will get a discount of as much as 30 % on occasion (the examples of very high discounts for which I have evidence were in glut periods). In general, the bulk buyers (supermarkets, variety stores and greengrocery chains) want Class I produce and will use their market power to obtain it (1, 2, 3). The small greengrocers must take what is left and many of them do not buy Class I, as their customers do not want it. As a result, the full discount is given on large orders of Class I while no discount is given on small orders of Class 11, so the prices for Class I are below those in a perfect market while those for Class 11 are unchanged.

As the difference in price falls, it will pay fewer producers to sort their produce and there will be a shortage of Class I. The equilibrium position depends on the elasticity of demand for Classes I and 11, their cross elasticity, the marginal cost of sorting and losses in sorting.

Naturally, this is a simplification. Large buyers buy a range of qualities, usually at the top of the scale, while many greengrocers buy only the best. For some products caterers buy large amounts of low quality. Instead of a reduction in price the large buyer may get better quality at the same price, but this is effectively a discount.

Discounts are sometimes given when costs are reduced, when, for instance, produce is delivered direct to the shop instead of going through the usual market channels, but these discounts do not come within the scope of this argument.

The explanation is economical, being based on the observation that discounts are given mainly to firms buying Class I, but it explains a wide range of other observations such as (i) to (iv) already referred to.

Other factors

While it is convenient to examine one factor at a time, most economic phenomena must be explained by several factors working together. In this case we should consider the possibilities that the grading system used by the producers may not bear much relation to that used by the consumers (6), that the quality of the product changes between the producer and the consumer (1,2,3), or that the phenomena are due to temporary disequilibria in the marketing system with short run oversupply of Class I reducing the grading premium below the cost of grading.

Implications

The explanation given here suggests that the practice of giving discounts for bulk sales reduces marketing efficiency in many ways. The producers who produce the most desirable quality in the right amounts get a lower price. Consumer preferences are not communicated to producers. Producers are encouraged to split consignments among a large number of wholesalers. Small retailers are forced out of business though they are no less efficient than the bulk buyers. The wholesaling sector does not benefit from discounts as the total quantity sold is not increased, as average price and commission may be reduced and as lower prices may reduce supply, though there may be an increase in the proportion of bulk sales, which cost little more to administer than small sales. Individual wholesalers benefit only if they attract more business or a greater proportion of bulk sales. Market discrimination pays the individual wholesaler when discounts are given to the buyer with the most elastic demand-the bulk buyer. If bulk buyers have the most elastic demand at market level too, total revenue to the industry may be increased by the discounts, though the other inefficiencies remain.

If groups of producers compared the prices they got from different wholesalers they could recognise and avoid those wholesalers who give discounts. If enough groups did this, wholesalers would only be able to give discounts at the expense of their own commission, not at the expense of the producer's price. The producer would also get a higher price from meeting the consumers' requirements if the commission were on a sliding scale, with a lower rate for larger sales instead of 10% on all sales, but the scale would have to be precisely graduated in relation to wholesalers' cost curves, which is impractical.

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