The Industrial Organization Framework

*Structure-Conduct-Performance*

- Public Policy
- Structure ↔ Conduct ↔ Performance
- Basic Conditions
- Firm Decision Environment

Questions of Conduct

U Why does it matter if Safeway Australia refuses bread deliveries from 3 regional suppliers?
U Why did cattlemen bring legal action against Tyson regarding the use of “captive supplies” (cattle owned or forward contracted by beef slaughter companies)

Conduct

*Actions of firms within the market, acting either independently or together*

- Pricing Behavior
- Product Strategy
- Advertising
- Research & Innovation
- Collusion
- Mergers & Divestures
- Information use
- Exchange terms
- Legal tactics
Firm Decision Environment

- Alternatives
- Incentives
- Control & influence
  - Corporate structure
  - Consistency between owners’ goals and management goals

Prescription Drug “Competition Matrix”

<table>
<thead>
<tr>
<th>Drug Stores</th>
<th>CVS</th>
<th>Walgreen</th>
<th>RiteAid</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Retail</td>
<td>Wal-Mart</td>
<td>Target</td>
<td>Others</td>
</tr>
<tr>
<td>Supermarkets</td>
<td>Safeway</td>
<td>Krogers</td>
<td>Albertsons</td>
</tr>
<tr>
<td>Online</td>
<td>Drugstore.com</td>
<td>AmericanDrugStores.com</td>
<td>CVS.com</td>
</tr>
</tbody>
</table>

Performance Defined

- Bain
  - "The composite end results which emerge when a group of firms pursue their respective lines of conduct."
- Caves
  - "The appraisal of how far the economic results of an industry’s behavior fall short of the best possible contribution to reach particular goals."
- Brandow
  - "How well an industry does the things that society might reasonably expect it to do."
From the Headlines...

Regarding Cargill's purchase of Continental Grain announced November 1998... "The question is really what's the appropriate amount of economic power to be exercised and should there be any sort of public intervention to restrain that power."

Regarding Smithfield Foods' purchase of Murphy Family Farms announced September 1999... "U.S. Sen. Tom Harkin, of Iowa, and Secretary of Agriculture Dan Glickman have urged the U.S. Justice Department to launch an antitrust review of Smithfield Foods Inc.'s proposed merger with Murphy Family Farms of Rose Hill, N.C. They say that the Smithfield-based meatpacker's market dominance could wipe out smaller hog farms and give it too much control over the industry."

Performance

How well the market does what society wants it to do

(Brandow)

- Profits
- Fair pricing
- Quality products
- Variety
- Market Access
- Acceptable use of resources
- Equity
- Distributional
- Informational
- Innovation

Performance Issues

Brandow: "...how well the industry does the things that society might reasonably expect it to do."

Criteria

- What outcomes does society want?
- Norms
- What benchmark do we measure against?
- Measurement
- What "value" do we use for measurement?
Pseudo-Variety in Beer?

**Pseudo-Variety**
- The illusion of variety / "Appearance of enormous diversity and bounty" w/ very little variety, except in packaging
- Anheuser-Busch (46% of U.S. Beer Market)
  - Bud Light, Bud Dry, Bud Ice, Bud Ice Light, Michelob, Michelob Light, Michelob Dry, Michelob Ultra, Busch, Busch Light, Busch Ice, Natural Light, and Natural Ice
- Miller (over 29% of U.S. Beer market):
  - Miller High Life, Miller High Life Lite, Miller High Life Ice, Miller Lite, Miller Genuine Draft, Miller Genuine Draft Light, Miller Ice House, Milwaukee Best, Milwaukee Best Light, and Milwaukee Best Ice.

Source: www.oligopsonywatch.com

The Case of Coffee

<table>
<thead>
<tr>
<th>Producer</th>
<th>Price/kg</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ugandan Farmer</td>
<td>$0.14</td>
</tr>
<tr>
<td>Local Middleman</td>
<td>$0.19</td>
</tr>
<tr>
<td>Regional Miller</td>
<td>$0.24</td>
</tr>
<tr>
<td>Transportation to Kampala</td>
<td>$0.02</td>
</tr>
<tr>
<td>Exporter</td>
<td>$0.45</td>
</tr>
<tr>
<td>Importer</td>
<td>$1.64</td>
</tr>
<tr>
<td>Shop Owner - Instant Coffee</td>
<td>$26.40</td>
</tr>
</tbody>
</table>

Source: www.oligopsonywatch.com

Australian Bread Market Conduct...

- Safeway Australia
  - Refused to accept bread from 3 bakeries.
  - Bakeries were also supplying regional retail competitors that heavily discounted the bread.
  - Re-established purchases after discounting ceased.
- "Price fixing and misuse of market power"
**Pickett, et al vs. Tyson Fresh Meats, Inc.**

- Tyson Foods - Largest U.S. beef packer
- Pickett, et al (American Cattlemen) claims:
  - Tyson used Captive Supply (CS) inventories with the purpose or effect of lowering cash prices.
- CS not necessary:
  - Y for quality
  - Y to keep plants full
  - Y for efficiency
  - Y for risk management
- Only impact of CS is lower cash price
- Initial ruling AGAINST Tyson; Later overturned

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"Captive Supplies" for 4 Largest U.S. Beef Packers (Ward, et al)

- Consistent relationship between increasing captive supplies and lower feed cattle prices
- Elam (monthly data): $0.00 to -$0.37/cwt.
- Schroeder et al. (transaction data): -$0.15 to -$0.31/cwt.
- Ward et al. (GIPSA transaction data): -$0.01 to -$0.36/cwt.
- Schroeter et al. (GIPSA transaction data): -$0.02/cwt.
**Contracts and Performance**

**Farmer Price Impact (U of Nebraska Study)**
- 10% of pork production - corporate contract
- Pork packers pay 6% less to hog farmers than they pay when the corporate presence is less than 10 percent.
- When 50% of pork production is controlled by corporate contracts, the price paid to independent farmers drops 26 percent.

**Rural Community Impact (Virginia Polytechnic)**
- Compared economic benefits for communities with 5,000 “independently produced” hogs versus 5,000 corporate contracted hogs.
- Independent farmers “produced 10% more jobs, 20% more retail spending and 37% more local per capita income.”

**Cattle Feeders Motives for Supply Contracts or Marketing Agreements (Ward, et al)**

**Most important** –
- Access to carcass premiums
- Access to detailed carcass data
- Guaranteed buyer for cattle
- Increased marketing efficiency

**Least important** –
- Pressure from packers

**Captive Supply Solutions?**

**Free market** – Let the market function without constraint

**Mandate regulatory constraints on the marketplace** (WORC proposal, Johnson amendment, Grassley bill)

**Are either of these “fair”?**

**Middle ground** – Consolidated Beef Producers, US Premium Beef, Ranchers Renaissance

*Source: Clem Ward, Oklahoma State*
Government’s Impact...

- Anti-trust laws
- Sherman Act (1890)
- Clayton Act (1914)
- Robinson-Patman Act (1936)
- Packers and Stockyards Act (1921)
- Capper-Volstead Act (1922)

Goal of anti-trust law
- Provide competitive business environment that allows achievement of society’s performance goals

Continuum of Vertical Coordination

<table>
<thead>
<tr>
<th>External Coordination</th>
<th>Internal Coordination</th>
</tr>
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<tbody>
<tr>
<td>Spot Markets</td>
<td>Contracting</td>
</tr>
<tr>
<td>Contracting</td>
<td>Strategic Alliances</td>
</tr>
<tr>
<td>Strategic Alliances</td>
<td>Ownership Integration</td>
</tr>
</tbody>
</table>

Food Chain Clusters...

"Vertical Consolidation?"

- "Supply Chain"/Marketing channel consolidation
- Alliances, integration, joint ventures
- Dominant food chain “clusters”
- Gene to Supermarket

Control decision-making at many levels of the food chain

Performance: Balancing between efficiency and power
**Increased Consolidation.... Opposing Views**

U "...Consolidation in U.S. agriculture is generally a positive trend, one that leads to lower priced, higher quality food products for consumers and a leaner industry better equipped to compete in global markets." Drabenstott 1999

U "New study finds consolidation harms nation's consumers and farmers. The study reveals the complex web of relationships among a handful of firms in the food chain. Food is different than other goods and services, and it would be dangerous to permit a few major firms to control decision making throughout the entire food chain." Heffernan 1999

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**The Industrial Organization Framework**

Structure-Conduct-Performance

Public Policy

Structure → Conduct → Performance

Basic Conditions

Firm Decision Environment

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"Virtually every market attribute is influenced by other market attributes, and the chain of influence is circular and endless."

Sosnick, pg. 84