One of the last truly market driven commodities, Pecans are still pretty much bought and sold as they always have; for cash. Historically, because Pecans were purchased on a cash basis, and the bulk of the product was sold to markets within North America, the marketing of the finished product was generally left to the Shellers. As such, having few options, Growers were pretty much locked into whatever they were offered by the Shellers. Supply generally dictated price. However, the financial crisis of 2001, and the emergence of a larger overseas market, has dramatically changed how Pecans are bought and sold. With Growers now taking a more active role in the financing of the inventory sold to the Shellers, and with the emergence of more direct sales from Growers to various overseas markets, particularly China, supply alone no longer dictates price. With a larger portion of the crop now being exported overseas, it has become even more important for sellers to understand the broad range of factors that impact the market. The following factors are not new to pricing and marketing decisions, and are certainly not the only factors that need to be taken into consideration when making pricing decisions. However, in today’s economic climate, they have taken on a more prominent role in the development of effective marketing strategies:

1) Marginal Propensity to Consume and Elasticity of Demand
2) Historical Pricing relative to Supply
3) Competition
4) Understanding your Customer
5) The value of the US Dollar

While the basis for all pricing decisions revolves around supply and demand, this past year illustrated just how important it is to understand some of the other factors that can come into play during the development of product pricing. After all, the industry had just come off the second largest crop in history, shipments overseas, particularly to China, were at record highs and due to the alternate bearing nature of Pecans, most observers were certain that the 2008 crop would be a smaller than normal ‘off-year’ crop thereby leading to higher prices later in the year. Yet, with so many positives, why did the industry end the year with only a minimal gain in consumption, the largest carryout in industry history and meat prices at or below those of the prior year?

**Marginal Propensity to Consume and Elasticity of Demand**

Without going into a long explanation of these two principals, it is important to have a good understanding of how they work before attempting to develop a long range pricing strategy. Briefly stated, Marginal Propensity to Consume is the mathematical relationship between the changes in consumer income relative to consumption. Elasticity of Demand is the mathematical relationship between the consumer’s tendencies to purchase a particular item relative to the change in its price.

With respect to the Marginal Propensity to Consume, while it may have taken the US Government a year before it was ready to declare that the country had been in a recession for all of 2008, it didn’t take the nation’s marketers very long to figure it out. While Pecan contract shipments remained strong throughout the year, overall nut sales started slowing relatively early in 2008. After the first quarter, many retailers were already reporting significant drops in sales, and by the fourth quarter, many segments of the industry were reporting sales as much as 40% off prior year sales. With massive lay-offs, higher fuel prices, the slump in housing sales and finally the fall market collapse, consumers were not in a spending mood. As spendable income shrunk, so did consumption.

With respect to Elasticity of Demand, many within the Pecan industry seem to forget that Pecans not only have to compete with every other nut, but must also compete with other ingredients, snack items and inclusions. Product pricing is critical. Unlike the drug dealer who can charge whatever he wants for his product (inelastic demand), Pecan producers and Shellers cannot. Pecan prices are very elastic. If the price gets too high, buyers will quickly shift to other alternatives. While most Pecan contracts were written at very competitive prices early in 2008, by the start of the second quarter, spot prices had jumped dramatically thereby forcing buyers to look for cheaper alternatives to fill any additional requirements.
There is an oft quoted statement that ‘those who fail to learn from history are destined to repeat it.’ So it is with the Pecan industry. While pricing decisions are impacted by a number of factors, historical pricing should always be used to assist in the pricing validation process. In the classical supply/consumption vs. price graph, one would expect that as supplies increase, prices would go down resulting in an increase in consumption. Conversely, as consumption increases, supplies will diminish thereby causing prices to rise. When one plots total supply, consumption and their relationship to the price of Fancy Junior Mammoth Pecan Halves, one would expect to get a graph that, with the exception of extenuating circumstances, would approximate the classical supply/consumption vs. price graph. The following graph illustrates this relationship in the Pecan industry for the past eighteen years. The illustrated Junior Mammoth prices represent the average contracted price for Junior Mammoth Pecan Halves for the associated crop year. This is what the graph looked like in January and February 2008. As expected, contract pricing dropped as a result of the large crop.

However, that situation changed dramatically by the end of March. With the Chinese paying more for inshell than the Sheller’s could get for the shelled meats, large lots of top quality nuts were sent overseas at inflated prices. As is the case with most large crops, inshell that would yield Mammoth and Jr. Mammoth Halves was already in short supply. The inshell shipments to China only made the situation worse. Further, on the assumption that prices would be even higher in the fall, many growers decided to hold their inventory. As such, Sheller’s who needed to satisfy the needs of long standing domestic customers for Mammoth and Jr. Mammoth halves were forced to adjust their prices on all of their products to reflect higher inventory replacement costs. The following graph illustrates what had happened to the price of Pecans by the beginning of the second quarter. Not only does the graph illustrate the largest supply situation in the history of the industry, it also illustrates how Pecan prices had reached the second highest price in the history of the industry. As a result of this ‘supply/price’ inversion, anticipated future spot sales, or additional contracts, failed to materialize.
Regardless of the fact that Pecans have a very loyal following in North America, they still must compete with other tree nuts, inclusions and ingredients, especially overseas, when buyers are planning their pricing strategies, new product development and promotional plans. The price of other Tree Nuts, particularly Walnuts, has a significant impact on Pecan sales, both domestically and overseas. Last year, the two nuts that Pecans most frequently have to compete with, Almonds and Walnuts, were priced considerably below the price of Pecans. Because of their record crops, Almonds-1.5 billion pounds (kernel basis) and Walnuts-434,000 tons (inshell basis), at various times during 2008, the prices of both were well over $2.00/lb lower than that of Pecans. As such, buyers adjusted their purchases accordingly across all nut categories. This was also true for overseas inshell sales. While inshell Pecans traded between $1.35 and $2.00/lb, Jumbo Hartley inshell walnuts were trading around $.85/lb. Since the Chinese could buy US Walnuts at prices considerably below their domestically grown product, Chinese buyers shifted their purchases accordingly. As a result of the aforementioned pricing disparities, Pecans had to compete with very cheap Walnuts in the Baking, Confectionary and Produce categories; had to compete with cheaper Almonds in the Ice Cream, Produce and Snack Nut categories; and had to compete with cheaper Cashews in the Snack Nut, Confectionary and Baking categories.

Understanding Your Customer

In today's competitive market place, simply knowing the name and phone number of the buyer is no longer sufficient. A supplier must be able to anticipate the customer's needs well in advance of market changes so that they can always be one step ahead of the competition. Years ago, a buyer would only need to worry about one or two commodities. He/she would buy sugar, or oil or corn syrup, and as such, would become an expert on that commodity. Today, that same buyer is responsible for the purchase of thousands of different items, many of which are not commodities. It is therefore impossible to become an expert on all of the items that need to be purchased. Information becomes power, and the supplier who is able to provide accurate, timely and cost effective solutions will continue to enjoy a favorable relationship with his customer.
In addition to knowing what is purchased, how it is purchased, when it is purchased and what outside factors impact purchasing decisions, a thorough understanding of how purchasing decisions are made, how marketing plans are developed and what the customer’s long term objectives are is imperative. Whether dealing with a domestic or export customer, the first thing to remember is that Pecans must compete with cheaper alternatives in all product categories, particularly if the customer can substitute Walnuts for Pecans. It is also important to remember that larger domestic buyers generally develop marketing strategies a year in advance, and as such, price projections, changes in supply, etc. become critical to new product development and to the maintenance of a good long term relationship.

When dealing with overseas buyers, Walnuts become an even bigger impediment to new market development. Because Walnuts are grown in many countries around the world and have been traded worldwide for centuries, they are well known and familiar to most end users. Pecans, on the other hand, have only been traded internationally for the past twenty years or so. They are still not well known outside of North America. This is particularly true in most Asian markets. Because of this, price tends to play a more important role in market penetration and new market development. Demand tends to be more elastic. China, which in recent years has dramatically increased its purchase of inshell Pecans, has demonstrated extreme sensitivity to changes in price particularly when compared to cheaper Walnuts. Historically, when it comes to most commodities, in order to minimize this sensitivity, China will buy heavily in the ‘on-years’ to allow averaging in the ‘off-years.’ This was the case with the 2007 crop. It would appear that approximately 1/3 of China’s 2007/2008 purchases were made to satisfy 2008/2009 requirements. As such, new crop Pecan shipments to China dropped off dramatically until contracted commitments were satisfied.

The Value of the US Dollar

Unlike Almonds and Walnuts, where almost 70% of the crop is sold overseas, until relatively recently, only about 10% of the Pecan crop was sold into the export market. As such, the value of the dollar had little or no impact on Pecan sales. However, with the emergence of China as a major player in the overseas Pecan market, the value of the US Dollar has had a greater impact on overall Pecan prices. For most of 2008, the US Dollar remained relatively weak against most major currencies (Yen, Euro and Pound). As such, Pecan exports reached record levels by the end of July. However, as the year drew to a close, and particularly after the fall market meltdown, the dollar strengthened dramatically resulting in a significant drop in exports, particularly to Asia. Korea, for example, saw its currency (Korean Won) go from approximately 1,000 Won to the Dollar in July to approximately 1,500 Won to the Dollar in September/October. As a result, export shipments ground to a halt for the balance of the year. Dramatic declines were also seen in exports to all of the EU countries and Great Britain.

How did we get here?

In summation, the following is a brief recap of the 2007/2008 marketing year:

1. Due to the slowing economy, nut sales started to lag in early 2008.
2. The price of inshell going to China was too high when compared to meat prices.
3. Sales of low count inshell to China contributed to shortages in Mammoth Halves, Jr. Mammoth Halves and Extra Large/Large Pieces.
4. Growers, not satisfied with prices offered by Sheller’s, continued to either sell to China at higher prices or to hold product for later sale at anticipated higher levels.
5. Sheller’s had to raise their prices to reflect increased replacement costs.
6. Due to the dramatic increase in meat prices after the contracting season ended, the industry was forced to deal with the largest supply in its history combined with the second highest meat prices ever.
7. Because of the supply price inversion, buyers switched to cheaper alternatives, and as such, most normally anticipated spot meat sales, or additional meat contracts, for the balance of 2008 never materialized.
8. Any price advantage gained relative to Walnuts during the fall of 2007 and the 2008 contracting season vanished thereby minimizing any significant gains in consumption at the expense of the Walnut market.
9. Due to the strengthening of the dollar later in the year, as well as cheaper pricing of other nuts, overseas buyers cut back on their purchases of Pecans.
10. The industry realized only a minimal gain in consumption leading to the largest carryout in its history and prices at or below those of the prior year.