

## **BUSINESS STRATEGIES IN A NEW COTTON MARKET**

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### **Abstract**

Provisions of the 1996 Farm Bill have turned the cotton industry's focus on business strategies that improve efficiency and productivity. Lower production and marketing costs are important to maintain cotton acreage near current levels. The goal is to hold production costs under 70 cents per pound and to substantially reduce marketing costs. Cooperation and teamwork by all businesses associated with the cotton industry is essential for keeping an internationally competitive industry.

Production systems that increase yields and management strategies to control costs are keys to profitable cotton production. Improved quality assists in expanding use and leads to a more efficient and competitive textile industry.

### **Introduction**

The 1996 Farm Bill is having far-reaching effects on cotton producers, local rural economies, and agribusinesses. Provisions of the new Bill has set in motion strategies that will improve efficiency and productivity of the U.S. cotton industry. The focus is on a cost-effective production and marketing system.

The flexibility of planting cotton, or some other crop, has major implications for business supplying production inputs and services, producers, lenders ginners, transportation systems, oil mills, warehousing, merchant-shippers, and textile manufacturers. Producers will plant all of their crop land. Therefore, those agribusinesses serving cotton producers may experience the greatest adjustments and restructuring. The resulting need is for each segment of the cotton industry to cooperate and coordinate to capitalize on cost reducing opportunities as a team.

An important strength of the new Farm Bill is that it gives farmers freedom and flexibility to plant alternative crops. Yet, it puts producers operating in a market economy subject to considerable production and price risks. Thus, decisions concerning production and marketing systems must be streamlined and profit motivated.

The most efficient production systems produce cotton for a cost of 60 to 70 cents per pound. These operations can produce cotton at a price that is competitive in the

international markets. The intense price competition with man-made fibers and foreign growers requires the lowest production and marketing costs possible.

### **Cost and Returns, Delta Example**

The high cost and income risk of growing cotton can be demonstrated by reviewing cost and returns to cotton across the Mid-South states of Louisiana, Mississippi, Arkansas, and Tennessee. This Delta region in 1996 averaged gross returns per acre of \$638 on a 786 pound yield and a 72 cent price, according to USDA. The variable cash expenses totaled \$367 per acre, fixed cash expenses of \$65 ( $\$367 + \$65 = \$432$ ), with total ownership costs of \$623 an acre. The \$432 cash expenses adds up to a cost of 55 cents per pound. That does not include returns to ownership costs. Total cost is 79 cents less seed value equal to 9 cents per pound of lint.

Cash expenses of \$432 left \$206 to cover the ownership costs of capital replacement, operating capital, other nonland capital, land and unpaid labor. Also, looking at risk of cash outlays to gross income, the ratio is \$1.48 returns for every dollar of cash expense. The return for corn often exceeds \$2 for \$1 cash expense, and soybeans even higher.

Determining your cost of production per pound and knowing each of the categories of costs, such as chemicals, fertilizer, machinery and labor, provides insight on how to best use inputs. Records indicate that farmers, even in similar areas, have considerable differences in both variable and fixed costs.

The use of a standardized performance accounting system that is designed to be used in making management decisions is essential to a profitable cotton operation. Such accounting data provides a clear breakdown of cash and fixed costs per pound for all crop and livestock enterprises. Thus, production costs and returns are known at the end of each year.

The financial risk has increased because of production and price uncertainties. The alternative grain and soybean crops have gained increased attention because they offer reduced income risk when prices are favorable relative to cotton.

The infrastructure of agribusiness and rural communities will need to adjust to cope with greater economic instability. The pressure on producers to manage market risk internally will encourage more integration of production and marketing activities. The integration can be accomplished by innovative private enterprise or expansion of producer-owned cooperative associations. The result will lead to greater concentration in agricultural businesses and a possible change in the market structure for cotton.

### **Yield Up, Costs Down, Income Up**

A powerful strategy to reduce production costs is to increase yields and, at the same time, reduce production costs. Yield improvement has great potential. Yields can be boosted by

plant breeding and the use of biotechnology, more balanced crop rotation systems, effective insect control, productive soils, new production systems that improve timing, row spacing, plant population, and use of chemicals.

Costs can be reduced by group discounts in purchasing large quantities of supplies, careful use of all inputs, large operations that realize benefits from economies of size, leasing of some equipment, custom operations, joint equipment ownership and partnership with suppliers.

A small increase in yield and lower production costs alone promises to curtail the decline in cotton acreage, expand use, and substantially increase producer income. Thus, a very reachable goal of a 5 percent increase in yield and 5 percent reduction in costs would help stabilize the agribusiness serving cotton, and maintain rural economies. Keeping U.S. cotton production costs low and price competitive with foreign producers and man-made fibers is essential in maintaining the cotton industry.

#### **Improved Quality a Marketing Advantage**

The value of cotton depends, to a great extent, on the condition and quality of the fiber. Better quality enhances price and makes the crop more marketable. Quality cotton has strong advantages to textile manufacturers. High speed spinning equipment requires quality fiber for higher quality end products.

Effective harvest aid chemicals help in getting a head start on harvest. Mature cotton, harvested as early as possible, ensures better quality over cotton that remains open and subject to weather-related deterioration.

Domestic textile mill use of cotton would likely increase

substantially with favorable producer price incentives for the qualities that improve mill performance. The more desirable spinning properties pave the way for a more productive, competitive and profitable textile industry.

Further communication between mill operators and producers is needed to reinforce the economic viability of the industry. Direct mill contracts speed the communication process regarding the desirable quality attributes and improves both producer and mill income.

#### **Cooperation and Teamwork Essential**

The U.S. has the capability to substantially expand cotton production. However, the challenges to cope with the risks associated with adverse weather, insects, disease, volatile prices, man-made fiber competition, foreign production, and worldwide farm and trade policies must be anticipated and managed to include economic incentives to producers.

Acreage recovery from the steep 18 percent decline from 16.9 million acres in 1995 to 13.9 in 1997 mainly depends on reasonable production and marketing costs and favorable cotton pricing opportunities.

The U.S. cotton industry has a challenge to slow the industry's decline. To do so, all segments of the industry need to unite from producer to mill operators, cooperate in a common goal to seek ways in reducing production and marketing costs, increase yields, improve quality, reward producers for quality and expand cotton consumption.

The opportunities include new business strategies to meet the challenges of a new cotton market driven by international competition and flexibility to plant alternative crops based on economic returns.