

Niches, Commodities, and You

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Commodity producers receive, on average, only 20 cents from each food dollar. In Virginia, with the elimination of the tobacco and peanut programs, rising input costs, limited farm size, and pressures from development, farmers are looking for alternatives to commodity production. Niche markets, which target products to underserved consumers, are one alternative that many pursue. In some cases, however, these niche markets themselves evolve to become commodity markets. What defines a niche market, when does it cease to be a niche market, and why does it cease to be a niche market?

What is a niche market?

Niche markets are characterized by a limited number of buyers and sellers, a highly differentiated product, and significant barriers to entry into and exit from the market. Not all these features need to be present for a niche market to exist, but they often go hand-in-hand. Examples include kosher milk, “natural” poultry, and grass-fed beef.

Niche marketing is targeting a product or service to a small portion of a market that is not being readily served by the mainstream product or service marketers. . . . Niche marketing is servicing a portion of a unique market, or a unique portion of a common market, not already served. (Schwart, McCorkle, and Anderson)

When does a niche market become a commodity market?

Some niche markets remain niches for a long time, while others can rapidly evolve into commodity status. The

Corn, soybeans, wheat, and barley are typically considered to be commodities. Commodity markets are characterized by a large number of buyers and sellers trading a standardized product.

underlying supply and demand factors drive this change or lack thereof. For example, niche markets frequently reflect limited growth potential relative to the overall size of the market—kosher milk is only a small portion of the total milk market, just as gluten-free foods are a small portion of the total wheat, barley, and rye market. For the large firms that dominate food markets today, the limited sales potential of these niche markets makes them unattractive. They are left to a few smaller, specialized producers. These smaller operations can get a price premium that compensates them for their serving the relatively small market.

This price premium, relative to the commodity price for a comparable product, reflects two things: 1. a higher cost to produce the product, and 2. a margin of profit that can exist due to limited participation and competition in the market.

How does a niche market become a commodity market?

Niches tend to convert to commodity markets as the result of changes on the supply side of the market. Two scenarios can be described, both stimulated by perceptions on the part

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of suppliers of opportunities in the market, often due to growth in demand.

The first scenario is when firms (often large ones) take notice of the price premiums on a product and the growing demand for the product. They think, “This market is growing and if I enter it, I can take advantage of access to less expensive inputs, existing production facilities, or other advantages I have to achieve scale economies and produce the product for less.” The focus of new firms is typically on existing firms’ relatively higher production costs that constitute the price premiums. The market must be growing for them to be attracted to it, or they must be able to reach a scale of production that permits significant cost savings and profit potential.

Organic production has become just such a market. A few years ago, organic foods were a small niche in the market until growing demand stimulated the interest of larger industry players. Each year since 1997, organic food sales have nearly tripled in sales--a growth between 17 and 21 percent, while total other food sales over this time period have grown only 2 to 4 percent a year. Organic food sales now represent approximately 2 percent of food sales nationally (Organic Trade Association).

Over this period, many supermarkets, supercenters, and large corporations have developed their own brands of organic products. Kroger has Naturally Perfect, ConAgra’s Hunts brand is making organic products, Dean Foods owns Horizon Organic, and Sam’s Club introduced Member’s Mark in January 2006. Even more recently, Wal-Mart has become a major player in the market. For many organic producers, the entry of large retailers in the market signifies a shift in market power to the retail level. This shift leads organic producers to anticipate lower prices even as the volume of organic produce sold grows. Many people feel that the once niche organic market has now made the transition to a commodity market.

In the second scenario by which niche markets convert to commodity markets, firms, not necessarily large ones, become aware of the positive profit from limited participation and decide that they would like a slice of that pie, too. If more than a few firms make this decision, entry into the market results in increased competition to the point where prices fall, eliminating the positive profit as prices are pushed down to cover only the cost of production.

Wine is a good example of increased competition driving prices down. Local wines were a niche market for many. Wine consumption increased from 1999 to 2000, only to drop

2.5 percent from 2000 to 2005. As producers saw the rise in the price of wine grapes, they went into wine grape production, causing an over supply relative to consumption. In 2002, many articles appeared telling of vineyards letting grapes rot because the price was less than the cost of production and harvesting. Many vineyards were plowed under at that time.

In both these scenarios, organic products and wine, niche markets ceased to be niches and became commodity markets.

The answer to the question, “When is a niche market no longer a niche?” is when its revenues cover cost of production and offer nothing more. The niche disappears when the “uniqueness” of the offering disappears.

Creating a niche market

Not all niche markets become commodity markets and their attractiveness to many producers is well justified. Nevertheless, when contemplating entry into a niche market, producers should look ahead to the possible evolution of that market and let such possibilities inform their investment and market entry decisions.

Creating a niche market requires some careful, thoughtful research and imagination. Since a niche market targets a product to a small portion of the market, you need to know several things: what your market area is, what and who your competition is, and what is not being provided by the existing market that you might provide. You need to accept the fact that while in a niche market you may be number one, in the broader market you will never be--that is what makes a niche market a niche. At some point the idea that you come up with, if it works, may be copied by others and your niche may well disappear.

Your target market may be a geographic region like a county or several counties; a zip code or several zip codes; a particular ethnic group like Hispanics; a certain educational level; or a selected income level. Your target market may be a combination of any of these characteristics.

Once you decide to whom you are marketing, you need to consider what your competition has to offer your potential customers. For example, suppose you decide you will target the Hispanic population in your county with hot peppers and tomatoes. You check the grocery stores and find they have some varieties of hot peppers and even fewer varieties of tomatoes. You go to the local health/natural food stores and ethnic markets where you find no fresh hot peppers and only one tomato variety. The farmers’ market has

several vendors who offer at least two varieties of hot peppers, but the total number of varieties is limited. Tomatoes are the same way--several vendors offer different varieties, but overall, little variation in varieties is offered.

Your challenge is deciding which pepper and tomato varieties are most desired by your potential customers. Are they the ones that are currently offered? What additional ones can you provide? Can you provide them in a different way? Can you offer some sort of value added like salsa from a Mexican recipe? Can you package them so that they are more appealing to customers? If you dried them, would they appeal to a larger clientele?

The key to creating a successful niche is to meet a market need that is not currently being met.

The advice given by many entrepreneurs is to start small. If you succeed, you can expand. If you fail, you have gained an education and face only limited losses.

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