

Some Fundamental Changes Now Occurring in Retail Fertilizer Markets Will Impact Producers

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There has been a great deal of change in retail fertilizer markets over the past three years. Price volatility and price increases immediately come to mind. But, in addition to the unprecedented price volatility, there have been basic changes in the trade practices at the manufacturing, wholesaling, and retailing levels in the fertilizer value chain.

Shift to global industry

Some date the beginning of the changes to the 2003-2005 period. The two large farmer-owned manufacturing firms Farmland Industries and CF Industries exited the industry during this period. Farmland filed bankruptcy and CF Industries was converted to an investor-owned company. But the transition of fertilizer manufacturing from a North American Midcontinent industry to a more global industry had begun in the mid to late 1990s, well before that time.

Nitrogen fertilizer manufacturing, in particular, has become a global industry. Relatively low natural gas feedstock prices in the Former Soviet Union (FSU) and the Middle East (compared to domestic U.S. natural gas prices) favor more offshore production of nitrogen product. The need to ship the finished product over a much longer distance means that the lead time required between manufacture and delivery is much longer. It also means that international exchange rates become a factor in fertilizer pricing. The significant decline in the value of the dollar earlier this year resulted in stronger grain prices, but it also increased the import price for many fertilizer products.

Inventory pricing changes

The exit of Farmland and CF did coincide with a radical change in trade practices at the manufacturing and retailing levels. The production of these farmer-owned firms was more-or-less committed to the U.S. markets and to a great degree committed to the cooperative distribution system. Farmland and CF were willing to undertake the inventory risks and provide a great deal of stability in retail markets.

Inventory was manufactured more-or-less continuously and moved down the logistics channel to the wholesale and retail level in advance of the season. Much of the inventory moved into retail warehouses was un-priced and there was no commitment to price it before the local cooperative decided to price it. Requests to change fertilizer products even after they were priced were often honored. These policies provided producers and local cooperatives with maximum flexibility. The policies also had a large influence on the trade practices of other manufacturers and local retailers in the market.

In the past two or three years the remaining manufacturers have no longer been willing to absorb this inventory price risk. Retailers have been required to place orders and pay for product prior to manufacture. In essence manufacturers have pushed the inventory price risk down the chain to wholesalers and retailers. Because there is no effective way to hedge fertilizer products, there is no good mechanism for retailers to manage the inventory price risk they have been forced to accept.

During this two-year period, some of the added inventory risk has been absorbed at the wholesale and retail levels. But doing that is very similar to holding an un-hedged grain inventory—a large risk that few are willing or able to undertake. And the magnitude of this risk has increased twofold or in some cases threefold as fertilizer prices have skyrocketed. Those who lend operating capital to retailers for inventory financing are no longer willing to do so under these circumstances.

Retail market impacts

This all adds up to a much changed retail marketplace for producers. Up to now producers have incurred some price risk as they purchase their fertilizer product. Price could rise if they have not priced their tons or it could fall after they have committed to a price. Most producers are accustomed to this kind of risk and routinely accept it.

Going forward producers will face an added risk of, product or supply availability risk. Since retailers can no longer afford to finance large inventories of un-priced fertilizer there is no assurance that enough product will be there to supply producer demand in season. If producers do not place an order and price the product well in advance it may not be available when they need it.

Finally an additional change in trade practices has begun to evolve during the past 12 months at the wholesale level. Unlimited fertilizer supplies are no longer being offered to retailers from all manufacturers on a continuous basis. Defined quantities or “blocks” of product are being offered on an intermittent basis to retailers. In many cases these quantities are less than the retailer would prefer to purchase or could sell promptly.

Keep communicating with dealer

This means that the retailer may no longer be able to offer a price for fertilizer product to all customers on a daily basis. Sales can be made only to the extent product has been made available for the retailer to purchase. While that quantity may be adequate to promptly fill some customer orders, it may be inadequate to meet all customer demand at the time.

Whether or not this is a permanent change in trade practice is unknown at this time. For the near term producers need to be aware that filling their fertilizer needs for the coming year may be different than in the past. There is less opportunity for producer price shopping when manufacturers require prepayment from the dealer and offer smaller quantities of product to dealers more frequently. Maintaining an ongoing relationship and frequent communication with the dealer about supply becomes as important as searching the market for the lowest price.