
Commodities Versus Differentiated Products

Commodities and differentiated products are the two ends of the product spectrum. A product is a commodity when all units of production are *identical*, regardless of who produces them. However, to be a differentiated product, a company's product is *different* than those of its competitors. On the continuum between commodities and differentiated products are many degrees and combinations of the two.

Commodities

Commodities are fungible. This means that each unit of a commodity is exactly like every other unit. For example, every bushel of number 2 corn (15.5 percent moisture) can be substituted for every other bushel of number 2 corn. Because the identity of each producer's corn does not have to be kept separate, the corn from many farmers can be mixed together. This also means that the price for corn on any given day, at any given location, is the same for all farmers.

Commodities tend to be raw materials like corn, wheat, copper, crude oil, etc. Only commodities can be traded on "futures" markets because every unit is the same. Differentiated products tend to be finished products.

Price Takers

People that produce commodities are referred to as "price takers." This means that an individual producer has no control over their price. On any day, they must take what the market offers them. For example, a Midwestern corn farmer has no influence over price because each farmer's corn is the same. Buyers don't have a preference which farmer's corn they buy.

Differentiated Products

A company's product is a differentiated product if it is uniquely different than those of competitors. If the product is different, the producer can make

the case that it is better. If it is a better product, the company can charge a higher price for it. For example, efforts to *build a better mouse trap* are based on the premise that, if you can build a better one, it will have more value to the customer and you can sell it for a higher price. This is in stark contrast to commodities where every unit is the same, regardless of who produces it.

Price Maker

The producer of a differentiated product is said to be a *price maker* rather than a *price taker*. A price maker has some influence over price, but not as much as most people believe. Essentially a producer of a differentiated product creates a separate market for their individual product. For example, the demand for "Johnson's Better Organic Milk" is unique to Johnson. This allows Johnson the opportunity to charge a price that is different than that of other organic milk.

However, there is a perception that *price makers* can automatically generate profits because they can charge any price they want for their product. It is true that producers of differentiated products can charge any price they want. Actually, commodity producer can do the same. But will anyone buy the product at that price? Only if the perceived value of the product to the consumer is greater than the price. Remember, the calculation of profits involves price multiplied by sales, not just price.

Perceptions are Everything

A differentiated product doesn't need to be a better product, it just needs to be *perceived* as a better product by the buyer. Much of the advertising and promotion that occurs in our society – of which there is plenty – is focused on trying to convince

consumers that their product is better than those of competitors. Whether it is actually better is immaterial. The only thing that counts is if you can *convince* the consumer that it is better. For example, is mass-produced beer better than micro-brewed beer, or vice-versa? There are millions of beer drinkers who will argue that question from both sides.

The Value-Added Differentiation Fallacy

There is the false perception in agriculture that the emergence of niche markets provides for product differentiation. For example, the organic milk market niche offers you the opportunity to differentiate your milk from commodity milk. While it does allow you to differentiate your milk from commodity milk, your organic milk is not a differentiated product. Simply producing organic milk only puts you in a different (albeit smaller) commodity market. Your product is no different than any other organic producer's milk.

Differentiation is only of value if it is specific to *your product*. So you need to convince organic milk drinkers that your organic milk is better than that or your competitors. One way of doing this is to create a *brand* for your product (e.g. Johnson's Better Organic Milk), and promote your brand to organic milk drinkers.

So a niche market does not automatically provide you with a differentiated product. It simply puts you in a different commodity market. The advantage is that it does provide you with the *opportunity* to differentiate your product. By branding your product, providing services, focusing on selected markets, etc., you can create a differentiated product. This is something that is almost impossible to do in agriculture's traditional broad commodity markets.

See the **Ag Decision Maker website** for more [economic and business analysis concepts](http://www.extension.iastate.edu/agdm/vdanalysis.html#concepts), www.extension.iastate.edu/agdm/vdanalysis.html#concepts.