Conclusion

Using the coffee industry as a model, this report demonstrates how changes in costs pass through into manufacturer and retail prices. We find that both retail and manufacturer coffee prices respond to costs slightly less than one-for-one (in absolute terms) with changes in commodity costs. Given the substantial fixed costs in coffee manufacturing, a 3-percent change in retail prices is likely to result from a 10-percent change in commodity prices. Since manufacturer prices adjust approximately one-for-one with commodity prices (rather than proportionally), the margin increases in percentage terms as costs fall. We do not find that coffee manufacturers take advantage of commodity-cost variation to raise prices. Coffee prices do not respond systematically more to commodity cost increases than to commodity cost decreases.

During periods of relative stability on the commodity market, manufacturer prices may not change at all for a year or more. In addition, price changes are highly synchronized both within brands and between brands. Coffee manufacturers announce many of the price adjustments involving a large number of brands and products.

These results, demonstrating the pricing patterns in one food category, may be applicable to similar manufacturer and retail markets as changing prices and/or costs move through the system to wholesalers and retailers. In particular, if an industry is subject to large fixed costs or markups, the percentage pass-through of costs may be extremely low.

This report focuses on documenting the response of prices to cost changes in the coffee industry, but how firms respond to cost changes may also be explained by demand and supply factors. Firms often maintain fixed prices for their products for long periods of time. This price rigidity may play an important role in pricing dynamics. A successful model of pricing in the U.S. coffee industry is therefore likely to include both standard demand-and-supply factors as well as some additional barriers to price adjustment that cause firms to make only infrequent adjustments to their prices.