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Evolution of a Merchant

California cotton merchant Ernie Schroeder, Jr. explains how his firm is adapting to the paradigm shifts in the global cotton business.

By Drew Harris

Developments in the global cotton landscape during the last decade have been astounding. Shifts in production and consumption have caused "emerging" markets to become some of the most important players in the industry, while traditional locations for both fiber production and spinning have a diminished role.

In addition to these market shifts, cotton merchants have experienced a sea of change in how they conduct business at home and abroad. Because of industry consolidation, many cotton merchants have been purchased by large multi-national, multi-commodity organizations that trade a variety of goods all over the world. In this scenario, cotton vies for attention with other crops and commodities within the firms, often competing with capital investments and other funds.

Competition spills over into other areas. Container availability and warehouse space have become issues in some areas as cotton competes with other commodities and goods. Banks and financial institutions sometimes see cotton as an uncertain investment, especially after the fluctuations this year on the NY futures market. Managing risk is now more important than ever.

If this wasn't enough, cotton continues to battle for market share against polyester and other man-made fabrics (MMFs). While cotton is the fiber of choice for developed markets around the world, many of the world's spinning mills still turn to MMFs for their yarn and fabric needs. However, cotton now faces competition of a different kind, a different hurdle on the production side. Producers around the world are planting alternative crops, such as corn and soybeans, both for their use in food and fuel. In this environment, cotton merchants must overcome a variety of obstacles to remain competitive. They must adapt to sustain their business for the future. The market is changing, and with those changes must come the evolution of the cotton merchant.

Diversity is Key

Jess Smith & Sons in Bakersfield, California, is a prime example of a U.S. merchandizing firm that has adapted with the times. Started in 1943 by Jess Smith and owned by the Schroeder family since 1983, the California cotton firm has expanded its operation to include all U.S. growths with offices in Arizona, Texas and Mississippi. Jess Smith & Sons also owns warehouses and offers financing to growers which helps to diversify their business in cotton. But in the environment of lower U.S. acres, especially in California where cotton acres are

Ernie Schroeder, Jr.

being switched to long-term crops such as almonds, cotton merchants must look for other opportunities outside of cotton. Ernie Schroeder, Jr., CEO of Jess Smith & Sons, explains:

"I think this is something that all merchants are dealing with right now. Because of decreasing acreage in the U.S., merchants must get involved in either diversifying into other commodities or other businesses, and a lot of merchants have already been forced into doing that. You always have to change with the times, and this leads to new opportunities. If you don't change or evolve, then you will be left behind."

With volatile futures markets not always reflecting cash prices, Jess Smith & Sons enhanced their risk management strategies several years ago to focus on options. This year this strategy proved extremely important as they were able to take advantage of market opportunities.

"At Jess Smith & Sons, we focus extensively on diversification. In cotton, we handle not just Californian growths, but all U.S. cottons, especially niche cottons like Pima, Acala and Fibermax. So that is one kind of diversification," Schroeder said. "Then we also have warehouses and we finance farmers – so this is another way to grow our business. We then diversify our commodities with our own farms and almond and hay exporting businesses, and this helps to maintain a very constant volume of total product."

One reason this diversification fits well with Schroeder's cotton operations is the seamless integration of certain commodities with the company's current infrastructure. Like most cotton merchants, Jess Smith & Sons has a network of agents, representatives and business partners around the world that can assist with other operations. This utilization of resources is critical in a market that is already experiencing razor-thin profit margins.

"If you have a streamlined organization, then you can use your staff for many different jobs. Almonds are a good example," Schroeder said. "A lot of the markets that they go into are the same markets that import cotton -- especially India, China and some European countries -- so we are able to use our same staff for invoicing, shipping, selling, and you can use some of your same agents on the ground."

Merchants Become Partners

The role of the cotton merchant and the relationship with mill customers is changing, bringing a new dynamic to the industry. While merchants and mills have always had the traditional "adversarial" buyer/seller relationship, some merchants like Schroeder see this becoming more of a complex, fluid partnership.

"I think one of the biggest changes with our operation has to do with the relationships with the mill customers. In the past, there wasn't really as much of a partnership with the mills. It was more of a simple sales situation, but that has completely evolved into something that I think is very dynamic and unique. Now we have a very close working relationship with our customers, almost like a partnership, and it is a very personal relationship," Schroeder said.

Merchants also need the knowledge of their customers' operations. Cotton merchants have evolved to become more than sellers of raw cotton fiber – they must be knowledgeable in spinning, knitting, weaving and textile production.

"I think it is very important to understand what products your mill customers are making, so that you can help them select certain qualities to help them make a better product. In the past, you really didn't know what the mills were making – a shirt, a sheet, or a towel – but now you know their yarn counts and we are helping select the best cotton for them using our extensive lab testing before shipping," Schroeder said.

"Even on a consumer level, you have to pay attention to what fabrics are popular and what stores sell certain items. You are looking to the consumers to see what they demand. So there is a lot more interest in what the cotton is finally being made into, and I think it is in the merchant's best interest to help the mill select the right cotton to make their best product."

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In this new scenario, the merchant has evolved from the traditional cotton buyer and seller who is focused only on price, to a trusted advisor and confidant on whom the spinner can depend. This relationship relies more on personal and face-to-face interaction, requiring more travel and investment into the client's needs. But Schroeder believes this will be the new standard for merchants to follow, and in an increasingly competitive business environment, the only way forward for successful merchandizing firms.

"We have always operated as the merchant and the seller, but now we have taken on more of a consultant role, which I think is a good thing. You need to visit the mills, get to know them on a personal level and understand their requirements – that has all become a must," Schroeder said.

"For example, we have a profile on all of our buyers that tells us not only what they have bought in the past, but also what products they make. Then we can look at the options and advise them on what growths they should select. This is totally different than how it used to be. Mills used to request a quality with certain specs and the merchant would give them a price and that would be it. Now it is the opposite of that – we really work together in a partnership." ⊕