

Values-based food supply chains: Executive summary

Country Natural Beef, CROPP/Organic Valley,
Shepherd's Grain and Red Tomato

Steve Stevenson, CIAS

June 4, 2009



Mid-sized farms and ranches are disappearing because, individually, they are often too small to compete successfully in international agricultural commodity markets, yet they are not positioned to bypass these markets and directly market food to local consumers. Case studies of four innovative enterprises—Country Natural Beef, CROPP/Organic Valley, Shepherd's Grain and Red Tomato—offer models of how mid-sized farms and ranches can prosper through the construction of a “third tier” in the U.S. agri-food system. Known as “mid-scale food value chains,” these new business structures focus on strategic alliances that effectively operate at regional levels with significant volumes of high-quality, differentiated food products, and distribute profits equitably among the strategic partners.

- **Country Natural Beef** is a 100-member rancher co-op in the northwestern United States;
- **CROPP/Organic Valley** is a 1,000-member, multi-regional farmer co-op marketing organic dairy, eggs, vegetables and other products;
- **Shepherd's Grain** is a 35-farmer LLC marketing sustainably grown and functionally specified flour in the northwestern United States; and
- **Red Tomato** is a non-profit, market-oriented, fair-trade business supporting 35 fruit and vegetables farmers in the northeastern United States.

Historical development

Introduction. These case studies represent four agri-food sectors: beef, grain, fruit and vegetables, and dairy. They are located in the northwestern, midwestern and northeastern regions of the United States. Country Natural Beef and Organic Valley were formed in the 1980s, while Shepherd's Grain and Red Tomato began in the 1990s. All began as small, independent enterprises involving fewer than a dozen producers.

Founding principles and strategic goals. All of these case enterprises share some central characteristics, including environmentally regenerative farming and ranching systems; differentiated, higher-quality, higher-value food products; values-based, market-oriented, strategic supply chain business partnerships; economic sustainability through supply control coupled with fair, stable, and transparent pricing mechanisms; and a commitment to diversified farm and ranch structures, rural communities and future farmers and ranchers.

Organizational development. Country Natural Beef and Organic Valley are both producer cooperatives, yet they are significantly different in terms of whether producers are required to make a financial equity contribution to the cooperative; Shepherd's Grain is a farmer-owned LLC with additional associated producers; and Red Tomato is a non-profit organization that generates income from marketing, consulting fees and grants. Currently, the approximate number of farmers and ranchers associated with these enterprises ranges from approximately 35 to 1,000. There are about 35 fruit and vegetable producers with Red Tomato, roughly the same number of wheat farmers with Shepherd's Grain, 100 ranchers with Country Natural Beef, and nearly 1,000 Organic Valley dairy farmers located across the country.

Historical performance indicators. All of these businesses have performed well. They have reaped the benefits of clear principles, appropriate organizational

models, effective leadership, good business decisions, and—importantly—being positioned to take advantage of expanding markets over the past several decades for the kinds of food values and products associated with these enterprises. In addition to growing numbers of farmers and ranchers associated with each business, current indicators of performance include: increasing acreage under sustainable farming and ranching systems; ongoing maintenance and defense of producer-determined prices; and annual increases in gross sales of 15 to 30 percent based on annual sales ranging from \$250,000 to over \$400 million. A key strategy of all four enterprises—Organic Valley, Shepherd's Grain, Oregon Country Beef and Red Tomato—is balancing supply with

A key strategy of all four enterprises is balancing supply with markets through membership numbers.

markets through membership numbers. This is relatively easy to do when markets are stable or expanding predictably. See

“Future Dynamics,” below, for information about these four value chain enterprises as they work their way through the current recession.

Current dynamics

Creating and marketing differentiated, high value food products. Value chains are predicated on producing and marketing significant volumes of differentiated, higher value products (Appendix A, page 7).

Product differentiation and branding. There are several shared, fundamental dimensions on which these businesses build differentiation claims. These include food quality, nutritional excellence, food safety, consistency and reliable logistical performance. These businesses vary in their emphasis of a second level of product differentiation claims: environmentally regenerative farming and ranching systems; locality and regionality; family-organized farms and ranches; and “fair” prices for farmers, ranchers and supply chain partners. Third level differentiations engaged by several of the businesses include functional performance, special packaging and value-added processing. It is a challenge to communicate the deeper, more complex values that differentiate

these businesses. These include land stewardship, fair prices, and diverse farm and ranch structures. Shepherd's Grain is a leader in communicating land stewardship values. The role of price varies among businesses and customers. All businesses own and support their own brands.

Standards and certification. Country Natural Beef, Shepherd's Grain and Organic Valley employ third-party certification under national standards. These standards are set out by the Food Alliance (environmental and social responsibility), the USDA National Organic Program, the Whole Grains Council and Orthodox Union Kosher. Two cases have internally generated standards. These include Country Natural Beef's “Grazewell” principles and Red Tomato's “EcoApple Protocol” based on integrated pest management.

Identity preservation throughout the value chain. All four enterprises seek to have their brands and identities retained throughout their supply chains. Mechanisms vary depending on whether sales are through food supermarkets or food service organizations. Many food service partners actively promote case enterprise brands. Tensions exist with some supermarket partners regarding brand retention and balancing enterprise and farmer/rancher identities. Shepherd's Grain is experimenting with a co-branding project with a regional, retail flour company. Organic Valley sells a small percentage of its milk to a business that is both a competitor and a partner for processing and sale under the partner's label.

Interaction with, and feedback from, customers and consumers. Regular contact with and feedback from value chain customers are part of each case enterprise's sales and logistical support functions. This includes rapid recalls and correcting problems. With regard to educating and listening to consumers, case enterprises collaborate with strategic partners to “tell their stories” via public press attention, point-of-sale materials and increasingly sophisticated and interactive websites. Case enterprises vary in terms of their use of farmers and ranchers as storytellers, marketers and listeners. Country Natural Beef is a leader in employing producers in these roles.

Creating effective internal organizational forms.

Successful value chain businesses aggregate and market products through effective organizational structures, and develop and/or hire competent leadership and management (Appendix A).

Organizational structure. These case studies indicate that a range of organizational structures can work well for value chain enterprises (see “Organizational development,” page 1). Country Natural Beef is a “no assets/no debts/no employees” cooperative, Organic Valley is a regionally expanded cooperative and Shepherd’s Grain uses a core LLC structure. Red Tomato has both an income-generating business and non-profit status. Convergence toward an “honest broker/fair trader” business role can be seen in all four enterprises. The three farmer and rancher-based enterprises developed respect and responsibilities for serving as “honest brokers” for their supply chains, while Red Tomato has assumed a “fair trader” business role. In their key roles of facilitating and stewarding the integrity of value chain business relationships for all strategic partners, the four case enterprises are good examples of business models designed for the protection of a range of collectively important spaces, or “commons” (see *Capitalism 3.0*, authored by Peter Barnes, Berrett-Koehler Publishers, 2006).

Competent leadership and management.

Leadership is strong and competent in all four cases. The two older enterprises—Country Natural Beef and Organic Valley—offer instructive models for developing leadership and management structures that effectively couple farmers and ranchers with food system professionals. These enterprises are also involved in implementing leadership succession strategies that maintain managerial competency and company culture.

Selecting markets and value chain partners.

Successful value chain partners have similar values, different competencies and complementary business models (Appendix A).

Farmer/rancher partners. All case enterprises have identified key characteristics for recruiting and inviting new members when markets exist for additional product. Combining structural and personal attributes, these characteristics include

farm or ranch capacity, food quality, location, economic match and appropriate certification. These enterprises look for new members who are reliable, open, cooperative, active participants with an interest in marketing and willingness to represent the business. In all cases, prospective members are evaluated by current members. The screening of potential new producer members by existing members is an important process in all four enterprises. Country Natural Beef requires a two-year trial membership.

Retail/food system partners. For the most part, the retail and food system partners of case enterprises share basic values. Still, these partners range considerably in size,

scope, age and how they engage, rank and market the values associated with their products. Value chain strategies differ with regard to “pioneer/smaller/niche” partners vs. “follower/larger/mainstream”

With the exception of one butter manufacturing plant owned by Organic Valley, these businesses do not process and distribute their own products. Instead, these functions are carried out through partnerships and contracted services.

partners. For Shepherd’s Grain’s original, smaller customers, the Shepherd’s Grain story was the most important differentiating characteristic, followed by product quality and, finally, price. Larger and more recent customers rank quality above story and price, however. Economic and logistical matches and commitments to long-term business relationships are also key qualities of these partnerships. Country Natural Beef has one retail partner that accounts for 60 percent of its business and over 80 percent of its top-value meat cuts, requiring this business to work with food service partners who buy lower-value cuts. Organic Valley has made decisions not to partner with certain large retail firms.

Processing and distribution partners. With the exception of one butter manufacturing plant owned by Organic Valley, these businesses do not process and distribute their own products. Instead, these functions are carried out through partnerships and contracted services. For the three enterprises that deal with processed food products

(Country Natural Beef, Organic Valley, and Shepherd's Grain), access to appropriately scaled and located processing facilities has been critical to their success. In all instances, the brand identity of the enterprise is maintained through to the retail or food service customer. These businesses prefer agreements with mid-scale, family-based processing or distribution companies, but some forge agreements with the regional representatives of large national or international businesses. With a few exceptions, the value chain partners of the four enterprises are privately owned and not subject to Wall Street pressures. In two cases (Country Natural Beef and Shepherd's Grain), the processing partner fills the important roles of assuring quality,

With a few exceptions, the value chain partners of the four enterprises are privately owned and not subject to Wall Street pressures.

buying unsold product at commodity rates and facilitating distribution schedules. Organic Valley has recently

built a new distribution center in the Midwest and is developing its distribution sector as an income center and a service to smaller organic companies.

Strategic partnerships replace capital and expertise. All four case enterprises have acquired, through partnerships, important kinds of information and expertise on production, social, economic and business issues. All of these enterprises differ when it comes to investing in bricks and mortar. Organic Valley's decision to build a new headquarters and midwestern distribution center contrasts with alternative strategies employed by Country Natural Beef and Red Tomato. Organic Valley is the only case enterprise to acquire physical capital. Red Tomato and Country Natural Beef have made conscious decisions to not own "bricks and mortar" (buildings) or "steel and rubber" (trucks).

Developing effective supply chain logistics. In addition to values-based business relationships, successful value chains require increasingly sophisticated logistical systems as they grow larger and more complex (Appendix A).

Production and aggregation. Across the four cases, key production variables include environmentally regenerative farming and ranching systems, supply and quality control, and farm and ranch economics and efficiencies. Important aggregation variables include transportation and logistical efficiencies, supply and sequencing control and post-harvest handling. For some value chains, product supply and sequencing decisions begin two years prior to processing and sales.

Processing and distribution. Webs of partners often tie together production, processing and distribution for these four value chain enterprises. Particularly important is the interface between processing and distribution. As indicated above, value chain processors can assume important responsibilities with regard to assuring product quality, facilitating warehousing and/or transportation schedules and serving as back-up buyers for unsold product. Given economies of scale in the processing and transportation sectors, partnerships can be developed with quite large companies. Distribution partners can also augment the sales capacity of case enterprises.

Accounting. As these case enterprises grew, accounting functions such as records, invoicing and payments were often the first of the logistical operations to be separated out and performed by special staff. The financial and logistical roles that processing partners play in several value chains require effective communication with accounting staff. Country Natural Beef is experimenting with an electronic identification system for both animals and meat products that will provide information not only for accounting, invoicing and rancher payment, but for feedlot and ranch management decisions.

Logistical coordination. In all cases, competent logistics managers are the pivot persons around whom complex and time-sensitive logistical strategies are engaged. Given the complexity and importance of logistical performance, these enterprises designate specialized staff to coordinate logistical flows from producers to processors, distributors and customers. This coordination also involves the sales, marketing, production and accounting functions of an enterprise, and

schedules can reach forward as far as two years. Little surprise that these case enterprises often hire and train highly experienced and skilled food system professionals to coordinate these logistical flows.

Achieving economic sustainability. In successful value chains, commitments are made to the economic welfare of all strategic partners (Appendix A).

Pricing philosophy. All case enterprises employ pricing systems based on two sets of principles: 1) supply management and stable pricing, and 2) cost-of-production-based pricing. The first set of principles is intended to significantly unhinge “economic sustainability” from fluctuating commodity markets and pricing systems. The second principle seeks to cover farmers’ and ranchers’ production and transaction costs, plus a return on investment and a reasonable profit. With the assistance of agricultural economists, Country Natural Beef and Shepherd’s Grain calculate production costs based on a sample of their farms and ranches. Organic Valley also bases its prices on farmers’ production costs, with regional adjustments. Red Tomato employs a “dignity pricing” model that is based on farmers’ senses of current costs and historical prices; this model better fits complex, multi-product farming enterprises.

All four enterprises demonstrate the importance of selling a high percentage of products as identity-maintained, differentiated and higher-value, and having commodity market options available as back-ups for unsold product. Both Country Natural Beef and Shepherd’s Grain sell their products to processors, yet retain identity, pricing and marketing authority. Their processors can sell their extra inventory into commodity markets, if necessary. Recently faced with high and volatile commodity prices, several case enterprises are seeking methods within their sustainable pricing models to address these challenges for both producers and other partners in the value chain.

Payment practices. Payment practices range from relatively simple and straightforward (Red Tomato and Shepherd’s Grain) to multi-dimensional and complex. Country Natural Beef ranchers are paid in six installments keyed to feedlot and slaughter

dates, carcass quality, age and source verified premiums, and final cooperative profits. These payments can stretch over 18 months. Organic Valley payments are based on milk components, quality and cleanliness, regionally adjusted premiums and final cooperative profits. Deductions include milk pickup and trucking fees and a required, annual purchase of preferred stock in the co-op.

Communicating sustainable economics in the marketplace and with enterprise members. Rising input costs and volatile commodity markets have heightened the importance of communicating with customers about the values and true costs associated with sustainably produced food. High commodity prices also require education of enterprise members, some of whom may wish to abandon value chain pricing systems for temporarily higher commodity payments.

Securing technical support. The case enterprises have secured technical support for agronomic issues (Shepherd’s Grain and Red Tomato), costs of production (Country Natural Beef, Organic Valley, and Shepherd’s Grain), environmental impacts (Country Natural Beef and Shepherd’s Grain), organizational structuring and facilitation (Shepherd’s Grain and Country Natural Beef) and information technology (Red Tomato). In turn, these case enterprises have provided support to other developing food enterprises through formal and informal consulting (Red Tomato, Country Natural Beef, and Shepherd’s Grain), as well as through providing services and financial support (Organic Valley).

All four enterprises demonstrate the importance of selling a high percentage of products as identity-maintained, differentiated and higher-value, and having commodity market options available as back-ups for unsold product.

Future dynamics

Internal organizational issues. These enterprises are exploring organizational development frameworks that are appropriate to their unique goals and stages of maturity. Shepherd’s Grain is exploring formal organizational structures that will carry the business

beyond the charisma and energy of its founders. Country Natural Beef is fine tuning its authority frameworks and consciously pursuing leadership succession strategies. Red Tomato is engaging internet technologies to improve internal communication and develop sophisticated, web-based food commerce. Organic Valley is revitalizing company culture for significant numbers of new employees and farmer partners. All of these case enterprises are exploring regional expansion and growth.

Issues with supply chain partners. The two younger case enterprises—Red Tomato and Shepherd’s Grain—are exploring business relationships with larger, mainstream customers. Some of the partnerships being explored by the younger businesses are potentially important for the value chain business model. Shepherd’s Grain has included strategic partners on its new management board, and Red Tomato is exploring deeper strategic business relationships with core growers and customers. The older two enterprises are facing significant supply chain challenges and opportunities such as the availability and price of organic grain for Organic Valley farmers, and diversification beyond a primary retail customer for Country Natural Beef.

Economics and efficiencies. As these enterprises and their markets mature, all of them are exploring where efficiencies can be achieved throughout the supply chain. These explorations involve farm- and ranch-level strategies such as new animal and crop genetics and grower education; enterprise-level strategies including regional purchasing groups and information technology; and value chain-level strategies such as electronic ear tag systems, information technology and use of railways. Particularly important is Shepherd’s Grain’s new pricing model—worked out in conversation with value chain partners—which addresses volatile commodity markets and offers protection for both farmers and customers.

Strategies for maturing markets. In addition to achieving efficiencies, case enterprises are looking to engage new markets through new, domestic and international geographies, new products with value added through processing and/or packaging and new, larger, mainstream customers. Given the “conventionalization of natural food,” all case

enterprises recognize the need for ongoing value differentiation, with several enterprises pointing to deeper ecological stewardship (carbon footprint) and social justice (fair trade). For seasonal and perishable products, Red Tomato’s ideas regarding multi-regional, year-round value chains are intriguing.

Value-chain-linked enterprises are particularly susceptible to perceived contradictions within their practices and/or the practices of strategic partners. For example, Country Natural Beef was caught in a labor unionization flap between the United Farm Workers and one of its strategic partners, Beef Northwest. Organic Valley’s decision to temporarily contract with a 5,000-cow organic dairy farm to maintain its Texas milk pool resulted in conflicts over the cooperative’s family farm values.

Signs of maturing enterprises. While these case enterprises vary in age and organizational maturity, all have given thought to what “too big” means in terms of serving farmers, ranchers and customers well. As Organic Valley demonstrates, size can have important positive consequences. Several of the case study enterprises are exploring business expansion models based on multi-regional growth and autonomy that use core company competencies and infrastructure. CROPP is a leader in the use of such expansion models. All of the case enterprises foresee expansion through some form of replication in other regions, with possible federation or association. “It’s better to move the idea than move the wheat” (Shepherd’s Grain).

Positioning value chains in a troubled (and contracting) economy. All of these case enterprises began and grew during an expanding economy, and most are currently experiencing a softening of markets. “This is a time of incredible flux... We are currently testing our assumptions” (Organic Valley). “We will likely see more separation between price sensitive and value sensitive customers” (Shepherd’s Grain). “Maybe the language/concept of self-regulation would speak to people at this moment” (Red Tomato). “We’ve lived off our equity before and we can do it again” (Country Natural Beef). The Agriculture of the Middle project plans to monitor these four case enterprises as they work their way through the current economic recession.

Appendix A

Values-Based Food Supply Chains: Strategies for Agri-Food Enterprises-of-the-Middle

Steve Stevenson (gwstevenson@wisc.edu) and Rich Pirog (rspirog@iastate.edu)
www.agofthemiddle.org

Definitions and distinctions

The terms *value* and *values* are used in different ways when referring to food production and food business networks.

1. *Value-added* is used to characterize food products that are converted from a raw state through processing that gives the resulting products an incremental value in the market place. An incremental value is realized from either higher price or expanded market. For example, jams, cheeses and pre-cooked meats are considered value-added products.
2. *Value-added* is also used to characterize food products that gain incremental value in the marketplace through differentiation from similar products based on attributes such as geographical location, environmental stewardship, food safety or functionality. Examples of this type of higher value product include locally grown produce, organic or IPM-grown fruits, antibiotic and/or hormone free meat, or functionally specified hops and baking flours.
3. The words *value* and *values* are also used to characterize the nature of certain business relationships among interacting food business enterprises. In general, this collection of relationships is known as a supply chain (see below). When these relationships are expressly based in an articulated set of values, they are becoming known as *values-based supply chains* or *value chains*.

Some people in the agri-food business community use the term value chain to focus on supply networks that deal with food products given incremental value through processing and/or attribute differentiation (#1 and #2 above). **In the Agriculture of the Middle (AOTM) and Association of Family Farms (AFF) initiatives, the term values-based value chain embraces both product differentiation and the characteristics of the business relationships within a food supply network.**

A *food supply chain* is a network of food-related business enterprises through which products move from production through consumption, including pre-production and post-consumption activities. Typical links in the supply chain are:

inputs → producer → processor → distributor → wholesaler → retailer → consumer

For example, a food supply chain featuring pork products might include feed suppliers or veterinarians, a cooperative of farmers, meat packing and fabrication plants, food distributors, marketers, supermarkets and consumers. Pre-production activities might include university-based research and development, and post-consumption activities could include waste disposal and recycling, while government regulations would likely be engaged throughout the chain. Increasingly, supply chain analyses also are including such pre-production links as agricultural research (e.g., genetics) and post-consumer links such as waste disposal and recycling <www.valuechains.org/valuechain.html>.

Conventional food supply chains exhibit the following key characteristics:

1. Business relationships within the supply chain are often framed in win-lose terms, with resulting levels of inter-organizational mistrust. Relationships are constructed as competitive, even adversarial, whereby each company seeks to buy as cheaply and to sell as expensively as possible.
2. Farmers, ranchers and fishers are treated as interchangeable and exploitable input suppliers, often operating in restricted markets or under short-term contracts where they usually bear the risks.
3. The benefits and profits from the selling of finished food products are unevenly distributed across the supply chain, with food processors and marketers usually receiving a disproportionately higher share.

4. Operations are increasingly located and coordinated on a national and international scale, with food production, processing and marketing sited according to short-term economic gains for those parties who dominate the chain.

Traditional food supply chains can handle both undifferentiated (commodity) and *value-added* food products.

Values-based food supply chains differ from traditional food supply chains in the following important ways:

1. Business relationships among *strategic partners* within value chains are framed in win-win terms, and constructed on collaborative principles that feature high levels of interdependence and inter-organizational trust. All value chain partners have a strategic interest in the performance and well-being of other partners.
2. As producers of differentiated food products, farmers, ranchers and fishers are treated as strategic partners with rights and responsibilities related to value chain information, risk-taking, governance and decision-making.
3. Commitments are made to the welfare of all strategic partners in a value chain, including appropriate profit margins, living wages and business agreements of appropriate duration.
4. Operations can be effectively located and coordinated at local, regional, national and international scales.

These *values-based food value chains* are distinguished from traditional food supply chains by the combination of how they differentiate their products (food quality and functionality, and environmental and social attributes) and how they operate as strategic partnerships (business relationships). **Value chains can be smart from both business and ethical perspectives.**

Mid-tier food value chains are values-based strategic alliances between midsize, independent (often cooperative) food production, processing, distribution and sales enterprises that seek to create and retain more value on the front (farmer/rancher) end of the chain, and effectively operate at regional levels with significant volumes. Significant volumes for these value chains normally range between quantities handled by commodity systems and amounts produced for direct marketing. Regionality will vary with geography, geographic identities, food products and market demographics.

General characteristics of values-based value chains

Value chains have the capacity to combine scale with product differentiation, and cooperation with competition, to achieve collaborative advantages in the marketplace.

Value chains are successfully employed in such higher-volume, complex product industries as cars and trucks, consumer electronics and high-end apparel. The automobile industry provides good examples of cooperation within supply chains and competition between chains.

The Toyota value chain¹ is a good example of distinguishing between strategic (value adding) partners and non-strategic suppliers—makers of engines and transmissions contrasted with makers of belts and hoses:

- a. Successful value chains choose strategic partners that bring distinctive competencies but similar values, visions and goals.

Value chains contrast with two other models for complex business networks:

- a. Competitive bidding (arm's-length) relationships with suppliers; and
- b. Internal ownership of business activities (vertical integration).

¹For more information on Toyota, see:

Dyer, Jeffrey. 2000. *Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks*. New York: Oxford University Press.

Handfield, Robert, and Ernest Nichols Jr. 2002. *Supply Chain Redesign: Transforming Supply Chains into Integrated Value Systems*. Upper Saddle River, NJ: Prentice Hall.

Value chains outperform other complex business models in rapidly changing markets.

Value chains emphasize high levels of performance and inter-organizational trust.

High levels of performance are essential to consistently deliver high quality products and services:

- a. Develop appropriate standards and conduct performance evaluations across the entire value chain;
- b. Employ quality assurance systems (with realistic allowances for surprise events);
- c. Employ continuous improvement systems and target support for underperforming partners in the value chain.

Inter-organizational trust among strategic business partners is pivotal:

- a. Inter-organizational trust is the mutual confidence that business partners will fulfill their agreements and commitments and will not exploit each other's vulnerabilities;
- b. Inter-organizational trust is different from interpersonal trust: the trust will still be in place even if key people leave their respective organizations;
- c. Inter-organizational trust is built upon the fairness, stability and predictability of agreements among strategic partners.

Value chains emphasize shared values and vision, shared information (transparency) and shared decision-making among the strategic partners.

Strategic partners need to share common values and a common vision regarding product quality, partner relationships and customer treatment.

Successful value chains develop effective systems for sharing information and governance:

- a. Shared information (transparency) improves productivity, enables rapid response to market changes and effectively engages discriminating customers. The Dell computer company, which has eliminated retail outlets and middlemen by selling custom-made computer systems directly to customers over the internet, employs a particularly effective information system to communicate with customers and strategic business partners;

- b. Shared governance means all strategic participants benefit from the value chain's business, and all have a say in business developments.

Value chain governance can be framed in familiar terms and mechanisms:

- a. Legislative (setting standards for the chain);
- b. Judicial (monitoring performance in the chain);
- c. Executive (coordinating procedures and flows in the chain).

In successful value chains, all partners experience an authentic sense of fairness and justice:

- a. Distributive justice, where rewards and profits are distributed fairly among all value chain partners;
- b. Procedural justice, where rules of business in the value chain are experienced as fair by all partners.

Value chains make commitments to the welfare of all strategic partners in the chain, including appropriate profit margins, fair wages, and long-term business agreements.

Partners in Japanese value chains express their relationships as "co-existence and co-prosperity:"

- a. Partners have strategic interests in the others' welfare;
- b. Together, they race to the top instead of the bottom.

Strategic partners are rewarded through agreed-upon formulas for adequate profit margins above production and transaction costs, and for adequate returns on investment:

- a. Cost-based pricing in which profit margins of strategic partners are built in from the beginning;
- b. Living wages and supportive workplaces for employees of strategic partners;
- c. Community-supporting business practices, e.g., opportunities for local community investment in value chain businesses

Cost-based pricing requires a high degree of information sharing regarding sensitive economic data:

- a. Sharing economic information can be a challenge for new value chains;
- b. All partners are required to know their true cost structures (production and transaction costs);
- c. Ongoing cost reduction strategies across the chain result in shared benefits.

Successful value chains are built upon long-term

strategic partnerships:

- a. Agreements and contracts are for appropriate, extended time periods;
- b. Extended agreements provide confidence for investment in new productive or cost-saving assets;
- c. Legal contracts are often relaxed with development of substantial trust in mature value chains. Strategic relationships are increasingly held together by mutual obligations and opportunities, not legal force.

Additional applications to mid-tier food value chains

Mid-tier food value chains are appropriate for situations in which regionally oriented markets are developing for significant volumes of differentiated, value-adding food products.

1. The combination of significant volume and differentiated food products corresponds to the needs of a growing food service sector of the U.S. economy. Examples include Bon Appétit Management Company <www.bamco.com>, Hot Lips Pizza <www.hotlipspizza.com>, Sysco <www.sysco.com> and Shepherd's Grain <www.shepherdsgrain.com>.
2. Regional supermarket and restaurant chains seeking to distinguish themselves from national chains are also likely candidates for value chain partnerships. Examples include New Seasons Market <www.newseasonsmarket.com>, Burgerville <www.burgerville.com> and Oregon Country Beef <www.oregoncountrybeef.com>.
3. As evidenced by these four case studies, significant opportunities are emerging for farms-, ranches- and fisheries-of-the-middle.

Horizontal collaborations are often required to assemble sufficient volumes of differentiated food products for mid-tier value chains.

1. Multi-lateral collaborations such as co-ops and Limited Liability Corporations (LLCs). Examples include Organic Valley <organicvalley.coop> and Thumb Oilseed Producers <www.thumboilseed.com>.
2. Bi-lateral collaborations such as aggregating firms. Examples include Niman Ranch <www.nimanranch.com> and Laura's Lean Beef <www.laurasleanbeef.com>.

Appropriate standards and efficient methods of third-party certification are applied throughout the value chain.

1. Standards related to key value chain dimensions (for example, food quality, environmental stewardship, animal welfare, workplace conditions and business ethics);
2. Efficient, computer-based certification systems.

Farmers and ranchers can maintain ownership and control of brand identities on food products throughout the value chain.

1. Development and defense of regionally meaningful identities and brands;
2. National seal to support regional and local brands.

Given historically adversarial business models in traditional U.S. food supply chains, it will likely take time for all strategic partners in new food value chains to become comfortable with alternative business models based on trust and organizational interdependence.

1. Participatory governance structures will be particularly important for food value chains that engage strategic partners of differing size and experience;
2. Non-strategic partners will likely be rare in mid-tier food value chains.

Challenges faced by farmers, ranchers and fishers when constructing mid-tier food value chains

Farmers, ranchers and fishers face several types of challenges in building mid-tier food value chains:

Finding appropriate value-chain partners and developing mechanisms for building trust, transparency and decision-making;

Determining effective strategies for product differentiation, branding and regional identity;

Developing food quality control systems that address weather, seasonality, multiple production sites and quality-preserving distribution mechanisms;

Determining appropriate strategies for product pricing that are based on understanding true cost structures. Two contrasting strategies are cost-based pricing and paying premiums above commodity market prices;

Building sufficient trust among competing producer groups to form networks of farmers, ranchers and fishers large enough to supply significant and consistent volumes of high-quality, differentiated food products;

Acquiring adequate capitalization and competent management;

Accessing adequate technical, research and development support;

Creating meaningful standards and consistent certification mechanisms across the value chain; and

Developing equal economic power for value chain negotiations.

This project was supported by the National Research Initiative of the Cooperative State Research, Education and Extension Service, USDA, Grant #2006-55618-17014.



Organizations involved with this report:

The National Task Force on Renewing an Agriculture of the Middle is concerned with a disappearing sector of mid-scale farms/ranches and related agrifood enterprises that are unable to successfully market bulk commodities or sell food directly to consumers. See www.agofthemiddle.org or contact convening chair Fred Kirschenmann, Iowa State University, 515-294-5588, leopold1@iastate.edu; or administrative chair Steve Stevenson, University of Wisconsin-Madison, 608-262-5202, gwsteven@wisc.edu. The task force has three areas of emphasis:

New business and marketing strategies will seek to create business networks or “value chains” that link farms/ranches-of-the-middle with food system partners to meet a growing demand for differentiated, high-quality food products. Currently operating as the Association of Family Farms.

Public policy changes include those that can be secured in the relatively short term that directly affect middle market development, and more systemic policy changes over an extended period of time that will fully equalize economic environments for farms/ranches-of-the-middle.

Research about and education support from scientists associated with the initiative and land-grant university community on the business and policy strategies, at both the regional and national levels.

The Center for Integrated Agricultural Systems (CIAS) is a research center for sustainable agriculture in the College of Agricultural and Life Sciences, University of Wisconsin-Madison. CIAS fosters multi-disciplinary inquiry and supports a range of research, curriculum and program development projects. It brings together university faculty, farmers, policy makers and others to study relationships between farming practices, farm profitability, the environment and rural vitality. For more information, visit www.cias.wisc.edu or call 608-262-5200.

Many thanks to the organizations and individuals who provided the information for the case studies.

Edited by Cris Carusi, CIAS.

Publication design and layout by Ruth McNair, CIAS

Photos from Organic Valley Cooperative.