Values-Based Food Supply Chains:
Strategies for Agri-Food Enterprises-of-the-Middle
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Definitions & 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 raw product through processes that give the resulting product 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 have incremental value in the marketplace by differentiating them from similar products based on product attributes such as: geographical location; environmental stewardship; food safety; or functionality. Examples of this type of "value-added" products include locally grown produce, organic or IPM-grown fruits, antibiotic and/or hormone free meat, or functionally specified hops or baking flours.

    3. The words "value" and "values" are also used to characterize the nature of certain business relationships among interacting food business enterprises, rather than any attribute of the product itself. 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, more succinctly, "**value chains**".

  Some 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 AOTM/AFF initiative***, **the term "value chain" embraces *both* the characteristics of the business relationships within a food supply network, *and* product differentiation**.

- A *food supply chain* is a network of food-related business enterprises through which food 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 farmer producers, 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.

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Increasingly, supply chain analyses also are including such pre-production links as agricultural research (e.g., on genetics) and post-consumer links such as waste disposal and recycling. (See www.valuechains.org/valuechain.html.)

- *Traditional 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 risks are usually born by producers.

  3. Benefits/profits from the selling of final 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.

- *Food value 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 inter-organizational trust. ("Strategic partners" are those businesses that significantly add value to food products and/or to supply chain performance. It is possible that not every business "link" in the chain is a "strategic partner.")

  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 fair profit margins, fair wages, and business agreements of appropriate duration.

  4. Operations can be effectively located and coordinated at local, regional, national, and international scales.

These *food value chains* are distinguished from traditional food supply chains by the combination of how they operate as strategic partnerships (business relationships), and how they differentiate their products (focused on food quality & functionality and on environmental & social attributes).

- *Mid-tier food value chains* are value chains consisting of midsize, independent (often cooperative) business enterprises that produce, process, distribute and market significant volumes of differentiated and value-added food products at regional scales. ("Significant volumes" for these value chains normally range between volumes handled by commodity systems and volumes produced for direct marketing.)

General Characteristics of Value Chains

- ***Value chains have the capacity to combine scale with product differentiation, and cooperation with competition, to achieve collaborative advantages in the marketplace.***
  1. Value chains are successfully employed in such higher-volume, complex product industries as auto/truck, consumer electronics, and high-end apparel;
  2. The automobile industry provides good examples of cooperation within supply chains and competition between chains;
  3. The Toyota value chain 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;
  4. Successful value chains choose strategic partners that bring distinctive competencies, but similar values, visions, and goals;
  5. Value chains (vertical coordination through alliances with strategic partners) contrast with two other models for complex business networks:
     a. competitive bidding ("arms-length") relationships with suppliers; and
     b. internal ownership of business activities (vertical integration);
  6. Value chains outperform other complex business models in rapidly changing markets…."learning" value chains

- ***Value Chains emphasize high levels of performance and high levels of inter-organizational trust***
  1. 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 & target support for under-performing partners in the value chain.
  2. Inter-organizational trust among strategic business partners is pivotal.
     a. inter-organizational trust is different from inter-personal trust (meaning that the trust will still be in place even if key people leave their respective organizations);
     b. inter-organizational trust is built upon the fairness, stability, and predictability of agreements among strategic partners;
     c. inter-organizational trust is the mutual confidence that business partners will fulfill their agreements and commitments & will not exploit the other's vulnerabilities.

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- ***Value Chains emphasize shared values and vision, shared information (transparency), and shared decision-making among the strategic partners***
  1. Strategic partners need to share common values and a common vision regarding product quality, partner relationships, and customer treatment.
  2. Successful value chains develop effective shared information and shared governance systems:
     a. shared information (transparency) improves productivity, enables rapid response to market changes, and effectively engages discriminating customers…the Dell computer company employs a particularly effective information system to communicate with customers and strategic business partners;
     b. real partnership means all strategic participants benefit from the value chain's business, and all have a say in business developments.
  3. 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).
  4. In successful value chains, all partners experience authentic senses of fairness and justice:
     a. distributive justice (rewards/profits are distributed fairly among all value chain partners);
     b. procedural justice (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 fair profit margins, fair wages, and business agreements of appropriate extended length***
  1. Partners in Japanese value chains express their relationships as "co-existence and co-prosperity."
     a. partners have strategic interests in the others' welfare;
     b. races to the top contrasted with races to the bottom.
  2. Strategic partners are rewarded through agreed upon formulas for adequate profit margins above production 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
  3. 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. on-going cost reduction strategies across the chain result in shared benefits.
  4. 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. (See www.bamco.com; www.hotlipspizza.com; www.sysco.com.)
    2. Regional supermarket and restaurant chains seeking to distinguish themselves from national chains are also likely candidates for value chain partnerships. (See www.newseasonsmarket.com; www.burgerville.com; www.oregoncountrybeef.com)
    3. Significant opportunities are emerging for farms-/ranches-/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 (co-ops & LLCs) (See http://organicvalley.coop; www.thumboilseed.com.)
    2. bi-lateral collaborations (aggregating firms) (See www.nimanranch.com; www.laurasleanbeef).

- ***Appropriate standards and efficient methods of third-party certification of the standards are applied throughout the value chain.***
    1. standards related to key value chain dimensions (e.g., food quality, environmental stewardship, animal welfare, workplace conditions, and business ethics);
    2. efficient computer-based certification systems.

- ***Farmers/ranchers maintain ownership & 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/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.

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Farmer/ Rancher/Fisher Challenges for Constructing Mid-Tier Food Value Chains

- Finding appropriate value chain partners and developing mechanisms for value chain 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, based on understanding true cost structures…cost-based pricing contrasted with premiums above commodity market prices.
- Building sufficient trust among competing producer groups to form farmer/rancher/fisher networks 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;
- Developing countervailing economic power for value chain negotiations.