

Values-based food supply chains: Strategies for agri-food enterprises-of-the-middle

G.W. Stevenson, UW-Madison Center for Integrated Agricultural Systems
Rich Pirog, Michigan State University Center for Regional Food Systems

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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*.

Some people in the agri-food business community use the term “value chain” to focus on supply chains that deal with food products given incremental value through processing and/or attribute differentiation (#1 and #2 above). **Within the Agriculture of the Middle (AOTM) initiative, the term ‘values-based food supply chain’ places emphasis on *both* the values embodied in the food products *and* the values associated with the business relationships within the supply chain.**

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.



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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>.



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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 these supply chains are framed in win-win terms, and constructed on collaborative principles that feature high levels of interdependence and inter-organizational trust. All values-based food supply 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 supply chain information, risk-taking, governance and decision-making.
3. Commitments are made to the welfare of all strategic partners in a values-based supply 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.



Photo credit: Good Earth Farms

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These values-based food supply 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). **Values-based food supply chains can be smart from both business and ethical perspectives.**

Regional values-based food supply chains are 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. They handle product quantities between the quantities handled by commodity systems and amounts sold through direct marketing channels. The size of the “region” will vary with geography, geographic identities, food products and market demographics.

General characteristics of values-based supply chains

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

Values-based supply 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 supply 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:

¹For more information on Toyota, see: Dyer, J. 2000. *Collaborative Advantage: Winning Through Extended Enterprise Supplier Networks*. New York: Oxford University Press and Handfield, R. and E. Nichols Jr. 2002. *Supply Chain Redesign: Transforming Supply Chains into Integrated Value Systems*. Upper Saddle River, NJ: Prentice Hall.



Values-based supply chains often outperform other complex business models in rapidly changing markets.



1. Successful supply chains choose strategic partners that bring distinctive competencies but similar values, visions and goals.

Values-based supply chains contrast with two other models for complex business networks:

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

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Values-based supply chains emphasize high levels of performance and inter-organizational trust.

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

1. Develop appropriate standards and conduct performance evaluations across the entire supply chain;
2. Employ quality assurance systems (with realistic allowances for surprise events);
3. Employ continuous improvement systems and target support for underperforming partners in the supply chain.

Inter-organizational trust among strategic business partners is pivotal:

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

Values-based supply 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 supply chains develop effective systems for sharing information and governance:

1. Shared information (transparency) improves productivity, enables rapid response to market changes and effectively engages discriminating customers;
2. Shared governance means all strategic participants benefit from the supply chain's business, and all have a say in business developments.

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

1. Legislative (setting standards for the chain);
2. Judicial (monitoring performance in the chain);
3. Executive (coordinating procedures and flows in the chain).

In successful values-based supply chains, all partners experience an authentic sense of fairness and justice:

1. Distributive justice, where rewards and profits are distributed fairly among all supply chain partners;
2. Procedural justice, where rules of business in the chain are experienced as fair by all partners.

Values-based supply 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 values-based supply chains express their relationships as “co-existence and co-prosperity:”

1. Partners have strategic interests in the others' welfare;
2. 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:

1. Cost-based pricing in which profit margins of strategic partners are built in from the beginning;
2. Living wages and supportive workplaces for employees of strategic partners;
3. Community-supporting business practices, e.g., opportunities for local community investment in values-based supply chains.



Photo credit: Paulette Philipot Photography

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

1. Sharing economic information can be a challenge within new values-based chains;
2. All partners are required to know their true cost structures (production and transaction costs);
3. Ongoing cost reduction strategies across the chain result in shared benefits.

Successful values-based chains are built upon long-term strategic partnerships:

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

Additional applications to values-based food supply chains

Values-based food supply 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 Country Natural Beef <www.countrynaturalbeef.com>.
3. As evidenced by these nine 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 values-based food supply chains.

1. Multi-lateral collaborations such as co-ops and limited liability companies (LLCs). Examples include Organic Valley <organicvalley.coop> and Shepherd's Grain <www.shepherdsgrain.com>.
2. Bi-lateral collaborations such as aggregating firms. Examples include Good Earth Farms <www.goodearthfarms.com> and Full Circle produce delivery <www.fullcircle.com>.



Photo credit: Home Grown Wisconsin

Standards related to key value chain dimensions (for example, food quality and environmental stewardship) are applied throughout the supply chain.

Appropriate standards and efficient methods of third-party certification are applied throughout the supply 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, e.g., Oregon Tilth <www.tilth.org>.

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

1. Development and defense of regionally meaningful identities and brands;
2. Co-branding with strategic partners.

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

1. Participatory governance structures will be particularly important for food chains that engage strategic partners of differing size and influence;
2. Strategic partnerships can be developed with large mainstream companies, e.g., Shepherd's Grain's relationship with the Archer Daniels Midland milling company in Spokane, Washington.

Challenges faced by farmers, ranchers and fishers when constructing values-based food supply chains

Farmers, ranchers and fishers face several types of challenges in building these supply chains:

Finding appropriate supply 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 or 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 supply chain; and

Developing equal economic power for supply chain negotiations.

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Organizations involved with this report:

The National Initiative on Agriculture of the Middle is concerned with a disappearing sector of midscale farms/ranches and related agrifood enterprises that are unable to successfully market bulk commodities or sell food directly to consumers. See www.agofthemiddle.org. The initiative has three areas of emphasis: new business and marketing strategies; public policy changes; and research and education support.

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 multidisciplinary 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.

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