

## Values-based food supply chains: Organic Valley

Steve Stevenson, CIAS June 4, 2009

Spokespersons: Jerry McGeorge and other Organic Valley managers

Interview Dates: 03/20/07, 09/30/08 and 10/03/08

Website: [www.organicvalley.coop](http://www.organicvalley.coop)<sup>1</sup>



### Historical development

**Introduction.** Organic Valley began as the brand name used by a group of Wisconsin family farmers who, in 1988, organized an organic vegetable marketing cooperative under the name Coulee Region Organic Produce Pool (CROPP). A short time later, seven dairy farmers joined the co-op. Renamed the Cooperative Regions of Organic Producer Pools in 2001, the cooperative has grown to be the largest organic farmer-owned cooperative in North America, with over 1,300 members residing in over thirty states and the Canadian province of Ontario—or about ten percent of the organic farming community in the United States. Introductions to Organic Valley can be found in the article “Natural Allies” in the 10/19/07 issue of the Madison Wisconsin weekly newspaper, *Isthmus* <[www.thedaily.com/isthmus/article.php?article=11261](http://www.thedaily.com/isthmus/article.php?article=11261)>, as well as the “Our Story” section of the Organic Valley website <[www.organicvalley.coop/our-story/overview/](http://www.organicvalley.coop/our-story/overview/)>.

Within a year of CROPP’s initiation, dairy products became the cooperative’s leading sales category. Currently, more than 85 percent of Organic Valley’s sales are dairy related. Dairy farmers make up approximately three-quarters of the co-op’s members, with most residing in the Upper Midwest. In addition to dairy products, CROPP also sells organic eggs and produce under the Organic Valley label, as well as organic fruit juice and soy products. In 2007, sales of Organic Valley products topped \$432 million and the cooperative employed over 400 people, most working in a newly constructed headquarters and distribution center in rural, southwestern Wisconsin. The cooperative also sells organic beef, pork and poultry through a wholly owned subsidiary, the Organic Prairie Family of Farms. This case study does not include an analysis of Organic Prairie. For an introduction to Organic Prairie, see [www.organicprairie.com](http://www.organicprairie.com).

**Philosophical and strategic goals.** According to CEO George Siemon, “*Organic Valley is a social experiment disguised as a business*” (George Siemon, CROPP CEO, interview, 03/20/07). More information about Organic Valley’s philosophy and goals can be found in a 2002 interview with George Siemon on the Organic Valley website <[www.organicvalley.coop/newsroom/about-organic-valley/ceo-interview/page-1/](http://www.organicvalley.coop/newsroom/about-organic-valley/ceo-interview/page-1/)>.

### *Organic Valley mission statement.*

“The purpose of the Cooperative Regions of Organic Producer Pools is to create and operate a marketing cooperative that promotes regional farm diversity and economic stability by the means of organic agricultural methods and the sale of organic products” <[www.organicvalley.coop/our-story/our-cooperative/our-mission/](http://www.organicvalley.coop/our-story/our-cooperative/our-mission/)>.

“Organic Valley is a social experiment disguised as a business.”—  
CEO George Siemon

**A broad definition of organic.** CROPP defines organic as, “A philosophy and system of production that mirrors the natural laws of living organisms with an emphasis on the interdependence of all life” <[www.organicvalley.coop/our-story/our-cooperative/our-mission/](http://www.organicvalley.coop/our-story/our-cooperative/our-mission/)>. “*Organic, as CROPP has framed it, takes the big view, focusing not just on farming techniques and fair pricing but on the larger values of sustainability and regional food systems*” (*Isthmus*: <[www.thedaily.com/isthmus/article.php?article=11261](http://www.thedaily.com/isthmus/article.php?article=11261)>).<sup>2</sup>

**Evolving organic food paradigm.** Organic Valley has created a pyramid model that illustrates

<sup>1</sup>All websites referenced in this document were accessed on 4/23/09. Links in pdf are live.

<sup>2</sup>A broad definition of “organic” provides CROPP with a framework for adding additional values and differentiations to Organic Valley products as the organic industry becomes increasingly more like the conventional market.

what it calls the “evolving organic food lifestyle.” The USDA organic standards banning the use of synthetic pesticides and fertilizers represent a bottom platform supporting additional agri-food related values such as humane animal treatment, local food and growing your own <[www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/](http://www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/)>.

**Multiple background goals.** Within these broad frameworks, Organic Valley engages multiple goals that address fair, farmer-determined food prices; good tasting, nutritious food; ecological and economic sustainability; healthy livelihoods and communities; cooperative principles; and respect for biological and human diversity. The co-op’s website describes in detail how its goals go beyond USDA organic certification <[www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/](http://www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/)>. The *Isthmus* article describes how Organic Valley incorporates economic, social and cultural agendas in its view of organic <[www.thedaily.page.com/isthmus/article.php?article=11261](http://www.thedaily.page.com/isthmus/article.php?article=11261)>.

*“We know what our job is: It’s to get CROPP to the point where our farmers have a choice—they can farm, they can retire, they can sell to the kids. That’s the exit strategy for our current farmers—it’s a future for their kids.”—Chief Financial Officer Mike Bedessem*

**Stable pricing through supply control.** Through matching supply with demand for its products, CROPP successfully maintains for its members a stable pay price

throughout the year that reflects their expenses and profit needs. This contrasts with conventional milk pricing systems, which can fluctuate widely over a given time period. For more information, see part three of the *Isthmus* article <[www.thedaily.page.com/isthmus/article.php?article=11261](http://www.thedaily.page.com/isthmus/article.php?article=11261)> and “Achieving economic sustainability,” page 9.

**Commitment to future farmers.** “We know what our job is: It’s to get CROPP to the point where our farmers have a choice—they can farm, they can retire, they can sell to the kids. That’s the exit strategy for our current farmers—it’s a future for their kids.”

(Mike Bedessem, CROPP Chief Financial Officer, quoted in the *Isthmus* article <[www.thedaily.page.com/isthmus/article.php?article=11261](http://www.thedaily.page.com/isthmus/article.php?article=11261)>). Organic Valley is committed to creating opportunities for the next generation of family farmers, as evidenced by their contribution of \$50,000 to the University of Wisconsin-Madison School for Beginning Dairy and Livestock Farmers <[www.organicvalley.coop/newsroom/press-releases/details/article/organic-valley-contributes-50000-to-university-of-wisconsin-school-for-beginning-dairy-and-livesto-1/](http://www.organicvalley.coop/newsroom/press-releases/details/article/organic-valley-contributes-50000-to-university-of-wisconsin-school-for-beginning-dairy-and-livesto-1/)>.

### Organizational development.

**A “New Generation” cooperative.** CROPP is a new generation co-op in the sense that it brings on new farmer members only as markets for their milk are secured<sup>3</sup> (See “Achieving economic sustainability,” page 9).

**Leadership.** CROPP is led by a seven-person, farmer-elected board of directors and an executive management team that guides the marketing and operations functions of the cooperative. For more information about the executive management team, see the Organic Valley website <[www.organicvalley.coop/our-story/our-cooperative/our-leaders/](http://www.organicvalley.coop/our-story/our-cooperative/our-leaders/)>.

**Growth with regionalization.** While the Upper Midwest remains the center of the CROPP/Organic Valley enterprise, the cooperative has established milk pools that provide both regional identity and fluid milk for processing and delivery in eight regions of the United States, from New England through Texas to the Pacific Northwest <[www.organicvalley.coop/our-story/meet-the-farmers/meet-the-farmers/](http://www.organicvalley.coop/our-story/meet-the-farmers/meet-the-farmers/)>. While the Midwest remains the primary source for “hard products,” or cheese and butter, demand has grown to the point where CROPP has begun to manufacture cheese in Vermont and butter in the Pacific Northwest (Jerry McGeorge, Director of Cooperative Affairs, interview, 09/30/08).

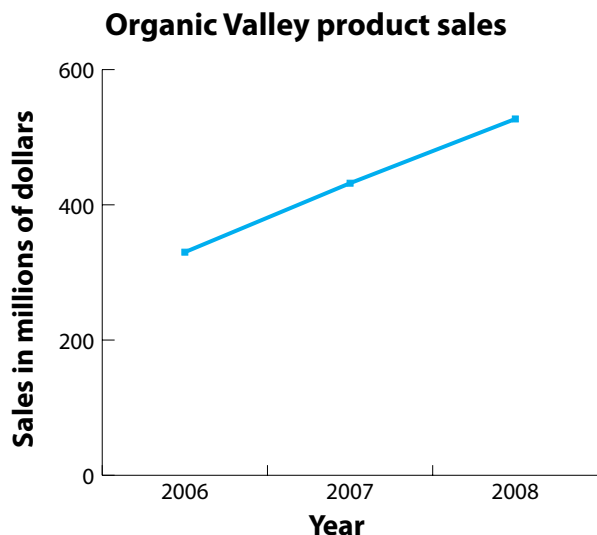
**Growth with specialization.** CROPP has spun off two wholly owned, legally separate entities: Organic Prairie Family of Farms <[www.organicprairie.coop](http://www.organicprairie.coop)>, which produces, processes and sells organic meat products, and Organic Logistics LLC,

<sup>3</sup> For a critical analysis of aspects of new generation cooperatives, see [www.rurdev.usda.gov/rbs/pub/jan01/critical.htm](http://www.rurdev.usda.gov/rbs/pub/jan01/critical.htm).

which focuses on distribution logistics for Organic Valley, Organic Prairie and smaller organic food companies <[www.organiclogisticsllc.com](http://www.organiclogisticsllc.com)>. These new companies were spun off both to provide them the full attention of their own governing boards and management, and to insulate the Organic Valley brand from any liability risks associated with the new enterprises (Jerry McGeorge, interview, 09/30/08).

**Financial affairs.** CROPP is in strong financial shape as indicated by several factors:

**Strong sales.** Sales of Organic Valley products grew at annual rates between 20 to 38 percent during the past several years, with sales of \$330 million in 2006, \$432 million in 2007, and \$527 million in 2008 (Jerry McGeorge, interview, 09/30/08).



**Stable, premium prices to farmers.** With few, and minor, exceptions, CROPP has been able to maintain stable pay above commodity prices to its dairy farmers in recent years. The base pay price from 2006 through 2008 was \$22.00, \$22.50, and \$24.75 per hundredweight (about 11 gallons) of milk, respectively (Jerry McGeorge, interview, 10/14/08).

**Timely construction of new buildings.** To accommodate its growing operations, CROPP has built two new buildings in recent years, including its headquarters in LaFarge, Wisconsin (popula-

tion 786). This is the same rural Wisconsin town where the cooperative began 20 years ago. The second building is a state-of-the-art distribution center in a “green” industrial park close to Interstate 90, located in the nearby Wisconsin town of Cashton, population 805 <[www.organiclogisticsllc.com/facilities.html](http://www.organiclogisticsllc.com/facilities.html)>. <sup>4</sup> Consistent with CROPP’s broad definition of “organic,” both buildings were constructed according to the guidelines of the Leadership in Energy and Environmental Design (LEED) Green Building Rating System <[www.usbbc.org](http://www.usbbc.org)>.

**Annual profit distribution and debt.** For the past several years, the CROPP Cooperative has generated profits of one to two percent of gross sales (Theresa Marquez, Chief Marketing Executive, interview, 03/20/07). CROPP’s profits are distributed to CROPP farmers, employees and the community through an established formula <[www.organicvalley.coop/our-story/our-cooperative/](http://www.organicvalley.coop/our-story/our-cooperative/)>. Funds for constructing and equipping the two new buildings were generated by a mortgage provided by the State of Wisconsin Investment Board and by a \$21 million public offering of non-voting stock. This left CROPP with relatively little debt—less than \$10 million—to private banks (Mike Bedessem, interview, 03/20/07). For more information, see “Going mainstream” in the *Isthmus* article <[www.thedailypage.com/isthmus/article.php?article=11261](http://www.thedailypage.com/isthmus/article.php?article=11261)> and “Strategic partnerships replace capital and expertise,” page 8.

**Historical performance indicators.** Organic Valley’s strong financial performance is largely due to the success of its dairy pool, as well as the combination of competent leadership and CROPP’s historical timing. Developed in the late 1980s and early 1990s, the Organic Valley brand was well positioned to ride the 22 percent plus growth rates that organic food sales generated beginning in the late 1990s and continuing to the present (Jim Wedeberg, Dairy Pool Director, interview, 03/20/07). The growth of organic dairy products and milk has been particularly robust. “*The growth of milk has been even faster than other organic products, in part, because of the concerns of parents ... They’re thinking, ‘What are we putting in our children’s bodies?’ A lot of parents are concerned about growth hormones, pesticide residues, antibiotics.*”

<sup>4</sup> A related article in Madison’s *Capital Times* discusses how Organic Valley raised capital for its expansions through the sale of Class E preferred stock <[www.madison.com/archives/read.php?ref=/tct/2006/05/11/0605110451.php](http://www.madison.com/archives/read.php?ref=/tct/2006/05/11/0605110451.php)>.

*Those are the reasons they buy organic dairy*” (Phil Howard, rural sociologist, quoted in the *Isthmus* article <[www.thedailypage.com/isthmus/article.php?article=11261](http://www.thedailypage.com/isthmus/article.php?article=11261)>) (See cross-case study observations #1 and #11 on page 13).

### 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 15).

**Product differentiation and branding.** The Organic Valley brand is “...one of the strongest brands in the entire natural foods business” (*Isthmus*, <[www.thedailypage.com/isthmus/article.php?article=11261](http://www.thedailypage.com/isthmus/article.php?article=11261)>) and the “...number one brand in the country’s natural food stores” (Mike Bedessem, interview, 03/20/07). Including Organic Prairie’s meats, consumers can find the Organic Valley brand on over 500 products <[www.organicvalley.coop/products/](http://www.organicvalley.coop/products/)>. Organic Valley products are differentiated on multiple dimensions including product qualities, stories and values, and logistical services.

- 1) Leading *product qualities* is the organic differentiation, both the narrow USDA definition and CROPP’s broader definition <[www.organicvalley.coop/why-organic/overview/](http://www.organicvalley.coop/why-organic/overview/)>. While CROPP frames “... organic as a choice, not a moral issue” (Jim Wedeberg, interview, 03/20/07), it is clear that CROPP positions Organic Valley products as strongly associated with superior taste, nutritional value and food safety, as well as with human, animal and environmental health. For more information, see the FAQ page of the Organic Valley website <[organicvalley.custhelp.com/cgi-bin/organicvalley.cfg/php/enduser/std\\_alp.php](http://organicvalley.custhelp.com/cgi-bin/organicvalley.cfg/php/enduser/std_alp.php)>, particularly “About Conjugated Linoleic Acid” and “About Organic Valley Cartons.”

Organic Valley uses powerful and sophisticated *outreach to parents and children* including Ovie’s Underground <[www.oviesdigs.com](http://www.oviesdigs.com)>.

com>, Mothers and Fathers of Organic <[www.organicvalley.coop/farm-friends/moms-dads-of-organic](http://www.organicvalley.coop/farm-friends/moms-dads-of-organic)>, *The Organic Manifesto of a Biologist Mother* <[www.organicvalley.coop/farm-friends/moo/the-organic-manifesto/page-1/](http://www.organicvalley.coop/farm-friends/moo/the-organic-manifesto/page-1/)>, and *We the Mothers* <[www.organicvalley.coop/farm-friends/moo/we-the-mothers/](http://www.organicvalley.coop/farm-friends/moo/we-the-mothers/)>.

In addition to the core organic messages associated with Organic Valley products, CROPP also seeks differentiation through product value additions including pasture butter, sliced cheese, and aseptic packaging:

“Greener Grass=Better Butter: Organic Valley Introduces Pasture Butter” 01/09/08 <[www.organicvalley.coop/newsroom/press-releases/details/article/greener-grassbetter-butter-organic-valley-introduces-pasture-butter](http://www.organicvalley.coop/newsroom/press-releases/details/article/greener-grassbetter-butter-organic-valley-introduces-pasture-butter)>; “Hold the Ice: Organic Valley Introduces Shelf-Stable Litres for Half and Half and Two Milk Varieties” 09/27/07 <[www.organicvalley.coop/newsroom/press-releases/details/article/hold-the-ice-organic-valley-introduces-shelf-stable-litres-for-half-amp-half-and-two-milk-variety/](http://www.organicvalley.coop/newsroom/press-releases/details/article/hold-the-ice-organic-valley-introduces-shelf-stable-litres-for-half-amp-half-and-two-milk-variety/)>; “Who Sliced My Cheese? Organic Valley Now Offering Pre-Sliced Mild Cheddar, Baby Swiss, and Provolone” 09/27/07 <[www.organicvalley.coop/newsroom/press-releases/details/article/who-sliced-my-cheeses-organic-valley-now-offering-pre-sliced-mild-cheddar-baby-swiss-and-provolone/](http://www.organicvalley.coop/newsroom/press-releases/details/article/who-sliced-my-cheeses-organic-valley-now-offering-pre-sliced-mild-cheddar-baby-swiss-and-provolone/)>

In addition to the USDA Organic Certification, many Organic Valley products carry Orthodox Union Kosher Certification <[www.organicvalley.coop/fileadmin/pdf/kosher.pdf](http://www.organicvalley.coop/fileadmin/pdf/kosher.pdf)>. See “Standards and certification,” page 5, for more information.



*An array of Organic Valley products*

2) *Stories and values* associated with the CROPP Cooperative and the Organic Valley brand engage not only human, animal and environmental health, but also the health of rural communities and the diversity of the nation's farm structure. CROPP's differentiation strategies communicate these values by emphasizing the family farm nature of the cooperative's membership (see cross-case study observation #2). The regional nature of its milk pools is reinforced through unique, regional milk cartons <[www.organicvalley.coop/newsroom/photos/images/regional-milk-cartons/](http://www.organicvalley.coop/newsroom/photos/images/regional-milk-cartons/)>.

Similar to the Country Natural Beef cooperative, Organic Valley employs CROPP farmers as "farmer ambassadors" for marketing in retail stores and food service institutions, as well as public appearances and speaking engagements (Theresa Marquez, interview, 03/20/07 and Jerry McGeorge, interview, 09/30/08) (See cross-case study observation #3). Interestingly, with all its emphasis on family farming, CROPP has not been able to craft a definition for "family farm" that works across all regions of the country. "*Early on we struggled with a definition for a family farm but have backed off... There's too much difference in regional cultures. For instance, Midwest family farmers milk their own cows... while family farmers in the West and South hire milkers. We are now more interested in whether farmers want to cooperate, and we do on-farm checks of farms that milk more than 500 cows*" (Jim Wedeberg, interview, 03/20/07).

3) Finally, CROPP seeks differentiation through important *logistical services* that include food quality monitoring, traceability and recall capacity, and prompt delivery. Organic Valley milk is regularly tested for pathogens at the farm level. Final products are routinely evaluated by inspectors at processing plants, and CROPP has the laboratory capacity at its LaFarge headquarters to spot-check products such as cheese, butter and dried milk powder. Furthermore, the cooperative and its trucking partners have the capacity to trace (and recall, if necessary) every case of product that carries the Organic Valley

label (Jeff Kragt, Director of Dairy Production, interview, 03/20/08).

CROPP achieves logistical efficiencies through regionalization. Organic Valley's fluid milk can be delivered to a customer's distribution center the day after orders are received. Other products take longer, but most can be delivered within two to three weeks (Jeff Kragt, interview, 03/20/07). Over the past two to three years, Organic Valley has transitioned into being the U.S. price leader for most organic dairy products. With this position comes the requirement that "*CROPP couples the highest quality products with on-time delivery. ... To earn the premium, you need to deliver the goods*" (Jerry McGeorge, interview, 09/30/08).

**Standards and certification.** Food supply chains that are larger and more complex than direct-to-consumer marketing require clearly communicated standards and, often, third-party certification (See Appendix A).

All producers, products and manufacturing plants associated with Organic Valley are inspected annually and certified according to USDA organic standards. Certification is done by Oregon Tilth Certified Organic, a USDA-accredited, independent, third-party organic certification agency based in Salem, Oregon.<sup>5</sup> CROPP CEO George Siemon was instrumental in creating the USDA standards. For a critique of the USDA's organic framework and Siemon's response, see "Sleeping with the enemy?" section of the *Isthmus* article <[www.thedaily.com/isthmus/article.php?article=11261](http://www.thedaily.com/isthmus/article.php?article=11261)>. Some Organic Valley products are also kosher <[www.organicvalley.coop/fileadmin/pdf/kosher.pdf](http://www.organicvalley.coop/fileadmin/pdf/kosher.pdf)>.

**Identity preservation throughout the value chain.** A feature of the value chain business model for food is that farmers and ranchers have the right to

*"CROPP couples the highest quality products with on-time delivery. ... To earn the premium, you need to deliver the goods."*—  
Coordinator Jerry McGeorge

<sup>5</sup> CROPP's organic certificates can be viewed on its website: <[www.organicvalley.coop/trade/certificates/](http://www.organicvalley.coop/trade/certificates/)>; national organic standards: <[www.organicvalley.coop/why-organic/organic-defined](http://www.organicvalley.coop/why-organic/organic-defined)>.

maintain their identity and brand on their products as deeply into the supply chain as they choose. Co-branding with other value chain partners is a viable strategy (See Appendix A and cross-case study observation #12). For an example of co-branding, see the “Identity preservation” section of the Shepherd’s Grain case study.

In CROPP’s early days, as much as 60 percent of its milk was sold anonymously into the conventional market (Jim Wedeberg, interview, 03/10/08). Today, all of CROPP’s dairy products are marketed as organic, with roughly 60 percent sold under the Organic Valley label <[www.organicvalley.coop/products/](http://www.organicvalley.coop/products/)>. The 40 percent of products not sold under the Organic Valley label include milk and non-fat dry milk powder sold to the New Hampshire-based dairy company, Stonyfield Farm,<sup>6</sup> for yogurt sold under that company’s label (25 percent), as well as milk sold to several supermarket chains for their house brand organic milk (15 percent) (Mary Ewing, Production Department, interview, 03/20/07). For more information, see “Going mainstream” in the *Isthmus* article <[www.thedailypage.com/isthmus/article.php?article=11261](http://www.thedailypage.com/isthmus/article.php?article=11261)>.

**Interaction and feedback from customers.** The Organic Valley website is set up for interaction with retail <[www.organicvalley.coop/farm-friends/overview/](http://www.organicvalley.coop/farm-friends/overview/)> and wholesale <[www.organicvalley.coop/trade/overview/](http://www.organicvalley.coop/trade/overview/)> customers. CROPP production and logistical functions are sensitive to quality control issues, traceability and product recall.

**Creating effective internal organizational forms.** Successful value chain businesses aggregate and market product through effective organizational structures and develop and/or hire competent leadership and management (See Appendix A).

**National cooperative.** See “Organizational development,” page 2.



*An Organic Valley dairy producer*

**Regional organization.** See “Organizational development,” page 2, and cross-case study observation #14.

**Competent leadership and management structures.** CROPP is led by a seven-person, farmer-elected board of directors and an executive management team.<sup>7</sup> The board of directors meets monthly. CROPP farmers also participate in the cooperative’s governance through a dairy executive committee that is composed of one farmer representative per milk pool, which adds up to about 40 representatives. This committee provides feedback to the board and management through semi-annual pool meetings and other channels (Jerry McGeorge, interview, 09/30/08) (See cross-case study observations #4, #5 and #6).

**Selecting markets and value chain partners.** Successful value chain partners have similar values, different competencies and complementary business models (See Appendix A and cross-case study observation #8).

**Farmer partners.** In addition to cooperative attitudes, requirements for dairy farmer membership in CROPP include such criteria as organic certification, sufficient scale (bulk tank with capacity for five milkings), high milk quality (low somatic cell count), an equity investment of 5.5 percent of

<sup>6</sup> For an introduction to Stonyfield, see the “About Us” page on the company’s website <[www.stonyfield.com](http://www.stonyfield.com)>. Stonyfield offers an example (parallel to Whole Foods) of increasing corporate concentration in the natural foods sector with the acquisition in 2002 of a controlling interest in Stonyfield by the large French-based consumer products company, Groupe Danone <[www.danone.com](http://www.danone.com)>. In turn, the West Coast yogurt company, Brown Cow Farm <[www.browncowfarm.com](http://www.browncowfarm.com)>, was added to the corporate mix in 2003.

<sup>7</sup> See the biographies of the CROPP management team and their mixture of agriculture- and food system-based backgrounds, often organic related <[www.organicvalley.coop/our-story/our-cooperative/our-leaders/](http://www.organicvalley.coop/our-story/our-cooperative/our-leaders/)>.

annual income, and farm location in reasonable proximity to current milk pool trucking routes <[www.farmers.coop/farmers-wanted/cropp-standards-and-membership/](http://www.farmers.coop/farmers-wanted/cropp-standards-and-membership/)> (See Appendix B on page 20 and cross-case study observation #7).

Good examples of CROPP's farmer members can be found at the "Meet the Farmers" section of the Organic Valley website <[www.organicvalley.coop/our-story/meet-the-farmers/meet-the-farmers/](http://www.organicvalley.coop/our-story/meet-the-farmers/meet-the-farmers/)>, as well as in the *Isthmus* article <[www.thedailypage.com/isthmus/article.php?article=11261](http://www.thedailypage.com/isthmus/article.php?article=11261)>. The cooperative provides an impressive range of services to its members including a toll-free farmer hotline, consultation from a staff milk quality team and veterinarian, as well as information regarding where farmers can purchase feed, pest control supplies and veterinary supplies that meet organic standards <[www.farmers.coop/resources/overview/](http://www.farmers.coop/resources/overview/)>.

Given the growing market for organic dairy products, CROPP actively seeks new, qualified farmer members <[www.farmers.coop/farmers-wanted/overview/](http://www.farmers.coop/farmers-wanted/overview/)>. To bolster recruiting, the cooperative provides consulting and financial assistance to help farmers make the transition to organic dairying <[www.organicvalley.coop/newsroom/press-releases/details/article/organic-valley-announces-transition-to-organic-fund/](http://www.organicvalley.coop/newsroom/press-releases/details/article/organic-valley-announces-transition-to-organic-fund/)>.

**Retail and food service partners.** Sales of organic dairy products are experiencing the fastest growth in mass-market stores, while sales in natural food stores are relatively flat. *"We can't be afraid of new people coming into our industry ... Yes, we're growing in the mass market, but our love and devotion is still in the natural market ... That's the group we cater to. They are the core organic shopper. They are the pioneers"* (Therese Marquez, interview, 03/20/07). Organic Valley's partnerships with retail customers are characterized by: a) a clear sense of mutual benefit; b) comfort with financial transparency (cost structures can be shared and honored); and c) openness to a long-term relationship. CROPP currently does little business with the food service sector, and sees this as a potentially important area for growth (Jerry McGeorge, interview, 10/03/08).

**Processing and distribution partners.** CROPP owns only one processing facility—a butter-

manufacturing creamery in the rural community of Chaseburg, Wisconsin. Other Organic Valley dairy products, as well as soy and juice products, are processed on contract by outside companies strategically located throughout the country. The processing of fluid milk is the most dispersed, with plants contracted in California, Washington, Colorado, Texas, Minnesota, Wisconsin, Indiana, New Jersey and New York (Doug Bean, manager of product transportation, interview, 03/20/07) (See cross-case study observations #9).

Processing partners are selected initially on the basis of geographical location. Matching processors with CROPP farmers is sometimes a chicken-or-egg calculation. In order to be profitable, 30,000 to 40,000 pounds of milk needs to be collected daily on each collection route. The capacity to deliver high-quality products is a second criteria, particularly important for cheese manufacturers (Mary Ewing, interview, 03/20/07). *"We like to partner with family-owned, independent processors where we can ... A good example is the family-based Schroeder Dairy in Minnesota. This is easier to do with cheese plants than with milk plants ... We contract with a Dean's milk plant in New York which has the capacity for ultra-high temperature pasteurization"* (Mary Ewing, interview, 03/20/07) For more information on Schroeder Dairy, see [www.schroedermilk.com/contract\\_packaging.cfm](http://www.schroedermilk.com/contract_packaging.cfm).

Processing agreements are evolving from handshake understandings to more formal contracts. This is particularly the case with regard to assuring the capacity to convert the spring flush of milk to nonfat dry milk powder. CROPP has entered into written contracts for such dry milk conversion with the large Midwestern dairy cooperative, Foremost Farms <[www.foremostfarms.com](http://www.foremostfarms.com)> (Mary Ewing, interview, 03/20/07).

*"We like to partner with family-owned, independent processors where we can... A good example is the family-based Schroeder Dairy in Minnesota."*—Mary Ewing, Production Department

CROPP's approach to distribution parallels its approach to processing. Products are distributed

primarily by trucks. CROPP owns no delivery trucks. The cooperative has contracts with transportation companies for the distribution of Organic Valley products across the country. Trucking companies are selected based on their rates, capacity, service, scale and fit with CROPP's support for smaller, family-owned businesses. *"We seek out trucking firms that specialize in particular geographical "lanes," such as from Wisconsin or Minnesota to Florida. It's a win/win deal. We offer them a consistent weekly load which enables them to find return loads. In exchange, they can provide us with better rates and service. ... We do background checks on all our carriers. The best carrier is not always the cheapest. We prefer firms with 50 or less trucks. Family-owned companies are a good fit with family farms"* (Doug Bean, interview, 03/20/07).

While CROPP trucking agreements are handshake understandings, the cooperative requires proof of insurance coverage and rate structures (Doug Bean, interview, 03/07/07). Organic Valley is considering changes to its current approach to distribution. *"We would consider owning our own trucks if contracting became too expensive ... We are looking closely at transporting more product by railroad as fuel prices force higher trucking rates"* (Doug Bean, interview, 03/20/07).

CROPP's manager of product transportation, Doug Bean, has worked in the grocery business and owns a small trucking firm. This is a good example of bringing professionals with key managerial competencies and similar values into enterprises owned by farmers and ranchers.

***Strategic partnerships replace capital and expertise.*** One of the reasons that CROPP succeeded when other organic dairy firm start-ups in the 1980s failed is because, *"... through most of our life we did not sink money into bricks and mortar"* (Jim Wedeberg, interview, 03/20/07). By contracting out key parts of its processing and distribution, CROPP employed strategic partnerships to reduce capital expenditures and broaden its expertise.

However, within the past several years, CROPP has built a new company headquarters and distribution center, and it may build additional distribution centers on the east and west coasts. These decisions

to build were made because CROPP was seriously outgrowing its administrative and warehousing space, and was committed to remaining in rural communities. *"Given our druthers, we'd prefer to not invest in bricks and mortar, but we need to look at the available options"* (Jerry McGeorge, interview, 10/03/08). *"Build the business and then build the buildings"* (George Siemon, interview, 03/20/07) (See cross case observation #10).

***Developing the distribution sector as a service and income center.*** The Organic Valley distribution center at Cashton, Wisconsin, was completed in conjunction with the development of Organic Logistics, LLC, as a new service and profit center for CROPP <[www.organiclogisticsllc.com](http://www.organiclogisticsllc.com)>.

Designed to provide a range of high quality, affordable distribution services for smaller organic food companies, this new enterprise is a win/win for CROPP, which needs full trucks to garner the best "weight breaks" through its contracted freight agreements, and the smaller companies it serves through Organic Logistics (Doug Bean, interview, 03/20/07). The new, green, state-of-the-industry distribution center is also an important platform on which to build future logistical capacities for the cooperative and its partners.

***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 (See Appendix A and cross-case study observation #15).

***Production and aggregation.*** In 2007, slightly over 50 percent of the milk from CROPP's 900 plus dairy farmers was processed and sold as fluid milk (Mary Ewing, interview, 03/20/07), with the rest used for cheese, butter, cottage cheese and other Organic Valley dairy products <[www.organicvalley.coop/products/](http://www.organicvalley.coop/products/)>.

CROPP staff members develop milk collection routes within geographical regions that result in efficient, profitable collections and deliveries to the contracted dairy processing plants. These aggregation logistics, as well as farmer relations, are supervised by CROPP-employed Pool Coordinators who

often live in the regions they serve. For a listing of Pool Coordinators, see [www.farmers.coop/us/support/contactus](http://www.farmers.coop/us/support/contactus).

**Processing and distribution.** Processing is done on contract by dairy manufacturing plants located close to the regionally organized milk pools. Hauling large loads of milk achieves scale and processing efficiencies, as “...*scale helps CROPP recruit efficient, high-quality manufacturing plants, and reduces ‘line loss,’ the eight to ten percent of milk that remains in the processing plant’s lines upon shut down*” (Mary Ewing, interview, 03/20/07).

Processed fluid milk is distributed regionally by contracted trucking firms that pick up Organic Valley-branded milk at the processor’s loading dock and deliver it to customers’ distribution warehouses. Other Organic Valley products, including cheese, cottage cheese, eggs and juice, are currently routed through CROPP’s distribution center in Cashton (Doug Bean, interview, 03/20/07). If plans to establish major CROPP distribution centers on the east and west coasts materialize and Organic Logistics LLC continues to grow, future distribution of Organic Valley products will be increasingly accomplished regionally.

**Accounting.** All invoicing, payment and accounting functions are performed by CROPP employees under the direction of CROPP’s chief financial officer (See cross-case study observation #16).

**Logistical coordination.** Logistical coordination is done through the new distribution center under the direction of CROPP’s chief operating officer (See cross-case study observations #10 and #15).

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

**Pricing philosophy.** Stable prices for farmers are fundamental to CROPP’s mission and business model. Price stability is accomplished through controlling the supply of Organic Valley products. Operationally, this means: 1) managers from CROPP’s marketing, sales and production departments participate in weekly coordination meetings (Theresa Marquez, interview, 03/20/07); 2)

new CROPP farmers are brought on only after markets have been secured for their milk; 3) a reserve pool of organic

dairy farmers supplies milk during periods of the year when demand outstrips supply; 4) fluid milk is converted into dry milk powder and stored during periods of the year when supply exceeds demand; and 5) the cooperative retains the right to drop purchases from its newest farmer members. Reaching the point where 100 percent of CROPP’s milk is sold as organic has been crucial to making the numbers work (Jim Wedeberg, interview, 03/20/07) (See cross-case study observations #1 and #11).

CROPP translates its values into *value-chain business decisions* about pricing. In 2000, CROPP was facing an oversupply of milk and needed to decide whether to drop the farmers most recently signed on to the milk pools or to reduce all farmers’ pay price by 30 cents per 100 pounds. “*The farmers voted to drop the collective pay price*” (Jim Wedeberg, Mike Bedessem and Theresa Marquez, interviews, 03/20/07) (See cross-case study observation #13).

In 2004, CROPP had been selling Organic Valley products to Wal-Mart for several years. In keeping with its business model, Wal-Mart began pitting its organic milk providers against one another, demanding lower prices and more milk from each of them. Meeting Wal-Mart’s demands would not only have shortchanged CROPP’s smaller customers, but also altered the cooperative’s vision for value-chain business relationships and long-term economic sustainability. So, CROPP made a decision nearly unheard of in the conventional food industry and said ‘no’ to Wal-Mart. “*We asked ourselves ‘Which retailers have been with us in the past and will stick with us down the road?’ We’re independent. We answer to ourselves, not Wall Street, so we can do it. We can keep our soul*” (George Siemon, quoted in *The Nation* <[www.thenation.com/doc/20080324/hightower\\_demarco](http://www.thenation.com/doc/20080324/hightower_demarco)>).

*“Scale helps CROPP recruit efficient, high quality manufacturing plants, and reduces ‘line loss,’ the eight to ten percent of milk that remains in the processing plant’s lines upon shut down.”—Mary Ewing, Production Department*

**Payment practices.** The cooperative's board of farmer directors, in dialogue with the executive management team, determines the target payment price to CROPP's 900-plus dairy farmers. Payments are initially calculated on a base component price determined by adequate levels of butterfat, protein and other solids of a given farm's milk. The base component price is then adjusted up or down after a series of milk cleanliness tests including somatic cell and other bacteria counts. Finally, a regional premium is added to the adjusted price based on the costs of producing milk in given regions of the country.

In 2008, regional price premiums per hundred-weight of milk varied from \$1.50 in the Upper Midwest and West to \$5.00 in New England and the Southeast. Finally, \$75 is deducted from each month's milk check to pay for trucking, and CROPP farmers are required to make a one-time purchase of preferred stock in the cooperative equal to 5.5 percent of their gross annual sales to CROPP. For a description of CROPP's payment plan and information on regional premiums, see the CROPP website <[www.farmers.coop/farmers-wanted/pay-prices](http://www.farmers.coop/farmers-wanted/pay-prices)>.

CROPP is currently reviewing its methodology for calculating its base price and regional premiums (Jerry McGeorge, interview, 10/03/08). Farmer contracts with CROPP can be terminated by either party with a 180-day notice, and CROPP makes it clear to its members that the pay prices are target prices that can be adjusted downward depending on the financial performance of the cooperative. For the past several years, CROPP has earned a profit of one to two percent of gross sales, and nearly half of this profit has been distributed to its farmer members. For some farmers in some years, this bonus has amounted to over \$100,000 (Theresa Marquez, interview, 03/20/07) (See Appendix B).

**Pricing Organic Valley products.** When pricing its dairy products, CROPP starts with the price paid to farmers and adds on layers of costs associated with the processing and distribution of the product, including a reasonable profit margin. Pricing decisions are made by the cooperative's vice

president for sales and chief financial officer, who also take into account market conditions and the competitive landscape (Jerry McGeorge, interview, 10/03/08) (See cross-case observation #11).

***Communicating sustainable economics in the marketplace and with enterprise members.***

CROPP spokespersons emphasize the importance of stable, cost of production-based pricing for both farmers and customers through negotiations based on financial transparency. Given the volume of organic milk that CROPP markets, the cooperative is able to influence the price paid to organic farmers throughout the industry (Jerry McGeorge, interview, 10/03/08) (See cross-case study observations #12 and #13).

**Acquiring technical support.** In its early years, CROPP received assistance with organizational structuring from groups like Cooperative Development Services <[www.cdsus.coop](http://www.cdsus.coop)> and similar groups. Currently, CROPP provides support to other groups on a range of fronts, including distribution services for smaller organic companies through Organics Logistics, LLC, and targeting ten percent of annual profits to a range of community organizations. CROPP CEO George Siemon was instrumental in creating the USDA organic standards.

**Future dynamics**

**Internal organizational issues.**

**Revitalizing company culture.** The CROPP cooperative is growing rapidly. Fifty percent of its farmers and 35 percent of its employees have joined within the last three years. This makes socialization into company culture particularly important (Jerry McGeorge, interview, 10/03/08). "*Culture is key and needs to be reinforced from all sides: employee culture, farmer culture and consumer culture*" (George Siemon, interview, 03/20/07). Mechanisms for reinforcing company culture include significant use of the Organic Valley website <[www.organicvalley.coop](http://www.organicvalley.coop)>, interaction between employees and farmers at outreach events, and the semi-annual meetings of the 40 milk pools. CROPP screens for "cooperative" people in selecting farmers and employees. "*CROPP spends considerable time exposing employees and farmers to the co-op's mission and the meaning of that mission*" (Jerry McGeorge,



Organic Valley CEO George Siemon

interview,  
10/14/08).

**Leadership succession.** While the current CROPP leaders are not near retirement, the cooperative's management is concerned about succession issues. *"The first generation of managers is either organic farmers or people with a passion for organics.*

*... There's a concern about the second generation"* (Mike Bedessem, interview, 03/07/07). *"Company culture is strong ... I'm not worried about the managers. ... I'm more worried about the farmers ... Democracy can be weak ... I have faith in the current board, but need to educate them on succession issues"* (George Siemon, interview, 03/20/07).

**Other issues.** CROPP'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. This issue was covered by a Madison newspaper, *The Capital Times*: <[www.madison.com/tct/news/stories/294113](http://www.madison.com/tct/news/stories/294113)> (See cross-case observation #17).

#### Issues with supply chain partners.

**Food service as a growth area.** CROPP sees food service as a potentially significant growth area (Jerry McGeorge, interview, 10/03/08).

#### Challenges with organic grain production.

Organic feed production is not keeping up with organic livestock production, resulting in expensive feed prices and a growing advantage for dairy farmers with sufficient land to grow their own feed (Jerry McGeorge, interview, 10/03/08).

**Potential shifting of distribution by rail.** See "Processing and distribution partners," page 7, and the following section on distribution efficiencies.

#### Economics and efficiencies.

**Increased distribution efficiencies.** CROPP has laid out the following scenario for its future logistics: 1) East and West Coast distribution centers, with the Cashton, Wisconsin, complex serving as the Midwest's distribution hub and the replenishment center for the other distribution centers; 2) increased use of railroads for CROPP distribution—both east/west and north/south lines—as fuel prices climb and regulations on truck drivers increase; 3) increased use of "inter-modal systems," which are wheeled containers that interface with trucks, railroads and ships for product transportation to Hawaii and Alaska (Doug Bean, interview, 03/20/07).

**Reducing farmers' input costs.** Farmers' input costs can be reduced through 1) on-farm energy generation including methane digesters, windmills, solar power, micro-hydropower and biodiesel; and 2) regional purchasing collectives for organic animal feed.

#### Strategies for a maturing market.

**Continued growth of Organic Logistics LLC as a service/profit center.** See "Selecting markets and value chain partners," page 6.

**Growth in new market sectors:** CROPP has targeted several new market sectors: 1) food service; 2) value-added products such as pasture-based butter and sliced cheese; and c) markets outside the contiguous 48 states, such as Alaska and Hawaii (Jerry McGeorge, interview, 10/03/08). *"Milk has been the leader in mainstream supermarket outlets, but we still have plenty of room for placement of other products such as cheese, butter, juice and eggs"* (Jerry McGeorge, interview, 10/14/08).

**Organic plus: Moving up the organic pyramid.** What features of Organic Valley's pyramid model for the organic lifestyle might be effectively engaged to further differentiate and sell its products in an organic industry that is becoming more like the conventional market?<sup>8</sup> Fair trade? Pasture-based farming systems? Bioregional foods and diets? Food miles? Animal welfare? Family farming? *"I have teenage children who are very aware of issues*

<sup>8</sup>The pyramid model can be viewed at [www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/](http://www.organicvalley.coop/why-organic/organic-defined/evolving-organic-lifestyle/).

*like global warming and carbon footprints. ... Their purchasing choices are very likely to be quite different. ... That should be good news for an organic food company” (Jerry McGeorge, interview, 10/03/08).*

### **A mature Organic Valley: Has CROPP grown up?**

**Criteria for “too big.”** CROPP has historically believed the cooperative would be too large when it could no longer serve its farmers and customers well (Mike Bedessem, interview, 07/20/07; Jerry McGeorge, interview, 10/03/08).

#### ***Size has important positive consequences.***

CROPP’s size and the strength of the Organic Valley brand enable the cooperative to exert significant influence over product quality and farmer pay price in the organic dairy sector (Mike Bedessem, interview, 07/20/07; Jerry McGeorge, interview, 10/03/08).

***Regionalization has enabled CROPP to grow and remain effective.*** Clearly growth through regionalization has been a successful strategy for CROPP, enabling both logistical efficiencies as well as regional identity and brand growth. *“One future scenario would be toward more autonomy by our regional pools and a “federation of co-ops”... but that would be a ways down the road and require lots of discussion ... Our regional structure is currently working well” (Jerry McGeorge, interview, 10/03/08).*

### **Positioning value chains in a troubled and**

**contracting economy.** *“This is a time of incredible flux. We don’t have many answers because things are too fluid at the moment ... sales are definitely slowing down and we run the risk of becoming oversupplied. However, like all prudent businesses, we are currently testing our assumptions, re-examining our business practices and trying to position ourselves to provide our customers with products that they truly value” (Jerry McGeorge, interview, 10/14/08).*

## Cross-case study observations

1. A key strategy of all four enterprises—Organic Valley, Shepherd’s Grain, Oregon Country Beef and Red Tomato—is balancing supply with markets through membership numbers. This is relatively easy to do when markets are stable or expanding predictably (see observation #11, below).
2. 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.
3. Enterprises vary in the degree to which they employ farmers and ranchers as business representatives, storytellers and listeners. Country Natural Beef is a leader in employing producers in these roles.
4. The two relatively mature cases—Organic Valley and Country Natural Beef—exhibit the importance of developing leadership structures that couple farmers and ranchers with food system professionals, and implementing leadership succession strategies that maintain managerial competency and company culture.
5. 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.
6. 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 Peter Barnes. 2006. *Capitalism 3.0*. San Francisco: Berrett-Koehler Publishers.
7. The screening of potential new producer-members by existing members is an important process in all four enterprises.
8. Value chain strategies differ with regard to “pioneer/smaller/niche” partners vs. “follower/larger/mainstream” partners. See the “Selecting value chain partners” section of the Shepherd’s Grain case study. With a few exceptions, the value chain partners of the four enterprises are privately owned and not subject to Wall Street pressures.
9. 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.
10. All four case enterprises differ when it comes to investing in bricks and mortar. Organic Valley’s decision to build a new headquarters and distribution center contrasts with alternative strategies employed by Country Natural Beef and Red Tomato.
11. All four enterprises employ pricing systems based on two principles: 1) supply management and stable pricing, and 2) cost of production-based pricing.
12. All four enterprises demonstrate the importance of selling a high percentage of products as identity-maintained, differentiated, higher-value products; 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.
13. Creative work is being done to adapt value chain pricing mechanisms to volatile commodity markets. Shepherd’s Grain is a leader in engaging volatile commodity prices.

14. 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 such expansion models.
15. In all cases, competent logistics managers are the pivot persons around whom complex and time-sensitive logistical strategies are engaged.
16. As value chain enterprises grow and become more complex, the accounting functions (bookkeeping, invoicing and paying producers) are often the first to be separated off from the logistical bundle.
17. Value-chain-linked enterprises are particularly susceptible to perceived contradictions within their practices and/or the practices of strategic partners. Examples include Beef Northwest's labor issues for Country Natural Beef and the family farming flap associated with a large Texas organic dairy farm for Organic Valley (see the "Future dynamics" section of the Organic Valley case study).

## Appendix A

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

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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* 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](http://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 chain<sup>1</sup> 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).

<sup>1</sup>For 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.

## **Appendix B CROPP cooperative dairy member agreement**

This agreement is made between the Cooperative Regions of Organic Producer Pools – CROPP Cooperative, LaFarge, WI, (the “Cooperative”) and the undersigned producer (the “Member”).

The Member shall satisfy all membership requirements of the Cooperative. Member agrees to be bound by both Cooperative bylaws and this agreement.

Members of the Cooperative, who are actively shipping milk, are members of the CROPP Dairy Pool. Member pledges all organic dairy production to the Cooperative, and assigns all rights to proceeds from sales of the milk/dairy products. The Members hereby appoints the Cooperative as its exclusive agent in the marketing of organic milk/dairy products.

The Member acknowledges receipt and will abide by the CROPP Dairy Pool Manual and all the policies therein. The Member agrees to participate and abide by policies and decisions of the CROPP DAIRY EXECUTIVE COMMITTEE and the CROPP Board of Directors.

This agreement shall be in effect continuously from date hereof, subject to the right of either party to terminate said Agreement at any time by giving 180 days notice in writing.

The Member shall be a certified member in good standing of an Organic Certification organization approved by the Cooperative. Member represents that all production is produced using certifiable practices and shall take full responsibility for all organic claims of member production.

The Cooperative shall provide accurate records of member milk production, equity position, and quality results to the Member.

The Member agrees that equity distributions by the Cooperative shall be based on their volume of production in proportion to the production of all dairy members.

The Member shall satisfy the requirements of the Dairy Pool Capital Base Plan by the purchase(s) of Preferred Stock. Purchase(s) of the Preferred Stock must be made according to the guidelines of the CROPP Dairy Pool. If the Member breaks this contract then, in addition to all of its other rights and remedies, the Board of Directors has the discretion as to the timing of the redemption of the Preferred Stock.

The Cooperative will pay the Member for their certified organic milk according to the rates and programs established by the Dairy Executive Committee and the Board of Directors for the Member’s region. The Member acknowledges that the CROPP pay program is a target and may require a price reduction if the actual financial performance of the Co-op requires it.

The Cooperative cannot guarantee results or profit and therefore, the Member agrees to release the Cooperative and its employees from any and all liability for any damages that may occur as a result of the Cooperative’s advice or requirements regarding production.

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### 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](http://www.agofthemiddle.org) or contact convening chair Fred Kirschenmann, Iowa State University, 515-294-5588, [leopold1@iastate.edu](mailto:leopold1@iastate.edu); or administrative chair Steve Stevenson, University of Wisconsin-Madison, 608-262-5202, [gwsteven@wisc.edu](mailto: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](http://www.cias.wisc.edu) or call 608-262-5200.

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