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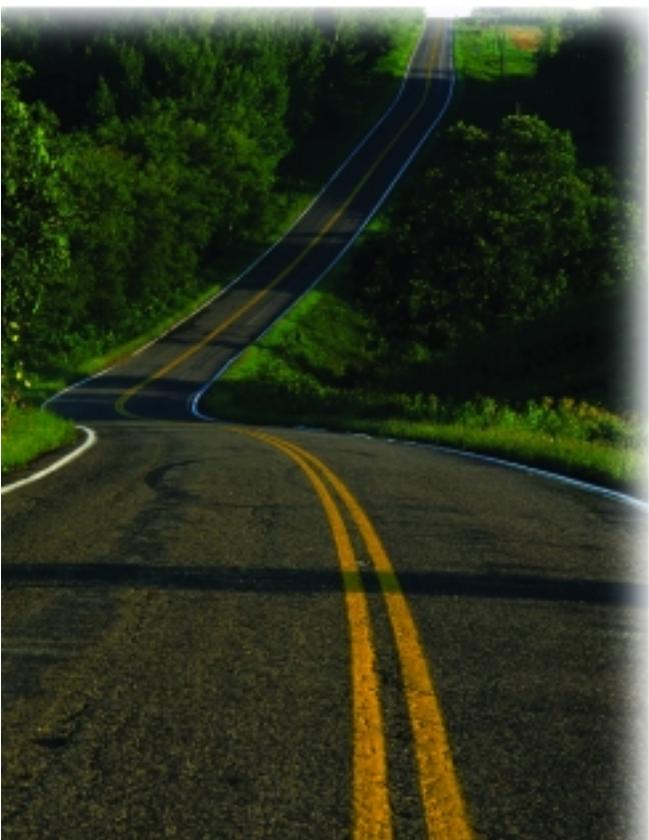
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Commentary on the rural economy



Producer Alliances in the New Agriculture

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Traditionally, agriculture was an industry of farmers producing standardized commodities for a common market. But today's new agriculture has changed. The focus is increasingly on end products rather than raw commodities. Product markets have opened up huge new opportunities for producers—and huge new challenges.

To meet today's new challenges and take advantage of new market opportunities, an increasing number of producers are turning to alliances. Alliances are not a new concept in agriculture. In the early 1900s, alliances were formalized to create market access for commodity producers and to provide affordable services and inputs. Most of these alliances took the form of cooperatives and received special policy attention. But the new agriculture of the 21st century has put many

commodity producers in a profit squeeze. And many producers wonder if alliances can help them return to profitability.

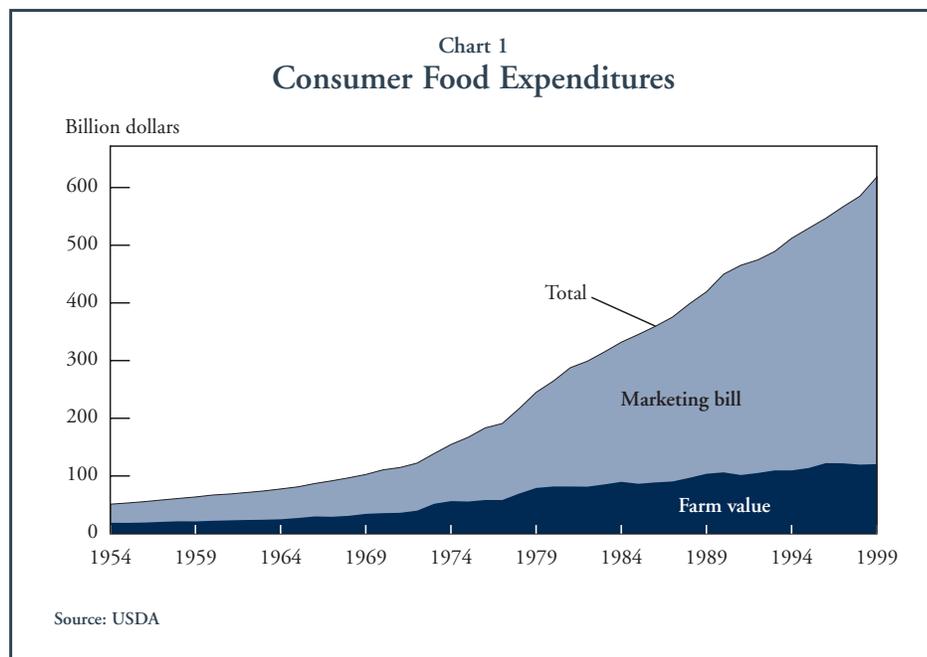
New alliances for a new agriculture

Producers of agricultural commodities across rural America have been put to the test over the last decade. Crop and livestock producers alike have watched profit margins vanish as real commodity prices have fallen. U.S. producers saw their share of the consumer food dollar shrink from nearly 40 percent in the 1950s to half that in 1999 (Chart 1). At first it seemed the only way to manage the risks of commodity production was to get bigger, and thus lower costs, or else exit the industry. Now it appears there is another viable option—product agriculture.

Product agriculture has emerged largely in response to the increasing sophistication of consumer preferences. Consumers demand high-quality, safe, nutritious foods that are easy to prepare. This demand has created niche markets that large processors and retailers have been quick to exploit. But individual producers have found it difficult to tap these new markets, because reaching the consumer often requires more resources than one farmer can supply.

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One way to get specialized products from farms to consumers is supply chains. Supply chains are effective mainly because they offer a good way to coordinate activities from production to marketing. Coordination creates cost efficiencies and allows the quality and safety of products to be moni-



tored along each stage in the supply chain. Processors and retailers typically lead the supply chain, but leadership can actually come from any stage in the chain—input provider, producer, processor, or retailer.

To help producers reap more of the benefits of supply chains, producer alliances have evolved. Many of these alliances have been labeled “new generation cooperatives.” New generation coops typically limit membership, impose strict quality and delivery standards, and require a fairly substantial investment up front.

But other new marketing alliances have also emerged that resemble both traditional and new generation cooperatives. These alliances offer new opportunities for farmers to shift their focus from commodities to products, even though engaging in processing activities per se may not be feasible.

Producer alliances generally engage in one of three types of activities. Some alliances identify special products for specific processor or retailer needs—sometimes for direct sale to consumers. Other alliances have shifted to product agriculture in one fell swoop by building or acquiring processing facilities. Still other alliances have taken a more conservative approach by partnering with businesses or other alliances already

involved in producing food products.

Some success stories

Many producer groups that focus on products have been operational only a short while, and many are still in the formation stages, so the jury is still out on just how well producer alliances can help farmers tap opportunities in product agriculture. But some groups are well-established and show the different relationships producers are forming and the activities they are pursuing.

Direct marketing cooperatives. A great deal of attention has focused on new generation cooperatives. But many cooperatives have formed with value-added agriculture in mind and do not require huge investments. Across the country producers are identifying products that are more valuable even before they are processed. These groups have formed marketing cooperatives and are selling their specialty products to food processors and retailers—and in some cases are marketing directly to consumers.

Numerous markets exist for producers of specialty products. Organic products such as fruits, vegetables, meat, and eggs are a growing market. These products are often difficult for processors and retailers to find, so a premium is generally paid for the prod-

ucts. Products produced both with and without biotechnology have also found special market outlets because they are difficult to segregate in traditional commodity markets. Many consumers are also keen to buy farm fresh produce. For example, HyVee grocery stores sell farm fresh hormone-free eggs at more than double the price of the store brand, a premium even some price-conscious consumers are willing to pay. It is difficult to pinpoint exactly how many alliances are engaged in this approach. But it is safe to say that direct marketing is becoming a much more widely used tool for producers to capture more of America's food dollar without investing in costly food processing facilities.

Dakota Growers Pasta Company.

The 1980s brought turmoil to durum wheat producers in North Dakota. But the decade also sparked a new momentum toward product agriculture. One alliance that emerged from those troubled times was the Dakota Growers Pasta Company, an initiative of North Dakota wheat producers.

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North Dakota produces roughly 65 percent of the nation's durum wheat, which is used almost exclusively in the production of pasta. Yet prior to the 1990s much of the state's durum wheat crop was sold and milled elsewhere. Rural leaders liked the idea of building a pasta plant in the heart of durum wheat country. In 1990, they launched plans for Dakota Growers Pasta Company. In November 1993, the cooperative's first pasta products began appearing on grocery shelves.

Dakota Growers is owned solely by 1,157 durum wheat producers in North

Dakota, Minnesota, and Montana. The North Dakota and Minnesota facilities process durum into semolina, which is then used to make over 80 varieties of pasta. The cooperative's pasta products are sold to customers in the retail, food service, and ingredient markets, making Dakota Growers a completely integrated pasta manufacturer.

By integrating production and processing, the company has been able to trim costs and achieve efficiencies associated with scheduling, inventory management, and product quality. An early feasibility study projected that farmers involved in the entire production process could potentially receive as much as a dollar extra in returns on a bushel of wheat. While investing in bricks and mortar required a substantial initial investment, rural leaders found it hard to ignore the potential gains for farmers and the local economy.

Since its inception, Dakota Growers has benefited both growers and their local communities. Farmers have received patronage refunds ranging from 20 cents to one dollar per bushel every year after the startup year. In addition, members have received a price for their durum wheat that exceeds the average price in North Dakota. And the communities that are home to Dakota Growers have expanded their tax base and created nearly 300 jobs for residents—a welcome change for communities accustomed to bleak economic outlooks.

U.S. Premium Beef. The U.S. cattle industry has changed so drastically in recent years that just four processors now control roughly 80 percent of the nation's beef production. At the same time, consumer tastes and preferences have evolved to include more than just hamburger and steaks—people want quality meals that are nutritious and easy to prepare. As consumer demand has become more sophisticated, producers have seen profits from selling live cattle diminish. In the mid-1990s a group of cattle producers became convinced that to survive they had to add more value to their products. Soon, U.S. Premium Beef was born. Membership required cattle producers to purchase stock at \$55 per share with each

share entitling them to deliver one animal per year. The first U.S. Premium Beef cattle were delivered to processing plants in December 1997.

In the early planning stages, producers were reluctant to invest in actual processing facilities, even though market research

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showed that the coop needed to own a piece of the processing pie to reap maximum benefits. Since U.S. Premium Beef was a group of producers—not processors or food marketers—they could either jump into a highly concentrated market by building processing facilities from the ground up, or they could partner with someone already in the processing business. They chose to partner with Farmland Industries and purchased a 29 percent ownership stake in Farmland National Beef, an industry leader in value-added beef products.

This business strategy has proven successful for U.S. Premium Beef and its producer members. Bigger profits and access to product markets have helped cattle producers both large and small. Success appears to have been driven by several factors. Like many new generation cooperatives, a substantial initial investment of \$38 million at the outset insured that members were committed to success. Producers had the incentive to continuously produce high-quality cattle since premiums are paid based on the quality of each animal. Producers receive the final carcass data from every steer sold to

help them improve their product.

As a result of this commitment to adding value, premiums paid to U.S. Premium Beef producers continue to climb. During the life of the cooperative, producers have received an average premium of \$12.76 per head over the market price, with premiums in 2000 averaging \$14.35 per head. More striking are the premiums received by producers producing the highest quality cattle. In 2000, the top 25 percent of cattle in terms of quality averaged a premium over market price of a staggering \$41.13 per head (Chart 2).

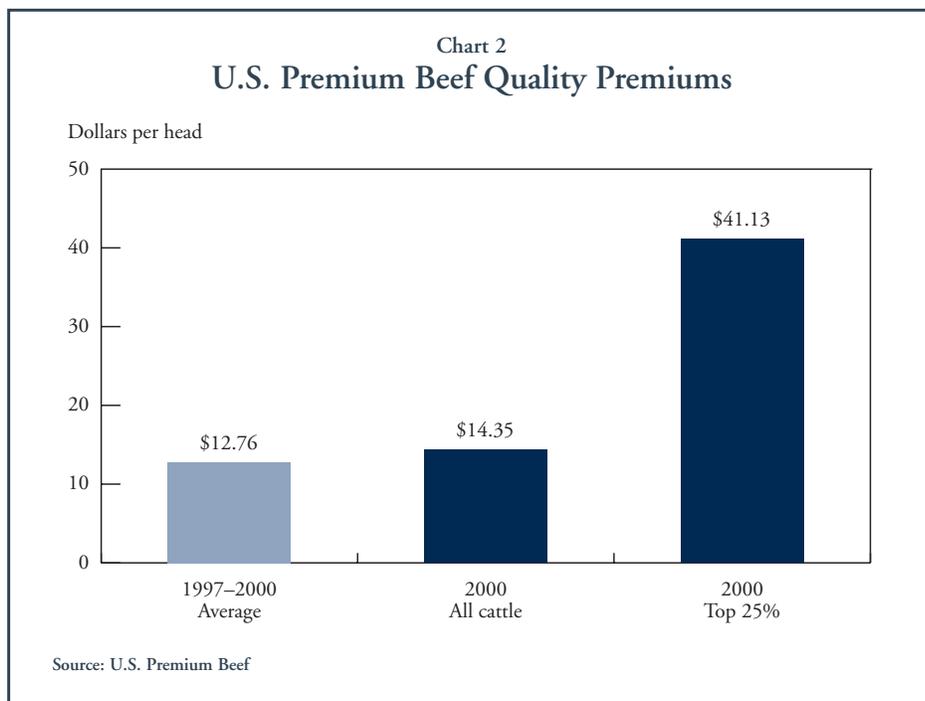
The premiums paid to members have kept cattle producers knocking on the doors of U.S. Premium Beef. The cooperative's membership has grown from 200 producers at startup less than four years ago to

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more than 1,500 across 33 states today. Unlike Dakota Growers Pasta Company, U.S. Premium Beef did not put community development high on its list of priorities largely because their producers span many states. Still, roughly 1,000 jobs have been created in Farmland National Beef's meat-packing operation since U.S. Premium Beef jumped on board.

Conclusions

Agriculture's shift from commodities to products is well under way. To take advantage of the opportunities offered by product agriculture, many producers must form alliances with other producers.



Alliances have evolved as agriculture has changed over the years. The success stories described in this article show how two producer alliances discovered first-hand the benefits of producing products, despite the significant investment sometimes required.

The benefits of producer alliances extend beyond the members of the alliances themselves. In some cases, processing activities generate employment opportunities for hundreds of workers. A large business such as a processing plant can also boost the tax base for a local community, helping to fund sorely needed schools and other public projects. For many rural places, a shift to product agriculture may be a key ingredient for survival and prosperity.

Product agriculture poses new challenges for policy as well. Many of the laws that helped foster traditional alliances have been on the books more than 70 years now. These aging policies were aimed at commodity agriculture and are ill-equipped to handle many of the unique issues facing producers in today's product-oriented agriculture. New policies could help encourage new alliances, with new structures, and new goals—and at the same time help tradi-

tional cooperatives redefine themselves so that they too can seize the opportunities offered by new agriculture.

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