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DEVELOPING VALUES BASED DISTRIBUTION NETWORKS TO ENHANCE THE PROSPERITY OF SMALL AND MID-SIZE PRODUCERS: A CASE STUDY OF HIGH PLAINS FOOD CO-OP

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Introduction

High Plains Food Co-op is part of "a value chain" in which buyers give a high priority to supporting small- to medium-scale growers. In this study, we adopted the term, "values-based supply chains" to refer to supply chains that include fair pricing for producers, distributors and consumers; that identify the source and production system throughout the chain and which include small and mid-scale growers. Values-based supply chains are growing in popularity due to the increase in demand for local food from consumers, restaurants, institutions and retailers. The structure of these emerging distribution enterprises varies widely as does their financial sustainability, so a growing body of research has examined some of these value-based supply chains to determine areas of successes and challenges.

This project examines the financial sustainability, policy and entrepreneurial factors that affect the conduct and performance of emerging distribution networks embedded in food-based value chains. The case focuses on the range of issues that govern everyday distribution activities, to shared values that bring producers and consumers together, and broader issues related to the networks' roles in regional food systems.

This case study is a part of a larger study conducted with support from a USDA Competitiveness for Small and Midsize Farms grant project. A total of 11 case studies were conducted by research teams at UC Davis, Portland State and Colorado State. Each team conducted interviews using an interview guide to allow for cross-state comparisons, but some flexibility allowed each case to have its own focus. In each case study, there were four main areas of interest: basic supply chain network characteristics and scope; financial organization/structure, capitalization and performance; policy and regulatory issues; and entrepreneurial skills and business acumen. Data was gathered through phone interviews and personal visits with distribution network and value chain leaders to assess the four broad factors and how these factors have affected the distribution network.

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2 This project also wishes to acknowledge the leadership team at High Plains Food Co-op for their time and contributions to this case.

High Plains Food Co-op

Size
In 2009, High Plains Food Co-op (HPFC) had total revenue of $30,000. HPFC is limited in growth currently because it is minimally capitalized: the enterprise uses two member producer trailers to make deliveries and rents a warehouse in Denver, CO. HPFC employs two paid, part-time members (20 hours per month) and uses unpaid labor (paid with food credits) from 10 to 20 board members and regular members. It has 194 members: 40 are producers and 154 are consumers.

Type
HPFC is a distribution co-op owned by both its customers and its producers. It should be noted that the co-op has a unique co-op model in which both producers and consumers are members. This membership and governance structure creates a vested interest from both groups in the continued success of the co-op.

Time in Business
HPFC began in 2008 with support from another successful co-op, The Oklahoma Food Co-op. They received significant technical assistance from the Oklahoma Food Co-op in the initial planning and development stages of the business. The Oklahoma Coop's most significant contribution to the HPFC was share ware, their computerized ordering system.

Scope of Offerings; who they work with (suppliers and buyers)
HPFC works with local farmers to assist them in connecting and selling their products to individual consumers along the Front Range of Colorado (from Fort Collins to Denver to Colorado Springs), as well as to customers in St. Francis and Atwood, Kansas. The Coop sells vegetables, meat, eggs, dairy, grains, flour, value added products, and non-food value-added items such as gardening supplies, beauty products and plants.

The Story
HPFC began in 2008 and is modeled after the Oklahoma Food Co-op. The Oklahoma Food Co-op has a successful business model and was willing to share their knowledge. Before organizing, a regional set of food community members gathered in Atwood, Kansas, to discuss the possibility of starting a food co-op. By the end of the first meeting, they already had 30 members. Two years later, the co-op had 194 members of which 40 are producers. They are still in the startup phase of business and predict they will remain in a growth phase (which is generally undercapitalized and understaffed) for another year or two, at which time they hope to reach a point of financial sustainability and an ability to make greater capital and hiring investments.

Size, reach and customer
HPFC services customers within about a 300 mile radius of where production occurs. This is a very large distribution area relative to other food hubs in more populated regions, but is necessitated by the type of agriculture and population characteristics of the Great Plains region (a reason they felt compelled to follow the Oklahoma model which operates in a region with similar characteristics).

***High Plain's Vision Statement*:**
The High Plains Food Cooperative is committed to developing a self-reliant, self-empowering community, by offering a retail exchange to the Front Range of Colorado for goods and services which are grown, produced, traded, and distributed locally, in a sustainable, equitable, and responsible manner.

We engage in sound ethical business practices as we treat members, vendors, suppliers, volunteers, and the community fairly, honestly, and responsibly. We will expect those with whom we conduct business to do the same.

We value resource and raw material renewability by encouraging recycling and the reuse of materials. We believe the long-term cost to society of landfills and waste disposal must not be passed on to future generations.

We support ethical and healthy animal husbandry practices and believe that harmful or cruel treatment of animals is undesirable behavior in a sustainable economy.

We celebrate the cultural diversity of the High Plains and seek to create a marketplace reflective of this diversity. We encourage members to strengthen their cross-cultural understanding by experiencing the variety goods and services that are offered.

HPFC's customers are households located in Western Kansas and along the Front Range of Colorado while most farms are located in far Western Kansas and Eastern Colorado and along the Front Range. Their typical customer is a dual income family, with income of around $50,000-100,000, with one to two children, and living in the more populated areas on the Front Range of Colorado, as well as nearby, smaller cities in Western Kansas.

Value proposition

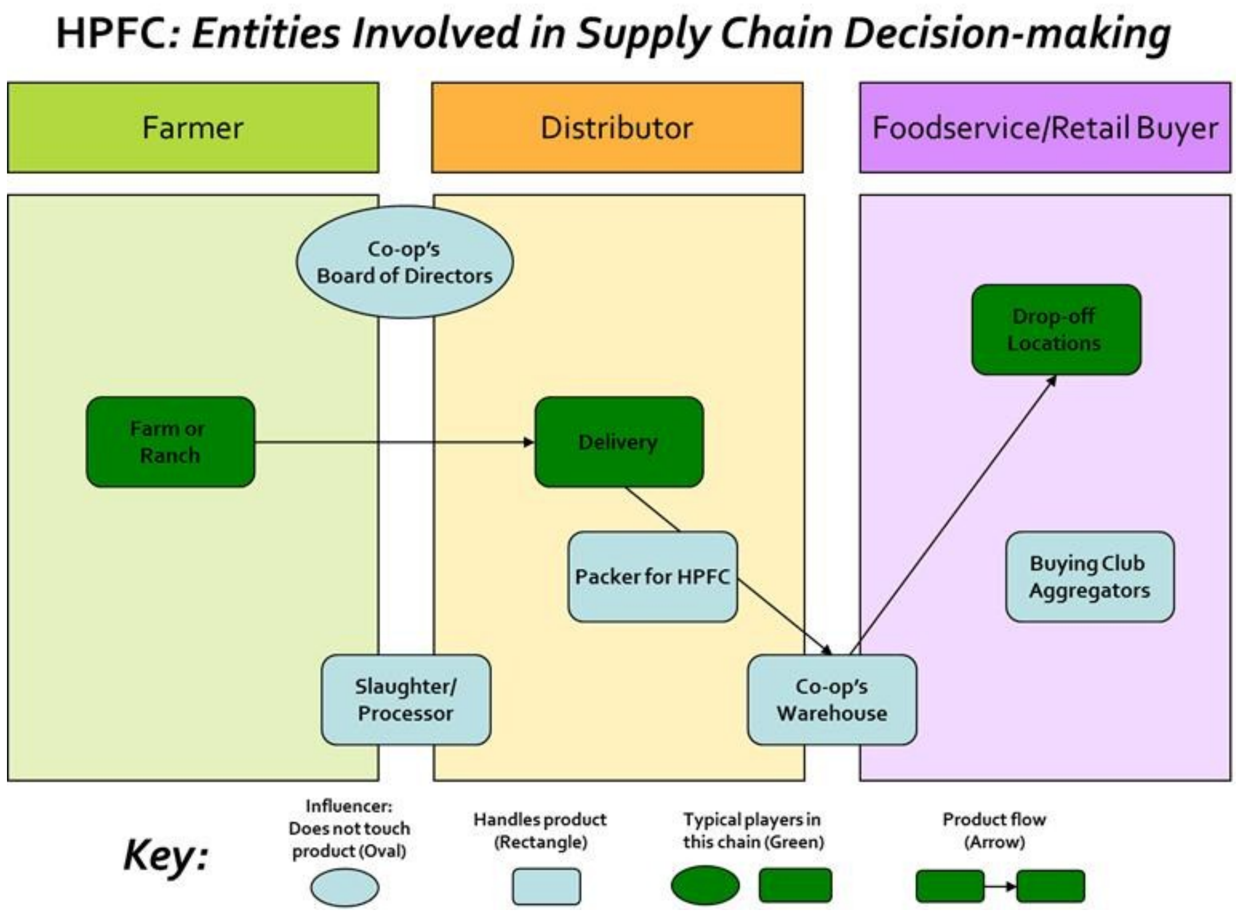
High Plains Food Coop is a grassroots network of High Plains and Rocky Mountain Front Range producers and consumers united by their common interests in locally grown food and other locally made value-added products. The High Plains Food Cooperative strives to be a business that is environmentally sustainable, economically viable, and socially just. To foster a local food community and promote a culture of stewardship by cultivating farmer-consumer relationships, promoting the enjoyment of healthful food, increasing food security through diversity, and enhancing overall rural sustainability. We bring the farmer's market to your front door. (Mission statement taken directly from Co-op website: http://www.highplainsfood.org/).

Competitive advantage

HPFC is one of the only businesses of its type in the Great Plains region, bringing product from the Eastern Plains of Colorado and the Western Plains of Kansas to the population center of the Front Range. The essential business of the cooperative is to provide a marketplace where willing buyers and sellers who are members of the cooperative can meet. At no time does the cooperative ever have title to any of the products and the enterprise carries no inventory. So in the supply chain figure on the next page, one should note that the farmer or rancher maintains ownership through all stages of the supply chain, but other actors in the coop may provide brokering and distribution services. Processing of livestock is coordinated by the rancher before any product is brought to the centralized warehouse, so processing regulatory compliance is handled outside the Coop.

Still, through their coordination and organizational structure (with consumer members), they are able to provide an avenue for producers to direct market who might otherwise find it infeasible (because of distance or small volumes), and provides urban consumers with product to which they would otherwise not have access.

The High Plains Food Co-op Food Supply Chain



Note: The slaughter/processor is a direct relationship between livestock producers and those who handle the harvest of their animals. The packer for HPFC is the one who packs and expedites orders for each consumer member.

Findings from different perspectives

Distributor

Basic Supply Chain Network Characteristics

HPFC is a distribution co-op, owned and managed by its members who supply the capital and share in the profits via patronage dividends. What makes HPFC interesting is that they are owned by both the buyers looking for local products and the food enterprises who are seeking to develop regional markets (since their locales are lightly populated). This has a potential for conflict of interest, as one party wants to pay the lowest price and the other wants to receive the highest price.

HPFC addresses this issue by leaving all the pricing up to the producers and encouraging competition among the set of suppliers so that buying members can have choices that are suitable to their values and preferred pricing points. Although this is not necessarily the best price available to the consumer in the broader food retail market, they are provided a unique marketplace to buy many goods that would be otherwise unavailable. Given the nature, values and mission of the producers involved in the co-op, the goal is for every member (including buyers) to be better off, not just producers. In short, the HPFC business model is focused on being socially just. People that prescribe to this type of business want everyone in the system to win.

The HPFC website is where almost all of the buying and selling transactions take place. Producers are responsible to list what products they are selling and for what price. The customers browse the website and check a box for what they want to purchase and in quantity. There is an opening and closing date for the buying to occur each month, after which the food is dropped off at a specific location on a specific day.

The producer is responsible for producing their items and for dropping off their food at HPFC's central distribution center, so one end of the supply chain is still producer-driven. Producers take turns driving a truck route and picking up products to be delivered to the warehouse in Denver. Farms located very close to the warehouse drop of their product directly. The co-op is then responsible for further distribution; specifically, they are charged with boxing up the items (when aggregation is necessary) and delivering to the ten pickup locations nearby buyers, where the products are picked up by the customer. At no point does the co-op take ownership of the items. Although they have insurance responsibilities from the producer to the consumer, they are merely an agent to the producers. They also refer all complaints, potential returns and feedback directly to producer members.

They do play a "gatekeeper" role in setting some production standards that their producer sellers must adhere to. For more details see the Producer guidelines: http://highplainsfood.org/pdf/producer_guidelines.pdf.

HPFC is continually looking to get more diverse and local suppliers. As they were just concluding their second year of business when this case was developed (Fall 2009-Winter 2010), growth in volume, scope and product diversity was very important to their business strategy. Fresh produce is the product category where they are currently the least competitive due to extreme seasonality. In order to grow their producer network, they have two training sessions per year to build networks. Their most successful training was in Southern Colorado. They are trying to get a complementary producers group started in the nearby region of Alamosa, Colorado, (commonly referred to as the San Luis Valley) as it has a much longer growing season compared to the current producers that are part of HPFC. By expanding into other areas of Colorado, they will be able to expand their offerings as well as help the producers in the San Luis Valley region to reach the large customer base on the Front Range. Although they do not seek out organic producers, a large portion of their producers do fall into that category.

There are a variety of different standards to designate products as local. HPFC defines local as the high plains food shed, which ends up being within about 300 miles of the Front Range of Colorado. They occasionally get some pushback from urban clients due to their broad definition of local. They maintain in their marketing messages that, "based on the land and weather in Colorado, a broader regional definition allows them to sell the variety of products that make their business attractive to consumers."

All of the producers in HPFC are local (or regional depending on your definition) and it is likely to continue to be this way. Product attributes such as grassfed, organic, etc. are producer specific and information on these claims can be found on each producer's website. As described in the co-op bylaws, each producer will be visited annually to ensure they are adhering to the standards set forth by the co-op and that they have the appropriate paperwork to prove their certifications, if such claims are given to buyers. When selling value added products, proof that people are paying more for a quality that does exist is very important. Yearly audits are a way to ensure this continued quality; so in essence, the cooperative serves as a 3rd party verification to the buyers.

Some HPFC members participate in third party certification programs such as Buy Fresh Buy Local and Simply Kansas. Buy Fresh Buy Local chapters are located throughout the country and their goal is to connect consumers in communities throughout the country to the freshest, most delicious locally grown and produced foods available. Simply Kansas is a logo that signifies that at least 75% of the product was grown in Kansas. In addition to these two certification programs, each producer can be part of additional certification programs such as organic, grassfed, etc.

Doing business with small and mid-scale producers can sometimes be difficult. HPFC believes that in order to make these relationships easier and more productive, it would be helpful to have technical assistance in training, promotion and marketing. One way in which they are currently building relationships is through identifying a producer in a different area of the state who wants to develop a local food system. HPFC, with resources and support from Rocky Mountain Farmers Union in Denver, Colorado, provides trainings and informational sessions in the area with other local producers that might want to create a network in their own area. The intention is that the network will grow and be a part of the larger HPFC with its own distributions points. These producers need education and resources in order to create successful networks. For goals, HPFC plans to apply for a value added distribution grant though the USDA to get some assistance in this arena.

Financial

Of the HPFC's current producers, 26 are small producers with less than $250,000 in total farm sales and four are medium producers with less than $1 million in total farm sales. The small producers represent about 75% of their total sales and medium producers represent the remaining 25% of sales. For 2008, their first year of business, they had operations in place for the last 8 months and their annual sales were $10,424. Sales in 2009 were $30,000.

There are several places the value chain mission of this cooperative influences financial performance. For one, the costs for purchasing from local small and mid-scale producers can often be more expensive, and subsequently, marketing operations targeted toward this type of producer have greater challenges in securing financial capital during the startup phase of the business. HPFC predicts they will be in the startup phase until their 3rd or 4th year of business, at which time they hope to reach financial sustainability.

Part of the marketing challenge for HPFC is the commitment to be "fairly priced and socially just" to buyers without constraining the pricing needs of producer-sellers. The potentially higher costs of purchasing from small and mid-scale producers are not directly managed by the co-op. Producers price their own goods and they pay the co-op a 15% fee on all goods sold. The consumer also pays the co-op a 10% fee on all goods they buy. This leaves the co-op with 25% of all goods sold for their operating budget. Although this does not directly address the higher costs of doing business with small and mid-scale producers, it is a guaranteed margin that allows the co-op some flexibility to deal with the higher costs of doing business. So, the volume of sales is the most risky aspect of this operation, and if larger orders are not eventually realized, there will be few resources to staff or add resources to the enterprise.

To assure fair returns, the co-op recommends to their producers that they build the 15% fee into the price of the good. Therefore, the customer is effectively paying the entire 25% markup fee, but if the producer is building off of their perceptions of wholesale prices, this should be somewhat comparable to other market venues. In actuality, depending on the item and the season, the overall price can be very comparable to the average grocery, but sometimes it is considerably higher. As the producers and consumers learn from the success (or failure) of different pricing schemes, it is likely that only unique items of value to buyers will continue with premium pricing, but again, this is a risk to the coop if the commitment to fair returns keeps the sales volume from expanding (due to perceived affordability concerns). Surprisingly, in the existing consumer member interviews, affordability was never raised as an issue (but those with concerns were likely dissuaded from joining this coop model).

In terms of governance, HPFC is a co-op. It is an entity owned and managed by its members. It was originally financed though co-op membership and a USDA grant, so they did not use any debt. The co-op has two types of membership: an owner and a non-owner. An owner pays a one-time fee of $100 and $20 annual fee. A non-owner pays an annual fee of $40. The $100 ownership fee is the equity in the business and the annual fees are used for cash flow in the operational budget. The current membership is 194, 40 of which are producers, while the remaining 154 members are buyers/consumers.

The business plan for HPFC was developed with the help of Rocky Mountain Farmers Union, Ogallala Commons and Rawlings County Economic Development. The basic business model was taken directly from the Oklahoma Food Co-op, a very successful business that is part of Ogallala Commons. For the actual writing of the business plan, they contracted a micro business development consultant out of Denver, Colorado.

The biggest finance challenge that HPFC faces is capital. They need more capital in order to grow, but getting a loan with good terms is very difficult. They are a new business and are still very small. The next investment they need to make is for a trailer and a freezer. This could cost up to $25,000 if they choose to purchase new equipment. An investor offered to donate $10,000 so HPFC could make a large down payment and secure a loan with zero percent interest for 2 years. At the time of writing, HPFC chose not to pursue the investment at this time. At the close of 2008, HPFC had zero debt and around $12,000 in equity. Debt was identified as one way to grow the network, but acquiring debt in the current financial conditions and with a new, small business can be very difficult.

Policy and Regulations

The main regulatory issues preventing HPFC from sourcing more local products has to do with processing capacity. With about 70% of HPFC business being livestock products, processing is a very important piece. There are very few small processors still in business, and the majority that are do not have USDA inspection capacity (limiting interstate shipments which is problematic for this multi-state coop). Some producers have to drive as far as 5 hours to find a small processor. Local producers have discussed opening a small facility nearby, but most see a lack of skilled processing labor as a constraining factor. In 2010, there were at least three active development projects in the region to open new processing facilities. A workshop sponsored by Colorado and Wyoming in Fall 2010 had over 100 attendees from 10 states exploring mobile processing capacity as another option to address this supply chain barrier. It should be noted that HPFC does not directly integrate meat processing, but its sales volumes may be constrained by producer-members' access to such marketing infrastructure.

There is a current food safety bill emerging in Washington D.C. that involves changing the regulations regarding interstate distribution. Because much of HPFC's business is across the Kansas/Colorado boarder, if this bill passes, HPFC could be presented with some issues regarding food safety compliance, additional recordkeeping requirements, and ultimately, costs of membership and registration.

Any type of regulatory compliance is often cost prohibitive for small co-op members. Some of the regulations that are more difficult to comply with include certified scales and weights (that require any sales made on a weight basis is measured with Colorado Department of Agriculture-approved scales (representing an investment of approximately ($1000), and the USDA meat-processing requirements discussed above.

Entrepreneurial

The Online Food Market is the core value proposition of this Coop: it is intended to bring fresh, healthy, locally grown and produced food to the buyer in a cost-effective and convenient manner. Product selection varies significantly by season, but this is communicated to consumers, and less seasonal than many direct markets in Colorado because of the availability of livestock products year-round. While many of the producers are organic, the mission more broadly encompasses sustainable practices to allow for small, non-certified farmers.

Consumers place their order on-line, producers deliver products to the HPFC warehouse, and the food is further distributed to one of ten locations near consumer members.

This model follows the Oklahoma Food Cooperative and the Nebraska Food Cooperative under advisement of these groups and the business development consultation that framed the business plans for those cooperatives.

Acting as the agent for producer members, the High Food Cooperative posts and markets the products the producers have for sale, receives orders, provides delivery to other members of the cooperative, collects monies from the consumers and forwards the payments to the producers. Acting as the agent for consumer members, they provide an online catalog of available local food products that includes information about how and where the product was grown or processed. They do provide a basic screening of products and producers based on published parameters and standards, and provide education on the advantages of membership.

In essence, the entrepreneurial model of the cooperative is to provide a marketplace where willing buyers and sellers can meet. At no time does the cooperative ever have title to any of the products or inventory. The products that go through our distribution system are owned either by the producer, or by the consumer who purchases "title" to the product from the producer. All complaints should first be brought to the attention of the producer, unless it is a situation where the cooperative itself is at fault. If a successful resolution cannot be found by the affected producer and consumer members, the cooperative's arbitration procedure can be invoked.

HPFC sees that its business challenges will evolve through each phase of development. During the startup phase, the challenge has been undercapitalization, which keeps the co-op from hiring any full time employees. The producer members are grounded in their own business operations and without enough money to pay a full time co-op employee, many business processes remain under-developed. In short, the part-time staff are concerned that there is no focused management of the coop, its operations or its long term growth. During the growth phase, the main resource challenges will be related to acquiring sufficient capital and equipment without using debt.

The members of the management team at HPFC have previous experience in running their own businesses, direct marketing, and community involvement with previous leadership positions. Chris, a member of the management team, was a county Economic Development Director with an interest in renewable energy and local foods. The board is comprised of seven members that put in a combined average of about 20 hours per week of unpaid time into running the business.

HPFC has drawn on other members of the community to start up and to grow their business. These community members include Rocky Mountain Farmers Union, Ogallala Commons, Kansas Farmers Union, Kansas Department of Commerce, Colorado USDA Rural Development, and the Oklahoma Food Co-op. These groups offered assistance with writing the business plan, writing a grant proposal, helping to develop the business model and much more.

Farmer

Financial

The producers interviewed range from very small with no other commercial distribution outlets to larger producers that sell to retail outlets and restaurants. Of the three farmers that were interviewed, all have seen their businesses grow since becoming a HPFC member; with one farm having an estimated 15% sales growth in the 6^{th} months since they joined HPFC. Another producer has seen a very small but steady increase in sales. And although growth has been slow, this producer thinks business will continue to increase as the co-op becomes better known, and they themselves get more accustomed to marketing in this way.

All farmers receive the same margin for the products when they sell through HPFC and when they sell through other outlets. The co-op charges a 15% fee that the producers add on their price, so the customer pays the fee and the farmer receives the same price for their product. When asked how goods are priced for the co-op, the smallest producer, selling yak meat, said they looked at what beef producers were selling their products for and priced theirs to be the same. The other two producers priced their items for the co-op in the same manner they price at their other outlets.

Policy

None of the producers interviewed indicated that regulation is an issue. The more established producers were USDA compliant before joining HPFC, so they did not have to change any of their practices when they became members.

HPFC has specific labeling and packaging requirements for its producers. One producer interviewed said the system was a little difficult at first, but is now very easy and an efficient way to package their products.

Entrepreneurial

All farmers interviewed viewed their relationship with HPFC in a very positive light. For the producers located in Kansas and the eastern plains of Colorado, access to consumers in the Denver market is one of the most important criteria they noted for helping them make their decision to join HPFC. Due to their distance from Denver, selling their products to these customers would be otherwise impractical. Producers run the delivery route and work at the distribution center once or twice a year. By sharing this responsibility and the large hourly commitment, producers are able to distribute food to Denver without having to spend a 15 hour day delivering their products once a month. In addition to market access, producers see the on-line form of business done by HPFC as a very effective and efficient way to do business. It is easy for both producers and consumers to relay information easily and quickly.

One producer said one of his favorite parts of being a HPFC member is getting to occasionally meet the end users of his product (without having to interact for every buying transaction). For his other sales, he generally sells to restaurants and retail outlets and rarely gets to meet the happy customers that enjoy his product.

Consumer

Four consumers were interviewed, and although they were different, they had very similar motivations for being HPFC members. They liked the access to products otherwise unavailable, supporting the local economy and small family farms and what seemed to be most important, getting to know their farmers.

The main products purchased by the consumers interviewed were eggs and frozen meat. They all said that they were unable to find products with the same quality at any other location in their area (Colorado's Front Range).

Customers interviewed listed specialty markets as their primary shopping locations, including Whole Foods, Sunflower and Vitamin Cottage. They were all "foodies"; they were very specific about the type of eggs they purchase and how their meat is produced. They were customers very aware of the food system and how their food is grown. Many went to great lengths to find they exact product they wanted produced in a very specific manner.

Of the four consumers that were interviewed, most said the prices at HPFC were higher than at their primary shopping outlets, but that buying from HPFC is not about price. They cited product quality, access to products that they are otherwise unable to find in their primary shopping outlets, and supporting their local farmers as their primary motivations to join HPFC.