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Strategic Marketing Decisions for Organic Agricultural Producers[1]

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Abstract

A group of organic agricultural producers facing a strategic decision is featured. If they decide to form an organization to market their produce jointly, they will have to select a distribution channel. This case presents the demand conditions, requirements, advantages, and disadvantages of different distribution channels for organic vegetables, both on a general level and as they relate to this particular group. The following channels are addressed: roadside stands, farmers= markets, distributors, retailers, restaurants, institutions, and processors. Study questions for use in an academic course or workshop are included.

Keywords: organic agriculture, distribution channels, strategic management

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IAMA Agribusiness Case 10.1

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Background of the Project and the Growers

One evening in January, 2006, Jerry Elliot drove to the monthly meeting of the Central Scenic State Organic (CSSO) Growers. This grower group was a nonprofit organization made up of about 30 organic farmers and gardeners located in the area. Elliot was the president of the CSSO Growers, and had held this position for over two years. Elliot had been involved in organic farming for twenty years. He held a bachelor's degree in general studies from Centralia State University. This program allowed him to develop a background not only in the bio-physical sciences, but also in philosophy, communication, and management. Elliot was well known and respected in the sustainable agriculture community of the Scenic State. As president of the CSSO Growers, he had the opportunity to hone his participatory management style. He believed that it was important to get all stakeholders to participate in the formulation of a strategy. That way, there was greater buy-in when it was time to implement what was planned. Elliot's interests included public speaking, hiking, and camping.

The January meeting of the CSSO Growers was an important turning point in a project Elliot had been working on for six months. This project involved the formation of a marketing cooperative. Elliot had been investigating the feasibility of a cooperative to market the organic produce grown by the members of the grower group. Despite the wintry weather, he looked forward to the upcoming production season, and reaping the rewards of his effort on the project.

Part of his investigation involved compiling an inventory of the resources the growers could potentially contribute to a cooperative. Six members of the CSSO Growers (in addition to Jerry Elliot) had expressed interest in jointly marketing produce at the prior meeting. In the weeks since the meeting, Elliot met individually with each of these growers to gather information about the resources at their disposal. One important set of information was the volume of organic products produced by the growers.

As indicated in Table 1 below, the seven growers, including Elliot, produced an extremely diverse selection of products. The products produced included fruits, vegetable, and grains. It should be noted that many of the products produced were specialty or heirloom varieties. Examples of these were blue potatoes and tomatoes with a camouflage-pattern appearance.

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Table 1: Crops Produced in 2005 by Members of the Central Scenic State Organic Growers.

Crop	Volume Produced by CSSO Growers	Availability
Hay, alfalfa	6,515 bales	All year
Apples	555 tons	8/15 – 2/28
Soybeans	1,406 bu.	All year
Rye	980 bu.	All year
Blueberries	46 tons	7/13 – 9/15
Spelt	119 tons	All year
Oats	855 bu.	All year
Soft Red Winter Wheat	530 bu.	All year
Hard Red Spring Wheat	512 bu.	All year
Hairy Vetch	N/A, cover crop	N/A
Winter Squash	5,530.5 bu.	9/15 – 12/31
Sweet Corn	109,375 ears	8/1 – 9-30
Tomatoes	19,765.6 Twenty-five lb. cartons	8/10 – 10/31
Green Beans	17.2 tons	7/1 – 9/31
Peppers, Bell	4,285 bu.	6/15 – 10/15
Summer Squash	1,843.5 bu.	7/15 – 9/15
Cucumbers	18.2 tons	7/7 – 9/21
Cabbage	56.3 tons	7/1 – 10/31
Eggplant	1,513 bu.	7/1 – 10/31
Peas	2.1 tons	6/1 – 6/30
Spinach	7.5 tons	6/15 – 10/15

In addition to the crops produced, some of the growers raised animals. The applicable animals were beef cattle, chickens, sheep, and turkeys.

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An overview of the characteristics of the growers and the resources at their disposal is given in Table 2.

Table 2: Resource Information for Members of the Central Scenic State Organic Growers.

Number of Growers	7
Total Acres Farmed in 2005	397
Irrigated Acres	71
Farm Size, in Acres (Mean and Range)	Mean = 56.5 Range: 3 to 110
Number of Growers with Internet Access on Their Home Computer	5
Years of Farming Experience (Mean and Range)	Mean = 29.8 Range: 7 to 42
Number of Growers Willing and Able to Research Customer Needs by Visiting a Library or Through the Internet	7
Number of Growers Willing and Able to Visit Potential Customers to Show Samples or to Describe Production Capabilities	7
Number of Growers With Access to an Adequate Amount of Debt Capital to Operate, and Expand, if Necessary	7
Age of Growers, in Years (Mean and Range)	Mean: 52 Range: 40 to 66
Annual Gross Sales in 2005	Mean: $32,400

The seven farming operations varied substantially in size and degree of commercialization. Four of the producers ran operations that were established businesses. The other three were smaller, and they expressed their intent to commercialize their businesses. Two of the larger farms were almost exclusively vegetable operations. The owners of these operations had established customer bases. They sold through a number of farmers= markets, which sometimes required them to travel close to 100 miles to reach a particularly desirable market. They also marketed to retailers (mainly natural food stores and food cooperatives). Minor marketing outlets for these growers were selling to individual consumers and restaurants. Among the other two relatively large producers, one had historically focused on grains and one on fruit. Both of these growers had minor vegetable enterprises.

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Each of the seven growers maintained that they had individually achieved a high level of customer satisfaction. All of the growers mentioned that they were willing and able to research customer needs and demand trends. Each also indicated a willingness to visit potential customers (e.g., restaurants, processors, and retailers) and to provide samples. The commercial-sized operations generally had strong and recurring cash flow. All of the growers reported having good credit, which indicated they had access to debt capital if needed for expansion.

Three of the farms used part-time, temporary employees on a seasonal basis. These employees primarily assisted with harvesting. The other four farms could be described as Aone-man operations," with help from family members as needed. The growers and their families, however, had a strong belief in producing safe and healthy food. These beliefs translated into a good work ethic in performing production tasks. The buildings and equipment of the growers were adequate for their enterprises. Six growers had at least one barn, and one grower stored his equipment outside. Each grower had a tractor. They had a good assortment of cultivation tools and harvesting equipment. A couple of growers mentioned that they had greenhouses to start seedlings. Generally speaking, the growers in the group were well educated. All had at least a bachelor=s degree or some technical training beyond high school. Four of seven growers had graduate degrees. Most of the operations had family members, such as, spouses, adult and minor children, who participated actively in production and/or marketing.

The growers generally did not engage in systematic, long term planning, either individually or as a group. Elliot sensed that the two major challenges of a possible marketing cooperative would be establishing goals that all participants could agree on, and coordinating production and logistics to achieve scale economies or other synergies. It was vital for the growers to overcome these challenges.

At the meeting, Elliot planned to present a great deal of information to the CSSO Growers. First would be an assessment of the demand for organic produce (broadly, and at a local level). The resources and skills of the group of growers involved with the project would also be reviewed. Finally, different potential future directions for the group would be laid out.

Organic Farming and Organic Food

Elliot and all of the other CSSO Growers were certified organic. Organic agriculture could be defined as "good farming practices without using synthetic chemicals." (Kuepper and Gegner) According to Greene, there were 2.2 million acres of certified organic cropland and pasture in the U.S. in 2003.

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The National Organic Program was implemented by the USDA starting in 2002. Its goal was to provide uniform national standards for organic food in the U.S.

From a practical standpoint, a list called the National List of allowed and prohibited substances identifies the inputs that are permissible for organic foods. The National List is maintained by the National Organic Standards Board (NOSB). Members of the NOSB are appointed by the Secretary of Agriculture and serve five-year terms. Following is a summary of the technical requirements for a firm to be certified organic.

- "Abstain from the application of prohibited materials (including synthetic fertilizers, pesticides, and sewage sludge) for 3 years prior to certification and then continually throughout their organic license.
- Prohibit the use of genetically modified organisms and irradiation.
- Employ positive soil building, conservation, manure management and crop rotation practices.
- Provide outdoor access and pasture for livestock.
- Refrain from antibiotic and hormone use in animals.
- Sustain animals on 100% organic feed.
- Avoid contamination during the processing of organic products.
- Keep records of all operations." (Organics Consumers Association)

To receive organic certification, farms must complete and submit an application to an Accredited Certifying Agent (ACA) and pay a fee. ACAs must be accredited by the USDA. In August, 2006, there were 94 ACAs. Part of the application process is the development of an organic systems plan. After the application is received by the ACA, an inspector from the ACA visits the farm to perform an audit. The audit primarily consists of reviewing documentation to confirm that no inputs besides approved substances on the National List were used on the applicable farmland in the three prior years. Handlers and processors of organic foods also must be certified. Producers of inedible fibers (e.g., cotton and wool) may be certified, but there is no certification for processors of these fibers. An exception to the certification requirement is that farms with gross receipts less than $5,000 per year may label their products as organic without going through the certification process described above. (USDA Agricultural Marketing Service)

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The Demand for Organic Produce

The word organic emerged in the marketplace to differentiate agricultural products based on production methods (Klonsky and Tourte). The key point is that organic has positive brand capital in the collective consciousness of consumers. Many consumers assume that food products labeled organic are safer, more healthful, and more wholesome than other products. Table 3 presents information regarding demand for organic products in the U.S. and the EU.

Table 3. Statistics concerning demand for organic products in the U.S. and the EU.

A. Organic Sales and Growth Rates	Date	Source
Annual sales of organic food in the US: $13.8 billion	2005	Organic Trade Association
Annual sales of organic food in the EU: nearly $13 billion	2003	Dimitri and Oberholtzer
Annual per capita sales of organic food products: $34 for the EU and $36 for the US	2003	Dimitri and Oberholtzer
Annual sales of organic fresh fruits and vegetables in the US: $4.019 billion	2003	Nutrition Business Journal (NBJ)
Annual compound growth rate of sales of organic products: 20%	1995-2005	Govindasamy, et al
B. Domestic Market Penetration of Organic Food		
Nearly 10% of Americans consumed organic food regularly (several times per week)	2004	Whole Foods
73% of US consumers purchased organic food products occasionally, and 23% purchased them at least once per week	2006	Hartman Group
C. Organic Products Availability		
Organic products were available in 20,000 natural food stores and 73% of all conventional food stores	2002	Dimitri and Greene
Organic food experienced an increase in distribution in foodservice venues, including national parks, resorts, major league ballparks, universities, and hospitals.	2005	Haumann

Local Demand Conditions

In seeking out markets for agricultural products, it is often a good idea to start locally. If customers can be obtained locally, then transportation costs

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and time in transit can be minimized. Minimizing time in transit is especially important with fresh produce, due to its limited shelf life. The central part of the Scenic State (i.e., the local market for this grower group) was comprised of two counties, Olsen and Glasgow Counties. These counties had a combined population of 243,000, and a median household income of nearly $40,000.

The central part of the Scenic State was a reasonably well-populated area. More than 3 million people lived within 150 miles of Olsen and Glasgow Counties. This population was mostly urban and suburban, with a broad distribution of incomes and ages. There were two major urban areas near the Central Scenic State. A city with 950,000 residents was roughly a two hour drive to the east, and a major urban center with a population of more than 2 million was two hours west. An interstate freeway connected these two cities. The CSSO Growers were all located within forty miles of this freeway. Also, there was a strong union presence and tradition in the Scenic State. This contributed to a preference of many consumers there to buy local products.

Distribution Alternatives

There were several different methods, or distribution channels, that could be used to market organic vegetables. Each had pro=s and con=s to be considered by the grower group. The methods to be considered include farm markets (roadside stands), farmers= markets, distributors, retailers, restaurants, institutions, and processors. Estimated costs of pursuing each of these distribution channels is listed in Table 4 at the end of this section. Both the start-up cost of becoming established in each distribution channel and the annual, recurring costs are listed.

Selling directly to consumers through farm markets (i.e., roadside stands) was a marketing method commonly used in the Scenic State. Advantages that apply uniquely to selling through a farm market include the following: transportation and commuting time is minimized, family members can readily get involved with marketing, and growers control the days/hours of the market. The following advantages apply to farm markets as well as farmers= markets (to be considered next): these channels are easier to enter than selling through intermediaries, growers receive full consumer price, growers can provide information and promote products directly to customers, and growers control the presentation of their products.

Limitations of using a farm market include the following: success depends largely on the quantity/quality of the traffic in front of the grower=s farm, a farm market allows for sales from one location (versus the multiple locations that distributors and retailers provide), farm markets tend to have a more

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limited selection of produce than other outlets, an investment in fixtures (e.g. tables and a canopy) must be made, resources are required to staff the sales booth, and problems with zoning and neighbors may arise.

The second potential distribution channel for the growers was farmers= markets. There were also a number of farmers= markets in the Central Scenic State and nearby areas. Some of these markets operated year-round, but most of them were seasonal (June through October). Organic producers who sold at farmers= markets in the more affluent communities received a substantial premium for their fresh produce, with prices sometimes as much as 75% higher than for conventional produce in supermarkets. The advantages of selling at a farmers= market include the following: more traffic (than a farm market), customers are more desirous of locally-grown produce than customers in typical retail outlets, growers can pool their investment in fixtures and booth rent, and growers can pool their products and sales efforts. Disadvantages of farmers= markets include the following: transportation costs (i.e., time, fuel, and vehicle wear-and-tear) and space rental must be incurred, area farmers= markets had limited days and hours, and pricing tends to be competitive due to comparison shopping.

The Scenic State had a well developed distribution system for fruits and vegetables. Because of the distance to out of state distributors, it would not be economically feasible for this group to do business with any distributor outside of the Scenic State. The only certified organic distributor in the Scenic State, Veryfine Produce, was located in Glasgow County. Veryfine had positive customer relationships and a favorable reputation among retail and food service buyers in the Scenic State. This firm had specified a minimum volume of produce that growers had to supply in order to qualify as a supplier. There were only two members of the CSSO Growers who had sufficient individual volume to meet this requirement.

A couple of advantages of marketing through a distributor (specifically, Veryfine) are that this would allow the CSSO Growers to market a much higher volume than would be possible through farm markets or farmers= markets, and that Veryfine could take over some of the essential marketing functions (e.g., selling to and communicating with retailers, and making deliveries). Veryfine also contributed a number of resources and skills to its supply chain, including: distribution and logistical experience, a reputation for service, and access to their network of retail, food service, and institutional buyers.

Like other distributors, Veryfine had their own needs in addition to what was required by the consumer. Examples of these needs included uniform product size, packaging, and labeling. For the CSSO Growers, meeting the specific needs/requirements of this distributor would involve overcoming

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major barriers, especially the minimum volume requirement. It was possible, however, that the CSSO Growers could combine forces to overcome these barriers. Importantly, Veryfine already had a group of growers whose products they handled. If the CSSO Growers wanted to break into Veryfine=s distribution pattern, they would have to displace other growers who had traditionally provided the supply. If these growers selected Veryfine as their distribution channel, incremental costs (e.g., for stickers, labeling, and packaging) would have to be accounted for. Finally, the CSSO Growers would receive a wholesale price for their produce by Veryfine. This would generally, but not always, be less than the price they would receive if they were selling directly to consumers (Ricks).

Another distribution alternative for the CSSO Growers was to market through retailers. Both of the nearby urban areas had an established, competitive retail food infrastructure. While supermarkets were the food retailing format that sold the largest volume of fresh produce, other formats also existed. These other types of stores included produce markets, convenience stores, and natural foods cooperatives, among others. The major supermarkets had centralized purchasing operations. These retailers dealt in extremely large volumes and required consistent quality produce on a year-round basis. The owners of some of the independent grocery stores and produce stores expressed an interest in buying produce locally. It was difficult to determine, however, if these comments were sincere or merely public relations.

In recent years, natural food retail chains including Whole Foods, Wild Oats, and Randall=s Better Health Food Stores established themselves in these two metropolitan areas. They had even begun to open retail stores in medium sized cities in counties adjoining Olsen and Glasgow Counties. One of the natural food chains mentioned above had implemented a system in which produce buyers traveled up and down the local interstate highway, stopping to buy produce from local growers. Finally, there were two natural foods cooperatives that operated retail outlets in the Central Scenic State. These organizations had historically favored produce from smaller, local farms.

Marketing through retailers would have a number of advantages, including the potential to sell a substantially larger volume than would be possible with direct-to-consumer methods and that certain investments and expenses related to selling directly to consumers (e.g., fixtures, rent, and wages) would be avoided. In addition, the growers would have access to the customers and marketing skills of retailers.

Retailer customers would also have their own needs, beyond those of the consumer. These needs would correspond generally with those mentioned in

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the discussion of the distributor (Veryfine Produce), with the additional need for convenient delivery. Further, potential retailer customers that sold produce already had produce suppliers. This would require the CSSO Growers to displace the current suppliers. In addition, many area retailers only bought through distributors, and sometimes retailers in the area charged suppliers a slotting fee to get new products onto their shelves. Finally, if the CSSO Growers chose to sell to retailers, they would have to build trust and establish relationships. This would take time and effort.

The Central Scenic State had many restaurants. There were at least 120 independently-owned restaurants in Glasgow County and at least ninety in Olsen County. These restaurants were typically stand-alone enterprises where the owner did the purchasing, which allowed for flexibility in menu composition. These characteristics made the independently-owned restaurants relatively good candidates as customers for the CSSO Growers. But due to the variation in the quality of fare at these restaurants, substantial investigation would be required to determine which were the most promising prospects. Another prime potential set of customers for the CSSO Growers was the group of gourmet restaurants located in the metropolitan areas to the east and to the west. Further, chefs at gourmet restaurants often preferred to use organic produce in their recipes, and they were willing to pay a high price for the desired ingredients.

As customers, restaurants (especially upscale, gourmet restaurants) would be more amenable to accepting unusual varieties and small quantities compared to retailers. Some area restaurants had demonstrated a demand for locally-grown, in-season produce. Products sold to restaurants generally would not have to look as good as products destined for markets where the consumer selects the produce. Marketing to restaurants would require a lot of time in relation to the volume of product delivered. This alternative would involve frequent deliveries of small quantities. Kazmierczak and Bell mentioned high delivery costs and delayed payment of accounts as drawbacks to this marketing alternative. Finally, selling to upscale establishments located in the metropolitan areas outside of the Central Scenic State would require the growers to incur substantial transportation costs and delivery time.

There were a number of institutional foodservice customers in the area. The largest of these was Centralia State University, which was fifty miles northeast of Lake City, the county seat of Glasgow County. The university had over 40,000 graduate and undergraduate students, about 15,000 of whom lived in dormitories. A student group at the university (the Sustainable Agriculture Action Group) had made a request to the administration for more locally grown, organic food to be served in the cafeterias at Centralia State. Other major local institutional foodservice customers included the public school systems in Olsen and Glasgow Counties, a community college with

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8,500 students, three large hospitals, and a county-operated senior citizen housing complex. Marketing to institutional customers would be similar in many ways to supplying restaurants. Institutional customers, however, could allow for larger volume than individual restaurants. On the other hand, there is more pressure on institutional buyers to keep costs down. A possible exception would be if the CSSO Growers could arrange preferential treatment at Centralia State University, due to lobbying by the Sustainable Agriculture Action Group.

Marketing organic fruits and/or vegetables to a processor was another option for the CSSO Growers. In order for the processed product to be labeled organic, the processor as well as the grower had to be certified organic. There were approximately eighteen certified organic processors in the Scenic State. One quarter of these processors processed fruits and vegetables.

One positive aspect of marketing to processors would be the possibility for the growers to market some produce that did not look good enough for fresh sales. Perhaps more importantly, selling to processors would provide the opportunity for the CSSO Growers to market a much larger volume of produce than would be possible through direct-to-consumer channels. In addition, some processors in the Scenic State gave their growers a purchase commitment prior to planting season. This limited the marketing responsibilities of the growers.

Marketing to a processor would include a risk of non-payment, if payment was not received at the time of delivery. If the CSSO Growers would establish a supplying relationship with a processor, they would run the risk of the processor closing or changing product lines, which could result in a lack of a market for the grower=s crop (Ricks). Organic fruit and vegetable markets were thinner than conventional markets, which would magnify the problem if a processor were to discontinue a product with an organic fruit or vegetable ingredient. Marketing to a processor would involve transporting the product, possibly over substantial distances, which would require the grower group to incur significant transportation costs. As with the other channel customers discussed above, marketing efforts would be required to sell to processors. This would probably involve making sales calls and delivering samples.

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Table 4: Costs[2] of Pursuing the Distribution Alternatives Available to the CSSO Growers.

Alternative	Start-up Cost	Annual Recurring Costs
1. Farm market	$5,000	$15,876
2. Farmers' markets	$960	$21,960
3. Distributor	$320	$14,400
4. Retailers	$2,560	$25,200
5. Restaurants	$4,800	$32,600
6. Institutional Foodservice	$1,600	$14,000
7. Processor	$5,200	$13,800

Table 5: Estimated Demand for Each Distribution Alternatives Available to the CSSO Growers.

Alternative	Estimated Annual Demand	Assessment of Variability/Risk of Revenues	Risk Notes
1. Farm market	$44,100	Medium	Risk arises primarily from location factors
2. Farmers' markets	$36,000	Medium/Low	Can expect a steadier flow of customers than with a farm market, although weather can negatively affect sales
3. Distributor	$33,075	Medium/High	May not be able to arrive at a deal with the distributor, or have the capability of meeting the distributor's needs
4. Retailers	$33,075	Medium	There are diverse segments of potential retailer customers, some of which are well-suited to the products grown by the CSSO Growers
5. Restaurants	$35,280	High	Requires ~9 restaurant clients to move sufficient volume, tends to be a turbulent industry
6. Institutional Food service	$26,460	Medium/Low	Some potential institutional foodservice customers may have the discretion to give local producers preferential treatment in purchasing
7. Processor	$26,460	High	May not be able to arrive at a deal with processors for the selected commodities, or have the capability of meeting the processors' needs. Possibility of a product line being discontinued.

[2] Costs were estimated by the authors.

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Elliot faced a dilemma regarding what recommendations to make at the meeting of the CSSO Growers. At the prior meeting, four other growers expressed interest in marketing their produce jointly. Elliot interviewed these four plus two other growers since the meeting, to ascertain the resources at their disposal. There were other organic growers in the region who may have been interested in a joint marketing organization for produce, but Elliot was unable to set a meeting with them to discuss the group=s plans and the resources they could contribute.

Keeping all this in mind, Elliot pondered what recommendation would be best for the group. As he conceived it, the future direction of the group would have at least two dimensions. First, the members of the group would have to agree to go ahead with a joint marketing project. Elliot felt strongly that they should pursue such a project, and he planned to energetically make his case for this at the meeting. If the group responded as he expected and decided to go forward with a joint marketing approach, they would face other decisions. They would have to decide how to cooperate and which marketing channel to pursue.

Discussion Questions

A. List the strengths, weaknesses, opportunities, and threats for the group.

B. Which two or three factors from the previous question have the most bearing on the ability CSSO Growers to organize and achieve success in jointly marketing their products? Explain why.

C. What market opportunities are available to the CSSO Growers?

D. Develop a number of strategic alternatives for the group related to how they could work together.

E. Prepare a quantitative analysis using the information from both Table 4 and Table 5.

F. What course of action would you recommend for the group? Address specifically whether the group should organize, and, if so, how they should proceed. Please provide justification for your answer, i.e., tell why your recommended action plan is the best alternative. Be sure to state your assumptions.

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