

THE INTRODUCTION OF A SUPPLY CHAIN/CONSUMER FOCUS IN FARMER CONTROLLED BUSINESSES IN THE UK

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Abstract

This paper assesses the effectiveness of the traditional models of cooperation and analyses best practice in collaboration between farmers seeking to gain significantly greater scale and flexibility in an increasingly global food chain. The UK grocery retail sector is one of the most concentrated in Europe and the total income from farming is estimated to have fallen 11% in real terms in comparison with 2004. Drawing upon broader strategic management thinking and relevant international practice, the study seeks to identify new feasible models for farmer collaboration. Existing forms and attitudes towards traditional business cooperation in the UK farming sector will continue to be insufficient to gain adequate market power and profitability within an increasingly competitive global food and farming industry. UK farmer collaboration needs to address the global scale of the food supply chain and to do so is likely to require a radical re-think of the most appropriate business structures and alliances.

Keywords: supply chain, UK, model, farmer collaboration

Introduction

The Foot and Mouth Disease caused a huge trauma in the UK farming industry. In August 2001 the Government appointed the Policy Commission on the Future of Farming and Food, chaired by Sir Donald Curry CBE, to advise the Government on how to create a sustainable and competitive farming and food sector. The starting point for the commission was that the situation in the English farm and food industry was completely unsustainable. The diagnosis indicated that farming was detached from the other sectors of the economy and was “serving nobody well” (Curry, 2002).

Among the recommendations of the commission, there was an important emphasis on the need to increase collaboration because it was seen as the best way for small farm businesses to obtain the benefits of being a large farm business (Curry, 2002). The need for strengthening collaboration within the food supply

chain was identified as so important, that one of the immediate consequences of the recommendations was the creation of English Farming and Food Partnership (EFFP) in 2003.

The need for a radical change in the UK farming industry has been quite clear since the Mid Term Review (MTR) of the Common Agricultural Policy. Nowadays, food and farming is a global business, and the people involved in the sector have to recognise the urgent need of adapting to the new economic environment. Experts in farmer collaboration such as Parnell (1999) and The Plunkett Foundation (1992) had previously made clear the need for bigger, better, more effective and efficient Farmer Controlled Businesses (FCBs), and also set the challenge to explore and evaluate new approaches to develop farmer controlled enterprises more imaginatively.

Aim and Objectives

The main aim is to identify new forms of collaboration between farmers with the need to gain significantly greater scale and flexibility in an increasingly global food chain.

The research objectives are:

To assess the effectiveness of the traditional models of cooperation.

To develop a new model of cooperation within the food chain from which UK farmers can achieve greater competitiveness

Procedures

Primary research has been limited to EU member countries (primarily Spain and France) as the legislative framework of the Common Agricultural Policy (CAP) significantly limits opportunities for the transfer of operating models from a non-EU business environment.

Using an inductive grounded theory approach comprising a series of Delphi iterative face to face interviews, two rounds of guided interviews were completed. These comprise, 35 experts in the field of business collaboration, selected using a purposive sampling approach. Interviewees include leading academics, government officials and advisors, and managers of the most profitable and/or innovative EU-based collaborative ventures.

The objective of the first round of interviews was to identify the parameters of best practice and develop a working hypothesis of how current cooperative models might be supported or challenged effectively. The second stage was completed in order to refine these frameworks using expert opinion, particularly those who are dealing with farmers on a daily basis, in order to gather a closer and more practical view.

The Food Industry

The economic reality is clear; almost every sector of the UK's food industry is suffering from over capacity and lack of investment. In addition to this, the supermarkets are cutting the number of suppliers, and in this reduction process they only deal with the companies that are able to deliver both the required scale and quality standards (Key Note, 2004). According to the Institute of Grocery Distribution (IGD) (2005) the UK grocery retail sector is one of the most concentrated in Europe. A measure of the market share of the 3 or 5 largest firms shows that the top five grocery retailers have 63%, and the top 3 firms 48%.

At the same time, the total income from farming is estimated to have fallen by 8.9% in current prices, or by 11% in real terms in comparison with 2004, reaching £2.5 billion in 2005. In real terms the total income has slipped below the levels of the late eighties, but is still 40% above the lowest point of 2000 (Defra, 2005).

However, the London Economics (2004,) investigated the main determinants of the farm –retail price spread and concludes that:

UK farm gate-retail price spreads are generally not among the highest in the EU Member States

The results suggest that, overall and for the period covered by the analysis, concentration in the retail domestic market does not seem to have a significant impact in the evolution of spreads

The sterling/euro exchange rate and costs in the supply chain, appear to increase retail farm spreads in most commodities groups, therefore, this would suggest that UK farm products are subject to significant competition from countries inside the Euro area.

Farmer Controlled Business (FCBs)

Regarding collaborative ventures and in order to compare the relative importance of FCBs in different countries, table 1 shows their market share per sector for a selection of EU countries.

Table 1. Market share of UK & non-UK FCBs 2001(%)

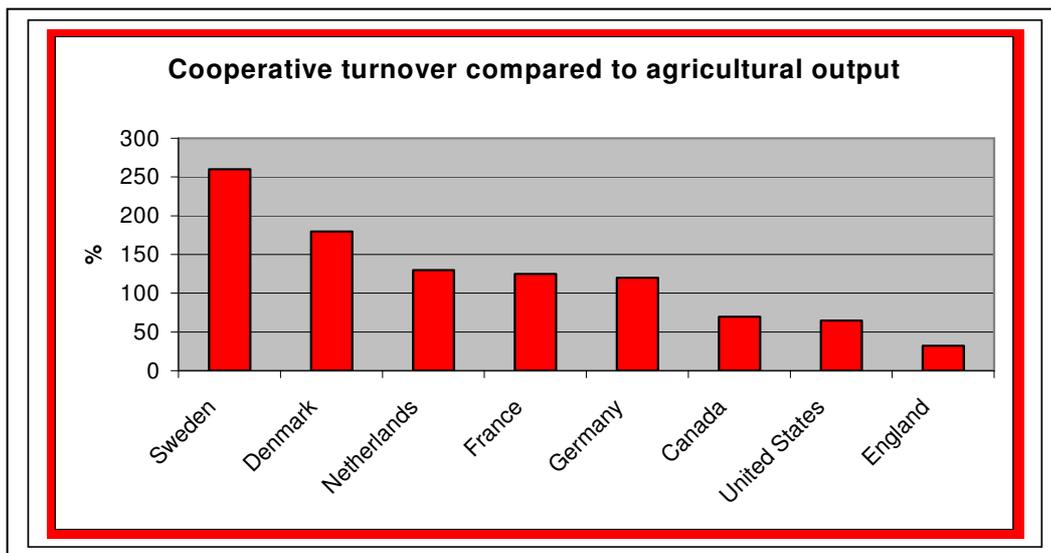
	Dairy	Fruit & Veg	Meat	Farm inputs	Grain
France	49	35-50	27-88	50-60	75
Germany	55-60	60	30	50-60	
Denmark	93	20 – 25	66 - 93	59 - 64	87
Netherlands	82	70 – 96	35	40 – 50	
Sweden	99	60	79 - 81	75	75
UK	50	35 – 40	20	20 - 25	20
Spain	45	35	35	50	35

Source: *EFFP (2004) and MAPA (2003)*

It is clear from table 1 that the UK FCBs hold a quite small proportion of the market if compared with other EU countries, particularly northern European countries. Even in sectors like meat, where the market share of UK FCBs has been traditionally very small, other European countries have FCBs with significant market power.

Another way to evaluate the importance of the FCBs sector is to compare the cooperative turnover with the total agricultural output. Graph 1 shows that doing such a comparison the English FCB sector is quite small in relation to a selection of European and North American countries.

Graph 1 Co – operative turnover compared to agricultural output in Europe.

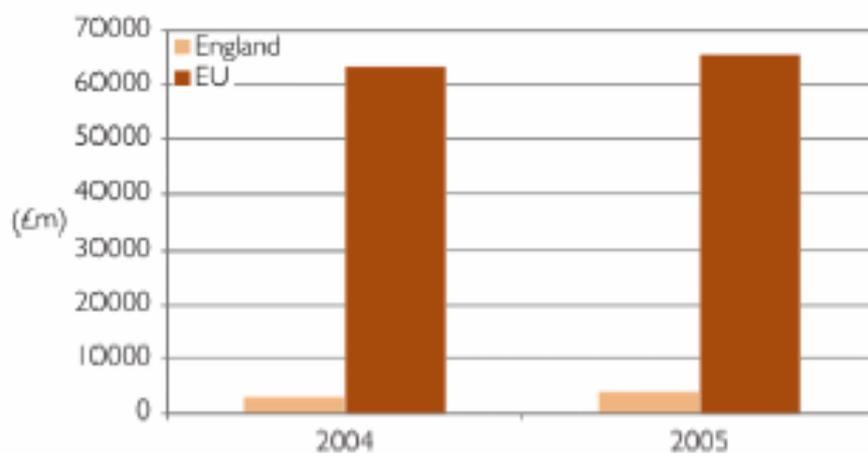


Source: EFP (2004)

It is also interesting to highlight the fact that in many countries the Cooperative turnover is higher, and in some cases more than double the total agricultural output, representing the significant importance of the FCB sector for the farm industry.

The comparison of the top 30 FCBs in England with the top 30 FCBs in Europe is shown in Graph 2. The difference in turnover between both groups is very significant. Additionally, it can be added that all of the top 30 EU FCBs had in 2005 turnovers above £1 billion.

Graph 2 Turnover of the top 30 FCBs in England Compared with EU



Source: EFP (2005)

Globalisation

Fulton (2000) said that globalisation has increased both the rate and the nature of social and economic change, through rapid advances in technologies, the declining of the nation-state and its consequent borders, the fluid movement of goods and people and the blending of cultures. Thomson (2001) predicts that there are very good opportunities for well organised, market orientated and adequate size producers that can satisfy the needs for price, quality, marketing support and volume.

In the UK, English Food and Farming Partnerships (EFFP) (2006) emphasises that it is quite clear that in the future the competition will be between global supply chain and not within the supply chain, opening opportunities for world class FCBs. For that reason, EFFP suggests that English FCBs should change to a more global market driven mindset in order to exploit international market opportunities.

Fulton and Gibbings (2000) said that globalisation and an industrialised agriculture are very related. Globalisation has increased the social economic changes, affecting the role of governments regarding agriculture by increasing their regulations on environment, health and food safety. Simultaneously, the consumers are widening their demands for different products, and changes in technology are affecting the way food is produced, processed and distributed

Thinking about the competitiveness of the UK farming sector in this new era, Hampson (2006) reports that even the most cost effective UK farmers might not be able to compete with the low-cost imports on price alone. This suggests that market differentiation will be the way forward to keep farmers' viability in a globalised market.

Torgerson (2004) argues that direct payments to farmers have acted as incentives to increase farm size, but also as a barrier to farmers organizing together in order to increase their income from the market. In other words, farmers traditionally have relied on government support as their major source of income isolating them from the market forces.

The New Way

In her research about cooperation in the UK red meat sector, Bowles (2004) said that the different social economic environment that is affecting the UK farming, in comparison with the economic environment at the times when agriculture cooperation started and developed in mainland Europe, requires different cooperative models able to achieve significant scale of operation in the short term.

To gain more value for farmers, FCBs should change from a defensive cooperative model to a more offensive and risk-orientated model, which has to be able to attract investments. The traditional model of cooperation has its limitations in being able to raise capital from non-members; therefore there is a need for new models that are more attractive to external investors (EFFP, 2006).

“Inevitably, the traditional organization of ownership, control, and business conduct of cooperatives restricts vertical expansion into value-added activities, exploitation of market opportunities at both farm and processing level, and creation of superior customer value. As a matter of fact, the organizational arrangements of traditional cooperatives hinders them from making their escape from production-orientated to market-orientated business.”

Kyriakopolus and van Bekkum (1999)

Thelwell (2004) argues that the fragmentation at production level is the main barrier for UK farmers to gain more economic and political power. Therefore, collaboration is the only way to gain the required scale to influence the market, and to do so, farmers will have to compromise some of their individual freedom and start to invest in their market beyond the farm gate in order to change from production orientated operations to market led ones. Traditional cooperatives need to be adapted to the post-modern business environment (Goldsmith, 2004)

The message is clear: to achieve real benefits there is a need for a change in the mindset of all businesses involve in the UK supply chain (English Food & Farming Partnerships, 2006). British farming has to approach the new political and market developments with an alternative “thinking” (Askew, 2006).

Results: The Models

The outcome of the research has been to develop three discreet but combinable models of collaboration. Each model requires different levels of commitment from its members and would suit different business situations. It is assumed that the prime consideration for members of any organization of primary producers is a desire to receive enhanced financial benefit from their participation. Each model reflects the detailed comments of interviewees.

Model 1: NETASSOC

This model allows a group of farmers (also industry-related non-farmer businesses) to collaborate in a formal business relationship. The volume, price and quality of the products are agreed in advance, (there must be at least a clear description of the products to be traded). In some cases it will be possible to have standardised contracts between the members and guidelines about the operational requirements to participate in the NetAssoc. For example, a beef farmer and a finisher might be members of a NetAssoc. The farmer might agree to sell his calves to a finisher. The number of calves, the breed, the weights, delivery dates, etc, would have been agreed in advance.

Members would be registered with the NetAssoc but would be flexible in agreeing to contracts in any one trading period. This would allow a better coordination of the chain; increasing the efficiency and the quality of the final product. Here supply and demand are matched within a flexible and yet agreed framework where the parties would have redress to law. Interaction among members would need little additional supervision or control. The level of organisation can vary, being loose or tight at varying times.

There are no entry barriers beyond acceptance by existing members of the basic rules of the NetAssoc and no exit barriers other than the restrictions of an individual contract. Co-ordination could be shared by the members to reduce overheads. Collectively members of the NetAssoc might decide to bid for contracts – if successful they may decide to appoint professional co-ordinators. However a simple database of contracts would also suffice.

The NetAssoc thus promotes the matching of supply and demand. Production quality is determined by individual contracts. Increased communication, improved flows of information and increased mutual trust and dependency should result. It is extremely flexible for the participants and no initial investment is required. Basic governance would develop only on the basis of success and mutual agreement. As scale increased the members of the NetAssoc might conceivably vote to become a group member of a NetCoop.

Model 2: NETCOOP

This model is an adaptation of the traditional model of cooperatives. Members have to acquire “rights” to participate in the coop (buying or delivering products). The number of rights purchased for each member will be in relation to the amount of products allowed to be traded, and will relate to the voting power of the member, increasing the commitment and the sense of ownership towards the NetCoop.

Members will receive market price for their products, and a further “bonus” which represents the ability of the NetCoop to add value to the inputs, allowing a clear differentiation between the product delivered by the member and the performance of the NetCoop as a business. This kind of procedure drives the producers to increase the quality of their production and it is a good way to evaluate the performance of the NetCoop’s management team.

Where the NetCoop operates in more than one sector (business or products), the member’s “rights” will determine the number of “participations” acquired by a particular member. These “participations”

represent the share of the whole NetCoop that belongs to each member and therefore relate to the voting power i.e. a member will receive market price for the products traded (x amount of potatoes), plus a later “bonus” based upon the added value of the product sector (performance of the potatoes business within the NetCoop), plus a “participation dividend” related to the profitability of the NetCoop as a whole. This increases the global vision of the business and spreads the risk of the membership.

The valuation of the members “rights” will vary with the overall performance of the Netcoop and these rights will be tradable and may therefore offer the opportunity for a capital gain.

The model offers many options and could be the basis for a federal model, where individual producers own the ‘rights’ and a first tier coop or Net Assoc owns the ‘participations’ in a larger NetCoop (related to the number of rights of its members), thus giving them the voting power and participation in the overall performance of the federated coop.

The performance of the NetCoop and a real sense of ownership are at the centre of this model, compelling forces to drive a focus upon the needs for consumer and a broader vision of the requirements of the supply chain. It is also a flexible structure more suited to a complex and changing business environment.

Model 3: NETBUS

The NetBus is a traditional registered company, with the key difference that its shareholders are other business/companies who are participants of a specific supply chain. It is a network of businesses that form a company, bringing integration, coordination and flexibility to the supply chain. The members form a company in order to increase collaboration and commitment with the common objective of long-term sustainability and competitiveness. Because every stage (every individual business member) of the chain owns shares in the company, there will be clear benefits from the sharing of information and the seeking of maximum efficiency at every stage. The structure could be a horizontal or a vertical organization, so the possible shareholders are: primary producers, processors, input companies, traders, financial institutions, service companies, universities, NetCoops, FCB, and so on. Everybody buys shares, participates in the profits, and the company is run as a normal profitable business. Therefore, each member has to deliver (products or services) to meet the company expectations, otherwise it should be provided by someone else. These kinds of requirements will pressure each member to be the best in their particular area, and the return will come as dividends and as an increase in the share price.

Some restrictions are necessary to ensure the primary producers maintain majority ownership, and the NetBus may decide to limit membership. This could be done by the introduction of different type of shares with different rights over profits and over voting power.

There is a huge potential for the synergy coming from the participation and commitment of businesses from different elements of a supply chain. Without doubt it will increase the coordination, efficiency and long-term competitiveness of the participating members. Bargaining power increases exponentially allied to a significantly improved flow of commercial information between its participants. Because of the integrative nature of such an organisation, there will be a need to demonstrate compliance with anti-trust or Office of Fair Trading regulations, however it is an ideal model to compete against other supply chains and to develop new products or enter competitive markets.

Conclusions

The proposed models seek to overcome the perceived limitations of traditional models of UK Farmer Controlled Businesses in the new economic environment. The second round of interviews presented the

business models to experts in the field of collaboration in order to refine them and adjust them. The overall conclusions are:

The models offer a different framework that will increase the consumer/supply chain focus and the flexibility required by UK FCBs to increase their competitiveness.

The payments of dividends or bonuses act as a more visible benefit to being part of the organization. There needs to be established the right to trade ownership and a financial framework attractive to external capital.

The proposed models offer mechanisms that increase the motivation for participation and develop a stronger sense of ownership that will be reflected in higher commitment.

The models 2 and 3 provide a better environment for the development of the management, increasing the possibility of better performance, control and career options.

The models offer new opportunities for proactive new members with a continual interest in increasing their level of participations. Such participating members will support the recruitment of well-educated and/or experienced leaders.

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