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DEVELOPING VALUES BASED DISTRIBUTION NETWORKS TO ENHANCE THE PROSPERITY OF SMALL AND MID-SIZE PRODUCERS: A CASE STUDY OF COLORADO HOMESTEAD RANCHES

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Introduction

Colorado Homestead Ranches 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 Colorado Homestead Ranches for their time and contributions to this case.

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Colorado Homestead Ranches

Size

Colorado Homestead Ranches (CHR) and Colorado Homestead Meats (CHM) are organizations that directly represent six ranches that sell between 250 and 400 head of cattle each year (representing almost about one-fifth of their total marketable numbers). In addition, they process and market meat, produce and other food products as a partner with about 20 other producers from the Western Slope of Colorado. In 2009, sales were over \$1 million and if you include their own meats and products processed and/or marketed through their retail stores and farmers market booths, and well over \$1 million if you include fees for meat processing for community members and other meat enterprises.

Type

CHR is a group of six Western Slope, Colorado ranches that was formed to provide high quality beef, marketed directly to their customers, in order to retain the greatest value. They began selling at farmer's markets and gradually increased their customer base by selling to restaurants, opening their own retail food market (Homestead Market), purchasing a USDA packing plant and operating a wild-game processing facility. CHR direct markets through their storefront and farmers market, to restaurants, and through wholesale distributors. In addition to providing a supply chain for their own members, they have provided market access for a number of other partners.

Time in Business

CHR was formed in 1996 with five of the ranch family members, and an additional owner/member was added in 2004. In 2002, the Homestead Market opened in Paonia, CO. In 2003, a USDA inspected packing plant was purchased and updated in Cedaredge. In 2006, another plant was purchased in Delta, Colorado.

Scope of Offerings; who they work with (suppliers and buyers)

CHR sells beef, pork, chicken, elk, fish, lamb, buffalo, and processed meats. Meat is sold individually packaged and vacuum sealed. Beef is also sold as a ¼, ½, or whole. They sell frozen ready-to-eat entrees, eggs, cheese and milk, greens, jams and jellies, salad dressing, wine, and candy. They source all beef directly from CHR members while other products are sourced from local farmers and ranchers. They sell directly from their store, to restaurants, and at farmer's markets.

The Story

CHR is a group of six family owned cattle ranches located on the Western Slope of Colorado. After exploring several options for cooperative marketing with other programs in Colorado, and hearing about the successes of Oregon Country Natural Beef from Doc and Connie Hatfield (<http://www.oregoncountrybeef.com/>), these ranch families decided they wanted to form their own vision of a meat marketing company.

CHR was formed as a C-corporation in 1996 with equal stock ownership and an informal agreement that each producer would provide equivalent hours and effort on behalf of the company until they grew enough (in sales and resources) to hire staff and pay salaries. CHR initially operated as a marketing enterprise for the ranches, but later integrated into processing activities as well. Individual ranches maintain ownership

and are responsible for all cattle production activities. Each CHR member has a specific set of responsibilities but indirectly supports all phases of the business. Communication and a strong commitment to the success of the business from each family has been an important piece of its continued success (and a testament to their vision of following the example set by Oregon Country Natural Beef).

CHR grew steadily since its inception, and even with the recession and economic downturn, sales have remained stable. They first began selling frozen beef from owners' freezers with most of their promotion from word-of-mouth recommendations from existing customers. The next step to gain more visibility and access to the high-end consumers located in nearby mountain communities was to sell at farmers' markets (and they even helped to begin Aspen's farmers



market). This was, and still is, an effective way to grow the customer base, ensure strong one-day sales, as well as a place to try new products and get immediate feedback. But due to extreme seasonality and the small geographic area they can serve, this marketing strategy limited their growth potential. CHR explored other avenues to sell product, but found retail space hard to obtain due to its small volume of sales and restaurant customers were difficult to build a business on due to inconsistent sales.

This led CHR to a new, retail-oriented marketing strategy. They opened their own store in Paonia, Colorado, in 2002. This was adjacent to an existing wild-game processing facility, which gave them greater potential cash flows to cover the store's capital and overhead expenses. A positive spillover for their local food community was that they provided market access to a large number of other food producers who were also challenged by their reliance on farmers markets and other retail/restaurant accounts. By all measures, this market has become an important economic and networking node for Paonia, as part of their Main Street and other community events.

The next challenge for this group was processing: in short, they had trouble scheduling enough slots to process enough meat for their needs in some seasons, and fees were taking a toll on their bottom line. Subsequently, they decided to purchase a USDA-inspected packing plant in Cedaredge that had been processing CHR's beef since they began in 1996. This processing facility provided them stable, year round processing capacity, a new sales venue in another small West Slope community, and the ability to support other meat producers who needed access to reliable, quality processing facilities.

As CHR continued to grow, they realized they needed a more updated processing facility and bought a new

USDA packing plant in Delta, Colorado, in 2006. This has not only enabled them to expand processing services and capacity, but also opened up yet another retail market in a relatively larger town in that same region. Delta has a population of over 7,000, in contrast to Paonia's 1650, but is also less than an hour from Grand Junction, with a population of over 50,000. In essence, CHR has gradually become vertically integrated into CHM, with an identity as a major provider of processing and marketing services to their own members and other regional food enterprises. This is a unique case among the emerging set of joint marketing ventures by producers. In their efforts to secure market access, and then processing capacity, they have not only grown their own enterprise, but have also provided these same services to other producers in the region.

Although the other producers will not directly benefit from earnings by CHM, most would tell you that the market access points and processing services are provided at reasonable terms, and an important element in their own ability to remain viable in direct markets.

Size, reach and customer

CHR ranches are located in the North Fork Valley of Colorado near Paonia, CO. Products are sold from the Homestead Market in Paonia, the store front in Delta, the Aspen farmers' market (located about 80 miles away), the farmer's market in Grand Junction (located about 80 miles in the opposite direction, but closer to Delta), and at four restaurants (all within about 50 miles).

In 2010, CHR will sell between 250 and 300 head of cattle with projected sales of \$375,000 for just their own meats... This number is down from previous years (in 2009 they marketed 400 head), but due to an overall price increase, gross sales have remained steady. In the summer of 2010, CHR increased the price on all beef products and did not see any effect on

demand. In addition to selling their own products, they also sell products for around 20 other local producers from their storefront and at the farmers' markets. At the storefront, sales of other producer's goods represent about 78% of sales, and at the farmer's markets this represents about two-thirds of total sales.

More importantly, they represent a local, reliable processing facility for other meat producers (an increasingly important service in a state dependent on livestock and with strong consumer markets). At the processing plant in Delta, in 2009 they processed 1,140 head of cattle, 304 lamb, 629 pork and 9 goat. As of August 2010, they processed 871 cattle, 451 pork, 77 lamb and 56 goat.

Value proposition

CHR has established itself as a premier beef producer and marketer as well as a loyal community steward. They sell all natural beef that is raised without the use of growth hormones or antibiotics. All cattle are born, bred, and raised on family owned and operated ranches. They are fed on the open range and then finished in a small, non-commercial feedlot maintained on one of the CHR ranches. Animals are humanely shipped to

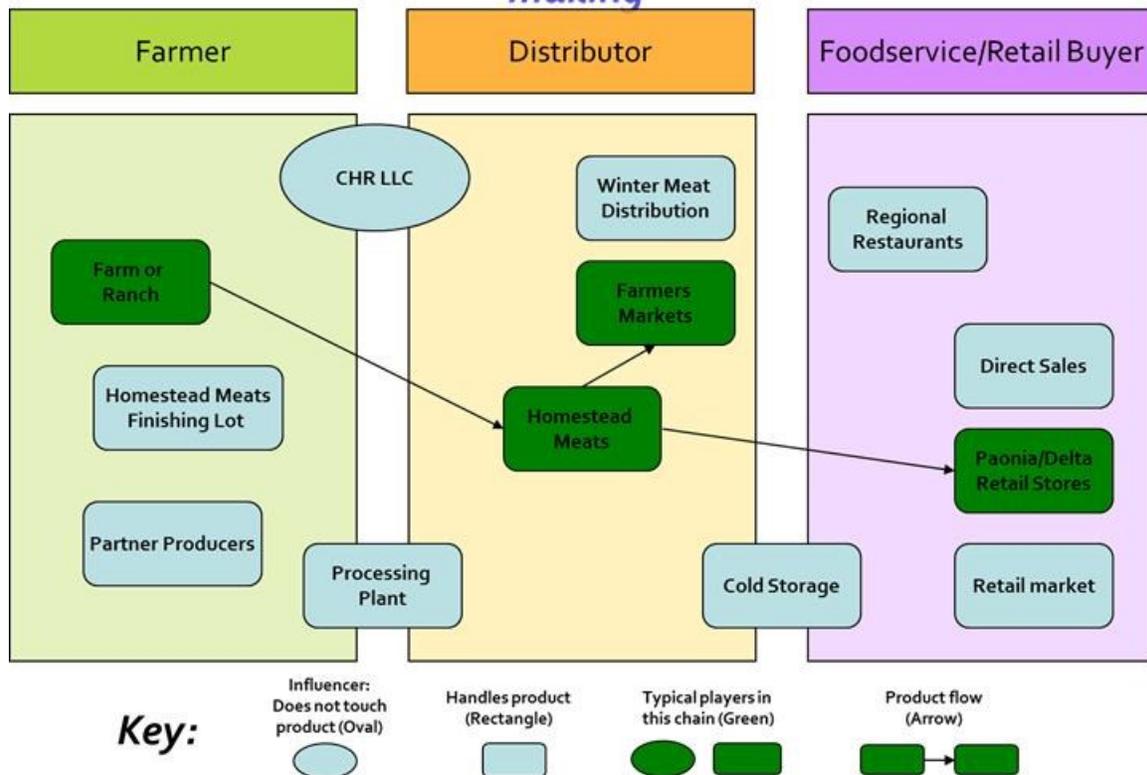
CHR's USDA-inspected processing plant where they are aged for 14 days to ensure a tender and flavorful product (statements taken from CHR website, with visits to site to document such practices). Before CHR even began, the member/owners were recognized as leaders in Conservation, the Beef Industry and their Community organizations, an essential element in their ability to grow their enterprise and partnerships in this community.

Competitive advantage

CHR is similar to other local niche beef producers because they sell direct to their customers at Farmer's Markets, but what gives CHR an advantage over its competitors are its variety and locations of sales outlets. Not only do they have their own USDA packing facility and wild game processing facility, but they own their own retail stores in areas where the food retailing options and choices were otherwise fairly limited. In addition to selling their own products at this store, they have become a place for other local producers to sell products, which allows them to be more attractive to consumers, financially viable and contribute to the growth of other food-based businesses in the region.

The Colorado Homestead Ranches Food Supply Chain

Case CHR: Entities Involved in Supply Chain Decision-making



Findings from different perspectives

Distributor

Basic Supply Chain Network Characteristics

There are two main products that move through the CHR supply chain: beef and all other producers' products.

The supply chain of beef will be discussed first. Cows are raised on each individual ranch and then delivered by each rancher to a small feed lot operated by the ranchers. Once cows are fed to the appropriate size, one of the ranchers delivers them to the packing plant in Delta, CO. Once the cows arrive, they are officially owned by the marketing enterprise jointly owned by all the ranchers, Colorado Homestead Ranches. They are processed and sold directly at the store front in Delta or taken by a rancher (a task rotated among members) to the store in Paonia. Product that arrives in Paonia is sold at that storefront, taken to farmer's markets in a rancher's truck (market operations also rotate among families), or taken on a third party food distributor to Montrose and Crested Butte. In the last case, there is a seafood distributor out of Montrose that delivers products near the CHR locations and has an empty truck for the drive back. CHR pays a small fee and the distributor takes their product back to Montrose. This is a very effective way to reach another market while minimizing time and energy resources. The restaurant customers located in or near Delta come to the plant to pick up their products.

In the case of most other products, each producer delivers to the stores in Paonia and in Delta. CHR pays the producer for their goods and then marks them up by 50%, on average, to sell to their own customers. They essentially buy product at wholesale and then resell it at their various venues, but allow food producers to maintain pricing authority and determine their own values. In a few cases, especially with perishables like produce and cheese, CHR carries product on consignment.

Financial

CHR has found that as they have grown and become more vertically integrated, the financial aspects of the business have become more and more complicated. Instead of being able to simply pay for processing, therefore knowing the exact cost, they are now running a processing facility where they process their own beef as well as product for many other producers. They

have found this to be very complicated and their current computer system (or lack thereof), does not allow them to accurately track the businesses' expenses in a way that makes each enterprise's performance clear.

The gross revenue data for the processing facility is available, but breaking out individual costs per head and per species is not currently possible. They are at a key period in their growth curve in which they are no longer small, but still, cannot quite afford the sophisticated operating systems of a medium size processor. In addition to the complexity of integrating a processing facility (without establishing a new enterprise), they have fine-tuned the roles and responsibilities of members (so they can focus on their own comparative advantages). For example, the family that runs the Paonia store knows everything about their own store, but not very much about the processing plant in Delta. In short, CHR has become too big for all the ranchers to understand all the details about the entire company. So fortunately, they can depend on the strong trust that has developed between them; they know everyone is doing their job well and there is no reason to interfere.

The store in Delta is also a wild-game processing facility. When CHR was first interested in buying this store, the wild-game was a big selling point, and really provided them more certain cash flows in the early years. They were able to subsidize the store with the processing facility because it is so lucrative. Even today, about 15% of their total sales at the Delta store are from the wild-game processing facility.

Pricing beef products has been difficult for CHR and is not an exact science. Not only do costs vary widely across cuts, but it is difficult to break out these differences. The main pricing technique used is to look at how other producers are pricing their products and use that as a base price, with some fine-tuning based on what inventories show them is in greatest (and least) demand. Entering 2010, their prices were on the low side compared with their competition. So, beginning in summer 2010, CHR decided to increase prices; a 10% increase for the high end products and a 0-5% increase for the lower end products. They saw no decrease in demand. This might indicate that their prices were too low and they may have even greater flexibility to increase prices on some cuts in the future. At a time of economic recession, the price resilience speaks to the willingness to pay of their customers.

Markup on the beef is not currently calculated since they do not process independently, and return a stable beef price to ranch-owners. In essence, CHR is run as a break-even enterprise, in an attempt to maximize returns to the ranch. Processing has helped and hurt. By “controlling” one of the major post-farm gate costs, it has given the organization greater economic control of their supply chain. Plus, when possible, they use economic returns from processing for other enterprises to fund the CHR operations. However, without better financial control systems, they are currently unable to track how they perform independent of processing.

The markup on other food producers’ products is 50%, a very standard retail markup, considered fair by their trade partners and justified by the operating costs of the storefronts.

Policy

Regulatory issues have not been a large concern for CHR since their purchase of the new processing facility in Delta, Colorado. Before this purchase they owned a very old plant in Cedaredge, Colorado, which they were concerned may lose its certification under more stringent criteria. They worked hard to keep Cedaredge operating up to regulatory expectations, but as CHR grew it was evident that the costs of keeping up with regulatory compliance at that plant was not going to be feasible. When the Delta plant, an updated facility, went up for sale CHR decided that ownership of that plant was a better solution. In the new plant, they have perceived no risks or threats of noncompliance, but a more up-to-date recordkeeping system would help if traceability systems are demanded and become more complex.

For one of the case interviews, the plant was visited, including a full tour and interview with the plant manager. The plant manager, Dale Hall, values the availability of the inspector at the plant. She sees them as the experts and they help to ensure there are never any food safety issues or liabilities for CHR.

The main challenge for CHR’s processing is related to scale. Because they are unable to spread costs out over a large volume of animals, some expenses are just too great. An example of this occurred in when CHR tried to work with Western State College. The college required the plant to have a metal detector in order for them to buy product, but they were unable to absorb this expense given the small size of the plant. There-

fore they were unable to exploit this business opportunity.

One of systems they recently implemented at the plant enables them to trace all products back to a specific animal. Traceability is a very important both from a food safety standpoint and from a marketing standpoint, and for now, they are able to comply with standards in the operation.

Entrepreneurial

In its original years of inception, CHR members spent approximately 50 hours per week managing operations and sales. This “unpaid” commitment to the management of the business allowed it to grow (in equity and market size) without the typical financial constraints that a business faces while in its growth phase. Each producer has an equal stock ownership in the CHR C-corporation and an informal agreement to provide equivalent hours and efforts on behalf of the organization. It should be noted that this was easier to negotiate because the participating ranches were of similar size, so there was no dominant supply partner among them.

Originally, each CHR member has a unique set of responsibilities as well as supporting all phases of business. Karl Burns was originally responsible for all accounting and financial oversight, and continues to support in this role even though they firm hired an accountant. Norm Smith is responsible for oversight and general contractual strategic planning and Susan Smith, his spouse, is one of the managers at the retail store. Jim Ayer is responsible for coordinating the production to primal cut processing phase of meat production and Susan Ayer also works and provides meals at the retail store. Chad Campbell is in charge of quality assurance at the finishing lot, is the prime contact for the Aspen Farmer’s Market, and coordinated with the processor before CHR owned their own facility. Steve Kossler is the president of CHR and provided general management for each segment of the CHR operation.

To this day, the members act as a management team, all committed to providing labor for direct marketing and planning activities (this was the management set-up for the early years of 2003-2006). Currently, much of the roles are the same as they were from the beginning. Members have taken turn being president over the years and they have hired a few more hands to help with the increased business. Since taking over the processing facility in Delta, a store manager and a plant

manager were hired. The CHR members did not have experience in processing plant management, so these hires were needed, and benefit the broader operation as well.

In addition to a strong management team, CHR has utilized USDA grants and Colorado State University Extension to assist them in business planning and development. CHR received their first grant in 2002 and contracted CSU to conduct a feasibility study to assess the potential for ready-to-eat entrees. In 2004, CHR received a USDA Rural Development Value Added grant and contracted CSU to conduct market research to pinpoint customers and plan for directed marketing. CHR has made each step of their growth in an informed, calculated manner; allowing the business to grow steadily and continue to make profits for the producers.

As markets grew and the processing facility was integrated, CHR began to pay salaries to some of its members, and hired outside staff for other activities. The payroll has grown to include 15-16 non-family members with no equity stake in any of the ranches that supply the meat business. In addition, they pay five of its members for at least some of their market staffing services. Still, capital resources are constrained enough that there are many unpaid hours committed by the owners.

Farmer

The discussion of CHR from the farmer's perspective is with rancher interviews of Norm Smith and Steve Kessler, two of the founding CHR members.

Norm noted that, "When the five original ranching families came together to create CHR, one of the main goals was to get away from the price volatility and uncertainty that comes with selling cows on the open, cash market." The families wanted to take control of their pricing, so CHR was borne as a marketing business for their beef. This all began 14 years ago and it is very evident that all families have been working very hard. Raising cattle and running a ranch is a full time job. When you add two stores, two processing facilities and farmers' market booths, it seems that marketing operations begin to detract from efforts made on the home ranches. In short, it feels like two full time jobs. For this reason, both ranchers interviewed see CHR in both a positive and a negative light.

On the positive side of things, they are always learning and have interesting and eye-opening experiences. As a traditional producer, one rarely has the opportunity to have direct contact with their customers. Steve said that it is the customers that have taught him how to run his business better. They are the reason CHR began selling so many other producers' meat. Customers wanted beef, but they also wanted chicken and lamb from their local food shed. It is quite evident that the producers enjoy the recognition and praise from their happy customers. The resulting high morale is a benefit they would never see if they were to sell their product on the open market. From a broader view, not only have they had the experience and knowledge of being ranchers, but now they have expertise as retail store owners and operators, processing plant owners, and farmers' market merchandisers.

On the negative side, the ranchers work incredibly hard since the hours required for CHR in addition to running each ranch are significant. Each rancher invested cows to begin CHR, essentially providing equity through animals, and they have not yet been paid for these cows except through equity on paper. Either in the future or if they ever choose to sell the business, they may be financially rewarded for their hard work. But like much of farming and ranching, the wealth is tied up in the business, so it is not a liquid asset. Moreover, valuing such a business is challenging, because it is so closely connected to the actual value chain in that local area, so there are no comparable businesses to appraise its value against.

Consumer

One customer of the processing plant was interviewed in addition to two individual consumers from the Aspen Farmer's Market. The customer of the processing plant raised goats for cheese and then processed her billy goats in Delta to make sausage. Raising and processing the goats for meat is an ethical decision, not a financial one, since the market value of their meat is small relative to the dairy operations she focuses on. The owner wants the lives of the billy goats to have a purpose. She is very grateful to be able to utilize the Delta plant. She said it is calm and humane and she feels good about taking her goats there to be processed. She mixes the goat meat with pork to make her sausage. At this point she breaks even on the sausage enterprise, but it helps her meet her goals with the billy goats. She hopes to begin raising her own pigs and will

hopefully make money on the sausages once she can use her own pork product in the blend.

Customers are very vocal about how much they like CHR products. At the Aspen farmer's market, a number of customers came up to the rancher running the booth and said they tell all their friends about the product and that it is the best available. Word-of-mouth advertising was very evident and the ranchers say it is still their main form of advertising. One of the customers interviewed uses CHR as her sole source for meat.

Because all product is frozen, she comes each week and stocks up. This seemed to be the case with many customers as most would buy enough from CHR's offerings (their own beef as well as pork, elk, buffalo and chicken from other producers) for at least 3 meals. CHR has a very good reputation in Aspen and their customers are very good about spreading the word. On average, they will gross \$3000 per day at market; about \$1000 of the total is sales of their own beef and the remaining \$2000 is sales of other producers' products (pork, chicken, etc.).