A New Brand of Agriculture: Farmer-Owned Brands Reward Innovation

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Abstract

Commodity agriculture. as currently practiced in the midwestern United States. is an extremely efficient way of organizing production and distribution. It allows for inexpensive production and bulk transfers of huge quantities of meat. grain. and other agricultural products. As a consequence. it has brought enormous savings to U.S. and international consumers. This system has evolved in accordance with market forces that we expect will survive for decades.

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A New Brand of Agriculture

Farmer-Owned Brands Reward Innovation

BY DERMOT J. HAYES AND SERGIO H. LENCE

Commodity agriculture, as currently practiced in the midwestern United States, is an extremely efficient way of organizing production and distribution. It allows for inexpensive production and bulk transfers of huge quantities of meat, grain, and other agricultural products. As a consequence, it has brought enormous savings to U.S. and international consumers. This system has evolved in accordance with market forces that we expect will survive for decades.

There are aspects of the commodity system, however, that are not desirable. For example, the commingling that occurs to take advantage of bulk handling means that consumers cannot send signals to producers. Consumers might desire food products that are different from the commodity standard, and they might be willing to pay a premium, but the producer does not get this signal.

In addition, competitive pressures mean that farm operations must grow larger to reduce unit costs of production. Governments throughout the world have attempted to slow growth in farm size in order to ease the transition for those who are forced out of farming, and to prop up rural communities. These government "protections" distort markets and sometimes lead to international tension, as each country defends its own interventions.

Farm groups have attempted to address these issues in two ways: by developing alternative uses (such as ethanol plants), or by creating differentiated niche products (such as food-grade soybeans grown exclusively for tofu). However, when these efforts are successful, they are quickly imitated, and competition drives profit margins lower.

A third possible solution — farmer owned brands — has recently begun to emerge. This solution requires cooperation between producers and government, but it also relies upon market forces. In essence, the solution allows farmers to own their own brands and to control the production of branded quantities, much as already occurs in other sectors of the economy. In the European Union, branded commodities are described as having either a "guarantee of origin" or a "guarantee of production process." (In the U.S., the description will include a reference to a federal marketing order.) Neither of these phrases captures the essence of the concept, so we refer to them as "farmer-owned brands."

The Economics of Farmer-Owned Brands

The key criteria to establish successfully a differentiated agricultural product are summarized in Box 1. Some consumers are willing to pay premium prices for differentiated products. These premiums can occasionally result in niche markets, such as those that exist for organic products and local farmers' markets. Dedicated consumers are essential for the success of a farmer-owned

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brand. But producers in traditional niche markets do not attempt to control supply: that is, they do not prevent imitation. Therefore, profits for producers of organic and local products are likely to follow the pattern found in commodity product marketing. Successful branding requires producer control over the quantity supplied, and this is the key difference between farmer-owned brands and organic products or farmers' markets.

In order to control supply without violating federal price-fixing rules, farmer-owned brands must be based on some fixed and identifiable attribute. For example, a particular brand might specify that the product can only come from a certain area (Vidalia onions are a prominent example — see below). Alternatively, supply can be controlled by limiting membership in the producer group to a relatively small number of high-quality producers.

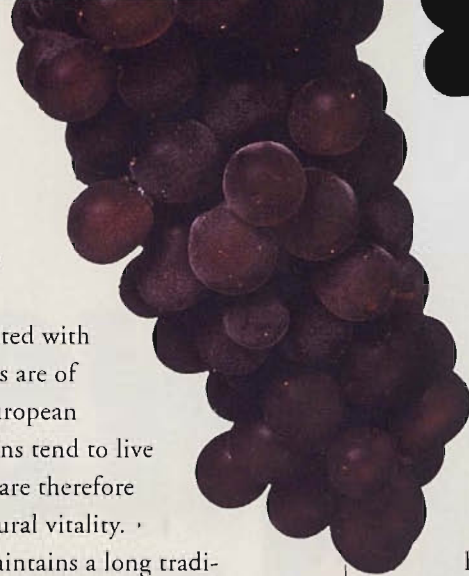
A third way would be to impose strict (for example, environmentally friendly) production and/or quality standards, possibly allowing for some flexibility over time to accommodate changes in market circumstances. This model resembles that used by the Boston Brewing Company, marketer of the Samuel Adams brand craft beers. Boston Brewing contracts production of Sam Adams to breweries around the country, under exacting standards.

A fourth way is to require the farmer-owned brand to use some ingredient or process that can be controlled by the producer group, either through intellectual property rights or through trade secrets.

A successful farmer owned brand will become a temptation for imitators from outside the original group. Similarly, attempts by members of the group could subvert the group's intent by expanding their individual outputs. If these pressures result in an expansion of supply, the brand fails.

The most obvious way to restrict this supply expansion is to use regulations to protect the property rights of those who own the brand. These regulations might be the same as those used to protect branded products in other sectors, with the crucial exception that the regulation must be strong enough to restrict additional production from within the group — an issue that is not faced by corporate brand owners. The ability to restrict production brings relief from the boom-bust price cycles associated with commodity markets.

The incentive structure for a farmer-owned brand differs from incentives in a commodity system. Farmer-owners value the brand name, and therefore want to maintain high quality standards throughout the group or association. Further, farmers in the group are rewarded for innovation in production and in marketing the branded product.



The Situation in the European Union

The problems associated with agricultural commodities are of great relevance in the European Union, because Europeans tend to live closer to farm areas and are therefore more concerned about rural vitality. European agriculture maintains a long tradition of regional production methods, and the most successful of these are liable to be copied. Agriculture in the E.U. is currently evolving from one based on price supports to one based on income support. This has put enormous cost pressure on farms, which, if left alone, would result in a rapid commoditization of many food products.

These circumstances have created interest in branding and several hundred new brands are introduced each year. The emphasis on selling the brand concept to consumers and policymakers is key to finding ways around E.U. price-fixing laws.Any positive impact on farm profitability is therefore viewed as a by-product of the more important goal of protecting the food supply. Nevertheless, the programs work and operate exactly as they might be expected to if they were set up to maximize farm profitability. Two of the more successful cases are "Brunello di Montalcino" and "Parma Ham."

Brunello di Montalcino

Montalcino is a small, saucer-shaped valley in Tuscany that is said to be an ideal location for growing Sangiovese grapes (called "Brunello" in Montalcino). Producers in this area have formed an association that owns the brand called "Brunello di Montalcino," and this association limits the quantity of grapes grown under this brand name.

Individual vineyards have their own labels, but most of the marketing and promotion of the Brunello di Montalcino brand is done by the producer-owned association. This makes economic sense, as some of the surviving vineyards harvest less than two acres. The association also suggests a minimum price for wine bearing the "Brunello di Montalcino" brand name. Individual vineyards

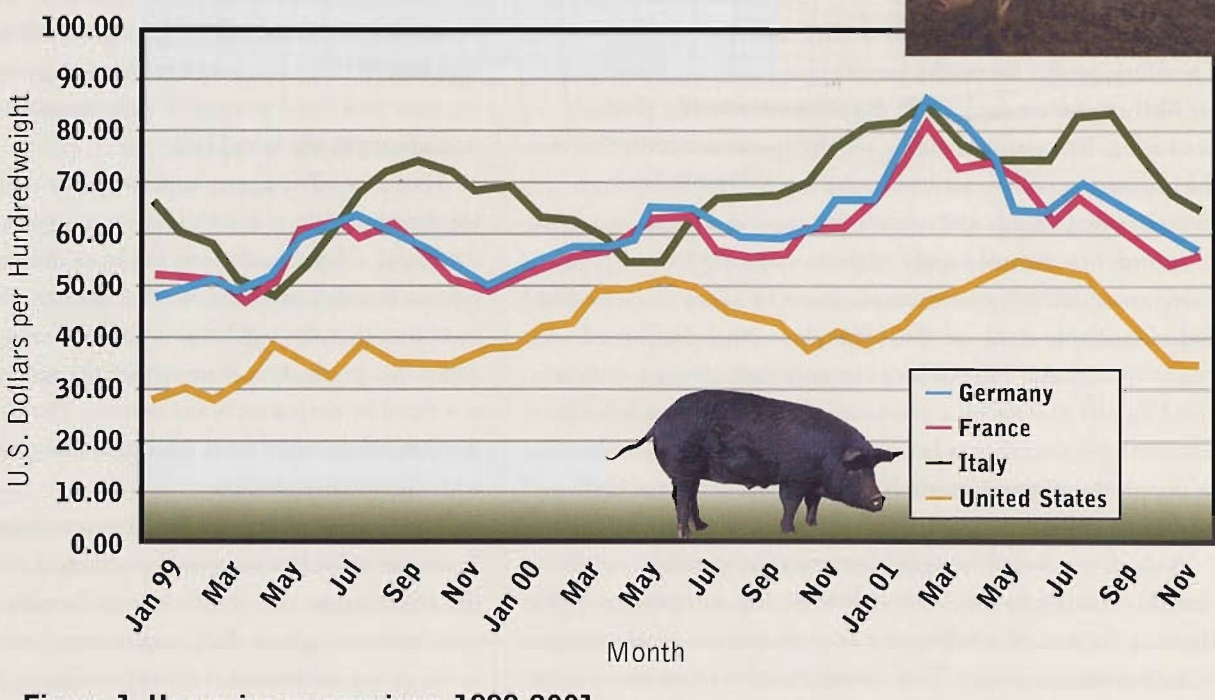


Figure 1. Hog price comparison, 1999-2001
(E.U. prices are deadweight basis; U.S. prices are national base for 51-52 percent lean barrows and gilts)

are free to charge more than this suggested minimum, and virtually all of them do.

The production area is set by the association and is rarely changed.

The association also limits the yield of grapes and the yield of grapes (to maximums of 3.2 tons per acre) and the yield of wine from the grapes. Production of "Brunello di Montalcino" is further restricted by other means, such as prohibiting irrigation. The strict rules underlying this brand are enforced using support from federal and state regulations. Attempts to use this name outside of the European Union would be opposed by the European Union in international regulatory groups such as the World Trade Association. Vineyards eligible to use the "Brunello di Montalcino" brand command enormous premiums, and land that is eligible for this brand sells at a sixfold premium over otherwise identical land in the same area

The wind blows into this region from nearby mountains and these climatic conditions are said to give hams a unique flavor.

Parma Ham: Producing Prosciutto

A second successful E.U. example is "Prosciutto di Parma" or "Parma Ham," a dry-cured ham produced in the Parma region of Italy. This brand is owned by a group of ham processors, rather than by hog farmers. Processors maintain control over production using a government regulation that specifies that all ham bearing this brand must be cured in a very small area just south of the city of Parma.

The argument used to justify this restriction is that the Parma region has produced dry-cured ham since at least the times of the Roman Empire, because its weather is ideally suited for that process. The wind blows into this region from nearby mountains and these climatic conditions are said to give hams a unique flavor. As a result processing facilities are required to have windows facing the mountains to allow this "special" air through the curing rooms.

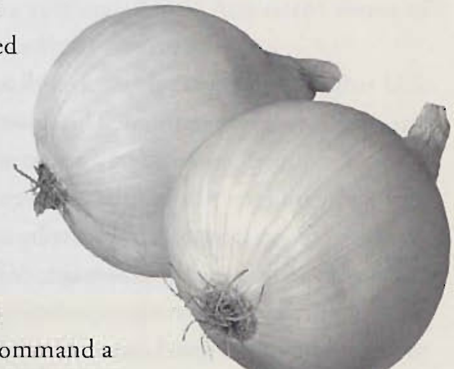
In addition to restrictions on curing, the "Prosciutto di Parma" must be produced using the from pigs raised in certain regions in the north of Italy. Only traditional Italian breeds such as the Italian Landrace or the Italian Large White are allowed.

This creates the possibility that some of the economic success of the program might be transferred to Italian hog producers. Figure 1 compares hog prices for several countries. Italian hog prices have averaged \$7.44 per hundred pounds higher than German hogs over the 1999 to 2001 period. In this case, there is no evidence that Italian hog producers can profit from the existence of the "Prosciutto di Parma" brand. This is true because there is no restriction on the number of hogs that are grown in Italy. However, the higher prices observed in Italian hog production have probably allowed the Italian hog industry to survive in the absence of trade protections from less expensive E.U. producers in the Netherlands, Ireland, and Denmark.

The "Brunello di Montalcino" and "Prosciutto di Parma" brands are only two of many such farmer brands that have succeeded in the European Union. Other successful farmer-owned brands include those found in cheese production such as Parmesan, lentil production in Castelluccio, Chianina ground beef, Champagne, and olive oil from several different "ideal" locations.

Vidalia: An Example of a Successful U.S. Farmer-Owned Brand

Farmer-owned brands are relatively rare in the United States. However, the Georgia Department of Agriculture has used a state regulation to brand Vidalia Onions. Vidalia onions are grown only by a group of authorized farmers in the region around Vidalia in southern Georgia. The producers use a registered trademark and a federal marketing order to restrict marketing and production of these unique sweet onions. A recent study by Clemens demonstrates that Vidalia onions command a significant premium over the same type of onions grown in other locations, and that their producers enjoy higher returns.



Can the Midwest Jump on the Bandwagon?

It seems highly unlikely that the Midwest will ever create and register "extra-virgin soybean oil" or "Iowa Grown Corn." But other products seem ideal for branding. For example, Japanese consumers have discovered that beef originating from packing plants located along Interstate 80 has a better flavor than other U.S. beef. This is probably true because mid-western beef is typically produced from calves that are grain fed for as long as six months. Beef from other U.S. regions comes from calves that have been fed grain for much shorter periods, and the meat is typically older and less tender than the mid-western product. As a result, Japanese consumers have now begun to request "I-80 Beef" — a brand that does not yet exist.

It should be possible for a group of cattle feeders to find a suitable location for the production of this type of beef and justify why beef from this location has special characteristics. A key element in the "I-80 Beef" brand would be for state and federal regulators to protect the brand from overproduction from within the group, as well as protecting it from outside competition. This latter feature has not been evident in the attempts seen with this type of product to date.

In the same way, in each county, producers could probably describe a unique way to make ice cream, cheese, sausage, or ham, or unique ways to feed and process pigs, cattle, chickens, or turkeys. These special products are more likely to succeed if there is a genuinely perceptible flavor difference, such as might exist with range-fed poultry. Other possible brands might be based on production practices that use science to improve flavor and tenderness.

Criteria for Successful Differentiation of an Agricultural Product

- Market channel must be able to transmit price signals from consumers to producers.
- Product must achieve a scale of production sufficiently large to justify the costs of creating and maintaining the differentiated image among consumers.
- Imitation of the product must be prevented.
- Method of supply control must not violate laws against price fixing.

Whatever the innovation, the cases we have studied in Europe may be harbingers of a new strategy, enabling American farmers to make the most of the unique characteristics of their products in the marketplace.

For More Information

Clemens, R. "Why Can't Vidalia Onions Be Grown in Iowa? Developing a Branded Agricultural Product." MATRIC Briefing Paper 02-MBP 3, Midwest Agribusiness Trade Research and Information Center, Iowa State University, September 2002. Available online at www.matric.iastate.edu.

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