



WHY PRODUCERS SHOULD AT LEAST BE THINKING ABOUT BECOMING A QUALIFIED SUPPLIER

by Danny Klinefelter

For the past twenty years we have heard that U.S. and Canadian agriculture are moving toward a bi-modal structure comprised of a relatively few large scale commercial producers and a large number of smaller, often part-time farms. In many ways I've always felt this was a gross oversimplification; but, there is a rapidly growing trend toward two types of producers in another context. I believe we are moving toward an industry structure made up of open market commodity producers and qualified suppliers for coordinated supply chains. Obviously the speed and extent of this transition will differ dramatically by commodity and by geographic region; but, the impact will be pervasive. Almost all broiler and seed production, and the majority of vegetable and pork production already reflect this model.

As with much of what I've written previously, I don't expect my opinion to be overly popular; but, I do think it's prudent for producers to consider. Like everyone else, I have heard the evils of captive supplies; but, in many respects it's a concept that makes sense. The last part of this article will address some of the reasons why it makes sense.

Why do I think producers should at least be evaluating their supply chain options and working to identify and develop relationships? Remember the old axiom "a day late and a dollar short"? At some point, becoming part of a coordinated system may not be an option and it could be too late for a producer to get into the most attractive relationships. Historically, the typical pattern has been for a processor or retailer to start with a large number of initial suppliers and then over time cull down to a much smaller number of the best performers. For example, fifteen years ago one major U.S. food processor was contracting with nearly 1000 growers. Today they have fewer than 100 producing more than the original group. The other 900 are either no longer producing the crop or are producing for someone else. What this indicates is that if a producer does decide to pursue the qualified supplier strategy, he needs to be committed to doing what will be required to remain in the top end of the group. Otherwise, he may make a substantial investment and still end up on the outside looking in. It also means that the qualified supplier strategy won't be the best choice for all producers, even some of those who have the opportunity to participate in what would initially appear to be very favorable relationships. In any case, it will be extremely important for producers to consider how to structure their business in order to manage the risk involved in these arrangements.

Producers will need to do their homework in order to make sure they are properly positioned if they ever do decide the qualified supplier route is the way to go. Most of the documentation and requirements aren't something that can be accomplished overnight. It's also important to recognize that the speed of the transition to coordinated supply chains and traceability will be heavily event driven, e.g., by value trait developments, disease outbreaks, bioterrorism, food safety issues, GMO contamination, etc.

The findings of Canada's Best Management Practices of Leading Farmers Project indicate that this trend isn't isolated to the U.S. The study found that 13 percent of Canadian farmers currently have some type of formal arrangement with a processor or retailer. However, 66 percent of the top 10 percent do.

The implications of a coordinated system becoming closed to all but selected qualified suppliers would be significant to independent producers in a number of ways. Not only would that particular output market be closed, but so could access to specific inputs and technology, e.g. genetics, services, designer chemicals matched to specific genetic attributes. Non-participants could also be cut off from access to specific information such as performance benchmarks and market signals versus what would likely be increased open market volatility as captive systems either dump surpluses or go into the market sporadically to cover shortages. One critical input market that will also be impacted both in terms of access and pricing is the capital market, i.e. if a producer doesn't have a locked in market or price, he may not be able to get funding or at least not at a competitive rate. This issue will likely be exacerbated by lender responses to increased risks, by favorable captive financing opportunities and by the introduction of new risk management tools such as group based self-insurance programs. The development of alternative forms of business relationship models such as rights of first refusal, geographic exclusivity and franchising arrangements would only serve to widen the gap.

There are several things producers and policymakers need to recognize that are driving this trend. First and foremost is that all farmers are not alike. They differ in terms of management ability, the ability to work with them, their willingness to change and adapt, their ability and willingness to document and verify what they are doing, and the quality of what they produce. Beyond these factors, there are several other major drivers that also need to be recognized. One is the ability of the processor or retailer to limit and mitigate the economic impacts of the legal liabilities and media driven public perceptions associated with issues such as food safety, bioterrorism, BSE, GMOs, environmental contaminants, etc. In some cases, it's not that a closed system is more efficient than an open market system; but, that the firm can't afford the risks associated with the contingent legal liability or the loss of public confidence that would occur if they weren't able to demonstrate the ability to isolate and contain the source/cause of problems as they arise.



FarmTech 2006

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The ongoing drive to reduce costs and drive out inefficiencies through such process improvement methods as lean manufacturing, 6 Sigma, TQM, balanced scorecarding or continuous improvement management systems are also behind many of the structural changes. Other factors include the need to reduce variability, increase predictability and shorten the response time to changes in conditions or markets. Quality assurance programs also demand more consistency and process compliance, including documentation and verification. Anyone who has been through a HACCP or ISO certification and subsequent compliance audit has a good feel for what's involved. The need for better supply alignment to improve timing in terms of when, where and how much, such as just in time inventory systems and optimal plant operating efficiency and capacity utilization are also driving the movement to more coordinated linkages. Protection of GMO patents is also a growing factor. The mapping of the human genome and the related developments that will occur in attribute specific pharmaceuticals and nutraceuticals will only accelerate the trend. Finally, developments in technology are going to continue to make traceability and anytime intervention both more feasible and economical. Remote sensing, embedded chips, GPS verification and tracking, containerization and bar coding are just a few of the more important current examples.

Change and the rate of change are both exciting and frightening; but, they are also sure to continue and accelerate. Remember, Darwin didn't actually say it was the survival of the fittest, what he said was that it's not the fastest, strongest or smartest who survives, it's those that are able to adapt to change.

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