

# BEYOND FRESH & DIRECT

BENEFITS • CRITERIA • CONNECTIONS • STANDARDS • VALUE ADDED

# VALUE ADDED

Should You Produce Your Own Specialty Food Products?

**SOME SPECIALTY FOOD MANUFACTURERS ARE, THEMSELVES, FARMERS WHO RAISE A RAW PRODUCT AND THEN “ADD VALUE” TO IT BY PROCESSING IT INTO A SPECIALTY FOOD PRODUCT. THESE ARE CALLED “VERTICALLY INTEGRATED” BUSINESSES BECAUSE THEY ENGAGE IN TWO OR MORE STAGES OF PRODUCTION THAT ARE COMMONLY PERFORMED BY SEPARATE COMPANIES.**

**FOR EXAMPLE, A DAIRY THAT MILKS ITS COWS AND SELLS ITS MILK IN BULK TO ANOTHER COMPANY IS NOT VERTICALLY INTEGRATED. A DAIRY THAT MILKS ITS COWS AND THEN PROCESSES THAT MILK INTO CHEESE IS VERTICALLY INTEGRATED.**

This fact sheet provides information for you to consider in assessing whether to add value to your farm products and, if this makes sense, tips on how to develop a successful vertically integrated business.

## REASONS TO CONSIDER VERTICAL INTEGRATION

Most farms produce ingredients and leave the value adding to others. This is a sensible decision because the other businesses are very good at these processing and marketing activities. But some farms determine that vertical integration (adding value) represents a smart move for their business. Three potential reasons are:

- 1. It makes the best use of your entire farm production.** Processing your lower quality ingredients into marketable products such as jams or pies may represent a reasonable option. Additionally, you can generate cash flow year-round for your farm even when you don't have any crops to sell.
- 2. It provides additional market opportunities.** Many consumers seek out processed products that they can directly purchase from farmers.



### 3. Processing may be something that you do well.

Some farmers discover that their skills in processing and marketing specialty foods provide new profit opportunities.

## HOW TO ANALYZE THIS DECISION

Because vertical integration means adding a very different business to your current operation, you should conduct the same level of analysis as if you were starting a new business — because you are. You should complete a feasibility study, and if it justifies moving forward, develop a comprehensive business plan for the expanded business. Being realistic is critical. Just because you can profitably grow and sell cabbage and carrots, does not mean you can profitably make and sell sauerkraut or kimchi.

Things to consider in your business plan include:

**Talent** Do you or someone on your team have the interest, skills and expertise to be a great specialty food manufacturer - say turning your cows' milk into gouda or corn into tortilla chips? And if you have the talent, do you have the time? If not, you will need to hire that expertise.

**Markets** Too many food entrepreneurs get excited about making a food product, but neglect to adequately assess if they will have a robust market for it. Just because you have markets for your cucumbers doesn't mean those same customers will want to buy your pickles— or buy them at the price you need to sell them at to be profitable. That's why a marketing plan needs to be included as part of your business plan.

**Equipment, Infrastructure & Financing** Processing your raw ingredients into a specialty food product almost always requires specialized equipment, as well as other start-up costs. Before you begin, determine what you need and how you will access the necessary financial capital.

**Regulations** While farming has its share of regulations, those associated with making and selling processed food products are extensive and seem to be constantly changing. If you are going to be making specialty food products, you, or someone on your team, will need to understand and be able to comply with a wider array of regulations.

## STEPS TO VERTICAL INTEGRATION

Vertically integrated businesses develop in all sorts of ways, but frequently they develop in stages, rather than all at once. Here are some potential paths:

**Testing the Market** Your farm grows or produces a product — e.g. vegetables, or milk, or fruit. If you want to explore creating a value added product, you can start out doing small test batches. You might do this yourself or work with a food business professional who can help develop a recipe and create the product. If you are satisfied with the results, scaling up may follow several paths.

**Using a Co-Packer** During or just after the testing phase, you could decide to work with another company, known as a co-packer, that can produce the specialty food for you. Your farm provides the recipe, specifications, label, and key ingredient, and the co-packer produces the product which you then sell. Some farms decide that using a co-packer is the best option for their business because they don't have to take on the added risk of acquiring additional equipment and skills.

- o For example, an orchard in Minnesota produced apples which they sold wholesale and at their farm stand. They often had seconds they couldn't sell, so they contracted with another business to turn those apples into cider. Eventually, they purchased their own apple press and built a commercial kitchen to make their own apple cider.
- o A number of years ago, an organic grain farm recognized the lack of flavorful, organic tortilla chips. After preparing a business plan, the farm family decided to expand their business to include making chips. They started by using co-packers, although it was a challenge to find one that could produce the product to their specifications. Eventually that co-packer was bought by a larger company, and they had to find another option. After more business planning, the family decided to build and operate their own plant in their hometown.

**Producing the product yourself** You might decide to go straight from testing a product to acquiring the equipment or renting a commercial kitchen to make the product yourself. This might be a good route if you have the skills and capacity, and the capital costs are limited. For instance, this might make sense for a small goat dairy that wants to start making cheese, or for a berry farm that wants to start making jams.

- o A Minnesota farmstead cheesemaker made her first batches of cheese in a university food lab. Since then, she has purchased the necessary equipment and began making cheese on her own farm.

Even if you start by using a co-packer, you may later decide to bring the production in-house. Moving to in-house production will always be a big change because it means adding a new business.

**Further Expansion** Farms that produce value-added products may reach a point where their own supply of ingredients isn't adequate to meet the demand. Sometimes these farms decide to expand by purchasing and then processing ingredients from other farms. This is generally done when the value-added, specialty food products are generating sufficient profits to drive this expansion. It allows the business to access larger markets.

- o An Oregon livestock producer was dissatisfied with the processing options available for his animals. He developed the expertise and made the investments needed to do all of the post-slaughter processing himself. He then expanded his business by processing animals purchased from a select group of farmers and selling the processed meats under his own label.



## MARKETING

Since specialty food products are already premium products, a key question is whether products from vertically integrated farms provide farmers with additional advantages in the marketplace. The answer is "sometimes." There are benefits from being your own ingredient supplier, and a growing number of buyers are looking for products with connections



to farms. If you have an excellent product and story, vertical integration could be a major selling point. The advantage often comes down to marketing. If you decide to create your own value added product using ingredients from your farm, here are some marketing tips:

**Build Demand with Stories** “Stories” about your farm help customers feel a strong connection with how their food is produced and the values that your product embodies. For many vertically integrated specialty food businesses, farm stories sell the product.

- o A specialty grain company includes the following description of its products on its website: “Our products are sown, grown, harvested, and sun cured with care and milled to order on our farm in the Methow Valley in northern Washington so you can enjoy the most delicious plow-to-package grain money can buy.”

**Special Events, Tours, and Tastings** You can use farm events, tours and in-store tastings to attract and retain customers. These experiences can generate revenue while also building customer connections and product loyalty.

- o A California farmstead cheese company shared this example: “We offer private tours and tastings which are very popular. Fees range from \$150 for up to six people for a weekday basic farm tour and tasting lasting 90 minutes to \$650 for up to ten people for a weekend deluxe farm tour and tasting lasting 2.5 hours.”

## KEY TAKEAWAYS

- o Become an expert on the entire supply chain. Vertical integration requires learning a whole new business – from knowing how to make the product (and having the equipment and staff to do so), to dealing with a completely different set of regulations, and to accessing a different set of markets. If you want to move forward, a feasibility study and business plan are essential.
- o Retain control. Being vertically integrated lets you control the process and your product from beginning to end. You can guarantee its quality and authenticity.
- o Use your entire crop. As a vertically integrated company, you may still sell some of your crop through “fresh and direct” outlets. But you can also process your excess, seconds, or by-products into specialty food products and generate year-round cash flow for your farm.

If you decide to vertically integrate and have the capacity to do so, new marketing opportunities can emerge for your business. Potentially, you can tap into new or underdeveloped markets and control more of the “seed to table” supply chain in your region. To avoid common pitfalls, be realistic, conduct a feasibility study, and develop a business plan that will address the availability of labor, skills and finances, as well as market opportunities.

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This fact sheet is part of a project exploring the opportunities and challenges small and medium-size farms encounter when they seek to enter the rapidly-growing specialty food marketplace as either ingredient suppliers or manufacturers themselves. The project included a survey of specialty food manufacturers in California, Minnesota, Oregon, Washington, and Wisconsin in 2015 and interviews with selected manufacturers and farmers who supply manufacturers in four broad food categories: dairy; grain, and baked goods; processed meats; and processed fruit, vegetables, nuts and herbs.

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