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

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Introduction

La Montanita 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 La Montanita for their time and contributions to this case.

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La Montanita

Size

The Co-op currently stocks and sells over 1,100 products purchased from nearly 700 local growers and producers, at a value of more than \$2.7 million annually. In 2008, sales through the distribution center (CDC) were \$2.2 million, 70% of which was sold to La Montanita stores.

Type

La Montanita is a retail store Co-op with 4 locations in New Mexico. The CDC is a retail-driven food hub considered an additional store operating under the Co-op umbrella organization. The Co-op retail stores buy directly from farmers, from the CDC, and from traditional distributors.

Time in Business

La Montanita was founded in 1976. In 2006, the Coop invested \$150,000 in a renovating a warehouse and leasing trucks to assist regional growers with distribution and wholesale market coordination; CDC began operations in 2007.

Scope of Offerings and Food System Partnerships

The CDC provides 3,000 square feet of refrigerated storage, 1,000 square feet of frozen storage, and 6,000 square feet of dry storage. The CDC sells mostly to La Montanita retail stores, but also sells to other specialty retailers and restaurants. They sell less perishable produce, dairy products, bakery products, processed food, meat, pet food and non-food items.

The Story

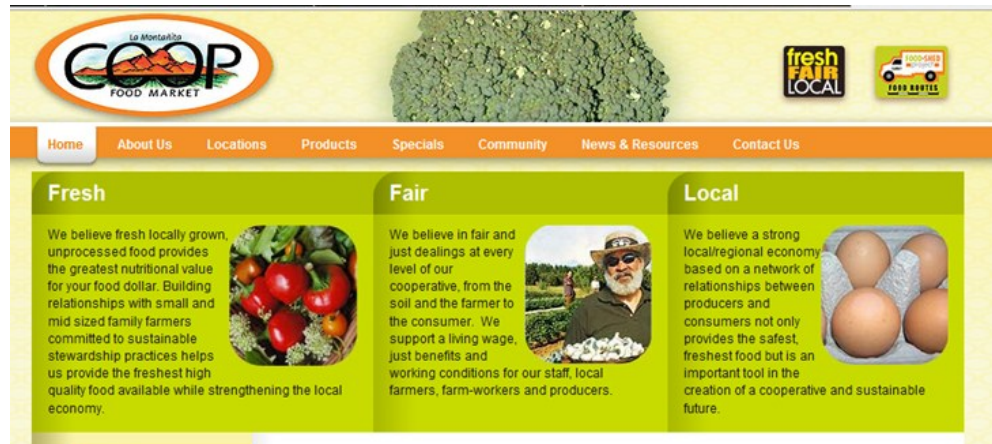
La Montanita Co-op is a community-owned, consumer cooperative with four locations in New Mexico. It has been in business for over 35 years and was one of the first retail stores to offer local farmers a place to sell their produce outside of farmers markets. All stores offer fresh organic produce, bulk foods, local organic beef, lamb and other meats and cheeses, fair trade products and a wide variety of natural and organic groceries, freshly prepared deli foods, natural body care, vitamins and supplements.

The distribution arm of the Co-op, CDC, began in 2007 as a means to extend the reach and market access

of the enterprise, since those elements are La Montanita's core mission to the producers and the community. This has created wholesale markets, provides product pick-up and distribution points throughout the region, and supplies delivery service and refrigerated storage for local farmers and producers. With a line of products that includes over 1100 products from nearly 700 local producers, and sales of locally sourced foods equal to 20% of total purchases, the Co-op is a leader in the local foods movement of the region. Given the geographic range of the Co-op members, this organization may be considered more regional than local in scope.

Mission Statement

La Montanita's mission is to provide to our member/owners, at the lowest price possible, exemplary customer service, environmentally sound products, and the highest quality natural and organic food. We are committed to ethical business practices, participatory management, and cooperative principles. Our intention is to provide to the entire community, through practice and education, a working model for a healthy, sustainable future.



Size, reach and customer

Products going to the distribution center are either picked up at the farm using one of the two refrigerated trucks, or they are dropped off at the distribution center by the farmer. Once they reach the CDC they are then distributed to La Montanita retail stores, specialty retailers and restaurants with the CDC trucks. Products are sourced from farms within 300 miles of Albuquerque, including Southern Colorado, and then distributed across New Mexico. The definition of local is based on the physical characteristics of the region and on the San Juan Mountains water shed and the Rio Grande. Most of the farming in the region is based on river basins, so the CDC looked at traditional agriculture in the region and defined local for their organization accordingly. In short, a sourcing area of ten miles from farm to plate is not realistic in a high desert climate.

Value proposition

La Montanita Co-op is a community owned natural foods market and distribution center. The Co-op services any customer and the focus of their business is to facilitate distribution and access to market for local producers. They provide many services beyond buying and reselling including: carrying invoices centrally for producers who deliver to facilitate direct contact with the buyer, renting space for members' usage, buying raw products in bulk on behalf of members to assist value added food producers in keeping input prices

low, and assisting in product development and marketing. The organization is part of a buyer centric supply chain. All stakeholders are seen as equal with a deliberate effort to maintain equal access and power among buyers and sellers.

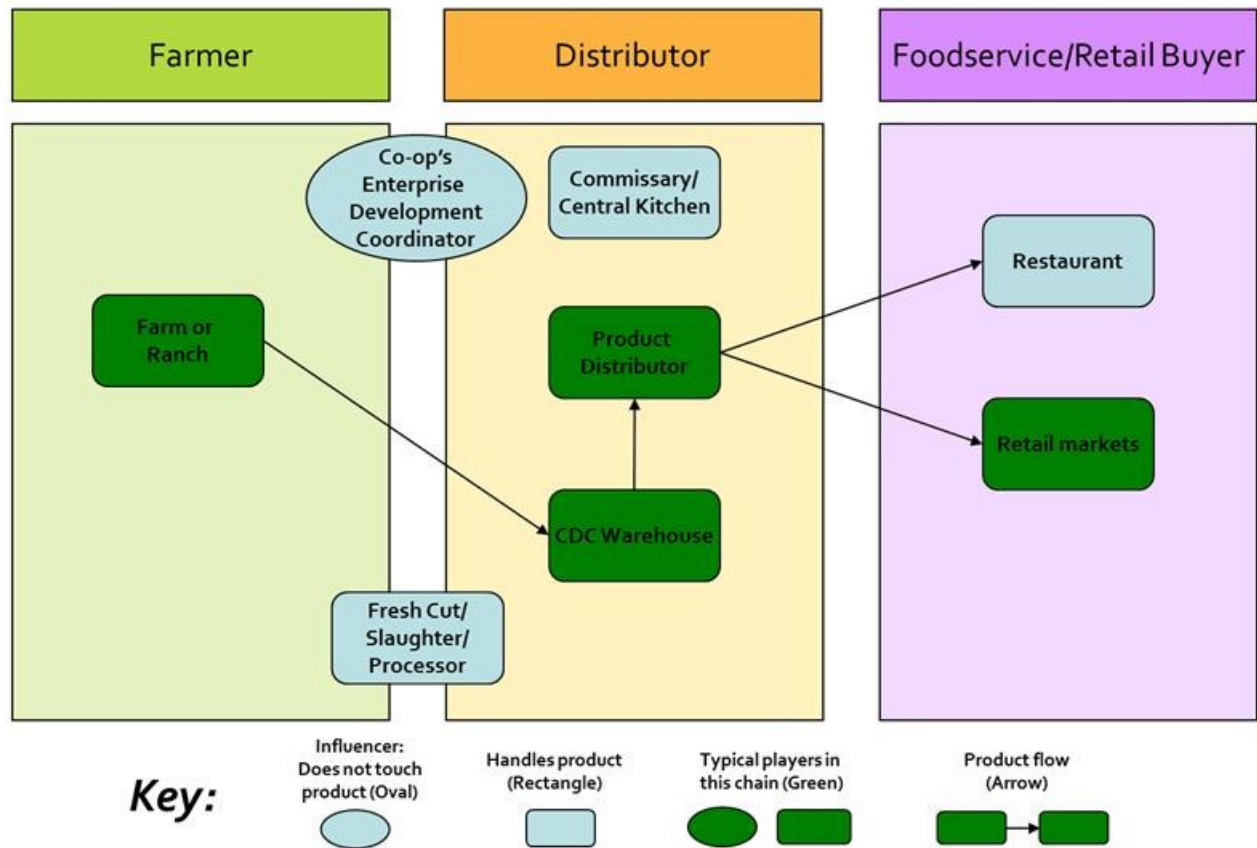
Competitive advantage

La Montanita has been in business for over 35 years and has developed strong relationships with farmers and with the community. The Co-op has created a place where community members can buy local goods year round and farmers can be paid a "fair price" for what they have produced. Establishing a "fair price" is not straightforward, but it is the feeling of the Coop that, with input from producer members, they are able to establish a price that gives producers a reasonable profit margin and allows them to produce in a way consistent with the values of their members.

The Co-op is very committed to helping farmers grow their business and support them in any way possible. The CDC has collaborated with a number of different farmers to help them to create and market new products. These unique products are then sold at the Co-op, so both "incubator" support and market access are provided during the early stages of grassroots food product creation. Some examples of such projects are described below.

La Montanita Food Supply Chain

La Montanita: Entities Involved in Supply Chain Decision-making



Findings from different perspectives

Distributor

Basic Supply Chain Network Characteristics

The CDC is different from normal supply chains for three main reasons: it works with small producers that are unable to sell through traditional distributors, enabling producers access to new markets and buyers access to new products; it is a business partner for the small farms it works with and actively participates in helping farmers grow their business; and lastly, all members of the supply chain are seen as equal.

The following are a few examples of projects the CDC has engaged in as part of a values based supply chain:

One of their producers had pomegranates that could not be sold as fresh produce due to damage. The CDC worked with the pomegranate grower as well as a local apple juice manufacturer to create a new product, pom-apple juice. A logo and label was designed and



this product is now sold at the La Montanita Co-op stores. The CDC was able to help create a new income stream for these farmers in addition to carrying a special and unique product to sell to their customers at the co-op.

The CDC bought 200,000 lbs of winter wheat from local farmers that they store and grind at a family mill.

The wheat is trucked from northern New Mexico to grind and distribute as flour. The CDC is working with a local bakery to use the flour and has created a label for the bakery to use on the New Mexico wheat products.

There was a small family dairy farm that needed some help selling their milk. The farmer bottles the milk and

then they sell to it to the CDC. The milk is picked up 3 times a week by the CDC and delivered all around the state. The CDC allowed this small farm to expand production dramatically with this new distribution channel.

There is a significant fresh goat cheese glut in the market once a year. The CDC is working with a local restaurant chain to feature this goat cheese at that time. In addition, the CDC lent one dairy a cheese aging cage so they could take some of the milk during the glut season and make aged goat cheese to be sold at a later date. The dairy now has a new income stream because they can store and sell at higher prices after the glut has dissipated.

These projects take a significant investment of time and resources from the Coop.

- The CDC invests the business acumen and time of paid staff in projects meant to benefit them, but also their producer-suppliers who will have a better developed business products.
- For example, the marketing department uses their design and marketing knowledge to create a professional package and label
- Moreover, the CDC bears the risk inherent in launching a new product by using their promotional resources to increase customer familiarity.
- Good marketing is the key to a successful project in its initial phases, and it is clear that many new product offerings were more often successful because the food businesses have CDC as a partner.
- In summary, allow CDC may directly benefit from its role in product development, the investment it makes is also justified in their broader mission of bringing more regional foods, with qualities demanded by their buyers, into the marketplace

Another aspect that sets the CDC apart from a traditional supply chain is how products travel from the farm to their destination. Sometimes farmers aggregate where there is a cooled storage location and the food is picked up by the CDC, sometimes the food is picked up at an individual farm, and sometimes the farmer drops it off at the warehouse. It all depends on the agreement that was made with the farmer and the CDC at the time of purchase. Margins vary from product to product. With produce, a 15% mark-up (defined as the difference between the price paid to growers and the

price paid by the food buyer) is sufficient, but if it is a high volume, high dollar item the margin can be as low as 10%. Generally speaking, the co-op determines what the retail price would be and works backwards from there in determining price points with its producer members.

If the food is picked up from the producer (rather than brought to a central location), the product is put on a truck and loaded into the warehouse. At this point, the CDC takes title to the product and it is no longer owned by the farmer. Once the food is at the warehouse, it travels in refrigerated trucks to its final destination. When they run their trucks to farms, the distributor attempts to plan supply drop offs to the farmer while picking up food, due to the concerns about added miles and energy within the distribution process.

Occasionally the CDC is simply transporting goods for a producer; the product never enters the warehouse. In this case, the CDC does not take title to the product, and acts simply as a transport partner. Orders are called in and delivered on regular routes. The CDC has a price list that is emailed out every week to their customers. The CDC cannot handle all of the products that are sold at the co-op, so the co-op still has a thriving “back door” for farmers. In short, the more tender and perishable products, such as salad greens, are sold directly to the back door of each store by the individual farmer and do not go through the CDC.

Financial

In 2008, CDC sales were \$2.2 million, 70% of which was eventually sold through La Montanita stores. All products sold through the CDC are a part of their value-added line. This line has both local and non-local products, all of which have added features that go beyond the standard expectations of that product. A few examples are organic, humane certified, small scale, and free range. These products include meat, dairy, produce, processed foods, pet food, and non-food items.

The CDC is very committed to paying farmers a price that covers their cost of production. This is a tricky balance between fair returns to producers, retaining enough margins to keep CDC financially viable, and assessing what consumers are willing to pay. In general, the prices for local products are higher than their non-local counterparts. The Co-op works hard to educate their customers on the real cost of food and all the

related costs but these higher prices have presented a marketing challenge given current economic conditions; in short, they struggle to determine what the market will bear. At the time this case was developed (Summer 2010), the CDC was not yet able to financially support itself. As mentioned earlier, the fees charged to producer-members to support the CDC vary by product, and are kept low as part of the broader organization's mission to give fair returns to producers and fair prices to consumer-members.

The Co-op invests about \$150,000 per year to subsidize CDC operations, and it was inferred that it was worth that much to La Montanita to have more regional products available. Although the CDC has been unable to cover all its costs, the perception is that increased revenue at the Co-op stores from the CDC's efforts (and products it could not otherwise offer) have not been quantified and could offset at least a part of this economic loss. In the long run, CDC will need to be financially self-sufficient to remain operating, even though it indirectly benefits the stores' regional product availability. This issue does raise an interesting point related to Values-based Supply Chains: what stages of aggregation, distribution and consumer marketing are not able to compete with more conventional enterprises? In the geographically disperse areas, such as the Intermountain Southwest, the answer appears to be distribution.

The CDC was originally funded by a couple of small grants: \$20,000 from the NM Department of Agriculture for the first year, and small grants each subsequent year for specific projects. With the exception of these small grants, all money to run the CDC is provided by the Co-op using retained earnings: but no debt has been acquired. At their current size, the CDC cannot achieve the economies of scale necessary to turn a profit so sales growth has been identified as an imperative goal going forward. Two aspects were identified as ways to increase the amount of products sold through the CDC: infrastructure (discussed here) and coordination (discussed in the section on entrepreneurship). One primary need, identified by the leadership, was for refrigerated depots in rural communities throughout the region, serving as a location for farmers to aggregate their goods. In addition, a variety of infrastructure projects that will help growers to extend their seasons, such as value-added processing, post-harvest technology methods (such as cold storage or controlled atmosphere to delay perishable products from decay-

ing) and hoopouses, would benefit producers and increase product sales for CDC. However, CDC will struggle to fund such projects given its own financial constraints.

Governance and Organizational Policies

La Montanita's Board follows the Carver Policy Governance model (available on their Website). The model emphasizes the board's role in clearly stating what the organization is to accomplish (Ends Policies) while avoiding unacceptable actions (Executive Limitations Policies). Through policies, the Board clearly delineates its responsibilities, communicates what the Board expects of the organization and delegates formation of policies on operational issues to the General Manager. The Board maintains oversight on broader organizational mission and strategic decisions, while giving autonomy to the General Manager to complete all functions delegated to that level. For compensation, Board members receive an 18% discount, but no cash allowance in exchange for monthly meetings and some committee work.

The General Manager demonstrates accountability to the Board by producing regular reports explaining how he/she is complying with Board policies. Some examples of policies meant to provide oversight (without interference) include: clearly delineated schedule of reports on specific operational elements of the business (financials, customer value, staff treatment), financial constraints (approval for purchases over \$25,000, ratios that must be maintained) and maintenance of core organizational values (no discrimination, abiding by cooperative principles).

Part of La Montanita's commitment to its Value-Based supply chain is based on their commitment to the Cooperative Principles including: Voluntary and open membership; Democratic member control; Member economic participation; Autonomy and independence; Education, training, and information; Cooperation among cooperatives; and, Concern for the community. But, in their own organization, they developed a set of "Ends" policies that refine and add on to some of those cooperative principles.

Ends

A cooperative community based in the shared benefits of healthy food, sound environmental practices and a strengthened local economy with results that justify the resources used.

The Sub Ends are:

1. COMMUNITY
 - a. A community based on trust, comfort and personal relationships.
 - b. A vital gathering place.
 - c. People have healthier options
2. ECONOMY
 - a. A direct linkage between the Co-op's positive financial health and the members' well being.
 - b. Local producers and manufacturers benefit
3. EDUCATION
 - a. A community informed of:
 - i. The cooperative model
 - ii. La Montanita's values
 - iii. Broad producer/consumer impacts on local and global Health.
4. AGRICULTURE
 - a. Farmland conservation is supported.

These ends appear to impact the conduct and performance of La Montanita, evidenced by both priorities revealed through their operational model and interviews conducted with both producer and consumer members. The cooperative principles, commitment to providing value to buyers and providing market access to local producers. Their designation in recent USDA Know your Farmer, Know your Food promotions as a urban regional food hub suggests they are innovators in the regional food hub movement, and acting as a community connector in the Southwest region.

Regulatory Compliance

The Co-op abides by all food safety regulations and has a full time staff member in charge of this area of the business. Legally, the Co-op manages any remaining liability and risk through a very large liability insurance policy that also covers farmers who sell through the CDC. Unlike many traditional distributors, the Co-op does not require each farmer to carry their own liability insurance, so the Co-op covers the risk. Because these insurance policies are often cost prohibitive for small farmers, the CDC's policy allows many farmers to manage at least one wholesale account through shared liability.

The largest challenge for small producers when it comes to regulations is in the area of food safety. Reg-

ulations are inherently created for larger operations, and more safety precautions become necessary as the operations increase in size and in distribution area (i.e., abiding by different state public health codes when crossing state lines, the need for USDA inspected meats rather than products processed in state-inspected facilities). Complying with more regulations is typically very costly (in money and the time needed to assure compliance), and for small producers they can be cost prohibitive. New regulation is always an area of concern for the CDC as it is often the smaller producers that they count on to supply their food that could be affected. The CDC sees a big problem if policy makers do not protect small farmers from meeting and paying the same fees as the mega producers, so the current Food Safety legislation working through Congress (Summer 2010) is being closely tracked by this organization.

Entrepreneurial

La Montanita is a very successful and professionally run organization as demonstrated by the success of the business over the last 35 years. The Co-op has turned a profit almost every year since they have opened their doors, and they have earned this profit while providing fair wages for their employees, fair prices to their producers and with a commitment to give back to the communities where they operate. As a signal of their commitment to grow the local food system, La Montanita uses its profits to support local food producers and facilitate market access. They finance the CDC and provide it the financial capital to operate (since 2007). The Co-op's board of directors governs through a process called Policy Governance. The model emphasizes the board's role in clearly stating what the organization is to accomplish while avoiding unacceptable actions (taken from the co-op's website).

The management team has been working with values based marketing channels for the past 25-30 years. Most of the team has been in the food industry for 25-30 years, and most have worked in organic and local food systems even longer. The general manager of the Co-op ran large warehouses for many years before coming to La Montanita and has been very crucial in helping the CDC to run more efficiently. Team members have been professionals in food and/or farming industries for decades and bring many different skills to the table.

In terms of coordination, if the farmers from a region could come together and plan jointly, they could better meet the needs of their customers (for example, past coordination solved issues with an oversupply of all tomatoes but too little cilantro). More coordination among small farmers would allow them to expand offerings and conduct production planning that would stagger when products ripen, so as to not glut the market.

One of CDC's organizational principals is 'concern for the community.' This principal is why the CDC began and this principle governs much of how it is run. La Montanita hopes that the CDC can cover its costs through its economic activity, but that is not the primary mission of the firm. The point is rooted in the Co-op's commitment to the community. The co-op employs an Enterprise Development Manager, whose job it is to help local food businesses become more successful. This manager helps farmers and other food businesses determine how to help their business whether it be to direct them to sell at a farmers market or through the CDC. He does what is best for the food business; he does not simply try to get more producers to sell through the CDC. The Co-op is investing in the broader needs of the food community and believes that in the process they will develop a value for co-op members. They are a successful business that has been around for many years, thus affording them the luxury to make decisions that could have an indirect benefit to co-op members. They are not forced to always make decisions that have a direct, tangible benefit or immediate cash flows.

Alliances with other businesses and organizations have been important to the success of the CDC. Farm to Table has helped with staffing and research, the New Mexico Department of Agriculture has supported the project through grants, and the Coop shares meeting and consulting time with Santa Fe Alliance (a restaurant focus group). In addition, they work with farms, farms education services, the Southwest Marketing Network, the Good Food Network, and the Rio Grande Ag Co-op on various projects that benefit their members and communities. These alliances have helped the Co-op guide and channel their resources to their best use.

The CDC has faced some challenges along the way. At the beginning, the main challenge was simply how to do their operations effectively and efficiently. They

had experience in running grocery stores, but they had never run a distribution center. First they needed to find a warehouse they could afford, learn the key business strategies of the warehouse business, find farmers with like-minded values, and develop truck routes. The new General Manager of the Co-op had spent much of his career in distribution and his knowledge was invaluable. The CDC has now passed the start-up phase and they are into the growth phase of their business. They have some good systems in place and now know what products should be sold through the CDC and what products are too perishable for the CDC to handle given its facilities and equipment.

The warehouse business is complex and La Montanita's leadership still thinks they have a lot to learn in order to expand and financially sustain the project. They need to determine strategies that will make the CDC self-sufficient. It is a non-profit part of the business, so they would like it to cover expenses but they don't need to make money. Still, they are fully committed to making the CDC work, even though it loses money each year.

Farmer

Basic Supply Chain Network Characteristics

Luz Hernandez of Gardner's Farm sells about 60% of her product through the CDC. She is able to grow crops year round and sells to the CDC during the winter months, from about October through June. During the rest of the year she directly sells her products at her local farmer's market and she also operates a CSA. Luz has worked with La Montanita since around 2006 and they have helped her build her business tremendously, so that they are now the only distributor she works with. They have given her an outlet to sell her products during the months when the direct selling opportunities (and cash flow) are otherwise sparse.

Customer (Restaurant and Grocery Store)

Basic Supply Chain Network Characteristics (Restaurant)

The restaurant featured in this case is located in Santa Fe, NM and local food is a large focus of their business and its mission. They opened their doors in 2009 and have been working with La Montanita's CDC since that time. They work with a number of different purveyors but the CDC is the only one that provides solely local products. The business is very ingredient focused; the restaurant will buy from 10 different distributors to get what it needs. At the end of the day, it's

about quality and taste, not price. Much of the time this means local food and the CDC has allowed them to get more food from local producers than they would otherwise have access to. The restaurant is thrilled to be working with the CDC. They provide a great and unique service and product line for restaurants, allowing them to procure quality, local ingredients all while supporting local producers.

Financial (Restaurant)

The restaurant buys, on average, about \$1,000-\$1,500 through the co-op each week. Prices are never negotiated with the co-op. The restaurant knows the CDC is struggling financially and they want to do their part to support the distribution business. But on the same token, they do not have the ability to negotiate with their larger distributors either; being such a small customer, they have very little leeway for negotiation. Although most prices are the same or higher than conventional channels, they are able to purchase really good deals through the CDC occasionally; for example, both sugar and milk (two staples) are cheaper from the CDC than they are through Shamrock.

Comparing prices from the CDC with traditional distributors was difficult because the same product is not always available or the type of product cannot be readily compared. The restaurant enjoys purchasing from the CDC and has not found price to be a limiting factor.

Policy (Restaurant)

The restaurant did not know if the CDC has different terms than the other distributors, they pay everyone when the invoice comes in, so payment terms are not important to this buyer. The restaurant enjoys the personal relationship they have with the CDC. If they need something or have a question, they know exactly who to call and their problems will be dealt with immediately. With the bigger purveyors, a small restaurant's business isn't very important and it is very difficult to get any sort of direct response to a problem.

Basic Supply Chain Network Characteristics (Retail Grocer)

The grocery store interviewed is a small independent grocery store located in Taos, New Mexico that has been in the business of selling natural foods for 24 years. The store has always tried to buy and sell locally, when possible, but there were barriers to securing local foods in the past. The problem they have always

faced is distribution. Small growers have a hard time meeting the needs of the store when they operated independently; especially regarding timing and consistency. Throughout the years there have been several co-ops and other stores that have tried to do distribution. According to the store's management, the CDC has been most successful so far.

Right now, the CDC is the store's only local distributor that has any significant quantity. They do receive a lot of local produce from growers that deliver to the store directly. The only exception is with Colorado peaches. Every year they try to find a good distributor, but noted many struggles in that product category.

This store has been working with the CDC since it began in 2007. This relationship has made connections between a few new grocers and smaller producers possible. One product that was mentioned is organic local milk. The grocery store is able to purchase this milk through the CDC at a price lower than they were able to buy through Shamrock, with the added bonus that there is more transparency about where and by whom the milk is produced.

Financial (Retail Grocer)

Sometimes purchasing through the CDC is more expensive than through other avenues, but sometimes it is not. It is completely product dependent. For local vendors, those 30 miles to the south of the store, it is almost always more expensive to go through the CDC. Still, local food purchases by this store are consistently increasing. As more product becomes available, the grocery store purchases more items through the CDC as well as from other sources. Although the store purchases a significant amount from the CDC, they get at least as much, or more, local products independently.

But in general, working with the CDC has not raised the store's prices on items they do purchase. The fresh produce department is the one store category that noted CDC's prices are too high. If the store purchased these items through the CDC, they believe that the price of the produce will be too high for their customers, so the grocery store currently purchases these products through other avenues. One potential market barrier in this case is the strength of direct markets: when seasonal markets are so strong, it may make it difficult to find sufficient quantities at wholesale price points to meet the needs of grocers.

Prices are negotiated with the CDC. The non-local items the CDC carries represent good prices and values at times, and deals are negotiated on a case by case basis. The grocery store does not negotiate prices with their larger, more traditional distributors. As a small store, they have very little power to negotiate with such a large company. But when working with the CDC, a much smaller business, the grocery store is able to negotiate prices so that both parties can mutually benefit.

Policy (Retail Grocer)

The grocery store enjoys working with the CDC because of its personal relationship. The manager knows they can call the CDC with any questions and they will have an immediate response and help from the staff at the CDC. In the context of other purveyors, they are a relatively small store of little economic importance, so their business and satisfaction warrants

less attention. In short, customer service from CDC is worth the occasional higher price points.

Regulation poses challenges for the local producers that the grocery store would like to purchase from. They have heard local meat and dairy producers face significant challenges, but are bound to source meats from USDA inspected plants. There is interest in a broader array of local foods, but some local food enterprises may be constrained by lack of access to approved processing kitchens (which the retail store must require per public health codes). In short, some businesses are small and regulatory compliance is challenging, but the stores can do little to help mitigate regulatory requirements required by federal, state and local government agencies. However, the grocery store does not require that their local producers carry a liability insurance policy.