

## A New Brand of Agriculture? Farmer-Owned Brands Reward Innovation

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Commodity agriculture as currently practiced in the U.S. Midwest is an extremely efficient way of organizing production and distribution. It allows for inexpensive production and bulk transfer of huge quantities of meat and grain and has resulted in enormous cost savings to U.S. and international consumers. This system has evolved in accordance with market forces, and we expect that these same forces will allow the current system to survive for decades.

There are aspects of the system, however, that are not desirable. For example, the commingling that occurs to take advantage of bulk handling means that signals cannot be sent from consumers 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 farmer does not get this signal.

In addition, competitive pressures mean farm operations must grow larger to reduce costs. As farms have grown larger, governments throughout the world have attempted to slow the process 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 can lead to international tensions, as each country defends its own interventions.

Farm groups have attempted to address these issues by working together to build value-added processing facilities such as ethanol plants and to create niche products to satisfy the desire of some con-

sumers for variety. However, whenever these efforts are successful, they are quickly imitated, and profit margins get smaller and smaller.

A third possible solution has recently begun to emerge that meets consumers’ desire for variety and quality and allows farmers to retain profit margins for long periods. This solution would allow some smaller operations to remain in business. The solution does require cooperation between producers and government, but it also relies upon market forces. In essence, the solution is to allow farmers to own their own brands and to control production of branded quantities, much as already occurs in other sectors of the economy. The phrase used in the European Union to describe this concept usually refers to either a “guarantee of origin” or a “guarantee of production process.” (In the United States, the description will include a reference to a federal marketing order.) Neither of these phrases really captures the essence of the concept. Instead, we refer to this solution as a “farmer-owned brand.”

### THE ECONOMICS OF FARMER-OWNED BRANDS

Some consumers are willing to pay premium prices for differentiated products, and these premiums can occasionally result in niche markets such as those that exist for organic products and local farmers markets. These consumers are essential for a successful farmer-owned brand. But producers in traditional niche markets do not attempt to control supply (that is, prevent imitation); therefore, profits for producers of organic and local products will follow the pattern described for commodity products. To be successful, branding also 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 assert supply control without violating price-fixing rules, farmer-owned brands must be based on some fixed attribute. For example, a particular brand might specify that the product can only come from a select area and justify this restriction based on the specific attributes of the region. Another legal way to control supply would be to limit membership in the producer group to a relatively small number of high-quality producers (or to severely restrict admission into the group). 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. A fourth way is to require the farmer-owned product to use some ingredient or process for which the producer group can control access, either through intellectual property rights or through trade secrets.

In all cases, a successful product will become a temptation for imitators from outside the original

group and will generate attempts by members of the group to expand their individual output. If these pressures result in an expansion of supply, the brand will fail. The most obvious way to restrict this type of 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 they must also have the power to restrict additional production from within the group—an issue that is not faced by corporate brand owners. With this ability to restrict production comes freedom from the boom-bust price cycles associated with commodity markets.

Farmer owners will capture the benefit associated with product improvements; consequently, they can be expected to pay close attention to quality. Notice how the incentive structure for a farmer-owned brand would differ from that in a commodity system. Farmer owners would value the brand name and would therefore want to maintain high quality standards throughout the association. Further, farmers would be rewarded for innovation both in production and in marketing.

### THE SITUATION IN EUROPE

The problems associated with agricultural commodities described earlier are in many ways of greater relevance in the European Union. Europeans tend to live closer to farm areas and they are therefore more concerned about rural vitality. Also, there is a long tradition of regional production methods, and the most successful of these are liable to be copied. Finally, E.U. agriculture 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 commodification of many food products.

All of the above has created a great amount of interest in the process of branding in the European

Union. Dozens of individual centers are currently working on the issue, 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 European price-fixing laws, and any positive impact on farm profitability is therefore viewed as a by-product of the more important goal of protecting the food

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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 that we encountered on a recent study tour in Europe 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 brand is done by the producer-owned association (about 60 percent of the association’s budget is spent on promotion). This makes a lot of 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 are free to charge more than this suggested minimum, and virtually all of them do.

Importantly, the production area is set by the association and is rarely changed. The association also limits the yield of grapes and the yield of wine from grapes (to maximums of 3.2 tons per acre and 68 percent, respectively). 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 authorities. 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 Organization. Vineyards that are eligible to use the Brunello di Montalcino brand command large premiums.

### PARMA HAM

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. They maintain control over production using a regulation that specifies that all ham bearing this brand be cured in a very small area just south of the city of Parma. The argument used to justify this restriction is that this region has been used to dry-cure 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. This is the rationale for requiring that processing facilities have windows facing the mountains to allow this “special” air through the units. Interestingly, however, with modern climate control these windows are seldom (if ever) used.

Another requirement of the “Prosciutto di Parma” brand is that the ham be produced from a pig raised in certain regions in the north of Italy. Further, only traditional Italian breeds such as Italian

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Landrace or Italian Large White are allowed. This creates the possibility that some of the 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 this period. In this case, there is no evidence that Italian hog producers can profit from the existence of the "Prosciutto di Parma" brand 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 a tiny fraction of those that have succeeded in the European Union.

#### AN EXAMPLE OF A SUCCESSFUL U.S. FARMER-OWNED BRAND

Farmer-owned brands are relatively rare in the United States. One successful brand involves Vidalia onions, a registered trademark of the Georgia Department of Agriculture. Vidalia onions are grown only by a group of authorized farmers in the region around Vidalia in the South of Georgia (see "Why Can't Vidalia Onions Be Grown in Iowa? Developing A Branded Agricultural Product" by Roxanne Clemens, MATRIC Briefing Paper 02-MBP 3, available at [www.matric.iastate.edu](http://www.matric.iastate.edu)). The farmers use a trademark and a federal marketing order to restrict marketing and production of these particular sweet onions.

#### CAN THE MIDWEST JUMP ON THE BANDWAGON?

It seems highly unlikely that the Midwest will ever create a brand of extra virgin soybean oil given current consumer preferences and produc-

tion practices. But other products seem ideal for branding. For example, the Japanese beef consumer has 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 midwestern beef is typically produced from calves that are grain fed for as long as six months. Beef from other U.S. regions is typically older and less tender than the midwestern product and comes from calves fed for much shorter periods. 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 some special characteristics. A key element in this brand would be that state and federal regulators would agree to step in to protect this brand from overproduction from within the group and 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 products are more likely to succeed if there is a genuine 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.

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

#### Criteria for Successful Differentiation of an Agricultural Product

- Product must 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.

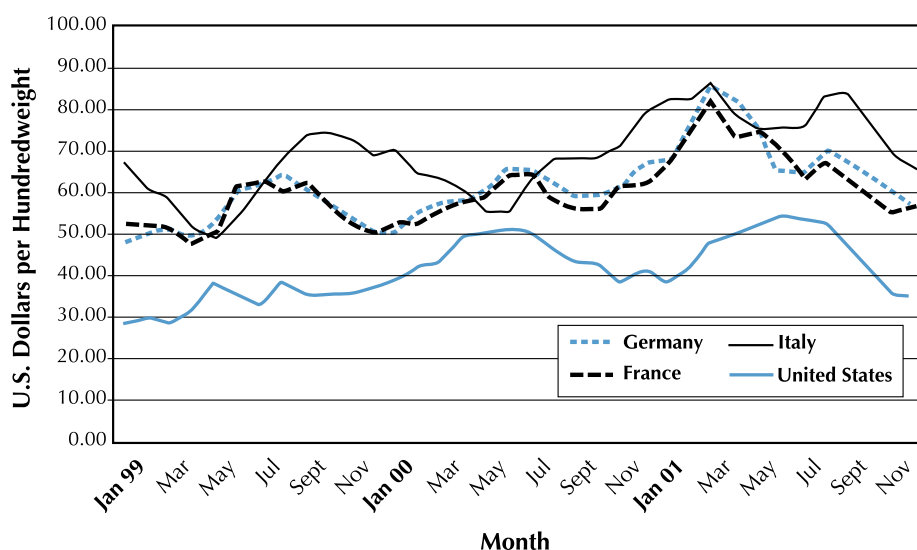


FIGURE 1. HOG PRICE COMPARISON, 1999-2001 (E.U. PRICES ARE DEADWEIGHT BASIS; U.S. PRICES ARE NATIONAL BASE FOR 51-52 PERCENT LEAN BARROWS AND GILTS)