Strategic Positioning Under Agricultural Structural Change: A Critique of Long Jump Co-operative Ventures

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Structural change is a disruptive process. Whether you are in the steel industry in the 1970's or production agriculture in the 1990's the effects are extremely unsettling (Rose and Thomas, 2000; CP, 2000). Producers are being forced to either exit the industry or adopt new business models, but to accomplish this they are faced with the difficult task of strategically repositioning themselves. Just in the state of Illinois, for example, there are currently forty value added processing business plans in development (Saputo, 2000). These long jump ventures into processing are risky though and raise important fundamental questions about how producers select appropriate strategies; the subject of this manuscript.

Specifically, this manuscript addresses three aspects of the strategy process. The first is whether long jump type ventures such as hog slaughter or ethanol production are strategically sound. The second aspect is a discussion of how firms develop sound strategy. Third, using this understanding of strategy, the paper offers relationship management and service innovation as an alternative to long jump brick and mortar investments for creating value. Finally, a case study of the Wairarapa Lamb Cooperative demonstrates an application of relationship management.

The effects of structural change in North America are especially acute for grain farmers and hog producers. The rate of exodus of independent farmers is startling throughout the prairies of Canada and the Midwest U.S. A recent article in the Canadian press stated that 6,000 farmers were forced out of business in 2000 and 6,000 more will be forced out in 2001 (CP, 2000), a 7% annualized attrition rate (Statistics Canada, 2000). In the United States, the number of hog operations fell at a similar rate, 6.7%, since 1989 (Table 1). Other than a brief respite in 1997, hog prices have fallen over the last 10 years (Figure 1). This is due, in part, to the rapid increase in production capacity by integrated swine systems. Consequently, returns to outdated organizational forms decline and capital leaves searching out superior opportunities. For

example, capital continues to flow to integrated systems, such as Smithfield Foods whose market capitalization has risen almost $1,000,000,000 or 148% since 1996 (Morningstar, 2000).

One of the most common strategic choices for producer groups are producer-built processing plants, e.g. hog slaughter and ethanol. Three rationales are often given by producers for vertically integrating. The first is to take control of their own crop (Smith, 1998; Producers Alliance, 1999). Harold Tilstra, a farmer from Luverne, Minnesota is senior vice chair of Cornerstone Cooperative and chair and chief executive officer of Agri_Energy LLC., a producer-owned ethanol company in southern Minnesota. In an interview he commented that

> ...such a concept (producer-owned value added production) is critical to farmers seeking to survive in the future. Agriculture margins are increasingly narrow ... and...retaining commodity ownership until additional value has been built into their crops means more returns for producers as well as economic growth for their communities.(Tilstra in Smith, 1998)

However, does this strategy really mean "more returns for producers"?

A second rationale, is that integration allows producers to capture the higher returns and lower price volatility downstream (Forester, 1996; Siebert et al, 1997; Smith, 1998; Smith, 1999, 1999; Ball, 2000). Gary Ball, salesman for Ursa Farmer Co-op in Illinois commented:

> As a rule, selling pork makes money and when it doesn't, it loses a whole lot less than selling hogs. It is clear the independent pork producer needs to capture a larger portion of the farm to market share. Owning and operating your own packing plant is the most profitable and efficient way to secure a larger slice of the farm to market share. (Ball, 2000: p. 10)

This is analogous to a story about the famous 19th century American bank robber Jesse James. When finally apprehended, Mr. James was asked why he robbed banks. He is supposed to have replied, "because that is where the money is." Simply because greater returns reside down stream is not a sufficient condition justifying direct investment. Producers are correct recognizing that an ever increasing proportion of a food product's final value is produced and

captured by enterprises beyond the farm gate (Fabi, 2000). A fundamental question and a question of strategy remains; how best can producers capture a greater proportion of the value in the down stream supply chain.

Finally, a very practical rationale for integrating downstream is to replace lost markets due to industry consolidation (Illinois Farm Bureau, 1999; Ball, 2000) . This has been especially acute for an Illinois group, who have recently formed American Premium Foods. American is a recently established Illinois new generation cooperative (NGC) whose objective is to build a producer-owned hog slaughter plant. This group, like many NGCs, funds itself through producer equity, government grants, and debt capital. In the case of American, 30% would be producer equity, 11% contributed by the state, 14% through capital leasing, and 45% bank financed (Smith, 2000). The company would be structured as a new generation cooperative with the average member investing $23,400 (Smith, 2000). When asked why they thought the construction of a new packing plant was a good idea, members felt they had to do something because their traditional marketing channels and outlets had disappeared (Baumgartner, 1999; American Heritage Farms, 1999; Baumgartner, 2000;).

While these rationales are common justifications provided for forming a NGC (see American Heritage, 1999; American Family Farms Co-op, 1999; Illinois Farm Bureau, 1999; Waner, 1999; Merritt, 1999; Producers Alliance; 1999; Smith, 2000), there is no discussion of the fundamental value created by the new organization nor the uniqueness the venture brings to the supply chain. Schumpeter (1951,1997), one of the leading theorists on innovation and entrepreneurship, outlines an important linkage between uniqueness, dynamics and a firm's ability to command a price premium. The reward for organizing new combinations of resources valued in the market is entrepreneurial profits. These rents provide the incentive for innovation

and are the catalyst for economic development (Schumpeter, 1997). Therefore the premiums that producers are searching for will materialize not only by reorganizing into new organizational forms, but more importantly by creating unique value not found elsewhere in the marketplace. Assuming a dynamic innovation process, innovation rents and unique market positions for a new venture, are not perpetual but dissipate over time through competition and substitution (Schumpeter, 1951).

Strategic Positioning

For producers, the forces of structural change are strong and the need for strategies to participate in downstream markets is critical. Strategic positioning develops an adaptive strategy for value creation in response to acute changes in a firm's competitive environment (Rumelt, 1974; Itami, 1987; Quinn et al, 1990: Prahalad and Hamel, 1990; D'Aveni and Ilinitch, 1992; Prahalad; 1993; Mintzberg, 1994; Mintzberg, 1998). Two of the most compelling concepts from the strategic positioning literature are core competency (Quinn et al, 1990: Prahalad and Hamel, 1990) and tacit knowledge (Itami, 1987; Nonaka and Takeuchi in Mintzberg, 1998) These concepts have been very useful explaining why in dynamic environments some firms succeed while others languish.

First, successful adaptors understand their capabilities as bundles of competencies, not products or functions (Prahalad and Hamel, 1990; Mintzberg and Quinn, 1996). This is especially critical in dynamic industries or periods of structural change where products become outdated and adaptation is required. Competencies are the human capital in the firms, the shared knowledge, the corporate history, communication networks and traditions, organizational structure, and collective learning (Prahalad, 1993). It is all that remains if you were to remove the products. Itami (1987) identifies core competencies as invisible assets, and even though

they are difficult to measure, is the essence of a firm's value. "Invisible assets are the real source of competitive power and the key factor in corporate adaptability for three reasons: they are hard to accumulate, they are capable of simultaneous multiple uses, and they are both inputs and outputs of business activities (Itami, 1987: p14)." When applied to producer ventures; if all producers are attempting to do is vertically integrate through physical asset accumulation, they can be at best no better than anyone else in the market with the same bundle of physical assets.

A key component of core competencies is information and knowledge. Managing the flow of information and productivity of these knowledge assets is complex yet critical for strategic repositioning. A firm that has little experience in an industry has little access to critical information flows nor experiences to build the intangible assets necessary for competitive success (Prahalad and Bettis, 1986). External information flows originate in the firm and flow to clients and suppliers, internal flows pass to the firm from the clients and suppliers, and intra-firm flows occur across functions and divisions with the firm (Itami, 1987). These information flows and management are critical to the learning organization (Mintzberg, 1987; Senge, 1990;) and the buildup of, and production from, the stock of invisible assets and the firm's core competencies. Without these experiences the firm can not create the intangible asset base necessary for competitive success. Firms can purchase hard assets, but as they are not inimitable they do not generate value by themselves but rely on the intangible assets as the source of value (Itami,1987).

This understanding of the significance of the core competencies is consistent with the Nonaka and Takeuchi's (1995) discussion of tacit knowledge and effective decision making. Knowledge is explicit when it is articulated and codified in writing, verbalized or coded in drawings, computer programs or other products. Tacit knowledge however is uncoded and non-

verbalized. It reflects the difference between what we know and what we can tell (Polyani, 1966). Thus tacit knowledge may not even be able to be verbalized or articulated. It can be acquired largely through personal experience and is often embedded in the routines of organizations or individuals and therefore difficult to copy and convey. Much of the knowledge needed for successful decision making in a complex world is not explicit. It is made up of unique experiences generated over time and through interactions that can not be replicated by formal rules (Mintzberg, 1987).

> Managers... need to get out of the old mode of thinking that knowledge can be acquired, taught, and trained through manuals, books, or lectures. Instead, they need to pay more attention to the less formal and systematic side of knowledge and start focusing on highly subjective insights, intuitions, and hunches that are gained through the use of metaphors, pictures, and experiences (Nonaka and Takeuchi, in Mintzberg, 1998)

Decisions are made on instinct and common sense, then they become explicit and finally are judged within the organizational context. Once judged either favorably or unfavorably, they are interpreted and become again part of the tacit knowledge base. This occurs in a spiraling process from tacit to explicit and back again through an important confirmation step (Nonaka and Takeuchi, in Mintzberg, 1998)

Strategy emerges from this incremental process of building experiences and expertise that is brought to bear on the next set of challenges (Quinn, 1977; Mintzberg, 1987) A firm wishing to engage in a long jump venture, say from production to processing, in addition to gaining access to physical assets must access this tacit knowledge that produces value. But a structurally inconsistent situation arises; to be successful tacit knowledge is required as it is fundamental to value creation and competitiveness, but by definition a firm undertaking a long jump venture possess little tacit knowledge overlap.

Strategic Positioning: The Opportunity Gap

Understanding one's own core competencies and access to, or the possession of, tacit knowledge are fundamental to strategic repositioning. Prahalad (1986, 1990, 1993) captures the significance of these concepts in his model of the productivity and opportunity gap (Figure 2). A firm has two basic strategic positions, a focus on productivity or a focus on opportunity. Each strategy has its place.

A productivity gap focuses on present routines, processes, products, and markets (Prahalad, 1993). Decisions in such firms involves improving productivity of known systems and routines. This strategy is important for success when markets are static, mature, or fully competitive. If preferences remain unchanged or markets are mature, firms are able to invest in assets corresponding to long production runs and lowering marginal costs (Ng and Goldsmith, 1998). In fully competitive markets, price is fixed and profitability is driven by improving production efficiency and minimizing costs. Historically, commercial agriculture has focused on the productivity gap. The fields of farm management and agricultural economics, based on the neoclassical traditions of Walras (1954 in Varian, 1984) and others, have historically focused on optimizing the input mix and minimizing costs. Example methodologies are the production function approach, linear programming, and measuring productive efficiency. These have been appropriate methodologies because historically agricultural markets have been competitive, dominated by commodities, employed broad and relatively static standards and grades, and where price has been exogenous to the farm's problem.

The difficulty arises when markets are dynamic, firms enter a period of structural change, or when markets become less competitive and more rivalrous. Product or production-based strategies are lost because the markets are lost. The comfortable fit between production process,

product, and market is altered. In terms of strategic positioning, continued focus on the productivity gap is relatively simpler because it attempts to make known processes better, serve known markets more effectively, and produce known products more efficiently. However, globalization and the structural change that results have seriously challenged the traditional business model of being the world's low cost producer of commodities. Technology is packaged in ever more useable formats adaptable by almost any producer in the world (Goldsmith and Ramos, 2001). Falling farmer incomes in North America reflect decreasing commodity prices outpacing producers' abilities to increase productivity. The productivity gap strategy is a failed strategy as costs become harder to reduce, foreign producer's are willing to accept lower prices, and commodity's share of total food value declines. This requires U.S. producers shift away from the productivity gap and focus on the other half of the value creation equation, defined by Prahalad (1993) as the opportunity gap.

To accomplish such a strategic repositioning, a firm assesses itself not on its current or historical production plan, the products that it produces, but on its core competencies. During times of increasing turbulence and instability, firms need to refocus on investment in, and leveraging of, knowledge assets that are inimitable and provide them a competitive advantage in markets where direct competition between firms (rivalry) is the norm. The concept of core competency shifts the strategy process away from the obvious to the yet unexploited. Producers looking to create more value from their competencies shift their managerial focus from the production side of the business to the marketing side. The marketing knowledge gained then feeds back into changes and adaptations to the production plan and asset mix. Joining a firm's understanding of its core competencies with a demand or market perspective allows firms to create value by more directly addressing client needs and opportunities. New opportunities in

agriculture arise from the uniqueness of the farm as a resource base when matched with the needs of downstream clients or consumers.

Strategic repositioning during periods of market turbulence involves a four-part process (Figure 3), Prahalad (1993) calls this the strategic architecture. The first step is to recognize a firm's core competencies. What are the firm's inimitable resources? In the case of an agricultural cooperative, what intangible assets does it bring to the supply chain? Second, is to move beyond the productivity gap and a cost focus, and give attention to the opportunity gap and a value focus. Part of this process involves understanding broad trends and indicators from secondary sources. More importantly this involves understanding the business practices of client firms. Suppliers are hard pressed to create value without an understanding what clients value. The third leverages resources. Firms need to access resources outside their own firm to acquire the necessary tacit knowledge and avoid the managerial burdens of vertical integration.

Finally, the firm determines the appropriate governance structure to leverage the knowledge and capture value. Contracting or the use of a minority joint venture as opposed to integration may better balance the knowledge requirements, managerial burden, and rent capture (Figure 4). The Value Creation Triad relates governance structure and value creation. By itself governance does not create value but it can be conducive to creating value. The triad models a tradeoff problem between the need for knowledge that can be sourced either internally or externally, the management burden, and the ability to capture rents. There are numerous governance options open for producers to participate in the supply chain (Adams and Goldsmith, 1999). On one end of the governance continuum resides the spot market strategy option where producers operate decoupled selling commodities. At the other extreme resides the long jump option of full integration where the producers own both sides of the transaction.

Interestingly neither extreme strategy on its own contributes the necessary tacit knowledge. In the spot market case, producers' value in the supply chain is captured in the commodities they sell. External knowledge may be high but none of that information flows back to producers as the marketing stages are decoupled between production and processing. With vertical integration producers own both sides of the transaction. The ability to capture rents from the new supply chain arrangement is highest because of complete ownership. Correspondingly managerial burden is high. What limits the value creation in this scenario is the inability to source knowledge because producers' internal knowledge base is rooted in production and vertical integration constrains information partnering. Producers, realizing the inconsistency between available knowledge and management responsibility might try to access knowledge outside the firm (Figure 5). But as stated above, tacit knowledge is the source of value and innovation rents, therefore contributors of knowledge will require excess economic rents for the knowledge and innovation they are contributing to the chain. Therefore it is imperative that these relationships are viewed to be mutually beneficial to both parties to the relationship. Producers are forced away from a pure vertical integration strategy to quasi-integration, such as contracting and joint ventures where managerial burdens are less, and knowledge leveraging can occur.

We have argued that long jump producer-owned ventures are flawed attempts at strategic repositioning. Structural change and economic duress for producers is real and producers are looking for alternatives to the commodity model. The following section introduces Relationship Management (RM) as an alternative. An RM strategy, relying on an assessment of core competencies, is focused on the opportunity gap. It addresses the knowledge and managerial constraints described above, involves quasi integration as opposed to vertical integration, allows

superior risk diversification, and provides access to the higher returns and lower volatility of downs stream markets.

Relationship Management

Relationship management (RM), also known as one-to-one marketing and relationship marketing, may serve as a better strategic fit for agricultural producers. Relationship management is a fairly new field having arisen out of the quality movement in the 1980's and formalized by Berry (1983, 1995). In RM, upstream supplying firms change their strategic position from an arms-length relationship with clients focused on product exchange to one of partnering. Client share, the percentage of client needs being met by an individual supplier dominates the traditional strategy of market share (Peppers and Rogers, 1993; Moon, 2000). The upstream firm is not simply selling a product but a bundle of attributes and services. The quality may be unobservable ex-ante but critical to the downstream client ex-post. The ability to increase client share is wholly dependent on building a relationship and exchanging knowledge with the downstream firm. Value, and the associated innovation rents are created through the sharing of knowledge and the joint learning (Slater, 1995; Pine et al, 1995).

Relationship management is also about market deference. When greater value is produced downstream in the chain and at the same time many industrial firms are aggressively rationalizing their supplier base, supplying firms create value by customizing their offerings, servicing needs, and adapting their production systems, more effectively matching the downstream firm's needs. While in agriculture there has been much talk about "rights" to a certain portion of the food value pie (Fabi, 2000), a relationship management strategy instead focuses on increasing supplier's value capture by mutually increasing the size of the pie. By

assisting the downstream firm respond more quickly and uniquely to their clients' needs, greater total chain value is created providing the possibility for additional rents to flow upstream along the chain to the supplier. This type of strategy requires a willingness by firms to collaborate and not compete across stages in the supply chain.

As a strategy it moves the supplying firm's focus from transactions (products) to relationships and is consistent with the shift from the productivity gap to the opportunity gap. In RM the supplying firm crosses the boundary of the transaction to engage in a partnering relationship with the client (Table 2). The nexus between upstream supplier and downstream client is no longer simply a product but more importantly a knowledge exchange. This knowledge transaction serves as a resource for both firms, helps bind the supplier to the client, and serves as a value center. Relationship management is a dynamic concept because of joint learning and feedback. As both firms evolve within their own competitive spaces and with each other, new knowledge flows across the relationship membrane and is integrated into the value creation process. The boundary between the two firms becomes blurred as incentives become aligned, knowledge ownership is fuzzy, and joint-satisfaction is fundamental.

Value is captured by the upstream firm because the relationship is inimitable and important to the downstream client. If the supplier delivered a commodity product or service it would receive commodity-level prices and encounter commodity-level competition. If however the supplying firm's relationship creates a unique offering for their client that is differentiated, then it is less likely to be copied, commands a price premium, inhibits rivalry, and promotes income stability. Instead of the zero-sum game of transaction-based relationships, risk, cost, and value sharing become fundamental components of the relationship.

Traditionally in agriculture, the production process of the upstream farm firm does not

reflect the needs of the downstream client. The focus of the transaction is the product, e.g., corn or hogs, and producers are defined as such. Since the product is a commodity, the end product's characterisitics are commonly known, thus are not unique to a particular supplier. The price signal, which normally occurs ex-post (at harvest) provides sufficient, though limited information for the producer to adjust the production plan. The transaction is completely arms length.

In RM, the process is the opposite, the supplier first understands the needs of the client then goes about producing the good by leveraging its own core competencies combined with knowledge partners. Information, is present ex-ante not ex-post, is not limited to price, and involves numerous product and service attributes. Suppliers have greater opportunity to market their core competencies through a relationship which is much broader and more dynamic than simply through a product-based transaction. Historically in commodity agriculture, firms within marketing segments focused strategy narrowly on their immediate markets, isolated in their own supply chain "silos". Alternatively, the trend in the economy at large has supply chain players crossing antiquated supply chain boundaries to access and leverage resources from their partners in order to address increasingly complex production problems(Quinn et al., 1990; Rackam, 1996).

In agriculture the lack of coordination in the supply creates huge impediments to value creation (Zell, 2000). There are numerous opportunities in agriculture in the areas of quality control, identity preservation, and property rights protection for producers-client relationships to create value. Producers bring numerous core competencies to the supply chain. 1) Land: Crop production is extensive and producer control and care are not easily replaced by integrated supply chain systems. 2) Production flexibility: While during the last twenty years crop

production has become more specialized in response to a commodity production system, potential exists for producers to adapt to a new agricultural model dominated by dynamic niche markets which employ more flexible production systems. 3) A lack of organizational bureaucracy: Producers directly control their production thus are able to respond to the market's demand for identity preservation and other quality control needs. 4) Production risk mitigation: Producers could play an important role decreasing supply risk if, for example, they were aligned in a regionally diversified fashion; 5) Logistics: With on-farm storage capabilities and transport, producers could address many of the material flow needs of downstream procuring firms.

As well, the vast knowledge base of food and ingredient manufacturers and retailers would benefit producers and producer organizations enabling them to better leverage their core competencies to create new products and services for the supply chain. Relationship management addresses the predicament faced by farmers that want to reduce volatility and risk by conducting business in more stable portions of the supply chain. Through a supply chain relationship, producers would be integrating themselves into the supply chain without the managerial burden of vertical integration. The relationship itself is a form of capital, social capital, that generates rents and binds firms together. The supplier, by creating a unique offering creates relationship specificity. This specificity raises the cost of exit for the purveyor adding stability to the relationship. This should be especially appealing for agricultural producers looking to reduce volatility.

Implementing a RM strategy is a process involving client identification, differentiation, interaction, customization (Peppers and Rogers, 1999). To these four steps we add a fifth step, bilateral double-loop learning (feedback). Client identification is similar to market segmentation, except it is conducted at the firm level. Using secondary data and referrals, target

firms and their business characteristics are amassed. The second step involves client differentiation. Clients will differ in terms of their value to the supplier and their needs. A system like Curry and Curry's (2000) involving a client pyramid is an effective way of differentiating customers by value to the supplier. Clients can be differentiated in many ways, such as, by product, sales, purchase practices, and location. The third phase of implementing an RM strategy is interacting with the firm. This is a critical step not only because of its importance in terms of knowledge management but because of its complexity and expense. The success or failure of RM is how well the supplier understands its client needs and can establish a learning relationship. The challenge is for supplying firms to shift focus from its own production system to learn about the downstream business. Only by understanding the needs and pressures that face the downstream firm, can the supplier adapt its production and marketing processes. The needs assessment, the process of learning about a client's needs, is normally conducted with the employee responsible for input buying and with senior managers of the client firm. Both provide valuable information on client needs. The buyer provides the technical information and immediate concerns about the purchase, while senior management provides a broader and more dynamic vision of how the product affects the rest of the company as well as the needs of the client's client (Wood, 2000). There exist published semi-structured interview instruments for eliciting client needs (see Anderson and Narus, 1998; S4 Consulting, 2000; Curry, 2000).

The fourth stage, customization, is the introduction of client needs into the product and service offering of the suppling firm. In the ability to customize products and services lies the secret to competitive advantage. In this area of competition producers may have an advantage, because bureaucracies do very poorly at producing lot sizes of one. While large firms may have the ability to access and process large quantities of data, smaller more nimble organizations are

better able to implement knowledge. Speed not only in service but in R&D and production are becoming more and more critical. Bureaucracies again are at a disadvantage because of their preference for long production runs and routines. Turbulent environments favor organizational forms that are more flexible and whose capital is fungible (Ng and Goldsmith, 1998).

Bi-directional double loop learning, the fifth stage, closes the relationship process feeding information back aiding the supplier to improve its product and service offerings. Client interaction is not simply an initiating event but an on-going dialogue. This makes RM a dynamic strategy where as client needs change, supplier offering continually adapts.

Where does group action and cooperatives fit into this business strategy? While individual entrepreneurs may be very successful in direct marketing efforts to independent retail outlets (Duffy, 2000), the greater trend in supply chain management is supplier rationalization (Rackam, 1996). More and more input supplies are originating from fewer and fewer suppliers. Also concentration and supply chain coordination is occurring downstream so scale and scope are critical to providing good service.

> In the last few years, customers have been rejecting traditional transaction-based vendor relationships at a dizzying pace. They've been downsizing their supply base, and replacing their myriad vendors with a few small number of long-term relationships offered to only a select few. There's a widely quoted figure that customers are working today with a third fewer suppliers than they did ten years ago. (Rackam et al., 1996: p.3)

Therefore the ability to deliver quantity, the capability to provide speed, and yet the capacity to service a broad range of needs requires a large organization. Group action in the form of new generation cooperatives or LLCs could afford the scale to have dedicated or sourced expertise bridging the gap between production competencies and supplier needs. Scale would also afford

the organization the capital to invest in service related assets, like storage, transportation, and product research. These assets if assembled strategically into a sizeable organization would lose their traditional specificity due to location. Interregional or international producer organizations could reduce tangible asset specificity and production risk through geographic and political diversification. While such organizations are more complex, they posses the benefits of greater product and service flexibility, access to critical resources, and greater market access. Brick and mortar producer-owned processing ventures on the other hand create dedicated facilities that are highly specific.

> I keep trying to convince my partners and our client companies that we don't want to invest in hard assets. They are too short lived and risky. We certainly don't want to invest in bureaucracies. We want to invest in people who... can mange outside contracts with the best sources in the world, and who can concentrate their energies on that small core of activities that creates the real uniqueness and value-added for the company, but it's a tough sell against traditional thinking (a venture capitalist in Quinn, 1990).

Finally, relationship management, addresses a continual problem for cooperatives, sourcing capital. RM as a strategy leverages resources through mutually beneficial supply chain relationships. The challenge for producer groups is how best to invest limited resources. Not only are there specificity risks to hard assets as described above, but investment in tacit knowledge acquisition is critical. This would indicate then that producers would be better served investing in soft rather than hard assets. The following case study provides an excellent example of producers leveraging limited resources and selecting soft over hard assets.

Wairarapa Co-op

An interesting empirical observation of relationship management is from an ad hoc case in New Zealand. Following the wide-ranging economic reforms in the mid 1980's of the New Zealand economy, including the agricultural sector, a small group of Wairarapa farmers

recognized that they needed to identify and develop an alternative marketing channel for their core product, lamb, as the traditional channels where not providing sufficient economic returns.

After some initial research, the group recognized that there was a market opportunity in the Bay Area on the West Coast of North America providing a high quality chilled lamb product to both the hotel and restaurant trade as well as the supermarkets that were servicing either ethnic communities of traditional lamb consumers or high disposable income consumers. They were faced two basic questions 1) how to develop the market in the Bay Area, and 2) how to establish a supply chain flexible enough to ensure a sufficient supply of the specified premium product.

A closed membership cooperative was established to provide the initial financing for the development and establishment of these marketing opportunities. The cooperative members each had to provide an establishment investment of approximately NZD 10,000. This was later increased through two additional funding drives to approximately NZD 40,000. For this equity investment members received the first right of supply for the new marketing channel. The cooperative developed a flexible market driven supply chain starting with information collection and knowledge acquisition from the customer and client in marketplace which then flowed back directly to the individual chain participants including producers. This allowed chain members to adjust their operations to deliver the combination of product and service attributes that maximized their residual claims. The cooperative made minimal investments in hard physical assets, effectively all of the financing was used for market development and supply chain relationship development. Bank financing was engaged only after market were established and product was being produced. This financing was used to support the organizations working capital requirements with inventory providing collateral.

To assist with the US market development they hired an expatriate International Food

Marketing consultant based in Berkeley, California. This individual possessed numerous years of international food industry experience as a past executive of a Californian-based international supermarket company. The consultant provided the cooperative with substantial explicit and tacit knowledge assisting the cooperative with understanding the dynamics of the market, how supermarkets within the region purchased meat products and how and who managed the in_store product marketing and promotion. This tacit knowledge was critical to the success of the operation as the Californian market differed substantially from the New Zealand market. One of the cooperatives farmer directors relocated to the Bay Area so that he could not only understand the market better and establish the US head office, but so that he could be located closer to their consultant. This facilitated the tacit knowledge transfer and learning process.

Gaining access into the supermarket required not only the regional purchasing managers consent, but it also meant developing individual relationships with the individual meat department managers in each individual store to obtain preferential meat counter space. This type of relationship development was also imperative in the hotel and restaurant industry too, where head chefs make all purchasing decisions. As a consequence, relationship development and management became a strategic initiative of the organization. The relationships were mutually beneficial for both parties; the cooperative received superior market information allowing them to better meet their clients requirements, product was customized daily to the individual stores requirements which reduced the meat managers labour costs, in_store promotional activities where developed, and in return the cooperative usually received preferential meat counter positioning and better market information both of which translated into increased sales.

Active relationship management has been critical to the operations success. This allows

for direct client feedback which can be quickly transformed into value either by slightly altering product mix for the next delivery to better match their client's needs or if substantial market changes are observed information can be passed back to New Zealand. The local processor-partner could then alter the product mix or processing schedule and producers adjust their animal specifications or production practices. Given the 12_week delay between initial slaughter and delivery into the North American market it is important that members at the top of the chain receive information about changes in demand requirements and specifications as soon as possible.

They developed a successful cold chain through a series of mutually beneficial relationships with the chain members. They rented cooling, fabrication and processing space, utilized labor from a local cool store, and accessed knowledge and services from a local meat processor, all in the San Francisco area. A solid relationship with the fabrication facility and their butchers was important so that product could be customized on a daily basis to customer needs. This increased the value of the product and services provided to meat managers who soon recognized very little additional in_store skilled processing was necessary.

Similarly, in New Zealand, all the animals were processed into primary cuts, packaged in Captec _ a specialized vacuum_sealed seven_layer foil bag filled with nitrogen _ and chilled through a local meat processor. The Captec technology allowed for the lamb to age without quality deterioration due to oxidation. In actual fact the meat improved becoming more tender and minimizing adverse aromas. The relationship they developed was mutually beneficial to both parties' requirements with respect to pricing and flexibility. It was important to obtain the willingness of the processor to provide flexible processing runs because order and scheduling requirements in the US market often changed on short notice due to variable market conditions.

Two cooperative directors personally supervised the relationship management with the processor to ensure that it remained mutually beneficial.

The prevailing market dynamics often resulted in quick and unexpected changes in product requirements so it was necessary that producers were willing to be flexible. As a result, many of the members were required to make changes, often substantial, to their production processes and practices. Lambs could no longer be sold when it suited farmers; instead they were sold to the cooperative when it best suited the market. The increased managerial complexity was more than made up by the returns generated from the overall operation.

The ad hoc case has provided a simplified example about how producers through group action can access external tacit knowledge to leverage others as well as their own core competencies to create additional value.

Conclusion

As described above, agricultural structural change is a powerful force and producer adaptations are necessary to remain competitive. There are numerous strategies available to producer organizations as they attempt to find their place in the supply chain. Strategic management theory and empirical evidence suggests that long jump or radical strategic shifts are unlikely to be successful. The logic is that sustained competitive advantage is derived from a firm's ability to produce value. In order to produce this value the firm requires assess to knowledge. The type of knowledge that generates innovation rents is knowledge that is inimitable, tacit knowledge. Firms by understanding their core competencies come to understand their own uniqueness in the marketplace as well as their inadequacies. In an attempt to add value to their offerings this leads firms that are resource constrained to avoid long jump ventures and move incrementally, remaining close to their competencies. Through relationship management,

supply firms can assess knowledge and participate in value creation without the knowledge and managerial burden of vertical integration. Wairarapa Co-op serves as an excellent case example of producers forgoing brick and mortar investment even though doing so would have given them direct control over their product. Instead they invested their limited funds in soft knowledge assets such as market reconnaissance and marketing expertise. These investments served them well by not only generating value at the initial stages but through their flexibility as market conditions changed over time.

Table 1. Number of Swine Herds in Selected States and the United States (1989 - 1999)

Location	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Average Annual Change
Illinois	16,600	15,300	14,800	13,500	11,500	11,000	9,600	8,800	7,500	7,000	6,500	6.08%
Indiana	15,000	13,000	12,000	12,800	12,300	11,200	9,600	8,500	6,500	6,400	6,200	5.87%
Iowa	37,000	35,000	34,000	35,000	33,000	29,000	25,000	21,000	18,000	17,500	14,500	6.08%
Missouri	16,000	16,000	15,000	13,000	11,000	10,500	8,500	7,000	5,500	5,000	4,000	7.50%
4-State Region	84,600	79,300	75,800	74,300	67,800	61,700	52,700	45,300	37,500	35,900	31,200	6.31%
United States	300,910	268,140	247,090	240,150	218,060	207,980	182,700	157,450	122,160	114,380	98,460	6.73%

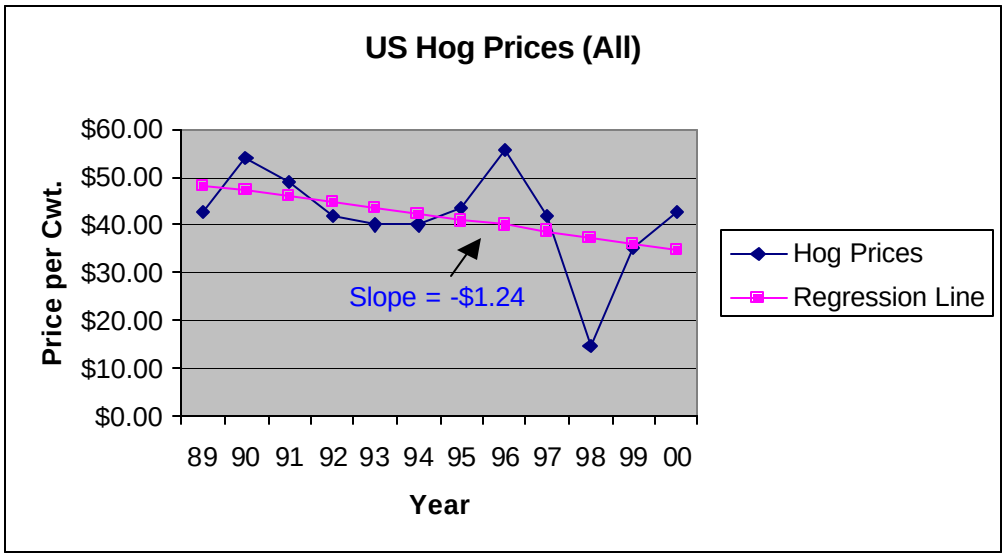
Source: NASSa, 2000; NASSb, 2000; NASSc,2000

Table 2: Key Differences Between the Concepts of Relationship Marketing and Transactional Marketing

	Criterion	*Relationship Marketing*	*Transactional Marketing*
1	Primary Objective	Relationship	Single Transaction
2	General Approach	Interaction-related	Action-related
3	Perspective	Evolutionary-Dynamic	Static
4	Basic Orientation	Implementation-orientated	Decision-oriented
5	Long-term vs. Short-term	Generally Long-term	Generally Short-term
6	Fundamental Strategy	Maintenance of Existing Relationships	Acquisition of New Customers
7	Focus in Decision Process	Post-sale	Pre-sale
8	Intensity of Contact	High	Low
9	Degree of Mutual Dependence	High	Low
10	Measurement of Customer Satisfaction	Direct	Indirect (market share)
11	Dominant Quality Dimension	Quality of Interaction	Quality of Output
12	Production of Quality	The Concern of All	Primary Concern of Production
13	Role of Internal Marketing	Substantial Strategic Importance	Limited Importance
14	Importance of Employees	High	Low
15	Production Focus	Mass Customization	Mass Production

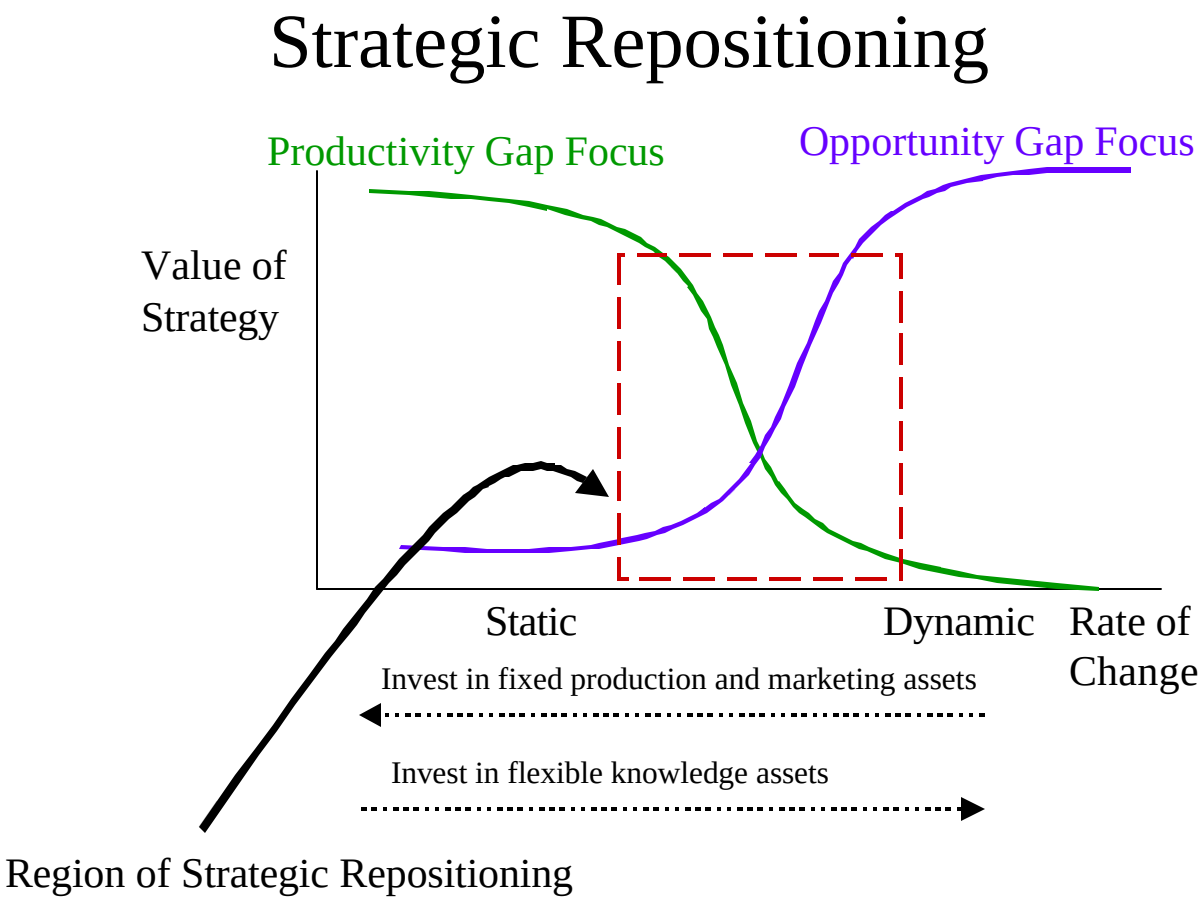
Hennig-Thurau and Hansen, 2000

Figure 1. US Hog (All) Price 1989 - 1999



Source: NASSd, 2000

Figure 2:


Strategic Repositioning
Productivity Gap Focus
Opportunity Gap Focus
Value of Strategy
Static
Dynamic
Rate of Change
Invest in fixed production and marketing assets
Invest in flexible knowledge assets
Region of Strategic Repositioning

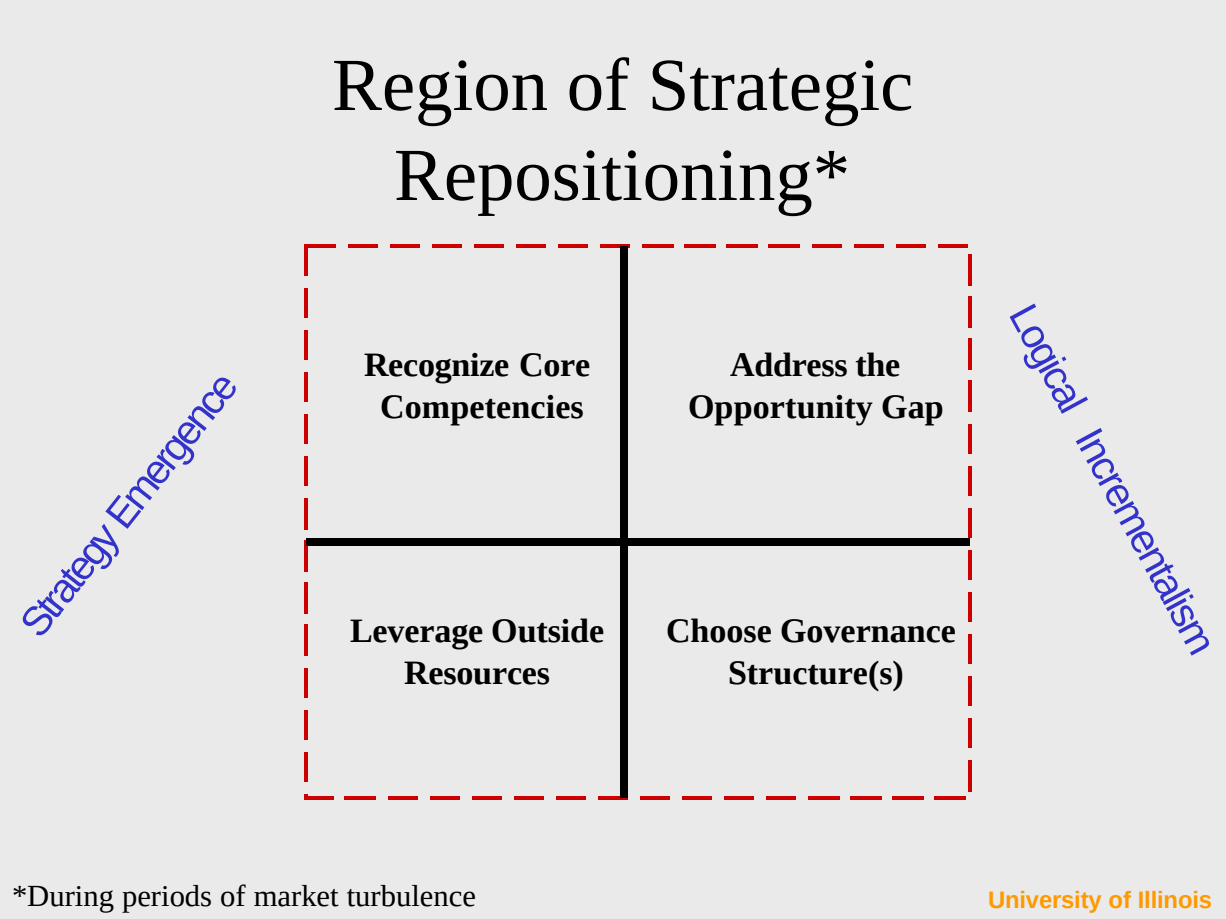
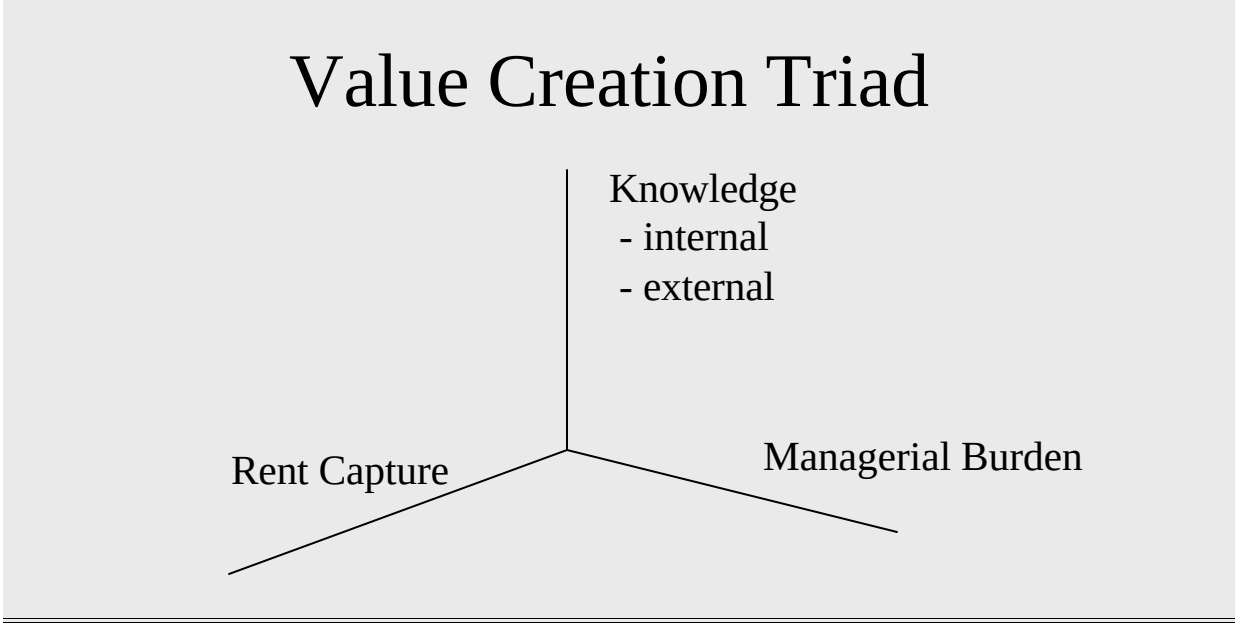

Region of Strategic Repositioning*
Strategy Emergence
Logical Incrementalism
Recognize Core Competencies
Address the Opportunity Gap
Leverage Outside Resources
Choose Governance Structure(s)
*During periods of market turbulence
University of Illinois

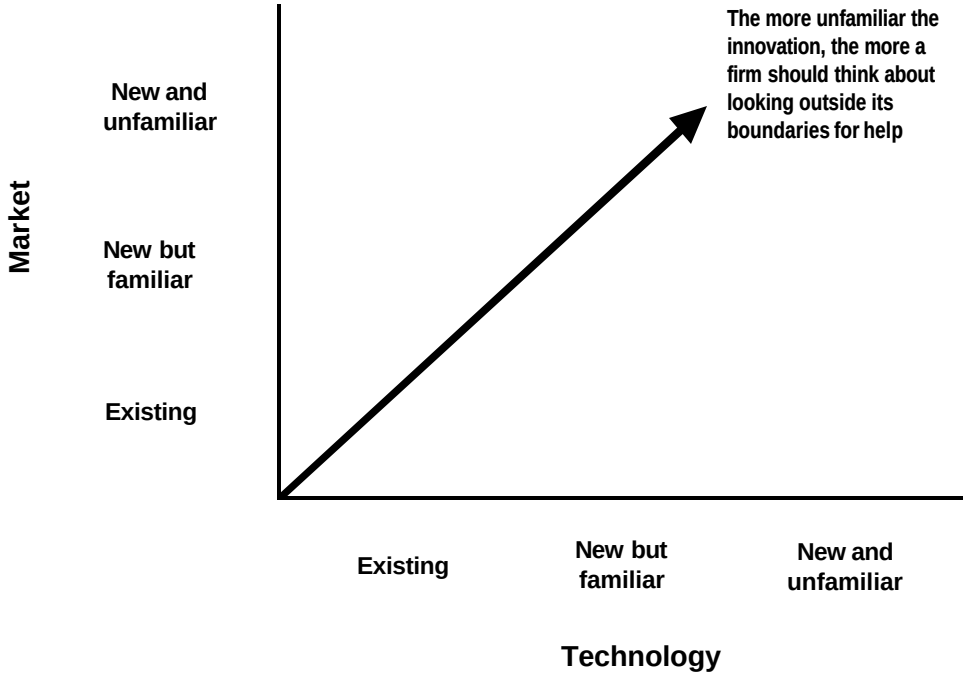
Figure 3:



		Resource Leveraging		
	Spot Market	**Contracting**	**Minority JV**	**Vertical Integration**
Internal Knowledge	0	+	+	0
External Knowledge	+++	+++	+++	0
Management Burden	0	+	++	+++
Rent Capture	0	+	++	+++
Value Creation	**0**	**+,++,+++**	**+,++,+++**	**0**

Figure 4.

Figure 5: Innovation Adoption under Familiarity Constraints



Source: Adapted from Afuah (1998)

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