

Sustainable Industries

Local motion

by Amy Westervelt - 11.24.08

With fuel costs on the rise and the locavore movement garnering more press than ever before, now might seem like a great time to be a part of the local food chain. But despite interest from both consumers and retailers for all things local, even some of the most successful players in the West Coast's regional food supply chain say it's a challenging industry, not for the faint of heart (or wallet).

Growing an enterprise to the point of profitability without losing the quality and hands-on feel that makes local food appealing to buyers is the primary challenge facing local food producers and distributors. Others include quality control, securing distribution and, for some, securing manufacturing partners.



Local vs. regional

Portland-based Hotlips Pizza is a prime example of both the potential successes and challenges inherent in the local food business. The chain uses only local ingredients and is set up in a spoke-and-wheel configuration: A central hub receives ingredients from farmers, prepares toppings and sauces, and distributes everything to nearby restaurants. For each hub, co-owner David Yudkin says he needs four stores in order to turn a profit. "So, if I were to expand into Seattle, for example, I'd need to go in and right off the bat open a central kitchen and four stores," he explains. "That's a lot of capital up front."

In addition to the pizza restaurants, Yudkin recently launched a local soda brand, which is distributed through Hotlips. "We thought it was sort of silly to deliver our 100 percent local, healthy pizza with colored corn syrup that does nothing for the local economy," he explains.

The soda has been a hit, and Yudkin now delivers it as far north as Vancouver, Wash., and as far south as Ashland, Ore. Still, he says it would be expensive and difficult to take the same model and replicate it nationwide. "The challenge is ramping up sales to a big enough volume to justify the capital expenditure on the equipment," Yudkin says, adding that, whereas the pizza business requires a constant flow of ingredients (costs) and creates a constant flow of sales (return), the soda business requires a large capital outlay when the berries are in season.

In addition to equipment that could process and bottle more soda, Yudkin says he would probably need to import skilled labor to work such equipment if he were to expand his soda business to ship his product outside the region. "Fuel costs are creating an atmosphere where regional food production makes more sense than it ever has, and I think we're going to see a resurgence in manufacturing," he says. "The problem is that we've had about a 50-year gap between the last time we produced our own food and now there's a huge labor vacuum there; no one knows how to work the machines anymore."

The Wal-Mart effect

One way for local businesses to have it both ways—produce locally and sell at national scales—is to partner with more conventional businesses. Wal-Mart (NYSE: WMT) announced earlier in 2008 that it had increased its purchases of local foods by 50 percent, and intended to grow its local purchase more over the next two years as part of its commitment both to sustainability and to its own bottom line.

Manteca, Calif., farmers Van Groningen & Sons have been selling watermelons and pumpkins to the retailer since long before its local foods marketing campaign; but the farm was able to shift from selling to Wal-Mart through a third-party distributor to selling directly to the big-box store 10 years ago, according to Ryan Van Groningen. "When it comes to economies of scale, retailers and distributors give a farmer the most sales, which helps us to grow the business and be as productive and economical as possible," he says.

While Wal-Mart is one of the farm's largest customers, Van Groningen and his family haven't put all their eggs in one basket. "We have positioned our company to sell to more than one retailer or customer in order to spread out our business, and as far as I know, Wal-Mart promotes that philosophy with their vendors," he says.

Other retailers have begun promoting locally produced food more heavily as well, according to Van Groningen, but none so much as Wal-Mart and none with the retailer's infamous contract pricing. "In terms of profit margin, with contract pricing, some years are better than others but over time, they equal out to the same price as the market pricing that other retailers use," Van Groningen says.

National networks for local

Organic Valley knows a thing or two about Wal-Mart: In 2005, the big-box retailer was the co-op's third-largest customer, but with demand for organic milk skyrocketing and production dropping, Organic Valley dairy farmers opted to walk away from the deal and prioritize the natural foods stores that had helped build the business. In various interviews about the decision, the co-op's spokespeople said they feared the partnership with Wal-Mart would eventually make them dependent on one customer, leaving the business vulnerable.

After setting up a vast and fairly sophisticated network of local producers and regional plants, the company reported that it needed to keep a tighter rein on demand to secure its business for the

long term. Although it imports soybeans from Asia and South America for its soy products, Organic Valley taps into a network of local farmers across the country to maintain local quality at a national scale with its dairy operations. "Milk is a heavy liquid, so it's expensive to ship, and it's also highly perishable, so we want it traveling as little as possible between where it's produced and where it's sold," explains Theresa Marquez, the co-op's chief marketing executive.

Farmers in various regions buy into the co-op when they become Organic Valley members and, according to Marquez, they need to be both efficient and either large enough on their own to fill a truck with milk—or have a few neighbors that can help. "If you can't fill a tanker then you need to have someone close by who can help; we need to be efficient, and what's efficient right now is filling a tanker," she says. "Other than that, you need to have good quality milk and you need to have refrigerated tanks."

In addition to connecting with farmers, Marquez explains that Organic Valley has had to build up a network of regional processing plants in order to ensure milk products stay fresh. Organic Valley manages 90 plants around the country within seven regional production areas (New England Pastures, Northeast Pastures, Heartland Pastures, Texas Pastures, Rocky Mountain Pastures, Pacific Northwest Pastures and California Pastures). It has two plants in Portland. "All of our farmers in that region go to that plant and that market," Marquez says. "You have to build a very deep infrastructure that includes seed mills for animals, vets, farmers and plants in order to make it work."

Each of the co-op's seven regional production areas produces milk with a different regional label to clue consumers into the fact that the milk is local. Using regional production plants and keeping trucks full are two ways Organic Valley is keeping its fuel costs as low as possible, according to Marquez.

However, the co-op has suffered the same peaks and troughs in its business as the rest of the organic milk business has in the past two years. Thanks to recent changes to the National Organics Standards Board (NOSB) rules governing organic milk certification, it has become more expensive for dairy farmers to convert. That fact, coupled with the rising cost of feed, has resulted in a reduction of the number of organic dairy farmers coming online. This follows on the heels of an organic milk glut caused by a spike in the number of dairy farmers seeking certification before the new rules went into effect. Nonetheless, according to published earnings reports Organic Valley co-op farmers have historically earned an 8 percent return on their investment (each must purchase stock in Organic Valley equivalent to 5.5 percent of their base annual income).

Having it both ways

Salem, Ore.-based Truitt Brothers provides yet another model for blending local food with economies of scale. The company runs a local business side by side with a national business. Truitt cans vegetables and fruits (predominantly green beans and pears) for large, conventional companies such as Kroger (NYSE: KR) and Sysco (NYSE: SYY). The produce that goes into the cans is grown

locally or regionally, according to co-owner and founder Peter Truitt, and is then shipped all over the country. But the Truitt brothers have started a sustainable food business on the side.

With both its cannery and its products certified by the Food Alliance, a Portland-based nonprofit that sets standards for sustainable agriculture and food-handling practices, Truitt Brothers has set about producing its own line of canned vegetables and fruits in partnerships with some of its neighboring farms. "The conventional business is still what pays the bills, but the sustainable line is increasing every year—last year it increased fourfold, and this year it has already increased tenfold," he says.

The "sustainable line" Truitt refers to is grown locally by Food Alliance-certified farmers and processed according to Food Alliance standards. It bears Truitt Brothers' own label and sells exclusively in the Pacific Northwest. Although currently the conventional business makes the money, Truitt says the sustainable line is growing by leaps and bounds and may be able to stand on its own in the next few years, particularly if the company continues to win more Food Alliance-certified partners. Truitt says he sees a future in prepared meals that are certified, and the company is currently working on a chili for a local restaurant that will be comprised solely of locally raised grass-fed beef and pinto beans from a Farm Alliance–certified farmer.

And his conventional business is starting to show an interest in his sustainable business, as well. "Some of the big food management companies are really showing an interest in third-party certified food products," he says, adding that he likes the independence he has when producing products under his own label and according to his own rules, and will likely keep the businesses separate for some time.

According to Truitt, being local in the Pacific Northwest means already being prepared, financially and otherwise, for changes in the market wrought by climate change. "Our practices have always been governed by the state of Oregon, which has made us pay for our water resources really at a cost that is equivalent to what the social and other costs of water usage and wastewater treatment should be," he says.

Truitt explains that Salem is and has always been one of the more expensive places to do business, and that because of that, many of the canneries in Oregon went out of business long ago. He attributes Truitt Brothers' resilience to its ability to diversify, and cites the sustainable food line as yet another example. "Although we developed this really as separate from our conventional business, a lot of the larger distributors we work with are now interested in foods with some sort of third-party certification, and the Food Alliance certification is one of the most credible," he says.

Economies of scale

At the end of the day, it may not be necessary for local food companies to expand out of their regions in order to succeed. Hotlips is currently a profitable company, posting annual revenue of \$7 million by maintaining its Pacific Northwest distribution, according to Yudkin. Farther south, Van Groningen and Sons Inc. turns a healthy (though undisclosed) profit, managing to sell directly to West Coast-only retailers while counting Wal-Mart among its customers.

Schools have become one of the biggest consumers of local food entrepreneurs, thanks to the work of a few nonprofits and private companies on the West Coast, most notably EcoTrust in Oregon and Revolution Foods in California. The latter was able to find a willing partner in Austin-based Whole Foods Markets (Nasdaq: WFMI), which sold its produce at wholesale prices and purchased a small line of organic products under the Revolution Foods label for its stores. The business grew from three pilot schools to 40 within a year, and aims to be serving 10,000 students fresh and local meals within the next year, according to co-founder Kirsten Tobey.

Following author Michael Pollan's description of Whole Foods' CEO John Mackey as a hypocrite for marketing organic and sustainable values while buying from large-scale "factory organic" farms, Whole Foods launched an initiative to make it easier for local farmers to sell to the retailer directly.

In his written response to Pollan, Mackey wrote, "Whole Foods needs to do a better job of helping local growers sell directly to our stores without going through its distribution center."

EcoTrust in Portland is one of the groups that has helped Whole Foods accomplish its goal, connecting the retailer to local farmers in the Pacific Northwest. After spending the past few years building relationships and distribution links between local farmers and schools, it's a role EcoTrust is comfortable playing. And its work that has begun to pay off in the past year: A recent poll conducted by Oregon's Department of Education found that nearly a third of the state's schools had purchased food from a local farmer or food processor.

Preaching to the choir

Then again, West Coast local food companies may just have it easy given the region's large number of consumers who are both interested in and aware of the benefits of buying local. "It's really driven by how capital intensive your process is and what the local population will support," says Yudkin.

"If you start off in Alaska or someplace where there's not much density it would be much tougher. In Portland there's enough critical mass to support the infrastructure, and there's an awareness of supporting the environment and the local economy."

Truitt agrees, extending the support throughout the West Coast: "There's an awful lot of conversation out there, but when you get right down to when you get out of the West, there aren't many people doing things really correctly."