

## Mid-scale food value chains case study: Shepherd's Grain

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### Origins of Shepherd's Grain

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In 2003, Shepherd's Grain sold its first batch of specially blended baking flour to Hot Lips Pizza, a small restaurant chain in Portland, Oregon. Their initial sale of flour to Hot Lips Pizza was the culmination of more than three decades of wheat production experience and a healthy dose of creative thinking.

In the mid 1980s, a pair of wheat producers, Karl Kupers and Fred Fleming, became convinced that the conventional dryland wheat farming they were practicing was not sustainable in the Palouse region of eastern Washington. They set out to tackle both the agro-ecological challenge of sustainability by reversing soil erosion and soil degradation, and the economic challenge of remaining financially viable without federal commodity subsidies.

Karl and Fred addressed the production goal of environmental sustainability by developing alternative cropping systems based on direct seed, no-till technologies that don't require the soil to be plowed and crop rotations that keep diseases and pests from building up, reducing reliance on chemicals. They targeted the economic sustainability goal by creating a new business model that uses and optimizes strategic business partnerships to develop and market high-quality, regionally identified flours at premium prices. Fred argues, "Our kind of farming rewards innovators, saves farms and can change an ecosystem."

Growth has been slow and steady; in 2008, Shepherd's Grain marketed more than 500,000 bushels of wheat for 33 growers. Including land devoted to rotational crops such as legumes, barley and alfalfa and to wheat sold through conventional market channels, these producers farm over 100,000 acres using third party certified techniques that provide significant soil and water conservation benefits.

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### Key characteristics

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Product quality and the story behind the production system distinguish Shepherd's Grain in the marketplace. The flours produced from Shepherd's Grain wheat have unique and superior flavor, good nutritional value and excellent baking consistency. These qualities are a function of grain genetics, region, weather, milling and grain and flour handling. The Shepherd's Grain story includes three elements: the farming system, the farmers and the supply chain partnerships. The environmentally friendly farming system results in soil retention and regeneration, the use of fewer pesticides and significant carbon sequestration from reduced tillage and soil disturbance. The wheat is produced on family farms, some with a history that dates back four or five generations.

Aggregating products from several farms using a cooperative or other collective arrangement is a way to gain leverage in the marketplace. Farmers producing for Shepherd's Grain are members of Columbia Plateau Producers, which is set up as a closed limited liability corporation for tax and flexibility purposes. It essentially

operates as a closed cooperative and only seeks new growers when market demand for the products exceeds the capacity of the group.

The pricing philosophy that Shepherd's Grain has adopted is central to the business. The starting point was to unlink the price received by Shepherd's Grain producers from commodity wheat prices so their farmers could receive a more stable and equitable return. Shepherd's Grain decided to set stable, year-long prices based on cost of production plus a reasonable rate of return rather than charge a premium above commodity wheat prices. Cost of production is calculated as the sum of on-farm production expenses, transportation costs, Shepherd's Grain administrative fees and milling fees. This transparent approach to pricing was modified and updated in 2007 in response to extreme wheat market price volatility and the unexpected implications for year-long pricing (see the last section for a discussion).

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### Strategic supply chain partners

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Strategic partnerships based on values and relationships are central to everything Shepherd's Grain has accomplished. By working closely with supply chain partners, this group of farmers has been able to market identity-preserved flours even though the product passes through multiple hands from field to final consumer. Explaining the unique nature of Shepherd's Grain, Karl says, "The difference with Shepherd's Grain is, and was from the beginning, the desire to create, foster and sustain relationships with everyone that enjoys the fruits of the producers' labor."

Shepherd's Grain uses strategic supply chain partners to replace the capital and expertise that otherwise would be required to handle grain milling and distribution. These partners provided early assistance in assessing wheat varieties and flour quality, and in locating customers. Shepherd's Grain flours are milled at the Archer Daniels Midland (ADM) mill in Spokane, Washington, the only significantly sized flour mill in the region. While ADM is a massive multi-national firm, Shepherd's Grain has developed a close local relationship. The partnership with ADM provides several advantages to Shepherd's Grain including strict assurances that their products remain separate, excellent flour quality, marketplace credibility and a safety net, as ADM assumes ownership of the wheat once it is delivered to the mill.

Shepherd's Grain works with distributors such as Food Service of America that act as sales agents for their products. Nearly all sales are direct wholesale, which means that Shepherd's Grain depends on its customers to preserve its brand identity. Strategies for maintaining brand identity include a picture of Shepherd's Grain farmers on the Hot Lips Pizza website and farmer visits at Bon Appétit cafés. More recently, Shepherd's Grain has begun co-branding retail flour products with Stone Buhr.

Although commodity wheat is sold primarily based on price, Shepherd's Grain customers often have different priorities based on specific values and marketing strategies. Its original customers—small businesses such as Hot Lips Pizza and St. Honore Bakery—place the highest priority on the Shepherd's Grain story and consider quality to be the second most important element. Price for them is a secondary consideration. More recently, medium-sized customers such as HearthBread Bakehouse have flipped this order as quality is their primary consideration, followed by the story. While price is still only the third most significant criterion, it is of somewhat greater importance for these customers. The largest and most recent customers—Mostly Muffins and Full Bloom Bakery—place the highest value on quality and price, but still consider the Shepherd's Grain story

important. Third party verification and certification through Food Alliance plays a key role in communicating the environmental and social standards met by Shepherd's Grain farms.

Shepherd's Grain seeks out customers and business relationships that value the quality and story behind their products. In 2008, they parted ways with a customer that was only interested in price and not a strategic values-based relationship. Says Kupers, "Maintaining our story and identity are important to us ... if that's not important to the 'big guys,' then they can go somewhere else."

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### Response to market conditions

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In 2007, rapidly increasing commodity wheat prices challenged the year-long cost of production based pricing model used by Shepherd's Grain. In short order, the stable price that had been set for the year by Shepherd's Grain was well below the market price for commodity wheat. Member farmers who were leasing land quickly discovered that their landlords expected to earn benefits from the higher prices and threatened to revoke their leases. Shepherd's Grain subsequently established a new pricing system in consultation and collaboration with its customers. This system is more flexible, sets prices twice a year and is still based on the cost of production plus a reasonable profit margin. Now, however, it also takes into account the relationship between Shepherd's Grain wheat prices and the commodity market.

A longer version of this case study (and related research) is available [here](#).

Shepherd's Grain website: [www.shepherdsgrain.com](http://www.shepherdsgrain.com)

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