Nature's Bounty

Changing the Rural Economy

Note 03 July 2019

Nethergill associates

1. Serious Flaws

- Farmers tend to produce commodities
  - Added-value in farming is usually low and often minimised
    - Cash flow concerns favour the quickest routes to a revenue stream
    - Greater added-value activities are perceived to have two major problems for farmers:
      - More investment in time and capital
      - More exposure to customer choice: e.g. grain can sell into many distribution channels whilst multi-fibre brown bread sells only to a limited market segment
  - Commodities are the most vulnerable entities to pricing mechanisms based on matching demand to supply
    - The more basic the commodity the more variable will be the price set by the market
      - This has a massive impact on revenue line predictability
      - This uncertainty contrasts with the behaviour of cost inputs such as materials, rents, interest payments and labour costs

- Farming is capital intensive
  - Capital intensive businesses will have low asset turns[1]
  - However, as all businesses compete for scarce capital, farming has to compete with non-farming activities for capital. Capital, therefore, will always be drawn to those activities which offer higher rates of return
  - In an industry with an intrinsically low asset turn, the need to deliver a competitive return can only be met through high margin activities
    - So, margin has to compensate for asset turn which is tough or nigh impossible in commodity farming
  - To exacerbate the problem of winning good returns, farming has to cope with risks such as the weather and the prospect of unwanted infections, etc, which should command a further premium.

---

[1] The asset turn ratio is a measure that shows how efficiently a business is using its assets to generate sales

2. **The Constant Dilemma**
    - How does a commodity producer, working in an especially risky field of endeavour, secure a sufficiently high margin to deliver a competitive return when asset turns will inevitably be low?

3. **The Critical Issue**
    - The dilemma can only be resolved if farming moves towards a future where it commands a greater share of the added-value chain and improves its prospects for higher margins and premium prices.
        - A move from commodities to branded produce
        - Branding articulates a differentiation and an implied guarantee of quality and consistency in the product

4. **Understanding the Value-Added Chain**
    - A typical, but simplified, added-value chain will comprise:
        - The commodity supplier (e.g. a farmer)
        - A transformer (e.g. an abattoir, a flour mill, a creamery, etc)
        - A merchant (who will set prices and match demand with supply)
        - A wholesaler (who will offer different distribution channels)
        - A retailer (who will sell to end users and consumers)

    - A typical share of the added-value chain might be:
        - The farmer, who takes 15% of the final price to consumers
        - The retailer, who takes 35% of the final price
        - The merchants and transformers, who therefore enjoy the difference, which in this case amounts to 50% of the final price.

    - Strategically, the farming community must attack the transformers and merchants, by doing their jobs and playing their roles, together with taking a slice of the retail trade, so as to relieve the prices pressure exerted by supermarket chains

    - This means:
        - Farmers forming regionally-based fully-commercial producer groups (but NOT co-operatives)
        - Taking on the role of transformers and merchants to offer products which are differentiated in the marketplace, defendable by being exclusive (e.g. from the Yorkshire Dales National Park), and capable of being branded (e.g. through quality, process or recipe)
        - Taking a slice of the retail trade which might well take the form of denying the supermarkets access to the group’s brands except at a premium

Nethergill Associates