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Ag Decision Maker
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Romance vs. reality: Hard lessons learned in a grassfed beef marketing cooperative—Part Two

by Annie Wilson, member and former business manager, Tallgrass Prairie Producers Co-op, Rural Papers Newsletter, Kansas Rural Center, October 2001

Editor's Note: Tallgrass Prairie Producers Co-op operated from 1995 to 2000, raising and marketing grassfed beef from ten Kansas ranches. It ceased active operation in 2000. Part 1 outlined the story of the cooperative. While the cluster continues to explore ways to work together, former business manager Annie Wilson offers the following as their lessons learned in the hopes that others will benefit from what they've learned.

The purpose of this article is not to discourage other producers from niche marketing, but to share our experiences in our five years of marketing grass fed beef. We will provide some observations, including the contradictions and ironies we discovered in our strange adventures in the food marketing wonderland, where all is not as it seems

Lessons learned

1) The emperor may have no clothes

Don't automatically believe everything you read and hear about marketing projects. Any new business makes understandable attempts to project confidence in its enterprise, but saying it doesn't make it so. In addition, the ag media and some food reformers have a desperate need for attention-getting success stories and role models. The result of these two tendencies was that our little struggling cooperative was touted as an inspiration and example to others. We know of many other similar operations that are not yet profitable, but are nonetheless presented as successful models in marketing. This misrepresentation is unrealistic and possibly harmful, as it adds to deceptive and misleading myths contributing to the "local niche marketing as salvation for all farmers" movement. This may influence other producers to enter into similar projects at great personal risk. Producers who hear about these projects need to be extremely skeptical and find out the details before accepting the stories

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Handbook Updates

For those of you subscribing to the *Ag Decision Maker Handbook*, the following updates are included.

Corn and Soybean County Yields—File A1-14 (4 pages)

Livestock Planning Prices—File B1-10 (1 page)

Revenue Insurance for Hog Producers—File B1-50 (2 pages)

Please add these files to your handbook and remove the out-of-date material.

Inside . . .

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at face value. Also, especially in direct marketing enterprises, ask if the project is honestly accounting for all administrative time, delivery costs, etc.?

2) It may actually take a "rocket scientist."

Having farmers manage their own food processing and marketing cooperative is risky. Just as we ranchers wouldn't want a heart surgeon to run our ranch, we should not presume to perform heart surgery. Nor should we pretend we know how to survive in the technical food industry. Getting food to the consumer today safely, legally, and at a competitive price is an overwhelmingly difficult and high risk task, challenging even for experts. The idea of exorbitant profits earned easily by lazy middlemen is an out-dated myth.

In reality, most companies' profits are generated only at high risk in tiny margins per unit on huge volume, capital-intensive, highly technical operations. Survival as a niche company in such climate takes a specialized expert. So, our advice is to raise the capital to hire a trained, experienced professional. Don't do-it-yourself on this one. By the time you learn your lesson, you may have run out of capital and energy and missed critical early opportunities a professional would have seen.

3) Honest accounting or is your time really worth less?

Do-it-yourself farmer-run businesses often fail to honestly account for the farmer's own time contribution to the business. A sustainable business must account for time in planning meetings, in product and label development, record-keeping, advertising, taking orders, packaging and delivering orders, and collecting monies and bookkeeping. In addition, time spent in talking to customers must be accounted for. Getting close to the customer is a nice goal for direct marketers, but this can be time-consuming.

Working free or failing to account for every bit of this time leads to unrealistic, unsustainable business practices that are too labor-intensive and inefficient. A realistic opportunity cost of your time in production, delivery, etc., must be honestly accounted for, not only to determine accurate costs of doing business, but also to be sure you adequately value your own quality of life. An advantage of hiring professional managers is they will insist on being paid for their time, which results in honest accounting for administrative and other labor costs.

4) Are grants the answer?

We had the sincere and valuable support of some wonderful organizations when we started, and we will always appreciate what they did for us. But we must point out that most public agencies and private foundations give grants only for research and education, not for operating capital to actually implement research. Grants can be helpful in limited areas. For example, we received wonderful assistance in doing nutritional research that we were able to use in product development and labeling. However, some grants also are time-consuming and may unintentionally divert energy away from business development, subverting the business mission from profit to education. They also can mask the real need for hard capital and a solid business plan.

Be wary of outside sources of nonprofit income and focus efforts on private investors who don't just want to learn about change but want to implement change. Your mission must first be to make the business profitable for your producers; then if possible later, educate others.

5) Follow the rules - every time

We always maintained the highest ethical level regarding our production claims and following the USDA rules on labeling. This was a real hassle, but we always felt that our product's credibility depended on following the letter of the law. This was especially frustrating when we knew other products on the shelf were ignoring the rules. We often felt we were not competing on a level playing field. Nevertheless, we refused to compromise our principles just because we knew we could probably get away with it. We often said that if "60 Minutes" ever interviewed us, we wanted to be able to look straight into the camera and tell the whole truth with nothing to hide.

6) Do price and convenience matter?

Some claim that price and convenience are not important to the new ethical consumer; yet the economic and time pressures these consumers face are just as real as for anyone. People are all strapped for time, so convenience matters a lot. Be wary of field of dreams food distribution schemes which depend on people going out of their way to get your product. This reduces your market potential to an infinitesimal percentage and will eventually burn out both you and your customers. Also, our custom-

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ers tended to be well-educated but not necessarily terribly affluent. They can pay some extra for special food, but must be fiscally responsible and definitely have a "choke level." Marketing techniques which ignore price and convenience issues are doomed, reflecting a lack of understanding of economic realities of food marketing and distribution.

7) Are natural foods markets the answer?

The main market we discovered for our beef was the natural products market. However, we discovered several contradictions in dealing with that market sector. One of the largest sectors of the natural products market is not foods, but pills consumed by people who seem to have abandoned the concept of eating actual foods as the key to good health. Following the trend in conventional foods, the most profitable food products in the natural foods industry are not whole foods such as produce and grain, but heavily processed, packaged items. Again following the trend in conventional foods, the natural foods industry is becoming concentrated with little room for small suppliers. The beef that was most popular in natural foods markets was grain-finished, higher fat beef, and very few natural foods consumers were knowledgeable enough to make any distinction between grainfed and grassfed.

8) Are conscientious chefs the answer?

The food service industry including hotels, restaurants and institutions is extremely competitive, and cost-conscious. There is a growing movement of sustainable-minded chefs, but they are rare, may be demanding, and may not order on a consistent basis. Participation in food service requires a sophisticated level of operations that provides a high volume of certain specialty cuts, so you must complement this market with other substantial markets for low end cuts and hope they balance out. If you run out of supply for this market, you are dead.

Dealing directly with restaurants, instead of going through a food service distributor, also can lead to freight/distribution problems when their order sizes vary. Chefs often have very little understanding of these obstacles for the supplier. Finally, food service is a tough business and most restaurants are short-lived. Getting stuck with a large accounts receivable from a failed restaurant customer can be fatal. Stay on a cash-only basis.

9) Seasonality is a terrible handicap

We did not encounter any markets willing to accept only a seasonal supply. In attempting to keep up our supply for existing customers, our on-ranch costs for producing off-season grassfed beef were extremely expensive and unprofitable for producers—a production issue we never solved. Had our volume increased substantially, this would have been a crippling problem.

10) How different can you afford to be?

Your product must have attractive features that differentiate it from others. This may be simply a claim of quality. Or it can be a different way of producing the product that results in unique features. In any event, this differentiation must be carefully approached, answering two questions:

- How does it affect your cost of production and long-term profit potential? and
- What marketing benefits do you gain by doing it?

Our main differentiation was based on a very technical production model, grass finishing, which it turns out was expensive and significantly increased our on-ranch cost of production. Furthermore, most consumers did not begin to understand or appreciate the concept of grass finishing. In fact, we learned that most customers understand very little about livestock production in general, often not knowing enough to support sustainability even if they want to.

This all raises the issue: How much education of the consumer can you afford to do? Consumers generally recognize and trust the term organic without understanding all the complexities of production it requires. If your product feature is actually beyond or different from the definition organic, you have to independently translate your technical production model into understandable consumer benefits, such as improved nutritional value and supporting the environment.

Differentiating our product by its reliance on grass finishing meant consumers needed to first understand that most cattle are grain-finished, which they do not. Further, they needed to understand the nutritional differences of marbled, grain-fed and grassfed beef. This goes against the government-

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sanctioned USDA beef quality grading system that is the basis of conventional consumer wisdom on beef quality.

Moreover, dwelling too closely on the environmental problems of grain feeding may cause a strong backlash from the conventional beef industry. Furthermore, even the word "grain" is a very attractive word, especially to natural foods customers, who of course associate it positively with human consumption and transfer this to cattle without realizing the differences in cattle nutritional requirements. In summary, despite our strong commitment to the concept of grassfed beef, we wonder if some lessons may just be too hard and expensive to teach, at least at this point of consumer consciousness.

11) Quality of life and sustainability on a personal level

We wanted to start a marketing cooperative to preserve our way of life, but the time and pressure of running our own beef operation, and our financial losses, actually detracted dangerously from family life and our farm operations. Ironically, while trying to devise a way to produce beef in an environmentally sustainable way, we accidentally fell into a pressured schedule that was destructive to the values of family we were trying to preserve, and that was unsustainable on a personal level. Thus our business risk also became a personal risk. Agriculture is already hard enough. We strongly believe that supplemental enterprises must be consistently operated at a personal cost that will be compatible with farmers' values and way of life.

Summary

The Tallgrass Prairie Producers Co-op recommends that projects to market added-value beef be developed with a sound business plan, adequate capital, professional management, cost-effective operations, consistent supply, compliance with legal standards and access to low-cost processing and volume markets. All the costs of the business must be accounted for in order to protect the core values and goals of the farmers.

Many have described our odyssey as a remarkably successful effort that took us much farther than most groups of this type ever get. One expert characterized our activities as a "successful test market" of a product that could some day be taken to the commercial level with adequate capital and professional guidance.

In recent months, our co-op has been exploring the possibility of joining together to develop a cooperative tourism enterprise in which we would host guests on our ranches and offer authentic experiences in ranch daily life and prairie ecology. We also are considering remaining as a ranching cluster that shares production ideas and economic information in an effort to assist and advise each other on economically and ecologically successful ranching strategies.

We don't know where all this will lead us. What we do know is that we have been fortunate to know each other and have developed tremendous loyalty, respect, and affection for one another. No matter what happens, we have been through an adventure together that we will never forget, and we will always be friends.

Changing CCC loan reporting *

by Neil Harl, Charles F. Curtiss Professor in Agriculture, professor of economics, 515-294-6354, harl@iastate.edu

The choices in reporting Commodity Credit Corporation (CCC) loans have been clear for many years. But in early 2002, the Internal Revenue Service ruled that a change in reporting methods from treating CCC loans as income to reporting CCC loans as loans has been modified and relaxed. That is a significant change for affected taxpayers.

The basic CCC loan pattern

As is well known, an eligible taxpayer may use agricultural commodities as collateral for a loan from the Commodity Credit Corporation. The loans are, basically, non-recourse so that, at maturity, if the

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loan plus interest is not paid, the commodity may be forfeited to the CCC as full payment for the loan.

No election made. If the election has not been made to treat CCC loans as income when the loan proceeds are received, the taxpayer has no taxable income until the commodity serving as collateral for the loan is sold or forfeited to the CCC as payment on the loan. Thus, the mere taking out (and payment of) a CCC loan does not in itself have income tax consequences. Income tax is due on forfeiture of the commodity to CCC or sale of the commodity after discharge of the CCC loan.

Election made to treat CCC loan as income. A taxpayer may elect to report CCC loans as income in the taxable year in which the loan is received. The election, once made, applies to all subsequent taxable years unless permission is obtained from the Internal Revenue Service to change back to treating CCC loans as loans.

The election to treat CCC loans as income applies to all commodities for that taxpayer. Actually, the election involves reporting as income the value of the commodity held as collateral up to the amount of the loan rather than reporting the loan itself as income. As the regulations state—

> "If a taxpayer elects or has elected...to include in his gross income the amount of a loan from the Commodity Credit Corporation...then—
>
> "(1) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives an amount in addition to that advanced...as the loan."

IRS has ruled that a Section 77 election, once made, applies to all loans in that year.

For loans redeemed the same year, the courts have been divided. The Fifth Circuit Court of Appeals in the 1963 case of *Thompson v. Commissioner* held that no income was realized from the loan allocable to a commodity that was redeemed in the same taxable year that the CCC loan was taken out. As the court stated—

> "§ 77 does not prescribe that the loan is income. It prescribes that it should be 'considered as income' and when so done, the method of computing income so adopted shall be adhered to..."

The Ninth Circuit Court of Appeals, on the other hand, held in 1968 in *United States v. Isaak* that the loan amount was income, even though redeemed the same year. As the court noted, the loan is the taxable event.

Changing methods of reporting

A taxpayer who has been reporting CCC loans as loans may shift at any time to reporting CCC loans as income. The question is the procedure for shifting from reporting CCC loans as income to reporting such loans as loans.

Before 2002, under the regulations, application for permission to change had to be filed within 90 days after the beginning of the taxable year to be covered by the return. IRS has established procedures for taxpayers to receive a 90-day extension of time for applying for a change in method of accounting under the regulations. Note that, in general, requests for a change in method of accounting for several years have been able to be filed until the due date of the return with extensions.

Effective for taxable years ending on or after December 31, 2001, IRS has ruled that a taxpayer reporting CCC loans as income can switch automatically to treating CCC loans as loans. For the year of change, all loans that year are reported as loans. Loans taken out previously continue to be treated as if the election to report loans as income was still in effect. As the 2002 guidance states, the change is made on a "cut-off" basis.

This change can be very helpful for those wishing to shift back to treating CCC loans as loans late in the taxable year.

Ag Decision Maker Goes Electronic

by Don Hofstrand, extension farm management specialist, 641-423-0844, dhof@iastate.edu

This new Internet site can be found at http://www.extension.iastate.edu/agdm.

Like the print version, this decision-oriented agricultural business Internet site is designed for farmers, lenders, farm managers, agriculture instructors and others. It provides up-to-date information from agricultural economists at Iowa State University and other Midwest universities and institutions.

"The new online version offers a number of interactive tools we can't offer in the print publication," says Don Hofstrand, ISU Extension farm management specialist and editor of Ag Decision Maker. He urges all ag professionals and instructors to check out the Web site, even those who subscribe to the print version. Four types of information are offered on the site:

Newsletter Articles

This section is updated monthly and provides analysis and insight into many of the issues facing modern agriculture. All newsletter articles published since 1996 are available.

Decision Files

More than 160 Decision Files provide information and procedures for analyzing and finding solutions to many of the decisions facing farmers and agribusinesses. Each Decision File can be printed or read from your computer screen.

Decision Aids

Many of the Decision Files have Decision Aids (spreadsheets) for on-line computation. Just enter your figures into the spreadsheet to analyze your individual situation and save the analysis as a file on your computer.

Teaching Activities

Many of the Decision Files have Teaching Activities for use in high school classrooms. Students can complete the Teaching Activities from information provided in the Decision Files and save or print the document and provide it to their instructor. Teachers can access a restricted area of the site to get answer keys and other teaching tools.

The montly print publication will still be available for a fee. Those interested in subscribing to the print publication should contact Trece Lonneman at (641)-923-2856 or via e-mail at trece@iastate.edu.

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