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An Old and New Cooperative Alternative: Integration by Farmers Into Fluid Processing to Develop Local Brands to Capture Some of the Channel Margin

by

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The branded integration strategy is not new. Recall that Agrimark owned Hood in a joint venture with Agway for many years. It did not work for many reasons, including the fact that Agrimark was prohibited by the U.S. Justice Department from direct representation on the Hood board of directors. Justice feared vertical foreclosure, i.e. if Hood was controlled by Agrimark then other non Agrimark farmers and cooperatives might not be able to sell milk to Hood. On this point let us hope that Justice exercises similar concern on the current Hood, National Dairy Holdings merger where vertical foreclosure will, if the merger is allowed as proposed by the companies, cut Agrimark producers off from Hood.

Today smaller groups of farmers in New England are forming cooperatives and processing and marketing milk under their own label. Recently I received an e-mail that Don Francis wrote to the Working Lands Alliance Lobbyist. It addressed this issue within the current market and political context in a very telling fashion. It is printed below and my response follows.

Don Francis

“Armando, glad you clarified the dairy issue and our legislative priorities... The Grocers are pretty upset as we learned from Grace Nome and I would not like alienate them when we may need all the help we can get on the PDR issue. Your opinion please. On the grocery issue I was at a meeting in Woodstock with Family Farms a retail farm co-op located in MA who have been accepted into Big Y and Stop and Shop stores at no cost with their local milk which sells at a premium. The co-op is looking to expand to CT and is recruiting farms in Eastern Connecticut so they can sell in CT. If the chains will support local products we need to be careful on the issue of milk pricing and what their profit is if we want our farmers to get some of that profit. I think it might be beneficial to start a dialogue if the opportunity arises. Don”

Can farmers integrate into processing, sell their own branded milk and get some of that profit? Will retailers let the farmer on the shelf and share their profits with the farmer if we give them a break and stop pushing this fair pricing law? Will PDR get more money? There is a lot of the “fox and gingerbread boy” in this approach, Grace Nome and the retailers being the fox. Why would they be so generous? For that matter if they are so generous then why don’t they support the fair pricing approach? It gives farmers a share of channel profits.

We have some market-generated information on how a farmers Connecticut Grown brand might do in the market place. Look at the performance of Mountain Dairy.

Mountain Dairy does not sell in the state’s major supermarket chains. It sells only in the small independent Highland Park Markets (5 supermarkets) and a lot of other even smaller outlets. Highland Park’s private label milk is an innovative hybrid label that prominently identifies Mountain Dairy as the source. A copy of its label and bottle cap are attached. Mountain Dairy milk is BST free and promoted as such.

Table 1 uses milk price data from Highland Park and supermarkets that compete with it to identify the Highland Park/Mountain Dairy price situation. Do they get a premium? They do not. Look at the first row in Table 1. The hybrid Highland Park/Mountain Dairy milk currently sells for \$2.99 (whole and 1%) or \$3.19 (2% and skim) per gallon. When compared to milk prices in other stores these prices are not high. The A&P sells all private label milk for \$2.99 per gallon, all Garelick milk for \$3.29 per gallon, and all Hood for \$3.69 per gallon. It is the closest supermarket to Highland Park. Shaws has the same price as A&P except it charges \$3.49 per gallon for all Garelick. Stop and Shop private label is cheaper than HP/Mountain Dairy but its Garelick and Hood prices are much higher. Big Y private label and its mega brand milk are

slightly lower priced than H.P./Mountain Dairy but one could hardly call the difference a brand premium. Guida and Hood milk at Big Y are general higher priced.

Perhaps the clincher on the idea that the farmer brand sells at a premium is the Hood price in Highland Park. Hood milk sells below H.P/M.D. for 2%, 1% and skim. Moreover these prices are far below Hood prices in other stores. What gives?

The pricing manager at Highland Park explains that early last summer Hood offered their chain a permanent wholesale price reduction that gives them a much lower wholesale price than other supermarkets. In fact Hood wholesale price is lower than Mountain Dairy's. Highland Park passes the lower wholesale price on to consumers.

The impact on Mountain Dairy is obvious. Mountain Dairy can't charge a premium and the retail price for its product are at the private label level of the market. If Hood milk sold at \$3.69 per gallon as it does at other stores in the area, Mountain Dairy sales would be much higher. Hood clearly wants to and is severely limiting the sales of Mountain Dairy milk at Highland Park markets. In our analysis of milk prices in 195 stores across southern New England and eastern New York we found no other instance of such sharp price conduct by Hood.

We conclude that the Mountain Dairy works hard and finds it is hard work to get distribution. Costs to supply many smaller stores that it supplies are even higher than deliveries to the 5 Highland Park supermarkets.

Mountain Dairy is a very small player in milk processing and distribution. They process around 15 million pounds per year whereas milk production in the state is around 500 million lbs. Garelick processes over 1 billion lbs a year in its Franklin Mass super plant. Ever heard of economies of scale?

Also consider the fact that the consumption of fluid milk in the state of CT is about equal to the production of CT farms. To get a premium for all Ct farm milk would require that all milk in the state be sold at a premium. This simply cannot happen. Poor people and sensible people are not going to pay a premium for milk that is essentially identical to lower priced milk. Private label milk, the lowest priced milk, commands well over 50% of the retail market.

Also consider the price that any CT Grown premium would create given Hood at \$3.69 and Garelick at \$3.39 and store label at \$2.99. Selling CT Grown at \$3.75 or \$4.00 is a solution for at best a very small group of CT farmers. Just go into the store and look at the Vermont Organic Cow brand of milk. Sure it is there and they get over \$4 per gallon and in many stores over \$5, but how much milk moves under this label? And how much of that high price is kept by the retailer as to cover the added costs of this very slow moving brand of milk and to capture the same high profit rate that they earn on other brands? Category management practices for maximizing profits require that all brands earn their space in the dairy case.

Finally a strong case can be made for the following position. Consumers really do not need more brands of high priced milk. They need cheaper milk. Farmers also benefit from lower priced milk if the low price comes from margins rather than low farm prices.

Per Capita consumption of milk would go up much more if farmers focused on getting retail prices a little lower rather than doing “drink milk” advertisements. Cutting the price by 10% (only 30 cents) increases consumption by 6 to 8%. No advertising or check-off promotion for the amount of dollars spent today can come close to that impact.

The Mountain Dairy Highland Park strategic alliance to establish a hybrid milk brand is innovative and very attractive. Clearly Hood thinks that it is as well and views it a long term strategic threat to their brand dominance. Should farmers try to do more of this? Perhaps but

note that Mountain Dairy linked with a small independent chain, not a multinational retailer such as Royal Ahold/Stop and Shop or Sainsbury/Shaws or Tengelmann/A&P. Guida, a medium sized processor is linked with a medium sized (regional) chain, Big Y. Small farmer processors will be most successful if they locate smaller progressive pastures. Finally it is absolutely critical to understand that this a risky and competitive option and that it in no ways substitutes for a fair pricing law that elevates the price of raw milk to all farmers.

Table 1: Mountain Dairy: Private Label, Garelick, Guida, and Hood Milk Prices:
Coventry, Mansfield, Willimantic, CT

March 13, 2003				
Store/Brand	Whole	2%	1%	Skim
Highland Park Market: No. Coventry				
H. Park/MT. Dairy	2.99	3.19	2.99	3.19
Hood	3.29	2.89	2.89	2.89
A&P: Mansfield 4 Corners				
Private Label	2.99	2.99	2.99	2.99
Garelick	3.29	3.29	3.29	3.29
Hood	3.69	3.69	3.69	3.69
Shaw's: RT 32 Willimantic				
Private Label	2.99	2.99	2.99	2.99
Garelick	3.49	3.49	3.49	3.49
Hood	3.69	3.69	3.69	3.69
Stop & Shop: RT 32 Willimantic				
Private Label	2.99	2.89	2.79	2.69
Garelick	3.49	3.49*	3.49*	3.49
Hood	3.69	3.69	3.65	3.69
Big Y: RT 195 So. Mansfield				
Private Label	3.09	2.99	2.89	2.79
Mega	2.99	2.88	2.79	2.69
Guida	3.29	3.29	1.98**	1.98**
Hood	3.69	3.69	3.69	3.69

*Comes with a 50 cent gas coupon for Stop & Shop station

**Price special; regular price is \$3.29