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Business models for farming

Farm innovation and proposed system for entrepreneurs and farmers to operate for mutual benefit

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FARM INNOVATION AND PROPOSED SYSTEM FOR ENTREPRENEURS AND FARMERS TO OPERATE FOR MUTUAL BENEFIT

Innovation is crucial to economic growth and the alleviation of poverty. It does not just concern new production technology but also new business structures and marketing techniques. UK farmers tend not to maximise financial profit but wellbeing, which includes amenity and social gains. Where these objectives are met exposure to new risk is often considered unnecessary. However, this is only where profit is sufficient for cash needs. The removal of subsidy in the UK increases the need for new thinking. Imaginative joint ventures can enable new products to be developed while minimising production cost.

UK farmers need to move away from commodity production and commodity markets in order to achieve price premiums. Marketing mechanisms, contracts and branding have a role at least equal to the production of unique products.

A system is described allowing the entrepreneur to provide ideas, specialist skills and specialist equipment and the farmer to provide land, buildings and general equipment, livestock and, most importantly, economies of scale. The division of return reflects relative risk.

Key words: Farm innovation, Farm entrepreneurs, Joint Ventures

Introduction

There are a number of reasons why UK and European farming returns are low compared with other sectors:

- Few UK farmers consider return on investment. Both traditional and new farmers value the farmhouse and other amenity aspects and, like any householder, the house is not considered an asset demanding a commercial return.

- Farmers are often isolated and have very little experience of other industries. Leaving the industry is a much bigger step than for other entrepreneurs.
- In the UK tenant farmers frequently have relatively little capital and the capital released on retirement is in many cases insufficient to allow purchase of alternative accommodation and the cost of renting similar property off the farm is sometimes similar to the farm rent which includes a profit-generating land asset. In the UK pre 1996 tenancies limit the rent to below the open market value and where the farmhouse is included in the tenancy the total rent for land and property is often lower, or only marginally higher, than the open market rent for the house alone.
- Over employment is the norm in many farming sectors because i) more farm labour is a cost effective means (i.e. is taxable expenditure) of improving the principal's quality of life ii) the relationship between the farmer and employee is often very close and reduction in employment as new technology is introduced is unacceptable by any means other than natural wastage.
- Volatility of farming income can mean that the reaction to a fall in profit is not immediate since there is an expectation that profits will improve.

However, this situation can only continue where **the profit is sufficient to meet immediate needs**. In these circumstances farmers tend to accept a lower level of risk than would otherwise be the case. Where the return is adequate for immediate needs it is quite reasonable to avoid complication.

In theory, the UK farming subsidy is decoupled from production (although coupled to land) so its loss post-Brexit, as has been announced, should not impact on cropping and stocking. In practice, the subsidy is used to cross-subsidise the farming activity and provides the farmer with sufficient income to maintain lifestyle without risky change or socially difficult decisions.

In addition, the Government has proposed that while the subsidy is phased out in England, it will no longer be coupled to land. This is expected to reduce land values but more significantly is a major component of rent. A reduction in subsidy will be largely reflected in lower rents.

Regardless of whether loss of subsidy is reflected in profit or rent, the reduction in income will force many farmers and landowners to look for more income and accept a higher level of risk than they have been used to.

Thus at present few farmers would want the complication of letting or introducing contract farming or share farming arrangements onto small areas. In future these arrangements are likely to provide a **necessary** means to increase income.

Adding value

For a commodity, the price paid by a consumer will always be based on the lowest price available since there is nothing to distinguish different supplies. The producer will continue to supply where the cost of production plus target profit is at or below the highest cost producer prepared to supply that market. While the UK climate provides many production advantages, social and political constraints raise cost over those achieved by other producers. The need for more income forces a re-think.

While UK commodity prices have varied, marketing boards in the 1930s and more recently intervention buying, export restitutions and import tariffs have kept prices in a narrow range compared with other global producers. The return on marketing effort has been small and these skills have not usually been developed.

In order to avoid sale into low priced commodity markets the producer has to provide a unique product valued by the consumer and secondly limit supply to achieve the optimum price, needed to maximise profit, from the demand. To maximise profit requires a balance between volume produced and price: a bigger volume is likely to result in a lower price. Optimisation will require balancing the two components. Maintaining a limited supply and thus price requires a barrier to prevent production.

Unfortunately, quality attributes often have a high genetic component, which the farmer does not own. In this situation the supplier manages the market to maximise the sales return but this will often result in market saturation with the consequent loss of any significant premium for the producer.

To retain value the farmer needs to create a unique product. The advantage may be genetic improvement, processing of the commodity to produce a unique item, novel marketing or even branding although ideally the brand needs to have particular unique characteristics. Perception of quality can be as important as a definable characteristic.

The scope for producing distinction is vast. Many are familiar with Uber, Deliveroo and contactless payment cards. These all provide a better service than their more traditional equivalents. The fundamental services (taxis, food delivery and payment) are unchanged.

But there are lesser known examples. Liquid milk is almost the ultimate commodity and very difficult to make distinct. The UK still has a milk delivery service to the consumer in some areas although it is in decline. Historically, the milk was delivered daily or every other day to the consumer early in the morning. In contrast, the entrepreneurial owner of one business sourced milk directly from the farm and delivered in the evening. The buyer no longer had milk left on the doorstep during the heat of the day and did not have to leave the money overnight on the doorstep (pre internet) with risk of theft. The supplier met the customer, had a chance to build rapport (allowing further sales) and could claim the milk was the freshest in the area. Sales boomed and a serial entrepreneur was born.

Pricing may also enable products to be distinct. Many supplying professional services recognise that an increase in fee rate in itself suggests a higher quality service. The supply of sandwiches via supermarkets and petrol stations in the UK is less than 40 years old. Introduction was a success but the price was limited by the perception that they were a snack rather than meal. The introduction of ever more exotic fillings converted the sandwich from a snack to a meal replacement, allowing a higher price to be charged.

In the long term, in order to secure a premium supply has to be restricted. Restriction requires a barrier to market entry such as a patent, high capital cost, expertise or restrictive contract imposed by the party aiming to maximise value. A quality assurance scheme available to all does not supply the producer with value. Geographical designations are valuable since even an expert Stilton cheesemaker maker cannot produce Stilton cheese if not located in one of the three designated counties.

System weakness

While UK farmers in common with farmers elsewhere have a can-do attitude, most have little interaction with other industries and few have experience from other sectors. This means that transfer of new ideas is less than would be the case for other industries.

Ideas are hard to find. We need to encourage as many as possible to contribute and make it as easy as possible for those with ideas to make them work.

The entrepreneur is faced with a number of challenges such as lack of:

- suitable premises
- scale in:
    - Production
    - Marketing
- capital
- financial expertise
- legal expertise
- experience
- time

It is these barriers that systems need to be designed to overcome.

Possible solutions

Possible solutions in most cases require a new idea and the ability to devote time to make the idea work. In contrast to the low subsidy producers in Australia and New Zealand, the UK has a large internal market with exceptionally low cost to market. There is also a demand for novelty and the wide social mix means that the interest in a diverse range of agricultural products provides a unique opportunity for UK farmers in food and fibre production.

The proposal is that an environment is created on farms to nurture the entrepreneur and allow the entrepreneur to benefit from scale and capital.

There are many permutations but generally the entrepreneur provides ideas, specialist skills and equipment and the farmer allows production with economies of scale and experience. The return is divided according to risk.

Thus:

- The farmer provides land or stock and services to the entrepreneur. The farmer may also supply buildings. In exchange the farmer receives a rent or profit share for the fixed equipment and a contracting payment for services. A proportion of stock may be supplied by the entrepreneur or hired from the farmer.

- The entrepreneur provides the idea, manages the production and any processing, identifies markets and supplies any specialist equipment. Most importantly the entrepreneur only has to produce the crop where he has competitive advantage and no complementary production is needed to maintain rotation or production volume in order to achieve economies of scale.

Since much of the production work is delegated to the farmer in order to achieve the economies of scale, the entrepreneur is free to develop the product or may even operate part time.

While not an essential requirement there is a role for consultants and extension services to facilitate by providing agreements, sales contracts, budgeting services and assistance with grant applications.

The following illustrates the process:

Example - Coriander seed production in the UK

To illustrate the mechanism it may be possible to capitalise on the current demand for novelty gin. This is a relatively simple process and is reliant on differentiation. This may be achieved through a joint venture arrangement.

Coriander seed is the second major flavouring ingredient in gin after juniper. UK import statistics show imports of around 4,000t at about £1,000/t[1] after the cost of transporting to the portside in the UK. While the seed crop is not generally grown in the UK the leaf crop is grown and research uncovered a farm that grew the crop about 35 years ago and periodically prior to that. The UK crop produces a yield of about 1.5 t/ha with very low input cost.

The entrepreneur recognises that while the crop would compete with other land uses:

1. Over supply leading to a price collapse is a major risk
2. The crop has to be grown in rotation with crops where the entrepreneur cannot add value and would probably be unprofitable

[1] HMRC import statistics

3. The scale of operation would be small and therefore at a high cost

Point 1 is the major threat but the entrepreneur recognises two solutions. She could i) negotiate a contract with one of the major gin suppliers emphasising the brand value of a gin using local botanicals ii) produce her own gin using the farm production along with other cultivated and wild botanicals to produce an original unique product. This would require a use of a building although this would not need to be on site.

Grown jointly with the farmer, the entrepreneur gains a suitable rotation and primary cultivations, drilling and combine harvesting at a scale appropriate the whole farm area.

The provision of 12 ha would secure a rent of at least £3,000. This is not sufficient on its own but on this area would cover the loss of subsidy and match the additional rent that could be achieved from commodity crop production. It would not have been considered in the past when return was adequate for needs without the hassle of this and other niche enterprises.

If the venture went well there may be scope to substantially scale the business, for example, by producing other botanicals. Grant funding may be available to convert one of his buildings to manufacture gin and provide a visitor experience and provide an income for its use.

In addition, in contrast to other arrangements the farmer should be able to obtain over £250/ha for supply of labour and machinery which would maintain flexibility, the existing machinery complement and current labour force. Furthermore the entrepreneur may provide useful reserve labour for other farm work.

While this example perhaps lacks substance the point is made that there are opportunities that are not currently made the most of.

Other examples

There are examples of these kind of arrangements in operation with some very large businesses adopting the concept. UK vining pea production is an example of a large business operating in a similar way. The vining pea group is provided with land, supplies specialist harvesting equipment, processes the crop and markets the crop while the farmer supplies land and undertakes operations such as land cultivation, fertilising and spraying - providing economies of scale where it is possible to do so. The entrepreneur supplies specialist equipment where it is needed and marketing.

The arrangement suits livestock enterprises equally well where say a wagyu beef producer seeking to supply specialist meat into London (a similar enterprise to that described successfully supplies wagyu beef to the Amazon supermarket chain “Farmers' Market”) or a specialist cheese maker may add animals to an existing herd, allow economies of scale to be achieved while creating a new product.

Conclusion

Removal of subsidy will force change on the UK farming industry in order to generate cash even though many farmers are at present prepared to operate below the apparent economic optimum. Cash generation will require a fundamental look at UK competitive advantages, a search for innovation and acceptance of higher risk. The greatest opportunity for innovation is likely to come from the involvement of the largest number of people and with experience from outside agriculture. These demands may be best met through joint ventures within the existing farming units in order to achieve the available economies of scale from the initiative.

While upland livestock farms are the most subsidy reliant sector, and thus face the largest challenges, they would also benefit from structural change and innovation. Low population density makes it harder to introduce joint ventures such as those described but not impossible. The remote Scottish Isle of Lewis benefits from a farm based whisky distillery using some of the barley grown on the farm (thus retaining the economies of scale) with the distillery providing income from tourists as well as sales of whisky. Other remote farm diversifications may use the property element. Not all diversifications will be formed via a joint venture but a successful venture will usually require that the entrepreneur is underemployed if the venture is to be a success. There are a number of suggested means to enable farmers to achieve a premium from the UK market by exploiting product and supply chain innovation.

In order to maximise benefit entrepreneurs need to be encouraged in to the industry and mechanisms are needed to ensure economies of scale are achieved. As with any joint venture of the up most priority is trust supported by a pragmatic agreement with reward, input and risk fairly rewarded.