

# **FARMING IN THE 21<sup>ST</sup> CENTURY**

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## Preface

The U.S. agricultural industry is in the midst of major structural change — changes in product characteristics, in worldwide production and consumption, in technology, in size of operation, in geographic location. And the pace of change seems to be increasing. Production is changing from an industry dominated by family-based, small-scale, relatively independent firms to one of larger firms that are more tightly aligned across the production and distribution chain. And the input supply and product processing sectors are becoming more consolidated, more concentrated, more integrated.

Agriculture in the 21<sup>st</sup> century is likely to be characterized by: 1) adoption of manufacturing processes in production as well as processing, 2) a systems or food supply chain approach to production and distribution, 3) negotiated coordination replacing market coordination of the system, 4) a more important role for information, knowledge and other soft assets (in contrast to hard assets of machinery, equipment, facilities) in reducing cost and increasing responsiveness, and 5) increasing consolidation at all levels raising issues of market power and control.

These profound changes in the agricultural industry present new challenges and new opportunities that require new ideas and concepts to analyze and implement. They require new learning and thinking. Some of those new ideas and concepts are presented here, not as empirically verified truths, but as “thoughts” to stimulate different and better thinking. They have been developed based on observations, analysis and discussions with numerous managers and colleagues in agribusinesses in North America and Europe. This series focuses on Farming in the 21<sup>st</sup> Century; companion series are also available on Financing and Supplying Inputs to the 21<sup>st</sup> Century Producer (Staff Paper 99-11), and Value Chains in the Food Production and Distribution Industries (Staff Paper 99-10).

Our purpose in sharing these “thoughts” is to invite discussion, dialogue, disagreement — in general to encourage others to develop better “thoughts”.

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## **On Being a Qualified Supplier**

The relationship between producers and processors is expected to change dramatically in the future. Whereas producers in the past supplied generic commodities to processors primarily through open markets, the producer of the future will more likely be a qualified supplier of specific attribute raw materials to be used by a particular end-user.

What will processors expect of qualified suppliers? First, they expect them to be cost competitive in producing raw materials. Although processors in the future may source their raw materials from producers through contracts or other longer-term agreements rather than single transactions, they will still expect to buy those raw materials at the lowest cost possible.

The second requirement is consistent quality. Increasing quality expectations of end-users requires processors to source raw materials with more consistent quality characteristics. Producers may be rewarded for quality through premiums (or discounts on those raw materials that don't meet quality standards), or alternatively product that doesn't satisfy quality expectations may simply not be accepted by the processor.

A third requirement of a qualified supplier is that of reliability. Processors will increasingly schedule suppliers to deliver a specific quantity of raw materials at a particular time, and expect that supplier to do so. This reliability expectation will again impose more structure and tighter alignment in the supplier/processor arrangement.

A fourth expectation of the processor from a qualified supplier will be that of flexibility and adaptability. At the same time that the processor wants reliability, he or she will also want to have suppliers that can make adjustments in delivery schedules if needed, or over time change their production system to adapt to different end-user requirements. This balance (or maybe conflict) between reliability and adaptability, and the rewards processors provide the supplier for maintaining that balance, is one of the critical conflicts faced by a qualified supplier.

But being a qualified supplier is not a one-way street. What should a qualified supplier expect from his or her processor? First, a qualified supplier should expect equitable compensation for product and services provided, and equally if not more important, equitable sharing of the risk. In many fixed price contracts used in agriculture today, the risk between the producer/supplier and processor is not equitably shared; some form of revenue or profit-sharing based on resources contributed may be a more equitable risk and reward sharing arrangement than fixed price contracting.

A second requirement a qualified supplier should expect of the processor is market presence. With increased competition in the agricultural markets, a processor who does not have significant size or market presence may not be viable even in the short to intermediate run. Becoming a qualified supplier to such a processor may be committing to a company that may not be a long term player in the market.

A third requirement or expectation of the qualified supplier should have of the processor is dependability — the processor will take deliver of the specified product and compensate the supplier according to the agreement. And this dependability extends beyond a single transaction — the processor must be consistently committed and able to fulfill his or her commitment under the qualified supplier agreement.

Finally, a qualified supplier should expect the processor to provide him or her access to innovative products and services, and to consistently develop new markets. As competition results in substitute products and margin compression over time, the benefits of being a qualified supplier for a processor who does not innovate will be constantly challenged or undercut by competitive forces. So the producer must be willing to adapt to changing market conditions, and should expect his or her processor to not only have the market presence to anticipate these changing conditions, but to assist their affiliated qualified suppliers in adapting to these new markets.

To be successful in the long-run, producers should insist that they are qualified suppliers in an evolving supply chain, one that remains vital by constantly renewing itself through product, technology and market innovation.