

Risk Management

Adding Value to Agricultural Products

David P. Anderson and Daniel Hanselka*

Value-added agriculture generates several billion dollars in economic impact for the state of Texas each year. In fact, adding value to agricultural products beyond the farm gate usually has several times the economic impact of the agricultural production alone.

Agricultural producers receive a much smaller portion of the consumer's dollar than do food processors, especially processors who produce brand name items (e.g., Sunkist, Del Monte). Capturing those additional dollars by adding value to farm or ranch products is a goal of many producers. This leaflet defines value-added activities, outlines the economic forces that make adding value important, and provides guidelines for starting your own value-added business.

What is "Value Added?"

"Value added" means adding value to a raw product by taking it to at least the next stage of production. This can be as simple as retaining ownership of your calves and wintering them on wheat pasture or placing them in a feedlot. Value can be added through membership in a cooperative that processes your products, such as a cooperative cotton gin. Or, adding value may be as elaborate as going all the way to the consumer with a "case-ready" food product.

If you are considering a value-added enterprise, there are two key questions to answer:

1) What is customer value? and 2) What creates a value-added product?

What is Customer Value?

"Customer value" reflects the relationship between the benefits customers receive from and the price they pay for a product. The more benefits relative to the price, the higher the customer value. This does not necessarily mean that greater value results from a low price. The price of a particular product may be high, but if the associated benefits are high as well, the customers perceive the product as valuable. This interaction creates customer value and, thus, the opportunity to add value to your product.

Creating customer value is critical in building a profitable and substantial business. However, one must bear in mind that it is the customers' perception of value, not the producers', that is critical. Consider the case of pre-conditioning calves. Does the cattle buyer perceive the pre-conditioning program as adding value? That is, will the buyer pay more for preconditioned calves (enough to cover the added costs) than for other calves?

It is also important to recognize that different customers have different perceptions of added value. These perceptions correspond to their expectations of quality, service, convenience and selection.



*Professor and Extension Economist—Livestock and Food Marketing and Extension Associate—Economic Accountability, The Texas A&M System.

What Creates Added Value?

“Value” is usually created by focusing on the benefits associated with the agribusiness product or service that arise from:

Quality — Does the product or service meet or exceed customer expectations?

Functionality — Does the product or service provide the function needed of it?

Form — Is the product in a useful form?

Place — Is the product in the right place?

Time — Is the product in the right place at the right time?

Ease of possession — Is the product easy for the customer to obtain?

A product must have one or more of these qualities to generate additional value. Remember that a product is simply a bundle of benefits, and that the more benefits there are the more customers will perceive the product as having value.

What’s Driving “Value Added”?

Agribusiness, particularly the food sector, is rapidly consolidating and increasingly responding to the changing tastes and preferences of consumers. Consumers have higher incomes than ever before. They are focusing more on convenience, quality, variety, service, health and social consciousness. They are also faced with the increasing value of (and demands on) their time. In a nutshell, consumers are more value conscious than ever.

Consumers’ rising disposable incomes and the market fragmentation caused by retail consolidation exacerbate competition, but at the same time leave many niche markets to be exploited. This creates opportunities for producers to add value to their products.

Creating a Value-Added Product

To take advantage of opportunities in this area, one must know and understand customers. What consumer segments might want your product? What are the benefits desired by these potential customers? What criteria are they looking for when purchasing? Writing these down as

part of a business plan is an important first step in beginning a value-added business.

Any business enterprise can be thought of as a value chain. Each activity that is performed should add value to the product. To do this, one must meticulously control the activities at each step in the value chain: procurement of inputs; converting inputs into products; marketing and sales; supply chain logistics; and customer service activities. A new value-added business should focus on the product’s uniqueness. The uniqueness of your product or service (the value you add) is what ultimately attracts customers.

Obviously, this value-added strategy is very different from the commodity-oriented strategy with which most farmers and ranchers are familiar. In a commodity strategy, a producer focuses on the costs of production with the goal of being a low-cost producer. This is, in essence, a “supply-side” focus.

The value-added strategy, in contrast, involves a “demand-side” focus—determining who the customers are and what they want. Then, after assessing your resources and source of uniqueness, you provide a product or service that efficiently curbs production costs while meeting the needs of the potential market. Unlike a commodity-driven business, a value-added business cannot erode benefits or lower input specifications just to lower costs.

Steps to Success in a Value-Added Business

Building a new business is difficult and takes hard work (nothing new for farmers and ranchers). But, for all the uncertainty, there are ways to craft a successful value-added business strategy. The key factors in a detailed business plan are:

Operations plan — flow of the business, quality and cost control

Personnel plan — needs, skills and training

Sales plan — including challenging but realistic goals

Management plan — strengths, weaknesses and resources

Investment and financial plan — cash flow planning

Examples of Value-Added Agricultural Products

As an example of adding value to an agricultural commodity, consider wheat. Value can be added to wheat grain in many ways. One way is for farmers to produce wheat grain for use in feed or food products. Wheat straw, a waste product, can be harvested, processed and then turned into building materials. Another way to add value to wheat is to graze it with stocker cattle, which increases the yield of wheat by causing "tillering" of the plant, and also generates income from the cattle operation. Wheat grain also can be converted into organic natural foods and sold at health food stores.

It may be hard to believe, but value can be added to woody plants such as cedar and mesquite. Cedar fiber can be used to make boards and recap oil wells. Mesquite wood can be used to make boards, jewelry boxes, lawn furniture, and molding for floors. The sawdust and fiber from cedar and mesquite can be made into fiberboard. South Texas Molding, Texas Kiln Products and Uvalde Mesquite Company are some of the firms that add value to mesquite wood by making furniture and lumber.

There are also opportunities to add value in the fed beef industry. A rancher can add value by having a cow-calf operation or retaining ownership of his cattle through a feed yard. Another option is producing specialty products such as sausage and tamales, or processing tongue and some of the viscera into menudo or tripas. Booker Packing Company, Caviness Packing Company and J&B Foods are some of the companies adding value to meat successfully in spite of processing costs.

A recent survey of such companies indicated that their return on assets averaged 63 percent. Of the firms in the survey, 42 percent had fewer than five employees, 21 percent had sales between \$50,000 and \$250,000, and 26 percent had sales of less than 50,000 pounds of meat per year. Many of the firms are in rural areas, some close to urban centers, and they cater to the local population. The smaller firms tend to be the most profitable whether measured by sales dol-

lars, sales volume or number of employees. These small firms have developed value-added products and are marketing them successfully

Summary

Beyond business planning and market research to get to know the customer, the essential elements for success in a value-added business can be boiled down to four key ingredients for business managers:

- Adapt to market changes.
- Be open to exploring new ideas.
- Operate more as a resource manager than as a producer.
- Realize the importance of networking and the need to develop alliances.

These are difficult because they require a new vision of the farm or ranch. Managing resources and exploring new ideas means searching for new profit centers within your operation. That may seem tedious, but that is precisely what adding value is all about.

Internet Resources for the Entrepreneur

Opportunities for Adding Value to Your Products

ag.arizona.edu/arec/pubs/dmkt/dmkt.html

Horticultural Alternatives for Texas Agriculture

aggie-horticulture.tamu.edu/alternatives

Resource List for Marketing Alternative Crops

www.ianr.unl.edu/pubs/horticulture/nf107.htm

Potential Value-added Food Products Groups:

Marketing and Production Opportunities for High-end Consumer Food Products

agecon.lib.umn.edu/ndsu/aer419.pdf

Entrepreneur Magazine

www.entrepreneur.com

Alternative Farming Systems Information Center

www.nal.usda.gov/afsic/

Appropriate Technology Transfer for Rural Areas

www.attra.org

The Farmer's Guide to the Internet

www.rural.org/favorites.html

Adding Value to Farm Products: An Overview

www.attra.org/attra-pub/valueovr.html

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