Growth, business logic and trust in organic food chains: an analytical framework and some illustrative examples from Germany

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# Abstract

The organic food market in Germany has been growing significantly. While expanding, businesses and food initiatives face many challenges. The paper focuses on the challenge of maintaining the added values of organic farming and consumer trust. Both are key assets in organic food chains, and both are difficult to secure when volumes grow, distribution channels change and when producers, processors, sales businesses and consumers are less closely connected which tends to limit direct communication and transparency. In the central part of the paper, we present an analytical framework that can be used to better understand these connections. Focus is on changes in business logic, chain organisation and coordination. Three case studies of organic value chains in Germany are used to illustrate the application of the framework. The analyses show that business logics and strategies are implemented through a particular set of management and/or marketing instruments and that these impact on the organisation of the businesses, the linkages between chain partners and the marketing of products.

# Introduction

The German market for organic products has grown significantly. The annual volume of organic sales tripled since 2000 reaching 7 billion Euro in 2012. 3.5% of total food expenditures and 3.9% of total agricultural sales were organic in Germany (Köpke *et al.* 2013). However, the organic land area grew in a slower pace with only +50% from 2004 to 2011 (Koepke *et al.* 2013). The increasing demand for organic food and the growing gap between consumption and domestic production contributed to the development of much more globalised organic market structures (Köpke *et al.* 2013). Large-scale chains and operations mean that larger volumes can be provided. The development of larger and more globally integrated structures also means that the 'distance' between producers, processors, sales businesses and consumers has increased significantly. Large chains tend to provide standard qualities with a related loss in 'added organic value'. Other critical factors are anonymisation and lack of transparency (Baum 2013).

Recent events throughout Europe, such as elevated dioxin levels in organic eggs in 2012, EHEC germs on organic sprouts in 2011 and below base rate wages of an organic retail business in 2010 have arguably contributed to a growing scepticism towards the mainstream organic food system. Simultaneously, the progressive conventionalisation of the organic sector, especially in the processing and marketing structures, has become controversially discussed in the media. These major organic food scandals and the general decrease in trust found in related surveys are an expression of the fact that the communication along the chain is not as effective anymore and that chains have become less transparent and more anonymous. The *Oecobarometer* 2013, a survey conducted by the Federal Programme for Organic and Sustainable Forms of Agriculture (BOELN) analyses market trends and consumer views.

Elderly consumers buy less organic than last year: in 2012, 26% of the 50 to 59 year old consumers purchased always or regularly organic food but this group shrank significantly to only 19% in 2013. In addition, the share of elderly consumers increased stating that they will never buy organic (+9 percentage points.). 19% of all interviewees refuse to purchase organic products which are 4 percentage points more than in the precedent year. (BOELN 2013) Simultaneously, figures show that the regional origin of food products is of increasing importance for this consumer group (BOELN 2013). There are indications that the reason for this shift is an increasing lack of trust in organic food within at least the group of elderly consumers. The *Oecobarometer* ranks the motives for organic purchases in general: firstly, regional origin of food products with 87% of all interviewees; secondly, animal welfare with 85%, and thirdly, a low level pesticide contamination with 83%. More than half of the organic consumers (59%) buy organic due to the lower number of food scandals but this figure has been shrinking from last year (-5 percentage points). (BOELN 2013) Recent food scandals have hit conventional and organic markets due to fraud labelling or contamination (Dioxin, bacteria etc.).

This paper addresses these challenges in terms of business logics, business strategies and instruments. We will present an analytical framework that helps to answer the following questions:

* What business logics, business strategies and instruments are used by businesses and initiatives for managing 'added organic value' and trust?
* How are business logic and strategy changing in times of rapid growth in turnover?
* What strategies/instruments are used for securing the added values of organic farming and consumer trust? Or, in other words, how is growth successfully managed?

The focus in the analysis is on business logics, business strategies and instruments. More specifically, the connections between producers, processors, sales businesses and consumers, and the way they are managed need to be examined. The analysis goes in this respect far beyond an analysis of marketing and communication strategies. In the central part of the paper, we present an analytical framework that can be used to better understand business logic, chain organisation and coordination. The application of the framework is illustrated with three case studies of organic value chains in Germany.

# Theoretical background

Organic products are classified as “trust goods” because the consumer does not have the skills and the information to evaluate the quality of the goods encompassingly (Wieland *et al.* 2012*)*. For that reason, the additional value of organic goods (positive impact on biodiversity, reduced impact on water qualities etc.) needs to be implemented into the business logic and the business strategies when these values are to be maintained along the chain from the producer to the consumer. Organic food businesses with their original claim to share values seem to be predestined for business and management logics that go beyond pure profiteering. Such an approach is described by Porter and Kramer (2011) as "creating shared value" which involves creating economic value in a way that also creates value for society. Shared value opportunities can be realised by a) reconceiving products and markets, b) redefining productivity in the value chain and c) enabling local cluster development. Value chain business logics place emphasis on *both* the values associated with the food *and* the values associated with the business relationships within the food supply chain (Stevenson *et al.* 2011).

# Analytical framework

Two levels need to be distinguished in addressing the questions related to maintaining organic values from the producer to the consumer when chains expand: first, the business logic and second, the business strategy and the related instruments for the implementation of the strategy. A basic condition is that businesses and initiatives have to be economically viable in the long term, i.e. they need to (re)cover their full costs and ensure a minimum level of liquidity (economic sustainability). Additional aspects of the particular strategy of organic food chains vary. They could for example be:

* *differentiation in the 'market place'* via product or process attributes,
* *altruistic motivations* influencing the business logic vs. profit maximisation,
* *minimisation of 'distance'*, in particular between producer and consumer,
* *local or regional embedding* of business or initiative.

Differentiation in the 'market place' is probably the most common strategy but also the other three can be found. One or more instruments are used for the implementation of business strategies. Important is the implementation of the business strategy and its evolution during the growth process. Contracts and strategic alliances might play a key role.

The actual application of the analytical framework will use business and chain level data. Individual business data will be presented in the final version of this paper. Different data sources are used and often they will need to be combined. The main data sources are (in order of importance): interviews with key actors, annual business reports and business communications, a workshop with decision-makers from the chain's initiatives and/or businesses. The data gathered allow identifying, describing and assessing business logic and management concepts as well as strategies and instruments.

# Illustration of the application of the framework

The business logic represents the entrepreneur’s value system or the initiative’s overarching idea like product or process differentiation. It is driving the development of the organic chain.

**Table 1** shows how the business logic is supported by a business strategy which can be based on a range of instruments such as local labelling, animal welfare, artisanal production, the conservation of old varieties, adherence to social or ecological standards etc. Altruistic motivations, for example, can be expressed in paying above average wages or prices; or by providing support to small business partners.

## Table 1: Business strategies and the instruments for implementation

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| --- | --- | --- |
| Business logic | Business strategy | Set of instruments |
| *Differentiation in the 'market place'* | Process quality | Local labelling based on tagging of vegetable boxes, ear tag numbers on meat; participation at the Marine Stewardship Council etc. |
| *Altruistic motivations* | Fairness between chain partners | Higher product prices for farmers,Higher wages for employees and other contracts within businesses/initiatives and between chain partners |
| *Minimisation of 'distance'* | Low impact on climate change | CO2 footprint; 'food miles', local/regional labelling, regional window (*'Regionalfenster'*) etc. |
| *Local embedding* | Product origin “from the neighbourhood” | Local labelling, information on primary producers on produce, only typical products of the region |

**Table 2** contains three case studies of organic value chains in Germany that illustrate the application of the framework. In all three cases, it is a declared aim to maintain the added organic values. Well-working cooperation and communication within businesses and between chain partners is a key factor. The instruments supporting the cooperation between the nodes of the chain (e.g. contracting, integration of nodes, communication/marketing tools) and the internal organisation of the businesses or initiatives such as participation of employees in decision-making or the management structure are highly relevant for securing organic values and trust all along the food chain.

## Table 2: Characterisation of case studies

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| --- | --- | --- | --- |
| Case study | Business logic | Business strategy | Characteristics of the chain |
| I: Healthy food e.g. baby food | Very strong focus on consumers’ trust | Vertical integration of the chain | Well-known, “reliable” control body, strict control routines, transparency through the chain (accompanying certificates) and of cooperations |
| II: Wholesaler/ retailer e.g. box-scheme | Fairness | Transparent contract system | Association of producers, contracted deliveries, risk reduction for farmers, stable group of costumers, transparency of producer prices |
| III: Processor e.g. meat/dairy | High product and process quality | ‘Fresh and healthy’ from ‘happy’ animals | Daily processing, unbroken cold chain, proven hygiene standards, fresh delivery, chain transparency by e.g. ear tags and certificates |

# Conclusions

Business logics, strategies and instruments are critically important in an improved understanding of the development of the organic sector. The way they change in periods of (rapid) growth is a highly relevant success factor at business, chain and sector level. Business logics, business strategies and instruments are expressed in the connections between producers, processors, sales businesses and consumers, and in the way they are managed. The related analyses therefore need to go far beyond an analysis of marketing and communication strategies. Our analyses illustrate how business logics and strategies are implemented through a particular set of management and/or marketing instruments and that they impact on the internal organisation of the chains as well as each business. Business logics, strategies and management concepts differ from chain to chain; they drive decision-making and shape the evolution of organic food value chains.

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