



The Status of Food Hubs in Minnesota

A Report to the Minnesota Legislature



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Executive Summary

There are approximately 15 food hubs of varying sizes and structures operating in Minnesota. It is estimated that there are at least 300 food hubs in the United States that are engaged in various forms of local food aggregation and distribution. Most are new projects or start-ups, and some include value-added processing. Others are established commercial distributors who are incorporating local and regional sourcing into their business models.

The Minnesota Department of Agriculture contracted with Cooperative Development Services (CDS), a nonprofit organization that has been working across the organic, sustainable, local food system for almost 20 years, with projects completed at all levels of the system (producer, distributor, aggregator, retailer, consumer). In compiling their report, CDS conducted interviews with the University of Minnesota Extension Service as well as six active Minnesota food hubs. They also reviewed national food hub research and reports.

Key findings of their research include the following:

- There is no single business model for food hubs.
- There are many goals or definitions of success for food hubs.
- All hubs have a stated goal of achieving break-even and financial self-sufficiency.
- Support for new local food hubs is found in many forms.
- National food hub research is often flawed.

Based on their initial interviews and research, CDS finds food hubs face the following challenges and barriers to success:

1. Food distribution is a highly competitive business.
2. Food distribution is a high volume/low margin business.
3. Achieving success in mission often requires a trade-off with economic efficiency. Seasonal operation is a challenge for several reasons.
4. Most food hubs that appear to have reached break-even are located near, and service, major population centers.
5. Serving direct to consumer markets is very different from meeting wholesale market expectations.

CDS has outlined the following preliminary recommendations to overcoming barriers to success for new and emerging food hubs. Hub sponsors, champions and start-up managers should become very clear about the financial requirements (for both capital equipment and working capital) for start-up and long term operation.

1. All hubs need to use standard enterprise level accounting for effective management of operations.
2. Strategically choose market channels and product lines that right-size volume expectations with favorable margin opportunities.
3. Exhaust all opportunities to strategically grow profitable sales volume.
4. Consider partnerships that leverage the assets/resources of existing distributors.
5. Consider cooperative approaches to grow production volume.

As part of their contract with the MDA, CDS is continuing to conduct research, follow-up interviews, and analysis that will be provided to the MDA prior to the start of the 2016 Legislative Session. In the final report, they will seek to identify successful national examples of best practices for small rural hubs serving institutional markets, and others.

Introduction

This report is submitted pursuant to 2015 Legislation: SS Ch. 4, Art. 1, Sec. 2, Subd. 4:

Of the amount appropriated for the agricultural growth, research, and innovation program in this subdivision, \$250,000 the first year is for grants to communities to develop or expand food hubs and other alternative community-based food distribution systems. Of this amount, \$50,000 is for the commissioner to consult with existing food hubs, alternative community-based food distribution systems, and University of Minnesota Extension to identify best practices for use by other Minnesota communities. No later than December 15, 2015, the commissioner must report to the legislative committees with jurisdiction over agriculture and health regarding the status of emerging alternative community-based food distribution systems in the state along with recommendations to eliminate any barriers to success. This is a onetime appropriation.

Background

The Minnesota Department of Agriculture (MDA), in response to legislation passed and signed in 2015, sought proposals to research and report on the status of food hubs and other emerging alternative community-based food distribution systems in Minnesota. The goal of the research and reporting project was to provide a comprehensive report of best practices and barriers to success for food hubs based on a review of existing and failed food hubs in Minnesota, national research and recommendations related to food hubs, and interviews with the University of Minnesota Extension Service.

After publishing the request for proposals and reviewing responses, the MDA awarded the contract to Cooperative Development Services (CDS). CDS is a nonprofit organization founded in 1985. Drawing on the skills and expertise of an experienced and knowledgeable staff, CDS has participated in the development, restructuring, and expansion of cooperative organizations of all kinds. CDS has been working across the organic, sustainable, local food system for almost 20 years, with projects completed at all levels of the system (producer, distributor, aggregator, retailer, consumer). This experience gives them an in depth understanding of the financial, operational, market, pricing and supply challenges of developing viable alternative food systems. Qualifications of CDS staff involved in the preparation of this report can be found in the Appendix.

Data in this report relies upon the following activities performed by CDS as part of their contract with the MDA:

- An interview with University of Minnesota Extension;
- Six in-depth qualitative surveys with Minnesota food hubs, recently completed;
- CDS familiarity with national food hub research and reports;
- CDS experience with wholesale marketing of products certified by the Food Alliance (a sustainable certification program);
- CDS experience with market channel development for their value added producer clients;
- CDS business planning work, including feasibility analyses for two regional hub projects.

Prior to the 1-2 hour interviews, a questionnaire was created by CDS to capture information required by the Minnesota Department of Agriculture, as well as additional financial metrics of particular interest to CDS. The interview form and the phone interviews were structured with open-ended questions

(questions that do not provide response options). The open-ended form of interview was selected to obtain a more robust set of responses relative to food hub performance than is often found in published national reports. In reviewing national reports and studies, it is clear that reports based on forced responses were often aggregated and averaged with little regard to hub scale or markets served.

Definition of a Food Hub: Most commonly used definitions are very similar to the following, provided by the National Good Food Network, a project of the Wallace Center at Winrock International:

A food hub is a business or organization that actively manages the aggregation, distribution, and marketing of source-identified food products primarily from local and regional producers to strengthen their ability to satisfy wholesale, retail, and institutional demand

The traditional means of moving food from areas of production to markets of consumption relies upon fiercely competitive and highly efficient aggregation and distribution systems. These systems primarily source food from ‘large’ farms and regional/national brands where tight margins exist on large volume. Most food reaches consumers without much, if any, clarity about the farm(s) that produced it.

However, as consumers increasingly seek foods which are differentiated, sustainably produced, and source-identified, many producers and distributors have capitalized on this expanding market. The expansion of ‘local’ foods in wholesale, retail, and foodservice markets has primarily been supplied by commercial-scale producers who have sufficient supply and the on-farm infrastructure to meet the minimum volume requirements of local/regional distributors. Currently in Minnesota, nearly every food distributor sources increasing quantities of foods from a rather small number of wholesale-ready Minnesota farmers. With fresh produce, for instance, perhaps less than 100 Minnesota farmers currently supply 80 percent of the fresh produce moved through Minnesota-based distributors.

Many small producers in Minnesota and throughout the country are expressing desire to access wholesale, retail, and institutional markets but, as independent producers, are unable to meet the volume and standardized wholesale packaging required by commercial distributors. As a result, small farmers and many nonprofit organizations are addressing this issue by establishing ‘alternative’ community-based aggregation/packing/distributing/brokering businesses which may collectively be described as food hubs.

The Wallace Center has identified more than 300 food hubs across the United States which are engaged in various forms of local food distribution. Most are new projects or start-ups, and some include value-added processing. Others are established commercial distributors who are incorporating ‘local and regional’ sourcing into their business models. The food hubs interviewed by CDS for this report illustrate one or more of these attributes.

Interview with University of Minnesota Extension

University of Minnesota Regional Sustainable Development Partnership (RSDP): CDS conducted an open-ended phone interview with Greg Schweser, Assistant Director, Sustainable Local Foods, Regional Sustainable Development Partnership (RSDP), and University of Minnesota Extension Service. RSDP’s provide on-going educational services throughout each of their five geographic regions, plus statewide oversight. *Sustainable Agriculture and Food Systems* is one of their primary Focus Areas, which continues to be surfaced as a core function by their community partners in all corners of the state.

RSDP provides on-going educational services and facilitates discussions with numerous community groups who consistently identify ‘food issues,’ including food hubs, among their most pressing needs. These community leaders state the desire to develop robust local-based food systems which provide a number of perceived benefits including, but not limited to:

- Enhanced economic benefits to farmers
- Enhanced community-wide economic development benefits
- Enhanced landscape diversity
- Enhanced environmental benefits
- Enhanced food-crop resiliency and food security (California drought impacts)
- Promotion of better eating habits (children and adults)
- Enhanced human health and resiliency
- Enhanced diversity of farmers by: size, ethnicity, gender, age, etc.
- Greater access to healthy foods by all income groups
- Enhanced connection of the multiple roles food plays in affecting community pride/satisfaction

While community leaders acknowledge that ‘Changing the Food System’ will require a long-term vision possibly fraught with numerous challenges, they “need to start somewhere.” That ‘somewhere’ includes supporting individuals and groups eager to change the way food is produced and distributed, including via local food hub enterprises.

RSDPs note that the food hub ‘champions’ and supporting organizations are perennially optimistic about the formation and long-term sustainability of regional food hubs as on-going businesses. While RSDP guides producers to focus on business fundamentals when determining the type(s) of suppliers and the type(s) of markets, many farmers and food hub allies express great passion for developing hubs that specify sourcing from small and/or socially disadvantaged farmers and servicing high-volume, low-margin local markets. Many groups, for instance, target K-12 schools as one of their primary markets because they are passionate about providing great-tasting, nutritious foods to our children.

Community leaders, including some small farmers, express a strong desire to foster alternative food systems to venture beyond farmer’s markets and Community Supported Ag (CSA), which currently provide local food vibrancy but have limited market impact and are anecdotally reaching saturation in some locations. To that end, food hubs often target multiple markets including, but not limited to:

- K-12 schools
- Institutions (Post-Secondary Education, Health Care, Corporate, etc.)
- Childcare
- Local/Regional Retail Grocery
- Local/Regional Foodservice (Independent restaurants, restaurant chains, managed foodservice companies, etc.)
- Wholesale (via existing, commercial distributors)

As the RSDPs have interacted with numerous community groups about food hubs, the following needs have often surfaced:

- *Networking.* Farmers and community groups need access to the ideas and experiences of others doing similar work.
- *Feasibility analysis.* Groups need help/resources to facilitate independent feasibility studies to determine whether a food hub concept meets business fundamentals.
- *Food safety training.* Farmers need help understanding, interpreting, and implementing state and federal food safety requirements.

- *Price discovery.* Farmers are unfamiliar with the wholesale price point(s) at the farm-gate; food hub managers are unfamiliar with the wholesale price point(s) at the end-point market(s). Without reasonable price discovery, business planning is difficult for both food hub managers and farmers.
- *Accessing capital.* Farmer groups and non-profit organizations (or other community sponsors) need help acquiring the necessary start-up capital and infrastructure for hubs. Once started, most groups also need on-going operating capital until they reach a self-sustaining scale; some hubs acknowledge that their operations will indefinitely require capital in the form of grants and/or in-kind resources.

Location of Minnesota Food Hubs

CDS, in collaboration with RSDP, has developed the following list of known food hub enterprises as well as several food hubs which have ceased operations. While they have attempted to identify all food hubs, there may well be independent groups and informal networks of farmers and collaborative organizations operating without their knowledge.

Currently operating food hubs include the following six, which were interviewed for this interim report:

- Fresh Connect, Fergus Falls
- Sprout MN, Little Falls/Brainerd
- Minnesota Valley, Mankato
- Coop Partners Warehouse, St Paul
- Russ Davis, Inver Grove Heights
- Big River Farms, Marine on St Croix

Other known food hubs include:

- Headwaters Foods, Bemidji
- Farm Market Café, Onamia
- Local Harvest Market, Alexandria
- Willmar Food Hub, Willmar
- Lanesboro Local, Lanesboro
- The Good Acre, Falcon Heights
- Shared Ground Coop, St Paul
- Urban Oasis, St Paul
- Hmong American Farmer's Association (HAFA), St Paul

Food hubs which ceased operations include:

- Whole Farm Coop, Long Prairie
- SE Minnesota Food Network, Elgin
- Wholesome Harvest, (Iowa-based, but included Minnesota farms)

Note: There are many additional commercial food distributors serving Minnesota. These include several national broad line distributors as well as numerous regional produce-only distributors; all incorporate some local sourcing within their operations.

Interviews with Minnesota Food Hubs

CDS conducted open-ended phone interviews with six Minnesota Food Hubs, collecting preliminary data and observations from key management. While each of the hubs graciously answered questions and offered opinions and insights, some of their responses were confidential in nature. In many (most) situations, obtaining financial metrics was limited for a number of reasons. In some cases, the financial data and market performance was proprietary; in some cases the current 2015 performance data was not yet calculated; and in some cases the hub did not track financial metrics using standard enterprise analysis procedures. What follows is a brief summary of the hubs surveyed, including preliminary financial and market metrics.

1. Fresh Connect Food Hub, Fergus Falls, MN

<i>Date Formed:</i>	2014 (Pilot Year)
<i>Most Recent Full Year Operations:</i>	2015 (Second Pilot Year)
<i>Ownership/Structure:</i>	Project of Lakes Country Services Co-op LCSC Fergus Falls, MN.
<i>Estimated Sales:</i>	2015, \$70,000; 2014, \$35,000
<i>Stage of Development:</i>	Early (2 years)
<i>Contact:</i>	Jane Estes, Director of Operations, LCSC

Description:

Lakes Country Services Cooperative (LCSC), is a public, not-for-profit membership organization created by the legislature in 1976 to provide services to pre-K-12 educational institutions. LCSC currently provides services in a nine county area and has grown and expanded, “*To provide high quality, innovative programs to cities, counties and other governmental agencies and not-profit agencies.*”

The food hub was launched in a pilot form in the fall of 2014 aggregating food from local, mostly small producers, and delivering to school districts. In the summer of 2015 the hub piloted distribution to health care facilities in particular long-term residences and to two restaurant/retail customers.

A major goal for the Fresh Connect Food Hub has been to improve health in the region, through improved access to healthy, local foods. The initial focus has been on distribution of local food to K-12 schools, and to a limited extent, distribution to health care institutions. The hub has been championed by Dana Reith, the LCSC registered dietician, in collaboration with another regional organization - “PartnerSHIP 4 Health,” a four-county program to improve health in this largely rural area through improved diet, better nutrition, physical activity, and other means.

The hub has another primary goal of achieving financial self-sufficiency in the business of aggregation and distribution. A feasibility study completed in 2014 states, “*The first goal would be to start an aggregation and delivery service, the food hub, which like any service, should eventually be financially self-sustaining...Our recommendation is to move forward with a pilot year of operation to focus on institutional customers.*”

2. Sprout MN Food Hub, Little Falls/Brainerd, MN

<i>Date Formed:</i>	2012
<i>Most Recent Full Year Operations:</i>	2015
<i>Ownership/Structure:</i>	Transitioning from LLC to non-profit status
<i>Estimated Sales:</i>	2015, \$120,000 est; 2014, \$89,000
<i>Stage of Development:</i>	Early (three years plus several years of “pre-hub” operations)
<i>Contact:</i>	Arlene Jones

Description:

Sprout MN Food Hub manages the aggregation, distribution, and marketing of source-identified food products from more than 50 local and regional producers to strengthen their ability to satisfy wholesale, retail, and institutional demand. Currently, Sprout coordinates Farm-to-School (FTS) for six Central Minnesota school districts, wholesale sales for premiere and resort restaurants, and a Community Supported Agriculture (CSA) program.

Sprout originated from the farm of Arlene Jones (The Farm on St Mathias), a diversified vegetable and destination farm near Brainerd, Minnesota. Beginning in 2010 after 10 years of CSA operations, Jones initiated a Farm-to-School program with the Brainerd School District, facilitated by a modest Statewide Health Improvement Program (SHIP) grant. The season following, Jones engaged other local producers to join her FTS efforts, and the program benefitted from financial support of Region 5 Development Council and the Agricultural Utilization and Research Institute (AURI) to develop a feasibility study and business plan in 2012, which identified a LLC as the most expedient business structure and established marketing and financial goals for an aggregation and distribution enterprise. The process also established a not-for-profit entity for the purpose of fiscal oversight. The LLC is currently in the process of transferring its ownership to the non-profit entity.

The food hub operated 2012 through 2015 at The Farm on St Mathias, using the farm’s private infrastructure to aggregate and distribute food products. In late November, 2015, the food hub operations transferred to the Sprout Growers & Makers Marketplace, an indoor, year-round market for locally produced food and artworks in central Minnesota.

3. Minnesota Valley Food Hub, Mankato, MN

<i>Date Formed:</i>	2014
<i>Most Recent Full Year Operations:</i>	2015
<i>Ownership/Structure:</i>	Project of Minnesota Valley Action Council, a non-profit organization
<i>Estimated Sales:</i>	2015, \$170,000 est; 2014, \$45,000
<i>Stage of Development:</i>	Early (2 nd year)
<i>Contact:</i>	Joe Domeier

Description:

Minnesota Valley Food Hub describes itself as a “traditional, small produce wholesaler” that buys and sells local product. In addition to traditional distribution functions, the hub will wash and pack product and also does “fresh cut” processing for institutional buyers (cutting and slicing to order).

Located in a warehouse space in the Mankato home of Minnesota Valley Action Council (MVAC), the food hub is in its second year of operations. MVAC, one of the nation’s 1,100 Community Action Agencies, is a regional leader in the fight against poverty. It develops a portfolio of self-sustaining social enterprises that meet the new and changing needs of its clients while creating reliable revenue streams in a time of decreased government funding.

4. Cooperative Partners Warehouse, St Paul, MN

Date Formed: 1998
Most Recent Full Year Operations: 2015
Ownership/Structure: Subsidiary of Wedge Community Co-op, a consumer-owned natural foods retail grocery in Minneapolis, MN
Estimated Sales: 2015 est, \$25 million; local purchases \$4 million plus additional \$3-4 million cross-docked.
Stage of Development: Mature
Contact: Lori Zuidema

Description:

In 1999, the Wedge Co-op launched a wholesale distribution department, Co-op Partners Warehouse (CPW). This grew out of a desire to better access local and family-farmed organic produce. CPW is now a specialty distributor primarily sourcing perishable organic products to retail natural foods co-ops in six states, and other customers, and works closely with local and regional producers to help get their products to market.

Founded in South Minneapolis in 1974, the Wedge Community Co-op has more than 16,000 consumer owner members, and is one of the largest single-site retail cooperatives in the country with sales in excess of \$30 million. The Wedge continues as the parent company of CPW. A special membership category in the Wedge has been created for cooperatives purchasing product from CPW, and this allows retail cooperatives to participate in patronage distributions.

CPW operates year-round, and offers a full range of organic produce plus some additional products. Local produce is preferred and offered when available along with local dairy, cheese and some local grocery items. CPW sources produce not grown in the region along with out-of-season items from California and other regions. CPW seeks to work with family farms in those locations.

CPW provides a highly attractive “cross-dock” program to local growers including produce and meat. In this program CPW does not purchase product, but delivers product for producers, for a fee. In total, CPW purchase about \$3.5-4.0 million of local product and distributes an additional \$3 million of product in the cross- dock program for a total of \$6-7 million of local product handled.

5. Russ Davis Wholesale

Date Formed: 1955;
2012, Contract with Minneapolis Public Schools (MPS)
Most Recent Full Year Operations: 2015
Ownership/Structure: Private for-profit
Estimated Sales: >\$100 million overall; \$3 million MPS
5% MPS Farm-to-School, \$150,000;
20% MPS MN-Grown \$600,000;
75% MPS other produce, \$2.25 million.
Stage of Development: Mature
Contacts: Cricket James and Adam Gamble, Russ Davis Wholesale;
Andrea Northup, MPS

Description:

Russ Davis Wholesale (RDW) was formed in 1955 to procure and distribute fresh fruits and vegetables sourced from growers across the U.S., including Minnesota farmers. To that end, the company still purchases a large volume of Minnesota-grown products which make-up between 10-

15 percent of their year round business (as much as 30 percent of their volume during Minnesota’s peak produce months). Historically, RDW sold whole produce to retail grocers. Their 2010 entry into fruit/vegetable processing through their Crazy Fresh business provides value-added fresh products for foodservice accounts as well as grab-and-go packs in retail environments.

The RDW Farm-to-School (FTS) program has been in existence since 2012, with primary operations from their 60,000 square foot Inver Grove Heights warehouse, one of five warehouses serving Minnesota and adjoining states. This program specifies RDW as MPS’ prime vender for fresh produce, providing an approximately \$3 million fresh market for the district’s 35,000 students. This contract provides a market for RDW’s traditional Minnesota Grown program and their non-local products, but further encourages RDW to additionally source product from approximately 10 ‘small farmer groups’ identified within approximately 50 miles of MPS. This ‘hyper-local’ sourcing is a product of parents, teachers, and school board members whose goals include supporting small farms and/or farm groups who had not gained access to MPS or other wholesale accounts.

In the 2015-16 school year, the RDW program is expected to provide approximately \$150,000 of fresh produce from the small farm groups; \$600,000 of fresh produce from other Minnesota farmers; and \$2.24 million of fresh produce from outside Minnesota.

6. Big River Farms, Marine on St. Croix, MN

Date Formed: 2007
Most Recent Full Year Operations: 2015
Ownership/Structure: Big River Farms is a project of Minnesota Food Association (MFA), a non-profit organization.
Estimated Sales: 2015 est. \$100,000
Stage of Development: Mature, but transitioning away from wholesale markets
Contact: Katie Kubovick, Training Program Manager

Description:

Established in 1983, the Minnesota Food Association (MFA) provides a full range of educational programming about organic agriculture to beginning farmers and to all interested community members. MFA’s farmer training program serves individuals from socially-disadvantaged backgrounds, primarily refugees and recent immigrants. Aspiring farmers can choose to participate in varying levels of MFA programming, based on their needs and level of commitment to farming.

Big River Farms was created to aggregate/distribute fresh produce grown by farmers who were participating in MFA’s farm incubator program. MFA’s mission is to build a more sustainable food system based on social, economic and environmental justice. They seek to impact local food production, grow more sustainable food producers, and enhance their connections to markets and resources.

In 2005 the current farm was leased from the Wilder Foundation, located in rural Washington County, to remain close to immigrant populations and markets for local produce. In 2007 MFA began distributing produce under the name Big River Farms, opening up markets for the small-scale farmers in the training program. Organic certification was obtained in 2008, and the program continued to grow, launching numerous independent farm businesses in the ensuing years.

Big River Farms’ market reach served a variety of direct-to-consumer markets as well as a variety of wholesale grocery and foodservice accounts. While their marketing efforts successfully groomed

commercial accounts, the on-going market development demands meant that staff resources were drawn away from MFA's core mission of training immigrant/refugee farmers. As a result, in 2015 Big River Farms ceased serving commercial wholesale accounts, focusing instead on direct-to-consumer sales via the Big River Farms CSA, and limited farmers market and food coop sales. This strategy requires much less market development and permitted scarce staff resources to be re-directed to farmer training.

Preliminary Findings

There is no single business model for food hubs. Each of the six Minnesota hubs surveyed has a distinct business model with a different mix of market, product, services and/or supply channels. This is true of food hubs nationally as well. Comparisons across food hubs are made more difficult by this diversity. Best practices will also differ depending on the business model or activity undertaken.

CDS interviewed two established produce distributors who have a local program as part of a larger business. There are significant differences between these two. The larger of these has annual sales we estimate to be more than \$150 million and the smaller about \$25 million. We interviewed four small food hubs, three of which are new and in a start-up phase. The largest will sell perhaps \$170,000 of product this year. Making sense of this diversity, identifying best practices and opportunities to support local food expansion is complex.

Some of the other ways hubs differ include:

- *Definition of local.* Some define local as sourcing and selling within 50 miles, others a five state region. This creates significant differences in opportunity to source and sell product, the variety of product and potential efficiencies gained. The two established distributors in our sample have much broader definition of local.
- *Product mix.* All of the hubs surveyed handle fresh produce. Some are fresh produce only, others handle dairy, cheese, grocery items or meat. Some offer "whole product," others will prepare (cut, slice, and dice). Institutional buyers often required some pre-processing of fresh product. Two of the hubs (one large established hub and one start-up) have fresh processing as an offering.
- *Seasonal vs year round sales.* The two established food distributors surveyed handle a year round product mix with their local offerings coming in seasonally. The four small Minnesota hubs surveyed handle local product only, most of which is seasonal. Seasonality has been identified as a challenge by several interviewees.
- *Local only or local plus import.* Most established distributors provide year round supply, as do the two in our sample. In order to sell year round, the two established distributors sell a mix of imported and local product. While an exclusive focus on local might seem to be preferred by local food advocates, a larger product offering is often preferred by buyers. As a result the year round hub may achieve a greater market share in addition to efficiencies of scale.
- *Market channels.* Hubs and distributors differ by target market channels. Three major market channels for food distribution can all be found in the Minnesota hubs, in different combinations. Each of these channels has different margins, different product handling requirements, and expectations from the buyer. These are:

- Direct-to-consumer: Three small hubs have group CSAs; one has a farmers market presence;
- Wholesale distribution to retailers/stores: The two established distributors have retail stores as their major market segment; three of the small hubs have very limited retail customer business;
- Wholesale to food service (institutional sales): Three of the small hubs and one of the established hubs have farm-to-school programs and programs to other institutions.

There are many goals or definitions of success for food hubs. CDS found a mix of goals that vary from hub to hub. The success of the hub to its stakeholders and sponsors may differ based on the goals. Goals or success measures fall into these categories:

- Support small family farms with increased farm income/profitability;
- Foster local economic development and job creation;
- Create local food access for local community;
- Create healthy food access for those of limited means;
- Provide healthy food in schools and health care;
- Improve environmental practices in farming;
- Build community around food and farm connections; and
- Achieve a financially viable business that is self-sustaining.

It is important to note that there are unavoidable tensions between some of these values. Food hubs cannot eliminate the tensions. For example, to increase farm profitability for small family farms requires finding markets that can pay a sufficient price to cover the cost of small scale production and small scale aggregation along with a reasonable margin. This requires a focus on premium markets. At the same time, achieving a goal of food access for those of limited income will require an ongoing price income subsidy.

All hubs have a stated goal of achieving break-even and financial self-sufficiency. CDS observed that achieving financial break-even and self-sufficiency is a function of both scale and efficient systems. With regard to financial self-sufficiency, CDS found a significant difference between the two established distributors with local programs and the four small and not-for-profit sponsored hubs.

Both of the established distributors have achieved break-even scale and operate as mature businesses in the highly competitive market. Gross margin (sales revenue minus cost of product) for the food distribution industry averages 17.5 percent. Net margin (profit) in food distribution is in the range of 2 percent of sales. This is a low margin/high volume business. CPW estimates they achieved break-even at about \$5 million in sales. This was confirmed with another organic distributor start-up in New Mexico (La Montanita). A \$5 million break-even for a distributor is also consistent with CDS' generic pro forma work for a distributing food hub operating in premium markets.

These established distribution hubs manage their local food distribution within their larger, year-round business. Their commitment to local food handling is constrained to some extent by the necessity to achieve net income/profitability to continue. These constraints result in minimum supply quantities that may exceed very small producer capabilities; expectation that food be cleaned, sorted and packed for resale; and on the customer end, minimum order requirements that may exceed small customers capabilities.

None of the smaller hubs have yet achieved break-even. They report they are finding/suspecting that their initial feasibility studies under-estimated the operational costs of the hub, and in particular, the labor requirements. They are also encountering price constraints, especially with institutional

customers. Thus their target break-even sales levels are likely understated. Two are in the process of revisiting their start-up plan and break-even analyses. One of the small hubs is planning to transition from an LLC structure to a not-for-profit. Another of four small hubs, with the longest history, reports they ceased operating their marketing arm several years ago and refocused on their training mission. They found the demands of operating a hub detracted from the core activities of training. The three new small hubs are in early phase and are learning and appropriately adjusting their business model with experience.

Support for new local food hubs is found in many forms including:

- In kind use of sponsor assets including building space, trucks, equipment
- Services from sponsoring organizations including project leadership, legal services, grant writing, accounting services, information technology, human resource support and other
- Grants and donations from government entities and private foundations
- Volunteers
- Making do and going without

CDS has some frustration with the national food hub research. Many reports are narrative and tell encouraging stories of enterprises but lack a financial depth or sufficient information that could inform business planning. Many are written in early stage before the concept or approach has been proven. Other research reports appear to have gathered significant financial information from many hubs, but the information is reported in “averaged” aggregate form across many different sizes and types of hubs. In many cases the average is not representative of a specific model.

Challenges/Barriers to Success

- 1. Food distribution is a highly competitive business.** There is adequate and often abundant supply of most products. The existing food industry continues to consolidate at all levels from producer to processor to distributor to retailer and institutional food service. Price competition is fierce and customers most typically have expectations of low price. New food hub distribution businesses face the challenges of building to break-even volumes in the face of intense price and service competition from better equipped and better capitalized established firms.
- 2. Food distribution is a high volume/low margin business.** Because of the highly competitive nature of the sector, gross margins are very low, ranging from 15-18 percent for broadline distributors of conventional food products, to something just over 20 percent for distributors of higher priced specialty products. Price is a major driver of success for most buyers; public and not-for-profit institutional buyers are typically the most budget constrained and often have requirements to take lowest bids further complicating the tasks for food hubs seeking to compete in those markets. Hubs that focus on these institutional sales will be challenged to achieve margin to cover costs, or to pay producers a profitable price. The new hubs reported that they are already encountering price resistance in schools who have access to both commodity program products and high volume distributor products.
- 3. Achieving success in mission often requires a trade-off with economic efficiency.**
 - Assisting small or low-resource farmers is a perfectly legitimate mission for non-profit organizations. However, this mission typically is associated with economic implications that complicate economic sustainability. For example, purchasing multiple small lots from many producers requires more administrative overhead for distributors and transportation costs are also typically higher. There is more labor involved at several steps including accepting

deliveries, inspecting product, completing paperwork, billing, invoicing, sorting and consolidating into order sized quantities, and more. This additional cost is incurred by both small hubs and to some extent also by the larger distributors when working with very small producers and delivering to small markets.

- Producers that are new to wholesale distribution typically lack capacity for appropriate cleaning/sorting/grading/cooling/storage. These requirements are further increased by new federal food safety regulations. Substantial capital investment is required.
- It is important to note that consolidating small lots can achieve volume for customers, but does not necessarily achieve efficiencies of scale for producers. This additional cost is incurred by both small hubs and to some extent, also by the larger distributor when working with very small producers and delivering to small markets.

4. Seasonal operation is a challenge for several reasons. Most customers (including schools) need to access product beyond the local growing season. Buyers have a preference for focusing on a small number of vendors with reliable supply and known quality. In institutional sales, contracts generally are written for a full year and often multi-year. A seasonal hub has to ask a customer to “come in and out” of this relationship; the customer has to find another distributor of that product for the rest of the year.

A seasonal food hub will also have infrastructure that is idle during the inactive part of the year, so achieving sufficient volume to cover overhead will be more difficult. A success factor commonly cited in food hub research is the importance of having a professional distribution manager and experienced staff. A hub that runs seasonally will have a harder time attracting and retaining such a qualified manager and skilled staff.

5. Most food hubs that appear to have reached break-even are located near and service major population centers. There is just not enough population or volume in the smaller markets to achieve efficiency of scale needed for a full service food hub serving only local markets. Three of the hubs in our survey have a goal to both source and sell in relatively low population areas.

6. Serving direct to consumer markets is very different from meeting wholesale market expectations. Most small scale farmers sell direct to consumers at farmers markets or CSA’s; in general these markets provide higher prices and better margins for the small farmer’s scale of production. If these producers seek to enter wholesale markets, they must make a number of changes and learn new practices and disciplines to be successful, and this may take a few seasons of work. Changes include:

- Focusing on growing a larger volume of a few products with a wholesale market in mind, seeking to achieve better scale on those products;
- Making pre-season commitments and honoring those in season;
- Preparing and packing to customer expectations;
- Adopting good food handling protocols and complying with food safety regulation; and
- Ensuring they can achieve lower unit costs of production in order to profit at wholesale prices which will usually be 50 percent (or less) of direct-to-consumer prices.

There will be an initial sorting out period, as some producers choose to make changes while others self-select out.

Overcoming Barriers

CDS offers the following preliminary thoughts on best approaches to overcoming barriers to success for the new and emerging food hubs. As part of their contract with the MDA, CDS is continuing to conduct research, follow-up interviews, and analysis that will be provided to the MDA prior to the start of the 2016 Legislative Session. In the final report they will seek to identify successful national examples of best practices for small rural hubs serving institutional markets, and others. Some initial thoughts include:

- 1. Hub sponsors, champions and start-up managers should become very clear about the financial requirements (for both capital equipment and working capital) to operate a hub during start-up and ongoing.** While the hub will certainly have income from selling product (gross margin) this will not be sufficient to cover capital and operating costs for a significant period – or perhaps indefinitely. Based on the explicit values of the hub to provide benefits to the community, there is a need to identify a set of sponsorships and other supports to bridge this gap.
- 2. All hubs need to use standard enterprise level accounting for effective management of operations.** Because of the difference in revenue recognition rules in non-profit and for-profit accounting, non-profit organizations contemplating food hub operation must have capacity and commitment to enterprise level profit/loss accounting.
- 3. Strategically choose market channels and product lines that right-size volume expectations with favorable margin opportunities.** Some market channels offer better margin opportunities than others. Many public/non-profit institutional markets are the most price and margin constrained. Hub planners and operators should ensure that they have chosen to produce for market channels that offer the best margins possible. In some low margin channels, there may be individual mission-driven customers who can afford to pay price premiums in order to provide the hub with the needed margin.
- 4. Exhaust all opportunities to strategically grow profitable sales volume.** Food hubs at scale attempt to make use of staff, equipment and facilities on a year round basis in order to reduce unit costs. They also seek to serve a geographic footprint that optimizes sales opportunities and operating efficiencies.
- 5. Consider partnerships that leverage the assets/resources of existing distributors.** In general, there is excess capacity in the commercial food distribution sector. Existing firms that have under-utilized assets may seek to partner with others to achieve more profitable utilization of those assets, while bringing distribution expertise to the partnership. This may involve a hub champion shifting focus from operating a hub to aggregating market demand.
- 6. Consider cooperative approaches to grow production volume.** For those hub sponsors who seek to support small and low-resource farmers in entering specialty crop production, consideration should be given to formal and informal cooperation as both a cost-reduction strategy (i.e. sharing specialized equipment) and as an aggregation strategy (i.e. increasing marketing access and power). Cooperative action is not a panacea, however, as there have been both some notable successes as well as many failed efforts. Having the right product mix and marketing strategy are critical.

Next Steps

The MDA's contract with CDS calls for them to continue their research and analysis of food hubs both within and outside of Minnesota. They will provide the MDA with a final report prior to the start of the 2016 Legislative Session. For the final report, CDS will undertake the following activities:

1. Expand the number of Minnesota food hubs surveyed.
2. Summarize existing national food hub research and implications for Minnesota food hub development.
3. Seek to identify specific small hubs across the country that have achieved financial viability and contact them directly to discuss their model and recommendations for "best practices".
As described above, a limitation CDS has found in the national research, is that many research studies report aggregated and averaged data that appears to be positively skewed by a few large established survey participants. We will ask those researchers to direct us to their best examples, and then seek to make direct contact with hubs deemed to be most successful and incorporate that into this report.
4. Continue to gather information from our Minnesota hubs, in particular, updated break-even analyses and budgets.
5. Review CDS developed generic food hub "pro formas" for break-even benchmarks, and seek to analyze how these fit our Minnesota food hub projects.
6. Estimate the level of ongoing support / sponsorship of various kinds that might be needed to achieve the "public goods" sought by the Minnesota food hubs.

Appendix – CDS Staff Qualifications

Kevin Edberg brings over 30 years of experience in local foods systems work in Minnesota, and within that, over 15 years of specific experience in policy creation, assessment, advocacy and implementation. As administrator of all state local products promotion programs for Minnesota Department of Agriculture, he led creation of the *Minnesota Grown* program in 1987. Following progressive promotions over his 15 year tenure at the MDA, he served the last 6 years as Assistant Director of Ag Marketing and Development.

At request of USDA, he participated in over 3 years of discussions to review and create federal policy for support of direct marketing and local foods, resulting in the Farm Bill authorization and ultimate appropriation of federal funds for the Farmers Market Promotion Program (and later Local Foods Promotion Program).

Since October, 2000 he has served as Executive Director of CDS and is responsible for the overall strategic direction and management of the organization. He has a strong background in agriculture, economics, and marketing. He holds bachelor's degrees in horticulture, agricultural economics, and secondary science education, and has done graduate work in plant breeding and plant physiology, all at the University of Minnesota.

Joan Stockinger started with CDS as a consultant in 2006 and became an employee in 2008. She provides a range of business-focused consulting and development support to cooperatives of various kinds and to sustainable value-added agriculture projects. She has a wide range of hands-on experience with management of small and large businesses, including eight years as CFO of a start-up company (social venture capital), and over twelve years of marketing management in several industries.

At CDS she works in partnership with clients to perform feasibility analyses, financial plans, comprehensive business plans and market development projects. Recent clients include an integrated organic dairy producer and processor; a cheese and butter cooperative; a produce distribution cooperative; a pool of 20 wheat growers marketing branded flour; a cooperatively owned movie theatre in a small town; and a dairy pool seeking to develop value-added branded products.

Joan served two terms on the CDS board of directors prior to becoming a consultant with the organization. She also served for three terms on the board of directors for the North Country Development Fund including a term as president of the board during a critical period of restructuring and reorganization. Joan has an MBA from the Yale School of Management and an undergraduate honors degree in humanities from the University of Minnesota.

Bob Olson is a Cooperative Development Specialist with special emphasis in value-added agriculture and conventional farming/ranching enterprises. In this capacity he helps businesses plan for long-term viability by developing feasibility studies, marketing assessments, and business plans. His first 7 years at CDS were devoted to the Food Alliance Midwest (FAM) program where he served as Business Development Director. FAM serviced more than 70 agricultural producers operating in excess of 65,000 acres under sustainable management. His duties included producer recruitment and 'Partnership Development' with entities encompassing the entire sustainable food value-chain including distributors, retailers, foodservice management companies, and agency/nonprofit supporters.

Bob is Professor Emeritus, University of Minnesota Extension Service, where he worked for 25 years as an Extension Educator specializing in agriculture and natural resource issues prior to joining CDS in 2005. He holds undergraduate degrees in Plant and Soil Science, and a graduate degree from the University of Minnesota in Agricultural and Applied Economics.