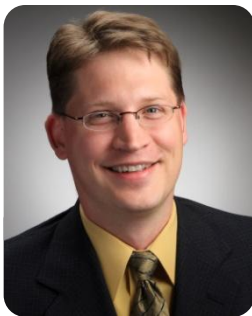


FOCUS: FRESH PRODUCE

Can being BIG get you closer?



Context Partner,
Mark Nelson

...When Trends Collide

Tesco recently discussed plans to rationalize its supply base and source more fresh produce directly; to become "a more vertically integrated business." Recent developments in *direct sourcing*, such as this announcement by Tesco or by Wal-Mart opening a direct buying office in Yakima, WA (2009), provide notice on how large retailers are dramatically reshaping fresh produce supply chains.

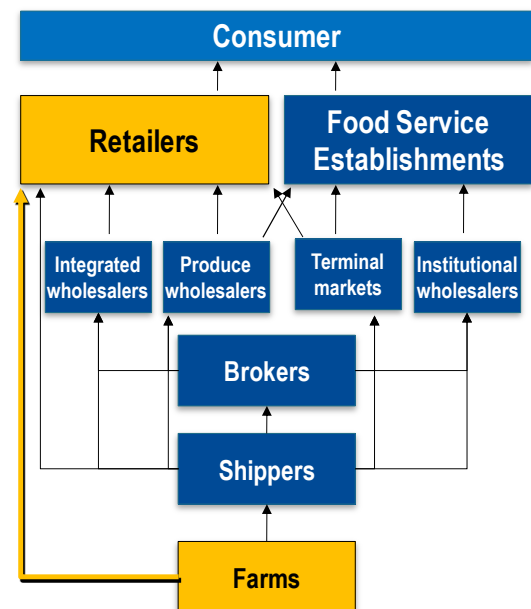
Through *direct sourcing*, retailers locate direct buying offices near major production areas to establish their own relationships with growers and put infrastructure in place to work with them directly; in effect bypassing shippers. Motives are both directly and indirectly economic: reduce distribution cost and establish proprietary systems to ensure food safety risk and traceability are being managed.

Verticalization is not new. In the U.S., many large retailers have already worked past produce brokers and percent of produce flow through terminal markets has been halved over the past 40 years. While shippers were an important champion of those historical trends, they now are in the cross-hairs of direct sourcing rationalization.

Meanwhile, *local sourcing* is becoming a permanent fixture within the year round supply of fresh produce. Initially predicated on fuel cost savings, the trend towards consumers buying *local grown* produce has morphed into satisfying their wants for supporting community, protecting the environment and advocating food systems. Sales of local produce are growing fast.

Forty years ago, ~70% of fresh produce flowed through terminal markets. Today, terminal markets account for less than 30% of U.S. fresh produce.

satisfying preferences of fresher, better tasting produce lifts sales and retains customers.



Context adapted from Roberta Cook, UC Davis

(Continued)

Tough Decisions and Support Systems Needed

For large retailers, *direct sourcing* necessitates adding field staff, information systems and possibly even facilities to manage and maintain direct grower relationships. Similarly, for retailers to source *local grown* produce, buying systems need to be supplemented. In the future, innovative information and distribution systems are needed including supplier hub websites, traceability programs and product consolidation. In addition, supplier training will be required to help growers achieve industry or retailer specific technical standards or develop customer -specific packaging.

Direct and local sourcing trends diverge when considering the source; the farms producing the produce. Through *direct sourcing*, the tendency is for retailers to gravitate to a select number of large growers. *Local sourcing* legitimizes smaller suppliers outside of major growing areas, allowing them to sell beyond the farmers market to large national and regional retailers. At least early on, systems to support both sourcing initiatives will need to differ.

"Shoppers' reasons for buying locally vary, with 57% purchasing local food because it was fresher and 54% wanting to support local producers and farmers - up from 29% in 2006."

Independent Grocery Distribution

Retailers need to weigh the benefits of rationalizing the supply chain through *direct sourcing* and driving sales through promoting *local grown* with one very large common denominator: RISK. Direct large grower relationships place retailers in a more exposed position to production uncertainties. Direct sourcing is a proven cost savings approach when supply is ample. When supply becomes tight, exposure to higher cost increases. Local small grower relationships also bear supply uncertainty because of the seasonality and higher variability of local production areas. Also, areas outside of major production regions typically have fewer food safety safeguards in place.

Getting the right systems in place to deliver on the benefits of these two major sourcing trends and effectively manage their risks will determine which retailers are successful in the fresh produce supply chain of the future.

Thinking about Fresh Produce? Contact Mark Nelson at mark.nelson@contextnet.com or ronnie.delacruz@contextnet.com.

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The Context Network provides business management and strategy consulting services to the world's leading agriculture, biotechnology and food companies and government agencies and institutions. Major areas of expertise include strategy, merger and acquisition support, valuation of new technologies, formation of alliances, and market research. The West Des Moines-based firm is composed of a core of professional consultants that is complemented by a network of hundreds of industry and subject-area experts.

