



Friona Industries, L.P.

Our learnings from this and other "alliance" projects have made us better producers and will eventually change our industry forever. Our goal is the advancement of our industry through the advancement of all its basic participants: cow/calf, stocker, packer, and end user. We know that if we can be a "facilitator" of some of these fundamental changes and new ideas, our company's success will move along with our customer's success.

—James Herring, President and CEO, Friona Industries¹

On October 4, 2000, James Herring, president and CEO of privately-held Friona Industries, the seventh largest cattle feeding company in the United States, strode through the doors of the new Wal-Mart store in Amarillo, Texas.

He first absorbed the enormity of what was described as the "new face of retailing" before moving on to the meat section. Laid out in cooled glass cases were unpacked strips of beef labeled according to different cuts and fat content. A little further down the aisle, the poultry and pork cuts were grouped by their well-known brands: Tyson, Perdue, Oscar Meyer, Hormel, and Smithfield. The beef products, however, did not carry multiple brand names or flashy logos. Most of the packaged cuts bore a bar code and price and a sticker indicating USDA approval.

There was, however, one stand-alone beef brand: Thomas E. Wilson produced by Iowa Beef Packers (IBP), the nation's largest meatpacker. In May 2000, IBP had secured a deal to provide case-ready,² branded, fresh beef for Wal-Mart. The deal signified IBP's strategy of shifting from beef as a commodity product to a value-added one. Since the mid-1990s, the company acquired eight companies whose specialties ranged from beef kabobs to deli meats. The company planned to spend \$100 million on its case-ready business.³ The market, however, was not rewarding IBP's efforts. Earlier that day, IBP had accepted a \$2.4 billion buyout offer by investment banker Donaldson,

¹ James Herring, "Friona Industries: Bridging the gaps," *Feeding Supplement Friona Industries, L.P.* (January 2000).

² Case ready beef was beef sold already pre-cut, weighed and packaged by packers direct to retailers. It streamlined handling and packaging (eliminated the butcher), and provided more control over food safety.

³ John Taylor, "Cutting-edge meat strategy . . .," *Omaha World-Herald* (April 22, 2000).

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Lufkin & Jenrette Inc. IBP shareholders were offered \$22.25 a share in cash, nearly \$4 more than its closing price the week before.⁴

The lack of a variety of branded⁵ beef products was one of Friona's and the beef industry's biggest challenges. It symbolized the industry's historical inability to work together and the lack of trust that existed among the various segments in the production chain that made money by undercutting the segment downstream.

Herring believed that if a consistent, branded beef product was to be realized, a process for identifying the cut of beef sold at retail to the calf from which it came had to be in place. Since the cattle industry was not vertically integrated, Herring believed the solution was through partnerships formed with key players throughout the production chain.

As he sought to help revolutionize the beef industry, and create a win-win scenario for all players, Herring faced a number of challenges: How would he bring together industry players who historically had had an antagonistic relationship? How could he get industry players to care about where their animal came from or where it would end up? Finally, would consumers take to an idea of branded beef? What did they really want? He hoped the Beef Advantage Project (BAP), a vertically integrated partnership directed toward a differentiated branded beef line with a major retail chain as the end-user, would provide some of the answers.

The U.S. Beef Industry

Trends

With retail sales of \$55 billion in 1999, the U.S. beef industry was the largest part of the nation's food and fiber industry, which in turn was the largest segment of the national economy. The U.S. cattle industry was made up of more than 850,000 small businesses (farms or ranches), operating in all 50 states. Accounting for less than 10% of the world's cattle inventory (in January 2000, there were approximately 98.1 million head of cattle down from 130 million in the mid-1970s), the United States produced nearly 25% of the world's beef supply.⁶ In 2000, the U.S. beef industry was expected to surpass production of 2.5 billion pounds, the highest level since 1976. However, industry analysts predicted production would decline 3% to 5% starting in the fourth quarter of 2000.

Beef consumption in the United States leveled off in the 1990s as the poultry and pork industries challenged beef's position as "The King of Meats." Lower prices, claims that white meat was healthier than red, a variety of prepackaged, ready-to-serve products, and effective brand campaigns that enabled consumers to form a relationship with certain poultry and pork companies, were some of the factors responsible for the shift. In the early 1990s, the poultry industry claimed that more chicken (per pound per capita) was consumed in the United States than beef. Cattlemen responded that beef sold at retail was a 94% boneless product, while chicken was only 69% boneless. Thus on a boneless basis, they asserted that in 1996, Americans still ate more beef (66.7 lbs.) than chicken (48.1 lbs.).

⁴ Scott Kilman and Paul M. Sherer, "IBP accepts \$2.4 billion buyout offer," *The Wall Street Journal* (October 4, 2000).

⁵ The term "brand" for fresh beef implied consistent quality and characteristics, improved eating experience, and greater accountability (www.beefboard.org, September 23, 2000).

⁶ www.beefboard.org (September 14, 2000).

A brand survey conducted with retailers and consumers in 1996 by the National Cattlemen's Beef Association (NCBA) determined that beef consumption would increase with improved product consistency, improved eating enjoyment, and more economical pricing. Consumers were dissatisfied with beef consistency and tenderness and the ability to create fast and easy meals around beef. National branding of commodity beef was not a major influential factor in beef consumption unless it was clearly a better, value-added product; 48% of respondents indicated they would buy more of a well-known brand, while 61% said they would be more drawn to a trusted brand that delivered quality and consistency. Meanwhile, retailers indicated a reluctance to sell only branded meat products in part because they feared that marketing only one brand would take away their control over competitive meat buying.⁷

By the end of the 1990s, however, it appeared as though beef was regaining its popularity, due in part to economic expansion and successful marketing from various beef organizations, that touted beef's protein benefit to a weight and diet conscious U.S. consumer. By 2000, beef was being consumed 77.8 million times each day across America; in a two week period, it was served in nine out of 10 households. Americans spent \$168 per household annually on beef compared with \$70 for poultry and \$59 for pork (see **Exhibit 2**).

According to the NCBA, home cooked fresh beef (hamburgers, steaks, roasts, etc.) was served 70% of the time, carry-out/frozen beef, 21% of the time, and processed beef, 9% of the time. According to industry analysts, beef demand increased 4.6% during the third quarter of 1999, over the same period in 1998. Consumer spending on beef from January through September 1999 totaled \$36.7 billion, a 4% increase over 1998. Increased spending represented a \$5 per capita gain and the largest increase in per capita spending since 1990.⁸

Beef was the most popular item at restaurants, with 7.2 billion servings annually, compared to 5.2 billion for chicken, 2 billion for seafood and 500 million for pork.⁹ Hamburgers/cheeseburgers accounted for 76% of restaurant servings; roast beef sandwiches (7%); steak entrees (5%); steak sandwiches (4%); roast beef/prime rib (3%); other beef entrees (3%); and ground beef entrees (2%).¹⁰

The Players¹¹

The highly fragmented beef industry comprised five segments: the cow-calf operator (ranchers), yearling-stocker operators, feedlots, packers, and retailers. The cow/calf operators were producers who raised cattle that produced calves and feeder cattle that were shipped to stocker operators and feedlots. Approximately 80% of cattle ranches had been family owned for more than 25 years and more than 10% for more than 100 years.¹²

The stocker operator put additional weight on the calves before they went into feedlots usually between 12 to 20 months of age. Stocker operators' role in the production chain had declined since 1976 as the U.S. cow-herd declined and more light weight calves went directly to the feedlot production cycle.

⁷ www.beefboard.org (September 23, 2000).

⁸ www.beefboard.org (September 14, 2000).

⁹ Ibid.

¹⁰ www.beefboard.org (September 23, 2000).

¹¹ Much of the information from this section was taken from *Ranchers Renaissance*, HBS case no. N9-900-008.

¹² www.beefboard.org (September 23, 2000).

The feedlot operators purchased the cattle from cow/calf or stocker operators and then finished growing them in feedlots for market. Roughly 105 feedlots accounted for 39% of feedlot cattle.¹³ (Table A shows the top seven U.S. feedlot companies by cattle capacity.)

Table A Feedlot Capacity as of September 2000

Feedlot Company	Capacity (Head of Cattle)
Cactus Feeders Inc.	465,000
Conti Beef (owned by Continental Grain)	425,000
ConAgra	345,000
Caprock Industries (owned by Cargill)	284,000
National Farms	269,000
J.R. Simplot	265,000
Friona Industries	240,000

Source: Friona Industries.

Packing firms purchased fed cattle, slaughtered them, and marketed parts of the carcass to retailers and institutional end-users. The majority of cattle were purchased from feedlots. Four packing firms—IBP, ConAgra, Cargill's Excel, and Farmland National Beef—accounted for 80% of all slaughtered cattle and 85% of boxed beef.¹⁴

Retailers cut and packaged beef into a variety of cuts and sizes for consumers. Like the packing industry, the retail industry was highly consolidated. The top 10 retailers accounted for 80% of sales. According to the NACB, 80% of beef was sold at the retail level: 60% through grocery stores, 20% through restaurants, 15% through fast-food outlets, 5% through institutions. Beef accounted for 40.2% of retail meat sales, compared to 22.9% for poultry.¹⁵

Most margins were created on the "buy." Raw material prices, therefore, were the key to profitability. Industry margins had been shifting since the early 1990s. The packer's share of beef's retail value had increased to 11.8%, while the retailer's share declined to 42.1% from a peak of 46.1% in December 1998. An increased packer's share of beef's retail value was consistent with the trend to further fabrication, pre-packaged beef, and increased value-added close-trimmed boxed beef. Total packer gross margins (combination of boxed beef and by-products) had increased from \$65.85/head in April 1998 to \$165.44/head during May 2000. Producers, meanwhile, received more than 50% of beef's retail value since mid-1999.¹⁶

Sources of Antagonism

According to Herring, margin competition among the players fueled industry antagonism making vertical integration difficult (see Exhibit 3 for profit volatility). He explained:

The biggest threat we have is the industry itself. The nature of the commodity system that has been developed will not allow us to go forward. And the

¹³ www.ams.usda.gov. (September 9, 2000).

¹⁴ Boxed beef consisted of primal and subprimal cuts from which much of the bone and excess fat had been removed. These cuts were an intermediate stage between the carcass and retail cuts and were put in boxes for shipping from the packing plant to retailers.

¹⁵ www.beefboard.org (September 23, 2000).

¹⁶ www.beefboard.org (September 23, 2000).

biggest threat to that is every participant in the industry depends now on taking somebody's pants down to create profitability for themselves. So the retailer is waiting until the packer has his pants down. The packer is waiting for feeders to be down. We're in turn waiting for the stocker or cow-calf to be down. So now it's all a system of adversarial players waiting for profitability to come from the other side. And that's a definition for failure in the commodity system and its attempt to create a consistent and reliable product for consumers.

Another source of antagonism that existed in the industry was the lack of pricing transparency. The U.S. Department of Agriculture (USDA) and private information services such as CattleFax and the National Provisioners "Yellow Sheets" disseminated cash price information through the industry on a daily basis. Producers often complained that packers were not reporting all prices. Packers tended to purchase animals under private marketing arrangements, (i.e., forward contracts, formula pricing and exclusive purchase agreements), in which terms, conditions and prices were not publicly disclosed. Between 1988 and 1997, 13% to 19% of the 15 largest beef packers' slaughter resulted from forward contracts and marketing agreements.

While some of these marketing arrangements were using publicly reported prices, many added premiums or discounts depending upon the quality of the carcass, known as grid pricing. Grid pricing applied a series of premiums and discounts to a base price for individual animals based on factors such as quality, yield, and weight.¹⁷ In early 2000, 50% of fat cattle were sold through a grid. Herring opined that in three or five years all fat cattle would be sold through some kind of grid formula. The key was being able to identify which grids fit which cattle. "The four major packers each have different customers with different needs," Herring explained. "One packer might target very lean, low quality commodity type beef. Another may be quality-oriented. Another pays for heavy lean carcasses so they will get more tonnage through the plant. All these require different kinds of grids. If you sell your cattle into the wrong grid, you're not going to like the result."¹⁸

There was increasing attention to tying grid prices further from the carcass down the process line to boxed beef. Traditionally, the packer bought the beef by arbitraging the value of the live animal to the end product. Tying grid pricing to boxed beef gave a more efficient pricing system because the value was related more to the individual cuts that were going straight to the retailer. Smaller producers, who utilized the open cash markets, found it difficult to determine the actual purchase prices of livestock.

In March 2000, Agriculture Secretary Dan Glickman announced that major livestock packers, product processors and importers would soon be required to report pricing details to the USDA's Agricultural Marketing Service (AMS). At stipulated times of the day, affected packers, processors, and importers were required to report to the AMS daily price and volume information on negotiated and non-negotiated purchases of cattle and boxed beef sales. They also were required to report the details of all transactions involving: domestic and export sales of boxed beef cuts, including branded product, sales of domestic and imported boxed lamb cuts, including branded product, and purchases of imported boxed lamb cuts, including branded product. "We need to ensure that small farmers and ranchers have a full and fair opportunity to compete in an increasingly concentrated agricultural economy," Glickman explained. "This new mandatory price reporting program will help producers by making the market more transparent, giving them better information about what's happening in the marketplace."¹⁹

¹⁷ "Ranchers Renaissance," HBS case No. 900-008.

¹⁸ Colleen Schreiber, "Individual Animal Management to be New Beef Industry Focus," *Livestock Weekly*, February 24, 2000.

¹⁹ Susan McAvoy and Lena Hogan, "Glickman Announces Mandatory Livestock Price Reporting," www.ams.usda.gov (March 14, 2000).

Despite the lack of trust among the segments, there were a number of alliances among producers, processors, and, in some cases, retailers. The Farmland Supreme Beef Alliance (FSBA) was formed in September 1995 between Farmland Industries, the largest farmer-owned cooperative in the United States, Supreme Cattle Feeders, a privately owned feedlot company, and Farmland National Beef Packing Company, owned by Farmland. Its objective was to generate consistent raw material for production of a branded line of beef called Farmland Black Angus. After meeting quality specifications, producer's cattle were enrolled in FSBA, fed by Supreme Cattle Feeders, and sold under a value-based marketing formula to Farmland National Beef. By the end of 1998 over 172,000 cattle had moved through FSBA, achieving an average cash premium of over \$14 per head. FSBA also provided cattle performance and individual carcass information back to producers.

Ranchers Renaissance was another alliance. Formed in 1997 as a vertically integrated cooperative consisting of 14 cow-calf producers and six commercial feedlots, its mission was "to create a customer-focused, integrated beef-production system with profits derived from increased efficiency and consistent high quality finished products." The feedlots were small, independent operations, the largest being 40,000 head. While not an alliance partner, Excel was the sole packer member and processed the cooperative's cattle. Cattle were priced as any of Excel's other suppliers. Ranchers Renaissance ultimate goal was to bring a retailer(s) into the cooperative and connect the value chain in beef production. Producers expressed some concern about such alliances. They worried about the treatment of cattle that fell below specifications. They believed that Ranchers Renaissance original goal was to develop premium markets for all the cooperative's cattle rather than target a particular specification.

The Dilemma

The ability of the poultry and pork industries to vertically integrate was largely due to consolidation and the compact nature of pig and chicken farming. Companies like Perdue and Smithfield were rapidly acquiring big and small firms across the value chain. Processing of the animal from birth to carcass to a final packaged product was within the ownership of one company.

Herring believed vertical integration within the beef industry was not feasible. Cattle raising required more extensive land than chickens or swine, as cattle needed considerable land to graze on. Thus a beef animal was more expensive to own per head. To own all the cattle, grazing land, feedlots, and packing-houses for a vertically integrated operation required billions of dollars. "The packing facility is 4,000 head a day, 20,000 head a week and a million cattle a year," Herring explained. "That's one single packing plant. For us to own the infrastructure to facilitate that whole process would take \$20 billion. We're not in the industry that can integrate rapidly at a relatively cheap price. It's going to take the cooperation and the template that allows the little guy to come through the system and be rewarded."

Approximately 98% of all American cattle producers were considered small or mid-size producers (under 500 cattle). Often cattle were kept in conjunction with a farming operation or as a sideline business. In addition, the cattle were often used to consume what was left after crops had been harvested. A further complication was that, compared to chickens and swine, there were more cattle breeds, which made standardization more difficult. This was reflected in meat retail prices that were considerably higher than both poultry and pork.

Furthermore, resulting from the industry segmentation, there was little concern about what happened to one's product upstream. There was a tendency for each player to dismiss any interest of the animal after its ownership had been transferred. Most of the time, the packer would not know from which ranch the cattle originated nor would the rancher have any idea where the animal he had weaned would be taken for slaughter. "The cow-calf producer doesn't know to which retailer his

product goes,” Herring opined. “Most don’t want to know. They are primarily concerned with generating profits in their particular segment.”

While vertical integration did not ensure financial stability for the large poultry and pork companies (see **Exhibit 4**), Herring believed that it was a key factor in their ability to turn out a standardized product in size, quality, tenderness, and taste. A reliable brand, Herring thought, was the key in giving consumers a good beef experience and thus reviving the whole industry. Product standardization was required to achieve this kind of branding. While meat inspection was mandatory and carried out by nine federal agencies, meat grading was a voluntary service paid for by meat processors and performed by the AMS. AMS grouped carcasses based on expected taste, appeal of cooked meat, and the quantity of the meat from the carcass. Quality grades were assigned to beef carcasses by USDA officials based on relationships between marbling (the specks of fat dispersed within the muscle) and the age of an animal. There were seven grades of beef, but only three were used for marketing: PRIME (meat from young animals with at least slightly abundant marbling), CHOICE (meat from young animals with moderate, modest or small marbling), and SELECT (meat from young animals with slight marbling). Lower grades (Standard, Commercial, Utility, Cutter, and Canner) were mainly ground or used in processed meat products.²⁰

Introduced in 1979, Certified Angus Beef (CAB) was the longest running brand and most recognized brand in the market. CAB was served in 3,500 U.S. restaurants and could be purchased in over 4,000 grocery stores worldwide.

While the beef industry lacked brand differentiation, efforts were being made to create convenient, ready-to-eat products; more than 30 new products were introduced in 1999 using currently undervalued beef cuts from the chuck and round. In the *Beef Made Easy* program, the NCBA helped retailers categorize beef products by cooking method rather than anatomy. Using color-coded merchandising tools and signage, the beef case included beef for stewing, steaks for braising, marinating, and sautéing, pot and oven roasts. Cooking instructions were included on the package to assist consumers in product preparation.

Case-ready packaging (such as IBP’s Thomas E. Wilson) was another way beef manufacturers were gaining momentum with retailers. As one senior executive at the American Meat Institute Foundation explained, “[Meat products] packaged at one central and controlled location that’s USDA inspected—unlike the back areas of supermarkets—[with] more automated, more sophisticated handling in controlled temperatures and under strict hygiene, gives a safer product.”²¹ It also enabled retailers to spend more time with consumers: “We focus a lot of time on helping the meat department sell more meat by keeping the meat cases full all the time. It frees up the meat department staff to do other work if they only have one full-service counter,” stated an Excel manager.²² According to Cryovac, a provider of case-ready technology, between 7% and 10% of beef in retail stores was case-ready, a figure that was expected to reach 40% to 50% by 2004.²³

The Turnaround

Founded in 1962 in Amarillo, Texas, Friona began as a partnership between several entrepreneurs in the Panhandle area to get into the burgeoning business of cattle feeding. The opportunity for large-scale feedlots came from being able to install cost efficient, integrated feed

²⁰ www.fsis.usda.gov, April 18, 2000.

²¹ Wendy Joy, “Ready for case-ready?”, *Supermarket News* (September 4, 2000).

²² Alison Paddock, “Managing the meat case,” *Grocery Headquarters* (July 1, 2000).

²³ Wendy Joy, “Ready for case-ready?”, *Supermarket News* (September 4, 2000).

manufacturing and delivery systems into the facilities. A typical 2,000 head of cattle feedyard quickly became one that could support much larger capacities.

In the Spring of 2000, with 530 employees, Friona comprised four businesses serving 25,000 livestock customers from Nebraska to the Gulf Coast. The Custom Feeding division operated five feedyards in the Texas Panhandle. The division accounted for 46% of the company's \$325million revenue in 1999 and 55% of total net income of \$10.8 million. Friona's feedyard income came from two sources: feeding its own cattle and providing a feeding service for others. While most profits came from the latter source, profits from feeding its own cattle were determined by subtracting feeding and health costs plus purchase cost from sales. Sex (heifers had an average feeding weight 80 pounds lighter than steers), and age/weight (lightweight and younger cattle were more efficient than heavier, older cattle due to less maintenance demands), were two important factors that impacted the profitability of cattle feeding. See **Table B** for impact of age and weight on average.

Table B Relationship Between Cattle Weight and Feed Costs

	Steers			Heifers		
Weight Range, lbs.	550-650	650-750	750-850	550-650	650-750	750-850
Ave. Daily gain, lbs.	2.8	2.9	3.1	2.6	2.7	2.9
DM Feed intake, lbs.	17.0	18.8	20.4	17.0	18.5	20.2
Lbs. Feed per lb. Gain	6.0	6.3	6.6	6.4	6.7	7.0
Feed cost per lb. Gain (in cents)	43.5	45.7	47.9	46.4	48.	50.8

Source: Keith Hansen, "Factors affecting feedyard performance," *Feeding Supplement, Friona Industries, L.P.* (January 2000).

The firm's Hi-Pro Feeds division, which accounted for 24% of sales and 23% net income, produced feed for cattle, horses, swine, and other animals under the Hi-Pro Feed and Godbold Feed brands. Friona introduced its Hi-Pro Producer's Edge Program in 1993, which paid ranchers a premium for preconditioning their calves at the ranch before being sold to the feedyard. Between 70,000 and 100,000 cattle entered into the Producer's Edge Program annually. Among other things, preconditioning enabled cattle to receive biological and parasitic treatments before entering the feedyard. According to Herring, less than 5% of cattle industry-wide were preconditioned. Finally, Friona's Hi-Pro Animal Health unit distributed pharmaceuticals in 34 states through its 22 distribution centers. The division represented 33% of revenue and 22% of income. Friona also had a credit service that provided cattle and feed financing for Friona feedyards.

Herring, a well-respected participant in the industry and chairman and president of his own cattle investment firm, LFS, joined Friona in 1989, at a time when the company was in financial straits. "Friona was basically dead in the water," Herring recalled. "When we got here our feedlots had only 26% capacity and the company was losing about \$4.5 million dollars a year. Our job was to take a real wounded duck and to try to sell it. But nobody could sell a wounded duck.

In his first year, Herring helped Friona turn its loss into a net income of \$2.3 million. He implemented an 11-point program that included eliminating and consolidating debt, buying out subordinate debt at a discount, selling non-core assets, and reestablishing an esprit de corps among Friona's employees. Even in his early years as CEO, Herring felt that the industry needed to move towards branding, vertical integration and consolidation. Herring reflected on the changes he implemented in his first year:

We created a mission statement, with a couple of important things: to provide a vertically integrated service franchise and to become our customer's primary information link. That was kind of far-sighted at the time. I'm proud of that

because that's exactly where we are today. We're right on the cusp of creating that system and little did we know that the information revolution and the Internet would help us reach this goal perhaps sooner. We understood that the market was segmented by these five segments in the supply chain and that it had been largely responsible for the beef industry's decline.

Nearly ten years after being scripted, Friona's mission statement was put into action.

Beef Advantage Project

In April 1999, McDonald's Corp. initiated the Beef Advantage Project (BAP) in partnership with Capitol Land and Livestock of Austin, Texas, one of the nation's largest cattle merchandisers with 1999 sales of \$156 million, Friona, and Excel, the third largest meat and poultry processor in the United States with sales of \$9 billion. BAP was a result of the Beef 2000 Task Force that McDonald's created to better understand the beef production chain, further enhance food safety, and, as Dave Delaney, Friona's General Manager of Feedyard Operations opined, "because they were tired of the beef industry being a commodity business." The Task Force asked segments in the chain to pick participants to partake in creating a cooperatively integrated production system to lower costs and add product attributes. Herring was named president of the general partner of BAP.

BAP's mission was to develop an efficient cattle production system to deliver to the consumer a beef supply that would meet their highest expectations for safety, taste, and tenderness. In order to do this, the type of cattle that could provide this beef supply had to be identifiable, which in turn meant implementing an intricate identification system to track cattle through the system. Unlike with the Ranchers Renaissance alliance, Excel was one of the partners that owned the cattle throughout the process and therefore had a vested interest in the cattle that came through. According to Herring, unlike the conventional production system based on transfer pricing, each partner had a vested interest in the end product, and they were therefore aligned to ensure that the animal was well treated throughout the whole production process.

All BAP cattle were given electronic identification tags that enabled the partners to track cattle all the way through the slaughtering process. Each tag had a unique ID number and radio-frequency transponder. Health and genetic information were attributed to each tag, which was archived in a computer.

A BAP private website, created and managed by Friona staff, provided market updates that were only accessible to the BAP partners. The website included: performance and carcass data for BAP cattle each week; visual presentation of cattle in one minute digital video segments; regular updates on calves purchased through special preconditioning sales; educational presentation of the types of cattle that did nor did not fit the program and why; performance and carcass data for individual animals; visual presentation of individual cattle through digital photos; and, overall updates on the BAP program and the industry.

Phyllis Hooker, head of Friona's marketing and technology division, explained the challenges:

As with any change in business, the cost may outweigh the benefits in the beginning. You must invest a great deal of time and money to position yourself for the future. Our efforts to track the cattle performance and feed that information back to the BAP partners and feeder cattle buyers is very time consuming. However, the benefits that will come out of this effort far outweigh the cost. As we get better at buying the type of cattle that produce a product the consumer desires, the entire

industry will benefit. The cow-calf producer will be rewarded for producing a more value-added calf; the efficiency of the feedyard will improve due to a more consistent supply of feeder cattle; a more consistent carcass size will improve the efficiency of the packer's business; and the consumer will benefit from a consistent beef supply that meets their requirements for taste, tenderness, and safety.

Randall County Feedyard, Friona's most efficient feedyard, was the site chosen for BAP cattle. This 65,000-head feedyard near Friona's headquarters, was a commercial operation until being committed to the program in January 1999. By August 1999, operating at 100% capacity, Randall was only feeding BAP cattle. Randall's manager, Richard Winter, described how BAP had altered his responsibilities:

One of the major changes that I've dealt with since the BAP program began is that Randall participates in the value of that animal through the whole chain. So my responsibilities don't end when the cattle walk on the truck. From day one, when I receive the cattle for the feeding process, I have to ensure that we're doing everything we can to complement the packinghouse end of the business. That means yields, grades, and the elimination of nonperformers. That's something that's always been there but we in the industry have done a poor job addressing the customer, who is the consumer. Our responsibilities tended to end when the cattle left the feedyard. The stopping point is now when the customer either makes a bulk order or the consumer reaches in the meat case and pulls out a particular product.

Because of BAP, the feedyard was sourcing all cattle from Capitol Land & Livestock. They were brought in on certain specifications based in part on muscle type, framesize, and genetic disposition. This predictability allowed for variances for factors such as outdates, projection of market dates, estimated costs, and estimated gains and all the particulars that were involved in producing a finished product made to be further processed, to be greatly diminished. Consistent supply, in an industry that was predictably cyclical was also the result of this predictability. Winter explained:

Historically, the feedlot industry suffered from a feast or famine environment where in the Spring and Fall we harvest the cattle as we harvest crops. They come off ranches and pastures into feedyards and the inventory would fluctuate greatly. It would not be uncommon for this feedyard to ship or receive 25,000 head of cattle in 45 days. That breeds inefficiencies because we have a static staff of people and it makes the workflow exorbitant for periods of time. Quite often, the details weren't addressed and the better cattle basically fend for themselves because they don't require as much attention as the highly stressed, sick cattle. But with the BAP program, we have a consistent supply of cattle that comes in on a scheduled basis, with excellent animal health.

"This business is always striving for full capacity," Delaney added.

The feedyard is like a hotel. You've got a fixed asset that's just sitting there. You don't want it to be underutilized. The problem with a normal feedyard is that if the inventory is down we have to buy cattle at a loss because we want to fill up the feedyard. I'm out there everyday struggling with how to keep these feedyards full and keep people employed. BAP gives us a guaranteed volume of cattle in and out every week, so I'm never worried about Randall. It's going to be full.

In the Spring of 2000, Randall's operated with 39 employees versus 55 employees in 1999 and 62 employees in 1995. Winter explained:

We are doing a better job because the inputs are much more manageable. We've gone from five people in the office, down to two to accommodate the requirements of a single customer. It allows us to budget better because we don't have those big swings in cattle inventory and we can spread our repair and maintenance costs, both on the mill and the facility, out into a more predictable and manageable schedule.

With the scheduled arrival of the cattle, Winter could also work on an assumed performance level. The feed mill could run more efficiently, which was the most important function in the feedyard as the mill was its main source of margin. Winter and his team could pre-plan, pre-order and produce the feed in volumes that met the requirements. This also enabled better utilization of equipment and mill manpower.

All BAP cattle had to be pre-conditioned off the feedyard site. At the feedyard, the cattle could then maximize the utilization of the feed and the feedlot environment. "We take the cattle off the truck and put them straight into the feed pen," Winter explained. "They've already been trained to eat out of a feed bunk and they already recognize a water tank. That may sound simple but if you take cattle from other environments, they have to be trained to a certain process and this can affect efficiency."

Ultimately, with a system like BAP that made transparent which animals gave the best yield, ranchers, feedlots and packers could identify the best and worst of their suppliers. This information would allow them to make better decisions and the industry would become more efficient as a whole. Winter explained:

One of the good things that can come from a partnership with the producer is that I take responsibility for the cattle when they arrive here. Whatever happened prior to their arrival is out of my control but I'm still liable for what happens here. I want to be able to trace it back to point of origin so if there's a horrible situation happening out of my sight, I can help stop it. Are a majority of the producers nervous about this level of transparency? Only if there's a degree of incompetence or lack of scruples. It's not impossible to imagine that taking place but it's not common because we're getting a tighter and tighter control on what we're doing

Another goal of BAP was addressing the issue of price discovery. Herring explained:

BAP cattle are priced on a formula/grid pricing model that uses wholesale boxed beef prices for all the various cuts, as well as hide and offal values. This method of valuation is important, because the BAP partners can evaluate each and every piece of the production and harvest model that is BAP in terms of how that model delivers a better, more consistent product to the consumer. Cattle that don't deliver production efficiency and correct product attributes are identified and eliminated from future procurement, and cattle that do deliver are identified and encouraged. Cattle are, in that way, are more accurately valued by the value they bring to the end-user market. Before alliances like BAP, we were primarily focusing on production efficiency and producing pounds of meat. Now, we are focusing not only pounds, but what kind of pounds. That's the direction that could change the image of beef in America forever.

Herring anticipated the implementation of the mandatory price reporting system. It was unclear whether the USDA/AMS requirements would eliminate the need to report prices for any branded beef product. If BAP products were to be subjected to this reporting, the transparency to other players would diminish BAP's competitive edge. Because BAP cattle were run under a

proprietary system and were classified as a branded product, Herring believed that BAP should not be subjected to mandatory price reporting.

From an industry standpoint, there was significant economic leverage with the BAP system. The most important question, however, was whether consumers would embrace the concept of branded fresh meat that delivered a promise of consistent quality under a branded name. Herring explained:

What we're doing is focusing on creating a niche marketplace for a branded, differentiated product by creating a vertically aligned system through BAP. A standardized system makes the production cycle go better. Raw materials are better, production systems are better, on-time delivery is better. Therefore it's a much more efficient product to produce. Because the raw material is more consistent and more efficient to produce and can be created to specifications, we have a better product and the consumer's got to love that. That's what poultry has done. They've made it more convenient because they've got control of the raw material that is going through the system.

Catalyst for Change

Herring's vision was proving easier said than done. "The biggest challenge I've had," he admitted, "is to communicate the vision and convince people in the industry that this is right. When you're going this way all the time and they're going the other way, it's a challenge to your communication skills."

There was concern as to how industry consolidation would affect the different players, particularly the small ranchers. With Ranchers Renaissance, many producers were confused by the proposed specifications and were unclear as to how they would meet them. In the case of the BAP, the proposed specifications included a smaller carcass with more marbled meat. Meeting these targets could potentially mean producers making expensive and time-consuming changes in the genetics of their herds. Many producers had an emotional and historic commitment to a particular breed. Producers based in south Texas, with a significant Brahman influence in their herds, questioned whether the specifications were feasible given the south Texas climate.²⁴

BAP was a significant financial exposure for Friona. Implementing the required technology came at a price and included extensive man-hours for development. Customers of Randall, Friona's most profitable feedyard, were displaced to its other feedyards. Herring was aware that closing Randall as a commercial operation potentially took away from Friona acquiring new customers. Meanwhile, the EID system cost BAP partners roughly \$250,000 plus \$1 per head of cattle put through the system.

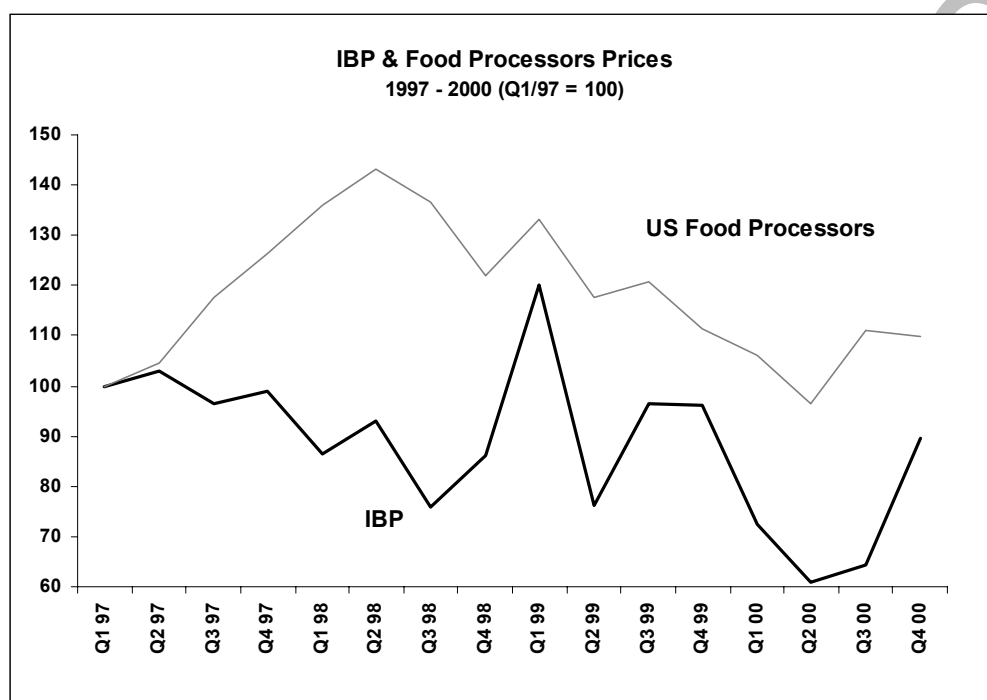
As he scanned Wal-Mart's numerous poultry and pork brands and the wide array of options tempting consumers, Herring stated that he was willing to take the risk involved in attempting to transform the beef industry:

Now, there are two roads, you either lose or you win. If you win big time, off it goes into the distance and we double the size of our feeding company. We bring all our customers through the system, we have a huge service franchise, and instead of a company that's worth a x million, the company's worth 4x million. If it doesn't work

²⁴ "Ranchers Renaissance," HBS case No. 9-900-008.

and the thing falls flat, my decision then is whether I'm going to chase it anymore with another series of players, or if I just go back to the old commodity game again.

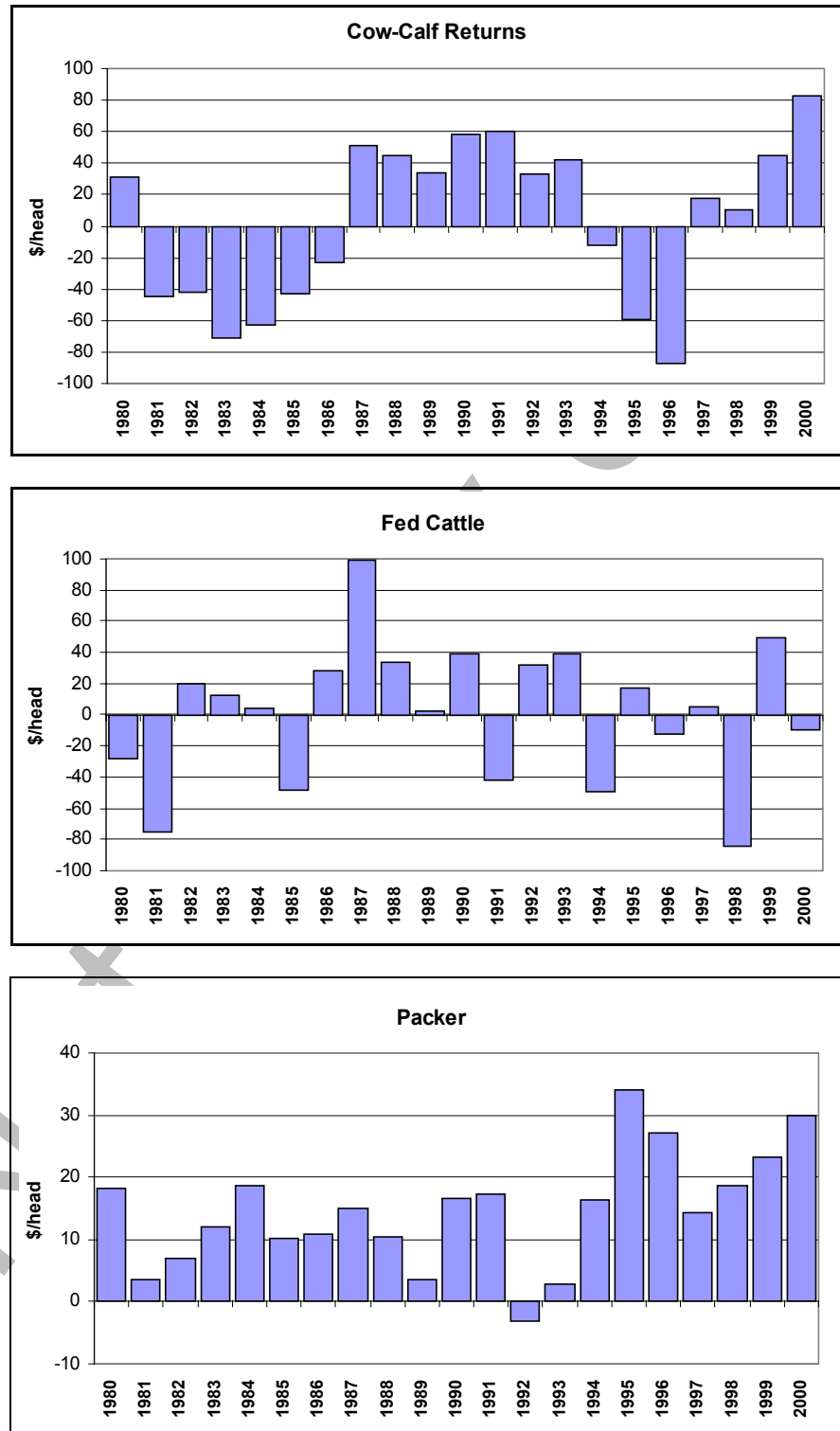
So we are taking a gamble that this is the template of the future. That's why nobody's ever done it. We've got a successful business here. We don't have to do this. We have a history of success in the cattle industry as it exists today. We have been successful in creating a service franchise in the livestock industry. But this is something different. This is a big-time change for the industry. We are creating a food company rather than a production company because that's the way we might be able to create a successful niche in a non-growth commodity industry. That's why I'm in it.

Exhibit 1 IBP and the U.S. Food Processors Index Stock Prices, Quarterly 1997-2000Source: *Datastream*.**Exhibit 2** U.S. Consumers' Meat Buying Trends, 1999

Protein	Dollars Spent per Household Annually	Annual Pounds per Household	Average Price (\$)
Beef	168	88.9	1.89
Poultry	70	57.6	1.22
Pork	59	34.3	1.73
Turkey	17	18.7	0.93
Ham	11	7.8	1.40
Fish	31	7.6	4.09

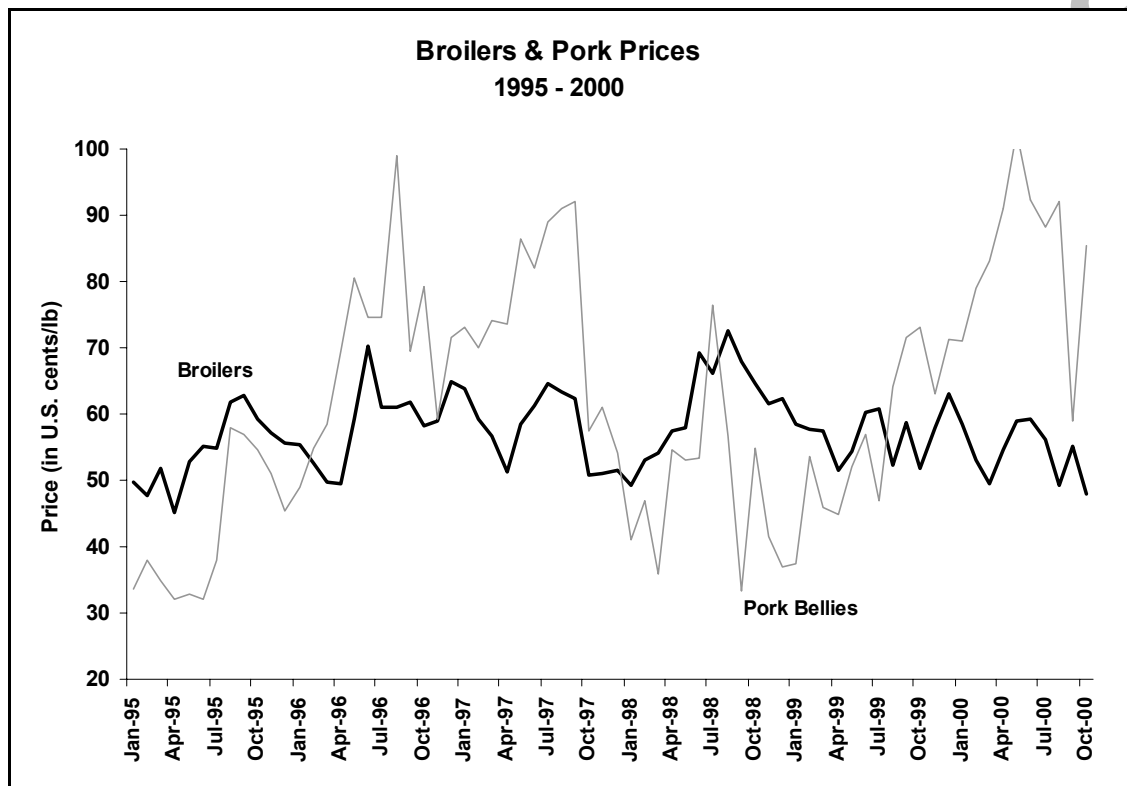
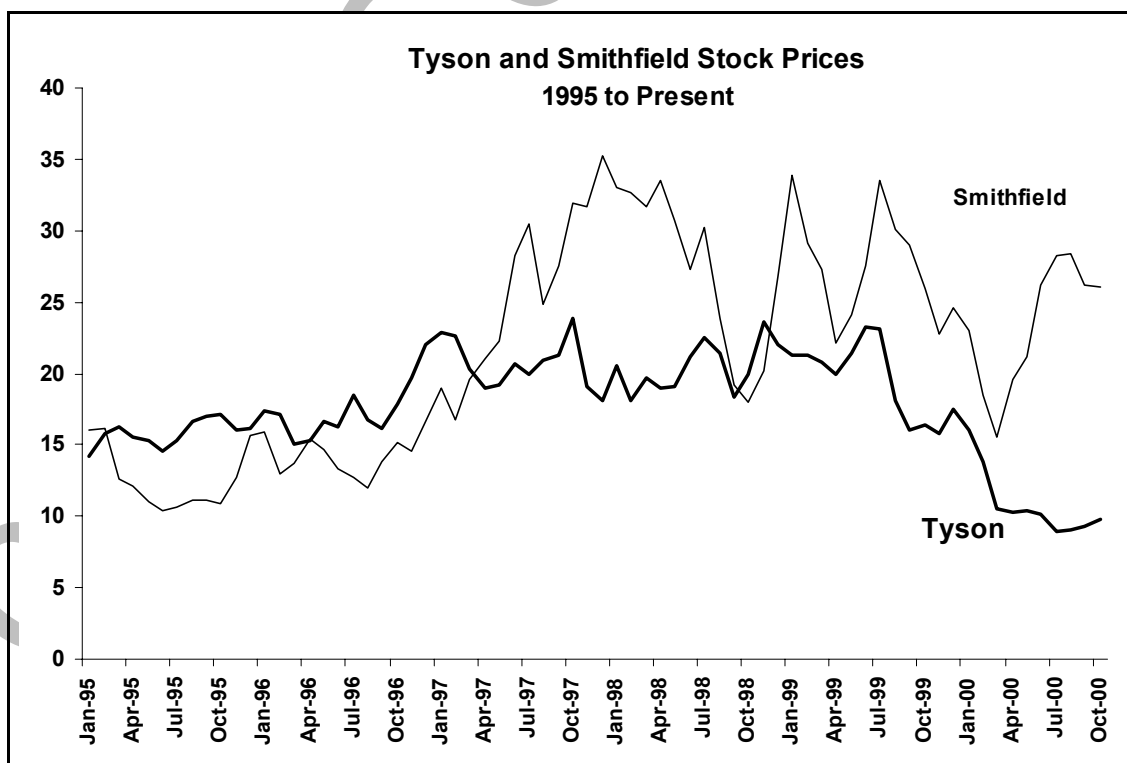
Source: NCBA/NPD Meat Purchase Diary, 1999.

Exhibit 3 Industry Returns, 1980-2000



Source: Cattle Fax.

Notes: Dollars per head. Profits are all Cattle-Fax estimates.

Exhibit 4A Broilers and Pork Prices, 1995 to 2000 (in US\$)**Exhibit 4B** Tyson and Smithfield Stock Prices, 1995-2000

Source: Datastream.