Survival Tactics for the Apple Industry

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Presented at the 44th Annual IDFTA Conference, February 17-21, 2001, Grand Rapids, Michigan.

This topic, "Survival Tactics for the Apple Industry," proved a very difficult assignment. First of all, I was pleased and honored when Matt McCallum invited me to serve on this panel to discuss the future of the apple industry. But I have struggled with my comments.

There are people in this room who are as qualified, indeed much more qualified, than I to discuss the topic. Also, I know this is a controversial topic. Last fall, the following question was posted on the listserv Virtual Orchard: "What one single thing, if implemented, could positively impact the doldrums of the US apple industry?"

It triggered a several-week debate, sometimes downright arguments. The general results are tabulated in Table 1. There was no unanimity in the comments of the participants. In fact, looking at the individual comments, some of the give and take bordered on hostile.

Knowing the controversial nature of this discussion, I pondered various approaches to this presentation. Should it be abrasive? How about upsetting? Then I discovered the February 2001 issue of the *Harvard Business Review* and an article titled, "How We Built a Strong Company in a Weak Industry" (1). The gist of that article can provide a springboard for discussion. It was written by Roger Brown who, with his wife, started Bright Horizons, a provider of workplace childcare and early education services.

TABLE 1

Summary of comments from on-line survey (Virtual Orchard) concerning problems in US apple industry.

Theme	Frequency
Improve quality	13
Industry organization	12
Balance supply with demand	7
Understand the supply chain	6
Educate consumers	5
Meet consumer needs	5
Brand marketing	3
Date stamping	3
Improve grade standards	2
New products	2
Nothing can be done	2

This employment ad caught my attention: "ENTREPRENEURS WANTED: Help grow an enterprise from scratch in an industry that offers no barriers to entry, chronically low margins, massive labor intensity, no proprietary technology, few economies of scale, weak brand distinctions and heavy regulatory oversight. Serious inquiries only."

Even though childcare seems worlds away from the apple industry, I saw similarities between the two in this list of weaknesses. The article describes how Brown methodically identified the weaknesses of the childcare industry and designed a business that built on the weaknesses rather than trying to solve them.

His first step was to get someone from outside the industry to help him take an objective view. He knew that existing childcare providers expended large amounts of dollars advertising to parents to convince them to use their services. He also knew that his competitors thought of the childcare industry as a commodity business. The way to survive was to drive down costs by paying just above minimum wages to its employees and striving to meet (or sometimes failing to meet) the minimum state licensing requirements.

A few well-managed organizations that take the initiative and the risk to do something different probably will save the apple industry.

His outside consultants helped him realize he needed a strong, profitable organization that would allow him to attract large amounts of capital. They looked at the weaknesses and how to turn them to their advantage.

One of the things the outside consultants were able to recognize was that innovative companies such as shoemaker Stride Rite were setting up their own childcare centers at their work sites. These were generally much higher quality facilities than those run by the traditional chains. They proposed that Brown's company become an outside operator of those centers.

By viewing these employers as the primary customer rather than parents, Brown could turn several of the industry weaknesses to his advantage. First, he could tap into the financial and other resources of these large companies. These employers viewed the childcare centers as a way to distinguish themselves in the eyes of current and prospective employees. It helped them increase their employee loyalty and retention rates. Therefore, the customer had a vested interest in helping achieve the goal of high-quality childcare. Brown effectively established a barrier to entry by meeting the needs of this customer base. His competitors, tied to the commodity mentality, could not satisfy the needs of these customers that were based on attracting and maintaining their employees, not on acquiring low cost childcare. He became a provider of services in a selected market.

Considering the employers as his primary customer also gave him access to a powerful, low-cost marketing channel. He no longer had to sell to one parent at a time. He had instant access to a large pool of working parents through the employers. The need for large advertising expenditures was eliminated.

He turned the industry weakness of chronically low margins to his advantage in a unique way. As an outside operator, the customer investment in facilities minimized the need for capital. Margins in the childcare business will remain low but Brown emphasizes return on invested capital rather than margins. Since invested capital needs are low, the return on invested capital is high and meets the expectations of investors.

Brown turned the industry weakness of high labor needs to an advantage by developing a well-qualified and adequately compensated staff of people. Again, the customer need of maintaining its own employee base rather than low-cost childcare made this possible. Labor is not a commodity; it is an advantage.

No proprietary technology was turned to an advantage by using existing technology to meet customers' needs. Web-connected cameras were used to allow parents to view their children from their workplace.

High labor costs meant few ways to create economies of scale for Bright Horizons. Economies came, not from purchasing power, but from the ability to innovate locally and deploy globally. Knowledge and techniques were spread across the network of childcare centers to gain advantage.

While weak consumer brands were an industry weakness, the need for national branding was eliminated by focusing on a set of customers—employers who valued partnerships with a strong, quality-oriented provider.

High regulatory oversight was grasped as a way to gain a competitive advantage. Rather than fight regulatory oversight, Brown concentrated his growth in states with high standards where his focus on quality set Bright Horizons apart from its competition.

Now, how can this apply to the apple business?

Some efforts are already under way to construct barriers to entry. The licensing and control of propagative material is one way. Some commodity groups have used federal marketing orders to attempt to balance supply with demand.

What have we done in the apple industry to take a hard, objective look at who is really our customer? And if we are asking our customers what they want, we are asking the wrong questions. We know they want the best quality at the cheapest price. A question more along the lines of what do you like and what don't you like about

FIGURE 1

Food service sales forecast for 2001.

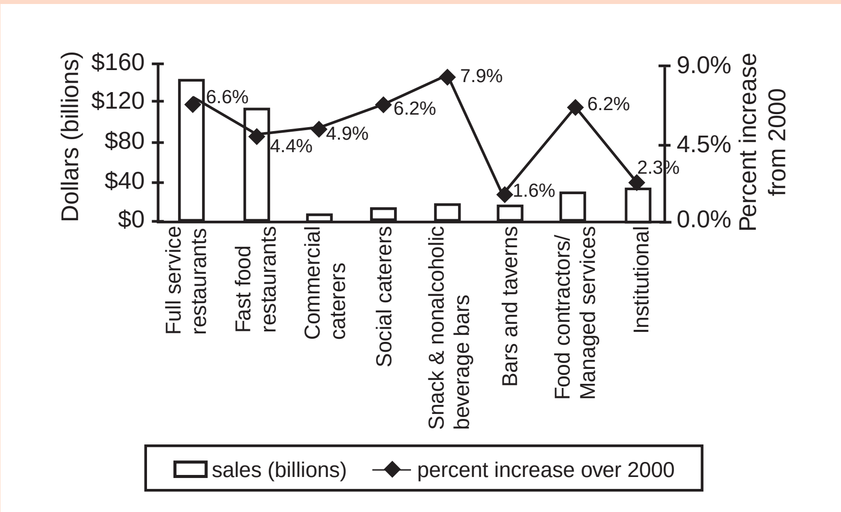
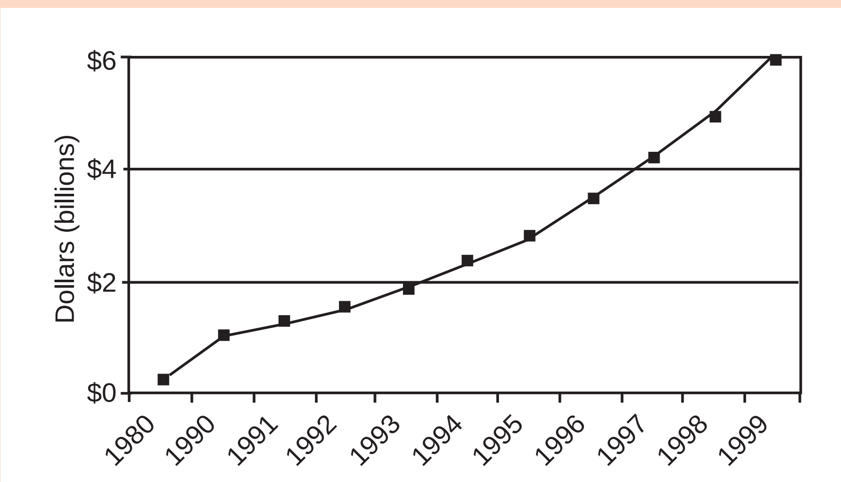


FIGURE 2

Organic food sales history.



your current suppliers will solicit a more thoughtful and thought-provoking answer.

Have we looked at new and unusual customers? Data from the National Restaurant Association (2) show significant growth in snack and nonalcoholic beverage bars (Fig. 1). Those are juice bars that cater to natural and health food users, usually high-end consumers. Is this a potential target for market expansion for our natural apple juice rather than competing for expensive, lower margin supermarket shelf space?

What are the opportunities in the organic market? As shown in Figure 2, organic sales are growing at a steady rate (2). Organic is still a small portion of the $480 billion total food sales. But they are growing and appealing to more consumers who value a lifestyle and commitment to health and well-being.

What innovative things can we do to bring capital into the apple industry? We are a capital starved business, as low returns have limited the resources available internally. But if not internally available, what about external? When the Browns were forming Bright Horizons, they went to Bain Capital who asked another firm, Bessemer Venture Partners, also to evaluate the business plan. Bessemer Venture required them to go through a psychological interview as part of the evaluation process. They were surprised but did it. Are we willing to do the unexpected to get the capital we need? Also note Brown's innovative approach to accessing capital. He did not try to raise it himself. He partnered with his customers and they provided a good portion of his needs.

The Browns addressed economies of scale through deployment of knowledge, not purchasing power. We can gain economies through purchasing such as group purchasing of inputs for the grower to the packer to the shipper.

Finally, a few well-managed organizations that take the initiative and the risk to do something different probably will save the apple industry. Those organizations must have the ability to pull together diverse groups and interests. The groups include any or all of the following: growers, processors, packers, shippers, brokers, wholesalers, retailers, chemical suppliers, package suppliers, lenders and investors. Interests include raw product price, packing costs, input costs, market share, margins and return on equity.

The transition will not be easy. There will be winners and losers. Not everyone will survive. But the transition must occur.

REFERENCES

(1) Brown, R. 2001. How We Built a Strong Company in a Weak Industry. Harvard Business Review. February 2001, p. 51.

(2) Larson, R. 2001. Recent trends in food marketing. Presentation at Growing for the Customer, Western Michigan University. Michigan State University—Extension. February 13, 2001.