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Title

Case Study No. 5: The Farmers Diner

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THE FARMERS DINER

Middlebury and Quechee, Vermont

MISSION

The mission of The Farmers Diner is to increase the economic vitality of local agrarian communities. The Farmers Diner creates great traditional foods using ingredients from farmers and producers who are as local as possible. Their foremost goal is to spend 70% or more of their food and beverage dollars with farmers and producers who live and work within a 70–100 mile range of the restaurant and to serve food at prices that allow those same farmers and producers to be regular customers.

HISTORY

Leaving a successful coffee shop business in New York City in 1997, Tod Murphy moved to an old dairy farm in Vermont to begin farming. Murphy had a connection to farming through his grandparents, and his time on their land deeply influenced him.

Following the move, Murphy became frustrated by what he saw all around him—farmers working their tails off selling at prices below the costs of production while the local markets (stores, restaurants) had an abundance of food produced far from the community. This disconnect was also hampering the local economy, as money was siphoned off like the milk truck heading out of town. The loss of markets meant the loss of farmers, which also meant the loss of supporting industries, in what many see as a downward spiral that will eventually cripple a community such that it loses its ability to feed itself.

Faced with this scenario, Murphy began to develop the idea for a traditional diner serving Americana fare at reasonable prices, with one major twist: the ingredients for his milkshakes, fried eggs, bacon, and burgers would come from the very farmers that he hoped would hang out in the diner.

In 2002 Murphy opened the first Farmers Diner, in what he calls an “Alpha Test,” in the small community of Barre, Vermont. This location was



Farmers Diner founder Tod Murphy with Denise Perras at the Barre, Vermont location.

used to test and verify that there was a sufficient supply of local ingredients to support a diner. The fifty-seat restaurant proved out the core concept but faced financial limitations due to the limited seating. After three years The Farmers Diner moved to its current Quechee, Vermont location and in 2009 the Middlebury, Vermont Farmers Diner opened to much fanfare.

While developing and opening the first Farmers Diner, Murphy purchased a small USDA-inspected butcher shop also located in Barre. Vermont Smoke and Cure was a 40-year-old local smokehouse that needed to survive if there was going to be any meaningful effort to rebuild the meat-processing

The Innovative Business Models Case Study Series

Developed by the UCSC Center for Agroecology & Sustainable Food Systems, this series of case studies focuses on the social and environmental efforts of innovative U.S. food system businesses across different geographies, scales, legal structures, and points along the food supply chain. While these represent only a handful of the thousands of socially and environmentally responsible food businesses across the nation, they have many features that others can learn from in developing sustainable businesses that incorporate the triple bottom line of people, planet, and profits.

infrastructure needed to serve smaller-scale, independent producers around the region. This butcher shop would not only make it easier to provide local meats to his restaurants, but would allow the farmers to direct market their own meat to other buyers and create value-added products from some of the lower-value cuts. Murphy owned this business for six years and spun it off when he felt it could stand on its own. He maintains a strong relationship with the new owners and a minority financial interest.

In 2008, Murphy brought in a new business partner and Operations Officer, Denise Perras. Together they have built the systems required to expand The Farmers Diner business to other regions interested in owning and operating a family restaurant featuring local food. Plans are in the works to create a “wheel and spokes” model of diners (what Murphy refers to as a “pod”), with a central commissary to do purchasing, receiving, and initial prep work and up to five diners cooking and serving the farm-fresh food. If this model materializes, Murphy and Perras predict annual purchases of regional food could top one million dollars a year. The multiplier effect of those purchases would be even larger, adding nearly six million dollars to the local economy as those farmers buy other goods and services from the region. Although this model is not yet tested, Murphy and Perras have been successful with just two diners and believe that their five diner/central commissary model would be even more profitable thanks to reduced overhead costs.

GEOGRAPHY/SCOPE

The Farmers Diner set out with a goal of purchasing at least 70% of their ingredients from farmers within 70–100 miles of each diner. They have achieved this goal and during the summer months, when regional produce is abundant, they can even exceed it.

The Farmers Diner buys from over fifty farmers in Vermont and New Hampshire, with purchases ranging from local milk and cream, to eggs and chicken, to corn meal and maple syrup. One of their cheese vendors, Cabot Creamery, is actually a cooperative of over 1,350 New England dairy farmers. Several new farms were able to get off the ground thanks to the assured cash flow that Farmers Diner contracts provided them.

The Farmers Diners works closely with their suppliers, helping to coordinate their distribution and in some cases facilitate further processing.

Murphy and Perras currently operate two Farmers Diner restaurants, one in Quechee and the other in Middlebury, Vermont. A third location, opening in a new region, is in the works but not yet publicly disclosed. Their long-term vision is to expand The Farmers Diner all over the country in partnership with local farmers, restaurant operators, and customers, serving farm-fresh fare regionally appropriate to each diner. They believe their model is scalable, and in fact would be more profitable by taking advantage of some economies of scale in order to offset the higher costs of their operating principles and regional purchasing efforts.



Tod Murphy in front of the original Farmers Diner.

PRODUCTS/SERVICES

Offering a menu full of tongue-in-cheek American classics such as the “Kitchen Sink Omelette,” the “Cock and Fire,” and the “Meatropolitan,” along with traditional fare such as creamy milkshakes, hush puppies, and a farmers breakfast, The Farmers Diner is reinventing the American diner. They serve breakfast and lunch, as well as new “small plates,” throughout the day. Their Middlebury location is open 24 hours a day on weekends, catering to the town’s large student population.

The Farmers Diner acts as a value-added intermediary between farm and plate. The diners purchase directly from farmers, offering competitively priced meals that cost only 7–13% more than those of other chain breakfast restaurants in Vermont. They do much of their own processing of raw ingredients and even cure and smoke some of their meats (via working with sister company Vermont Smoke and Cure). This processing helps keep their raw ingredient costs down and is necessary since much of the food-processing infrastructure such as small canneries or mills is no longer available in the region.

FINANCING

Murphy used approximately \$240,000 in initial capital from personal funds, bank debt, private investors, and private convertible debt to get the first Farmers Diner location off the ground and test the concept. Although the first diner did not prove profitable, he quickly relaunched the brand in Quechee with a larger space and reached profitability by the second year. His Middlebury diner has also been successful, reaching profitability in its first year.

Murphy is still paying off the original investors, most of whom entered into the arrangement expecting slower payback and lower financial returns than from many traditional investments. Many of these investors joined in Murphy’s vision because they embraced what is being called the “Slow Money” philosophy and support the notion of a “triple-bottom-line” company that, along with being economically profitable, includes social and environmental “returns.”

Due to the seasonal nature of the restaurant business, especially in a region with four distinct seasons, short-term debt is needed to fund operations in the off-season. However, this debt is paid off during the high season when cash flow once again becomes positive.

MANAGEMENT/BUSINESS STRUCTURE

Tod Murphy set up The Farmers Diner as an LLC (limited liability company) with multiple owners, including himself. The LLC model allows the ownership to expand as new investors are pulled in without the risk of personal liability or double taxation.

An LLC is also more flexible in terms of how it sets up its operating agreements and management structure. The LLC lets investors with passive income use the losses of the start-up years as an offset against capital gains taxes, allowing them to make a financial return even before the company begins making profit distributions. However, this structure also means that only a limited amount of outside capital can be raised in any given year.

Management at The Farmers Diner is organized by the original LLC operating agreements, a board of managers that oversees strategic planning, and company managers (Murphy and Perras) who oversee tactical decisions and day-to-day operations. This structure is nimble enough to adapt to rapid changes in the marketplace, but criticized by some who think that a more collective decision-making process should be instituted. Although Murphy and Perras rely on management-led decision making, they also actively gather and respond to feedback from their customers, employees, suppliers, and other partners, a strategy that helps explain the success of their restaurants.

LABOR PRACTICES

Employee turnover is an ongoing challenge in the restaurant industry, and is a factor beyond the ability of any one company to control or change. Many take restaurant jobs for temporary employment, as a jumping-off point for a different career, or as a first job after immigrating. In addition to making it more difficult to provide consistently good quality and customer service, employee turnover is extremely costly for a business.

The Farmers Diner is not immune to this industry-wide issue, but they are taking steps to address it by providing a career ladder for those with a passion for the culinary world and those willing to stay at the diner for more than a couple of years. They already provide profit sharing for longer-term employees (those with the company for more than two years) and are currently researching health insurance options. This latter effort may seem obvious, but it is important to point out that the majority of restaurant jobs come without health insurance; one nationwide study of over 2,000 culinary workers showed that only 17% of line cooks and waitstaff had employer-paid health insurance.

Employees are rewarded not only for their staying power, but also their effort, energy, respect for others, and their



Tod Murphy (left) with one of the local dairy farmers who supplies products to the Farmers Diner.

commitment. Some employees may not have a strong buy-in to The Farmers Diner mission of supporting local producers, but those that are passionate about the mission will often see their career opportunities expand. Those same employees may be running their own Farmers Diner franchise someday.

SOCIAL/COMMUNITY INITIATIVES

The Farmers Diner is really a social experiment that is addressing several critical questions: Can a community choose to support itself through the relationships of commerce, reward the farmers that steward the landscape around it, and provide decent jobs for their sons and daughters or neighbors? Can it provide “democratically-priced” food, as Wendell Berry once described it, for all people while strengthening the interdependent ties of a regional economy?

The Farmers Diner is trying to create an alternate food chain in which members of that chain are in a relationship with one another. The core of what they do everyday, sourcing local food, is highlighted in their menus that feature the supplying farmers, communicated to customers by their employees, and measured internally throughout the year. They have met and exceeded their goal of sourcing 70% of raw ingredients from a 70–100 mile radius around each diner, which provides a significant influx of dollars into their local, mostly rural economies. Additionally, an increasing number of menu items are highlighted by Farmers Diner as fair trade, which means the diner has purchased products from the farmers without any leveraging down of price or benchmarking the price against the global commodity index.

In addition to the relationships they develop with suppliers and their employees, The Farmers Diner supports their local communities through a number of efforts. They participate in numerous community events, collaborate with nonprofits, and donate food or cooking services for a variety of partners. This is not only part of their core value of rebuilding community, but also serves as a non-traditional marketing tool.



ENVIRONMENTAL INITIATIVES

The Farmers Diner's commitment to local purchasing also includes efforts to buy from the most environmentally responsible producers. Although not all certified organic, much of their produce is grown without the use of chemicals and all of their meat has to be free of non-therapeutic antibiotics or hormones (what is usually referred to as "natural") and come from animals that have access to pasture when seasonally appropriate. Additionally, by reducing the miles between farm and fork, Farmers Diner has surely reduced the company's carbon footprint.

By buying many of their raw ingredients direct from the farmer in bulk, and doing some of their own processing, the diners also avoid the food service industry's typical packaging. Take the egg, for example. Most breakfast restaurants cook with pasteurized liquid eggs that come in a non-recyclable, wax-covered aseptic box. The Farmers Diner instead uses fresh shell eggs that come in a crate, which can be reused by the farmer. For a place that goes through 130–200 dozen eggs a week, that represents a huge reduction in potential waste.

KEY CHALLENGES

The loss of the mom-and-pop café and the mid-scale farm was not inevitable, but rather a social process orchestrated through government intrusion in some cases (e.g., increasing regulatory burden, which led to the loss of smaller farmers and food processors) and the lack of government intervention in other cases (e.g., lack of enforcement of anti-trust laws, which led to consolidation of seed companies, processors, distributors, etc.). What The Farmers Diner and its farmer suppliers are up against is nothing short of a giant boulder that they are trying to push uphill.

Murphy, Perras, and the company's supplying partners are slowly moving that boulder up the hill, despite all of the government- and industry-led efforts to race that rock to the bottom. Illustrating this problem is the current ironic situation in the meat processing industry: despite the increasingly heavy regulatory burden that meat processing facilities face, the frequency and severity of meat contamination outbreaks are on the rise. Murphy would like to see burdensome food safety plans (know as HACCP) for meat processors eliminated and replaced with quality testing of the finished product.

Food costs for The Farmers Dinners are higher than those of many of their competitors, a fact that Murphy thinks represents a rigged economy based on abstract wealth creation and the passing of external costs on to others. Investors might not get excited by the profit returns that the diner is generating, but they are real returns, not abstract, and at 9% are in line with average business returns over the last 200 years.

Murphy takes a longer-term view to understand how his business is performing and to place it in the context of economic "evolution"; once more citizens realize how unrealistic and destructive the bubble economy was, they will begin to patronize and invest in businesses that are in it for the long haul and dedicated to improving their community.

Although there has been considerable interest in The Farmers Diner model and invitations from all over the country to start diners in other communities, the LLC currently lacks the senior management horsepower to take advantage of these opportunities. Likewise, even though there are plenty of self-described "socially-responsible venture capitalists," their short timelines and unrealistic expectations when it comes to profit levels have not made many of them a good match for investing in The Farmers Diner franchise. Indeed, the "pod" model of five restaurants around a central commissary is probably unattractive to many potential franchisees, requiring too high a level of investment and operational expertise.

CONCLUSIONS

More and more restaurants are increasing their efforts to source locally, at least on paper. The Farmers Diner is doing this for real, as it is their central mission. As The Farmers Diner makes the case for supporting local farmers and purveyors it is having a ripple effect on others in the culinary world. The diner is proving that it is not only possible to feature locally produced food, even in the northern climes of Vermont, but that it can be profitable even in a lean economy. The Farmers Diner also has a large group of suppliers, investors, customers, and other stakeholders who want to see the model succeed, and this web of relationships is helping to provide resilience in challenging economic times.

Once thought of as "elitist" or only for the rich, The Farmers Diner is proving that sustainable, local, and tasty prepared food can be for everyday people. It is the kind of place where your grandfather or teenage daughter would feel comfortable, a model with the potential to replicate itself all over the country.

FOR MORE INFORMATION on the Innovative Business Models Case Study Series, please contact the UC Santa Cruz Center for Agroecology & Sustainable Food Systems (CASFS) at 831.459-3240, or send email to casfs@ucsc.edu. You can learn more about CASFS at <http://casfs.ucsc.edu>

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