HOW FOOD BANKS CAME TO LOVE THE FREE MARKET

On November 11, Quaker gave 20,780 pounds of surplus cereal bars to America's Second Harvest, the nation's food bank network, which distributes such donations daily to nonprofit agencies that feed the hungry. From Alaska to New York, each of the 210 food banks desperately wanted the load. To get it, they had to compete. By Patricia Houlihan

Bidding started at 10 a.m. (CST). Two hours later, the winner was announced: Kansas City, Missouri, got the cereal bars for 11,418 shares. Invariably, there were disappointments, but few complaints. Since July, America's Second Harvest has used "the choice system," a method of online electronic non-cash bidding—devised by faculty at Chicago GSB—that lets food banks compete for products they want from about 75 truckloads of food donated every day. The participants lose far more often than they win, but say they vastly prefer the new approach to the "big brother" system—a rotating list that America's Second Harvest had used to assign donations for 15 years. "Deciding which products to bid on isn't easy, but we know our service area better than anyone else, and we know what kind of niche each product might serve," said John Arnold of Second Harvest Gleaners Food Bank in Comstock Park, Michigan. "For better or worse, the decision making is now precisely where it needs to be."

For big food producers like Kraft and ConAgra, America's Second Harvest provides a way to donate surplus food instead of paying to warehouse it—or throwing it away.
Feature America’s Second Harvest

In addition, manufacturers have the opportunity to give away products that are imperfect or close to their expiration date. Either way, the measure provides the corporations a tax break.

America’s Second Harvest accepts donations from 550 donors at 5,000 locations and distributes them daily across the 50 states, the District of Columbia, and Puerto Rico to food banks that are America’s Second Harvest network members. Those organizations, in turn, dole them out to local food pantries, soup kitchens, homeless shelters, and other charitable agencies.

The Challenge of Allocation

For America’s Second Harvest staff, allocation has always been a challenge. In the early 1980s, whoever could pick up food in a timely fashion got the donation. By the late 1980s, the organization began using goal factors based on poverty and population to determine the amount of food each member should receive for the year. America’s Second Harvest kept track as members approached their allotment, and as donations came in each day, staff offered the food to members first from receiving their share. The type of food rarely mattered: chicken, canned beets, fresh lettuce, apple juice, potato chips. Since the members paid for shipping, they were sometimes put off if freight costs were too high. Whether the local food bank accepted the food or turned it down, the load counted as an allocation, and that member dropped down to the bottom of the list immediately.

“When your name was at the top of the list, someone at America’s Second Harvest would call and say, ‘Would you like this load?’ If it was chicken, you were happy. If it was barrels of olives, it was maybe not the best thing,” said Susannah Morgan, executive director of the Food Bank of Alaska. “But whether you took it or not, your name would drop back down on the list until it worked its way back up again. From my perspective, there was practically no choice, only yes or no.”

In an attempt to help, America’s Second Harvest staff sometimes tried to guess who needed what; sometimes they even skipped a name on the list to save a member the expense of turning down a load, but that frustrated members, too.

“There might be a load of chicken in Florida, but America’s Second Harvest would say, ‘Alaska won’t want to go to Florida for it,’” Morgan said. “But they wouldn’t know if I wanted it or not, your name would drop back down on the list until it worked its way back up again. From my perspective, there was practically no choice, only yes or no.”

CREATING A NEW ECONOMY

Steve Saleh, ’86, was a policy analyst at the Department of Commerce when it funded a study of how nonprofits, including America’s Second Harvest, used the Internet. In conversation with David Prendergast, ’86, America’s Second Harvest senior vice president for planning, Saleh suggested Prendergast seek help from former teacher and friend Harry Davis, Roger L. and Rachel M. Goetz Distinguished Service Professor of Creative Management, and Robert Hamada, Edward Eagle Brown Distinguished Service Professor Emeritus of Finance. Both professors quickly agreed. “Allocation of scarce resources is what we teach and research at the GSB,” said Hamada. “That’s what economists do.”

Davis served as moderator for the new task force—three executives from the national offices of America’s Second Harvest and nine member food bank directors, a wildly disparate group ranging from ex-hippies to former military officers, all of them used to running their own operations. Some would accept only healthy foods while others were self-described “scavengers” and would take anything. Some served enormous metropolitan areas; others ran tiny rural food banks. And while most dealt with packaged goods, others distributed only prepared food that had been “rescued” from restaurants or delicatessens.

And after they agreed on a new distribution method, the task force members would have to convince the other 201 members it would work. “They had to own the answer themselves and feel it was as much their idea as it was ours, because they had to sell it to this very diffuse network,” Davis said.

He and Hamada tapped microeconomist Canice Prendergast, W. Allen Wallis Professor of Economics, to help. Prendergast was intrigued. “It’s not often you get to create a little economy all on your own. We were doing it from scratch.” In fact, their first step was to scrap the old system. Hamada thought of a bidding system immediately, but he didn’t mention it to the task force. “I had a model in mind of vouchers and bidding to elicit what kinds of things and how much is demanded—more
Chicago GSB faculty helped us come up with a real business solution.”—Maria Hough

Comparatively tiny and powerless, they were historically disenchanted. To incent them to participate, “the FROs were given a considerable amount of shares to join the system,” Prendergast said.

The task force came up with a formula to determine how many shares to distribute among the 210 members on the first day. One pound of food would equal 0.2 shares; a typical truck holds 25,000 pounds and would trade for about 5,000 shares. With about 75 truckloads donated a day, members would spend about 375,000 shares during one day’s transactions. “But that logic only works if people don’t keep shares in the bank,” Prendergast said. “We guessed that they’d keep an average of four days’ shares set aside and win a load once every two to three days.”

Another challenge was providing incentives to food banks to put anything they couldn’t use on the auction block. The extra food brought into the system was dubbed “maroon pounds” by the GSB faculty. Members with local product, like the Idaho food bank with extra potatoes, could offer it to other member food banks through the system, receiving 90 percent of the resulting shares; a 10 percent tax collected by America’s Second Harvest would be reallocated to members in greater need of assistance. “We had a long discussion about what the tax rate should be,” Prendergast said. “Some wanted it really high, but if you tax it 50 percent, you’re not going to get as much as if you tax it 10 percent. We provided incentives by keeping the tax low but reallocating it differently.”

CONVERTING TO A MARKET SYSTEM

Perhaps the most unusual challenge the task force grappled with was preparing food bank executives to operate in a free-market system because they could see that, over time, even small players acquired the loads they wanted.”

The prototype was a huge hit, convincing more than 200 food bank operators and executives at America’s Second Harvest that the market system would work for them. On July 1, with a few minor adjustments to the prototype, the choice system was launched and proved successful immediately, said Maria Hough, managing director of logistics at America’s Second Harvest. One measure is the number of maroon pounds—additional food brought into the system by food banks. Within the first three months, America’s Second Harvest distributed 72 million pounds of regular donations as well as six million in maroon pounds, she said.

Food bank directors also value the transparency of the system. “We don’t get loads of chicken and peanut butter every day, and we don’t give all the product to one state,” Hough said. America’s Second Harvest staff time has been freed up to seek more donations from manufacturers, both in volume and variety. For instance, items like shampoo and toothpaste, once thought to be of less value than food, are highly sought by food bank directors and their clients and are now among products offered.

Most importantly, the new system has made America’s Second Harvest a more efficient business. “We’re feeding more hungry Americans, so it’s all for the good,” Hough said. “But the Crafts and ConAgras of the world don’t donate their excess product just for philanthropic reasons. This is business-to-business. Chicago GSB faculty helped us come up with a real business solution.”

By the Numbers

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<th>Year</th>
<th>Amount from national donors distributed</th>
<th>Number of maroon pounds</th>
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<tbody>
<tr>
<td>2004</td>
<td>164 million pounds</td>
<td>8 million pounds</td>
</tr>
<tr>
<td>2005</td>
<td>200 million pounds</td>
<td>7 million pounds</td>
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<tr>
<td>2006</td>
<td>3 million pounds</td>
<td>66 million pounds</td>
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When natural disaster struck, America’s Second Harvest sent additional donations directly to food banks in areas serving storm victims without asking the members to use the new allocation system.

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Using its new allocation system, America’s Second Harvest was able to distribute significantly more food, beverages, and toiletries to food banks across the country. Statistics compiled after the first six months illustrate the increase between July 1 and December 31, 2005, compared with the same time frame in 2004.

- Members who have seen an increase in product
- Additional amount shared between members, also known as “maroon pounds” in 2005