

Submission On Kiwifruit Industry Review

1.0 Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. Our interests are in the development of public policies which will contribute to overall economic growth and community well-being. As part of this mission we have had a longstanding interest in policies affecting the marketing of agricultural products because of the importance of the agricultural sector's contribution to the national economy.

1.2 The main research studies which we have undertaken which are relevant to the kiwifruit industry are the 1992 ACIL report *Agricultural Marketing Regulation: Reality versus Doctrine* and the 1994 study *Restoring Kiwifruit Profitability: Choice, Ideas, Innovation and Growth*. These reports will be familiar to many of those involved in the review process and additional copies can be made available if required.

1.3 The essential conclusions of our analysis are that to maximise the contribution of the kiwifruit industry to the economy and to establish a dynamic environment for kiwifruit exporting, substantial reforms to industry structures are required. We believe the marketing of kiwifruit should become fully contestable and the Kiwifruit Marketing Board (KMB) should be corporatised so that a clear distinction is made between returns from the supply of fruit on the one hand and investment in marketing activities on the other. There are many options available for handling the transition from the present highly regulated industry to a normal commercial environment, although we believe change should be rapid so as to minimise continuing inefficiency in the use of resources and obtain the benefits of competition sooner rather than later. We continue to support these conclusions and have not seen any convincing rebuttal of our analysis. However, rather than canvas the wider issues raised in the previous NZBR reports, this submission concentrates on matters raised in the terms of reference of the present review.

2.0 Profitability the key

2.1 Given the consensus that increasing profitability of the industry is the goal, the issues to be resolved are:

- whether regulation of kiwifruit exporting is the appropriate response to the market realities;
- if regulation is considered necessary, what type of regulatory structure is required and how should its operating guidelines be constructed; and
- the strategies required to maximise profitability.

3.0 The marketplace

3.1 The global fruit market is diverse in terms of distribution systems, prices, attitudes towards branding and product quality. Whereas in major western countries it is common for buying power to be concentrated in the hands of around half a dozen buyers, in other markets there is a more even spread.

3.2 Major supermarket buyers generally want suppliers that can meet their special needs in terms of consistency of supply, volume, price stability, quality and service. The Steele report on the apple industry emphasised the importance British supermarket buyers place on "relationships". It said that price is usually a secondary consideration. This in itself suggests there may be less of a problem with multiple sellers than many in the industry have believed to be the case.

3.3 Even in the Western markets around 40 percent of fruit is sold through a myriad of channels to smaller outlets than the main supermarket chains. The lower volume buyers in these markets sometimes prefer to deal with suppliers who do not also supply their large competitors. They seek a point of differentiation which may be quality, price (higher or lower), reliability of supply, brand and innovation, or some combination of these attributes. These channels should not be ignored by the industry.

3.4 The Japanese market has unique characteristics which may require a different marketing strategy. This will change over time as the distribution channels become more like those operating in Western economies.

3.5 Given the diversity of the various markets and the constant change taking place, it is highly unlikely that any one company in New Zealand, or elsewhere, will be able to develop all available commercial opportunities. There is a great deal of scope to increase per capita consumption of kiwifruit in many markets.

3.6 While major supermarkets in most markets will need to be serviced by suppliers capable of handling large volumes, the NZBR believes there is no need for exporting to be restricted by statute to just one seller. These commercial imperatives will bring about firms of the necessary scale, as they have in other industries without statutory regulation. The record shows that, over time, monopolies, whether public or private, tend to become inefficient. Monopolies created by legislation often spend a considerable amount of time and money justifying their monopoly position. While useful, performance audits have serious limitations. The Deloitte's 1991 report on the KMB, for instance, did not foreshadow the 1992 disaster.

3.7 Any regulations controlling exporting for a transitional period should be justified by a rigorous analysis of the costs and benefits. They should also be flexible enough to deal with the constantly changing nature of the marketplace. The Auckland University report fell well short of what is required in this respect.

4.0 **Beware of marketing jargon**

4.1 The Auckland University report strongly supported what it called the "Retail Marketing Path" which it said was superior to the "Commodity Trading Path".

4.2 This analysis was simplistic and misleading. New Zealand kiwifruit is not a commodity like aluminium ingots or gold, but nor can it be distinguished

from other kiwifruit in the same way that producers of products such as cars can differentiate their products.

4.3 While the KMB may well receive higher wholesale prices for its kiwifruit than other suppliers, the margin will reflect superior product quality and service to the supermarkets, which has been achieved at a cost to growers. Crop management is just one technique which helps achieve higher wholesale prices. Others include broad marketing support, promotional allowances and/or advertising. Given the extent of competition in world fruit markets and the availability of substitutes, there is no way New Zealand can exercise monopoly power over prices.

4.4 Commodity selling should not be viewed negatively. Commodities can be produced very profitably by any party whose costs are below average. Whether kiwifruit is viewed as a commodity or as capable of being differentiated and branded has no bearing on the case for regulation. Clearly, branded products do not require single selling organisations. Nor do commodities - even in the case of the 'purest' commodities, such as the range of minerals (iron ore, copper etc.) produced in Australia, the industries do not operate with statutory boards, nor is there any pressure for them to be established.

4.5 The key issue is profitability - not the wholesale price. Producers should therefore regard with suspicion market price comparisons between exports from different countries which ignore quality, cost and profitability issues.

5.0 Marketing criteria

5.1 The terms of reference envisage other parties exporting kiwifruit either as part of the KMB's operation or independently. This is very desirable and will be an important element in a more profitable kiwifruit industry. The terms of reference also assume that, through regulations, producers should determine who shall export kiwifruit.

5.2 The export authority A single seller with the power to allow third parties to export kiwifruit will not be regarded as an impartial authority. There will be concerns that confidential information will be used by the single seller to

advance its position. Applicants will also be concerned that any markets they develop will be taken over by the single seller/licensing authority at some point.

5.3 Such a lack of certainty will discourage those with a long-term commitment to undertake the necessary investments in the marketplace. The result will be a lack of interest from those companies able to make a major contribution, the potential for distracting politics, and litigation from failed applicants.

5.4 There are also offshore legal implications from combining the two roles. In the United States a supermarket, for instance, could use antitrust legislation to take action against a New Zealand operation that sold kiwifruit and licensed other parties. There is no such legal risk where the consent granting authority is separate from the commercial operation. The KMB experience with countervailing action graphically illustrates the costs that can be incurred from breaches of US laws.

5.5 Finally, by combining the two roles of exporter and consent authority, the government would be creating potentially unhelpful tensions inside the organisation as it endeavours to reconcile the conflicting roles. Board directors will occasionally issue consents that are opposed by their management. It is clear that in order to give companies the right to export kiwifruit there must be a separate licensing authority.

5.6 **Export consent criteria** The criteria for considering export consents should be simple and should encourage innovative companies with ability to enter the business on a long-term basis.

5.7 Applicants should be required to demonstrate that their proposal will "Increase New Zealand kiwifruit growers' total income on a sustainable basis". There is no need to be any more prescriptive. Before turning down an export application, the export authority should be required to demonstrate that it will not achieve a net gain for the kiwifruit industry. The onus should be on the authority to show why a licence should not be granted.

5.8 **Collaborative ventures** Should the newly corporatised KMB want to establish joint ventures or use other companies to export its products, it should

be free to do so on a commercial basis without outside interference. It is inappropriate for any other party, including the NZKGI, to determine how such arrangements should be constructed.

5.9 Recommendations on marketing controls

- There should be one kiwifruit authority, controlled and financed by the kiwifruit industry, to handle generic research and development, promotion and trade access work, and to issue export consents to all parties including a corporatised KMB. It might be called the "New Zealand Kiwifruit Marketing Authority (NZKMA)".
- Export consents should be issued to all parties that can demonstrate their proposals will "Increase New Zealand kiwifruit growers' total income on a sustainable basis".
- Policies relating to collaborative marketing ventures by the new marketing operation should be determined by its management and board.

6.0 Corporatisation

6.1 The company model offers the best chance of creating a commercially oriented operation that minimises industry politics and maximises efficiency and the profitability of the industry. The problem of 'bundling' returns from fruit with returns on investment would be eliminated, and growers/shareholders would be in a much better position to monitor the performance of the marketing operation. In addition, other domestic and international operators should have the opportunity to compete with the grower-owned business on the basis of export consents.

6.2 Growers have two broad options:

- A multi-product international fruit company; or
- An export company that markets New Zealand kiwifruit through existing agencies, whether based in New Zealand or offshore.

Option A

6.3 The Auckland University report recognised that ideally the marketing arm of the kiwifruit industry should be able to service clients all year round and should sell other fruits. A strong marketing company along these lines would be able to achieve maximum control down the distribution chain.

6.4 This option carries very high commercial risks. The international fruit business is competitive and volatile. The Auckland University report failed to address the risk issues involved.

6.5 The capital requirements for this option would be up to \$1000 million. New Zealand's kiwifruit growers would not be in a position to make this level of financial commitment for what would be a high risk investment. Equity capital from other sources would be necessary. It could be expected that outside investors would not be prepared to allow growers to retain control from a minority position.

Option B

6.6 Under this option the company would manage the kiwifruit pool(s) and would undertake exporting where existing companies were unable to perform this role. In the marketplace the emphasis would be on direct selling to supermarkets or the use of one or more importers/distributors depending on the nature of the market.

6.7 This option may not permit the same degree of control of the distribution chain, depending on the nature of the relationships formed with other parties.

6.8 The capital requirement for option B has been estimated at around \$100 million. Shares could be restricted to growers with a limit on any one grower if considered desirable. It would be necessary for the industry to allow a market for the shares to develop so as to facilitate transfers of ownership as growers enter and leave the industry.

6.9 Recommendations on corporatisation

- A company should be established by the kiwifruit industry to take over all the commercial assets of the KMB - "New Zealand Kiwifruit Marketing Corporation (NZKMC)".
- Shares in the NZKMC should be issued to growers.
- The NZKMC should restrict itself to selling New Zealand kiwifruit.
- The NZKMC should manage the kiwifruit pool(s) making maximum use of existing exporters in the private sector and, if appropriate, the New Zealand Apple and Pear Marketing Board, as well as importers and distributors offshore.
- Directors should be appointed by shareholders on the basis of their commercial skills.

7.0 Conclusion

7.1 The present politicised structure of the KMB prevents the board and management from focusing solely on commercial issues. The recommendations in this submission would separate out the political and generic industry matters from the commercial export operation.

7.2 The New Zealand Kiwifruit Marketing Corporation would be owned and controlled by its shareholders who would be mostly or solely kiwifruit growers.

7.3 The New Zealand Kiwifruit Marketing Authority would be established by the government and would establish the regulatory environment for the industry after rigorously analysing the costs and benefits associated with licensing proposals.