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RESTORING KIWIFRUIT PROFITABILITY

Choice, Ideas, Innovation and Growth

Prepared by

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for the

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CONTENTS

EXECUTIVE SUMMARY

Everyone seeks better profitability

All parties in the kiwifruit industry are seeking improved profitability, which would contribute to an increase in national income. This is the primary objective of the current industry review which is evaluating options "to maximise the profitability of those in the industry and the net benefits to New Zealand."

Research into the kiwifruit market and marketing options is being directed by a steering committee. The committee is responsible for ensuring the research "is in a form that is useful to growers and the industry in their debate on any future changes."

The industry is trying to recover from a costly economic and financial crisis. Clearly changes are necessary and the challenge facing the steering committee, the industry and the government is to ensure these changes achieve the stated objective.

The correct answers will not be determined by averaging a range of views or trying to reach a politically expedient consensus. A systematic and analytical approach for assessing alternatives must be adopted.

A benchmark for comparison is essential

A benchmark is essential to ensure the assessment process is manageable and systematic. It is needed to provide a basis for assessing the costs and benefits of any alternative.

The international market where kiwifruit are sold is large, diverse and very competitive. Market participants and marketing experts hold differing views about marketing strategies. Circumstances and opportunities are so diverse that there will not be a single, correct answer.

This is the situation in most markets. In the overwhelming majority of cases, determining what is best is left to the competitive market process. Failure has usually characterised attempts to use control and command systems (regulation) for this purpose.

Like most countries, New Zealand has chosen not to be a command economy. Competitive markets and market forces drive the New Zealand economy. Competitive markets are clearly the preferred means - in New Zealand and internationally - for developing efficient industries and maximising national economic benefits.

It is for these reasons that the benchmark should be an unregulated, competitive market. To choose any other would be to use, as the standard of evaluation and comparison, an option which was the exception to the rule. This would be an unsatisfactory and unusual basis on which to determine industry policy.

Using a competitive market as the benchmark is not to suggest that competitive markets are perfect. This is clearly not the case. Neither should it be taken to suggest that regulatory modification of the market might not be justified in some circumstances. The objective is not to achieve perfection - it is to identify the best solution among the practical alternatives available. To decide a regulation is warranted means establishing beyond reasonable doubt that it would be superior to a competitive market in improving profitability in the national interest.

In the absence of regulations restricting choice, outcomes are determined in, and by, the market place. As regulation and control increases, so too does the need for authorised individuals to replace the market as decision makers and adjudicators of what is best. To recommend any regulation is to conclude that selected individuals can decide better than the market what is likely to maximise the profitability of all market participants. It would also be to conclude that kiwifruit is 'different', and that the approach which works best for most other industries would not be the best approach for the kiwifruit industry.

Regulation has been based on myths that kiwifruit is different

Some argue that, left to its own devices, the market will fail in a number of respects when it comes to kiwifruit marketing. The evidence suggests this view is not correct for the following reasons:

- The industry has no exploitable market power which would justify restricted exporting. Effective market power means being able to command consistently higher prices by controlling supply, including the supply of alternatives. Kiwifruit is one fruit in a very diverse international fruit market. The market is competitive and price sensitive. Trying to raise kiwifruit prices above the market causes buyers to turn to other suppliers or products.

- So-called weak selling is something many growers fear would result if competition is allowed. It is common to blame marketers for lower prices. However, it is unlikely that marketers will forgo profitable opportunities. They will be unable to do so persistently and survive in a competitive environment. The market has remedies for weak selling if it arises. For growers, competition is the best protection against weak selling. Paradoxically, weak selling is more likely to arise in regulated industries. A regulated monopoly like the Kiwifruit Marketing Board (KMB) could get away with weak selling on a persistent basis because there are no competitive benchmarks, and no way of knowing the effect on its profitability.

- Fearing competition in the belief that it will lead to growers being disadvantaged by the big and powerful, particularly multinationals, is to get the logic the wrong way round. The best way for growers to ensure maximum profits is to have competition for their fruit and an ability to choose where to sell. Producers in most of New Zealand's fastest growing primary industries have this choice and are reaping the benefits. They are not disadvantaged relative to bigger businesses because there is competition for what they produce. Competition ensures a diversity of business size and structure. Allowing others to participate increases the industry's access to ideas, expertise, capital, brands and market connections. Denying them the opportunity causes them to go elsewhere and compete with New Zealand growers by marketing the fruit of others.

- A belief that 'ownership and control' via regulation are necessary to maximise grower returns is another reason why many support the single seller. Growers should ask whether it is realistic to expect one organisation to maximise their profitability when it represents only one set of views and cannot explore all opportunities or test all ideas. In considering the merits of the KMB structure they should also consider that:

    - they are forced to buy marketing services from a monopoly supplier (the KMB) and monopolies have a poor record for maximising efficiency and minimising costs;

    - because KMB profits are bundled in with the fruit revenue, the orchard gate return is a misleading indicator on which to base profit-maximising production decisions;

    - they are the only source of equity capital to grow the marketing business, and debts incurred by the KMB are automatically the liability of each grower;

    - they have no idea whether the KMB is profitable because there is no relevant financial information, no dividends and no market-determined share price; and

    - because growers cannot vary their shareholding in the KMB independently of kiwifruit production, growers lack the sanctions against poor performance which are necessary for meaningful accountability to shareholders.

Market solutions work in other industries

Kiwifruit growers seeking improved profitability can gain useful insights from similar industries which have benefited from competition and minimum regulation. This report discusses a number of examples: forestry, cut flowers and mussels in New Zealand, fruit in Chile, and the UK milk market which is in the process of being deregulated. In these industries competitive solutions to threats and opportunities have emerged. The industries include both sizeable firms and successful smaller businesses. Small producers in them benefit from being able to choose among competing marketers.

This examination of similar industries is also useful in indicating that:

- competition encourages investment in marketing by farmers themselves, specialist marketers and vertically integrated companies - large and small, local and international;

- entrepreneurial incentives with rewards for risk taking have been critical to vigorous innovation, including on the part of individual growers and relatively small companies;

- strategic alliances have been formed where these are mutually beneficial because strength, size or coordination in a particular market situation makes all parties better off;

- quality requirements have been met by supplier identification and branding; and

- regulation which constrains market forces by restricting choice and opportunities is not sustainable in the long run.

The report concludes that freedom of entry for anyone wanting to market kiwifruit, and choice for growers when deciding how to sell their fruit, are the circumstances most likely to ensure the profitability of market participants is maximised in the national interest. A competitive market with minimum regulation is the option which is most consistent with the objectives which the minister has set for the review of the kiwifruit industry. While there will be vested interests which will advance a different view, the government must adopt a perspective which reflects its role as custodian of the national interest. It must have regard to the interests of not only existing kiwifruit industry participants but also future participants, new entrants and the wider community.

Criteria for transition arrangements

Restoring competition to the kiwifruit industry will require considerable change. How change will be implemented is an important issue in this review. There are essentially two choices: immediate and all-encompassing deregulation of exporting, or transition arrangements which implement changes gradually.

Experience in New Zealand and elsewhere is that the benefits of reform are maximised by the rapid introduction of market-oriented policies. Most of New Zealand's major beneficial reforms have been introduced quickly and decisively. Market participants have demonstrated an ability to adapt quickly to new circumstances. The catastrophic consequences usually predicted by those opposed to change have not materialised and in no case has there been any widespread desire to turn the clock back.

There are no reasons why comprehensive deregulation of kiwifruit marketing should not occur immediately. However, the political reality is that more gradual deregulation may be the only basis on which change can occur. If this is the case, then transition arrangements should meet certain criteria. In particular, they should:

- have as their endpoint the complete removal of any regulations restricting either export activity or grower choice when selling fruit;

- achieve this outcome at the end of a reasonably short period - say, two or three years;

- require the corporatisation of the KMB at the beginning of the transition period;

- be attractive to new entrants and minimise any controls over, or advantages temporarily conferred on, individuals or groups; and

- include sunset provisions to ensure transition arrangements proceed as planned and cannot be changed capriciously.

Options consistent with these criteria are outlined in the report.

1. INTRODUCTION

1.1 An Industry Review

In early 1993 the minister of agriculture announced a three stage review of the New Zealand kiwifruit industry. Stage one established a new representative body for kiwifruit growers. Elections for the new 38-member grower body - New Zealand Kiwifruit Growers Inc. (NZKGI) - were held in July 1994.

The second stage is an independent analysis of the export marketing of kiwifruit. The objective (from the terms of reference) for the second stage of the review is:

> ... to analyse the market environment (both established and potential) for kiwifruit exported from New Zealand and, given that environment, seek to evaluate marketing options for the kiwifruit industry in order to maximise the profitability of those in the industry and the net benefits to New Zealand.

The terms of reference require particular attention be given, *inter alia,* to the following matters:

- the key features of, and emerging trends in, global fresh fruit markets (including value adding opportunities) and the competitive position of New Zealand kiwifruit within those markets;
- whether present marketing arrangements are consistent with maximising the profitability of those within the industry and the net benefits of the industry to New Zealand, both in the short and medium term;
- whether changes should be made in order to maximise profitability and net benefits to New Zealand and the potential source and size of the gains from implementing the changes; and
- measures for assessing the annual performance of the New Zealand kiwifruit exporter(s).

The terms of reference also state that this market analysis "is not a performance audit of the New Zealand Kiwifruit Marketing Board" (KMB). This is an ambiguous proviso given that elsewhere in the terms of reference those undertaking the analysis are asked to "evaluate the effectiveness of the present KMB global marketing strategy" and to "evaluate the effectiveness of the single-desk structure in responding to the market issues identified". It presumably means that the evaluation is to be undertaken on an in-principle basis rather than a review which aims to pass judgment on the KMB's performance as a marketer. The latter is what is required.

The analysis for this second stage of the review is under the direction of a steering committee which has been appointed by the minister. According to the minister "the steering committee will ensure the analysis is in a form that is useful to growers and the industry in their debate on any future changes."

The minister has also said that "during the third stage of the review, called the Strategic Planning Stage, the Kiwifruit Industry Representative Forum (NZKGI) will go through a strategic planning and decision-making exercise based on the report from the steering committee."

The research in this report was commissioned by the New Zealand Business Roundtable as a public input to the review process. It examines the major issues relevant to deciding which approaches to kiwifruit marketing are most likely "to maximise the profitability of those in the industry and the net benefits to New Zealand".

1.2 Context, Objectives and Approach

The circumstances leading to the review are well known and documented. The industry has experienced a costly economic and financial crisis.

The downturn in the industry's fortunes had many causes, not the least being the rapid expansion of international kiwifruit production combined with a decline in fruit prices generally. The extent to which the crisis stimulated major changes to the KMB's marketing strategies and large reductions in marketing costs suggests the single seller marketing system was far from blameless as a cause of the dramatically lower grower returns.

In its relatively short history, the kiwifruit industry has tried a variety of marketing methods - unregulated competitive exporting, export licensing and a single seller to all markets except New Zealand and Australia - with each change bringing increased export regulation.

As with all regulated markets, politics have become entwined with commercial activities. The minister of agriculture recently observed that he spent more time in the kiwifruit and apple industries "trying to patch up politics" than concentrating on market issues. "That is annoying because it is totally unproductive", the minister said.[1]

There is a diversity of views about appropriate policies for the future. A significant minority of growers has been advocating a less regulated marketing system. However, the government has chosen to allow the present system to continue, pending the outcome of the current review.

In the meantime, the substantial changes the KMB is making to its *modus operandi* confirm the importance of market place threats (competition) in stimulating performance improvements - in this case a threat to the continued existence of the export monopoly and the need to prepare for the possibility of competition. The reaction is very similar to that of the Apple and Pear Marketing Board when it realised it would have to face competition on the domestic apple market.

1.2.1 Objectives - Profitability and the National Interest

New Zealand's farmers have a tradition of blaming the marketing system whenever output returns fall. Frequently the response has been to regulate marketing in the belief that this would improve returns.

Steadily increasing export regulation in the kiwifruit industry reflects these traditions and beliefs. In the late 1970s, when the competitive exporting system delivered returns growers considered unacceptable, they successfully lobbied for regulations restricting competition. The incumbent marketers were held responsible for the price decline. Later, and using the same flawed reasoning, growers secured a single seller exporting board.

When returns fell in the early 1990s, growers, who had previously blamed marketers in similar circumstances, were not so quick to accuse the marketers

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1 *New Zealand Herald*, 29 June 1994.

of failure and urge changes to the system. In late 1992 the associate minister for agriculture said "orchardists hit by plunging world prices should not blame the Kiwifruit Marketing Board. It was natural to look for scapegoats when things went wrong and the board was an obvious target. But critics should not be too zealous."[2]

The efficacy of the current kiwifruit marketing system is primarily judged by per tray export returns for kiwifruit. Maximising these grower returns is the primary objective that has been given to the KMB.

There is no useful information on the **profitability** of the marketing system. This is a consequence of the way the marketing system is structured. The KMB has no traded shares and does not report profitability or pay dividends. Maximising profitability and growth in shareholder wealth have never been explicit, measurable objectives of export regulation.

Earlier research has established that maximising output returns is not the appropriate primary objective for a marketing system or organisation.[3] The primary objective of any business - kiwifruit growing and marketing included - should be to maximise profitability. When businesses strive to maximise profitability (return on investment) in a competitive market, national benefits are also maximised.

The terms of reference for the second stage of the industry review recognise this fundamental point. The requirement is to evaluate different marketing systems in terms of their ability "to maximise the profitability of those in the industry and the net benefits to New Zealand". Particular attention is also to be given to "measures for assessing the annual performance of the New Zealand kiwifruit exporter(s)".

Replacing the traditional objective - maximising per unit export returns - with the correct objectives - maximising profitability and the national interest - implies some change to existing marketing structures even before market characteristics are considered. The reason is simple. The present marketing

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2 *The Dominion,* 30 September 1992.

3 ACIL (1992), *Agricultural Marketing Regulation - Reality versus Doctrine,* a report prepared for the New Zealand Business Roundtable, October 1992.

structure provides no basis for determining whether the objectives set down by the minister are being achieved. At the very least, current arrangements will need to be changed to rectify this fault.

1.2.2 Three Important Issues

There are three issues which are important in ensuring the main objectives of the review process are achieved, and which require comment at the outset.

First, the process appears predicated on the minister's often stated view that the government will implement marketing regulations that have the support of a majority of growers. This has implications for the views and rights of both the general community and of minority opinion in the industry, which should not be ignored.

It also begs important questions about how a 'majority' is defined. Is it a majority based on grower numbers or based on volume or value of production? What if a numerical majority of growers (but a minority of production) desire an approach which is not in the national interest? Even more important, who will ensure the national interest is protected if a majority of growers defined on any of these bases wants policies that are not in the national interest?

Second, the independent analysis of the export marketing of kiwifruit is to evaluate marketing options in the light of the market environment. The analysis is to be used by "growers and the industry in their debate on any future changes". Unless it is concluded that the optimum approach is to remove all export regulation and let the market decide what is best, the review process will need to decide what regulatory regime is preferable. Who would make this decision - given the reasonable assumption that industry participants and marketing analysts would have a diversity of views - and on what analytical and empirical basis would it be made?

This also raises questions about whether the review (particularly stage two) is being asked to determine the framework within which marketing will proceed, or to deliver more specific marketing strategies which the industry is to follow. The terms of reference appear to imply the former but this is not entirely clear. The latter would require extensive regulation, compulsion and restrictions on choice.

Third, particular marketing structures will have different implications for the production sector. This raises the bundling issue which is discussed in section 4 of this report. The current marketing system includes the KMB's 'profits' in the grower returns for kiwifruit. This sends distorted market price signals to growers. Unregulated, competitive marketing systems do not have this problem. Any approach to marketing which distorts production decisions will necessarily mean profits are not being maximised in a way that best serves the national interest.

This report first reviews the main features of international fresh fruit and kiwifruit markets and current forms of marketing. Some of the potential approaches to marketing would require regulation and restrictions on commercial choice. A basis for determining whether regulation is justified is proposed and applied to the issues which arise most commonly in the marketing debate. Next, a selection of other industries is examined to see what lessons can be learnt from them.

Conclusions are then drawn on how best the industry can achieve the minister's objective of maximising the profitability of those in the industry and the net benefits to New Zealand. The report finishes by discussing transition arrangements which could be necessary when changing current arrangements.

2. MARKET CHARACTERISTICS

2.1 The International Fruit Trade

In most industrialised countries fruit is an important part of the diet. The quantity demanded is influenced by prices, disposable incomes (although fruit tends to be no more income elastic than other non-staple foods), the composition and size of the population and consumer preferences. Increasingly, consumers are being encouraged to have greater regard to fresh and healthy products. However, fruit consumption (per capita) has not changed much since the 1970s. The major fresh fruit consuming regions are the United States, the European Union and, to a lesser degree, Japan.

Only 7 percent of world fruit production is traded internationally as a fresh product, although this ranges (for the major fruits) from 22 percent in the case of bananas down to 3 percent for grapes. On a tonnage basis, trade is dominated by bananas, then citrus, apples and grapes.

Over the past two decades the volume and value of international trade has increased considerably as a result of growing demand for fresh fruit year round, as well as population growth. World imports of fresh fruit totalled around $US23 billion in 1993. The European Union accounts for over 50 percent of this trade[4], with half of these imports representing intra-European Union trade. Other significant importers are the United States, Japan and Canada.

Supplies are principally drawn from South America (particularly bananas, but also grapes, citrus and apples), the European Union (citrus, grapes and apples), Africa (citrus), the United States (the four fruits) and Israel (citrus). Oceania (Australia and New Zealand) suppliers are small players in the total trade.

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4 Rabobank Nederland (1993), *The World Fresh Fruit Market*, p29.

Horticultural exports from New Zealand totalled NZ1.2 billion in the year to June 1993. Kiwifruit (NZ$370 m) and apples and pears (NZ$349 m) dominate. Ninety percent of New Zealand's horticultural exports go to the European Union, Japan, the United States and Australia, up from 80 percent five years ago.[5] New Zealand's two main kiwifruit markets are Japan and Germany which between them take over one half of New Zealand's exports.[6] Demand for fresh fruit in Germany has been growing rapidly in the reunified eastern part of the country.

2.2 How Do Others View the Fruit Market?

The minister's review of New Zealand kiwifruit marketing is not the first study of international horticultural markets and marketing. In the course of preparing this report various reviews were examined. They provide useful commentary and insights, and sometimes contradictory views, on market developments for fresh fruit.

A major review of international competitiveness in Australian horticulture, undertaken for the Horticultural Policy Council, concluded that:[7]

> The nature of world horticultural trade and consumer behaviour have changed rapidly and significantly over the past decade. Some of these changes include:
>
> - increasing demand for year round supply of products, requiring sourcing from both hemispheres;
> - consumers are becoming more discerning about quality, taste and food safety issues.

The Australian Industry Commission recently summarised the characteristics of world horticultural production and trade as follows:[8]

> Most countries have a capacity to produce horticultural products, although the mix varies.

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5 Tradenz (1992), *New Zealand in the Global Marketplace - A Strategic Overview and Corporate Plan 1992/93.*

6 *The Dominion,* 26 August 1994.

7 Horticulture Policy Council (1993), *Winning the Race: International Competitiveness in Australian Horticulture,* Industry Report No. 7, November.

8 Industry Commission (1993), *Horticulture,* Report No. 29, 18 February, pp7-8.

> In fresh form, horticultural products typically have a low value per unit volume. Most need to be carefully handled, and many are perishable. These attributes mean that packing and transport costs are high relative to the unit values that can be realised in domestic or export markets.
>
> Seasonality is an important determinant of world trade flows, especially between the northern and southern hemispheres. Their harvest seasons are reversed and it is expensive or impossible to store fresh horticultural produce for long periods. The potential for trade in fruit is further enhanced by world demand for both temperate climate (apples and pears, for example) and such tropical and sub-tropical fruits as bananas and mangoes.
>
> The prices realised for internationally traded horticultural products can be relatively unstable, both within and between seasons. With trade volumes mostly small in relation to production, marginal changes in regional production can translate into large quantities needed or available for trade in the short term. Similarly, large intra-seasonal price fluctuations in some markets can arise from the variable timing of import supplies, a short shelf life for produce and limited opportunities to trans-ship to other destinations. Price instability is also a feature for those horticultural products where world production and trade are highly concentrated.

Another review of the international fresh fruit market emphasised the importance of consumer preferences and highlighted how these have changed.[9]

> The quantity [of fruit] demanded is dependent on prices, disposable income, composition and size of the population and consumer preference.
>
> In the major consumer regions - the United States, the European Union and, to a lesser degree, Japan - consumption of citrus fruit and bananas in particular has increased greatly. Partly stimulated by increasing per capita incomes, there is a growing preference for high quality fruit which have a superior image. Consumers in these regions also prefer fruit which can be easily and conveniently eaten and which is sweet and fresh in flavour. Such fruit are also suitable for eating between meals. The quality and exclusive image of fruit are important factors, particularly in Japan. New types of exotic fruit, like avocados and kiwis, are able to stimulate an already saturated market, although this may be at the expense of established sorts of fruit.

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9 Rabobank Nederland (1993), *op. cit.*, p8.

> In tropical regions it is mainly indigenous fruit which is consumed. Demand for fruit is largely governed by product price and disposable income, and changes here have a greater influence on consumption in such regions. In view of the large number of consumers they contain, a number of these regions offer potential growth markets.

South East Asia, under the influences of population, per capita income growth and changes in taste, shows considerable promise as a market for fresh fruit. Imports have grown considerably, despite trade barriers against imports in certain countries (such as Indonesia and the Philippines). The region now accounts for 4 percent of world apple imports, 5 percent of fresh pears and 2 percent of fresh grapes.[10]

These and other reviews of the fresh fruit trade highlight several key features relevant to the competitive environment facing kiwifruit.

- Fresh fruit is still sourced primarily from domestic producers - trade tends to develop when the product is not able to be locally produced. Nevertheless, technological developments, transportation improvements and changes in relative supply costs can open up new possibilities to source fresh products.
- Fresh fruit has to compete for its place in the food basket against other foods and other consumer items. Moreover, per capita fresh fruit consumption has flattened out in industrialised countries. Thus growth opportunities, such as for new products, have to come substantially from market share changes.
- Some markets are growing in per capita terms - South East Asia, for example.
- The dimensions of quality are expanding to include the perceived healthiness of particular foods, the potential residues carried over from production and the environmental impacts of the production system itself.

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10 Department of Foreign Affairs and Trade (Australia)(1993), *Subsistence to Supermarket: Food and Agricultural Transformation in South East Asia*, AGPS.

2.3 The Kiwifruit Market

Kiwifruit was until recently considered to be in the exotic class. It is non-traditional and traded in only small quantities. Kiwifruit is not one of the significant internationally traded fruits, accounting for less than one percent of world fresh fruit consumption. Nonetheless:

> The kiwi has also carved out a significant position in the northern hemisphere and the avocado is gaining more ground in the USA and Western Europe. In relation to the four major fruits (bananas, apples, citrus fruit and grapes) these only have a modest position in the fruit market.[11]

Kiwifruit **production** exploded during the 1980s although it appears to have now 'levelled off' with an 8 percent fall in 1993-94 (Table 2.1). Lower prices to growers are likely to be the main reason. However, exports (international trade) grew by 7 percent in 1993-94.

Table 2.1: World Kiwifruit Production and Trade [(1)]

	Production (tonnes)	Exports (tonnes)	Trade proportion %
1991-92	840,800	433,037	52
1992-93	934,300	482,939	52
1993-94	858,700	517,800	60

(1) Principal countries - Italy, France, Greece, Spain, Portugal, Japan, US, New Zealand and Chile.

Source: USDA, Kiwifruit production and trade situation in selected countries, World Horticultural Trade and US Export Opportunities, April 1994.

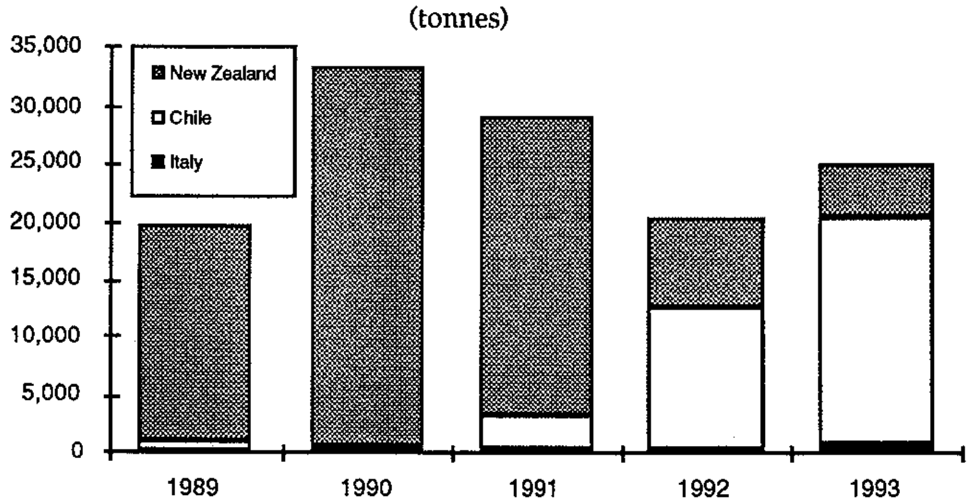
New Zealand is the dominant southern hemisphere producer (216,800 tonnes in 1992-93) compared to Chile's 115,000 tonnes. New Zealand exports around 85 percent of production, Chile around 70 percent.

Chile, now a major exporter, increased its sales to Japan by over 50 percent this season and has taken advantage of the gap left in the United States market

11 Rabobank Nederland (1993), *op.cit.*, p6.

resulting from reduced New Zealand sales because of the anti-dumping duty (Figure 2.1). Italy, now the world's largest producer, as well as France, Spain and Greece, are in the market for more of the year, also with more fruit. The quality does not match New Zealand export grade, but is improving.[12]

Figure 2.1 : US Kiwifruit Imports



Source: USDA, Kiwifruit production and trade situation in selected countries, World Horticultural Trade and US Export Opportunities, April 1994.

The USDA summarised the international kiwifruit scene as follows:[13]

> Kiwifruit production and trade in the 10 major producing countries have increased dramatically over the past decade, especially in the European Union (EU). By the end of the 1980s, production had far outpaced demand from the importing countries. This situation led to considerable vine-pulling and generally slower growth in planted area. Increases in world kiwifruit production combined with improved storage facilities and technology (e.g. controlled atmosphere storage) have allowed sales in the Northern and Southern Hemispheres to overlap, leading to downward price pressure. While devastating to many farmers in certain regions, the lower level of prices has probably helped boost kiwifruit consumption around the world.

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12 *The Dominion,* 26 August 1994.

13 USDA (1994), *Kiwifruit Production and Trade Situation in Selected Countries,* in World Horticultural Trade & US Export Opportunities, Washington, April, p46.

Table 2.2: Kiwifruit Exports: New Zealand

Year ending March 1994

Destination	Quantity	Market Importance	Value (a)	Average Unit Value (a)
	tonnes	%	$NZ '000 FOB	$NZ per kg FOB
EU	115,249.7	55.7	153,545	1.33
Japan	48,828.0	23.6	124,414	2.55
Australia	14,081.2	6.8	15,901	1.13
United States of America	6,825.0	3.3	10,980	1.61
Canada	6,123.4	3.0	10,278	1.68
Taiwan, Province of China	4,291.5	2.1	8,232	1.92
Korea, Republic of	2,462.9	1.2	5,009	2.03
Argentina	2,232.9	1.1	3,864	1.73
Hong Kong	1,664.5	0.8	3,400	2.04
Mexico	1,137.5	0.6	1,896	1.67
Saudi Arabia	857.1	0.4	1,790	2.09
Singapore	747.1	0.4	1,434	1.92
United Arab Emirates	667.4	0.3	1,425	2.14
Kuwait	362.8	0.2	774	2.13
Brazil	271.9	0.1	473	1.74
Reunion	167.4	0.1	259	1.55
Uruguay	163.2	0.1	277	1.70
New Caledonia	119.9	0.1	267	2.23
Bahrain	118.6	0.1	253	2.13
Indonesia	102.9		202	1.97
Malaysia	94.5		199	2.11
South Africa	64.1		102	1.59
Mauritius	52.4		81	1.55
Philippines	31.4		57	1.82
Thailand	30.0		91	3.03
French Polynesia	11.2		33	2.98
Kenya	7.9		17	2.13
China, Peoples Republic of	7.9		21	2.61
Fiji	3.8		14	3.73
Papua New Guinea	0.3		1	3.02
Cook Islands	0.2		1	2.97
Nauru	0.2		1	3.66
Samoa	0.2		1	3.10
Wallis and Futuna Islands	0.2		1	3.18
Guam	0.1		1	4.58
Niue	0.1		0	1.99
Total	206,779	100.0	345,291	1.67

(a) Values are those reported by the exporter at the time of export; realised value may be different.

Source: Statistics New Zealand.

Besides the major markets of the European Union, the United States and Japan, there are a host of smaller markets. The list of export destinations of New Zealand fruit (Table 2.2) highlights the significance of these other markets which, with the virtual exclusion of the New Zealand fruit from the United States, have become relatively more important.

2.4 The Outlook for Kiwifruit

MAF assesses the medium-term outlook for kiwifruit prices as follows:[14]

> More stable world production will help limit kiwifruit price falls over the medium term. However, other factors will continue to place downward pressure on real prices:
>
> - Price premiums and quality advantages currently obtained by New Zealand over its competitors, especially Chile, will continue to decline over the medium term.
> - Competition between kiwifruit and other fruit is expected to intensify as world production of most fruits is increasing while world fresh fruit consumption remains stable.

The USDA sees similar pressures on prices unless consumption lifts:

> In coming years the kiwifruit industry will focus efforts on how to balance supplies with demand, while seeking adequate returns to growers. Part of the task will be to stimulate demand among both importing and exporting countries. This is crucial given the potential for production increases in coming years.[15]

A review of world fruit by the Dutch Rabobank had the following to say about kiwifruit production and market outlook:[16]

> Kiwi production has increased dramatically in recent years and poses the question of market gluts.
>
> The kiwifruit industry is expected to continue restructuring in response to low world prices with some further decline in New Zealand kiwifruit production likely. Further increases in world kiwifruit supplies are likely, mainly due to previous plantings in

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14 Ministry of Agriculture and Fisheries (1994), *Situation and Outlook for New Zealand Agriculture 1994*, Wellington, June, pp62-63.

15 USDA, *op.cit.*, p46.

16 Rabobank Nederland (1993), *op. cit.*, pp18–19.

the European Union and Chile. Increasing world supplies will continue to exert downward pressure on real kiwifruit prices.

3. APPROACHES TO MARKETING

3.1 Horticulture Trade is Characterised by Diversity

Unlike world trade in some major commodities, there is no dominant form of trader in world horticultural trade. The Australian Industry Commission observed that:[17]

> Traders include private individuals, companies and cooperatives, vertically integrated conglomerates, and statutory national or regional single-desk buyers and sellers. Sunkist, a major exporter of US citrus, is a cooperative organisation owned by growers in California and Arizona. Chiquita, which began trading in Central American bananas, is now a multi-product firm operating in many countries. Single-desk importing and exporting through government agencies tends to be favoured by developing countries. New Zealand and South Africa also have single-desk selling arrangements for exports of some fruits.

With the diversity in marketing organisations in horticulture often cited as a characteristic of the trade, an overall appreciation of the structure of the trade and the relative role of particular traders is important. The following section presents an overview of the fresh fruit marketing channel. It draws heavily on recent research by the Rabobank Nederland describing, in general terms, the components of the chain, their responsibilities and the more significant trends taking place.[18]

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17 Industry Commission (1993), *op. cit.*, p9.

18 Rabobank Nederland, *op. cit.*, pp30-41.

3.2 The Fresh Fruit Marketing Channel

3.2.1 *Stages and Functions in the Fruit Trade: The Importance of 'Wholesale' Functions*

Differences in geographical location combined with the advantages of specialisation and scale in the provision of services mean that very little fruit is sold directly to the consumer by the grower. In major industrial countries a complex network of agencies forms the marketing channel through which collection, transport and distribution occur. Typically there are significant differences in the structure of the marketing channel between countries and between the various fresh fruits.

The marketing chain for fresh fruit consists, in principle, of the following three stages, but is dominated by wholesaling:

- Production
- Wholesale, including:
  - collecting/gathering product
  - international trade and transport
  - distribution
- Retail trade.

Figure 3.1 provides a summary of the players and distribution channels involved in the sale of fresh fruit. Wholesaling is highlighted because it traverses so much of the chain, and it is the stage that has changed most - in particular it has become more complex. Market demands are resulting in a steadily increasing number of operations to get the fruit from producer to consumer while guaranteeing suitability and availability for the consumer.

The majority of wholesalers specialise to a certain degree. The wholesale functions can be separated into three groups:

- **exchange functions**, including buying and collecting, selling and creating demand;
- **physical functions**, including storage, processing and transport; and

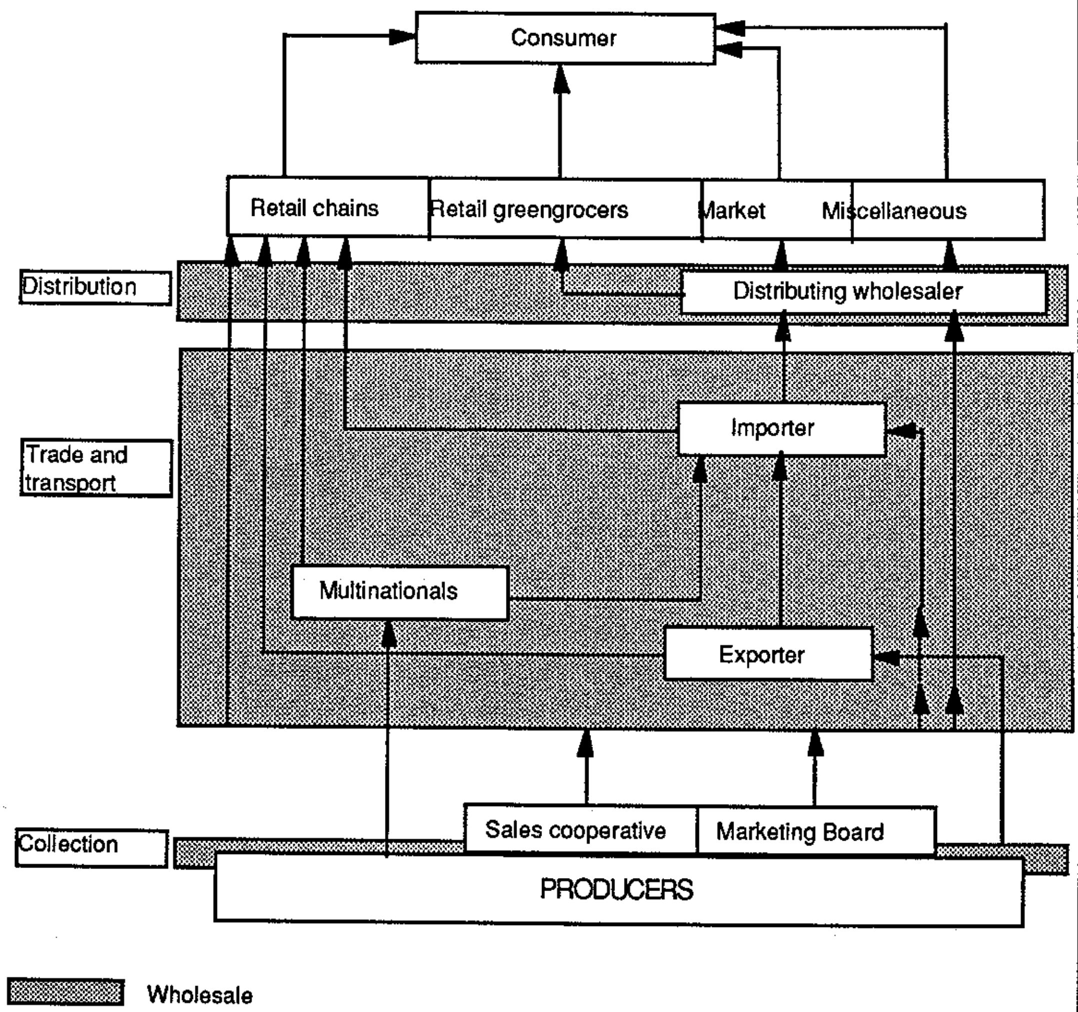
- **facilitating functions**, including sorting and standardising, financing, bearing risk and market information.

The importance of wholesale functions is gradually changing. Even though buying and selling remain the core wholesale activity, this cannot be properly carried out unless the supporting functions are present. Market information is indispensable to make trade transactions profitable and to deliver added value to buyers and sellers. Increasing expertise is becoming vital. For some companies the physical functions are the core activity on which their market position is based while other companies contract out this work to specialist transport companies. Financing and the bearing of risk are traditional wholesale functions.

A large number of forces are influencing the wholesaling function. For producers and customers alike, increased capacity and concentration is taking place, resulting in **forward and backward integration** which excludes wholesale as a separate function. In addition, new specialist companies, such as logistics service companies, are taking over other aspects of the wholesaler's role. Finally, a low barrier to entry exists as a result of the small scale, low initial investment required and the internationalisation of competition. All these factors suggest that the competitive position of the wholesalers is under pressure.

The different stages in the marketing chain, drawing on Figure 3.1, are considered in the next section. Particular attention is paid to the differing forms of wholesale but it must be added that, despite increasing specialisation in the wholesale business, a great many composite forms exist.

Figure 3.1: The Fresh Fruit Chain



Source: Rabobank Nederland.

3.2.2 *Production and Collection*

Fruit is predominantly **produced** by small scale family businesses domestically and in exporting countries. Expertise and entrepreneurship coupled with a personal labour commitment are decisive factors.

Sales organisations are often extensions of small scale production companies. Their task is to collect the producer's products and contribute to either domestic or foreign sales. Three kinds of sales organisations can be identified: individual growers and associations of growers, auctions and marketing boards. As a result of their original function, sales organisations are strongly product-oriented. The function as such seems assured of its future. However, the organisations will have to adjust their strategy from product to market orientation in order to be able to exercise some influence on their profits. Rabobank's specific observations about the role of marketing boards are instructive:[19]

> The marketing board has been particularly relevant for countries which are situated far from consumption centres. By collective delivery of a high quality product, including packing and transport to the importer, the greatest possible marketing power is generated. Efficiency in transport is encouraged, and a distinctive product in the market, partly based on high quality, is supported through the promotion of an own brand, essential to provide sufficient income for the grower once high transport costs have been deducted. The monopoly position that the boards have achieved on behalf of governments must also be viewed in this light. Such a monopoly creates stability and optimisation prices for the fruit grower; this position, however, is currently under pressure in a number of countries. Using market research, the boards also provide advice to producers on a range of issues, including which variety to grow.
>
> Sales organisations, including marketing boards, were established at a time when demand for fruit was greater than supply and when the market consisted of a large number of buyers and suppliers. Now that the number of buyers has drastically fallen and the market is showing signs of saturation, it becomes questionable as to whether the concentration of supply in its present form is still able to generate enough market power. The sales organisations will have to change from a product to a market orientation. This will create a conflict between short-term interests (obtaining the highest possible price for growers) and longer-term goals (investing in aspects of marketing). Due to the small scale nature of production and, in many cases, a limited and seasonal product package, a number of growers' associations have a relatively weak position in sales markets. It is conceivable that in time cooperation will take on an international form since not even national supply will be able to serve the large chains of retailers. In the globalisation of the fruit trade, a regional strategy has too many limitations.

Fruit collection is undertaken by exporters in countries such as Chile and Spain. In Chile a form of cooperative has been created between the six largest fruit exporters, the objective of which is to achieve uniformity and improvement in

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19 Rabobank Nederland (1993), *op. cit.*, pp32-33.

quality and packing. In the United States, grower-shippers exist in addition to the cooperative packers.

Multinationals are important competitors for the traditional marketing organisations. They enter into contracts with growers, guaranteeing a fixed price in advance and thus transferring the price risk from the grower to the multinational. In this way they are able to insist on high quality fruit.

3.2.3 *International Trade and Transport*

International trade in fruit is not at first sight so straightforward. In addition to a number of very large companies, there are many very small companies. Combinations of these frequently form in import and export, whilst exclusion takes place through forward or reverse integration in the chain. Transport over large distances creates a clear division between the collecting and distributing stages of the chain. These transport functions are often contracted out to specialist logistics companies.

The **exporter** fulfils a central role in the international trade of fruit, buying and selling fruit at its own risk and thereby bridging time and distance (Box 3.1). An exporter may also act as agent or broker, dealing on a commission basis only. In many cases there are close-knit contacts with importers and/or retail chains.

Box 3.1 Profile of an Exporting Company

Chile's leading fruit exporting company is David del Curtis. Dealing in the entire range of fruit from apples and pears to grapes and kiwifruit, the company grows 20 percent of what it exports and buys the rest from about 1000 Chilean growers. But it is only interested in export quality produce. Any fruit supplied to it which does not meet the standards required (and these vary from market to market in nightmarish detail) is wholesaled on the domestic market for what it will fetch and the grower paid accordingly.

Large importers typically import a range of fruit from a number of countries and orientate their own sales to several countries, delivering direct to retailers or distributing wholesalers. Smaller importers attract product from other importers or small parties in producing countries. Importers may be appointed panellists by the marketing boards to sell fruit in the board's name.

Multinationals and large trading companies occupy the leading positions in wholesale. The companies supply a large portion of the market and furnish a broad variety of most fruits from all over the world. The supporting marketing functions are becoming increasingly important for these companies. Due to the internationalisation and concentration in wholesale and retail, competition is intensifying.

Multinational trading companies are able to adjust to backward or forward integration in the production chain. Their own brand names are central to their market orientation. Their original high market share, created through a narrow range of products, gave these companies enough market strength to secure large margins. The limited range appears, however, to be too narrow a base, and companies are trying to reduce their dependence on bananas and take on an assortment of fruit.

3.2.4 Distribution

The **distributing and domestic wholesaler** mainly supplies the traditional retailer. The strengthening of the position of these forms of retail is important for the wholesale function. Through increased capacity and forward and backward integration in the chain, this wholesale function as a specialist activity is coming under pressure.

In addition, the market still offers scope to a limited number of small specialists in specific products or services. This latter group constitutes an interesting trading partner for the large companies. It is precisely those medium-size companies which will need to innovate in order to maintain their market position. For the large suppliers and buyers, a role may continue to be played by brokers with their slim service package and limited margins. Retail chain suppliers will have an intensive information exchange with their client, and this will be bolstered to a substantial degree by sales data furnished through scanning.

There has been a gradual increase in the development of large distributing wholesalers with many products and services. They can deliver products to the existing product range of the retail chains. This process of increasing scale appears to have taken root more quickly in the United States than in the European Union. In some countries there is a mixture of retail chains and small individual retail stores (Box 3.2).

Box 3.2: Horses for Courses: Marketing Structures in South East Asia

New Zealand Kiwifruit, August 1992, carried the following report:

"In 1989, under the new Board Structure, the number of importers was reduced to four, each with their own marketing segment:
- Park 'N Shop is one of the biggest supermarket chains;
- Wing Kee Produce, the first to handle New Zealand kiwifruit 15 years or so ago, specialises in distributing to restaurants, hotels and wholesale markets;
- Buah Buahan (Malay for fresh fruit) is the largest importer concentrating on supplying the wholesale market;
- Dah Chong Hong has its own food marts and also supplies Japanese department stores in Hong Kong.

"Even in this, the most sophisticated Asian market, up to 80% of produce is still sold via the wholesale market to retail outlets ranging from small shops to hawkers' stalls and open air markets."

In Singapore about 45% of sales are made through supermarkets, the highest proportion in Asia.

According to a recent review of South East Asian markets:[20]

"The majority of fresh horticultural produce sold in Singapore, Malaysia and Hong Kong is retailed through hawker stalls and wet markets. Supermarkets command approximately 25% of the retail market for fruit and vegetables in Singapore and Malaysia, and approximately 5% in Hong Kong. There is a gradual shift towards supermarket retailing occurring in these markets, particularly in Singapore.

"The trend toward supermarket style of fruit and vegetable retailing can be anticipated to continue because of a range of social and economic factors.

"Consumers will become more quality conscious than before, and it will become more difficult to place inferior grade produce."

In addition to the wholesalers, the brokers are important. Their intermediary service attracts a 3-5 percent commission. In the European Union this service is performed by marketing board panellists among others. In the United States, where the importance of brokers is increasing, there are nearly 1,000 brokers in fresh vegetables and fruit, with an average turnover of $6 million.

The **wholesale centres**, where wholesale traders are located and from where traditional fruit retailers collect their fruit, are situated near large cities.

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20 Philip B W and Deer T W (1990), *Vegetable Marketing and Production in South East Asia*, Technical Report No. 172, Department of Agriculture, South Australia, pp11 - 12.

Changes in distribution, whereby the fruit is increasingly being delivered by the wholesaler, are reducing the importance of these centres.

3.2.5 The Retail Trade

The retail trade can be divided into two categories: the traditional retail trade and the integrated retail chains.

The **traditional retail** trade includes specialist greengrocers, small food stores, daily and weekly markets and street vendors. In the United States there are specialty stores for which vegetables and fruit account for the majority of the turnover. In Southern Europe, daily and weekly markets are important. Traditional retail is mostly small scale. A lot of time has to be invested in purchasing, sorting, administration and selling. Wholesale has a permanent function in facilitating the purchase process. In a number of countries there are modern stores specialising in high quality and innovative variety, which distinguishes them clearly from the retail chain stores.

The integrated **retail chains** have a very wide range of foodstuffs. These large organisations integrate different stages of the production and marketing chain. The strength of retail chain stores is mainly expressed through the size and scale of operations, a preparedness to shorten the import line to the producers and strict product requirements in terms of time and place. In the food and confectionery industry, wholesale has largely been discarded and purchases are made direct through the industry.

In many major consuming countries, supermarket chains have an important position in consumer fruit sales. In the United States, 74 percent of all food is sold via the supermarket channels or warehouse stores. In the Netherlands over an 8-year period the market share of supermarkets in fresh fruit sales has risen by 7 percent at the expense of other sales channels. In Switzerland, one single chain has a 50 percent market share. Many other consuming countries show a similar trend. Another important trend has surfaced in the European Union: the market share of the traditional retailer is much smaller in Northern Europe than in Southern Europe. In Japan there are at least twice as many shops per capita as in Europe - Japanese women have traditionally shopped every day. With many small stores (with no storage space) the result is a system of many layers. Since the retail chain is itself often the importer's or marketing board's buyer, some elements of wholesale are excluded.

4. EVALUATING THE ISSUES AND OPTIONS

4.1 An Objective and a Benchmark

The purpose of the second stage of the review is to evaluate marketing options for the kiwifruit industry given the existing and potential market environment. There are two fundamental requirements for doing this satisfactorily.

The first is that there be a clear objective against which alternatives can be evaluated. The terms of reference for the second stage state the objective clearly. It is "to maximise the profitability of those in the industry and the net benefits to New Zealand".

This objective brings into focus the main challenge facing the review, the industry and the government: **How to ensure that any approach adopted is most likely to maximise profitability in the national interest, and to do so as consistently as possible over time?**

In the real world it is not possible to be absolutely sure about the right answer, certainly when it comes to the detail. What is required is a systematic consideration of relevant principles and information with the aim of reaching a judgment about what arrangement is **most likely** to achieve the objective.

The second requirement, therefore, is the practical one of giving the evaluation process a structure which makes it manageable and systematic. There needs to be a benchmark (or default option) against which alternatives can be assessed. Alternatives can then be evaluated in terms of their likely costs and benefits relative to the benchmark.

In this study the benchmark is an unregulated, competitive industry. This differs from current marketing arrangements in the kiwifruit industry and the reasons for choosing it as the benchmark need elaboration.

New Zealand has chosen not to be a command economy. Markets and market forces now drive most parts of the New Zealand economy. After a decade of regulatory reform, which is now delivering an increasing flow of benefits, the importance of competitive markets to national economic performance is difficult to deny.

A competitive environment is, therefore, the obvious benchmark from which to assess alternatives. This is not to suggest that competitive markets are perfect or that regulatory modification of the market might not be justified in some circumstances. However, to decide any regulation is in the national interest means establishing beyond reasonable doubt that it will deliver an outcome for industry participants and the country which is superior to that which would result if the market were left to its own devices.

This test is logical and reasonable given the established role of competition in the New Zealand economy and its repeated emergence as the preferred option around the world. The same conclusion was reached by the recent Hilmer Committee review of Australia's competition policy.[22]

> The Committee is satisfied that the general desirability of permitting competition was so well-established that those who wish to restrict or inhibit competition should bear the burden of demonstrating why that is justified in the public interest. This principle is already reflected in the agreed principles dealing with anti-competitive conduct, and the Committee proposes that it should apply equally to the actions of governments.

4.2 Competitive Markets are the Preferred Choice for Good Reasons

Competition and choice characterise most economies in the world. Where countries (or industries within countries or blocs of countries) have implemented alternative command and control systems, their eventual failure has led to a return to competitive processes for allocative and productive decisions.

The major reason for the superior track record of competitive markets lies in the demonstrated capacity of the market place to handle detail and complexity. Markets have a unique ability to sort and select the best from a dynamic and varied range of options. They also fulfil an important role in resolving conflicts between differing objectives and differing individual views about what is likely to happen, and what is the best response.

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22 *National Competition Policy*, Report by the Independent Committee of Inquiry (chaired by Professor F G Hilmer), Canberra, August 1993, p18

Command and control systems (regulation) fail because they cannot handle the detail and complexity as well as competitive markets. They are also inferior to competition in stimulating discovery and innovation, and are not as impartial and objective in resolving conflicts.

These general points are very relevant to kiwifruit marketing and the industry review. Kiwifruit markets and marketing are characterised by diversity and complexity. Moreover, marketing conditions are changing continously over time. There would have to be compelling evidence, therefore, to conclude that one organisation, representing only one set of views and ideas, could serve the profitability and national interest objective better than a competitive market. Is it possible for one organisation, particularly one as small as the KMB, to find and commercially exploit every opportunity?

It must be stressed that these questions do not imply criticism of the KMB's performance. They need to be asked even if the KMB were judged to be a completely successful marketing organisation. If the physical and commercial task is beyond the capacity of a single organisation, it will not be in the interests of grower profitability or New Zealand to continue with a mandated monopoly.

It is instructive to note that single organisations usually only exist in an industry when they are protected by regulation. Competitive industries often have a few large players but also include significant numbers of smaller businesses. It is hard to find an exception to the rule that competitive markets deliver organisational diversity and not a single dominant firm. This suggests that diversity is important.

Why does the logic and evidence in support of competitive exporting not carry the day when it comes to kiwifruit marketing? Most of the reasons given are variants on a common theme - kiwifruit marketing is said to be different and the approach that works best almost everywhere else is not appropriate for kiwifruit.

On the basis of probabilities alone, the likelihood of this conclusion being correct is slim. However, the view that kiwifruit is different has been sufficiently influential to result in extensive regulation in the industry. It is therefore important to evaluate the arguments.

4.3 Does the Market Fail in the Ways Suggested?

Improving market outcomes - in the form of industry profitability and national income - is the only legitimate reason for having regulation. Advocates of regulation argue that, left to its own devices, the market will fail in a number of significant respects when it comes to kiwifruit marketing. Each of these asserted 'failings' needs critical scrutiny.

Regulation is very important, so the argument goes, to exploit market power and ensure higher returns for growers. Growers are said to benefit from coordinated and disciplined marketing. Orderly marketing is claimed to ensure market premiums are secured and returned to growers, and the alleged problems of competitive markets - destructive competition, weak selling, poor quality control, lack of market development - are avoided. Does this represent the reality of present-day international markets?

4.3.1 The Market Power Argument

The view that New Zealand has, through its single seller kiwifruit marketing arrangements, an ability to influence the market in a way which benefits producers is encapsulated in the following statement from the KMB:

> New Zealand continues to earn price premiums and retain its edge by differentiating its kiwifruit through consistency in product quality, in-market customer service and trade support. Its most critical competitive advantage, however, **is the power it exerts within the marketplace through its ability to deliver orderly marketing through the single seller system.** This will become even more important to the industry's future viability, as the Board seeks innovative responses to the changing structures and power in these highly competitive world markets[23] (emphasis added).

True market power means being able to dictate successfully to the market. To do this the seller must be able to command consistently higher prices by controlling supply, including the supply of alternative products. To obtain higher prices, supply must be restricted. If, when buyers face seller demands for higher prices, there are other suppliers or suitable substitute products, then the seller has no exploitable market power.

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23 New Zealand Kiwifruit Marketing Board (1994a), *Annual Report 1994*, p11-12.

How closely does New Zealand kiwifruit meet the conditions required for any market power to exist? In a nutshell, not at all - not even remotely. Consider the characteristics of the market into which New Zealand sells kiwifruit.

Kiwifruit is a minor fruit in a large and diverse international fruit market. There are many supplying countries and a large number of markets. The KMB is a relatively small player in the fruit market, selling only kiwifruit. The availability of all fruit has demonstrable effects on the demand and prices obtainable for any individual fruit. There is no evidence of any successful monopoly behaviour in the international fruit market. It is a very competitive and price sensitive market.

Some of the best evidence for this view comes from the KMB. On virtually every occasion when there is an unfavourable price outcome to explain to growers, the Board cites either increased kiwifruit supplies from other producing countries or increased supplies of other fruits. Frequently it refers to both in explaining why it was not able to extract more from the market. The following are examples:

- In a report to growers on early 1994 season market developments in Europe, the KMB referred to:

  > "... another strong sales week against fierce competition from summer fruits" and "a market saturated with local summer fruits".[24]

- In the same report the Board had the following to say about the Japanese market:

  > "It has been uphill for New Zealand to date with good quality Japanese domestic product available all last month, hot weather creating interest in melons and Chile selling approximately 500,000 to 550,000 more trays than this time last season."

These are not explanations which would be expected from a marketer with effective market power. Having effective market power means being able to isolate yourself from these common characteristics of competitive markets.

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24 New Zealand Kiwifruit Marketing Board (1994b), *Kiwi Flier*, 6 July.

Shortly after the release of ACIL's 1992 report, the Director-General of the Ministry of Agriculture and Fisheries advised the minister of agriculture that he was "in general agreement with the thrust of the ACIL report, especially with respect to the assessment that New Zealand is a price taker on world markets for most, if not all, of its agricultural products".

In its review of horticultural marketing, the Australian Industry Commission reached similar conclusions, viz:

> Another argument put forward in favour of single-desk selling is that by controlling supply into certain markets, a price premium may be obtained. With the possible exception of dried vine fruits, the Commission is unaware of any horticultural product in which Australia, acting alone or in concert with others, has market power which could be exercised in foreign markets.
>
> Single-desk selling can have unfavourable side effects by diminishing or removing incentives to market competitively so that selling costs may be increased.[25]

Somewhat ironically, the only circumstances in which New Zealand might have enjoyed a degree of market power in kiwifruit were those when the industry was first established. In earlier research ACIL commented:[26]

> Essentially, the New Zealand kiwifruit industry has introduced marketing arrangements suited to exploiting market power after the conditions conducive to the use of such power have gone. If there were any case for single seller arrangements in the industry, it was much stronger two decades ago than it is today. Even the consultants who reviewed the industry in detail in 1988 only recommended 'coordinated and disciplined' marketing for a transitory period, envisaging a return to multiple exporters after identified problems had been rectified. This aspect of their recommendations has been overlooked by the industry and the government in putting the current arrangements in place.

A common mistake is to conclude that per tray returns for New Zealand kiwifruit which are higher than those of competitors is evidence of market power. What needs to be examined are the means and costs of obtaining these higher returns.

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25 Industry Commission (1993), *op. cit.*, p45.

26 ACIL (1992), *op. cit.*, p60.

Top quality will generally receive top prices. But achieving this quality is not costless - it is more expensive to produce and to market. Furthermore, it does not follow that higher prices resulting from higher quality always maximise profits. New Zealand's apparent record of obtaining prices at the top end of the market has not stopped the industry experiencing severe profitability problems.

An analogy may help to explain this point. Rolls Royce cars have a superior quality reputation and are considerably more expensive than a standard Toyota. However, Toyota's investors have consistently earned better profits. Kiwifruit growers, however, do not know how profitable their Board's marketing and pricing strategies have been. The industry's current financial circumstances do not suggest they have been more successful than anyone else. In fact, while New Zealand is reducing its production, the kiwifruit industry in some other countries is growing and increasing market share.

Prices received for kiwifruit will also reflect the marketing services offered by the KMB. Customers would be prepared to pay more if the deal involved services such as promotion assistance, storage and just-in-time delivery, favourable payment terms, or other marketing aids and inducements. When New Zealand growers compare their per tray returns with those received by other suppliers they have no idea whether or not the price difference is explained by New Zealand providing more marketing services and inducements. For all they know, the premiums may be less that the costs of obtaining them. The industry's poor profitability suggests that could well be the case.

4.3.2 The Criticisms of Competitive Exporting and Weak Selling

The proposition that unregulated exporting will result in sellers unnecessarily competing with each other and engaging in so-called weak selling is a fear held by many producers. This fear is extensively exploited by those who support regulation and a single seller.

Weak selling implies a situation where, for whatever reasons, an individual seller accepts a price lower than might have been obtained, forgoing revenue and lowering the prices the market is prepared to pay for the same product from other sellers. It is an extremely tempting explanation for growers wanting to blame marketers for unacceptable returns.

- *Faulty logic and the wrong evidence*

In all markets some participants perform better than others. While there are many reasons, they boil down to differences in commercial competence.

A seller who accepts a lower price because of poor market information might be judged inferior (a weak seller) to the better informed seller who obtains a better price. However, that may not be the correct conclusion. The apparent weak seller may have concluded correctly that the price discount accepted was less than the cost of being better informed.

Similar logic might apply when the seller has to decide whether to quit some supplies on the day rather than incur the costs of storage in the hope of a better price tomorrow. It may be that the storage option is not feasible. What is the best selling strategy if the product is on the verge of spoiling? Cut the price to make a sale, or avoid any weak selling accusations but incur the twin penalties of no sales revenue and the costs of subsequent disposal?

It is important to emphasise that a weak selling verdict cannot be reached on the basis of price alone. Profitability over time is the only reliable indicator of commercial competence and success. Whether a particular price outcome is profit-maximising can only be determined on the basis of all the facts likely to influence profitability. How often do those making accusations of weak selling possess all the facts necessary to reach a valid conclusion?

It is quite possible that the best marketers may be able to take less in the market, pay more to the producer and make sufficient profits to stay in business. It would be very counterproductive for growers to control or exclude these marketers because they accept a lower price from time to time.

- *Weak selling cannot be sustained if there is competition*

Why would profit-maximising marketers want to engage in price-depressing activities on any consistent basis? More to the point, how could they do this and remain profitable enough to stay in business? After all, unless weak selling is sustained behaviour, rather than an isolated event, its consequences are likely to be relatively minor in the overall scheme of things.

Commercial reality suggests that any exporter that persistently engages in weak selling would go out of business. To stay in business marketers must deliver prices to growers which ensure they continue to be supplied. If they cannot match the prices being offered to growers by competing marketers they will either fail or be taken over by others more successful at extracting profitable returns from the market.

This logic is of profound importance to growers. It means that the most effective sanction against so-called weak selling is the existence of competitive alternatives. The competition will ensure the incompetent cannot stay in business, and that growers will not be forced to use their marketing services while they do.

The corollary is of equal significance. The only circumstances in which a marketer could engage in weak selling on a persistent basis and stay in business are where there is no competition. In these circumstances, which exist currently in the New Zealand kiwifruit industry, there is no useful information on comparative performance and no marketing alternatives available to growers. Only in the circumstances enjoyed by the KMB could persistent weak selling occur.

Every season since its establishment the KMB has found it necessary to reduce prices in certain markets as noted in ACIL's earlier research. It was pointed out there that private exporter pricing behaviour which is labelled 'weak selling' is called 'strategic marketing' when practised by a single seller board. The fact that the Board has to face up to commercial reality in its pricing effectively demonstrates that the weak seller arguments are spurious.

- *Commercial solutions exist that are effective*

According to one marketing academic, such criticisms of the weak selling argument are unconvincing. In making this point he said:[27]

> Weak selling will recur whenever buyers have an interest in New Zealand fruit, more than one exporter seeks to supply a given requirement, and exporters are unable to differentiate their offerings. Each competing exporter will be motivated to drop price because even a reduced unit margin on a specified volume is better for that exporter than the loss of the sale.

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27 R W Cartwright (1993), *Comments on the report "Options for Kiwifruit: An Industry in Crisis,"* Key Issues, (mimeo), University of Auckland, January.

These are very particular market circumstances. If, as would appear to be the case, they are not common then presumably neither is weak selling. Alternatively, if they are relatively common, is regulating competion the only or the best solution? How might a competitive market cope with these circumstances if they were frequent and depressed profits?

Since the main objective of marketers is to maximise profits, they will try to avoid becoming victims of the circumstances described. Thus marketers will form commercial relationships, enter into contracts, provide diverse marketing services and develop brands. They will also search around for alternative buyers. Competitive markets stimulate strategies to combat these circumstances - with the objective of making demand less price sensitive and more profitable. In a competitive market such solutions would be likely to be implemented and the particular circumstances outlined would occur infrequently or not at all.

The following observations from a review of South East Asian markets from the perspective of Australian exporters illustrate the typical concerns about competitive selling and price cutting:[28]

> The South East Asian market place is characterised by an over-abundance of Australian exporting companies, many of which operate in an opportunistic manner. Because of a lack of overall marketing strategy, Australian exporters frequently compete with each other. This results in price cutting to buy or maintain market share, and often leads to a destabilised market.

However, the authors point out how the market is resolving these issues in ways that would be expected. They note that:

> Exporters with a good reputation in the market place pay close attention to product quality and specification. Importers dealing with reliable suppliers had few complaints about the standard of Australian produce while those purchasing through agents who purchased speculatively off market floors in Australia were critical of quality. There was strong competition between importers to secure 'exclusive' contracts with reliable suppliers.

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28 Philip B W and Deer T W (1990), *Vegetable Marketing and Production in South East Asia,* Technical Report No. 172, Department of Agriculture, South Australia, p13.

The last point about strong competition between importers to secure supplier relationships is an interesting one. If the 'weak selling' argument had any merit, this would presumably be a case of 'weak buying'. It highlights the fact that those who produce what the market wants will have commercial negotiating strength in a competitive environment.

Weak selling is a phenomenon discussed almost exclusively in relation to regulated agricultural marketing. In competitive markets where commercial solutions are allowed to develop, so-called weak selling problems are seldom raised. They do not appear to exist.

4.3.3 Is Competition a Problem if Trading a 'Commodity'?

An aspect of the weak selling debate which requires further discussion is the proposition that the problem of kiwifruit is that it is a commodity. The proposition usually carries two implications. One is that competitive selling cannot be contemplated because commodity trade involves price competition only. The other implication is that improving industry profitability will only be achieved by moving kiwifruit out of the commodity category.

If kiwifruit is a 'commodity', there is no reason why this should be a matter of particular concern. There is an enormous international trade in commodities which is clearly profitable or it would not occur. In New Zealand's case, for example, logs and most of the fishing industry's output are commodities under any conventional definition. By definition, some countries will have comparative economic advantages in the production of some commodities.

The resources sector is also in the commodity business. If problems of competitive exporting and weak selling were real and could be solved by regulation, one would expect to find extensive regulation of industries such as coal, copper or iron ore. However, the resource industries have few statutory bodies or regulatory restraints, and no major players are calling for them.

Focusing on the semantics of whether or not something is a 'commodity' is to risk overlooking the fundamental reasons which differentiate good from bad commercial performance. It also carries the risk that people may be led to the mistaken view that if kiwifruit could be transformed into a 'non-commodity', the industry's problems would suddenly disappear.

Some marketers say that kiwifruit are, and always will be, a commodity. They see commercial opportunities in being better than anyone else at finding and developing commodity markets, and supplying them using world class marketing services at the lowest possible cost. Other marketers are equally convinced that their strategies will take kiwifruit out of the so-called commodity category by developing brands and focusing only on premium fruit, quality packaging and up-market outlets. Some New Zealand companies are successfully marketing products that use kiwifruit and have other ideas in the pipeline. They presumably have little interest in the semantics of how kiwifruit is described since they use it as a raw material.

If the objective is to maximise the profitability of all participants in the industry then all these strategies, and others which have not yet been thought about, need to be commercially tested. Innovative entrepreneurs who are prepared to invest and take risks should be encouraged to do so, and not be prevented by regulation. Whether their ideas imply treating kiwifruit as a commodity or not is largely an irrelevant issue.

The diversity of market characteristics and commercial possibilities means that any notions of categorising 'commodity' opportunities as intrinsically inferior, or only being profitable if marketing is regulated, make little sense.

4.3.4 Does a Distorted International Market Justify Regulation?

Justifying regulation on the grounds that world markets are corrupted by subsidies and protection is another popular argument in the debate. New Zealand cannot, it is said, be better off having a so-called level playing field at home - that is, competitive exporting - while the world market is so distorted and unfair.

Many of the countries the New Zealand kiwifruit industry either sells to or competes with have intervention policies which make profitable exporting more difficult. However, this does not mean kiwifruit growers or New Zealand will be better off by constraining competitive exporting. The response should be determined by what is best for New Zealand.

A useful way to consider the logic is to begin with the widely accepted proposition that if there were no distortions in export markets there would be no grounds for controlling exports. How does this conclusion change if there are distortions?

Distortions are of three types - tariffs, subsidies and quotas (and equivalent non-tariff barriers).

Tariffs carry no implications for New Zealand export regulation policy which differ from a non-distorted trade situation. A tariff raises prices in the importing country, changes the domestic supply and demand balance and lowers imports. The commercial implications of a tariff are identical to those which would arise from a market-induced devaluation of the importing country's currency.

As with any price change in a market, the effects of a tariff have no implications which necessitate controls over exporting. Few would suggest that New Zealand should regulate exports whenever the currency of an importing country is devalued.

In the case of export subsidies the logic and conclusions are identical. Subsidised exports alter prices in importer markets. This is not a justification for controls over New Zealand exporting.

Quotas can be different but only in very particular circumstances. The issue with any form of quantitative restriction is whether it is designed to deliver economic benefits to particular market players and whether New Zealand can obtain any or all of those benefits (economic rents or price premiums). There are no kiwifruit markets where the quantitative restrictions are of a type that would cause New Zealand to forgo benefits by not regulating exports.

The only caveat is that exporters should avoid commercial behaviour which triggers importing country sanctions and, as a consequence, makes profitable exporting more difficult. There are many instances around the world where exporters cooperate commercially to avoid this happening. Japanese car exporters have responded in this way to quantitative import controls in the United States and the European Union. After a bad experience in the Economic Union market, Chilean apple exporters are now putting in place commercial coordination arrangements to avoid repeating the mistake.

The New Zealand kiwifruit industry recently provoked a protectionist reaction as a result of its marketing behaviour in the United States. New Zealand now has had to pay punitive anti-dumping deposits in that market and sales volumes have fallen sharply. It is ironical that this situation arose not through the behaviour of competing exporters but as the result of the actions of a marketing organisation which had total control over what was sold, where and at what price.

4.4 Overlooking the Benefits of Allowing Competition

The often expressed grower desire to own and control commercial activities past the orchard gate reflects the fear that if competition is allowed, and outsiders become involved, then growers would be disadvantaged. It is argued that in a competitive environment marketers would not have growers' interests at heart. With their presumed strength of bargaining power they would deliver reduced returns to growers. These fears seem particularly acute when the prospective new entrants are foreigners.

Most industries do not have these fears about competition and so-called outsider involvement, and where it does occur primary or raw material producers typically see themselves as beneficiaries. The common view is that an absence of barriers to entry and competition is the best protection individual market players can have. Is the kiwifruit industry fundamentally different, or are some growers harbouring misconceptions about the disadvantages and overlooking the advantages?

4.4.1 Diversity, Discovery, Innovation and Growth

The advantages of competition, and the reason why its adoption is so widespread, relate to the ability of competitive markets to maximise diversity, discovery, innovation and growth. No matter how good a business is there are always others who have ideas and see opportunities that even the best will miss. The basic nature of competition ensures the process is continuous with every profit-maximising participant trying to do things differently and better than competitors.

These competitive benefits cannot be maximised when there is only one player, no matter how well motivated, diligent or sincere the organisation and its personnel. There are two simple reasons for this. One is the physical impossibility of a single organisation replicating all the activities and outcomes found when there is competition. The other is that no system has yet been devised which is superior to competition in delivering the maximum amount of continous improvement in commercial performance.

It is, therefore, important that kiwifruit growers reconsider the wisdom of arrangements which restrict the market's ability to deliver the benefits of competition. The examples in the following sections illustrate some of these benefits.

- *Are fruit always being sold to the highest returning markets?*

On occasions the Board has changed the volumes it planned to sell in a particular market or diverted fruit to processing or animal feeding at short notice during the course of a season. Market circumstances can change rapidly and it is important that marketers react quickly. There is nothing unusual in that, and inflexibility in these circumstances would justify criticism.

However, in some instances where the Board has taken this type of action it is difficult to see how it would have resulted in growers and the industry being more profitable. Why would the Board sell fruit into any market at a price which is significantly lower than the next best alternative?

Japan has a record of being the highest priced market for New Zealand kiwifruit on the basis of average per tray returns obtained by the Board. Nearly 50 percent of grower returns come from sales in the Japanese market although it only accounts for one quarter of export volumes.

In August 1994 the Board sent half a million trays of fruit, some of which had been intended for Japan, to be juiced in New Zealand. According to media reports, the fruit was sold for well under $1 per tray at a time when it was bringing over $15 per tray in Japan. A representative of the Board was quoted as saying that:[29]

> ... the economic recession and unseasonally hot weather in Japan has hurt sales with all imported fruit sales down 6.9% on 1993. Prices for kiwifruit have been maintained at 1993 levels.

Does this mean that maintaining per tray returns from Japan at the same level as 1993 was the primary objective of the Board? Does this objective ensure maximum grower profits? Why not sell more in Japan at a lower price than in 1993 when the apparent alternative was juicing at less than $1 per tray? Would another shipment to Japan have actually dropped the price in that market to such an extent that juicing realised higher net returns over all the fruit involved? Chilean exporters increased their shipments and there was no spectacular price decline. Did they take advantage of profitable market opportunities New Zealand walked away from? It seems inconceivable that in

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29 *The Independent*, 19 August 1994.

the absence of regulation other exporters would not have been able to find selling opportunities which returned more than $1 per tray.

This is not an isolated example. In mid-1993 a newspaper reported that Korean and Chinese companies were critical of the KMB for refusing to sell them fruit.[30] Apparently one Korean firm wanted to buy 560,000 trays and there were offers from 11 other Korean-based companies. Two Chinese companies had also expressed interest in buying kiwifruit - some millions of trays according to the report.

The Board said it had closely researched both markets (Korea and China) and had "refused the offers for commercial reasons". At that time the KMB had one agent in Korea selling about one million trays per year and said it was also investigating opportunities in China. A Board representative said "we are trying to find the best options for access to the market based on the criteria we have set". A representative of the Korean buyers said "this country has 42 million people and companies that are based there know the market a lot better than the Kiwifruit Marketing Board does".

- *Who suffers the consequences of making mistakes?*

Prior to the commencement of the 1994 season the Board made significant changes to its marketing arrangements in Japan. This was done notwithstanding some rather complimentary media comments about its previous approach.

In an article in the Australian *Business Review Weekly* of 30 July 1993, "Brian Robins in Tokyo" had the following to say:

> Competition, local opposition and an allegation of price-fixing have not stopped the NZ Kiwifruit Marketing Board from protecting its market in Japan. The way in which the [Board] has protected its position in the market, and its growers, is a prime lesson in marketing.

The article also quoted a Board officer in Japan as saying:

> With the erosion of margins in Japan, this made it more difficult to achieve our sales targets. This led to the decision that the only

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30 *The National Business Review*, 23 July 1993.

> way to sustain the business was to run it ourselves. No one else would champion our interests. When the margins were there the wholesalers would work hard, but not as they declined.

According to Robins, "the lesson for the Board in its tussle in Japan has been: start only what you intend to finish. The Board is now locked into the long-term development of its own distribution in Japan. If it succeeds, it will form a vital case study for others keen to go into the market."

Twelve months later the Board comprehensively changed its marketing arrangements in Japan. Clearly it concluded it did not succeed. The article pointed out that the Board was "one of the few foreign groups to decide to push directly into the Japanese market". Was New Zealand one of the few to get it wrong?

In March 1994 the Board announced the appointment of Dole for sales, marketing and distribution in Japan. Details on how the arrangement was to work and why the change was made are sparse. The new approach coincides with extensive personnel and strategy changes within the Board.

According to media reports the Board has described the relationship with Dole as a "strategic alliance which would allow the Board to expand dramatically its customer base". Dole has apparently agreed to deal exclusively with New Zealand kiwifruit and use the Board's "world's finest" label.

Critics of the Board have frequently suggested the earlier approach adopted in Japan was wrong and probably feel vindicated. They have also suggested that by breaking existing relationships the Board will have created aggrieved commercial interests who will use other suppliers (e.g. Chile, Italy) to mount vigorous competition, compounding the costs of the mistake. There is clear evidence that this is happening.

The fact that the Board got it wrong in Japan is not the issue here. All marketers make mistakes. Besides, the Board has moved to rectify the situation. Rather, the episode highlights two important points:

- different experts clearly have different views on what is the best marketing strategy in any given market; and
- when regulation means only one view prevails, and that view turns out to be wrong, everyone in the industry incurs the cost.

These are real costs which need to be compared with any benefits of a single seller.

The changes to marketing arrangements in Japan, and a similar arrangement which the Board has established with a major marketer in the United Kingdom, also raise questions about the realities of successful marketing. A review of the kiwifruit industry in *The Dominion* on 26 August 1994 made the following point:

> Bringing in heavyweights like Dole in Japan and wholesaler-distributor Geest in Britian is part of the perceived solution [to improving industry viability]. They not only have marketing clout but are able to position New Zealand fruit in their 'basket' of products. And they know their market.

Is this a recognition that the Board cannot compete with these types of marketers in the market segments where they operate? Possibly the success of marketers in this league is due to their ability to supply a range of fruit (they are not single fruit marketers like the KMB) and their better market knowledge and connections. It would appear that the Board has now positioned itself as a middleman between growers and these internationally successful marketers. What benefits does the New Zealand industry obtain in return for these additional middleman costs?

- *Branding : what might be best for growers and why?*

Most marketers seem to agree that brands can contribute to commercial success. Certainly, the market appears to place a high value on well-established and successful brands.

The notion that branding improves profits, and can only be done by large businesses with the necessary resources, is another justification advanced for a single seller. The KMB has established a brand for New Zealand kiwifruit and claims a country of origin identity is important.

Since growers will always be interested in higher fruit prices, it is important to look at the ways in which brands and branding might increase returns. Is the KMB approach the best, or might growers be better off under a 'more brands the better' approach, including the use of established brands?

What is a brand? There seems to be a variety of views. It may be nothing more than a good trading reputation. Those involved in the market place repeatedly stress the importance of relationships, particularly trust and reliability, in successful marketing. This type of brand might, therefore, be personally based or it might be the trader's name, as is the case with Chiquita. At the other extreme, brands like Coca Cola command a premium related to the product.

It is not clear where the KMB's branding approach fits into a marketing strategy. Marketers contacted during this research had widely differing opinions on the Board's "world's finest" strategy. Some said it was a brand, others a label and the sternest critics said it was just a superlative. If there were competition, these differences of view would not matter - the market would determine who was correct.

Some suggest it is imperative that a brand be linked to the country from which the produce originates. On this question there is often confusion between branding and what are best described as appellation systems. The latter approach aims to gather together, under a single label or logo, producers in a region or country and develop consumer confidence in what the label or logo stands for. However, such schemes usually do not preclude individual brands operating within the scheme, as is the case with the New Zealand wine industry.

There would appear to be good reasons for questioning whether a country of origin identity is important to successful branding. If it is not, then growers are only being disadvantaged by preventing any brand being used on New Zealand kiwifruit.

To have value, brands must deliver consumer loyalty and, preferably, a higher price for the branded product. Do brands which are successful for these reasons depend on consumers knowing the country of origin of the product? Consider the following:

- Does a customer buy a Cadillac or a Rolls Royce because these brands stand for something, or because the cars are made in the United States and the United Kingdom respectively?
- Is the purchaser of a Sunkist orange necessarily concerned to know that it came from California?
- Does the purchaser of a Sony product buy it because the brand says it is made in Japan? Today, many Sony products are not made in Japan.
- When someone purchases a Chiquita banana are they concerned whether it was grown in Ecuador or Brazil?

- Are the drinkers of Coca Cola concerned to know the location of the plant that produced the particular container of drink?

These examples all support the proposition that branding success is not dependent on country of origin.

Finally, and to add further complexity to the branding issue, there is the growing phenomenon of retailer branding. Marketers make much of the growing importance of large retailers and the need to have relationships with them. If the New Zealand industry requires all fruit to be sold under the one brand, will this prevent access to important outlets? If the answer is no, because a single seller will be prepared to supply for sale under a retailer brand, does this not mean that branding diversity is necessary and restrictions should be removed?

The following two examples illustrate some of the issues which arise in the use of house brands.

The first example is from the United Kingdom:

- The introduction by British grocery chain Sainsbury of a high quality own-branded cola has bitten sharply into sales of Coke. But that is only sales in Sainsbury stores, and it is only in Britain that Sainsbury is such a strong brand name in its own right that it can challenge Coke. So in world terms there may be little damage. The experience, nevertheless, should be a warning against overvaluing any brand. It is just possible that the whole idea of brands has had a natural life of 100 or so years, and in the future we will not need them so much. Real quality will out.[31]

The other example is from Australia:

- Establishing a brand name for a commodity fresh-food product is not easy. Pacific Brands' Edgell Fresh division turns over $A12 million from the sale of fresh produce ... [and] ... will launch new products some of which will be branded with the Edgell name. But retailers are reluctant to stock fresh produce that carries a manufacturer's brand. [Woolworths says] ... do we want to sell, say, Edgell or Nestlé fresh produce, or should it be Woolworth's

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31 *The Australian*,(reproduced from *The Independent*), 15 July 1994.

> fresh produce? Our preference is for the latter, but it is an issue we have to sort out.[32]

The important question for growers is what approach to branding will be most likely to deliver higher fruit prices. It is difficult to avoid the conclusion that no options should be precluded.

- *Growers are buying marketing services from a monopoly*

Suggestions that the KMB is a monopoly are frequently countered by statements that because the Board has to compete with many other suppliers in the international market it cannot possibly be a monopoly or suffer any monopoly deficiencies. Moreover, removing the monopoly and introducing competition only benefit consumers and there is little merit in doing this if you export, according to the Board's supporters.

The point being missed here is one that growers should consider carefully. Growers are, in a very real sense, the Board's **consumers.** They buy marketing services from the KMB. Consumers are invariably disadvantaged by monopolies and are major beneficiaries of competition.

The Board accepts producers' fruit, markets it, deducts all the costs, and returns what is left to the grower. The amount deducted by the Board is the cost the grower has paid to have the fruit marketed. The fact that it is deducted rather than charged does not alter the point that it is a cost for a service the grower buys - in this case is compelled to buy. When a single seller like the KMB is the only source of marketing services, the grower has no ability to use competition to minimise this cost.

4.4.2 Consider the Benefits Outsiders Can Bring and the Costs of Keeping Them Out

To restore profitability the kiwifruit industry needs all the capital and expertise it can attract. There are unlikely to be net benefits from cutting off the industry's access to these resources and their market connections.

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32 *Business Review Weekly*, 18 July 1994.

John Robertson MP, at the time a member of Parliament's Foreign Affairs and Defence Select Committee, put the point this way:[33]

> One cannot discuss trade linkages without acknowledging the importance of investment linkages in the process of trade. Here again we have an institutional block - the producer board.
>
> Overseas investors with strong marketing structures abroad who wish to vertically integrate back into New Zealand are effectively shut out from our main agricultural industries. It is ironic that our ministers fly around the world singing the praises of investment in New Zealand while we preclude such investment from our largest industries.

In early 1994 the minister of finance said he was disturbed to hear a leading New Zealand businessman assess the agricultural sector in the following terms:[34]

> I have been involved in just about every business you can think of in my career, except agricultural processing and marketing. The reason is simple. Either outside investment is virtually blocked, as in the case of dairy and horticulture, or the rules of the game are capable of being changed overnight at the whim of a producer board, as in the case of meat and wool.

The minister reacted by saying that:

> Capital and ideas are too scarce or expensive for farmers to ignore such sentiments. In recent times too there has been plenty of evidence of thriving resource based industries, such as fishing and forestry, developing largely without reference to traditional ideas and methods.

An assessment of Chile's fruit industry led an Australian inquiry to conclude that "direct overseas investment, or cross investment with overseas buyers may also provide closer working arrangements and better long-term business strategies".[35]

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33 *The Dominion*, 30 September 1993.

34 Rt Hon Bill Birch (1994), Address to the Institute of Directors AGM, Hamilton, 11 February.

35 Australian Horticultural Research & Development Corporation (1993), *Chile - A Role Model for Australian Horticulture?*, A Study Tour Report, p39.

The advantages of diversified investment were highlighted by the Hon John Luxton when discussing future developments in the dairy industry. He commented:[36]

> At the heart of the wider debate on deregulating or removing the monopoly single seller status is the concept that new competitors would risk their capital and provide greater innovation and creativity, such as in Silicon Valley, the New Zealand electric fence industry or the New Zealand food processing industry, particularly since the interest by Heinz in Watties and General Foods.
>
> Some would suggest that the huge increase in outside investment into Telecom and the New Zealand telecommunications industry following deregulation of its monopoly might offer a scenario for a deregulated dairy industry. The remaining minority New Zealand owners have all gained considerably from the $2 billion increase in foreign investment in that company, together with the large investment in more than 100 new telecommunications companies established since deregulation.

The minister went on to say:

> Internationally, the food industry is growing and changing rapidly. Last year, Japan invested NZ$1000 million into the Australian food industry, 70 percent of its offshore investment in the food sector. Much of that was into joint ventures involving the Australian dairy industry.
>
> Some might suggest that is a reason to prevent change in New Zealand. But Japanese investment in New Zealand forestry and beef has been reaping substantial benefits for New Zealand producers.
>
> Other countries are investing at a greater rate in adding value in the food industry than New Zealand. We need to improve faster. We need new investment to improve our market position. We need new structures to enable that.

Luxton specifically mentioned the investment by Heinz in Watties. This is a vote of confidence by a very successful international company in New Zealand as a base from which to push into Asian markets. The move has been positively received because the company has a good performance record. A representative of the Vegetable Growers Federation pointed out that "the Heinz

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36 Hon John Luxton (1994), Dairy Farming in the Future - Does the Dairy Board Need the Dairy Act?, an address delivered in Morrinsville, 15 July.

brand [note, not a producer board-owned, country of origin brand] is well recognised internationally and there is potential under this and other labels for more value-added product to be exported from New Zealand" (parenthesis added).

The involvement of companies like Chiquita and Dole would bring similar benefits to the kiwifruit industry for the same reasons. Perhaps the KMB's new arrangements with Dole in the Japanese market signals a recognition of this fact. Keeping out the international players will only increase the market competition faced by New Zealand because these companies will go elsewhere and take their capital, brands and market connections with them.

4.4.3 The Supplier/Marketer Relationship is One of Interdependence

Large firms may enjoy some advantages in the international fruit market. However, this is not an argument to regulate for a single seller. Moreover, smaller firms are likely to be able to find profitable market niches.

In competitive markets, dominance by virtue of size is not usually associated with abnormal profits. In the absence of barriers to entry, new players are attracted to profitable activities and profits are driven towards normal levels. The international fruit market is no exception. It is a very competitive market with profits under constant pressure and participants continually seeking ways to improve efficiency in response.

Not everyone, however, shares these views. In February 1993, the KMB circulated to all growers a critique prepared by Professor Wayne Cartwright[37] of the December 1992 Douglas and Burgess report.[38] One of Cartwright's themes in this critique was that:

> ... at least comparable size, relative to competitors and buyers is required for competitive performance, and greater relative size can be a source of substantial advantage.

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37 R W Cartwright (1993), *op. cit.*

38 Sir Roger Douglas and B Burgess (1992), *Options for Kiwifruit: An Industry in Crisis*, 28 December.

Cartwright went on to suggest that:

> ... the relative bargaining power of large multinational brand marketers and small New Zealand exporters would serve as an effective siphon of income away from growers.
>
> Even more seriously, the Douglas-Burgess proposal would allow the large foreign fruit companies access to control exporting from New Zealand, through purchase of shares of the proposed companies. If this happened, growers would suffer a dramatic reduction in bargaining power, and erosion of the margin returned to them.

The clear implication is that the introduction of competition into kiwifruit marketing would have unfavourable consequences for the New Zealand industry and its growers. The propositions therefore need careful consideration.

- *Is it only big that is beautiful?*

If there is a direct, positive relationship between size and commercial success, then one would expect to see increasing firm concentration in most industries. Although such a trend has often been postulated, it has not in fact generally occurred.

Commercially the world is undoubtedly shrinking. National borders are becoming less relevant and large mutinational businesses are commonplace in most industries. But the competitive incentives driving these developments are not producing only larger and larger business entities as conventionally defined. They are also producing a myriad of commercial relationships and interconnections as alternative responses to the constantly changing commercial environment. These options do not require businesses to be big to survive.

Underpinning huge companies like Toyota and Boeing, for example, is a vast array of sub-contracting arrangements with hundreds of small and independent businesses delivering services and componentry. Relatively small Australian companies make parts for Boeing. Some Japanese assembled cars are fitted with wheels made in Tasmania. An Adelaide company supplies the US Harley Davidson company with all its motorcycle wheels.

Around the world, including in New Zealand, large wine companies buy much of their raw materials from small independent grape growers. In most countries the broiler industry depends on independent contract growers to raise the chickens. Small businesses in New Zealand are increasing tree plantings to supply large companies with logs, and individual flower growers are marketing direct to Asia. Large numbers of commercially independent wool growers provide the raw material for huge international textile companies. In Asia a lot of fruit is still sold by one-person businesses that own a barrow. Is kiwifruit really different?

If commercial success depends on size, the implications for New Zealand could be serious as its kiwifruit industry is extremely small relative to the international fruit market. The KMB's total turnover is dwarfed by that of Dole or Chiquita.

If, as Cartwright suggests, "at least comparable size, relative to competitors and buyers is required for competitive performance", does this mean the New Zealand kiwifruit industry will never be competitive? Does it mean that the Board's relationship with Dole in Japan is a mistake because "the relative bargaining power of large multinational brand marketers and small New Zealand exporters would serve as an effective siphon of income away from growers." The KMB is small relative to Dole.

A reasonable conclusion would be that the merits of competing views - size is imperative, or commercial success is possible with a variety of sizes and structures - should be determined by the market. If big is beautiful then relationships would form with the large international players. The entry of Heinz into New Zealand has been seen as an advantage, not a disadvantage, by New Zealand vegetable growers. Additionally, removing regulatory restraints would provide the KMB with the opportunity to grow into a more significant international player if this were commercially attractive. Its evolution into a successful New Zealand-based international fruit marketer is much more likely in a competitive environment than under regulation.

- *Without growers, marketers have no business*

Marketers need product to market. They have substantial investment in infrastructure, brands and customer relationships, and ensuring they have the supplies to make these investments pay is critical to success. They have a vested interest in ensuring that the supplies they need are available.

It hardly serves their purpose to drive suppliers out of business. This means ensuring the profitability of kiwifruit growing is at least comparable to that of alternative uses for land and other resources. The resources used in kiwifruit production can be used for a variety of other primary production purposes.

While production cannot be turned on and off instantly, unsatisfactory profitability will influence production levels quite quickly. The rapid growth of the kiwifruit industry, first in New Zealand and then in other countries, is evidence of what is physically possible. Similarly, many growers have rapidly reduced production and turned to alternatives as increased production resulted in sharply lower prices.

Marketers and growers who can supply what the market requires therefore have the basis of a mutually advantageous relationship. Growers can provide marketers with certainty of supply by relationship-building and contracting, thereby reducing their risks and increasing their rewards.

However, while grower profitability must be sufficient to ensure market requirements are met, this does not mean growers can successfully demand prices higher than the market is prepared to pay. The New Zealand kiwifruit industry has no monopoly power. There are no net benefits from trying to exploit market power when it simply does not exist.

One researcher described the interdependence of marketers and producers in the following terms:[39]

> From an international point of view, historical development implies that the control of the system will rest with the marketers and processors with contracts being formed with the producers in order to achieve the required level and quality of supply. This does not imply that the producers are necessarily disadvantaged in such a system as the business of the processors and marketers depends upon the product supplied by the producers and the quality and reliability of that supply. The whole system becomes interdependent and must be seen in this way, rather than as a confrontational process.

Under current marketing arrangements growers are **dependent** on their marketing organisation. They do not have the **interdependence** and its associated negotiating power which exists in competitive markets where they can exercise choice. Since the Board does not face any competition when securing export fruit, and because growers have no alternatives, the Board can take a grower's supply 'loyalty' for granted.

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39 R Sheppard (1993), "Agricultural Restructuring Effects: an Industry Perspective", Paper presented to the New Zealand Agricultural Economics Society Conference, 1-2 July.

- *Grower margins and income - a need to compare like with like*

One particular issue for kiwifruit growers when considering what is best for their profitability is to make sure like is compared with like. Growers could easily be misled by simplistic comparisons of prices, margins, profits and incomes because of the way the industry's marketing arrangements are currently structured. It is important to define clearly what these terms mean when making any comparisons.

Because profits from the Board's marketing business (which growers own) are bundled together with the fruit price in the orchard gate return, the grower's per tray return contains profit from both the orchard and the marketing investments. It is axiomatic, therefore, that if the two investment returns were separated the **apparent** return from fruit production would fall. In fact, it would not have changed - it would simply have been recorded separately and more accurately than is the case at present.

It is obviously quite correct to conclude that, if a business not owned by the grower did the marketing, then, if nothing else changed, the grower's margin and income would fall. It would fall because, compared with the current situation, the grower would no longer have an investment in marketing.

Growers should be free to decide whether to invest in a marketing business. At present all growers are currently compelled to make such an investment. If an alternative marketing investment were more profitable than the Board, growers' 'margins' and income would actually rise compared with the *status quo*. Alternatively they might invest in more orchards or in activities that have nothing to do with kiwifruit.

4.5 Grower 'Ownership and Control' Past the Orchard Gate

Single seller statutory bodies such as the KMB, and less draconian forms of regulation over exporting, are in large part the consequence of growers believing that their returns will be maximised only if they 'own and control' the marketing businesses.

It is easy to jump to the conclusion that the existence of returns which producers would prefer to avoid is evidence that the market is failing to work properly. There has always been ready grower support for the accusation that others are not doing the marketing properly or that others are making easy profits at growers' expense.

Rising prices are an important market signal that expanding production is likely to be profitable. However, unpleasant as they might be, falling prices are an equally important market signal. Given the rapid rate at which world kiwifruit production has been expanding, falling prices were hardly surprising. Without correct price signals, producers would not know what the market wants or what their competitors are doing. In this situation they would fail to implement profit-maximising strategies. As a consequence, the nation is also worse off.

The producer board form of ownership and control which kiwifruit growers have opted for distorts price signals in a number of ways.

4.5.1 The KMB's Structure Delivers a Bundled Return

In establishing the KMB, the aim was to deliver higher per tray returns at the orchard gate. If the ownership and control objective had been to invest in a marketing organisation which maximised the profitability of the investment (the correct objective and the one specified in the current review's terms of reference), a more conventional corporate structure would have been the natural choice. Performance would then have been judged on the basis of the organisation's profitability (dividends paid) and growth in shareholder wealth (share price).

The KMB structure results in growers receiving a bundled return. The per tray return the Board pays the grower combines returns obtained in the market for the fruit with profits made by the marketing business. This is a misleading price signal because it implies the profitability of growing kiwifruit is higher than actual market returns would suggest.

Bundling is not confined to the kiwifruit industry. It occurs wherever farmers have opted for a KMB-type structure. It is also a characteristic of cooperatives as a form of business organisation. Over the past two years the bundling issue has been widely discussed in New Zealand agriculture. It is generally accepted to be a problem in need of correction. The debate is now mainly focused on how large the distortions are in particular industries.

Obviously there will be no distortions if the marketing organisation does not make a profit. However, these would be circumstances where growers received no return on their compulsory investment in the KMB. This would not, or should not, be acceptable to growers.

On the assumption that the KMB makes a profit, the size of the distortion depends on the size of the profits relative to the actual fruit return. Kiwifruit growers should not be lulled into a false sense of security by thinking there is no problem because the size of the distortion might currently be small. The consequences of bundling compound over time for reasons which are discussed in the next section.

A point made by some who argue that bundling is not a problem is that all businesses bundle. What they mean is that conventionally structured businesses deliver a consolidated profit stream, and do not distinguish between the various sources of this profit. This is a correct observation, but the consequences in the case of companies are not distortionary.

With companies the consolidated profit stream only influences investment decisions. It has no direct influence on the investor's production decisions. This can be illustrated by considering a kiwifruit grower who also has shares in Fletcher Challenge. The Fletcher Challenge dividend will not be seen by the grower as a reason for planting more kiwifruit or spending on improved orchard productivity. However, the KMB's 'dividend', bundled in the per tray return for fruit, will be seen as part of the signal influencing these production decisions. That is the crucial difference.

4.5.2 Good Marketing Makes the Distortions Worse

The objective of the KMB is to maximise per tray returns to growers. The performance of marketers in the KMB is judged on how well they do this. Their incentive is to do whatever is necessary to demonstrate that they achieve better returns in export markets than anyone else.

While this might seem to be in the best interests of grower profitability, in fact it is not. Contradictory as it might seem, giving marketers this objective has perverse and unfavourable consequences for grower profitability and the national interest. In fact, the more successful the marketers in these terms, the more unfavourable these consequences become.

Under the present structures successful marketing means higher grower returns per tray. This encourages more kiwifruit production which marketers usually find they have to sell in lower returning markets. The downward influence this has on grower returns will incur criticism, so marketers need to find ways of increasing returns again. When they rise producers are again encouraged to produce more, and so on. It is this chain of events which ensures the consequences of bundling compound over time.

It can take some time for these consequences of bundling to become obvious in an industry. It is important that kiwifruit growers do not dismiss this issue because there is no evidence that it is currently a problem. Today's returns are hardly high enough to cause any rush into extra production. But this is a situation which reflects the industry's recent financial problems and a cyclical downturn in the world fruit market. When deciding on marketing approaches for the longer term, this deficiency in the single seller structure must be taken into account.

The focus on export returns also means the marketers have an incentive to raise minimum export quality standards. The kiwifruit industry has a history of this happening under the single seller. Minimum standards have been frequently increased, even in the course of a season on one occasion, and the Board has made unpredictable decisions about the export of fruit after all the costs of packaging it have been incurred. While these actions obviously raise per tray export returns, the question growers should be asking is : Did they maximise their profits? Under current arrangements they have no way of knowing.

4.5.3 Financial Risks Over Which Growers Have Little Control

All businesses need to be financed and the KMB is no exception. The two main sources of funding for any business are equity (money contributed by shareholders) and debt (borrowed money). The characteristics of a statutory body like the KMB influence how it funds its business, with consequences which can disadvantage growers. Growers are currently repaying debts incurred by the KMB on their behalf.

There are two separate issues to consider. The first is that the KMB's only source of equity funding is kiwifruit growers - they are the only shareholders. The Board can make a call on shareholders for funds and they are obliged to contribute, whether they like it or not. It can simply be deducted from their per tray return. Whether it is a good idea to have so little choice over an investment decision is something individual growers should consider. They should also consider the constraint that is imposed on the KMB's ability to raise capital in order to fund growth because only growers are allowed to invest.

In reality the Board faces restrictions on how much equity capital it compulsorily raises from growers. If deductions from the payout become excessive growers will complain about poor returns. This is particularly likely in the industry's current depressed circumstances. Consequently, the KMB and other organisations with the same structural features rely on debt funding more than conventional businesses.

What are the consequences of this for the grower/shareholders? Clearly they differ from the case for shareholders in limited liability companies which run into difficulties with debt. The KMB structure delivers the worst of both worlds for the shareholder. The organisation can incur debts and shareholders can do absolutely nothing about it short of leaving the industry. If the organisation then has trouble repaying these debts, regulation ensures the financiers get repaid in full.

It is easy to understand why financiers have considered statutory bodies like the KMB a good lending proposition, and not regarded high gearing as being very risky. As has been demonstrated recently in the kiwifruit industry, regulations ensure the financiers need not accept any of the consequences of bad financing decisions. With a competitive market and more conventional commercial structures, risks and rewards are shared more equitably.

4.5.4 Deficiencies in Performance Measurement and Accountability

The terms of reference for the second stage of the review require consideration to be given to "measures for assessing the annual performance of the New Zealand kiwifruit exporter(s)". This is a recognition that performance measurement and accountability are important in achieving maximum profitability.

The 'ownership and control' philosophy derives from a belief that it increases returns to growers. It is, therefore, necessary for growers to examine whether they get acceptable investment returns from the business they own and control. It is also important to consider whether accountability to shareholders under existing arrangements delivers effective control. Growers will certainly be disadvantaged if they cannot control what they own.

- *There are no useful performance indicators*

When considering how well the KMB performs, growers need to differentiate between indicators of activity and indicators of performance. Indicators of activity convey no useful information about profitability.

In his critique of the Douglas and Burgess report, Professor Cartwright stated:[40]

> The assertion by Douglas and Burgess that a weakness of the single-seller KMB structure is that there is nothing to compare its strategy against is difficult to understand. Surely the appropriate performance measure is the **profitability** of its competitive activity in international markets (emphasis added).

The point overlooked by Cartwright is that there is no information on the Board's profitability. The Board does not report profitability, does not pay dividends and has no market-determined share price. Growers cannot know how well it is performing as a business or investment. Furthermore, most of the information growers receive regarding the Board's activities is provided by the Board. Growers are poorly placed to evaluate such information. Monopolies are well known for managing information in an environment where alternative views and information are scarce, as a report of a grower study tour to Europe illustrates:[41]

> Everyone they met spoke appreciatively of the service and quality offered by the NZKMB - but, as John Dowling and Mike Christensen pointed out, all the meetings had been set up by the Board.

Board correspondence published shortly after the second stage of the current review commenced suggested possible attempts by the Board to influence the flow of information. According to one newspaper report, the Board suggested it should have representatives at meetings between key customers and the industry review researchers, and provide a schedule of questions for background information.[42]

- *Effective accountability requires investor choice*

In regulated agricultural industries it is common to hear producers expressing frustrations about their ability to ensure that those running 'their' organisation are effectively accountable to shareholders. The usual response is that producer boards provide more information than conventional businesses to their shareholders and are much more accountable to them.

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40 R W Cartwright (1993), op. cit.

41 *New Zealand Kiwifruit*, December 1992, p7.

42 *The New Zealand Herald*, 5 August 1994.

Ensuring good performance and effective accountability is not a function of the quantity of information provided, or the number of meetings KMB management has with growers. In fact, in politicised situations - that is, situations where commercial methods of performance assessment and accountability are not available - it is well known that the most effective means of silencing critics is to bury them in information. This is an effective weapon against all but the most persistent of critics. Since the information provided is of little use in assessing performance or making management more accountable, the organisation providing it faces little risk of anyone becoming better informed or exercising more effective control.

The findings of a 1992 Committee of Inquiry into South Africa's statutory marketing legislation illustrates the accountability problem:[43]

> The Committee received written and verbal evidence from many quarters of the established 'organised agriculture' including those in favour of maintaining the *status quo* as well as those in favour of change. The Committee perceived a disconcerting level of arrogance, self-righteousness and self-imposed omniscience among those in the former group. At the same time those who were prepared to face change had lost faith in the ability of their chosen or appointed representatives to resolve their problems, and feel powerless to change the system. Many also had to resort to subterfuge to get their views expressed to the Committee. In gathering its evidence, the Committee became increasingly aware that the system allowed certain individuals to act in a very authoritarian, domineering and dictatorial manner. Many who gave evidence explicitly requested the Committee not to make their identity known for fear of reprisal.

The introduction of audits of producer board performance is evidence that improvements in performance measurement and accountability were seen as needed. However, such audits are of little value to shareholders.

The objective of these audits is to make an independent assessment of the statutory body's performance. It is difficult for those conducting the audits to ensure independence as the body being audited is the client who also writes the terms of reference and pays for the audit. The Board is then able to summarise the findings and provide them only in a summary form to growers. Finally,

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43 *Report of the Committee of Inquiry into the Marketing Act*, Minister of Agriculture, Republic of South Africa, December, 1992, p16.

those being audited have considerable influence over what remedial action, if any, is to be taken.

The KMB was subject to a performance audit just prior to the disastrous 1992 season. The audit failed to identify the weaknesses in the Board's operations and strategy. However, this outcome does not necessarily reflect unfavourably on the competence of the auditors since they were only able to work within the constraints of the audit process. Effective performance measurement and accountability is only possible when the performance indicators explicitly measure return on investment and there are no restrictions on investor choice. The ability to decide whether or not to invest is the only means of effective control for an individual shareholder.

When the grower has this choice, rhetoric, control of information and similar tactics are ineffective. Even the smallest grower can examine the organisation's results, take advice if necessary, and then decide whether to retain the investment. Without investor support, directors and managers are unemployed. This is a powerful sanction against poor performance.

The current review requires marketing alternatives to be assessed in relation to the aim of maximising profitability. Reference is also made to measuring marketer performance. Growers and those responsible for the review need to ask how this will be possible unless structures have conventional, commercial performance indicators and provide investor choice. Regardless of what the marketing research turns up, there will, at the very least, need to be changes to the Board's structure to remedy deficiencies in performance measurement and accountability.

4.5.5 The Industry Has an Unusual Form of Vertical Integration

It is often suggested that single sellers have an advantage in marketing because they give the industry 'vertical integration' from grower to consumer. Vertical integration is common in world horticulture, as it is in many industries, and there is evidence it is increasing in agriculture generally.

The benefits of vertical integration can take a variety of forms. The key aim is to improve the efficiency and lower the costs of marketing.

Having all parts of the chain under one consolidated structure is only one form of vertical integration. The objectives can also be achieved in other ways such as contracting and even personal commercial relationships.

The kiwifruit industry, however, has an unusual form of vertical integration. Its producers are free to make production decisions as they see fit, and the rest of the 'organisation' is obliged to dispose of the fruit in the best way it can. This feature is combined with the fact that, in making these independent production decisions, producers are responding to a bundled return.

Producers wanting to maximise their profitability know this requires producing what the market wants. This is consistent with the 'market driven' approach all industries are urged to adopt. The kiwifruit industry's current arrangements are 'production driven'. That part of the industry past the orchard gate is obliged to sell everything produced, regardless of market demand or profitability. On occasions, the Board has responded to this problem by changing quality standards and not accepting the obligation to export all fruit submitted. However, this is hardly likely to be a profit-maximising strategy.

Producers have two options for reforming this feature of their industry's 'vertically integrated' arrangements. One is to accept that they are effectively employees in the production department of the industry. This would mean accepting instructions from the KMB and receiving a wage. This may have attractions for some growers given their current poor profitability. More likely, however, it will be unacceptable because growers value their entrepreneurial status and apparent commercial freedom.

The other option to separate the investment and product returns by restructuring the KMB as a corporate entity and have the marketing business decide what it will pay for various quantities and types of fruit. This is what happens in all other commercial situations other than the totally consolidated form of vertical integration. It still allows considerable choice for grower and marketer in deciding exactly how the selling arrangements will be structured. This can range from spot selling to contracts which include prices, fruit specifications and delivery arrangements.

5. LESSONS FROM THE EXPERIENCES OF OTHER INDUSTRIES

5.1 Introduction

A review of what is in the best interests of kiwifruit grower profitability can gain useful insights from experiences in other industries.

The purpose of comparisons is to examine the broader consequences of regulation in other industries, and how other industries respond in moving from regulation to competition. They are particularly useful for any industry having to face up to change and where some participants are uncertain about the consequences prior to the event.

Five 'case studies' are presented in this section of the report. The first three are the New Zealand forestry, floriculture and mussel industries. The other two are milk marketing in the United Kingdom - which is going through a process of deregulation - and the Chilean fruit industry, an industry with minimum regulation which is increasingly being recognised as an impressive performer. Each of these five industries has similarities with the New Zealand kiwifruit industry. A key lesson from the comparisons is the ability of competitive markets to handle both commercial threats and opportunities.

5.2 Marketing Forest Products: Individualism *and* Strategic Alliances

5.2.1 Government Withdrawal From Commercial Involvement

New Zealand has around 1.3 million hectares of planted forest, mainly radiata pine. There are also about 6 million hectares of indigenous forest, most of which are protected from commercial harvesting.

Prior to 1987, half of New Zealand's plantation forests (and its plantation-sourced forest product exports) came from government owned and managed forests. The government, in the form of the New Zealand Forest Service, was a forester and product marketer, often in direct competition with private operators. The Forest Service also had a responsibility to help private forest owners and marketers.

In 1987 the New Zealand Forest Service was disestablished with a view to enhancing the transparency and accountability of government forest operations. The major objective was to isolate the Forest Service's commercial activities and place them in a newly established state-owned enterprise, the New Zealand Forestry Corporation. The non-commercial functions of the Forest Service were transferred to two (new) government departments - the Ministry of Forestry (with responsibility for research, training, advisory and regulatory functions) and the Department of Conservation (with protection responsibilities for the indigenous forests).

In October 1989 under the Crown Forest Assets Act 1989, the Forestry Corporation was appointed as the government's agent for the sale of commercial forest assets with the objective of maximising sales revenue. Sales and transfers totalling 648,000 hectares have been made to date.

Eighty percent of plantation forestry and all marketing is now the responsibility of the private sector. The industry includes a number of large and medium-sized New Zealand companies such as Carter Holt Harvey and Fletcher Challenge, as well as several overseas companies. Farmers (as small plantation owners), independent processors/sawmillers and a few small export traders make up the balance of the industry.

The Ministry of Forestry now focuses on facilitating the achievement of the industry's objectives. Brown and Valentine summarise this role as follows:[44]

> It (the Ministry of Forestry) does not own or manage forests. It has responsibilities consistent with the general Government objective of quitting its trading and operational activities and establishing core policy agencies.

Underlying this restructuring was a view that government involvement had to have a sound economic justification. There was no intrinsic reason why a government agency could be expected to perform better than private interests or why the government needed to be involved in commercial forestry operations.

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44 C.J. Brown and J. Valentine, *The Process and Implications of Privatisation and Forestry Institutions: Focus on New Zealand*, Unasylva, 178, Vol.45, 1994.

5.2.2 *Current Industry Features*

Plantation owners now comprise large and medium-sized companies, the Crown and small, private plantation owners. Ownership shares are presented in Table 5.1. The two largest (New Zealand owned) companies own 40 percent of the total plantation area. Small, private owners account for nearly one quarter.

Table 5.1: Forest Ownership 1993

Owner	Share (%)
Carter Holt Harvey	24.8
Fletcher Challenge	15.7
Forestry Corporation of New Zealand	13.0
Other	25.5
Small private plantations	21.0
	100.0

Source: Ministry of Forestry, *Forestry Sector Issues: Post Election Briefing* , November 1993, pp7 and 39.

Exports of forest products (valued at NZ$2.5 billion in 1993/94) accounted for about 63 percent by volume of all roundwood removals from New Zealand forests. Around one third of these earnings came from logs and woodchips. Sawn timber contributes about 21 percent and pulp and paper another 27 percent.

Australia is the largest export market (30 percent of exports) with Japan a close second at 28 percent, and Korea purchases 14 percent. These three main markets account for over 70 percent of exports by value.

Most companies in the industry specialise in forests and forest products and are typically vertically integrated. Nonetheless, there is a ready market for logs from small plantations. Smaller producers are becoming a more significant section of the industry. Individual farmers and groups of investors are undertaking most - around two-thirds - of the new plantings (estimated at 120,000 hectares in 1994), with large forestry companies accounting for the remainder.

Significantly, plantings are increasing at a faster rate - about two to three times - than in the previous decade.[45] For the most part, non-company plantings are being made without contracts to purchase in future years. These investors are obviously confident that, with additional competition now evident in the marketing of logs and value adding, there will be ample demand for their output when harvest time arrives.

If they believe businesses buying, processing and exporting their output are profitable, they are free to invest in them or to set up such a business themselves. Such off-forest investment decisions can be made on the basis of profitability. They are independent of decisions about how much to invest in tree growing, and involve no bundling distortions. This is an economically sensible state of affairs.

Market assessment and development are the responsibilities of individual exporters. New Zealand's forestry export mix has been evolving in the direction of more onshore processing and increasing export of value added products (such as sawn timber, panel products, and still higher value added products such as mouldings and furniture components). These developments have been prompted by profitable opportunities including the improved cost competitiveness of operating in New Zealand.

Exporters cooperate to address particular market challenges - described by the industry as "flying in formation". These alliances are dynamic and vary from market to market and over time. Particular examples include joint marketing and joint promotional ventures for log exports to Japan. There has been a good deal of experimentation and, as in any business relationship, some alliances have worked and others have not. Furthermore, opportunities for working together change over time with specialisation and individual company strategy.

The industry is in the process of addressing the challenges and impediments to industry growth and development. It has specifically considered, but rejected, a set of targets for development or a 'corporate plan' for the industry.

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45 Ministry of Agriculture and Fisheries (1994), *op. cit.*, p78.

R&D is funded directly by industry participants; no industry R&D levy exists. Past R&D has yielded genetically improved seed stock, intensive management techniques and advanced processing, resulting in the production of timber of superior quality. Public sector involvement is in two areas:

- *Public Good Science Funding for Forestry* totals $19.7m for the five years to 1998. Some $9.2m is allocated under Output Class 9 (Trees and Plantation Management Systems) and $10.5m under Output Class 15 (Wood and Paper Processing). Some forest funding is also provided via funding for arable plants, construction and land use.
- *New Zealand Forest Research Institute* - established in 1921 is now a stand-alone Crown Research Institute. Public Good Science Funding accounts for around 60 percent of its funding. The balance is sourced privately from the sale of consultancy services and direct contributions to specific research projects.

Some R&D is funded and undertaken by the Ministry of Forestry. Its focus is on issues common to the industry, for example technical or economic barriers to imports of New Zealand product, regional implications of the Resource Management Act and support for efforts to improve the image of radiata in markets such as Japan. These activities mainly provide support to trade delegations, information publications and a forestry 'front desk' service. Industry organisations supply technical support.

The major companies are involved in generic marketing activities as well as promoting their own brands. Differentiating the New Zealand product from other suppliers of radiata pine has been suggested as a means of achieving a better price and to promote higher value products.[46] The Ministry of Forestry is consulting with industry, Tradenz and the New Zealand Way regarding an appropriate brand **to be used in conjunction with company brands.**

Government requirements for export inspection are minimal and provided (on a cost recovery basis) only where requested by the exporter. A typical example is phytosanitary certificates. The Ministry of Forestry audits

46 *ibid*, p14.

industry inspection practices to ensure their conformity with standard quality assurance procedures. It does not provide the inspection services *per se,* but rather the assurance that individual exporter services are appropriate and adequate to meet importing country requirements. Exporters typically offer a range of 'qualities' above the minimum required by importing countries.

5.2.3 Benefits From Competition - Including for Small Producers of Wood

It is now quite apparent that government ownership in forestry was a hindrance not a help. Government ownership led competing and downstream users of forest resources to modify their behaviour in a way that was not conducive to efficient resource use. Brown and Valentine summed up the situation as follows:[47]

> The Forest Service acted as a beneficent log supplier to processors - thereby encouraging inefficient practices and particularly discouraging investment in new technology. The result was a processing sector that struggled to compete in international markets and passed costs down to the New Zealand taxpayer through the need for protection and subsidisation. Over the past six years mill closures and supply disputes have become testament to the reality of exposure to market forces.

Antitrust regulation also impaired exporter competitiveness. Brown and Valentine argue that three of New Zealand's major companies were impeded by the Commerce Act 1986 from freely bidding for forests. For the most part, the output of the forestry sector is for export. With supply security and vertical integration being of "fundamental importance" for international competitiveness, issues of domestic concentration are of questionable relevance.

Since the government wanted to maximise the proceeds of forestry sales, few constraints to competition and bidding were imposed. Some of the successful purchasers were international firms. According to Brown and Valentine, foreign investment:

> ... had benefits in terms of the introduction of new technologies, the improvement of market awareness and

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47 C.J. Brown and J. Valentine, *op. cit.*

opportunities and promotion of efficiency through enhanced domestic competition.

There have been some tensions in the new competitive environment. A sharp rise in log prices in 1992/93 reduced log supplies to domestic processors because sawmillers were, initially, unwilling to meet the market. Instead they called for government restrictions on log exports - a call which the government rejected. Eventually, sawmillers accepted that they had to compete for wood and the upward trend in log prices has subsequently reversed.

5.3 Floriculture: Growth Through Innovation

5.3.1 Exports Growing Strongly

While the local market for cut flowers is expected to grow, much greater growth is expected in exports of exotic cut flowers. In 1992/93, domestic sales of cut flowers were estimated to be $65 million. Cut flower exports continued to expand, rising 27 percent to $36 million. This followed substantial growth in recent years (Table 5.2). Orchids are the major cut flower variety exported, at $17 million or 47 percent of total exports. Other cut flower varieties which are showing export potential include calla lilies ($3.9 million), Sandersonias ($1.5 m), roses ($1.4 m) and proteas ($1.3m).

Table 5.2: New Zealand Flowers and Foliage Exports, 1989 to 1993

	$000 FOB
1989	16 918
1990	19 275
1991	25 135
1992	28 305
1993	35 995

Source: MAF, *Situation and Outlook for New Zealand Agriculture,* 1994, p114.

New Zealand ranks as a significant exporter of floriculture (Table 5.3). The Netherlands ranks at the top for virtually all floriculture sales, and in most cases by a long margin. The major export markets for New Zealand flowers are Japan and the United States.

Table 5.3: New Zealand Floriculture Export Ranking 1992

	World Ranking	Value (US $m CIF)
Cut flowers	11	18.3
Cut foliage	-	-
Pot plants	32	2.1
All floriculture	22	20.4

Source: International Floriculture Quarterly Report, Volume 4, Number 4.

5.3.2 *Production and Marketing: Dynamic and Market Driven*

The flower and nursery product industry has developed rapidly in recent years. While the industry has always specialised in particular crops, the mix has changed in line with demand and the competitiveness of New Zealand supplies.

Typically, established varieties (for example carnations and chrysanthemums) have become 'commodity lines' supplied by low cost producers in South America, Asia and Central Africa. In these cases, sourcing decisions by importers are dominated by price. The New Zealand response has been to move into new and higher returning varieties.

Today's specialist crops for New Zealand suppliers are Zantedeschia, various orchid species (although Cymbidium orchids have remained an important sector for many years), Alstroemeria, Sandersonia and a range of exotic species.

Adaptability of producers to changing markets is a key feature of the industry - changing crops and cultivar development in particular. Flowerlands' example is typical (Box 5.1). 'Keeping ahead' through proactive product innovation is recognised as the cornerstone of the industry's future as a supplier.

Around 80 percent of flower exports are marketed by specialist marketers. Some, such as AFW (Auckland Flower Wholesalers), Eastern Globe and Tenneyson Growers are specialist cut flower marketers. Others such as Chiquita are specialist fruit and perishable product marketers. Flower supplies are either purchased on contract or sold on commission. Flower growers have choice. The other 20 percent of sales are made by vertically integrated firms (including individuals) which grow and market flowers.

Box 5.1: Flowerlands: Growth - Challenge - Rejuvenation

Flowerlands, located in Hastings, began as a family business over 40 years ago. It produced carnations, chrysanthemums and roses for both the local and export markets. In the late seventies/early eighties it was one of New Zealand's leading flower producers.

The late eighties saw increased international and local competition. Prices declined and the business faced major financial problems.

Today the direction of Flowerlands has changed dramatically. Carnations and roses are now only a small part of the business and are produced for specific niches in the local market including bouquet production (combining self-produced material with bought-in product of complementary types) for sale at dairies and garages in the Hawkes Bay area.

Production now focuses on the production of Zantedeschia tubers for export under contract to several large marketers, nerine bulbs and cut flowers, Sandersonia and a small amount of Gypsophila. The owners have altered the direction of their operation in response to changing market signals.

Some export marketing activities are coordinated by various industry councils such as the Calla Council and the Flower Exporters Council. Specific activities include agreed standards (such as the adoption of uniform colour grades for calla). Adoption of standards and participation is voluntary.

Flowers and tubers face few tariff trade barriers in importing countries. Quarantine requirements and regulations are addressed through individual firms having quality control programmes which are audited by MAF as required.

The emphasis on innovation means that New Zealand growers and marketers have some potential to secure higher prices, at least while supplies remain limited. Pressures for price undercutting by individual exporters are constrained by the ability to coordinate sales when such instances arise. There is a general recognition that prices significantly above the market cannot be sustained. In some instances the method of selling constrains supplier pricing behaviour. For example, the prices of Sandersonia (the vast majority of which are exported to Japan where New Zealand is currently the sole supplier) are determined in Japan in traditional (English) auctions.

Innovation is evident in all sectors of the industry - see Box 5.2. It is encouraged by the rewards which accrue to those who undertake the research and development. Institutional arrangements such as Plant Variety Rights facilitate the process by helping investors capture the benefits of their research. There are no regulators or monopoly boards granting export licences or undertaking R & D.

Box 5.2: Competitiveness Through Innovation

The world **Zantedeschia** industry comprises two major producers, Golden State Bulb Producers in California, (which will produce over 6 million Calla tubers for sale in 1994) and New Zealand. Golden State is a private company which has invested heavily in Zantedeschia cultivar development

The New Zealand industry has developed from the efforts of small operators such as Brljevich of Maungatoroto, Mudge of Otaki, and Harrison of Palmerston North who have carried out breeding and selection work over many years. These individuals have had extremely limited financial resources. However, their work has resulted in the New Zealand industry having a range of cultivars and a pool of genetic material that is amongst the best in the world. The New Zealand industry has almost total control of the current genetic types suitable for pot plant production, the major and most stable part of the ornamental industry in wealthy northern hemisphere countries. Whilst the Zantedeschia sector faces future marketing challenges, the efforts of these 'amateur' breeders have provided the industry with its competitive advantage.

Individuals in the **orchid** industry have also invested considerable effort in breeding new cultivars. One of the reasons this sector has remained a significant part of the New Zealand ornamental industry is the development of new cultivars that have better suited the requirements of buyers. The industry has been free to experiment with cultivar types and undertake market trials.

The **Sandersonia** industry has developed recently as a niche market for a high valued specialist product. Leading producers and marketers in the sector have recognised that there is a limit to how much of a single colour product overseas markets can accept before the crop loses its exotic appeal. As a result entrepreneurs such as Andy Warren are devoting considerable money and efforts to developing new colours in an effort to maintain and expand the New Zealand industry's competitive advantage.

Monty Hollows of New Zealand Nerine Nurseries has spent many years and several million dollars developing a whole range of new cultivars of **nerines** with a range of new colours that are more suited to growing in New Zealand than the old bowdenii types. This industry sector is just developing, but lateral thinking including the establishment of production facilities in China to supply the Japanese market is part of the strategic plan. Innovative grower commercial licensing agreements are being developed to allow some degree of control over the development of the industry.

To cope with market requirements and the high cost of freight the industry is developing more economic **off-shore tissue culture facilities**, growing on sites and international arrangements that add to the depth of the business and its ability to service markets. Currently material is being tissue cultured in Taiwan and India and grown in India, Central America and Europe. An interesting project involving the purchase of a large growing facility from the Treuhand Anstalt in East Germany is part of that strategic planning and lateral thinking.

R&D is funded almost exclusively by individual businesses. There is some joint investment via specific crop councils. Several firms have invested over a million dollars over a period of years to develop a competitive advantage. MAF support for the industry is provided through general advisory services.

5.3.3 A Thriving Industry Without Regulation and Controls

There are some in the industry who speak of chaotic competition and 'unsavoury' participants who do not take a long-term view and make it difficult for others. These problems have been taken care of by market competition. Those with longer experience in the industry realise that regulation is not in their longer-term commercial interests.

Innovation in production and product development has been a key to the success of the industry. It has occurred without regulation or compulsion. The role of individual entrepreneurs has been crucial. Strategic alliances, that is, producers and marketers working together, have been built as and when needed. Adjustment and adaptation has been gradual - driven by the (often differing) expectations about future directions and what will work best.

5.4 Mussels: Strength Through Competition

5.4.1 Another Small But Growing Industry

New Zealand has become a significant source of mussels for US and Japanese consumers. The New Zealand industry's growth over the past decade has been substantially export based. Fresh and frozen exports totalled 14,370 tonnes in 1993, having grown from virtually nothing in 1980. Domestic consumption is estimated at "anywhere between 20 and 40 percent of total production" by experts in the Fishing Industry Board. Greenshell™ mussel exports (fresh/frozen and processed) have become the seafood industry's fifth largest export product - totalling $55.3m in 1993.

Mussels are farmed by both small producers (typically a lease of 3 hectares with 6 lines of mussels) and large farms (dominated by the vertically integrated companies Sanford and Talleys Fisheries Ltd). Mussels are marketed by Sanford and Talleys Fisheries as part of the marketing and distribution of other seafood, as well as by niche market mussel suppliers such as Malbora Perna.

5.4.2 Growth Brought Marketing Challenges

Rapid growth in the industry has not been without its challenges. In the late 1980s, small farmers in particular became concerned at falling prices for mussels - a development they attributed to weak selling and price cutting by mussel producers as they sought to capture new markets and expand market share. There were calls for a statutory board or a substantial cooperative as a means of preventing such practices.[48]

Opposition to regulation centred on the potential damage to niche markets and commercial reputations which had been developed by individual mussel producers. It was argued that niche markets and markets sensitive to delivery service and other non-price factors could easily be lost with a single marketing agency.

A key factor in holding back the regulatory push was some straightforward analysis of why prices were falling. New Zealand production and exports were doubling year upon year and the price reductions being observed by farmers were the natural consequence of supply growing much faster than demand.

Significantly, the New Zealand industry has continued to expand even with lower prices. Growth remains profitable as the industry has continued to improve its efficiency and productivity.

A significant achievement of the industry was the opening of the Italian market to New Zealand product. This achievement did not require a statutory board to negotiate on behalf of New Zealand.

Although the United States and Japan are New Zealand's largest markets, the industry exports to a diverse range of countries.

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48 Proposals were outlined in Mussel Exporters Committee (1993), *Future Directions for the New Zealand Greenshell Mussel Industry*.

5.4.3 Meeting Marketing Opportunities Through Diversity

Table 5.4: Greenshell™ Mussel Exports: Top Four Destinations and Product Form ($ FOB.)

	Live	Half Shell	Meat	Whole	Other	Total
U.S.	2,561,339	8,319,882	1,456,770	667,150	240,854	13,245,995
Japan	7,474	6,893,832	4,415,592	62,813	248,560	11,628,271
Australia	0	2,082,527	2,329,148	919,110	1,734,845	7,065,630
Spain	0	3,705,900	2,903,419	199,425	34,651	6,843,395
Other	540,556	10,034,959	4,227,564	333,640	1,337,047	16,473,766
Total	3,109,369	31,037,100	15,332,493	2,182,138	3,595,957	55,257,057

Source: New Zealand Fishing Industry Board, (1993) The New Zealand Seafood Industry Economic Review.

Major markets have been developed through individual marketing activities or through building strategic alliances. These alliances extend beyond simply producers acting in concert - they include, for example, the complementary role of mussels in seafood exporting or food products generally. Product form is diverse - there are at least five major products. Half shell is the dominant form in most markets. Meat is a significant product form in all major markets.

The kiwifruit industry is still characterised essentially by one product form. However, in the mussel industry producers have developed competitive value added products. This has occurred without any regulatory supervision.

For the most part, promotion is the responsibility of individual producers either individually or in strategic alliances. The New Zealand Fishing Industry Board (FIB) undertakes generic promotion - Greenshell™ is the registered trademark belonging to the FIB.

5.5 Introducing Competition to Milk Marketing in the United Kingdom

The United Kingdom is completing a somewhat tortuous process of introducing competition into milk marketing arrangements. The history of regulation, the changes that became unavoidable, the unfavourable consequences of introducing change timidly and too slowly, and the eventual benefits from introducing competition are summarised below.

The important lessons for the New Zealand kiwifruit industry are:

- regulation which constrains market forces and suppresses entrepreneurial opportunities leads eventually to the need for change, whether everyone wants it or not;
- introducing change over an extended period and in a way that tries to satisfy every vested interest only adds unnecessarily to the adjustment costs; and
- the original statutory bodies found that experience allowed them to continue as dominant commercial players in a competitive market - they did not suddenly disappear.

5.5.1 Sixty Years of Milk Regulation

For 60 years to 1990, milk marketing in the United Kingdom was dominated by five regional statutory milk marketing boards (MMBs). Key features of the arrangements were:

- the MMBs were required to accept all milk;
- farmers were paid a pooled price comprising returns from all milk markets plus the returns from the Boards' own dairy product processing and marketing company, Dairy Crest Ltd;
- milk was sold to private dairy companies at prices determined by use (liquid or manufacturing). The respective selling prices were established by a joint committee of MMBs and the companies via the Dairy Trade Federation (DTF). Liquid milk prices were set higher than those for manufacturing use;
- the monopoly (MMBs) and monopsonist (DTF) combination potentially gave the industry considerable market power, but this was generally viewed as necessary (to ensure year round

supplies of liquid milk) and sufficiently constrained by the government having to approve maximum prices.

Several events occurred during the 1970s and 1980s which placed new pressures on these arrangements.

- On-farm productivity improvement caused milk supply to grow faster than demand. Indeed, milk supply quotas were introduced in 1983/84 to constrain growth.
- By 1983/84 half of all milk was going to manufacturing. The arrangement was looking less like a liquid milk security structure and more like classic price discrimination.
- UK membership of the European Union meant the traditional free access for manufactured products into the United Kingdom was replaced with levies and butter market intervention. Capitalising on the opportunity, milk prices were increased to be amongst the highest in Europe and a 'golden age' of dairying emerged.
- In the second half of the 1980s, threats of liquid milk competition from the Continent and the growing strength of supermarkets constrained liquid milk price increases and led to the abolition of maximum price regulation.
- The failure of the MMBs to maintain prices led some producers to circumvent the arrangements and sell directly to dairy companies. The MMBs also started to question whether their end use pricing was appropriate.
- While the MMBs' general status was upheld by the European Commission, questions were raised about them given the single market philosophy. Meanwhile the UK government was adopting a strong pro-competition policy stance.

5.5.2 1990: The Realisation that Reform was Needed

Against this background the MMBs began negotiations with the dairy companies (via the DTF) in the early 1990s to find an alternative way of pricing milk to replace 'end use pricing'. A tendering process, offering annual contracts to purchase milk, was proposed. The DTF resisted on the grounds that dairy companies would have to bid from a sole seller with a relatively fixed supply (because of supply quotas). It considered that, given the excess processing capacity in the industry, some companies would go to the wall. The proposal was dropped.

In January 1992, the largest MMB (England and Wales) proposed a voluntary cooperative open to all dairy farmers. Contracts between the cooperative and its customers would be established with prices set by supply and demand. Farmers would be paid a pool price. Dairy Crest (the MMB's dairy company) was to operate independently of the cooperative. While still opposed by the dairy companies, the proposal was cleared under the EU competition rules covering monopolies. However, the Commission noted that it "would have preferred a number of successor organisations rather than a single voluntary cooperative".

The first steps to disband the five Boards began with a parliamentary Act in November 1992. The vesting day was set at 1 April 1994 and the MMBs were to be finally dismantled by October 1994. The MMB for England and Wales proposed the creation of four separate organisations. Milk Marque Ltd was to be the producer owned cooperative, Dairy Crest Ltd was to become an independent dairy processing company (owned separately by farmers) and two transitional holding companies would be established.

Dairy companies were hostile to the proposal. They saw it as an attempt by the MMB to turn itself from a *de jure* milk purchasing monopoly to a *de facto* supply monopoly. They expected that Milk Marque would sign up the majority of dairy farmers giving it effective control over domestic milk supplies.

Two responses emerged: a call for an independent 'Milk Forum' to ensure fair prices, and new contracts by dairy companies to attract supplies direct from farmers. These contracts typically promised a premium over the price set by Marque Milk. There was also a widely held belief that Milk Marque's pooled price might be reduced by having to take milk from all farmers irrespective of size or location.

As a result of these proposed changes, competition for farmers to supply milk increased. With farmers facing choices in contracts and market opportunities, new issues arose. These included the capacity to withdraw from previously signed Milk Marque contracts, the source of start-up capital for Milk Marque and the implications for its cost structure, and existing haulage contracts where Milk Marque might have a competitive advantage.

Final approval for the changes was granted by the government in June 1994. Over 18 months had elapsed since the parliament had initiated the process. Vesting day was put back to November 1 1994. As at September 1994, Milk Marque had signed up 65 percent of supplies in England and Wales. Dairy companies were being invited to bid for this milk at auction and to establish a price. But the companies, via the DTF, asked for a judicial review, claiming that the government had allowed the creation of "a monopoly supplier of milk without proper negotiation or control". A ruling has yet to be made on that review.

One outcome of the process is higher milk prices - about 18 percent - for non-liquid uses e.g. butter and cheese. Major restructuring is predicted and the dairy industry has continued to protest against the new arrangements on that account. The full implications of the reorganisation are still somewhat speculative.

5.5.3 What are the Lessons ?

Four years of procrastination and uncertainty in changing dairy policy have had a generally detrimental impact on the UK dairy industry.

- The extent of distortions created by the regulatory arrangements, including the MMBs, only really became graphically evident once the arrangements began to be dismantled.
- Market demand for milk solids is still not being signalled clearly to producers.
- Industry perseverance with the anachronistic end-use pricing policy encouraged the sale of milk for production into products where market demand was falling or sluggish (liquid milk, butter, cheese) at the expense of products showing healthier demand growth.
- Past institutional arrangements stymied entrepreneurial initiative. Processors, including the MMB's own Dairy Crest Ltd, are now scrambling to develop a product mix of higher

value dairy products. Under the regulatory arrangements they faced no strong incentives to do this.

- Expectations of changes in milk marketing but uncertainty about their nature have disadvantaged milk processors. All have faced financier, creditor and shareholder nervousness and disquiet.
- Because the liberalisation process (consultations, agreement and implementation) has been drawn out, the UK industry has been disadvantaged relative to its EU competitors.

Farmer involvement in milk processing and distribution via the proposed independent but farmer-owned Dairy Crest is possible under the competitive arrangements. The distortionary consequences of bundling milk and non-milk returns into milk have been avoided.

Having an established position and capability in the market has been a significant advantage to Milk Marque in the new contestable environment. The disruption sometimes postulated with deregulation (price collapse, tarnished product image) has not eventuated. On the contrary, the changes have brought improvements in efficiency (e.g. product mix) and provided farmers with a diversity of milk contracting arrangements from which to choose.

5.6 Chile - An Example of Successful Competition in Marketing

Chile is now one of the world's largest fruit exporters. Over the past decade fruit plantings have increased by almost 10 percent a year. Kiwifruit plantings have increased by 225 percent over the past five years. While the New Zealand industry is in the doldrums, media reports talk of Chile's kiwifruit industry being "more buoyant now than it has been for a long time".[49]

Chile's annual fruit exports are approaching $US1 billion compared with only $US50 million in the mid-1970s. The United States and Europe accounted for 85 percent of exports in 1990-91. However, markets such as Japan, Mexico, Argentina and Brazil are growing rapidly.

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49 *Eurofruit Magazine*, December 1993/January 1994.

The reasons for this phenomenal growth are increasingly being studied by those experiencing competitive pressures from Chile and seeking to emulate its success.

5.6.1 Entrepreneurs and a Competitive Economy - Key Success Factors

The Australian Horticultural Research and Development Corporation recently commissioned a study tour of Chile's horticultural industries.[50] It concluded that the main elements of success have been:

- leadership through entrepreneurs entering the industry;
- government policies which provided strategic direction and coordinated incentives to capitalise on Chile's potential; and
- industry-supported and well focused science and technology.

It also cited the industry's "very strong free market and competitive base" and the "low level of government intervention and regulation" as competitive advantages. The authors concluded that "Chilean exports are facilitated by a very low level of government regulation".

Major economic reforms introduced in the mid-1970s have also been important in creating an environment conducive to investment and growth in the fruit industry. Significant changes included:

- reduced public sector debt and extensive privatisation of public sector enterprises;
- large tariff reductions;
- removal of restrictions on foreign investment;
- introduction of stable, long-term economic policies accompanied by a devaluation of the peso; and
- land reforms involving withdrawal of the state and increased private land ownership.

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50 Australian Horticultural Corporation (1993), *op. cit.*

5.6.2 Many Participants but a Few Large Players

The following are the key structural features of the fruit industry:

- Chileans own most of the land planted to fruit but foreign companies have a significant role in marketing, accounting for 40 percent of exports;
- 1600 of the 8000 fruit growers in Chile are considered significant commercial operations;
- there are about 400 fruit exporters, with 6 handling 45 percent of the trade (including Dole, Chiquita, United Trading Company and Unifrutti). The 6 largest exporting companies each ship between 8 and 14 million boxes of fruit annually and are supplied by 400 to 600 growers;
- larger export companies supply fertilizers, sprays, cartons, packing and marketing services. They also provide technical and quality control support to growers wishing to market fruit under the companies' export brands and via their world marketing networks, and are a source of credit to contract growers; and
- the majority of export packing is handled by exporters who have invested heavily in large packing and cool storage facilities strategically located in each major fruit producing region.

The Fruit Producers' Association of Chile represents over 3,500 growers. Currently its main focus is the improvement of fruit quality and hence grower returns. It currently funds some R&D from its limited resources. It also operates price information services.

The Exporters' Association of Chile has 46 members who handle around 95 percent of all fresh fruit exports. The Association's main objectives include promoting Chilean fruit in existing and new markets and improving product quality. It is a significant funder of R&D.

A diverse R&D program has contributed to Chile's fruit industry success. In the 1960s it was decided that tapping existing international research was the most cost-effective approach for rapid technology development. The government R&D organisation has been semi-privatised and a large proportion of R&D funding comes from the industry or individual companies.

5.6.3 Quality Improvement a Major Industry Objective

Inconsistent fruit quality is accepted as the industry's number one challenge. Major exporters employ quality assurance staff who oversee harvesting, packing, dispatch and outturn in export markets. The quality assurance industry has become a major service industry in its own right, with exporters providing their own staff or employing specialist companies to do the job for them.

The government has refused industry requests to enforce quality standards by legislation. However, the Exporters' Association has established its own system. It requires members to contribute to a guarantee fund. Those failing to meet agreed standards are penalised, including forfeiture of part of the guarantee contribution.

Exporters are also grouping together and implementing their own quality assurance arrangements. Penta, the grouping of Chile's five "most senior" export companies, has introduced a new quality seal, P-Plus. It will be applied to all pallets of fresh fruit cleared for exports by inspectors from a company contracted by Penta. This company is also coordinating Penta's promotional activities in Europe. Four of the fruit industry's medium-sized exporters are following this example and even proposing to take it further by combining their marketing functions into Europe.[51]

5.6.4 Benefits Obtained from 'Learning by Doing'

Growth and success in Chile's fruit industry has not come without mistakes and failures, some of them quite spectacular. However, the Chileans have shown great ability to learn from these mistakes. The need to improve commercial cooperation and undertake necessary rationalisation has been sharpened by the reluctance of the government to intervene every time a commercial problem has arisen. Consequently, the industry has faced strong incentives to find commercial solutions.

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51 *Eurofruit Magazine, op. cit.*

The following are two examples:

- When two grape berries in an export consignment to the United States were found to contain cyanide an immediate ban was placed on further exports. The resulting disruption to the fruit industry was enormous. The stringent industry security arrangements required by the USDA before exports were permitted to recommence were satisfactorily put in place by the Exporters' Association, which has since maintained them.
- In 1993 the European Union imposed large countervailing duties on Chilean apple exports and volumes to that market fell by around 40 percent compared with the previous season. The economic impact has caused the demise of some export companies and been a spur to mergers and joint venture arrangements among others. Exporters are actively pursuing means of improving coordination and 'trade management'. Calls from some parts of industry for more regulation are largely being ignored by the government.

5.6.5 Competition Does not Disadvantage Chilean Growers

Relative to many countries, Chile's production costs appear low. Profit margins have also narrowed throughout the industry over recent years. A common retort is that growers' incomes in Chile would be unacceptable to New Zealand growers. However, research shows that Chilean growers do not necessarily receive lower kiwifruit returns than their New Zealand counterparts and that incomes are not disparate when productivity differences are taken into account.

A privately commissioned study of New Zealand and Chilean marketing undertaken by Agriculture New Zealand came to the following general conclusion:[52]

> There is a widely held perception within New Zealand that New Zealand grower payouts are significantly better than Chilean grower payouts. On the evidence of this report, this is not the case. Comparison of New Zealand and Chilean kiwifruit value chains indicates that Chilean growers have

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52 Agriculture New Zealand (1993), *New Zealand and Chilean Kiwifruit Value Chains*, Tauranga, 20 December.

> been better off than their New Zealand counterparts. While New Zealand kiwifruit has fetched higher prices than Chilean kiwifruit in the marketplace and unit costs for things like shipping have been lower, **Chilean growers have received similar payouts and higher profitability** because of lower inputs and higher mature yields (emphasis added).

On labour costs and productivity (an acceptable proxy for grower income), the Australian study report concluded as follows:[53]

> Labour costs in general are extremely low by Australian standards ... . However, the efficiency of this labour compared to that in Australia is very low, and when this is taken into account labour costs become less important in the overall costs.

The Chilean fruit industry is now moving from expansion to a period of consolidation involving product refinement, higher value product development and a search for new products and different markets. There is little doubt that its competitive impact on producers and marketers in other countries will keep increasing.

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53 Australian Horticultural Corporation (1993), *op. cit.*

6. WHAT IS MOST LIKELY TO WORK BEST?

6.1 Who is to Decide What is Best?

The need for profitability in the New Zealand kiwifruit industry to improve is undisputed. However, the means by which industry profitability is to be improved must be in the national interest. This is laid down in the review's fundamental objective: "to maximise the profitability of those in the industry and the net benefits to New Zealand.

The practical question, therefore, is how is this objective to be achieved. At one end of the range of options is a competitive market with no regulations restricting choice or opportunity. At the other is a totally controlled industry - an industry run as though it were a single, vertically integrated business where all industry participants (growers included) implement the decisions of 'management and the board'. Current arrangements are close to this end of the range although the industry is not totally vertically integrated because there are no direct controls over kiwifruit production.

Moving from a competitive market model towards total integration involves steadily increasing regulation of commercial activities and steadily decreasing decision making freedom for industry participants. With unregulated competition, outcomes are determined in the market place. As regulation and control increase, the market is supplanted in its role as decision maker and adjudicator of what is best.

If the review determines that the industry is to be regulated in any significant way, those conducting it need to be sure that a regulatory structure will "maximise the profitability of those in the industry and the net benefits to New Zealand" more effectively than a competitive market. If regulation is recommended by the review, the government as custodian of the national interest has the responsibility of endorsing or rejecting this finding. To produce a sound result, the review must be based on systematic and rigorous analysis. No durable solution will be found by averaging a range of views or by trying to reach a politically expedient consensus.

6.2 A Competitive Market has to be the Benchmark

This report argues that an assessment of alternatives requires a benchmark and that a competitive market is the appropriate benchmark because competitive markets are the norm in the New Zealand economy and internationally. To use any other benchmark as the standard for evaluation and comparison would be to select an option which is very much an exception to the norm. This would be an unsatisfactory and unusual basis on which to determine industry policy.

The choice of a competitive market as the benchmark has onus of proof implications. If any alternative to the benchmark is favoured it must be shown to be more likely to achieve the profit-maximising objective. Since competitive markets are overwhelmingly the most successful mechanism for achieving this result in general, the superiority of an alternative needs to be demonstrated beyond reasonable doubt.

6.3 No Substantive Justifications for Departing from the Benchmark

The analysis presented in this report suggests there are no substantive or defensible reasons for kiwifruit industry policies to depart from the competitive market benchmark. The reasons for this conclusion can be summarised as follows:

- The market for kiwifruit is large, diverse and has growth potential. However, kiwifruit is only one product in a market which has many suppliers, contains many substitutes and is very competitive. Marketing methods currently used internationally reflect this diversity; there are numerous views on how best to market. These characteristics mean there is no single 'best' method of marketing.
- Competitive markets have been seen to work effectively in industries with characteristics similar to the kiwifruit industry. None of the other New Zealand industries examined in this report has the commercial or political problems encountered with kiwifruit, and they are all growing. A major reason for Chile's fruit industry success is minimum government regulation and interference.

- Regulation of the kiwifruit industry, including the industry's current arrangements, has had unfavourable consequences for commercial performance and the national interest. In particular, it has distorted the price signals to growers, made marketing performance difficult to monitor and suppressed innovation.

Many of the same problems formerly characterised other industries in the New Zealand economy. Their performance has improved markedly with the introduction of competition.

6.4 Others Have Reached the Same Conclusion

There is a widespread and growing view that regulation is not in the best interests of primary sector industries or their participants.

In his final address as President of Federated Farmers, Owen Jennings imagined he was speaking in the year 2005. Among other things, he suggested that by that time farmers would have changed significantly their attitudes to competition and outside investment. As he put it:[54]

> Increasingly, farmers realised that their interests were best served by having a strategic investment in their product beyond the farm gate, not by seeking legislative protection. They found that the new competitive atmosphere enlarged the range of an already diversified product mix, improved their returns, with more and more offshore countries and companies seeking the high valued, high quality food range from New Zealand.

Addressing a major conference in 1991, the Chairman of the Australian Horticultural Corporation stated:

> One of the most vexing questions which we continually face is single desk selling in export marketing. South Africa and New Zealand have been very successful in particular products using this system whereas Chile, the most successful modern day horticultural exporter, has a free market approach dominated by seven international exporter organisations which control

54 Owen Jennings (1993), President's Opening Address, Federated Farmers 1993 National Conference, Wellington, 19 July.

> 60% of the nation's crop from the orchard gate to the export market.
>
> My friends in Australian exporting point to dramatic failures in single desk selling and this experience must be heeded in Australia's export drive.

According to one of Israel's biggest citrus exporters, "producers are better served by export competition between a series of private companies than by the re-establishment of a single channel export marketing system".[55] This exporter's Managing Director said that the export sector had increased efficiency and quality and reduced costs for most citrus growers since competition was introduced in 1991. A report commissioned by the Citrus Marketing Board of Israel, which called for greater regulation of citrus exports, "had been rejected by major exporters as well as the citrus growers' association".[56]

The most recent horticultural industry review by the Australian Industry Commission concluded that:[57]

> A diversity of horticultural commodities is traded and a variety of organisations involved in trading - private individuals, companies, cooperatives, multinational firms and statutory marketers. These caution against opting for any single model through which Australian horticulture is likely to become more internationally competitive.

In the decade ending 1985, the World Bank supported 197 projects with agricultural marketing components. A study analysing the Bank's experience in the field of agricultural marketing reported as follows:[58]

> The projects reviewed tended to overinvest in marketing parastatals [statutory boards] and to have unrealistic expectations for their performance. But since some governments have a strong commitment to the use of the public sector for a range of sociopolitical reasons, a complete

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55 *Eurofruit Magazine*, June 1994.

56 *ibid.*

57 Industry Commission (1993), *op. cit.*, p10.

58 World Bank (1990), *Agricultural Marketing - The World Bank's Experience, 1974-85*, Washington, July.

> reversal of this approach could meet with opposition. In such cases, it might be more useful for World Bank staff to point to the evidence that marketing functions are often carried out as well or better in the private sector.

South Africa's Commission of Inquiry into agricultural marketing saw the removal of regulation as inevitable:[59]

> From a critical perspective, it is not clear that those who believe that they have superior knowledge and insight are well-equipped to bring about the necessary change to exploit new opportunities. This is especially true in those many cases where these same people stand to gain from maintaining the *status quo* ... . The Committee is of the view that this state of affairs is unsustainable, adding to the reasons why changes to the system of agricultural marketing are inevitable.

Even the Kiwifruit Marketing Board appears to have recognised the inevitability of change. In the latest Annual Report the KMB's new strategic goals are stated to be:[60]

- the world's best international marketer of kiwifruit, resulting in optimum and continuing profitability for shareholders; and
- the natural choice of growers as their international marketer.

In the same Annual Report the Chairman pointed out that "the Board will only earn the loyalty and support of the industry through a superior and sustainable level of performance."

Already the Board has demonstrated the benefits of competition, even if it is only in the form of a threat to its monopoly. In late 1993 the Chief Executive said "the board had reduced onshore costs from $2.34 a tray last year to $1.46 in 1993, a 37 percent drop. Offshore costs were cut by 21 percent from $4.51 to $3.58 a tray". These are extraordinary cost reductions for an organisation which was meant to be minimising costs since its establishment in 1989. The fact that they were achieved on falling sales volumes makes them all

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59 Report of the Committee of Inquiry into the Marketing Act, *op. cit.*

60 New Zealand Kiwifruit Marketing Board (1994a), *op. cit.* p15.

the more remarkable. One newspaper report, commenting on recent cost reductions by both the KMB and the Apple and Pear Marketing Board, asked:

> How was it that so much fat was in expenses previously? Why were savings not made earlier? Just how efficient were these organisations beforehand, and therefore can we be comfortable that the current slimmed down versions are still not inefficient beasts? If they were previously so slack on the cost side, does this point to inefficiencies in other areas such as marketing or product innovation?[61]

6.5 The Government Must Accept Final Responsibility

Kiwifruit industry policies must be in the national interest. It is the responsibility of the government to ensure this is the case. It has a responsibility to look after the interests not only of existing kiwifruit industry participants but also future participants, new entrants and the wider community.

Existing growers should not expect, whether by majority or otherwise, to be able solely to determine policies which have significant implications for those who may wish to enter the industry as well as for the economy as a whole. In other areas of the economy where regulatory reform has been necessary, industry participants, rightly, have not been allowed to dictate the form and rate of change. The Industry Commission has made the point that:

> ... majority producer support for compulsion does not necessarily mean that it encourages efficient resource use at the farm or industry level, or that it provides wider community benefits which justify statutory backing.[62]

Similarly, *The Herald*, in an editorial on agricultural export regulation, said:[63]

> The denial of anyone's right to trade his own produce other than on terms decreed by a collective has been abandoned even in the labour market.

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61 *The Independent*, 22 July 1994.

62 Industry Commission (1991), *Statutory Marketing Arrangements for Primary Products*, AGPS, p78.

63 *The New Zealand Herald*, 6 December 1993.

The new President of Federated Farmers could not have been more wrong when he declared recently that the future of producer boards was a matter for farmers alone. Protected monopoly in any sector is a cost to the entire economy, in distorted returns, deterred investment, restricted product development and marketing imagination. When the country's richest natural resource, well-watered soil, is so closed to competitive nourishment, the whole economy suffers.

7. TRANSITION ARRANGEMENTS

7.1 The Need for Change is Unarguable

Freedom of entry for anyone wanting to export kiwifruit, and unrestricted choice over how and to whom growers sell their fruit, are the circumstances most likely to maximise the profitability of market participants and best serve the national interest.

Establishing a dynamic environment for kiwifruit exporting will require considerable change to the existing highly regulated arrangements. How change will be implemented is an important issue in this review. There are essentially two choices - immediate and all-encompassing deregulation of exporting, or transition arrangements which implement changes gradually.

Experience in New Zealand and elsewhere is that the benefits of reform are maximised by the rapid introduction of policies conducive to choice, diversity, innovation, investment and risk taking. Most of New Zealand's major beneficial reforms have been introduced quickly and decisively. Market participants have demonstrated an ability to adapt quickly to new circumstances. The catastrophic consequences usually predicted by those opposed to change have rarely, if ever, materialised.

Invariably the major constraint on rapid policy change is politics - an endemic feature of regulated markets. Reforms which, through the introduction of competition, deliver meaningful performance measurement and market sanctions for poor performance are threatening to vested interests dependent for survival on political processes and control over information. Such changes put at risk political careers and aspirations, not to mention power, status and financial rewards.

Many people tend to fear change and have an impractical desire for 'proof' of the consequences before it is introduced. They find it difficult to draw parallels from changes introduced elsewhere, despite their clear benefits - for example, benefits to kiwifruit growers from more competition on the waterfront.

There are no compelling reasons why comprehensive deregulation of kiwifruit marketing should not occur immediately. However, the political reality in this industry is that more gradual deregulation may be the only basis on which essential change can occur. If this is to be the case, it is imperative that any transisition arrangements meet certain criteria.

7.2 Criteria for Assessing Transition Arrangements

Regardless of the detail, transition arrangements must:

- have as their endpoint the complete removal of any regulations restricting either export activity or grower choice when selling fruit;
- achieve this outcome at the end of a reasonably short period - say, two or three years;
- require the corporatisation of the KMB at the beginning of the transition period;
- be attractive to new entrants and minimise any controls over, or advantages temporarily conferred on, individuals or groups; and
- include sunset provisions to ensure transition arrangements proceed as planned and cannot be changed capriciously.

7.2.1 The Same Objective for all Alternatives

The case for completely removing regulations which restrict competition and choice is extremely strong. This objective must be common to any transition arrangements.

Leaving any significant regulation in place - partial deregulation - would markedly reduce the attractiveness of the industry to new entrants. Many potential participants, whose entry would be crucial to ensuring competitive benefits were realised in full, would be unlikely starters if there were only partial deregulation. There is ample evidence that the policy risk associated with regulation deters investors.

Partial deregulation would mean continuing regulatory distortions and costs, without many offsetting profitability or national interest benefits. This would inevitably lead to growing political pressures to return to a more complete regulatory regime. The liberalisation proceeds could easily be aborted.

7.2.2 *Don't Make the Changes too Drawn Out*

There are only two substantive reasons for transition arrangements. One is to allay the fears of those resisting change by having the positive consequences emerge gradually - "learning by experiencing". The other is to spread over time the commercial adjustments necessitated by change.

It was noted earlier that market participants have demonstrated great ability to adjust to opportunities in areas of the economy where policy reform has been rapid and decisive. This suggests that transisition arrangements need not be lengthy. The reasonable expectation is that the desire for gradualism will diminish quickly once the benefits of change start to emerge.

Regulatory change is not without its adjustment costs. The more rapidly participants respond to change, the smaller these costs tend to be. This is another compelling reason for keeping the transisition period short.

Finally, regulatory reform of any kind is always susceptible to political hijacking by vested interests. Having a short transisition period is one means of minimising this risk.

The exact length of any transisition period is a matter of judgment. Transition arrangements which phase in unrestricted competition within three years at the most would seem reasonable.

7.2.3 *The KMB Must be Corporatised at the Outset*

Introducing competition to kiwifruit marketing does not require breaking up or dismantling the KMB. In fact, to do so would be counterproductive - the industry should take advantage of the Board's existing market relationships and experience. All that is needed is that the Board be exposed to competition and its performance allowed to determine its future. The

Board would have an incumbent's advantage which should provide it with a head start in a competitive environment.

The Board must be corporatised at the outset of any transition arrangements to ensure it operates on an equal footing with other participants choosing to enter the industry. This is essential for two reasons.

First, the Board needs traded shares and explicit profits distributed via dividends to ensure satisfactory performance measurement and investor choice. If the Board is corporatised, with shares initially allocated to growers and able to be traded freely, it will be subject to the same market performance measures, incentives and sanctions as other participants.

If growers are attached to the Board for whatever reasons they can retain their investment in the Board as well as trade with it. Undoubtedly, however, some will choose to make independent decisions about where to invest and where to sell their fruit. They will presumably be influenced by where they obtain the best returns in each case. This choice and flexibility are currently not available.

Second, the Board's current structure bundles profits from the marketing business with market returns for fruit. This bundled return distorts growers' production decisions and is not in the best interests of either growers or the nation. The return needs to be unbundled regardless of any other changes, and this can only be done effectively by making decisions to invest in production totally independent of decisions to invest in the marketing organisation.

Unbundling is also essential to ensure that the Board offers prices for growers' fruit on a basis that is comparable with other participants. If the Board were allowed to continue to use its marketing business profits to subsidise what it was able to bid for fruit, it would have an unfair competitive advantage over other players.

7.2.4 Favourable Treatment of Industry Participants Must be Temporary and Minimal

The notion of transition arrangements implies gradualism in removing regulatory constraints. In turn, this means, for a short period at least, some controls over, or protection for, the incumbent and initial new entrants.

The number of new entrants may be limited at first. Forms of regulatory control over commercial behaviour may continue for a time. Controls over who can sell in which markets may be a feature of transition arrangements.

Regardless of the detail, the most important issue is to ensure that such transition features do not result in one set of institutional constraints simply being replaced by another. Given the benefits expected from competition, it is important, for example, that transition arrangements do not lead to a regulatory oligopoly replacing the existing monopoly.

Keeping the regulations to a minimum over the transition period, and the transition period relatively short, will be important in minimising these dangers. The other important constraint is the fifth criterion - ensuring capricious change is not possible during the transition period.

7.2.5 Sunset Provisions are Imperative

Ensuring that transition arrangements, once agreed and put in place, can only be altered by parliament enacting legislation for this specific purpose is probably the most important of the five criteria. This means transition arrangements with explicit and unambiguous sunset provisions. Provisions which leave the outcome at the end of the transition period up in the air and subject "to review at that time" are inconsistent with this criterion.

It will be recalled that the major review of the industry in 1988 only recommended controls for a limited period. This was conveniently forgotten with the passage of time. It is important that history not be allowed to repeat itself.

In the past, most regulation of agricultural marketing has been put in place because growers misdiagnosed unfavourable market outcomes as a failure of the market to work properly. Cyclical behaviour is an endemic characteristic of most markets, especially markets for primary products. Falling prices, for example, contain important market messages which need to be heeded.

It is important that politicians be assisted in resisting calls for re-regulation the moment some unpleasant but quite normal commercial event occurs. Sunset provisions which constrain capricious changes are the best way of providing this safeguard.

7.3 Alternative Approaches to Transition Arrangements

A strategy for deregulation which conforms with the five criteria outlined above places bounds on the options which could be considered if transition arrangements were implemented. In summary, any option should involve:

- a transition period of no longer than three years at the end of which all regulation would have been removed;
- corporatisation of the KMB at the beginning of the transition period; and
- sunset provisions which ensure that what is planned is implemented.

A number of approaches are possible within these bounds. Among the possibilities are the following:

- A set of regulatory controls over the commercial behaviour of marketers, with the extent of control reducing gradually over the transition period. A temporary and totally independent body may be needed to administer such controls.

- Limits on the number of new marketing participants with this limit being relaxed over the transition period. There are various ways in which such a temporary constraint could be set. For example, rights to export might be balloted or sold, or entry might be conditional on either meeting specified commercial criteria or achieving minimum contracted quantities of fruit.