

“SPE or Free”

What would happen to the Nelson kiwifruit grower in a deregulated environment??

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1. Executive Summary

The question I want to explore in this project is, “would Nelson kiwifruit growers be better off in a de-regulated environment or with the status quo”, the status quo being the “Single Point of Entry” structure that is protected by legislation where Zespri is the only marketer of choice.

I wanted to draw on several recent examples as opposed to what economic textbooks tell us what in theory should work. The case studies chosen are New Zealand kiwifruit industry (multi exporter era and current), the New Zealand pipfruit industry and the South African pipfruit industry.

A “Regulated” trading environment has a perception of inefficiencies, lack of innovation and abuse of a protected position of strength and can be an easy target for groups, for example disgruntled minorities within the industry or politicians, to remove legislation that protects the SPE structure.

De-regulation in many instances comes about through political interference as a result of pressures internally or externally. Many countries that New Zealand’s agricultural / horticultural industries compete against provide their farmers with significant subsidies or other forms of political protection, by contrast the New Zealand government offer virtually no assistance to its farmers with the exception of minor contributions into areas of research. E.g. Public Good Science Fund.

Two international examples of farm subsidies that exist currently:

- In Northern Italy apple growers do not have to pay tax from their orchard income. As postharvest companies they are also offered a 50% subsidy on packhouse/coolstore development if growers join together in larger groups.
- Australia does not import apples from any other country. They have achieved this protectionism based around the fear of importing unwanted pests into their orchards. Unfortunately for apple growers around the world this is not based on science and hence after 80 years of waiting New Zealand has recently brought this to the attention of the World Trade Organisation (WTO).

It is important that New Zealand politicians must not be bullied into the notion of being “pure” and free from any government support in light of our major trading partners being non compliant in this area. At recent WTO talks on Agricultural trade in Geneva “monopolies” such as the Canadian Wheat Board and potentially Zespri were at risk, New Zealand trade officials, if pressured, could and would have de-regulated the kiwifruit industry with a stroke of a pen.

The point here is that Zespri is considered a monopoly, and yes in terms of supplying fruit to global markets growers have little choice however it was grower choice that in 1987 the kiwifruit industry called for a report, which ultimately led to the creation of one single exporter of kiwifruit protected by legislation; i.e. Zespri. This regulatory environment was called upon because the existing multi exporter system was turning out to be a disaster for those with their livelihoods at stake.

Both the New Zealand and South African apple industries have been through de-regulation in recent times, both for differing reasons and after many tough years that has seen grower numbers fall significantly, both industries now appear to be in reasonable shape.

After seven years of de-regulation the New Zealand apple grower has lost a lot of money in the market place as a direct result of competing against other New Zealand growers, this is an unfortunate position but is inevitable when the same commodity is offered to many importers by many exporters. New Zealand apple growers are beginning to overcome this issue by growing new, licensed varieties that keep supply at a level where prices can be maximised.

The fundamental reasons that the New Zealand and South African apple industries are now enjoying success include:

1. Production has dropped allowing balance of crop to be sold at more economical prices.
2. Increase in innovation, i.e. new varieties that pay higher returns.
3. Transparency through the supply chain and clearer market signals back to growers.

Zespri has worked hard to eliminate the perceived issues that have caused issues with other historic producer board monopolies:

- Zespri spends significant money in areas that will create future grower wealth. E.g. New varieties, better production techniques, improved pest management etc.
- Zespri has a supply chain structure that is competitive and transparent and is built around involving both the grower and postharvest entities; the people who have the greatest investment within the industry.
- Zespri provide benchmarking that measures Orchard Gate Return against its competitors, namely Chile and Italy.

It is ultimately hard to predict the exact consequences if the industry de-regulated however there are valuable lessons from the past that should not be ignored, also current examples that give a good indication; these include:

- The current Australian market provides a glimpse of the future if multi exporters existed in an uncontrolled way - basically unknown volumes and unnecessary price destruction due to the volatility of volume.
- Historically we have seen the behaviour of multi exporter's pre 1988, the facts are well documented and in the end the vast majority of growers called for a unified marketing approach in order to save their livelihoods.
- Just as the New Zealand and South African apple industries have shrunk so would the kiwifruit industry, only the biggest and or best would survive; potentially not a bad thing however downsizing would be certain at considerable financial and emotional cost to many growers.
- If the kiwifruit industry was to be de-regulated the surviving suppliers would target the highest paying markets which would result in downward pressure due to oversupply.
- Many Nelson growers would change crops if kiwifruit margins decreased beyond today's levels; hops, apples and grapes are all currently performing well.

In conclusion I believe it is in the Nelson kiwifruit grower's best interest to support Zespri and the SPE structure as it is providing current premiums over competitors and also committing significantly to areas of research that will provide continued financial success.

The reasons that the South African and New Zealand apple industries are starting to feel optimistic about their future i.e. new varieties, transparency and efficient supply chain, Zespri has also identified and are dealing with effectively. Zespri will need to continue to benchmark these critical areas of their business.

Having competent executive and strong leadership from the board of directors is critical and will ensure growers remain profitable and have the ability to re-invest into new varieties and growing techniques well into the future.

As one executive said "The problems experienced by Producer Boards tend to be management problems and the answer is to do something about that. It is illogical to try and solve a management problem by adopting a weaker marketing strategy."

2. Objectives of this project:

- 1) Look historically at the kiwifruit industry and why the “Single desk” system was created.

- 2) Examine Zespri performance within a SPE structure.

- 3) Use Australia as an example of kiwifruit operating within a “multi exporter” structure in which many exporters compete in a single market.

- 4) Look objectively at the recent pipfruit organisations that have been through the de-regulation process here in New Zealand and South Africa but also looking at how these organisations have changed during the transition.

- 5) Offer a likely scenario based on the information gained from the above objectives and how this would affect the Nelson kiwifruit grower.

3. Introduction:

What is “SPE” ? (Single Point of Entry), essentially this refers to Zespri’s position as the only exporter of kiwifruit from New Zealand, this position is protected by legislation.

KNZ or Kiwifruit New Zealand is a separate organisation that has two key functions:

1. Authorises export of kiwifruit other than for Australia
2. Monitors and enforces the Kiwifruit Export Regulations 1999

By “authorising the export of kiwifruit” Kiwifruit New Zealand ensures Zespri adheres to the legislation.

Kiwifruit New Zealand also manages the collaborative kiwifruit marketing process under a specific set of rules that allows interested parties to market kiwifruit into customers / markets that Zespri may not service.

Collaborative marketing programmes are expected to:

- a) Increase the overall wealth of New Zealand kiwifruit suppliers and
- b) Be “collaborative” i.e. based on collaboration with Zespri.

Zespri itself also is involved in collaborative marketing; the process allows Zespri some freedom to target specific customers in unique situations.

The “Free” part of my project heading refers to a de-regulated environment in which any organisation is in a position to export kiwifruit in whatever market they choose.

4. Kiwifruit multi exporter era – Pre 1988

To understand why the SPE structure was created we must understand how the industry has evolved over time.

In the early 1980's up to 11 kiwifruit exporters existed in the Nelson region, over time this consolidated to 7.

The top 3 exporters by market share in the 1980's were:

- Fruitfed
- Wrightsons
- Turners and Growers

How did the Kiwifruit Industry grow so quickly?

As international tobacco companies began sourcing leaf from cheaper producers around the world in the early 1980's e.g. Pacific Islands and Africa the industry in Motueka became depressed.

The government benevolently provided financial assistance to the tune of \$7000 per ha to exit the industry, many growers gratefully took this and converted to kiwifruit at a cost of \$10,000 per ha.

Pastoral companies such as Wrightson's, Dalgety Crown and Elders assisted growers in their investments and cashflows by providing funding through export receipts. This type of scenario created a frenzy of kiwifruit development and by 1990 5.2 million trays of kiwifruit were grown in the Nelson region stretching from Golden Bay to Nelson and everywhere in between.

72 packing facilities packed the crop painstakingly into wooden single layer trays.

Exporter competition

Competition amongst exporters to procure crop was fierce with quite often the exporter with the lowest returns in one year offered the best incentives for the following season in order to secure market share.

A key procurement driver was cashflow. Exporters of choice were usually the ones that offered the best advance in October, 7 months prior to harvest, and in the vicinity of 30-40% of final returns.

Growers also played the procurement game to their advantage by splitting their crop between 2 or 3 exporters and it was not uncommon for growers to overstate their crops in order to receive more "advance" money.

E.g. Grower A averages 100k trays per year.

- Committs 60,000 trays to Fruited at \$2.50 per tray \$150,000
- Committs 25,000 trays to T & G at \$2.50 per tray \$62,500
- Committs 25,000 trays to Elders at \$2.50 per tray \$62,500

Total \$275,000

The grower in the above example has received \$25,000 more than what he or she is entitled to, a good cheap way to finance your business.

In essence the exporters who had the best procurement strategy often had good market share, consequently being very little incentive for the exporter to excel.

The offshore marketing strategy during this period of growth within the kiwifruit industry was one of an undifferentiated nature, the main purpose was to obtain distribution coverage in major markets.

Exporters within this strategy market the same product, in the same markets, using many of the same importers, same coolstores and similar commissions.

By 1987, with the crop a whopping 50% bigger than 1986, the seven competing exporters started to show their true colours by undercutting onshore and in the market place. With an increasing New Zealand dollar and interest rates the news was all bad for kiwifruit growers.

Supply into existing markets started to exceed demand and competition amongst exporters increased. Smaller exporters who could exit the market early, tended to have better overall prices.

By 1987 this undifferentiated marketing structure had served its purpose but was no longer perinent for two underlying reasons:

1. Now that kiwifruit was firmly established the challenge shifted from creating consumer awareness to increasing market sales to absorb increasing supply without dropping prices.
2. Inability to manage competition from other countries exporting kiwifruit.

Key aspects in 1987 that began the downward trend of prices included:

- New Zealand's traditional selling season was being squeezed from both sides as France, Italy and Chile increased production.
- The supply of kiwifruit was perceived to be large relative to historical levels therefore importers expected prices to drop to levels similar to other staple fruits such as bananas.
- Only one undifferentiated product was being exported from New Zealand but with numerous exporters and importers competing to sell it.
- Consignment selling means that growers bear the bulk of any price reduction.
- The seasonal "downward" pattern of kiwifruit pricing was widely known and expected.

In summary the distribution system in place for New Zealand kiwifruit created no market discipline and little ability to match supply with sales other than through price reductions....structural change was needed!

In 1988 the New Zealand Kiwifruit Authority commissioned Coopers and Lybrand to look at the historical market structure and to recommend on an appropriated structure for the future.

The report concluded that "there is an urgent need for the New Zealand kiwifruit industry to implement revised distribution and marketing strategies".

The report also recommended:

1. A single point of control for kiwifruit marketing
2. A single brand

As a result of this report and the desire of most kiwifruit growers for structural change some key people within the industry initiated change to the regulations to facilitate a "Single Point of Entry".

The NZKMB was established in 1988, however there was no honeymoon period as production from all around the world kept increasing, by 1990 72 million trays of kiwifruit were produced nationally and the worst was still to come.

1992/93 saw record low prices as supply exceeded demand globally, New Zealand growers pulled vines and production fell sharply.

The market had turned "catastrophic" according to the Chairman of that time Mr John Palmer.

A trading loss of \$74.46 million dollars was reported i.e. growers had been overadvanced by this amount.

Thanks to some hard work by a few industry leaders and the good relationships created between these people and their service providers and bankers; the industry was saved from impending bankruptcy.

The next three years the industry slowly pulled itself from under the mountain of debt and in 1997 the "Zespri" brand was introduced to the world; the rest as the say is history.

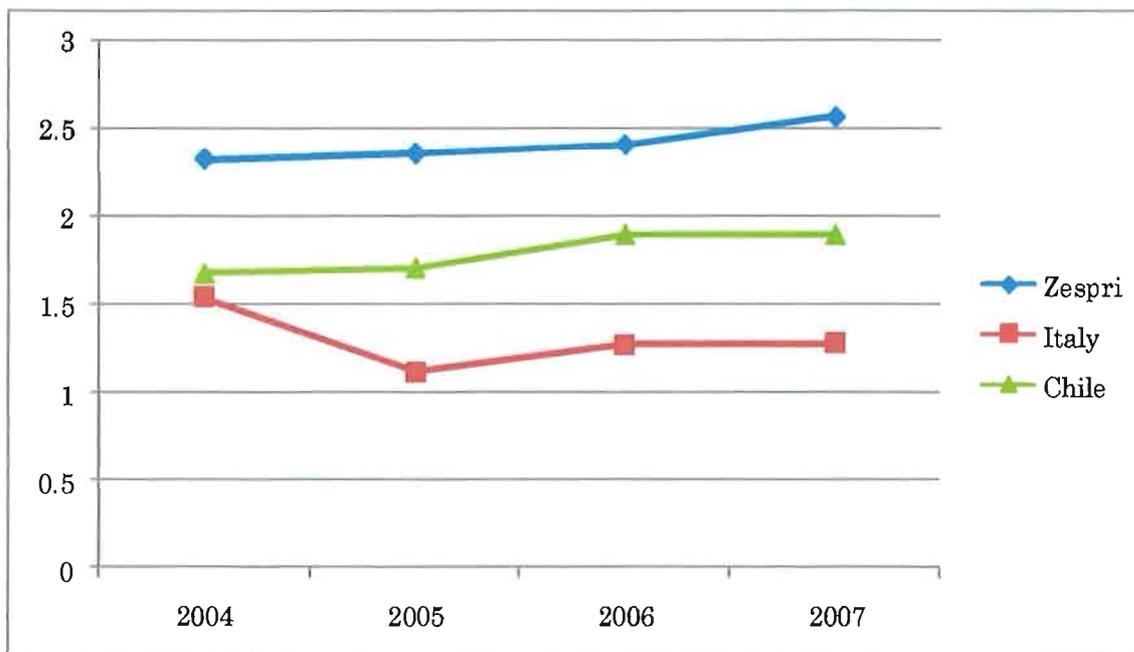
5. Current kiwifruit environment:

How is the Nelson kiwifruit grower performing under the current structure?

One of the biggest criticisms of a “SPE” structure is the difficulty in benchmarking the performance of a company such as Zespri because there is no true alternative in which to make a fair comparison.

“In- market” pricing is one measurement that can easily be monitored, below is a graph demonstrating Zespri’s relative position to its main competitors at a national level.

Table 1. In market pricing comparisons: Europe (Euro’s per kg)



Zespri enjoys significant premiums over its competitors in all markets through economies of scale, consistency of quality and effective promotional campaigns particularly at point of sale.

The Europe market accounts for approximately 50% of all kiwifruit shipped from New Zealand.

Orchard Gate Return (OGR)

It has been well documented that Zespri are and continue to perform well in the market place, equally important is the net orchard gate return, i.e. what is actually left once the costs of sales, logistics' and on-shore costs are taken into account.

New Zealand is a long way from its biggest market, Europe; consequently freight is greater for the New Zealand grower than that of its main competitor, Chile.

Below is a table that examines market returns, supply costs, orchard costs, production levels and most importantly what drops out the end for the grower.

NZ vs Chile - Comparative Returns

(NZD per Ha) (NZD 0.76 = USD 1)	Chile 2006	Chile 2007	NZ 2006	NZ 2007	Times 2006	Greater 2007
Net Market Return	23,197	13,438	54,688	52,497	2.4	3.9
Supply Costs	11,882	11,316	28,280	31,556	2.4	2.8
Orchard Gate Return	11,316	2,122	29,015	24,051	2.6	11.3
Net Orchard Return	6,382	-2,813	13,226	4,223	2.1	n/a
Return on Capital	8.0%	-3.5%	4.4%	1.4%	0.7	n/a
Capital cost of land	80,000	82,500	300,000	305,000	3.8	3.7
Production (t.e's)	5,972	6,055	7,099	7,731	1.3	1.3
Direct prodn cost	4,934	5,755	15,789	19,828	3.2	3.4
Net market Return	3.88	2.25	7.70	6.79	2.1	3.0
OGR return per t.e.	1.89	0.36	4.22	3.27	2.2	9.1

The way Zespri manages the onshore logistics' is very important in matching the supply out of New Zealand to what the market demands in any given week, i.e. what variety, what size in each variety and what pack type do the customers want their fruit throughout the season. There are significant costs in managing this process in an optimum way and to guarantee the quality whilst doing it so that in market premiums can be maintained.

The way Zespri cut the cake is very complicated and is largely driven by ensuring each grower is given equitable opportunity and no grower is discriminated against. Zespri must continually demonstrate transparency and signal accurately revenue and cost exactly where it occurs to allow for appropriate investment within the industry.

Zespri publishes a book outlining the various premiums/revenue streams available to the industry and on the flip side within the annual supply agreement outlines clearly the penalties that exist within the system. E.g. Off shore intercheck.

Below is a table that highlights some of the key areas that has an influence on how the cake is divided, some of these "premiums" Nelson growers traditionally struggle to achieve the "industry" average.

For example - Comparing time payment premiums:

Nelson growers in 2007 were 61 cents below the national average. Nelson fruit is loaded out early and generally the fruit loss is lower than Bay of Plenty suppliers. In 2007 industry average fruit loss was 30 cents, Nelson only 5 cents therefore the net effect of storing longer was not 61 cents but really only 24 cents ($\$0.61 - \0.25)

The two areas for Green growers to focus on are trays per hectare and better than average size, most premiums are linked to trays therefore the more trays then the more premiums. Larger size fruit will also pay more than smaller sizes.

Nelson vs Industry – 2007 actual returns:

	National Average	Nelson Average	Difference
Time Related Premium	\$0.92	\$0.302	\$(0.6181)
Kiwistart	\$0.24	\$0.075	\$(0.1650)
Korean premium	\$0.02	\$0.019	\$(0.0007)
Taste premium	\$0.98	\$0.860	\$(0.1202)
Pest Premium	\$0.09	\$0.09	\$0.00
STP premium	\$0.08	\$0.038	\$(0.0416)
Pack type premium	\$0.19	\$0.102	\$(0.0881)
Fruit Value	\$3.78	\$3.78	
Fruit Loss	-\$0.30	-\$0.05	\$0.25
Size profile difference		(\$0.1264)	
TOTAL	\$6.00	\$5.09	\$0.91

In summary the table illustrates that in 2007 Nelson growers were behind the industry average on nearly all “premium” earning streams. It is important to note that 90% of New Zealand’s kiwifruit is grown in the Bay of Plenty which has an ideal climate for kiwifruit production.

Zespri Achievements to date:

Zespri has generated premiums in the market place by creating points of difference from its competitors.

Zespri's significant points of difference are:

- 1) Quality and consistent quality through rigorous audit procedures from packhouse to market. Non compliance at any point in this supply chain results in meaningful financial penalties; i.e. there is real incentive to get fruit quality right.
- 2) Successful branding i.e. Zespri and the quality (point 1) on which this brand stands for is one of the most recognised brands within the fruit trade and consumers.
- 3) 12 month supply and retail promotion creates good turnover, retailers enjoy the high price (better margin) and product movement that Zespri brings to the kiwifruit category. Zespri spend a significant amount of money on promotion at point of sale, E.g. Store tastings using branded VW beetles has been hugely successful over many years in Europe; this concept is now used by Zespri around the world.
- 4) New and exclusive varieties – Zespri launched their “Gold” variety in 1999, exports from New Zealand in 2008 totalled 20m trays. The Gold variety has also been licensed to overseas growers who grow this fruit under contract for Zespri so that 12 month supply to customers can in the near future be achieved.

Zespri also has exclusivity on all new varieties that are created from the world's best kiwifruit breeding programme owned by HortResearch.
- 5) KiwiGreen – This is Zespri integrated fruit production programme which is based on soft chemicals and thresholds being met before a spray can be applied. Food Safety is a big issue for supermarkets and achieving minimum residue levels are critical for ongoing supply.

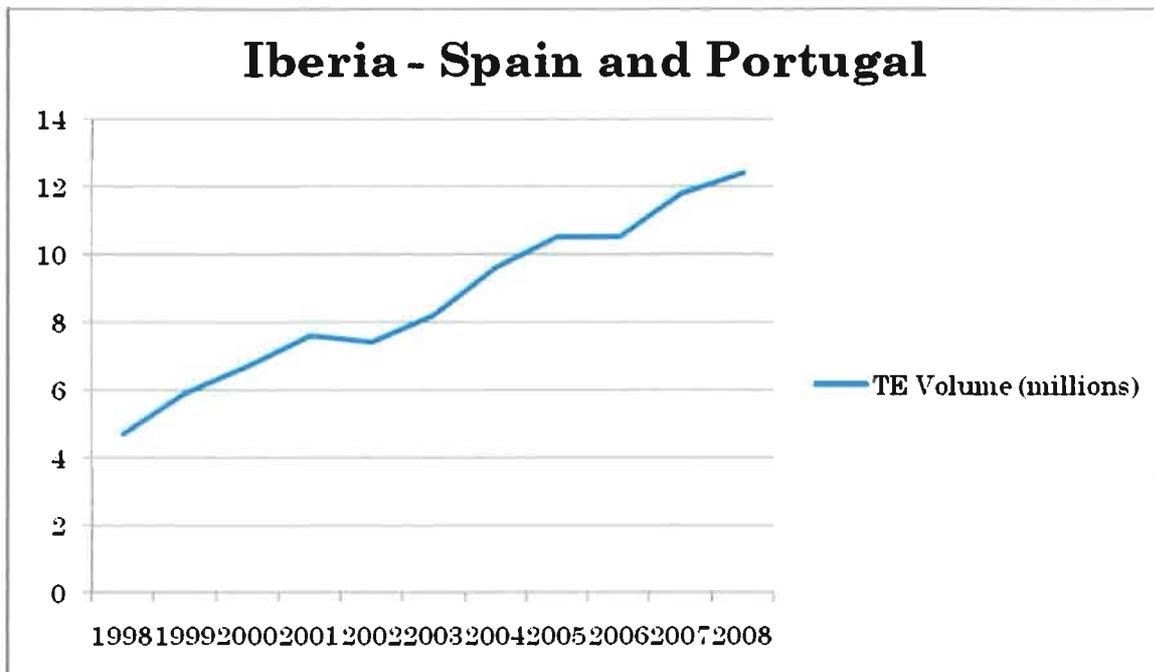
Has Zespri used its dominant position for the benefit of the grower?

Spain and Japan are two examples where the critical mass and successful branding within the SPE structure has created opportunities that would be hard to achieve in any other industry structure.

1. Spain:

Zespri has grown the Spanish market significantly in the last 10 years, at prices above many other markets Zespri service globally.

These figures are for Class 1 Green product only, Zespri also supply Green class 2 and Zespri Gold into this market.



2. Japan:

This is the highest paying market for kiwifruit in the world.

Ten years ago there were 8.5 million trays of “Green” sold at good local currency prices.

In 2007 11.5 million trays of “Green” sold at prices equal to or better than 10 years ago and 6 million trays of “Gold” at prices 20% above “Green”.

Just as importantly supply from Chile has gone from over 3 million trays down to 300,000 in the space of 10 years.

Yu-Jan Chen is Zespri’s manager for the Asia/Pacific region and has been responsible for the robust growth in these markets.

Yu-Jan states:

“Growers must grow very good tasting fruit to supply premium stores at a premium price if growers want to survive in this kind of environment. Just think how Japanese Kobe beef survived with USA beef competition, the price is 10 times different but it is still surviving. You need to have experts to sell these fruits not a trading firm.”

Potential disadvantages of an SPE structure

1. Lack of innovation

In theory if a company has no competition then the drive to be the best will be lost and true innovation will get lip service only.

Legislated producer board structures usually attract the following criticisms:

“Economies of scale and control arguments are usually made to justify statutory monopolies and are less important in determining efficiency than the inherently weaker structure facing such monopolies” (*Sieper, Coopers & Lybrand report*)

2. High Cost Management and Supply Structure

Zespri is sometimes criticised for having high supply costs that potentially negates the premium prices it can achieve in the market, having no competitor to compare with how do suppliers know that additional more expensive packaging, for example, is absolutely necessary.

E.g. If a certain market requires its own fruit labels then is the additional cost of implementing this recovered by satisfying this demand or worst case scenario potentially will you miss out on sales if this demand is not met.

What is important is the relationship between the marketer and its customers so that the important market requirements are met and the frivolous requests can be excluded, Zespri's reputation as a key 12 month kiwifruit supplier and the critical mass it now has globally is a big advantage in this regard.

Zespri's performance in conclusion.

From a Nelson kiwifruit growers perspective the following conclusions can be drawn as to how the current structure is serving them:

1) Nelson growers have in the past felt the Zespri payment system has treated them poorly due to the little opportunity to participate in various premiums e.g. the "Kiwistart" and "Time" premiums. There may be some merit in this however Zespri also has shipping and equitability considerations that do provide restrictions in what can be done for just Nelson kiwifruit growers.

Careful examination of the payment structure as a whole points to the fact that the fundamentally important drivers of Orchard Gate Return are production per ha and a desirable size profile; if one or both of these are average or better than national average then Nelson growers should be happy with Zespri's performance.

2) Nelson fruit is all shipped by September; this generally translates into lower fruit loss in comparison to the rest of the industry who continue shipping through to December.

3) Zespri continues to innovate at many levels particularly orchard gate, the main areas of focus include:

- extensive new variety development, Zespri has exclusivity to arguably the best kiwifruit breeding programme in the world.
- Orchard "Best Practice" strategies, E.g. pest control, dry matter accumulation.

4) Zespri has significantly grown key high paying markets in Asia and Europe without discounting price to achieve growth.

5) Zespri is investing in the future through research and development programmes in both new varieties and processed products.

6) Vertical integration from orchard through to the market place as nearly all growers are also shareholders with Zespri International Ltd. Growers participate in profit generated from Zespri International via:

- a) Commission generated through non New Zealand kiwifruit sales.
- b) Commission generated through New Zealand grown kiwifruit sales.
- c) Kiwifruit based processed products developed by "Aragorn", Zespri's fully owned processing based subsidiary company.

7) Zespri have achieved 12 month marketing through procurement of Northern Hemisphere supply in both Green and Gold varieties.

8) Zespri have successful Class 2 programmes that growers can participate in.

6. The Australian market:

The Australian market I believe is a window to the future if we want to look at the effects of a market in which numerous exporters operate.

The Australian and New Zealand markets were specifically excluded from the regulations allowing growers, supply entities and or exporters the freedom to send kiwifruit to these markets.

Both the Australian and New Zealand markets have traditionally been used as class 2 markets although class 3 product generally stays in New Zealand.

The Australian market is under the jurisdiction of the HEA who issues export licences for this market however it is limited in its powers and can really only stipulate quality specifications amongst other minor things. Volumes are monitored on a voluntary basis only, as a result prices vary greatly depending on what is shipped in any given year. The grade specifications stipulated under the HEA structure allows essentially class 2 product, as a minimum, into Australia.

It is important to note that the HEA provides a framework for product groups such as kiwifruit to set its own goals and objectives in terms of an export marketing strategy.

2007 results:

From a first hand experience most of Heywood Orchards class 2 fruit was programmed in conjunction with another packhouse into Australia on a fixed price arrangement of approximately \$14.50 per 10kg box depending on the size.

After the initial 3-4 containers the wholesale market throughout Australia became flooded with kiwifruit as New Zealand experienced one of its biggest crops on record with significant levels of class 2 adding to the problem.

The response from our receiver in Brisbane was to stop receiving any more fruit until things corrected itself in the market as the wholesale price had quickly dropped to \$9.00 per 10kg box.

For the next 3 months no fruit was shipped, the market did not improve and a point was reached where sales had to start again as the fruit quality was beginning to deteriorate.

A large quantity of class 2 fruit originally destined for Australia was now also forced onto the New Zealand market in order to move some product.

The total volume of class 2 kiwifruit was too great for the New Zealand market alone so a concerted effort was made with our Australian “partners” to continue the programme.

After protracted negotiations the receivers in Brisbane demanded the terms of trade be changed, the in-market fruit firmness pressure specification was increased by 50% effectively ending the “fixed price” arrangement agreed upon at the start of the season.

A total of five more containers were shipped in October, two of these failing as a result of the new pressure specification; despite this product being re-packed here in New Zealand. The failed product was heavily discounted.

The remaining product was sold onto the local market through to January or dumped.

In summarising the 2007 Australian market and lessons for future years:

- Huge volume of New Zealand kiwifruit entered this market and crashed prices on the wholesale market and put downward pressure at supermarket level.
- “Fixed priced” contracts became worthless.
- Unless the HEA structure in which the Australian market operates under can control the volume entering this market the same can and will happen potentially every year now that New Zealand is growing 100 million trays of kiwifruit consistently.
- NZKGI and KETA have requested Zespri stay out of the market with their class 2 programme to help alleviate the situation.
- Where supply exceeds demand and there is an undisciplined approach from suppliers fundamentally supplying the same product, the result will be downward pricing.

2008 Season in Australia:

The 2008 season has been interesting. The market began in a similar nature to that of 2007; the first container into Brisbane returned less than \$9.00 per 10kg box.

Shipping issues from New Zealand created a period of short supply and prices jumped significantly. This demonstrates again the simple philosophy of supply and demand, exporters know this however lower prices to the grower and lower commission still seem more desirable than sitting around a table to discuss sensible supply strategies.

7. New Zealand Apple and Pear Industry

The New Zealand apple industry was de-regulated in 2002 after several years of low returns, the majority of growers were against the government removing the regulations, the wish of the majority didn't make any difference and after 50 years the apple industry was free to do as it pleased.

After 6 years in the free market a comparison was made in the table below of a before and after scenario.

The table below represents, very simply, an 18 year period of grower returns for New Zealand's flagship variety, Braeburn.

The 10 years prior to de-regulation and the 8 years after, the figures are not FX or inflation adjusted.

Year	Pre De-Regulation Returns \$/Tce	Post De-Regulation Returns \$/Tce
1991	\$26.33	
1992	\$26.49	
1993	\$13.38	
1994	\$18.24	
1995	\$11.35	
1996	\$11.89	
1997	\$9.73	
1998	\$14.18	
1999	\$7.88	
2000	\$14.95	
Average return	\$15.44	
2001 (export permits)		\$18.04
2002 (full de-regulation)		\$18.75
2003		\$20.47
2004		\$15.11
2005		\$9.81
2006		\$19.42
2007		\$16.29
2008		\$25.00
Average return		\$17.86

A first glance look at the table suggests New Zealand apple growers are better off in a de-regulated environment.

The interesting part for me is that very good returns and very poor returns can be experienced under either structure, which suggests other external factors have a significant influence on market returns.

Some well known external factors that do impact on apple exports from New Zealand include:

- Northern hemisphere supply that overhangs into the “traditional” southern hemisphere window.
- Southern hemisphere supply particularly from South America which fluctuates wildly in export volumes.
- Foreign currency: E.g. If the Euro is strong then South American exporters will ship more products into Europe.
- Northern hemisphere summerfruit crop volumes. Stonefruit, berryfruit, melons etc are very seasonal and can totally dominate the markets during key summer months.
- Climate, hot summers in Northern hemisphere means a higher consumption in summerfruit, less people buy apples and kiwifruit.

The mid to late 1990's for Braeburn prices were flat due largely to an oversupply of this variety from New Zealand and also other southern hemisphere competitors. Braeburn can essentially be sold in just two markets namely Northern Europe and the UK with very limited volume into the USA; therefore this variety is vulnerable to oversupply particularly from New Zealand.

The Effects of De-regulation in the New Zealand Apple Industry

Tony Fissette has been General Manager for ENZA for over 25 years and has been on the roller coaster ride of the bumper Royal Gala and Braeburn years in the early 1990's through de-regulation and out the other side.

I asked him on his thoughts as to what the effects have been for New Zealand as a direct result of de-regulation.

- Since deregulation was introduced end of 2001, the New Zealand fruit business has lost some of its image, control, quality and money. This is really incomprehensible for a country like New Zealand which had a great image in the fruit business world with its clean/healthy & green environment, its top quality excellent fruit from outstanding growers, its good organisation and innovation.
- Under the single desk system New Zealand's competitors were the other Southern Hemisphere countries like Chile, Brazil, Argentina and South Africa. Europe has nearly never been a competitor to New Zealand as the seasons, varieties and quality is totally different.
- Since deregulation, more than 75 exporters offer New Zealand apples around the world with different brands; different quality, different prices and have become the biggest competitors to each other. Different exporters are travelling around the world and are visiting key importers/retailers with questions like "can you help us with our New Zealand fruit?" whereas in the past, the retailer treated us with respect for the New Zealand country, brand, quality, service and varieties and they were happy to work with New Zealand fruit.
- Due to the deregulation New Zealand apple growers have put the retailers in a stronger position. When a retailer in Europe gets an offer from 30 different New Zealand suppliers, prices can only go down. This not the "fault" of the retailer who has become strong in the last 7 years but it's the New Zealand grower who made the retailer strong, which has ended in bad results for the grower.
- The supermarkets in Continent and UK (and also in USA) feel much stronger, they always want more "specialities", and different packaging (which means an increase in costs) and they don't pay for all these extra costs. In the past, when we controlled the market, we did everything a retailer asked when they paid for it. Now, New Zealand importers are afraid to lose a customer so they do everything the supermarket asks for. But again, I will never blame a retailer/supermarket for this as it is created by the New Zealand growers who put themselves in a weak position.
- The hard discount stores like Aldi and Lidl will always take the same margin but if the prices are too cheap like the last few years, they are looking for their turnover and change to a more expensive apple like Pink Lady or Jazz. It has to

be very clear that nobody is interested in cheap New Zealand apples as there are enough cheap apples available from other Southern hemisphere countries or Europe.

I asked Tony if he could quantify the likely cost that de-regulation, in isolation, to the New Zealand apple grower assuming all other variables, such as foreign exchange, remained constant.

Tony's assessment:

For the 2 key varieties Royal Gala and Braeburn, I will try to make the following overview.

Royal Gala:

If in the last 7 years, there were approximately 50m cartons of export Royal Gala, I believe that New Zealand independent exporters and ENZA left a minimum average sales price of 1.5 Euro's on the table which is (if we take the calculation today from NZD) 150m NZD.

Braeburn:

Also around 50m cartons for export in the last 7 years, we lost a minimum average sales price of 2.5 euro (ENZA and New Zealand independent exporters) so that brings us to NZD 250m NZD.

Of course, it is extremely difficult to say what the complete losses were in the disaster year of 2005.

In reality and looking to the difficult currency of the last years, New Zealand growers left money on the table during the last 7 years for these 2 varieties - 500m NZD.

Other varieties like Cox and Pink Lady where only a few exporters have access there are no losses.

Analysing these comments from Tony Fissette it became obvious that price is not the key issue for retailers, if they maintain satisfactory turnover then its is in their interest to have higher priced apples on their shelves, this way they are earning higher margins per item of fruit.

The three most important issues for a retailer are:

1. Food safety
2. Quality/taste and then
3. Price

Given that the New Zealand apple industry is now firmly entrenched in a “free market” environment I asked Tony what are the key areas for growers to focus on to ensure future prosperity.

Tony's response:

- New varieties and innovation is the absolute future for New Zealand.
- As for the 3 typical NZ varieties: Cox will go slowly out of the market, followed by financial difficulties for Royal Gala (too much volume around the globe and less taste for the new generation) and only limited volume of Braeburn will survive.
- A supermarket will handle 10-12 varieties and a hard discount will handle 3-5 varieties. In these varieties is included: organic, different colour, cheap and expensive fruit, local and imported fruit.
- The absolute future is innovation with club varieties like Tentation, Pink Lady, Envy, Jazz, Zespri Gold etc. That is the only way to manage the volume, the right markets, the right quality/food safety and the price.
- I think that the New Zealand apple industry will absolutely shrink as (except from this year) there are still too much Royal Gala's and Braeburn grown in New Zealand. I also think that not only the fittest but also the most innovative exporter/company will survive.
- Another point is that due to deregulation, many companies export themselves and the export costs for a carton increase all the time and as we now all together are "small importers", port charges and other costs are also increasing as we have no power anymore.

8. Who makes the money – Normal market vs Weak market

Fundamentally monopolies are supposed to create artificially high prices for consumers, and where consumers do not have a choice this is true.

Zespri have an effective monopoly to sell New Zealand kiwifruit and yes this is the most expensive kiwifruit on the market in overseas markets however the consumer does have the choice to purchase cheaper kiwifruit from Chile, Italy, France, Greece or any other of the many countries that now supply kiwifruit into the global market.

What Zespri's SPE structure (monopoly) is preventing is unnecessary discounting by supermarkets that will try and use their size to push prices down to increase their margins.

Who really benefits in an undisciplined/fragmented marketing scenario:

1. The consumer? - No! Retail prices remain relatively constant from year to year.
2. The Importer? - No! As with the exporter, lower commissions are earned from lower prices and more pressure is applied on storage availability as sale volumes are generally slower.
3. The Exporter? - No! Lower commission is earned through lower sale prices.
4. The Grower? - No! Clearly lower sale prices are reflected directly on the bottom line.
5. The Supermarket? Yes! Increased margins.

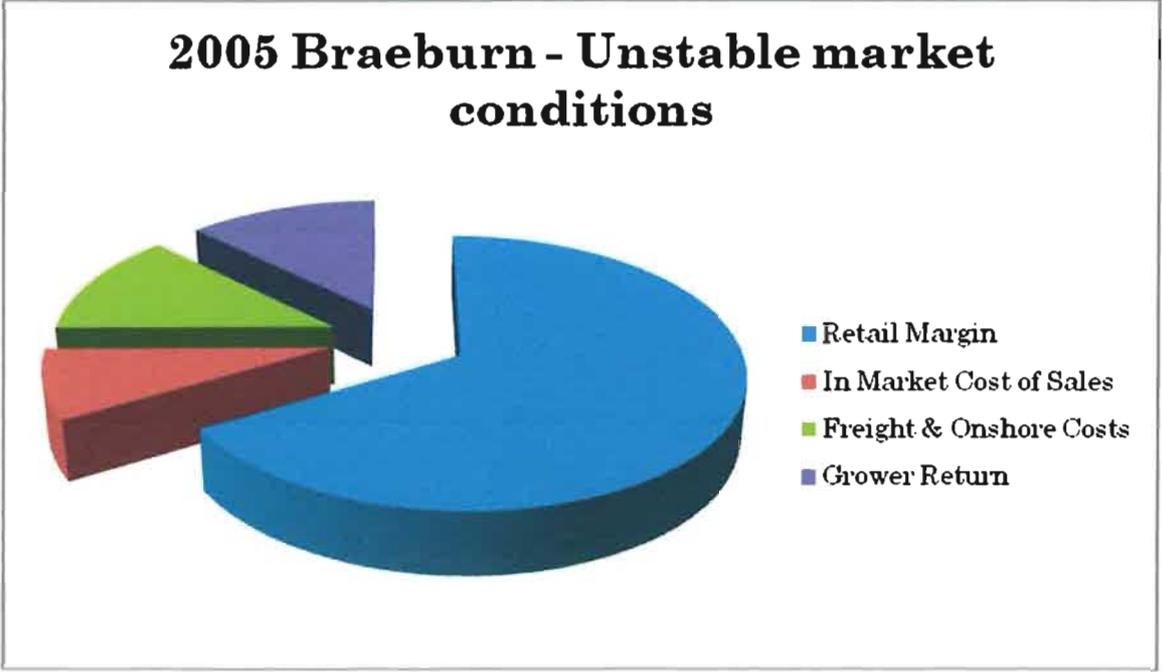
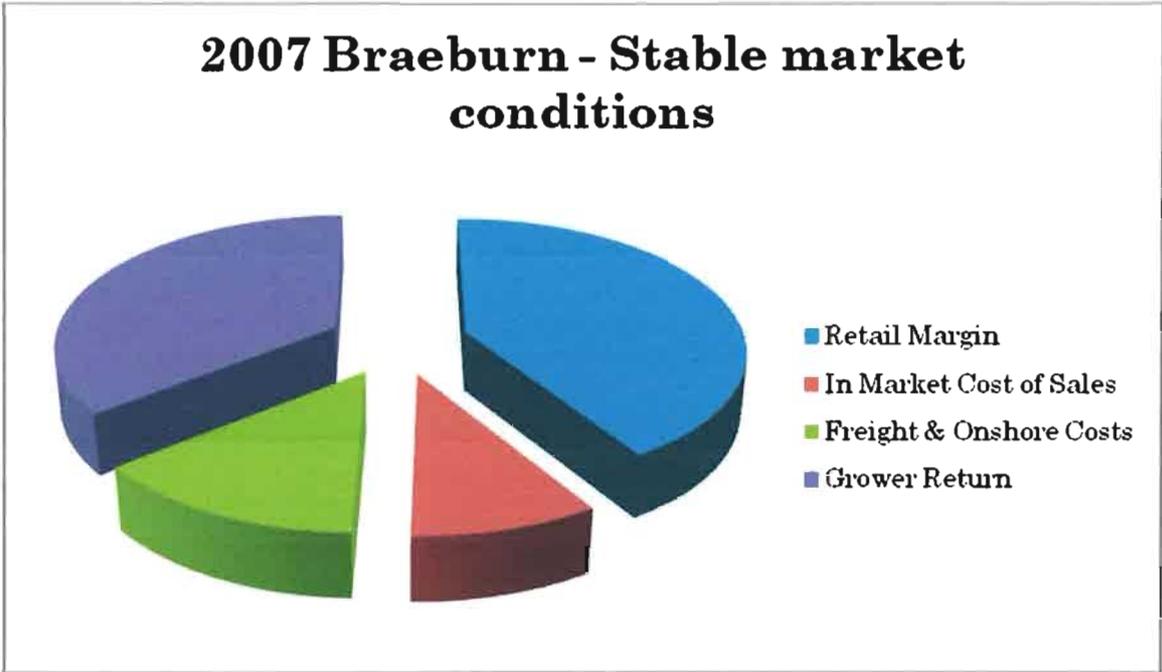
In the following table actual data is used from two different selling seasons which demonstrates what typically happens in a "weak" market year with multiple exporters compared with either a "strong" market or a SPE structure.

2005 vs 2007 Comparison:

The data used is factual and compares a Size 80 Braeburn sold into the EU, New Zealand's most important market for this variety, in two distinctive seasons.

	2005 SEASON PER 18KG TCE	2007 SEASON	DIFFERENCE
Sales Price Euro- 1.99 / kg	□35.82 (□1.99/kg)	□35.82	0
Supermarket Buy Price	□12.00	□22.00	□10.00
Supermarket Margin	198%	63%	135%
In market cost of sales: coolstorage, commission	□2.10	□3.10	□1.00
Freight, handling charges, On shore commission, etc	\$8.20	\$9.20	\$1.00
Grower Return (Using 0.569 □ conversion)	\$9.20	\$24.10	\$14.90

The data represented in a Pie graph format:



Notes to the graphs:

1. Both graphs represent a year end average, in unstable market conditions the price decrease throughout the selling period is significant, in a stable market the price remains largely the same.
2. During a period of depressed pricing the importer loses value in lower commission it is common that this lost value is made up in additional in market costs such as storage rebates and advertising, at the end of the day this all erodes into grower return.

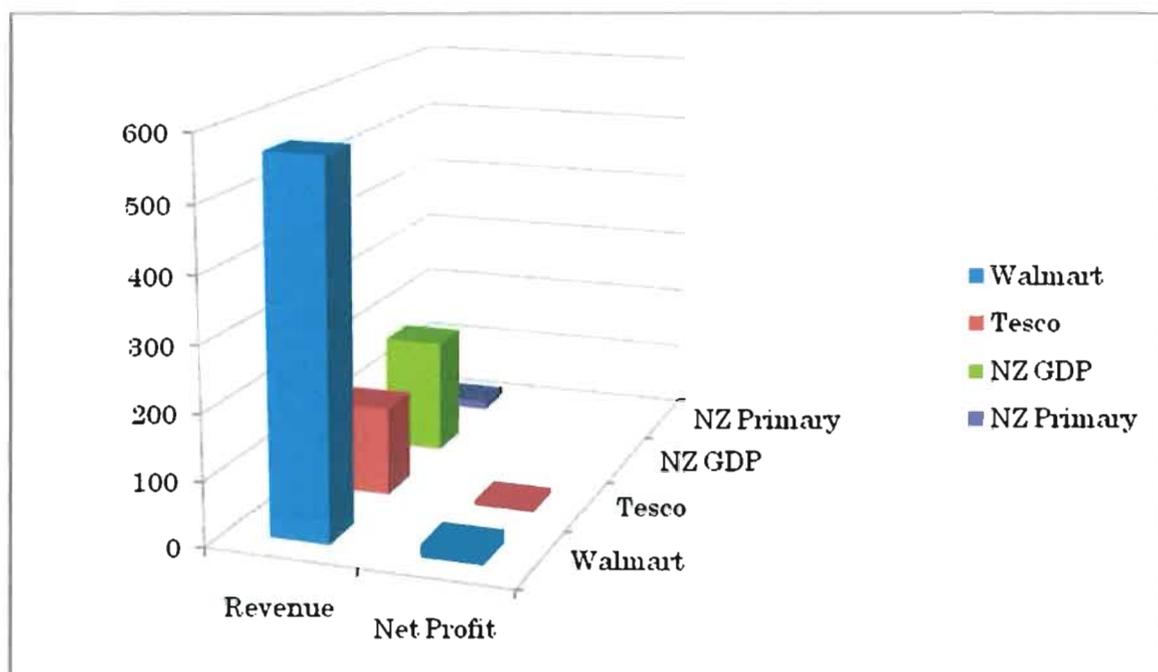
The influence of supermarkets

Supermarket business is big business and to demonstrate what growers / farmers are up against I have picked two of the biggest supermarket chains in the world.

Wal-Mart is an American company that is one of the biggest companies on the planet and has business interests worldwide.

Tesco is also global in its business and is based in the UK where it is dominant. (33% market share in supermarket trade).

Gross Revenue in NZD (billions)



NZ Primary – This represents Agriculture, Horticulture, Fishing, Forestry and Mining and accounts for 7.2 % of NZ’s GDP.

The Wal-Mart and Tesco figures were taken from the 2007 set of Annual Reports.

The NZ GDP information is current and taken from “Investment New Zealand”, the Trade and Enterprises specialist unit responsible for promoting investment opportunities.

This is the actual data that make up the pie graphs.

	Gross Revenue – NZD	Net Profit – NZD
Wal-Mart	\$567 billion	\$19.4 billion
Tesco	\$136 billion	\$6.8 billion
NZ GDP	\$177 billion	n/a
NZ Primary Industries	\$12.8 billion	n/a

9. South African Apple Industry:

I wanted to look at another countries experience in de-regulation and the South African pipfruit industry proved to be a good example as it too, like New Zealand apples, was a politically forced situation; only 4 years before New Zealand.

I was surprised that the South African industry had not been through a major transformation in terms of planting new and higher paying varieties. The table below shows a very small increase in Pink Lady, one of the highest paying varieties in the key markets of Europe and the UK.

VARIETY	1997 % OF AREA	2007 % OF AREA
Granny Smith	30	24
Golden Delicious	24	22
Royal Gala	9	12
Pink Lady™	5	7
Starking	9	6
Topred	7	6
Braeburn	3	0
Other	3	3
Fuji	1	4
Other	12	16

Traditional varieties such as Red Delicious, Granny Smith and Golden Delicious have decreased marginally but still account for over 50% of South Africa's planted hectares.

The most noticeable effect de-regulation has had is the "shrinkage" in both grower numbers and producing hectares.

In New Zealand this pattern was also evident, both grower numbers and producing hectares were down significantly.

New Zealand vs. South Africa - Key Statistics

	NZ 2000	NZ 2008	South Africa 1997	South Africa 2007
Planted Area (Ha)	15072	8950	24000	20526
Total Production (Tonnes)	509,142	422,017	696727	710,000
Tonnes per Ha	31.5 t	44.00	29.03	34.5
Number of Growers	1488	509	800	500

What caused De-regulation in South Africa?

De-regulation was political and very external. All agricultural industries were de-regulated on 1st October 1997, this included dairy, wheat and all meat industries.

Every agricultural sector had a single channel marketing organization and by the stroke of the pen the Marketing of Agricultural Products Act of 1997, were all de-regulated on the 1st of October; from total regulation to total free market.

South African Apple industry – a 10 year snapshot

In the initial years of de-regulation 137 exporters existed and the number ten years on is approximately 120, however there has been consolidation of larger exporters; 11 of the exporters handle 80% of the volume and the other 110 exporters account for the remaining 20%.

The 110 small exporters can still have a significant negative impact in a depressed market.

The structure between growers, exporters and importers has changed since the initial years after de-regulation, consolidation and a building up of alliances has taken place.

Capespan, who was the single desk marketer, has seen its share of the apple export business decline to 25%, "Colors", the second largest exporter accounts for 12% and then Dole at 10%; another 8 exporters have between 5% and 10% of the South African apple business.

The "Deciduous Fruit Producers' Trust" has created a Pome Fruit Marketing forum which gives much more accurate information than in the past regarding shipping data and even gives some price indications, this has significantly helped to mature behaviour of the stakeholders.

Growers that have formed joint alliances with their exporters or packing facility have been more successful in the new de-regulated environment; the small individual grower is an endangered species in South Africa.

For example the Fruitways Group which is owned by Alastair Moodie of the Moodie family has grown from producing 50,000 bins of their own fruit to a total volume of 300,000 bins of fruit but almost 220 000 of these bins are from alliance members and not their own farms. To form a successful alliance one has to have like-minded, progressive growers that produce fruit of very similar quality.

I questioned Peter Dall, a consultant in South Africa and Chairman of the Pink Ladys Grower Association, as to what the key areas of focus are for the South African growers are to survive in today's global fruit business.

Peter outlined three areas:

1. To increase production of export class fruit per hectare, that includes
2. producing fruit of the right size. Tons per hectare are probably the most important aspect. One of our local auditing firms does a survey of about 40 farms each year and the thing that stands out most in making farms profitable is production per hectare.

2. The next most important thing for the modern Southern African fruit grower is to focus on taking costs out of the chain, be it lowering production costs, packaging costs, transport costs, commission, whatever, they have got to look at ways of reducing costs in the chain.

3. The third most important point is to make sure one chooses the correct exporter for your profile and crop. There are many fly by night exporters that can ruin you overnight and we must make sure we make the correct selection of exporter.

South Africa has some unique problems all of their own but some are also an issue for horticulturalists here in New Zealand, the three main issues for the South African grower are:

1. Land reform. More “handing over” of productive land to the previously disadvantaged is taking place and there is a significant amount still to occur.

2. Global warming. South Africa is in a marginal apple growing area. Global warming is definitely affecting the capability to produce good quality pipfruit.

3. Labour. Even with a 28% unemployment rate, labour is becoming more and more of a problem. A lot of the labour does not want to work on farms. Farming has a bad image in South Africa and many of the unemployed would rather draw on welfare grants than work on farms. AIDS is having a significant effect reducing productivity.

With all of the information gathered on the South African industry it was hard to gauge if the surviving growers were happy with the environment or if they were desperate to get back to a regulated “one exporter” structure; so I posed the following question for Peter:

“Overall, ten years on, has de-regulation been a good thing?”

Peter Dalls’ response:

I believe if I had answered this question three years ago I would have said no. Today, I believe it has been good. It has been very painful and we have gone through hard times, exporters cutting each other’s throats and suspicion, mistrust was more the order of the day than cooperation.

However I’m now pleased to say there is greater cooperation, greater intelligence of what is going on in the market place, who has got fruit where and there is far greater cooperation between exporters to the benefit of all.

I believe the slight worldwide shortage of fruit has helped bring about this consolidation as there is not the fierce rivalry at present instead there is a realization that through co-operation there is a place in the sun for everybody.

I think the big exporters are seeing the benefits and I believe it will continue. I believe what de-regulation has created is a much leaner, efficient industry where the inefficiencies have been reduced in order to survive. Without de-regulation I believe we would not have become as lean as we are. I do not believe we would have been equipped to face the global market as well as we are today. I believe our intelligence is far better today that it was ten years ago. The new breed of South African deciduous fruit entrepreneur is far better skilled than those that were developed just post de-regulation.

It was interesting comparing the New Zealand de-regulation experience and outlook for the future against that of South Africa’s.

The key points I extracted were:

1. There has been a downsizing of their industry in both grower numbers and hectares grown in apples and pears, as there has been in New Zealand.
2. South Africa continue to grow traditional “commodity” varieties such as Granny Smith and Golden Delicious, New Zealand growers are re-structuring their orchards quickly over to “licensed” varieties such as Jazz, Tentation and Envy.
3. South Africa are focused on production per ha whereas New Zealand is driven by quality and innovation E.g. new varieties. New Zealand is also conscious of what the market wants E.g. Nil residues and are developing newer programmes that will maintain our growers as leaders in this area.
4. South Africa has major issues in terms of “Land Reforms” where the gap between wealthy Whites / Colours and the vast majority of Blacks keeps widening. Politicians

will look to try and address this issue; some South Africans are worried that what happened in Zimbabwe could happen in South Africa.

5. Yield per ha has increased for both New Zealand and South Africa as marginal blocks have exited the industries and more efficient growers have a greater impact on the average.

10. Direct Comparison: Zespri vs ENZA

Key Issue Rankings:

In the graph below I have attempted to place a 1-10 score against key areas within the 2 business's to identify what each structure potentially offers and also overall how do Zespri and ENZA compare.

This comparison is strictly based on my own observations, is subjective but is based on many years conducting business with both companies.

Ranking: 1 – 10. 1 = poor, 5 = Average, 10 = Excellent (in terms of effectiveness)

CRITERIA	SPE (ZESPRI)	FREE MARKET (ENZA)
Price stability in market	10	4
Market signals	7	6
Promotion	9	4
Brand strength / awareness	9	4
Customer relationships	8	5
Quality assurance	9	7
Logistics	9	5
Innovation		
- new varieties	8	7
- orchard best practice	8	5
Board / Management	8	5
Grower relations	8	6
Relative overheads	6	6
Average	8.25	5.33

Zespri vs ENZA summary:

- Many of the traditional areas you expect a “free market” structure to do well in Zespri are performing as good as and better than ENZA. This highlights the importance of good management and good governance and Zespri are clearly outperforming ENZA in this area.
- Both companies are accountable to their shareholders, for Zespri the suppliers are the shareholders so market performance means everything. ENZA’s shareholders are not generally suppliers; commission structure and other vested interests are important and potentially can be detrimental to supplier returns.

Conclusion:

1. The Nelson “green” kiwifruit grower would not be viable if the industry de-regulated, “gold” growers would remain profitable due to the production and price superiority it has over the “Hayward” green variety.
2. New Zealand’s primary industries need to decide a structure which best suits their individual needs, more importantly it must be decided by those with the biggest investment, the most at stake. The stakeholders inherent the most risk therefore should have the greatest influence on decision making in the short and long term.
3. New varieties, innovation, economies of scale, vertical integration and grower ownership are all ingredients that make for a successful marketing organisation of primary produce. Zespri, under the current SPE structure, are performing well in the market place, are delivering profitable returns to the New Zealand grower and are investing in new varieties and innovation that will continue the prosperity for growers into the future.
4. The best option for the New Zealand Kiwifruit industry, particularly the growers, is to retain the current regulated structure. Economies of scale and consistent quality for 12 months are but two criteria required to effectively trade with the giant supermarkets that exist in today’s market.

11. Acknowledgements/References:

1. Zespri and NZKGI for providing much of the statistical information.
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