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**RESTORING KIWIFRUIT
PROFITABILITY**

Choice, Ideas, Innovation and Growth

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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

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

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 trade⁴, 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.

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

Horticultural exports from New Zealand totalled \$NZ\$1.2 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.

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.

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.

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.

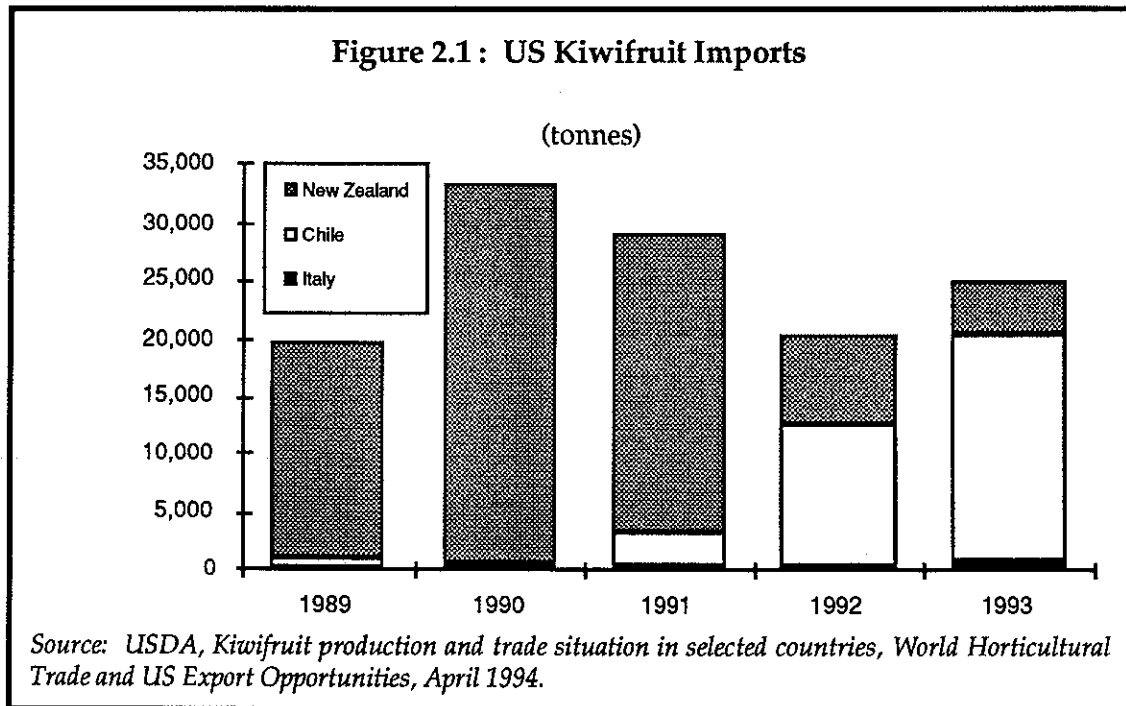
Source: USDA, Kiwifruit production and trade situation in selected countries, World Horticultural Trade and US Export Opportunities, April 1994.

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



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.

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

Destination	Year ending March 1994			
	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

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

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:

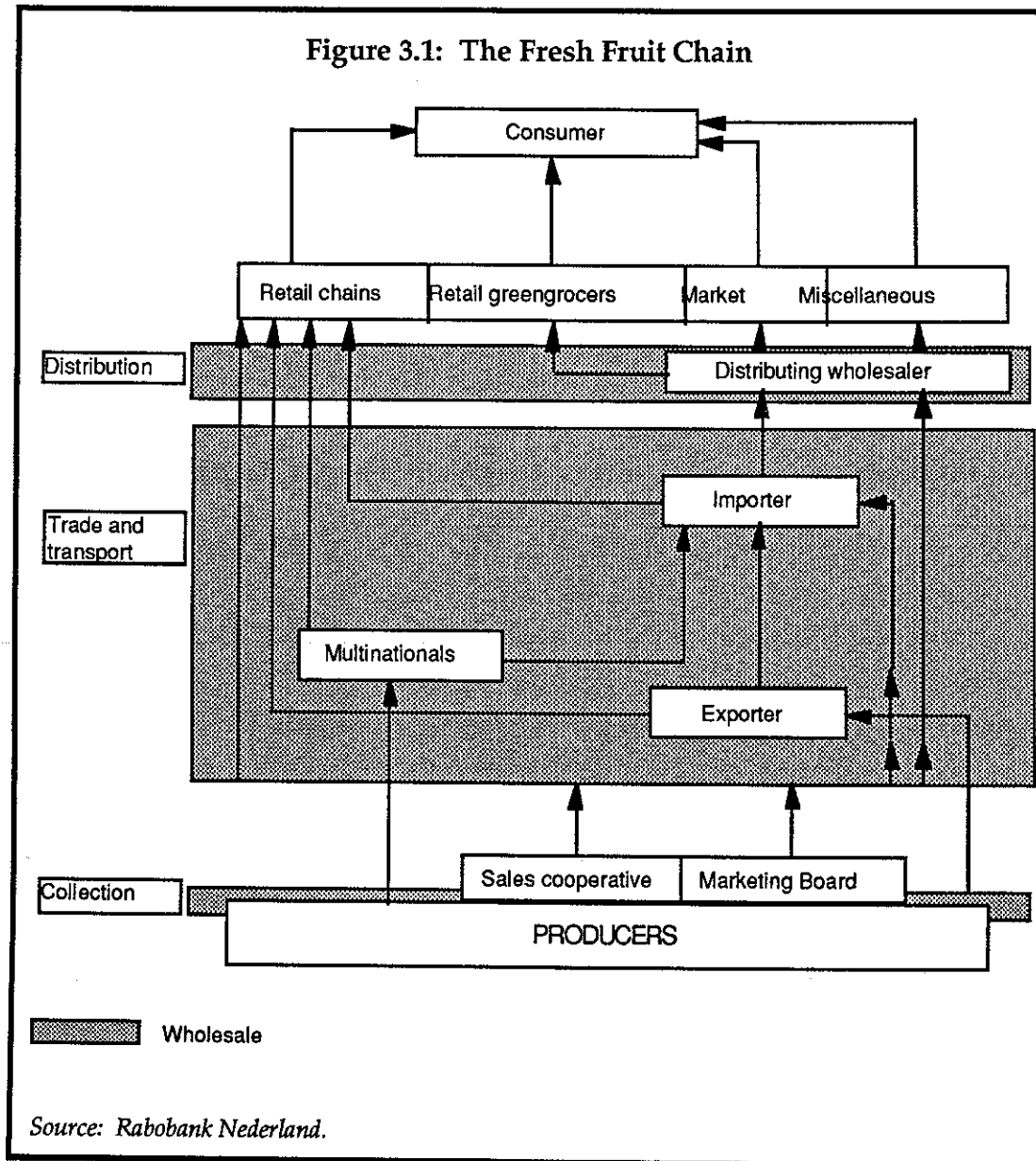
- **exchange functions**, including buying and collecting, selling and creating demand;
- **physical functions**, including storage, processing and transport; and

- **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.



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

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 Buahhan (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.

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.

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 continuously 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 markets²³ (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.

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.

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.

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 than 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.

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 competition 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.

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 continuous 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

²⁹ *The Independent*, 19 August 1994.