

**New Zealand Meat Industry Association
Annual Conference**

**Policy for Improved
Meat Industry Performance**

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POLICY FOR IMPROVED MEAT INDUSTRY PERFORMANCE

1 INTRODUCTION

When asked to speak at your conference I was told I'd be participating in a session entitled "Meat Industry 5 Years Out". Knowing the difficult circumstances being experienced by your industry, I wondered whether the title reflected some expectation regarding your fate. 'Down' maybe, but 'Out' I can't believe.

In fact, it's inconceivable to contemplate no meat industry in a country which rightly claims to be one of the world's most technically efficient growers of grass. Well, I think it's inconceivable! The worry is that not long ago many thought current events in the Soviet Union were inconceivable.

The history of the New Zealand meat industry appears to be one of under-performance. Over recent decades at least, the industry seems to have lurched from crisis to crisis, searching unsuccessfully for a solution to unacceptable commercial outcomes.

Why have you not apparently been able to get it right? Today I intend to answer that question, and explain the logic that leads me to the answer. I also have some comments on your recently announced Meat Planning Council.

I particularly want to talk about some fundamental principles which must be taken into account when devising policies and arrangements in any industry if it is to perform to its potential. These are principles which are often overlooked when you are up to your armpits in a swamp full of alligators.

Over the past twelve months I've been looking at policies and circumstances in New Zealand agriculture generally, including the meat industry. It's been a fascinating task if only because of a twenty-year absence from the country where I was born, and grew up.

Like any activity that requires a bit of thinking, you tend to be constantly mulling over the facts and issues searching for insights and answers. I think it was this process, together with the knowledge that I had to address your conference, that explains a dream I had a month or two ago. This dream was unusual to say the least, and I'd like to tell you about it.

2 A DREAM WITH A MESSAGE?

In this dream I was an invisible observer at what appeared to be a very important meeting. It was in a large wood-panelled room and a bevy of important-looking people were seated around an oval table.

At one end of the room there was what appeared to be a 'roll-of-honour'. There was a name in gold lettering against every year since 1922. However, the actual name appeared to change only infrequently.

At the other end of the room was a large glass showcase. It contained a very impressive scale model of a container ship. I can't remember the inscription on the plaque in detail, but it was along the lines of the model being a gift from a shipping conference, as a token of appreciation for having its rates pared to the bone every year since refrigerators went to sea.

I recognised many of the people around the table because I'd either met them or seen photographs. There were people from the Meat Board, the MIA and Federated Farmers. However, at one end of the table were some people I didn't recognise. Their chairs seemed to be slightly higher off the ground than everyone else, and the carved backs were considerably more ornate. Only when I looked at the name plates did I realise they were from the Electoral Committee.

I've always found that in dreams my hearing is not that good. However, I did hear some reference to 'marketplace franchising'. I'd never heard that term before in the context of the New Zealand meat industry so I didn't take much notice.

At this point the dream took a really strange turn. Into the room, completely unannounced, burst a bearded, long-haired gentleman, completely naked, and dripping wet. He started to expound some principle about displacement. You'll find this as difficult to believe as I did, but this fellow was, in fact, Archimedes.

Now you no doubt all remember that Archimedes was a Greek mathematician and inventor who lived about 2200 years ago. He is most remembered for the discovery of the important principle that the apparent loss of weight of a body totally or partially immersed in a liquid is equal to the weight of the liquid displaced. It is popularly believed that he made this profound discovery of principle while taking a bath.

You may also remember him as the inventor of the Archimedean Screw. While this sounds like an invention more relevant to the meat industry, it didn't figure in my dream.

The next fascinating development in my dream was the reaction of the people around the table to Archimedes' pronouncement of his profound principle.

"It sounds pretty theoretical", one person observed, and went on to ask whether Archimedes had done any displacing in the commercial world.

"It might apply in a bath", another sceptic observed, "but we operate in a very choppy ocean with lots of waves, bathers who cheat and will not cooperate, and where any sort of accurate measurement is virtually impossible".

Another person at the table said he'd heard the Greek government had policies which artificially increased the density of water. As far as he was concerned this made the principle irrelevant to any situation where the government provided no water density assistance whatsoever.

However, the comment which made me laugh out loud - not common in dreams - was the observation that in the northern hemisphere water circulated down the plughole in the opposite direction to that in the southern hemisphere. You simply

couldn't take some overseas theory and apply it in a country where the circumstances were so fundamentally different.

Poor old Archimedes. Looking dejected he trudged from the room. The meeting continued as though nothing had happened. The only evidence of the event was a wet patch on the carpet. Then I woke up.

I didn't think much more about the dream until a meat industry press release hit my desk on 23 August. I suddenly realised I had had a dream about my version of the Meat Planning Council.

It was only then that I started to wonder whether the dream had any messages of significance to my work. I've been thinking a lot about that in recent weeks. I've decided there are two points arising from the dream that contain food for thought.

The first is that the dream is probably signalling that there are still investors in the New Zealand meat industry who, like Archimedes, are going to take a bath.

And second, when that happens, it's worth considering more carefully the relevance and merit of the underlying principles, and not be preoccupied or distracted by largely irrelevant detail and qualifications.

As I said earlier, it's principles I want mainly to talk about today.

3 INDUSTRIES, COMPANIES OR INDIVIDUALS - THE IMPORTANT PRINCIPLES APPLY TO ALL

Over the years, I've worked on analysing problems and devising strategies for both individual companies and entire industries. It's clear to me from this work, and from logic, that the important principles underlying how people react to the incentives or circumstances they face, and the resulting outcomes, are the same regardless of whether one is considering industries, companies, or even departments and divisions within companies. Often the detail associated with the best strategy will differ, but the underlying principles will be the same.

In fact this is my first principle: **the important principles have universal applicability.**

Now, the person responsible for running a company, or a major division of a company, would consider the principles underlying how to run the business for best performance as self-evident truths, or second nature. Of course, this does not stop some companies from occasionally getting it wrong, or falling into a rut, and needing to revisit the principles as part of sorting out the problem. However, for the most part, executives such as yourselves are running companies on the basis of principles that are well-known and proven as the means of achieving good performance.

Within your companies you know it's important to have structures, management systems, and incentives which encourage effort and ideas, use resources efficiently and minimise costs. You want tensions which are creative rather than destructive, and consistent with corporate objectives. The human resources of a company perform better when they know what the rules are, can understand them, and believe they are fair and equitable.

I'm sure you also know from experience that the way you structure and run your company has to be able to accommodate organisational 'politics'.

The marketers always think the accountants are conservative and boring, and there are too many of them.

The accountants believe the marketers are egotistical spendthrifts who would send the company broke if they become too influential.

The people in the plant think they're the only ones who actually work. Everyone thinks the strategic planner is a 'head in the clouds' theorist.

If it can get away with it, the finance department will manage information, and want to be responsible for spending, as its way of increasing its power and influence.

The marketing department will say only it knows what's necessary to increase market share, and if it isn't given a free rein, everyone might as well go home.

All the managers will claim they need more resources and they will jostle and lobby to get them if they find that approach works.

On top of all this, the chief executive has to remain vigilant to ensure the company's management is not taken over by the PA or members of the board.

You know that if all these conflicts and counter-claims were resolved using democratic and popularity-based systems, your company's performance would fall away. Successful companies resolve these sort of tensions and competitive contests using performance-oriented structures, incentives and measurement. Successful companies are structured much like competitive markets.

The key point I want to make here is that all this applies equally at the industry level. In fact, at the industry level, it is even more important to get the 'rules of the game' right because there is no single person or group in charge - or at least there shouldn't be.

Here we have a vital clue to why industries get themselves into trouble. When, in any industry, one or more of the participants or influential parties can exert undue influence or control over the rules of the game for commercial or political advantage, the rot sets in. At an industry level this needs to be prevented for exactly the same reasons that you don't want one particular division, or department, or manager, calling all the shots in deciding what happens in your company.

Hence, my second **principle: in any industry, particular participants must not be able to introduce policies or rules which favour them relative to other existing or prospective participants.**

Ensuring that this principle is complied with at the industry level represents quite a challenge. The incentives you face as individuals mean you are naturally drawn towards favouring industry rules that appear to benefit your company. This challenge is even greater if the rules have been distorted in the past, and the removal of these distortions is going to cause your company some commercial pain.

In my view, smart industries are those where individual participants agree to have only industry policies which will ensure the commercial contest is fair, and the outcome reflects accurately who are the most competent and efficient industry performers. The single biggest challenge facing the New Zealand meat industry is to introduce and retain policies which are in the best interests of the industry, but which could well cause commercial pain to many of you, at least in the short-term. I'll say more about this challenge later, but first let me quickly run through some other important principles.

4 SELF-INTEREST DRIVES EVERYTHING

Despite the fact that we live in a fast-changing world, the fundamental characteristics of human behaviour have changed little since Archimedes, and how people react to particular circumstances remains relatively easy to predict. Equally constant is our tendency to introduce policies and rules which largely ignore these fundamental characteristics, and their predictable consequences. Then we express dismay when the policies fail to work as expected, and deliver unwanted commercial results.

Some feel uncomfortable with the proposition that most people are driven by self-interest. Perhaps it's because it carries connotations of selfishness and greed. These feelings are possibly stronger in a society or industry which likes to think it has a cooperative culture, or a sharing/caring philosophy.

As a recognition of this sensitivity, I prefer to talk about 'opportunistic tendencies'. Thus, my third important principle is: **all people exhibit opportunistic tendencies.**

The truth is that people prefer to be better off rather than worse off, and this is the basis on which they react to whatever circumstances they encounter. It is also the reason why they try to change these circumstances to favour them if they are given any chance of doing so.

At a more practical level, this principle is well illustrated by some advice a stock buyer once gave me when visiting a farm I worked on. "If you value your physical well-being", he said, "never stand between a farmer and a twenty dollar note". I've also read plenty in the papers recently about how important prices are in determining where farmers send their stock regardless of where their cooperative capital is invested. This principle is very widely practised, and very well validated.

Successful companies invariably operate in ways which capitalise on this principle of human behaviour, rather than attempt extensive containment or control. This is a recognition that, with the right policies and incentives, opportunistic tendencies become the driving force behind commercial success.

Exactly the same applies at the industry level but we frequently ignore that fact.

5 MAKING SURE INCENTIVES ARE NOT DISTORTED IS CRUCIAL

While the basic traits of human behaviour are pretty constant and predictable, the actual outcomes of that behaviour are very much determined by the incentives people face. I use the term 'incentive' as a label for anything and everything that has an influence on what people do.

The fourth principle therefore has it that: **the outcomes of behaviour are determined by the incentives people face.**

The interaction of incentives and normal human behaviour is at the heart of most of the problems industries experience when they introduce policies that distort market activity and prices. For example, when you pool transport costs you change the incentives which determine where companies locate plants, depots and other facilities. You also blunt the incentive everyone has to minimise these costs. Later on, when it's discovered that pooling is not a good idea, a lot of capital has been invested in the wrong places. The owners of this capital tend to resist the necessary policy changes being made.

Similarly, if everyone in an industry pays the same freight rate regardless of volume, service requirements, or negotiating skills, any advantages of plant scale that may exist will be at least partly neutralised. An 'unnatural' incentive will exist which favours smaller plants. If you then suddenly change the rules, at least some must wake up the next morning with a bad headache.

New Zealand used to have licensing which restricted new entrants in meat processing. These restrictions altered the incentives existing operators faced. They made it appear as though it was a sound investment to upgrade old and technologically obsolete plants. When it was realised that licensing was holding back technological progress, and contributing to 'soft' deals with the labour force, it was removed. New entrants then started to make this earlier investment less economic. Another round of headaches ensued.

There are a couple of rules of thumb which I use when identifying policies or policy proposals that are likely to cause an industry problems because they distort incentives.

First, I look for evidence of participants saying one thing in public and doing something different when it comes to managing their own assets. A slight variant on this rule of thumb is to scrutinise closely any policy proposal that does not seem intuitively to be in the best interests of the industry as a whole, and ask why it's being advocated. Beware, particularly, of those claiming they have a 'grand vision', or 'master plan', for an industry. Beware also of those who say that 'this time it's different', as defence against the suggestion that the mistakes of history are being repeated. It never is different.

Second, I'm alert to calls from within an industry for 'discipline', 'unity' and 'loyalty'. Such calls never have any significant or lasting effects on the behaviour of industry participants. However, they are good indicators that someone of influence is contemplating a new, or additional, distortion to incentives. As the old saying goes, patriotism is the last resort of the scoundrel.

Now it's quite obvious that incentives, regardless of where they originate or how they are influenced, are subject to change. Nothing stays constant for long these days. To stay in business you have to react and adapt quickly to changes.

However, the response of people to changes in incentives depends on how they see, or perceive, the source of the change.

6 POLITICIANS CAN BE LOBBIED BUT MARKETS CANNOT

Let me explain what I mean, and a useful starting point is my fifth key principle which says that: **politicians can be lobbied but markets can't.**

The market place has a good track record as the efficient and impersonal adjudicator in the competitive contest that all of us who run businesses are involved in. Markets handle the resolution of an amazingly intricate web of competitive objectives and needs. They ensure diversity of opportunity, and maximise the scope for innovation and ideas-testing.

Because the market place has these characteristics, and particularly because it's impersonal and generally considered to treat everyone the same, when changes in incentives are seen to arise from the market the usual tendency is to get on with the business of accommodating, adapting to, or exploiting those changes.

However, all of us would at least consider whether it might not be worthwhile asking someone with the necessary power to change the rules so we don't have to bother adjusting to the market. We can all be pretty ingenious at dreaming up plausible 'rationales' to support why this should happen. Almost always we will claim that what we are proposing is at least in the 'interests of the industry', and usually in the 'national interest'.

If government politicians are receptive to such requests - that is they are happy to pass legislation which allows changes to the rules - the processes of market intervention are engaged, and non market-based changes to incentives are the result. Then the ball-game alters quite dramatically.

An industry now finds itself in a situation where 'politics' becomes an important influence on the rules of the game, and on who wins and loses. An industry starts to be driven by a set of influences that no self-respecting executive would allow to develop within a company.

Individual industry participants now find it attractive, and essential in some cases, to lobby to have the rules changed further in their favour or, at the very least, not changed to their disadvantage. Generally, the longer this process goes on the more entrenched become the resulting 'vested interests', and the more distorted the industry's structure relative to what the market says should be happening.

Eventually, interventions have to be removed or they collapse, because the distortions they create become increasingly obvious, and further removed from market reality. When they are eventually removed, or modified significantly, high adjustment costs are incurred by those living in the 'cocoon' .

There are still people who believe governments can help industries by using their legislative powers to make rules and exercise control. Exactly the reverse is the case. When governments do intervene they become one more source of uncertainty which the entrepreneur must factor into decision making.

Through much of its contemporary history the New Zealand meat industry has allowed itself to be 'set-up' as a victim of these intervention processes and their inevitable outcomes. Virtually everything that the industry, its statutory bodies, and the government have done with the so-called objective of 'helping' the participants has, in fact, made the eventual solution more distant, and more commercially painful.

Essentially, when an industry succumbs to the temptation of allowing government and industry politicians to 'help', it delays inevitable market-related adjustments, and suppresses innovation and growth. The longer the delay the larger the backlog of commercial adjustment and the more commercially painful the eventual shake-out. Ask any Muscovite if you want a second opinion.

7 IT ALL ENDS UP IN THE BALANCE SHEET

To complete my set of important principles, the sixth simply says: **it all ends up in the balance sheet.**

The balance sheet is the most important document in the life of any chief executive. If it wasn't, we wouldn't have seen so much effort put into creative accounting over the past decade or so.

The past performance of a company, and its market value, are largely encapsulated in the balance sheet. Companies which perform well because they respond to and capitalise on market changes generally have healthy balance sheets. They are unlikely to have bankers breathing down their necks because they will not be heavily indebted and overgeared.

In an industry where there is extensive intervention it is also possible to find 'artificially' healthy balance sheets. This is commonly due to the advantages which are 'harvested' from the intervention becoming capitalised into the balance sheet. In fact, all incentives, be they market related or the result of intervention, become capitalised into asset values and the balance sheet.

However, if the initial benefits of an intervention policy become capitalised into asset values, what happens if the policy is removed? Clearly, asset values fall. And what happens if these assets are security for borrowing by a company that is highly geared? Bankers then take a particularly keen interest in what has happened, and what might be done to protect their investment.

It is only logical that in these circumstances affected parties will have strong reasons for not wanting the intervention changed, or for having something else put in its place. Taking a 'bath' would have to be the least preferred option. It is for these reasons that intervention, or more particularly its underpinning legislation, once in place in an industry is very hard to remove.

A good example of these principles at work is provided by the introduction and subsequent removal of SMPs. SMPs gave farmers rising returns not related to market circumstances. These 'artificial' profits were capitalised. Eventually, as with any misguided intervention that ignores the market, the price supports had to be removed. Asset values, particularly in the farm sector, collapsed.

The people most directly affected by the collapse were those with relatively high gearing. They had to realise asset value write-downs. For others only 'paper' losses were involved. While the adjustment was painful, survival was possible in most instances.

Similar logic and consequences feature, for example, in the history of meat plant licensing in New Zealand, and the effects it has had on some meat companies and their balance sheets. I believe the proposed Meat Planning Council is setting the industry up for another spin in this revolving door of intervention and barriers to entry, consolidation of vested interests, eventual collapse of arrangements, and the commercial pain of further adjustments to asset values.

8 NEW BARRIERS TO ENTRY

On the basis of what I have seen in the media there appears to be some confusion over whether this new Council is all about cooperative 'sweetness and light', or the same old police force in new uniforms. After the announcement of its creation the minister of agriculture said:

"The board and the industry lobby had developed a formula boosting export returns without undue interference in the commercial operations of individual companies."

The farmers also apparently think that it is a 'new-age' form of productive cooperation. The Chairman of the Meat and Wool Section of Federated Farmers said that it was the first time in his experience that "the industry as a whole has been able to commit itself to a solution that does not require statutory controls or government intervention". Isn't export licensing a statutory control any more?

However, in the very same newspaper article that carried this comment by the farmers' representative, the Chairman of the Meat Board was quoted as saying:

"Any exporter who tried to undermine the meat industry's newly agreed plans for coordinated marketing this season would not remain an exporter for long. If they really wanted to stand outside and did not want to participate when the rules had been agreed, the licence would not be continued."

Now that sounds pretty much like the words of a policeman to me.

I note particularly the reference by the Board's Chairman to the fact that the rules have been agreed. This is the essence of the continuing problems your industry is experiencing. As an industry you've allowed a sub-set of participants to have ownership of the rules of the game. The fact that it may be - temporarily at least - a majority sub-set does not alter the nature of the problem.

Of course it's important to maximise market returns. However, the Meat Planning Council is not the way to do it. The Council and its market franchising scheme appears to be the latest model from the industry's 'barriers-to-entry' production line. As an example of barriers-to-entry technology, its design is very refined - exquisite in fact.

The Chairman of the Meat Board has been quoted as saying that the Council would seek solutions to issues including:

- "• stimulating greater marketing in the Pacific Rim and Middle East;
- fostering innovation and better targeting in market and product development;
- creating a climate to encourage meat companies to become market-led rather than production driven;
- encouraging competition on aspects other than price alone; and
- ensuring exporters do not leave potential earnings unclaimed."

I would have thought that any self-respecting meat company wishing to stay in business would desire - in fact would need - to be constantly seeking solutions and success in these areas. So why, I ask, are they not doing this and why is a new Council necessary?

In the time I have today I can only address this question in broad terms. Let me leave you with the following points to contemplate.

The principles I have outlined tell you that companies will approach marketing, like everything else, in terms of maximising what they can secure from the incentives they face - that is their behaviour will reflect the environment they experience.

Therefore, how would you expect meat companies to behave if you constrained the set of opportunities available to them? Let's say, for example, you set up rules and restrictions on freight, grading, quality control, and who could sell what, in which markets.

Because commercial opportunities have been constrained, you would expect companies with normal opportunistic tendencies to concentrate their efforts in those areas where they have been left some commercial freedom. Conversely, innovation and investment would avoid areas where the rules constrain commercial behaviour.

The restrictions and controls also increase risks and this influences how companies behave. The risks are higher because a policeman owns the rule book and can rewrite the rules at any time. The MPC is the latest move to rewrite the rules.

The following are some of the consequences you would expect to observe:

- smaller companies, not having to worry about freight disadvantages because of lower volume, would have less incentive to chase opportunities in niche markets and develop higher value products;

- incentives facing individual companies to brand, and be prepared to back the quality reputation of their product, would be diminished; someone else is seen to be responsible for that and the commercial benefits of differentiation are constrained by common rules;
- companies which have markets allocated to them will be under diminished commercial pressure to perform; other companies will ignore opportunities in these markets because they know they are blocked out;
- in situations where companies can supply markets but are not responsible for the marketing, expect them to behave in an 'all care but no responsibility' manner; and
- do not be surprised if you hear a lot about 'destructive' price competition - so many of the other non-price opportunities for competing have been removed or restricted.

You also need to consider the effects on an industry of extensive and continuous policing of commercial behaviour. The principles provide guidance regarding the entrenchment of vested interests and the difficulties this causes in bringing about change.

But you also influence the industry's culture and confidence. Participants lose confidence in their entrepreneurial abilities and the will to fight and win is diminished. A culture develops where there is a fear to get out and have a go.

There will quite likely be some of you who remain unconvinced. To you I simply say, look at your history.

The meat industry has tried every known variation for marketing meat except letting entrepreneurs who specialise in the business get on with the job without interference. I see nothing arising from how you have done things in the past which would suggest that pushing people around and telling them what to do will work this time around.

It is true that some markets, notably the EC, impose requirements on you regarding volumes and prices. It may be necessary to have rules which ensure you meet these requirements and maximise returns. But why use a sledgehammer to crack a nut? And why not have arrangements which ensure you compete amongst yourselves for access to such markets.

Not only will this 'sharpen your claws' and therefore equip you better for success in all other markets, but you may find it encourages companies to look elsewhere for less restricted and more rewarding market opportunities.

As an industry, your commercial future depends on you coming to appreciate that working together as a 'New Zealand incorporated' club is a noble but commercially barren objective.

The consequences that will flow from the establishment of the MPC will be similar to those which resulted from meat plant licensing. It breaches, or fails to take into account, all the important principles I've been discussing.

It will suppress investment, innovation and ideas-testing in marketing and product development. By definition it must do this because those who believe they will benefit from its activities are those who find most of their commercial aggravation coming from innovative, new investment.

It will greatly centralise decision making over what's best for the industry in terms of marketing and market behaviour. Conceivably such centralised decision making might get it more right than wrong. But history does not inspire confidence that it will. If they get it wrong, they get it wrong for the whole industry - as the wool industry on both sides of the Tasman has recently and painfully discovered. Usually industries can handle mistakes made by some of their participants because others, taking a different view or approach, are getting it right. Choice, and diversity of approach, are hallmarks of successful industries.

9 CONCLUDING COMMENTS

To conclude, what do I think the next five years holds in store for the New Zealand meat industry?

First, I see a major risk. It is that the industry might experience one of its periodic market upturns in the next few years leading some participants to think the problems have been solved, while others have less incentive to keep arguing that they have not been solved.

However, in the final analysis you really have little choice regarding what you must do to secure the best possible commercial outcomes in the future. You must change industry policies to conform with, or take account of, the principles I have discussed.

New Zealand livestock producers, and participants in the meat industry, must come to understand that as long as the industry is underpinned by legislation which enables so much control to be exercised over commercial activities, past problems will continue, and possibly get worse. You should be asking yourselves why you persist with policies and strategies for solving industry problems which have failed you, and increased the pain, so frequently in the past.

In fact, it strikes me as somewhat ironic that after having made some progress in recent years in removing distortions to incentives, you are now proposing to reintroduce them in another form. But then again, such action is a classic symptom of any industry that has allowed itself to be driven too much by legislation and politics relative to the commercial incentives of the market place.

I thank you for inviting me to your conference. Telling people what I think to be true, rather than what I suspect they might like to hear, is one of my many faults for which I don't apologise. I only hope I don't leave Queenstown looking like Archimedes - naked and dripping wet.