Meat Industry Woes: can we do better?

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Published in Country-Wide South, 12 March 2007, p4, as “Supply clubs one option for Meat”

There are lots of unhappy sheep farmers at the moment. A season that gave promise of providing better prices than last year has spiralled down into the gloomy depths. Most farmers seem ready to blame the meat companies but many of the problems arise elsewhere.

The current exchange rates are hugely problematic for exporting industries, but even that is not the total answer. Farmers too have got to take some of the responsibility for the position the industry is in. And farmers are going to have to do something about it themselves if they want things to improve.

A lot of the problems stem from an exchange rate that is far too high. The dairy industry is weathering this storm better than the sheep industry, but that is because international dairy prices are at record levels. International lamb meat prices are also not too bad, but with an exchange rate of US70c to the NZ dollar, and the Euro at about 53 cents, prices would have to be exceptional for the industry to prosper.

Our exchange rate problems stem from interest rates that are considerably higher than in other western countries. These high interest rates exist because as a country we have an insatiable appetite for borrowing. Until we learn to save for ourselves this problem will not go away. And until it is worth saving, without most of the returns being lost through taxation and the effects of inflation, then it is not going to occur.

In New Zealand we reward those who speculate on land and property (no capital gains tax, unlike Australia and the USA) but tax people on their total interest earnings with no allowance for the loss of value of the capital in the bank. Is it any wonder that no-one saves? The outcome is high interest rates, high exchange rates, and export industries that are in despair.

Of course there is nothing that individual farmers can do about exchange rates. That is up to Government. So somehow, farmers have got to make the best of it until the wheel turns in their favour.

Or is there something that farmers can do? What is actually wrong with the meat industry that can be improved?
Quite simply the system is not working well. Rumours abound that the meat companies are undercutting each other in international markets. But if this is occurring then it is not by choice. It is simply because this is the only way the companies can sell the product on hand. No meat company can afford to keep it all in the freezer. It is called supply and demand.

Part of the volatility comes from changes in demand but there is not much we can do about that. So we need to look at whether there is something at the other end of the supply chain that we can influence. The reality is that the timing of when lambs are slaughtered, and the amount of product produced, varies between seasons. Outside of agribusiness, firms decide how much they can market, and then produce accordingly. In pastoral agribusiness we work the other way round. First we produce what the seasons allow us to produce, and then we market it. So it is not surprising that the meat companies face some challenges. It is the inherent nature of pastoral agribusiness.

Something that farmers could do is to start working collectively to put pressure on the meat companies. What would happen if a group of farmers in a region, with capacity to supply 100,000 lambs or more, were to form their own supply co-operative to negotiate prices with the meat companies? And what if five, or perhaps ten groups, were to do this? Farmers often complain about companies such as LandCorp getting premium prices. But to the extent that premiums do exist, it is because the big players negotiate not only on price but in relation to an extended supply season. If more of this were to happen it would be a big step towards a more integrated supply chain. But if farmers want to exert some market power through scale, then farmers would have to accept the discipline required on their part to provide supply as contracted. Too many farmers see contracts as one-way arrangements that bind others but not themselves.

There are also things that the meat companies could do better. It irks farmers to see laden stock trucks passing each other going in opposite directions. Some of this is inevitable with a competitive model, but there seems to be too much of it. It is even more frustrating to see the lack of advance information that the meat companies are able to provide to their farmer clients.

For the last two seasons we have seen high prices until about Christmas and then a disastrous decline. Very little of this can be blamed on exchange rates. In neither year did exchange rates shift appreciably at this time. Rather, the price slump was due to companies bidding up prices pre-Christmas to maximise throughput, and then using the post Christmas and autumn periods to cover their overheads and make profits. So this was all a consequence of company policies.

There is nothing fundamentally wrong with these policies, and an economist would say that they make a lot of sense in terms of encouraging farmers to slaughter their stock outside the peak part of the season. But if this is the way the industry is going to operate, then the meat companies need to be explicit that this will continue so that farmers can plan accordingly.
Right now there is something very confusing about both prices and information. For example, at 1 March 2007 the Agidata website shows the biggest co-operative paying 1.80 per kg for a 22kg lamb whereas Taylor-Preston’s export works in Wellington is paying $3.05 per kg. This is an extreme example at the heavy weight end of the scale, but how can we believe that the price schedule is reflecting prices in international markets when this sort of difference exists?

Some people are saying that we need to get a mega co-operative and that amalgamation of PPCS and Alliance is the answer. I am cautious on this. The reality is that one of these is a big co-operative with relatively low equity per kg of throughput, and the other is a considerably smaller co-op with relatively high equity per kg of throughput. Getting agreement on a merger may be difficult. Also, I have previously expressed caution in regard to EU regulations about one company dominating the European trade. Fonterra has recently had to agree that they themselves would be the European importers for only 55% of the butter they export to Europe, with European firms handling the other 45%. A combined PPCS/Alliance company would be over this percentage in terms of total NZ supply. My own preference is that it is better for the firms to build on their current negotiations to work together in specific overseas markets wherever that is feasible, but to retain their independent identity.

In the final analysis, if the markets are not working well then it will be the farmers who bear the cost. The current system is fine for the meat companies as long as they maintain cost competitiveness relative to the other companies in the trade. Therefore it is farmers who need to change the system.

The only way that farmers can do this is if they organise. They can form their own mini co-operatives or supply companies to co-ordinate supply, and to put market pressure on the processing companies. And they can organise to get the right type of directors on the big co-operatives. In the last year I have been surprised when talking to some of these directors, in an effort to increase my own understanding about the industry, how little they actually understood about the businesses they govern. It seems to be strong management but weak governance!

In amongst all the gloom there is one piece of good news on the horizon. Exactly how far above or below the horizon is not quite clear. But there is increasing realisation that the international bio-fuel industry has the potential to turn many things upside down. International grain prices are already very high and almost surely this is going to impact seriously on international beef, poultry and pork prices. Hopefully there will be a spin-off through into lamb prices that will benefit pastoral producers.

But can we afford to simply wait?