



Chairman's update

Dear All,

In this update

- **Drought**
- **Industry reform**
- **The role of Beef + Lamb New Zealand in industry reform.**
- **And, my own views about a way forward for the meat industry**

My last Chairman's Update focussed on the drought that has been severe in many parts of New Zealand, with the North Island particularly hard hit. As I write this, we are seeing some relief with rain spreading across the country, although it is too early to say that the drought has broken. **There is no doubt that the effects of this drought will be felt for a number of years, and the real challenge for us all is to ensure we try and confine the losses to this production year as much as possible.**

In my last note, which was also my address to the Beef + Lamb New Zealand Annual Meeting, I also talked about the frustration among farmers about the volatile returns for sheep meat in particular. I urged meat processors and exporters to step up and tell their farmer suppliers about the good work that has been achieved over many years in the transition to a high value food exporting sector.

I also talked about "the elephant in the room", and said the following;

"A simple merger of the two co-operatives as suggested by many is in my view not enough, but today I am calling on companies to address this area for once and for all. Farmers are increasingly demanding change away from the status quo. We have been told that even if there is not one dollar for farmers for a period of time after an industry reorganisation, they need to see some options on the table to give them confidence for the future.

If we do nothing, nothing will change. And that is the very point of all of the work I have talked about today. If you are happy with today's profits, then do nothing.

In the past six weeks since our Annual Meeting at the Upper Clutha A&P Show, there has been a lot of talk about industry performance, strategy and structure. The **Meat Industry Excellence Group** has been formed and is currently seeking support from farmers nationwide for change. They have outlined their principles including advocating for an entity that processes and exports 80% of New Zealand's red meat sector and a five point action plan to get there. **This is a positive step in the right direction. In my view it is critically important for the future of the sheep and beef sector that farmers apply some thinking to**

this area as the key sector that determines their income and therefore profitability.

I have had dozens of calls asking about the position of Beef + Lamb New Zealand in these discussions and also where I personally thought the industry needed to go.

Firstly, let me outline the position of Beef + Lamb New Zealand, your industry good organisation.

- The formation of Beef + Lamb New Zealand in 2004 also coincided with some of the last producer board reform underway at that time. Farmers strongly supported a more focussed organisation, investing on behalf of farmers in areas like research and extension, skills and training, market access and development and the provision of information for the sector. **The current New Zealand Meat Board Act 2004 developed at the time, does not allow the New Zealand Meat Board or Beef + Lamb New Zealand as an organisation to impose anything on the commercial sector. Farmers were very clear that the responsibility for holding the industry to account should lie directly with them.**
- **Notwithstanding that, at Beef + Lamb New Zealand we have agreed that we also need to be part of the solution, and help wherever possible assist in seeing a better performing industry.** When the “mega merger” was proposed by Alliance in 2008, we offered financial support to help develop the plan under discussion, although that was never called upon as the plan did not come to fruition.
- This year as the Meat Industry Excellence Group look for support among farmers for a similar plan, Beef + Lamb New Zealand is again discussing how we can help. Any change must be driven on commercial terms by farmers and meat companies in the first instance, but **Beef + Lamb New Zealand remains ready to assist, if and when a reform package is agreed and needing further assessment or underpinning analysis on the road to implementation.**

As a farmer and leader in one part of the industry, many people have asked me personally what I think should be done to improve the performance of the red meat sector. **I remain firmly committed to the work that needs to be progressed in the Red Meat Sector Strategy, and the on-farm component now underway with Primary Growth Partnership (PGP) funding forms a large part of this work. However I have also acknowledged on a number of occasions that this is only about half of the gains, and we need change beyond the farm gate to capture the full benefits outlined in the Red Meat Sector Strategy.**

An important point that is often missed in all of the debate among farmers is that **farmers do not own a majority of the red meat processing and exporting sector.** While SFF and Alliance Group are large in sheep meat, collectively their market share is still only 52.7%, and in beef they collectively hold 39% of market

share.

In looking at all the options currently being discussed, including an 80% entity, splitting processing and marketing, and a single marketing entity, amongst others, I have come to the view that none of these can be delivered easily due to the variety of owners and strategies that exist. **The circuit breaker in my mind that could unlock all these challenges is the adoption of “Tradable Slaughter Rights”, which was recommended to the then Meat Industry Council by consultancy firm Pappas Carter Evans and Koop nearly 28 years ago.**

I have not got a copy of the report, but my interpretation and understanding of how this could work follows. I also consider the implications of such a scheme for farmers and the wider industry.

1. We would need to agree on whether this is a species specific issue or should be applied right across the sector. I would suggest **the most pressing need is in sheep meat rather than beef**, but have no firm view on this at this stage.
2. We would need to decide a point in time where we would agree to allocate the maximum percentage of the annual kill allowed to be processed by each company during each year. For ease, I would suggest **the three year rolling production history used by the New Zealand Meat Board for quota allocation at the end of the 2012 season would be a good start.**
3. The Beef + Lamb New Zealand Economic Service would use its independent farm survey data to **forecast the number of animals available for the coming season, which would need to be regularly updated to ensure that it was as accurate as possible for maximum efficiency of the system and to take into account changes during the season.**
4. Each company would then be allocated a “Tradable Slaughter Right” (TSR) based on the percentage agreed in point 1. For example, if Company A was calculated to have 25% of market share in a lamb kill forecast of 20 million, then they would be allowed to kill a maximum of five million lambs for the season. **Any transgression above this right would lead to forfeiture for future years.**
5. Because there would only ever be 100% of the total estimated kill allocated as TSRs, if a company cannot procure lambs up to their maximum allowed, **then they would be able to trade that at a value that would be determined by the market.**
6. I would anticipate this scheme would not be set in perpetuity, but instead be **a transitional scheme to allow companies to right size their business, align processing requirements with their marketing plans and importantly form relationships with suppliers to meet those needs.** As a starter I would propose a five year period for TSRs.
7. New entrants would be allowed, but there would be a restriction placed on building new capacity for the duration of the TSR scheme, **with new entrants being required to procure a slaughter right at an existing facility.**

What would be the implications of such a scheme?

1. **In my view the adoption of TSRs would change behaviour overnight.** There would be much greater incentives to form relationships and contractual supply arrangements between farmers and meat companies. Meat exporters would be able to plan their marketing with more certainty, which would again provide them confidence to form more trusted relationships in the market.
2. **For farmers, the reality is that TSRs will reduce procurement pressure and competition at the farm gate.** This is an important point, and if TSRs were adopted farmers would need to accept that farm gate prices will change with a great deal of procurement pressure removed. In theory, those who commit should be rewarded with better prices, which is the reverse of what happens today in most cases.
3. **Rationalisation of excess capacity would be encouraged with individual companies able to decide on the positioning and level of capacity required to slaughter their allocation under their TSR.** Importantly, the costs of rationalising excess capacity will be met by the shareholders of individual companies, and not socialised across all farmers.
4. TSRs would encourage meat companies to consider consolidation with procurement pressure reduced across a year. **A merged company could make a far more compelling business case based on certainty of either supply or some return from a TSR if they chose not to procure the animals.**
5. **New entrants, which provide new thinking and innovation would still have access to the industry,** however they would need to be sure they could flourish in high value markets after paying the cost of a TSR for each unit of livestock.
6. Importantly, the adoption of TSRs would not be an issue for the World Trade Organisation and the rules of international trade that we have agreed to abide by. **Regulation within New Zealand would be required to enable TSRs to be applied but this is a domestic issue rather than an export issue.**
7. **The adoption of TSRs would be doable!!** This could be applied from the start of the new season, and while sovereignty would remain with individual companies in the first instance, the increased certainty provided by TSRs would encourage more conversations that could lead to meaningful change.

I am sure that there will be many who consider this either a step too far and also many who would say this does not go far enough. However what I have proposed is something that I think delivers meaningful change and importantly the behavioural change that is required to get this industry functioning better for all participants.

In closing I hope that the season delivers us a kind winter that enables us all to climb out of the drought hole that exists in many parts of the country.

As always feedback welcomed and encouraged on any of the above.

Kind Regards,

Mike

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