

# EXECUTIVE SUMMARY

New Zealand's sheep meat and beef sector has been suffering from a period of low profitability. This has been exacerbated by a nationwide drought, fluctuating commodity prices and, until recently, a strong New Zealand dollar. Many people also believe that the industry has been systemically underperforming.

This report takes a strategic view of the sheep meat and beef sector. It looks out over the next 10 to 15 years to identify and synthesise some of the main strategic opportunities and challenges facing the sector.

A Delphi survey of experts was conducted to draw on the sector's collective knowledge and expertise. Respondents included farmers, processors, stakeholder groups, researchers, observers, government, and international contacts and customers. The Delphi method involves two rounds of anonymous survey questions. It sets out to reveal what experts think, without them being influenced by the identity of others answering. The study does not seek to gain a statistically robust representative view of the sector as a whole, but rather to look for consensus and disagreement in respondents' informed opinions.

## STRATEGICALLY IMPORTANT FACTORS

The table below outlines respondents' top 10 factors of strategic importance.

### TOP 10 FACTORS OF STRATEGIC IMPORTANCE IDENTIFIED IN DELPHI SURVEY

FACTORS OF STRATEGIC IMPORTANCE	RANK
Sheep and beef farm overall profitability	1
Investment in sector research and development	2
Meat processing companies' overall profitability	3=
The importance to sales from using "New Zealand" in branding	3=
Reliance on generating and growing new markets to sustain the meat sector	5=
New Zealand ownership and control of sheep meat distribution and marketing networks and firms	5=
Level of co-operation between NZ companies to develop and sustain marketing internationally	7
The reliance on producer and processor efficiency to sustain the meat sector	8
Use of forward supply contracts for supplying livestock to processors	9
Marketing expenditure as a proportion of total expenditure by the sheep and beef sector	10

*We take a strategic view of the sheep meat and beef sector out over the next 10 to 15 years.*

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### PROFITABILITY AND INVESTMENT

These factors reflect a mixture of investment priorities – research and development and growing new markets – and structural issues, including ownership of distribution networks and international marketing co-operation. Overall profitability, both on-farm and at the processor level, is clearly identified as important, yet profitability is both a cause and effect of other actions. The industry might wait for higher profits before being able to invest in a step-change in innovation investment. In the case of co-operatives, farmers might forgo a greater proportion of short-term returns (payouts for livestock) in favour of allowing their co-operatives to retain more profits to reinvest in their future.

The reliance on producer and processor efficiency to sustain the meat sector was ranked as the eighth most important strategic factor. While productivity improvements will be important to remain competitive, the sector's future clearly lies in creating more value in its products, rather than competing on price and cost reduction alone. An interesting omission from the list of top strategic factors was security of inputs (that is, natural resources such as water, and human capability), which has been identified in other forums.

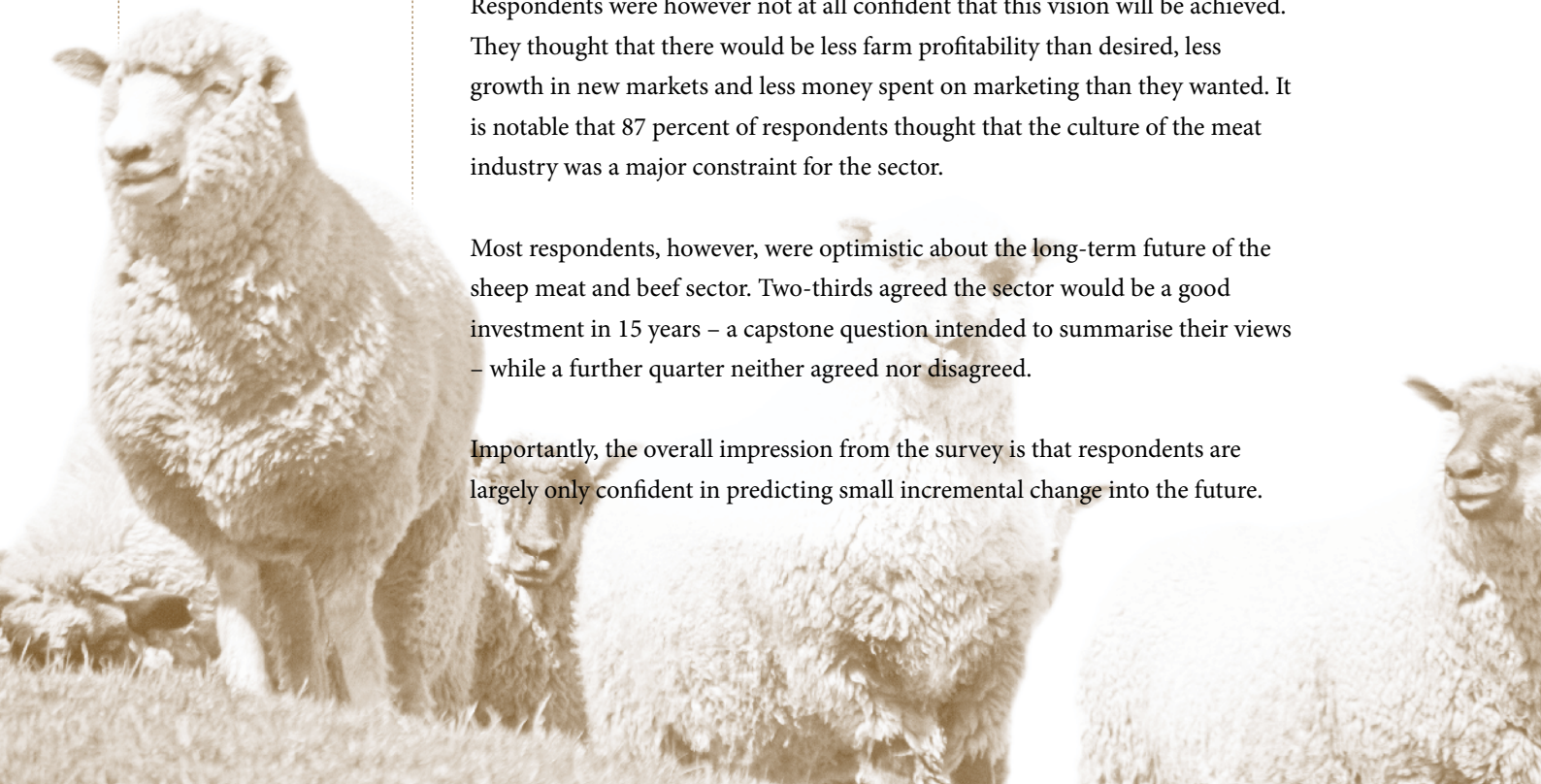
### VISION BUT A LACK OF CONFIDENCE IN ACHIEVING IT

Respondents had a vision for the sector in 10 to 15 years; an economically and environmentally sustainable industry that invests in innovation, has a greater focus on the market and is more co-ordinated across the value chain.

Respondents were however not at all confident that this vision will be achieved. They thought that there would be less farm profitability than desired, less growth in new markets and less money spent on marketing than they wanted. It is notable that 87 percent of respondents thought that the culture of the meat industry was a major constraint for the sector.

Most respondents, however, were optimistic about the long-term future of the sheep meat and beef sector. Two-thirds agreed the sector would be a good investment in 15 years – a capstone question intended to summarise their views – while a further quarter neither agreed nor disagreed.

Importantly, the overall impression from the survey is that respondents are largely only confident in predicting small incremental change into the future.



This does not rule out the possibility of more radical changes to the sector, but most respondents considered change of this nature as less likely. Most experts in the industry expect that the status quo will only change to a small extent in the future. This is not encouraging to those who believe that the status quo is not sustainable.

### CONSTRAINTS AND BENEFITS OF THE CURRENT SYSTEM

The results from the Delphi survey indicate what the sector thinks the future of the industry may look like in 10 to 15 years. We should also look at the current system and some of its inherent constraints and benefits. Some of the key characteristics of the current system are summarised below:

- › **THE MARKET AND TRADE ENVIRONMENT:** The sheep meat and beef sector relies heavily on a small number of traditional markets, although there has been recent growth into new markets (in particular Asia). The sector faces a variety of international competitors, and competes against a number of other protein sources. If the relative cost of producing meat in New Zealand continues to increase due to, for example, higher future land prices, then the sector may need to find ways of embedding more value in the products it produces.
- › **THE PROCESSING SECTOR:** The sector faces certain capital constraints that limit its ability to invest in areas such as innovation. In particular, farmers lack incentives to invest in their co-operatives, since their shares do not increase in value with the performance of the co-op. This differs from normal company shares or other co-operative shares whose value can increase. Consequently, co-operatives may be unable to reinvest at the desired rate.  
Structural overcapacity in the meat processing industry also leads to sub-normal profits for meat processing firms, limiting their ability to invest in the future. The dynamics of seasonality and seasonal (as opposed to structural) overcapacity, as well as the allocation of quota, can contribute to spot market relationships between farmers and processors, and production-driven business models. Both of these factors detract from the sector's ability to implement medium-term value-enhancing strategies.
- › **THE PASTORAL AGRI-SYSTEM:** Competing land uses and relative industry returns have recently led to a large number of conversions from sheep and beef to dairy or dairy support. The sheep and beef industry now depends more on extensive hill country than in the past, and this may increase the risk to the sector due to reduced access to lower-risk finishing land. Sheep and beef farming could also feel the squeeze on the more marginal extensive hill country if forestry's future returns improve. Land is not the only constraint. The cost and security of access to inputs such as water and fertiliser, as well as the quantity and quality of human capability in the sector, are likely to become more important issues in the future, although this is not highlighted by the Delphi survey results.

Much of the sector is characterised by spot market relationships between farmers



Photo: Meat & Wool New Zealand.

*Opportunities appear to exist for the sector to become more aligned and better connected across the value chain.*

and their processors. Farmers may find it hard to credibly commit a large proportion of their production to longer-term contracts due to the constraints of producing meat in a biophysical environment (for example, the variable impacts of weather, animal health). This predisposition to spot markets may become exaggerated by the increased risk from more adverse climatic events and an industry depending more on extensive hill country.

- › **THE INTERRELATIONS ACROSS THE MEAT SECTOR'S VALUE CHAIN:** Clear conflicts currently face individual sector participants as well as different points across the value chain. For instance, processors benefit from long-term supply commitments from farmers, which ensure certainty of supply. At the same time processors face short-term financial incentives to procure on the spot market to both maximise capital utilisation and gain maximum access to quota markets. Processors may also value farmers smoothing their supply curves in order to reduce seasonal spikes.

Opportunities appear to exist for the sector to become more aligned and better connected across the value chain, and to create greater value and higher returns to the sector.

### MEGA-TRENDS

Several forecasting and foresight initiatives have been undertaken recently to identify large-scale drivers for change. These mega-trends are likely to have wide-ranging and pervasive effects on society. From these studies and associated literature, this report identifies five mega-trends that are directly relevant to the agricultural sector:

- › **CHANGING DEMOGRAPHICS AND WEALTH:** The world is continuing to experience a substantial change in both demographics and wealth. As the changes become more pervasive, we can expect to see changes throughout the meat value chain, both in determining future markets and in the resulting impacts on meat processing and on-farm production.



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- › **FOOD, IMAGE AND BELIEFS:** Food consumption is changing for a number of reasons. Wealthy consumers are increasingly demanding products (including food) that help define their image and that connect with their core beliefs. This presents opportunities in terms of specialised and diversified products, but also presents challenges from an increasingly diverse marketplace.
- › **GLOBALISATION:** Despite recent concerns about the impacts and adverse consequences of globalisation, the international trading environment and increasing global competition is likely to be a trend that will dominate over the next 10 to 15 years. The two main sources of emerging international competitors are (i) low-cost countries and (ii) local and regional producers in the market.
- › **CLIMATE CHANGE:** Climate change is a driver for change in production and is shaping market expectations. Although climate change is a global phenomenon, impacts and likely mitigation measures vary regionally. The increased frequency of extreme weather events may well limit agricultural production and farmers' ability to plan and commit to longer-term supply.
- › **THE INCREASED PRESSURE ON THE NATURAL RESOURCE BASE:** New Zealand's pastoral agri-system operates within the constraints of a biophysical environment. Therefore, expansion and intensification of farming can put pressure on the natural resource base. Meanwhile, society increasingly expects the agricultural sector to perform better environmentally.

## SCENARIOS FOR THE FUTURE

Scenarios are not predictions; they are designed to encourage debate and inform decision-making by highlighting future strategic issues and challenges facing the sector. There are, of course, a multitude of other possible scenarios. This report concentrates on just four, which were chosen on the basis of factors identified in the Delphi survey as important strategic issues with uncertain future outcomes.

The first scenario paints a bleak future for the sector: it describes a situation where current negative trends are extrapolated into the future and where the sector fails to adapt to changing circumstances. The sector, of course, has great scope to adapt to meet future opportunities and challenges. The remaining three scenarios describe potential futures where the sector has, to varying degrees, managed to capitalise on different opportunities and has met certain challenges.

The four scenarios are summarised as follows:

- › **SLIPPERY SLOPE:** Failure to address key opportunities and challenges leads to a substantial reduction in the sector's size and scope. Profits not only retain their cyclical variations, but become systemically lower.
- › **A NEW MARKET ORIENTATION:** The sector is able to diversify into new markets and overcome

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the production challenges of greater year-round supply and product specification. Improved economies of scale lead to successful processor consolidation.

- › **SHRINK-TO-FIT:** The sector reduces in size, but is able to stabilise due to increased returns from reduced supply. Competitive advantages are achieved in areas such as environmental performance and the sector is able to meet exacting consumer requirements in traditional markets.
- › **THE KNOWLEDGE INDUSTRY:** The sector makes a step-change in innovation investment, allowing for greater product and process innovation. Strategic alliances are increasingly entered into with customers, allowing greater transmission of customer requirements through the value chain. Increased capabilities and intellectual property from research and development allows for the internationalisation of the meat sector and associated industries.

### ONE EYE TRAINED TO THE FUTURE

While the sector is rightly focused on the current issues that it faces, it is equally important to have one eye trained to the future. The purpose of this study is primarily to try and facilitate this by identifying and synthesising medium-term strategic opportunities and challenges facing the New Zealand sheep meat and beef sector. These opportunities and challenges are not definitive; they are a base for debate and discussion.

Collectively, the opportunities identified describe a vibrant sector that places New Zealand at the forefront of high-quality, sustainably produced meat and rewards farmers for meeting consumer expectations in both traditional and new markets. The report also identifies a set of challenges that, if met, will strengthen the industry's position globally, but if not acted on might well perpetuate a lack of profitability across the sector.

Despite the obvious challenges that the sector faces over the next 10 to 15 years, this study has identified a general positive slant to people's perception of the industry's future. Clearly, though, this rosy outlook will not be achieved through inaction or simply "carrying on as normal". New Zealand has, and should be able to maintain, a comparative advantage across much of the value chain. Leadership, vision and action are required from the sector to ensure this comparative advantage delivers a successful and sustainable industry into the future.