



Ministry of Agriculture and Forestry
Te Manatu Ahuwhenua, Ngaherehere

Review of the Regulatory Framework for Pipfruit Exporting

MAF Public Discussion Paper No. 23

November 2000

ISBN 0-478-20094-3

ISSN 1171-8951

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Executive Summary

This discussion paper invites submissions on the future framework for New Zealand pipfruit exporting.

The pipfruit industry is competing in a difficult international market. The New Zealand industry faces strong competition from overseas pipfruit suppliers and competition from many other fruits and snack food products. The international market is changing due to factors such as:

- Consolidation and rising service demands from the retail sector
- Globalisation of fruit trading
- Need for horizontal co-ordination and integration between product groups
- Competition for shelf space and impacts of house brands
- Differentiation in the retail sector
- Tighter specifications demanded in markets

Key elements in the New Zealand industry's response to the changing demands of international markets could include:

- Sustaining and enhancing ENZA's performance
- More differentiated approaches to export marketing
- Focusing on net returns to growers not on total sales revenue
- Encouraging new business investments and relationships
- Achieving efficiency gains and cost savings in the industry

The above issues are discussed further on pages 15-19 of the discussion paper.

This discussion paper presents several possible options to govern the future export marketing of pipfruit. Submissions are invited from growers, post-harvest operators and exporters on what they consider is the best possible framework to govern the export marketing of New Zealand's pipfruit. Submissions should follow the guidelines set out on pages 4-5 of the discussion paper. It is helpful to refer to the "Criteria to Assess Options" on pages 19-20 of the discussion paper when options are being considered.

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Review of the Regulatory Framework for Pipfruit Exporting

Introduction

Purpose of Paper

The purpose of this discussion paper is to encourage forward-looking and strategic thinking from the pipfruit industry and to invite submissions on the future framework for New Zealand pipfruit exporting. The objective of this is to provide a regulatory framework for pipfruit exporting which promotes the innovative capacity, market responsiveness, and long-term profitability of the pipfruit export industry.

Reasons for Review

The Apple and Pear Export Regulations 1999 have been in place since 1 April 2000 and enough experience has now been built up to allow their effectiveness to be evaluated. Since the Regulations were promulgated conditions in the industry have changed significantly. ENZA's Board is now rapidly moving away from the co-operative structure that formerly governed pipfruit exporting to a more corporate approach to its business. Independent exporters are now significant players in the export marketing of pipfruit and many growers have suggested that new approaches are needed to respond to changes in the retail sector in overseas markets. The pipfruit industry is under significant financial pressure. It is important that we have in place a regulatory framework that provides the best possible long-term basis for pipfruit export marketing.

This review aims to give growers, as well as post-harvest operators and exporters, the opportunity to give their views on the regulatory framework that is most suited to the industry. These views will be analysed to help form a basis for Government decisions on the future evolution of the framework governing the pipfruit export industry.

Invitation to Make Submissions

Submissions are invited on which of the options set out in this paper can provide the best possible framework to govern the export marketing of New Zealand's pipfruit.

The submissions will be summarised and analysed by MAF. The analysis will focus on information in the submissions that can contribute to MAF's advice to the Minister on the best future framework to govern New Zealand's pipfruit export marketing. MAF staff will be prepared to meet with industry groups as part of the consultation process if this is so desired.

Submissions on this paper should be directed to:

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Submissions on this discussion paper close at **5pm Wednesday 31 January 2001**.

Individuals and groups making submissions on this discussion paper are asked to indicate:

Who They Represent

Submissions should state whether they are on behalf of grower, post-harvest operator, exporter or other interests, and whether they are from an individual or a group. In the case of submissions representing the views of an interest group, the make-up of the group and the extent to which its members have been consulted on the submission should be made clear.

Which Option is Supported and Why?

Submissions should make clear which option is supported and why. If new options other than those outlined in the paper are proposed the submission should provide some detail on how any proposed new option would work. The “Criteria to Assess Options” on pages 19-20 should be referred to when options are being considered.

Any Other Comment

Any other comments on the discussion paper and the issues around it are welcome.

Scope of Paper

This discussion paper addresses the export marketing of apples and pears (excluding nashi and Asian pears). It focuses on the regulatory framework for pipfruit exporting. It excludes detailed consideration of other industry drivers, such as on-orchard productivity, the role of R&D and “industry good” issues. However, where relevant, the paper addresses these wider industry issues where they are linked with the export regulatory options that are canvassed.

Background

An understanding of the history and wider background of the pipfruit industry helps provide insight into the future directions the industry may take:

Historical Development of the Pipfruit Industry

New Zealand first began exporting apples in the 1890s, from Canterbury orchards to markets in Britain. However, large-scale production only came on stream by 1918, unfortunately coinciding with a shortage of shipping resulting from World War One. Increasing supplies of fruit being grown had to be sold locally, severely depressing prices.

The Fruit Export Control Board was set up in 1925. From 1926 this Board began exporting fruit to Britain. The Board assumed control over exports in 1927. Right from the beginning there were independents who objected to the Board-controlled system and they organised into a lobby group, “the 1928 committee.” The outbreak of World War Two and the subsequent disruption of shipping and markets saw Government take some control over the industry in

1939. The Apple and Pear Marketing Act 1948 formed the post-war basis for single desk export marketing.

The pipfruit industry has always been subject to varying marketing returns but was able to grow significantly by supplying the British market, and then exporting more widely. New Zealand's key advantages from the late 1940s to the early 1970s included a very favourable climate for pipfruit growing, access to the British market, the ability to supply fruit in the Northern Hemisphere off-season (the "out of season window"), and a strong system of innovation.

However, from the early to mid-1970s the industry went through a period of low returns. Only in 1977 was it boosted by the price impacts of poor crops in Europe. After this the industry enjoyed around 15 years of good returns, apart from two abnormally low price years in 1981 and 1988. From the 1980s the New Zealand industry was able to differentiate itself using new varieties such as Gala, Braeburn and Royal Gala. During the 1980s improved transportation, storage and off-season demand lifted the profitability of apple exporting.

Over the period 1985-1995 the production base grew from 7,226 hectares to 15,916 hectares and the value of pipfruit exports increased by around 100%. Prices peaked in 1991 and 1992, partly due to adverse climatic events in Europe. However, since then the New Zealand industry has struggled in an over-supplied market, and against a backdrop of contentious debate about the appropriateness of a single desk marketing structure. New Zealand's traditional selling period of May to September in the Northern Hemisphere has been affected by coolstore and controlled atmosphere technology which means local product may still be on sale when the New Zealand product arrives. This has severely eroded New Zealand's traditional advantage as an out-of-season supplier.

The World Pipfruit Industry

The situation in the New Zealand pipfruit industry can be placed in the wider context of international demand and supply.

Demand Trends

Per capita apple consumption in developed countries in Europe and North America is static or declining. People are consuming more foods away from home, "on the run," and in forms, and through lifestyle choices, that do not favour apple consumption. The quality of New Zealand apples has helped demand in the past. However, some competitors have matched these quality standards, at least for some major varieties. New Zealand's ability to differentiate through new plant varieties has been eroded by competition and by the erosion of the margins earned by these varieties. However, new variety development continues to be a competitive strength. New Zealand also has some potential to differentiate through quality standards, "clean green" production processes, niche products such as organic apples, and potentially through innovation in export marketing services.

Some supermarkets are specifying more demanding requirements for firm, juicy apples with high sugar levels and these requirements may well favour New Zealand over producers in different growing climates in Europe and China. The apple industry internationally is suffering and the most competitive New Zealand growers probably have the ability to out-

distance their overseas competitors, due to factors such as New Zealand’s system of innovation, and its favourable growing conditions.

However, the World Apple Review 2000 commented that “for the foreseeable future the global apple industry must assume that it will be operating in an environment of plentiful supplies of its own and competing products.” Inefficient growers in any apple exporting country will not prosper in this environment.

Production Trends

Over the 1990s world fruit supply as a whole has increased and total world apple production has continued to increase faster than most fruits. In 1999 world apple production achieved a peak of 60 million tonnes – a 6% growth over the average production for the previous three year period, with much of this growth coming from South America and China. Production has remained fairly stable in Europe and North America over this period. Low profitability is forcing some growers in Europe, North America and in the Southern Hemisphere to exit the industry and this may help bring supply more into line with demand. However, overall, world apple production may continue to grow in some countries, at least for some varieties. China, for example, has substantial plantings of young trees as well as the potential to dramatically increase its production per hectare. Chinese production is likely to have uneven impacts in the international market and may not necessarily challenge New Zealand in some higher value markets, e.g. in Northern Europe.

Production trends are set out in Table 1 below:

Table 1
World Apple Production By Region
(thousand metric tons)

Region	Average 1992-94	Average 1996-98	Preliminary 1999
Europe (excl. FSU ¹)	14, 067	14,001	14,047
North America	6,030	5,833	5,714
South America	2,673	3,083	3,440
Africa	1,340	1,526	1,546
Oceania	786	853	836
F.S.U.	4,984	4,682	3,515
China	8,928	17, 926	22,010
Other Asia (excl. FSU)	9,465	9,083	9,095
World	48, 273	56, 933	60,203

(Source: World Apple Review 2000)

New Zealand grows less than 1% of the world’s total apple production. Even among Southern Hemisphere producers New Zealand lacks a dominant position, as shown in Table 2 below:

¹ FSU = Former Soviet Union countries

Table 2
Southern Hemisphere Apple Production
(thousand metric tons)

Country	Average 1992-94	Average 1996-98	Preliminary 1999
Argentina	1,004	1,123	1,056
Australia	329	314	300
Brazil	666	739	945
Chile	827	933	1,165
New Zealand	469	539	536
South Africa	556	577	615
TOTAL	3,851	4,225	4,617

(Source: World Apple Review 2000)

However, while it is a minor producer, New Zealand is the seventh largest apple exporter in the world, accounts for around 5 percent of total apples traded internationally, and is responsible for over 20 percent of Southern Hemisphere apple exports.

The New Zealand Pipfruit Industry Today

The World Apple Report 2000 rates New Zealand as the world's most competitive apple producing country. The assessment criteria used to derive this rating are on-orchard production efficiency, industry infrastructure and inputs, and financial and market factors (such as inflation and interest rates). The competitiveness rating does not consider factors such as innovation, entrepreneurship and marketing performance.

New Zealand's international competitiveness rating does not translate into high orchard profitability, as reflected in MAF's pipfruit orchard models for the main growing regions, Hawke's Bay and Nelson. Overall, the model pipfruit orchards in Hawke's Bay and Nelson have made losses in most of the last five years and carry a substantial accumulated debt burden. This is illustrated in Tables 3 and 4 below:

Table 3
Hawke's Bay Model Orchard Actual and Forecast Budgets

	8 ha planted 1996/97	8 ha planted 1997/98	8 ha planted 1998/99	10 ha planted. 1999/00	10 ha planted Forecast² 2000/01
30 June Year End	\$241,641	\$169,254	\$202,028	\$223,914	\$342,236
Cash orchard income	\$166,677	\$157,099	\$166,760	\$220,130	\$277,150
Less cash orchard expenses	\$74,964	\$12,155	\$35,268	\$3,784	\$65,086
Equals cash orchard surplus	\$19,065	\$20,082	\$20,000	\$29,840	\$28,830
Drawings	\$11,100	\$6,928	\$0	\$3,300	\$0
Taxation	\$4,337	\$2,841	\$3,500	\$8,600	\$10,420
Principal	\$26,723	\$25,568	\$28,000	\$24,030	\$24,520
Interest and lease	\$13,739	-\$43,264	-\$16,232	-\$61,986	\$1,316
Disposable profit				Cumulative loss since 1996/97 =	-\$106,427

² It is stressed that the forecast for 2000/01 comes from model orchard data and not from figures published by ENZA.

Note that for 1999/00 only 11 orchards of the sample of 20 orchards will have a cash orchard surplus prior to interest. Only two of the 20 will have a disposable cash profit. The average disposable profit of the bottom 25% of orchards is estimated to be -\$147,000.

Overall, the Hawke's Bay model orchard in 1999/2000 makes the largest recorded loss since the inception of MAF's Monitoring Report. The 2000/01 forecast is more positive. However, for both the Hawke's Bay and the Nelson model orchards, it is stressed that the 2000/01 data is a forecast only, based on available information, and the final financial results could be different.

Table 4
Nelson Model Orchard Actual and Forecast Budgets

	11.5 ha planted	11.5 ha planted	12.8 ha planted	15 ha planted	15 ha planted
30 June Year End	1996/97	1997/98	1998/99	1999/00	Forecast 2000/01
Cash orchard income	\$276, 614	\$222,654	\$351, 761	\$415,944	\$557,659
Less cash orchard expenses	\$205, 850	\$226, 450	\$248, 300	\$381, 183	\$446,714
Equals cash orchard surplus	\$70, 764	-\$3, 796	\$103, 461	\$34, 761	\$110,945
Drawings	\$32, 000	\$28, 000	\$31, 000	\$28, 050	\$27,105
Taxation	\$7, 500	\$6, 200	\$9, 520	\$14, 025	\$10,905
Principal	\$4, 078	\$4, 078	\$8, 900	\$18, 750	\$19,050
Interest and lease	\$22,800	\$25,000	\$25,018	\$37, 440	\$33,030
Disposable Profit	\$4,386	-\$67, 074	\$29,023	- \$63,504	\$20,855
				Cumulative loss since 1996/1997:	-\$76,314

Growers with high on-orchard productivity, an appropriate varietal mix, scale economies and manageable debt levels can generally expect to be sustainably profitable, while those who lack these competitive strengths will struggle. There is concern that the industry is no longer appealing to young people, who have other career options, or to new investors, due to the investment interest around alternative horticultural crops.

Critical elements in the current and future competitive performance of the New Zealand industry include:

Innovation and Management of Technology

New Zealand has been innovative in production regimes such as the development of Integrated Fruit Production (IFP), and in post-harvest packing, grading and storage technology. New Zealand has earned premiums from new apple varieties it has developed (such as Braeburn, Royal Gala and Pacific Rose) and is a world leader in commercially successful new variety development. However, some new varieties fail to establish

themselves or to earn premiums. Premium-earning varieties tend to become price-driven commodities over time, especially as volume product comes available from overseas growers. In future, offshore and complementary production of New Zealand-generated varieties may be important to ensuring year-round supply of new varieties to supermarkets.

Research and development (R&D), both publicly and privately funded, is integral to the future of the pipfruit industry. ENZA has always been committed to R&D as a key competitive investment. ENZA’s ownership of FIPIA, its relationship with HortResearch, and its critical involvement in new variety development make it a key part of the pipfruit industry’s “system of innovation”. Pipfruit Growers New Zealand Inc. (PGNZI) has assumed a key role in “industry good” R&D with funding from growers under the Commodity Levies Act. New Zealand growers are innovative and have a high uptake and application of new technology.

Public R&D funding for horticulture is high both in absolute terms and as a ratio to private sector R&D funding. A vibrant and successful pipfruit export sector is important to sustaining the Government’s continued commitment to its investment in pipfruit-related research.

On-Orchard Productivity

New Zealand has among the highest apple orchard productivity per hectare in the world, though has only around half the number of trees per hectare as some competitors. Consolidation of smaller orchards, a systems approach to production, enhanced husbandry methods, and improved pruning, thinning and pest and disease management are seen as important to the industry’s future competitiveness.

Post-Harvest Competitiveness

New Zealand is a relatively high wage cost economy compared to some, though not all, of our competitors. We are a long way from our key markets. There are limits to the use of labour-displacing technology in the industry, and tighter and more demanding specifications from retailers and from ENZA and other exporters are imposing greater quality demands at harvesting and post-harvesting stages.

Post-harvest logistics and supply chain management substantially affect the proportion of total market revenue that is returned to growers. The returns to pipfruit growers as a proportion of total revenue earned in the market do not compare well with that achieved for some other fruit exports. Table 5 below compares returns to New Zealand’s two main types of export fruit, apples and kiwifruit, as at the year ending 30 September 2000:

**Table 5
Grower Returns from Apples and Kiwifruit for Year Ended 30 September 2000**

	Apples (per 18 kg carton)	Kiwifruit (per tray)
Total revenue (\$)	35.84	12.46
Return to growers	11.69	6.77
% of total revenue returned to growers	33%	54%

Consolidation in the packhouse sector, competition in on-shore logistics, and new technology such as colour grading appears to be improving the post-harvest competitiveness of the industry and there seems to be potential for further efficiency gains that can increase returns to growers.

Regional Bases of Production

There are significant regional differences in New Zealand that are reflected in varying performances for particular varieties, variations in packhouse and logistic support, and some differences in harvesting and marketing times. Some regional variations have marketing implications, such as where a region may be able to grow a certain variety within a time-frame to meet the needs of a particular market.

Financing the Industry

Growers typically borrow for both their capital requirements and operating expenses. There are significant climatic risks (e.g. hail) that can be insured against. A consortium of banks underpin ENZA's system of progress payments to growers. The banking industry enters into a wide range of financing arrangements for New Zealand food exporting industries, whether these industries are regulated or unregulated. ENZA's regulated position is not, in the long-term, crucial to the industry's bankability.

Role of Government in the Industry

The key role for government in the pipfruit industry is to maintain a framework for export marketing, to invest in pipfruit-related R&D, to maintain biosecurity, and to negotiate improved market access. Government will continue these key roles under whatever regulatory framework is agreed to for the future.

Single Desk Marketing of Pipfruit

New Zealand has marketed pipfruit through an exclusive or a modified single desk seller arrangement for over fifty years. Many growers are now in deep financial difficulty due to a range of factors, of which the most important is the state of the international market. The following arguments have been used in support of single desk marketing:

Weak Selling

Single desk marketing has been justified by concerns about weak selling, i.e. New Zealand pipfruit exporters may undercut each other. The volume and quality of New Zealand exports to particular markets does influence prices. However, generally price competition is between New Zealand exporters and overseas competitors, and New Zealand has no means of restricting exports from overseas competitors to prevent their undercutting our prices. Much competition in international markets is between pipfruit and alternative fruits and substitute products such as snack bars, rather than being between competing pipfruit marketers.

Weak selling would be a major risk if the market in which we are competing was the market for New Zealand-origin pipfruit. However, New Zealand competes in a highly competitive global fruit market with high substitutability between different fruits. Within the pipfruit market segment, competition may be based around factors such as apple variety, quality

characteristics (and their identification with brands), or differentiating features such as organic fruit. These factors are likely to be more important than the country of origin of fruit. However, New Zealand's clean, green image as an exporter of high quality fruit is likely to still be a useful differentiating feature in some markets.

ENZA Earning Premiums in International Markets

It is unclear whether ENZA is now earning premiums in international markets. Where it has done so in the past, it is not clear whether this resulted from single desk marketing, branding, new varieties, product quality, country of origin, service provision or other factors. Margins earned by ENZA may reflect the critical mass it has achieved as a global marketer, or its management of intangible assets, rather than the benefits of single seller marketing arrangements. There is now evidence that some independent exporters holding export permits are achieving higher returns in the market than ENZA for apples of the same variety and count size. However, this may reflect independent exporters achieving exceptional returns by targeting limited volumes of fruit into a selected number of high value markets. It is a much greater challenge to earn good returns from a much greater volume of fruit competing in a wider range of competitive markets.

Avoiding "Cherry Picking" in International Markets

It is sometimes argued that independent exporters can "cherry pick" the high value markets without carrying the burden of marketing the whole New Zealand crop. ENZA's current corporate strategy is to contract for that part of the crop it believes it can profitably market and it does not intend to market the crop as a whole. It could well be argued that ENZA now engages in "cherry picking", as do the independent exporters. Some argue that more exporters, with a wider array of market linkages and strategies, are needed if a much higher proportion of New Zealand's pipfruit is to be successfully marketed overseas.

Industry Co-operation on Major Production and Marketing Issues

A single desk model has been associated with the carrying through of some important changes for the industry as a whole. ENZA, science providers and pipfruit growers worked very effectively together in introducing Integrated Fruit Production (IFP) to the industry to reduce the use of chemical sprays, and to encourage biologically sustainable means of controlling pests and diseases. However, industry-wide strategies can be initiated and carried through with other regulatory structures and potentially through voluntary co-operation.

Overall Industry Perspectives on Single Seller Structures and the Role of ENZA

Pipfruit growers were generally comfortable with the former Apple and Pear Marketing Board (now ENZA Limited) when returns were adequate. Growers have generally believed that the Board or ENZA has achieved higher prices in the market for New Zealand pipfruit and that growers have obtained a higher proportion of this price than would otherwise be the case. However, support for the single desk structure has been eroded in recent years. Individually growers have often been critical of ENZA but collectively have maintained support for ENZA's privileged export right.

There is stated dissatisfaction from some offshore customers with ENZA's service delivery, and this has been cited as a reason for some loss of ENZA's market share to other Southern

Hemisphere competitors and to New Zealand independent exporters. However, many customers show long-term loyalty to ENZA and their confidence should be sustained into the future.

Over time ENZA has become more market and less production driven and in 2000 is clearly operating as a “hard nosed” commercial supply contractor and exporter. Corporate investment in ENZA and the emergence of independent exporters means it can no longer be argued that what is beneficial for ENZA is automatically beneficial for the industry as a whole. Growers exporting through ENZA have a limited shared interest with growers exporting independently. However, all growers may have an interest in having both a strong ENZA and a choice of exporter.

Overall, many people in the industry have expressed the view that ENZA needs competition to perform, that it has very strong and value-creating capabilities in pipfruit marketing, and that these capabilities should be sustained however the industry evolves in future.

Existing Regulatory Framework for Apple and Pear Exporting

The Apple and Pear Industry Restructuring Act 1999 converted the former Apple and Pear Marketing Board into a company (ENZA Limited) and provided for powers to regulate pipfruit exporting.

The Apple and Pear Export Regulations 1999 (the Regulations) give a privileged export right to ENZA, protect ENZA shareholders and suppliers through “mitigation measures” designed to prevent abuse of its dominant position, and allow for independent exporting through an export permits system. A key feature of the Regulations is their inter-dependence – it is difficult to significantly modify one part of the Regulations without having wider implications. For example, the mitigation measures are linked to and help balance ENZA’s privileged export right. In detail the regulatory regime is made up of:

New Zealand Apple and Pear Board

The Regulations create the New Zealand Apple and Pear Board as the body responsible for granting ENZA a privileged right for the export marketing of New Zealand apples and pears. The Board monitors compliance with the export marketing regime, including the mitigation measures, has an enforcement role, and appoints members to the Apple and Pear Export Permits Committee.

ENZA Limited

The Regulations prescribe a company form for ENZA. ENZA Limited is a company registered under the Companies Act 1993. It is required to remain a company “with no shares other than ones that are fully tradable at least among growers.” ENZA’s constitution (rather than the Regulations themselves) requires that shares must be owned only by shareholders who are engaged in the commercial sale of pipfruit and that shares are fully tradable among growers, though not outside the grower community.

The limited tradability of ENZA shares has had significant implications since the lack of external competition for the shares (compounded by the financial stresses on growers and ENZA’s perceived performance) heavily discounted share values. Two corporate investors

took advantage of these low share values in August 2000 and acquired a “cornerstone” shareholding in ENZA. This led to the corporate investors attaining a dominant position on ENZA’s Board. This substantially changes the grower-controlled model of ENZA by creating a divergence between ENZA ownership and pipfruit supply. Effectively, many suppliers of pipfruit own no shares in ENZA while the corporate shareholders are minor pipfruit suppliers. However, ENZA needs to retain supply from growers to be commercially successful, and most of ENZA’s suppliers still retain ownership of at least some ENZA shares.

ENZA’s privileged export right gives it a monopsony³ control over pipfruit exporting, subject to the mitigation measures, and to the provisions in the Regulations for independent exporters to be granted export permits.

Mitigation Measures

To balance ENZA’s privileged export right, and to ensure some protection of grower, supplier and shareholder interests, mitigation measures are prescribed in the Regulations. The key measures are:

Non-Discrimination Rule

ENZA is not allowed to unjustifiably discriminate between suppliers and potential suppliers through its pipfruit purchasing decisions and the terms of its purchase contracts. It can however discriminate on legitimate commercial grounds.

Non-Diversification Rule

ENZA is not allowed to go outside of its core business (pipfruit export marketing) and other limited specified activities except with the express approval of its providers of capital. ENZA shareholders and suppliers who have not agreed to diversification cannot be exposed to “more than a minimal risk”. The non-diversification rule restricts ENZA’s commercial flexibility in a way that may be inconsistent with trends in the international market. Retailers are increasingly moving to a smaller number of larger category managers who can provide a year round fruit basket, sourced from different countries and suppliers to increasingly stringent specifications. Regulatory limitations on ENZA may exclude it from competing more widely in fruit export markets.

Other Mitigation Measures

Other mitigation measures relating to information disclosure, protection for shareholders, and “arms length” rules applying to the relationship between ENZA’s core business and on-shore logistics are also prescribed in the Regulations.

³ A monopsony exists where there is only one buyer in a market. ENZA is a monopsonistic buyer in the market for pipfruit to export but has no monopoly in the international market in which it sells.

Export Permits Committee System

The Apple and Pear Export Permits Committee established in the Regulations approves permits for independent exporters of pipfruit provided the permit applications do not undermine the current marketing activities of ENZA and are not likely to result in any adverse effect on ENZA's reputation in relevant overseas markets. The "benchmark" set is therefore ENZA's marketing position, rather than the demands and opportunities of international markets, or total wealth creation for the New Zealand industry.

For the 1999/2000 season the Permits Committee granted permits for around two million cartons – around 10% of New Zealand's total export crop. Total exports of fruit authorised by the Permits Committee fell short of this figure. While the evidence is limited it does seem that independent exporters are adding value to the New Zealand pipfruit industry directly in the market, and perhaps indirectly through placing pressure on ENZA to perform. There is some evidence that permit holders may have retained New Zealand access to retail markets that New Zealand would otherwise have lost to competitors such as Chile.

Some parts of the Permits Committee system, including ENZA's access to information from applications, have been controversial. Fruit exported under permits may have had some negative effect on ENZA's performance in some markets, although this impact is difficult to verify, and in some cases it may have resulted from factors outside the control of the exporters. Some export permit holders, wittingly or unwittingly, may have breached permit conditions. It is unclear whether this behaviour by permit holders (or by the importers of their fruit) has materially damaged ENZA in the market.

Issues to be Addressed

Key issues that need to be addressed include:

Changes in the International Market

The New Zealand pipfruit industry must respond to the following changes in the international market:

Consolidation and Rising Service Demands from the Retail Sector

Many retailers are becoming more concentrated and typically want to deal with fewer suppliers, often as multi-product, year-round category managers. Category management demanded by retailers means that marketing businesses must offer a wide "fruit basket" sourced from different countries for 12 months of the year. Some supermarkets are demanding deliveries into a number of distribution centres from one site and with one invoice from the supplier. Such retailers are not primarily driven by the potential for occasional "cheap deals" from under-cutting suppliers who are not able to provide a long-term service. Factors such as reliability and quality of supply, logistics and technical backup are often more important to retailers than the ability to exploit "weak selling" by fragmented suppliers.

Some supermarket chains do place pressure on suppliers to reduce the administrative and management costs of supply, not necessarily to reduce the costs of particular supplies of produce. Some supermarkets are also demanding more without being prepared to pay more

for it. An example is a requirement that all fruit is grown using Integrated Fruit Production (IFP) techniques, but without a premium being paid for this.

Globalisation of Fruit Trading

Globalisation of fruit trading may open up opportunities for joint ventures between New Zealand fruit exporters and companies such as Dole, Chiquita, Del Monte and the Albert Fisher Group. These overseas companies may also wish to compete directly to access supply of New Zealand pipfruit, which in turn may bid up prices for New Zealand fruit. It is significant that offshore fruit businesses are already active in fruit export marketing from New Zealand, for example within the Horticulture Export Authority (HEA) framework.

Need for Horizontal Co-ordination and Integration between Product Groups

Changes in international markets are likely to require greater horizontal co-ordination and perhaps integration among fruit and other food industry groups. New Zealand's existing regulatory framework for pipfruit is based around specific fruits and does not lend itself to the horizontal co-ordination and integration that is needed to compete in the market as category managers. There is significant industry interest in closer horizontal co-ordination between New Zealand fruit export marketing businesses.

Competition for Shelf Space and Impacts of House Brands

Quality standards, service delivery and strong branding are important for pipfruit exporters to compete for shelf space and earn premiums from it. While the pipfruit industry has elements of a "fashion industry", limited shelf space constrains how many new apple varieties can be marketed. Competition for shelf space is important in the fresh produce area since apples are a mature product and a new variety can only win space in supermarkets by displacing an old variety. When a new variety wins shelf space retailers have to be confident that it can be supplied to tight specification standards on a year round basis. New Zealand has placed great emphasis on new variety innovation. While this has been an effective strategy it has its limits as a proliferation of new varieties can lead to product clutter. Developing and commercialising a new variety, learning how to grow it in different microclimates, and solving on-orchard and post-harvest management problems can be costly and time-consuming.

There is a trend for more supermarket house brands and for the quality of products offered under house brands to be increasing. To earn premiums New Zealand exporters need to have strong branding strategies or marketing positions to counter competition from house brands. A concern expressed is that independent exporters will sell apples for house brands that in turn will undermine attempts to position New Zealand apples under the ENZA brand or other New Zealand brands that may emerge. While this argument may have some merit any competitor can supply a house brand, and there is no reason why a New Zealand exporter would be more or less inclined to do so than an overseas one.

Differentiation in the Retail Sector

While consolidation is the major trend in the retail sector, differentiation is also occurring. Retailers may wish to differentiate through organic fruit for example, and will want the trace-back procedures and the relationships with suppliers to verify fruit attributes and quality.

Some retailers wish to remove middlemen from the market (“disintermediation”) by forming direct relationships at the packhouse or coolstore level, with logistics and shipping being contracted services. For other retailers direct relationships may be fostered with growers with the aim of ensuring that specific quality standards and product specifications are met and can be verified. ENZA’s privileged export right does not facilitate such relationships developing between retailers and New Zealand growers.

Tighter Specifications demanded in Markets

Retailers are demanding tighter specifications which must be met and verified through documented trace-back and validation systems. Some retailers are demanding guaranteed shelf life, increased sales support, and fruit packed ready for retail display. Because these requirements differ between retailers, export marketers must segment crops for the right market at the right volume. This may imply advantages from a wider range of export marketers who can focus on different markets.

Vertical Integration

Some retailers wish to integrate backwards through investment in the supply chain, for example to manage supply risks, enhance quality management, or create differentiating features. Because ENZA’s constitution bans equity investment from non-grower investors, retailer integration through investment in ENZA is effectively precluded.

How can the Pipfruit Export Industry Respond to Change in International Markets?

Key strategic elements in the industry’s response to the changing demands of international markets could be as follows:

Sustaining and Enhancing ENZA’s Performance

Under the existing Regulations most of our exports are handled by an ENZA which is focused on pipfruit exporting, lacks full commercial powers, and which despite its best efforts cannot be expected to identify and exploit all possible niche markets for New Zealand pipfruit. The importance of a strong ENZA is agreed by all key industry stakeholders. ENZA is the only marketing entity that currently has the knowledge, networks, supply chain links, experience in managing new varieties, branding and intangible assets to credibly market the bulk of New Zealand’s pipfruit. A successful ENZA is critical to the industry’s confidence, to continuity in marketing services to growers, and to sustaining an important New Zealand brand. Stability for ENZA may help many growers manage their cash flows and debt servicing at a time of real financial pressure in the industry.

In future ENZA could grow dramatically through diversification beyond New Zealand pipfruit and it could become a major international marketer of a wider “fruit bowl,” with full commercial powers. This would require the removal of the mitigation measures within the Regulations. Alternatively, if it remains focused on pipfruit, ENZA’s total market share and sales may drop and yet it could still deliver better net returns both on those sales and on the assets it employs.

In the short-term ENZA’s performance may improve due to new skills, ideas and disciplines from the new corporate investors, and growing pressure to perform arising from the export

permits process. Although two corporate interests dominate ENZA's Board, around 64% of ENZA shares are still owned by other growers. An enhanced ENZA performance is therefore in the interests of the two corporate investors, other grower shareholders, and those suppliers who can meet ENZA's requirements.

Fostering More Flexibility in Export Marketing

Viable independent exporters are already emerging from the Export Permits Committee process. More flexibility in export marketing will allow new opportunities to emerge. These may include new niche marketers, for example of organic fruit, offshore businesses marketing New Zealand fruit, new joint ventures across a range of food industry businesses, and the emergence of new groups of growers who have interests in a common variety or shared regional interests.

More flexibility and permissiveness in export marketing does not necessarily imply full deregulation, as it could encompass alternative forms of co-ordination or light-handed regulation. More flexibility in export marketing would ideally retain the best performance elements of the existing export marketing regime while adding "new strings to New Zealand's competitive bow". It implies a number of large exporters of New Zealand pipfruit, complemented by the emergence of smaller, niche-oriented exporters. ENZA could retain its dominance but would be under competitive pressure to perform from these other exporters. Marketing flexibility is consistent with strong market co-ordination within the industry and with co-operation on issues such as market access, quality standards, driving off New Zealand's clean, green image through reduced pesticide residues, and industry investment in R&D.

An ENZA that has to compete for fruit, and more export marketers seeking to develop new markets, may help increase grower returns. ENZA currently aims to market that part of the crop that it can profitably sell. The emergence of competing exporters can reduce the proportion of the crop that is dumped or confined to low value uses, for example by finding new market niches.

Focusing on Net Returns not on Total Sales

The impressive total export sales figures that the New Zealand pipfruit industry earns mask the poor net returns to growers, high grower indebtedness, and a dependence on off-orchard income. The focus must be on net returns for growers, not total sales. It is better, for example, for industry participants to have a sustainably profitable \$500 million export industry that can provide reasonable incomes than an impoverished \$600 million industry with excessive debt burdens, low or negative margins, and which distorts investment decisions amidst a range of alternative land and resource uses.

Encouraging New Business Investments and Relationships

There is potential to attract off-shore investment in export marketing of fruit. Overseas multi-nationals are already significant exporters of New Zealand fruit and vegetables and major wholesalers on the domestic market. Further overseas interest in export marketing of New Zealand fruit may open up new markets and has the potential to increase returns to growers.

Consolidation and Rationalisation

Some orchards do not have the production capability and scale economies to be competitive. Irrespective of the exporting framework, market forces will lead to the exiting of less efficient operators from the industry, consolidation of smaller orchards into larger units, and rationalisation and efficiency gains in the post-harvest packhouse, coolstore and logistics areas. This could see more efficient orchard businesses emerging and, where appropriate, shifts in land use into higher value crops or other uses.

Managing the Politics of International Markets

Pipfruit growers internationally are under severe competitive pressure. It seems important that New Zealand exporters avoid behaving in ways that invite claims of “dumping” or which antagonise overseas suppliers to the point where it creates political pressure for trade retaliation. Likewise, consumer sensitivity on issues such as food safety and low chemical residues are important to industry competitiveness. One shipment of apples with high chemical residues in a sensitive market could significantly damage the reputation of the New Zealand pipfruit industry and harm the image of our food industries as a whole.

Depoliticising the Industry and Reducing Lobbying Costs

The pipfruit industry is heavily politicised. This generates costs in the form of lobbying and the work that underpins it. It is often noted that pipfruit industry meetings can spend hours discussing domestic politics without any mention of overseas customers or markets. Depoliticisation of the industry will allow peoples’ energy, time and money to be redirected into wealth creation for the sector.

Management of Change Issues

Any transition to a new regime for the pipfruit industry should be managed to avoid fragmentation and discontinuity of the export marketing effort and disruption to supply chain management, to protect intangible assets, and to ensure that new exporters are viable in the longer term. Transition should also be managed to allow consolidation and rationalisation in the industry, and to allow non-viable growers to move to alternative crops or land uses, or to exit the industry. Management of change requires a partnership between industry and government, to retain the confidence of growers, their bankers, and offshore customers.

Options for the Future Regulatory Framework for Pipfruit Exporting

The following criteria have been developed to evaluate the alternative options to govern pipfruit exporting:

Criteria to Assess Options

Options can be evaluated by considering the extent to which they would:

- enhance the pipfruit export industry’s ability to understand and respond to international markets and customers
- enhance grower profitability and create wealth for New Zealand
- sustain New Zealand’s reputation as an export marketer of quality food products

- sustain and protect our system of innovation and ability to create wealth from our intellectual property
- enhance cost efficiency and the allocation of resources to their most valued use

In considering the outcome of the review the Government will want to satisfy itself that the preferred option is broadly supported by growers, and can be implemented in a way which minimises disruption to growers, as well as sustaining existing marketing networks and capability.

Option 1: Returning to an Exclusive Single Desk Model

The single desk model gives one export agency a single buyer power to purchase pipfruit for export, and full control over how that fruit is marketed. The single desk organisation would not necessarily be obliged to market all quality fruit growers could supply. A return to a single desk model would require new legislative provisions to establish some form of exclusive single desk export right. It is almost certain this would mean that ENZA would be given a single desk export right without any provisions for independent exports through the existing Export Permits Committee process established in the Regulations.

Benefits of an Exclusive Single Desk Model

- It could address concerns about weak selling
- It would ensure central co-ordination of export marketing strategy
- It could provide a basis for the marketing of the entire New Zealand export crop, depending on factors such as the governance and marketing strategy of the single desk organisation and how product specifications are set

Costs and Risks of an Exclusive Single Desk Model

- Grower choice would be removed
- It could stifle innovation and entrepreneurship
- It would hamper the development of new and differentiated niche markets
- The single desk organisation would lack competitive pressures to perform in the market and to reduce its cost structure
- It would be less flexible in responding to changes in international markets
- Independent exporting and ENZA's move to a corporate rather than a co-operative model are far advanced and it would be extremely difficult to return to an exclusive single desk model
- It could cause substantial commercial loss to some industry stakeholders, for example independent exporters

Option 2: Retaining or Amending the Existing Apple and Pear Export Regulations

The existing Apple and Pear Export Regulations 1999 reflect a hybrid between a single desk and a deregulated model of pipfruit export marketing. ENZA's privileged export right gives it very favourable powers over New Zealand pipfruit without the growers of that pipfruit having control of ENZA as their marketing arm. ENZA's privileged export right therefore appears to cause difficulties from a commercial, governance and accountability perspective. While the Export Permits Committee has carried out its difficult task very professionally and

ethically there is widespread dissatisfaction with the process itself and its practical impacts. For these reasons, it is difficult to envisage the indefinite continuation of the existing Regulations in unmodified form.

The Regulations could be amended to be either more restrictive of independent pipfruit export marketing or more permissive. The experience from the first season (1999/2000) under the Regulations suggests that they are already very restrictive both in the specific criteria governing export permits and in how the export permits process has worked in practice. It would be difficult to make the Regulations more restrictive without further severely limiting the contribution independent exporters can make to the industry. ENZA continues to be commercially constrained by the mitigation measures. Therefore, in practice, any amendments to the Regulations would seem to need to take a more permissive approach to export marketing and to the commercial powers available to ENZA.

It would be possible to allow the export permits process to continue to run for a period to allow viable independent exporters to emerge. This could be a means of retaining the benefits of ENZA's strong positioning in the market while allowing more contestability in pipfruit exporting. However, this is only a viable option if key elements of the Apple and Pear Export Regulations 1999, such as the mitigation measures, remain substantially unchanged for some time. This seems unlikely given the pressures for change in the industry and the control corporate investors have over ENZA.

Benefits of Amending the Existing Regulations

- Future change can be managed incrementally and based on experience built up with the Regulations
- Independent exporters have time to develop the networks and capabilities to become successful export marketers for the long-term
- No requirement for government to promulgate new legislation or make other major policy changes

Costs and Risks of Existing or Amended Regulations

- Significant industry groups do not support the existing regulatory framework
- Many consider it inappropriate for a privileged export right created by government regulations to be vested in an ENZA controlled by corporate investors who are not strongly representative of growers
- The combination of the existing Regulations and ENZA's corporate approach creates barriers to the export of that part of the pipfruit crop not contracted to ENZA
- The Regulations are seen as inequitable by independent pipfruit exporters
- The Regulations are difficult to amend without wider ramifications, for example concerns about the criteria governing the Export Permits Committee process are not easily addressed without weakening or removing ENZA's privileged export right
- There is inherent tension within the Regulations, for example relating to the provisions for independent exporting, and they continue to be a focus for political debate

Option 3: No Restrictions on Exporting ("Deregulation")

This option would involve revoking the Regulations and allowing anyone to export pipfruit.

Even with a completely deregulated export marketing regime there would still be important “industry good” issues that need to be addressed through some form of collective or co-operative action. These issues could in most cases probably be addressed through existing frameworks, such as the Commodity Levies Act 1990.

The South African experience with deregulation is worth citing. There is a widespread view that deregulation in South Africa has reduced costs, made it easier to service niche markets, and fostered entrepreneurship. Deregulation created new marketing capabilities in South Africa and attracted some offshore investment. There is also a view that reduced costs have been offset by reduced relative prices achieved in international markets. It is hard to verify and quantify these effects. In the first season of deregulation a number of the new exporters who emerged proved non-viable and went out of business, in some cases taking suppliers with them. A key lesson is that if deregulation was agreed to in New Zealand it would be prudent, as far as possible, to manage it to avoid “fly by night” exporters who lacked the skills and capabilities to deliver a viable and long-term service to growers. In New Zealand the Export Permits Committee process has already played an important role in fostering the emergence of some new pipfruit exporters who do have the skills to provide a quality service for growers.

The South African pipfruit export industry is still under considerable competitive and financial pressure, as with the industry in all major pipfruit producing countries. There are indications that under deregulation the South African industry needs to do better in maintaining and sharing industry-wide information bases and in working together on export marketing issues of common interest to the industry. Latest indications are that many South African growers and exporters would favour some form of market co-ordination or discipline. However, there appears to be no major constituency that wishes to return to the regulated industry of the past.

Benefits of Removing Restrictions on Exporting

Removing restrictions on pipfruit exporting might:

- De-politicise the industry and focus it on markets rather than politics
- Foster entrepreneurship and innovation in the export industry
- Improve our ability to compete in niche markets and to differentiate ourselves
- Allow more exporters to compete for grower supply and lift returns to growers
- Place competitive pressure on ENZA to perform better in the market and reduce its cost structure
- Make it likely that a higher volume of our export crop can be marketed

Costs and Risks of Removing Restrictions on Exporting

Removing restrictions on pipfruit exporting:

- Could lead to costs from the entry into the market of exporters who lack the skills and capabilities to provide effective marketing services to growers in the longer term
- May lead to New Zealand exporters undercutting each other in some price-sensitive markets
- May create the danger of wider damage to the industry as a result of the behaviour of some exporters, for example in relation to product quality issues

- May reduce information flows and interactive learning within the industry
- Could cause difficulties of co-ordinating and directing industry R&D and other “industry good” activities in a way that involves exporters as well as growers

Option 4: Horticulture Export Authority (HEA) model

The use of the HEA is, in some respects, a variant of Option 3 and is one which the industry itself would have to play the lead role in developing.

The HEA was formed in 1987 by the New Zealand Horticulture Export Authority Act. Its major roles are:

- Administering export licensing
- Monitoring and approving export marketing strategies
- Promoting quality management
- Acting as a forum for the exchange of information
- Encouraging market analysis and research and development

Growers and exporters together form a recognised product group which must satisfy Ministers that it is representative of growers and exporters. The recognised product group for a prescribed product then develops an export marketing strategy which must be approved by the HEA. These strategies set out general marketing objectives for the export of the product and may address issues such as export market information, product and market research, distribution, promotion, selling and export pricing. Strategies differ greatly between product groups. They are often broad, strategic, and permissive. However, where necessary, they can include prescriptive requirements, for example relating to quality standards. In practice, once the HEA endorses a product group strategy the exporters and growers are mostly able to “get on with it” without being constrained by detailed regulatory requirements. Under the Act, growers are free to contract with any exporter licensed for their product.

So far, the HEA Act has provided a framework for smaller and emerging export product groups rather than larger industries such as pipfruit. The HEA Act has never been tested with a very large and established product such as apples that competes in such a large number of different markets. A difficulty may be that the pipfruit industry would bring into an HEA Act framework a considerable amount of “historical baggage” which may not lend itself to developing a unified view of future export strategy. It may also be that the sort of issues newer industries have addressed through the HEA (such as quality standards) have already been dealt with in the pipfruit industry.

There is concern that the HEA Act takes a single product focus. However, this does not appear to constrain marketing of a wider “fruit basket”. A number of companies export a range of fruit and vegetable products that are licensed by the HEA and offer these products to retailers as part of wider fruit and vegetable supply arrangements.

A dominant export business such as ENZA may appear to have the ability to control a recognised product group. However, this so far does not appear to have occurred in practice. ENZA currently exports over 70% of New Zealand’s nashi within the HEA Act framework and yet has only one vote on the nashi product group and does not appear to dominate the export strategy.

It has been argued that the HEA Act “lacks teeth” to enforce an export strategy. The HEA does have significant powers, including the ability to decline or revoke licences. However, it has fostered an approach to export marketing that relies on shared interests and co-operation rather than punitive sanctions. The HEA has only ever revoked one licence and has set conditions on a number of others. Grower and exporter groups under the HEA generally follow the agreed strategy because it is developed by the industry itself and because it is in their interests to do so, rather than because of fear of sanctions or litigation.

Benefits of the HEA Model

- Encourages exporters and growers to work together in a way that fosters strategic thinking, information flows and synergies within industry
- Allows for market co-ordination while still providing considerable choice and permissiveness in export marketing
- Can set quality standards and avoid the export of poor quality product that could damage the reputation of the wider New Zealand industry
- Provides a basis for strategic industry directions for public and private R&D investment
- Low cost option compared to existing Regulations
- Is supported by the product groups involved (industries that are dissatisfied may leave)
- Focuses growers and exporters more on markets and less on industry politics than the existing regime
- It is, in practice, an enabling and light-handed form of regulation

Costs and Risks of the HEA Model

- The pipfruit industry lacks a unified strategic view and may struggle to work together effectively on export marketing strategy
- The HEA Act model has so far been used only by smaller horticultural export industries and is untried on an industry as large and diverse as pipfruit
- A dominant exporter such as ENZA may be reluctant to share information and work together with other exporters, or alternatively may attempt to dominate the export strategy development process
- Individual exporters that disagree with the product group strategy are still required to comply with it and this may stifle some niche-oriented market developments
- Innovation and entrepreneurship could arguably be constrained by a single product group
- It is a higher cost option than having no controls over export marketing
- Has more focus on politics than having no export marketing controls

The HEA Act is existing legislation and it is up to industry groups whether they choose to use it as an export marketing framework. If growers and other stakeholders supported the HEA model the Government would need to revoke the Apple and Pear Export Regulations 1999. The Regulations would be revoked irrespective of how subsequent events developed, including a failure by the pipfruit industry to form a product group and/or develop an export marketing strategy to meet the HEA requirements. If the industry supported the HEA model it would be up to the industry, not the Government, to meet the HEA requirements. Alternatively, if the outcome of this review process was removal of all regulatory controls on pipfruit exporting, the industry would still be able to avail itself of the HEA option at a later stage if it chose.

Other Options

Industry views on other options are welcome and will be considered.