The Role of Alliances in the Australian Meat Industry

A Report to the Meat Research Corporation

VCG Australia Pty Ltd

The Virtual Consulting Group

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EXECUTIVE SUMMARY

Background to Strategic Alliances

Strategic alliances are agreements between independent firms to co-operate amongst themselves so that they can compete more effectively with others. Firms decide to enter into strategic alliances because it helps them achieve some strategic end that they are unable to achieve as efficiently by other means. Vertical alliances involve firms at different stages of the supply chain. Horizontal alliances involve firms at the same stage of the supply chain.

Three worldwide trends in the food industry, agribusiness and business in general have made strategic alliances more common, particularly in food industries that are in competition with red meat. By recognising and responding to these trends, the red meat industry is attempting to maintain its profitability over the longer term.

- ◊ In wealthy countries, competition for the consumers' food dollar has intensified. Consumers are more demanding and have an ever-expanding range of choices as food markets become more fragmented. In the 'newly emerging' countries of Asia, diets are expanding to include non-traditional, western foods. Food companies are competing by seeking new ways to provide additional 'customer value' to these more discerning or new consumers. Strategic alliances offer one means to create additional customer value—for example, if customers want to be sure their food is safe, retailers need to have an integrated supply chain so that they know their suppliers and can trace back their supplies.
- ◊ The so-called 'industrialisation of agriculture' has also encouraged strategic alliances and the more industrialised sectors such as poultry have operated strategic alliances for many years. Successful competition with these industries will require that the red meat industry adopt similar alliances.
- ◊ Businesses everywhere are using strategic alliances to shift their 'boundaries' to give them more scale so that they can compete. This ranges from greater use of contractors to complete 'outsourcing' of supply as in the case of Nike.

Background to the Study

The MRC Marketlink program has been testing the use of strategic alliances to overcome problems of industry fragmentation, intersector conflict and a commodity trading culture, which lead to inconsistent product supply to consumers. The alliance concept is well received by many but others fear it will lead to loss of price discovery mechanisms and to market domination by foreign-owned companies.

The MRC commissioned VCG Australia to carry out this independent investigation of the cases for and against strategic alliances in the red meat industry. It examines the likely impact of alliances on the production sector, on market forces, on price discovery and on shift in the balance of market power. The report has been prepared by a team of independent specialists with experience in marketing, agribusiness, economics and the red meat industry. It critically examines the theory and practice of strategic alliances in the meat industry in Australia and overseas and makes recommendations for the support of strategic alliances as part of Marketlink II

The Case Against Strategic Alliances

Opposition to strategic alliances is based on two major concerns—one economic and the other social. The economic concern is that alliances will shift market power away from producers to others further up the marketing chain—processors, retailers and exporters. Opponents suggest that alliances will favour the bigger operators leading to increasing industry concentration—a few large firms controlling a major share of the market. Increased concentration means greater market power and opponents suggest this will mean that producers can be more easily exploited. This economic concern has been growing amongst producers and some consumers in Australia and it has been raised by producers in the US on several occasions in the past, particularly when beef producers are struggling with low profits. Those opposed to strategic alliances raise four specific concerns in relation to the shift of market power. These concerns and our assessment of them are presented below.

- ◊ *Alliances will increase industry concentration which will result in exploitation of producers.* Our assessment is that the trend towards increased concentration is being driven by overall industry economics and the need for greater efficiency rather than by the formation of alliances. If alliances were encouraged in Australia, the major impact is likely to be increased efficiency and competitiveness rather than exploitation of producers. It is also important to recognise that, although industry concentration in meat processing in Australia is increasing, it is still less than one third of that in the US. Despite the widespread concern about exploitation as a result of industry concentration in the US, extensive studies in the US have been unable to show that industry concentration has led to exploitation of producers. The available evidence is that although concentrated firms potentially may have more market power, they have not used this power to exploit producers.

- ◊ *Alliances provide an opportunity for (unfair) price discrimination.* In a competitive market, the difference between the price paid for identical livestock in different locations should only reflect the difference in transaction costs (transport, handling and other costs) to have those stock processed. In theory, transactions through alliances reduce competition and thus provide scope for price discrimination. In practice, it seems that this is not occurring. In Australia, experience to date has been that producers in alliances obtain higher values for their stock, presumably because the transaction costs for the buyers are lower. In the US, where there is much greater use of alliances and other means of by-passing the public auction, studies have shown there is relatively little price discrimination. Our assessment is that, in Australia, alliances would not lead to reduced competition or to price discrimination

- ◊ *Alliances will interfere with the price discovery process because more transactions will be conducted in private and this will mean that it becomes impossible for producers to assess whether they are receiving a fair price.* Evidence from the US where private transactions account for almost 20% of trading is that there is only about 1% difference between the price in spot markets and that in marketing agreements. There is no reason to suggest that the situation in Australia would differ in this regard. However, our assessment is that the existing price discovery process is weak in Australia because, in some marketing channels, the price paid does not accurately reflect the value of the livestock. This needs to be addressed through the introduction of Value based marketing (VBM). Alliances will assist introduction of VBM and will shift the reference price to the retail or export prices.

Good public information about costs of transforming livestock to retail or export product and public information about retail and export prices will provide better price discovery mechanisms.

◊ *Alliances will lead to a loss of control to foreign operators who will seek to exploit producers through transfer pricing and other means.* Our assessment is that alliances themselves will not significantly influence the level of foreign ownership or the nationality of the owners. If foreign operators were gaining a greater share of livestock supply through the use of alliances it would only be happening because they were paying higher prices to producers. The best defence against transfer pricing may be to develop alliances with operators serving markets where transfer pricing was not possible.

The social concerns are that alliances will lead to loss of independence, loss of the family farm and adverse environmental impacts. Our assessment is that whilst there are trends impacting on each of these concerns, alliances are likely to be relatively minor contributors to those trends in the foreseeable future.

The Case for Strategic Alliances

Support for strategic alliances is based on three considerations: improved production and marketing effectiveness and efficiency through greater customer focus; a better match with the changing business environment; and scope for expansion of the boundaries of the business.

◊ *Alliances can help improve the effectiveness and efficiency of participants.* All firms along the value chain are under competitive pressure to improve their efficiency. Some of the changes needed will require collaboration amongst those in the chain and this may only be possible through an alliance. Alliances are likely to improve effectiveness and efficiency in a number of ways including: lower cost opportunities to understand customer needs as a result of better and cheaper communication along the chain; creation of an environment which facilitates the introduction of VBM; facilitation of quality assurance systems such as Cattlecare; provision of the opportunity for through-chain benchmarking; and improved risk management through reduced price and supply risks.

◊ *Alliances can help the industry respond to the changing business environment.* The changing business environment for the red meat industry means that a significant part of the 'higher value' trade in meat in the future is likely to be directed through business systems or networks relying on integrated supply chains to create 'customer value'. These integrated supply chains will be characterised by reduced numbers of suppliers probably in the form of alliances of well-coordinated supplier groups. For those operators in the industry who are interested and able to make greater profits from this 'higher value' trade than from other trade in red meats, it will be essential that they are involved in some form of alliance ie that they collaborate with processors and retailers or exporters to create an integrated supply chain. Through that alliance they will be able to improve the flow of information back along the supply chain to the producers.

◊ *Alliances can expand the boundaries of a business.* For producers and their families, this means the opportunity to learn new skills about marketing and customer relationships and to achieve new status over and above being "just a farmer". The image of agriculture will be redefined from an industry operated by low status and lowly skilled labourers to one operated by highly skilled professionals.

For other operators in the value chain, alliances provide similar opportunities to expand the boundary of the firm without the costs and risks associated with full-scale vertical integration where the integrator owns and operates every facet of the business.

The benefits from alliances appear substantial and the risks associated with their greater use appear limited and manageable. Those producers who do not participate in alliances are unlikely to be adversely affected. The concerns associated with price discovery and shift in market power appear unsubstantiated and can be minimised by ensuring better public access to relevant market information.

Expected Impact of Strategic Alliances in the Red Meat Industry

Our analysis leads us to expect that the overall impact of strategic alliances will improve the competitiveness of the red meat industry in Australia. We expect that the process for this improvement will be as follows:

- ◊ A small proportion of producers will decide to participate in alliances and will look for opportunities to join or create horizontal or vertical alliances. Most of these producers will initially become involved in horizontal alliances so that they are able to overcome the weaknesses associated with their individually small supply capabilities and poor access to market information
- ◊ The successful horizontal alliances will foster a marketing culture with a customer focus. Members will become aware of what the customer wants and focus their efforts on producing these products. This will influence the production and marketing practices of individual operators and the group as a whole. Those changes in production and marketing practices will help participants become more competitive. Their improved performance will set an example that others in the industry will want to emulate.
- ◊ Many if not all the successful horizontal alliances will eventually choose to be associated with and participate in vertical alliances. Some vertical alliances will be "through-chain"—from plate to paddock. Others will be more limited in scope—from processor to horizontal alliance or from wholesaler/marketing agent to producer. In all successful cases the communication between participants in vertical alliances will be better than that amongst those outside the vertical alliance.
- ◊ Producers in vertical strategic alliances will further improve their competitiveness by developing a better appreciation of customer needs and improving the efficiency of overall red meat production—more of their production will meet specifications and less will be downgraded; participants will sell more product; and, in some situations, participants will sell more product at higher value. Processors in alliances will improve their throughput and overall efficiency because they will have greater security and consistency of supply. Wholesalers, retailers, exporters and food service industry suppliers in alliances will improve their customer value and expand their market share and overall profitability. Successful alliances will be those where the increased profits are shared fairly amongst all participants.
- ◊ Those producers who choose not to participate in the alliances will not be adversely affected compared to the situation that would apply if there were no alliances. To the extent that alliances facilitate the more general introduction of value based marketing outside alliances, those producing better than average

product will be better off while those producing worse than average product will be worse off. Industry as a whole would be better off under these circumstances.

◊ Although we envisage that strategic alliances will have a substantial impact on the industry over the next 3-5 years, we also recognise that most red meat will be marketed outside alliances. Our judgement is that by 2000 perhaps 6,000 producers accounting for up to 10% of red meat production might be operating in horizontal alliances of some sort and less than half their production (5% of total red meat production) would be marketed through various vertical alliances. This would mean that at least 95% of all red meat is still marketed outside alliances.

Conclusions to the Study

1. The case in support of use of strategic alliances in the red meat industry is stronger than any case against such alliances. The experience in the US provides the most compelling evidence that strategic alliances do not lead to exploitation or other forms of abuse of market power. The best defence against such abuses and anti-competitiveness would be to ensure that all sectors of the industry have access to reliable and comprehensive market information. Overall, our assessment is that the competitiveness of the red meat industry will be improved by expanded use of strategic alliances between different segments of the value chain.
2. Alliances will only develop and remain active where they deliver additional customer value and greater long term profits for all participants.
3. Alliances between producers and processors are much more likely to deliver additional customer value and therefore to be sustainable if the producers are themselves organised in a horizontal alliance.
4. These alliances will function side-by-side with the traditional marketing channels and will not interfere with the operations of other channels that will continue to account for the majority of red meat sales.
5. Alliances will be developed all along the value chain and most alliances will not be through-chain but will involve only part of the chain. Alliances will be most likely to form with minimal outside support in situations where there is already a high level of industry concentration in the industry segments of both partners.
6. Alliances between individual producers and processors and/or retailers will be the most difficult to establish and will remain rare. Alliances between groups of producers in horizontal alliances and processors and/or retailers will be much more easily formed and will constitute the first step towards improved marketing.
7. Alliances do not occur spontaneously but require careful planning and interaction between partners. This will be the first step to better communication between all partners.
8. It needs to be accepted that individual businesses involved in an alliance will not channel their entire product through the one alliance until they have developed sufficient trust in the alliance.
9. The increased use of product branding will spread to the meat industry and this will provide a focus for the development of further alliances. Many of these alliances will extend from producer to retailer or food service outlet.

10. Alliances do not pose any significant threat to producers provided that steps are taken to monitor their development and to ensure that relevant market information is publicly available outside alliances.

11. Price discovery processes for the industry will not be adversely affected by greater use of strategic alliances and in fact the present rather ineffective system could be improved if strategic alliances serve as a vehicle for introducing value based marketing.

12. Marketlink II has a critical role to play in creating an environment in which value based marketing can be implemented.

13. The further development of alliances is not expected to shift market power to processors and retailers to any greater degree than would apply if the formation of alliances were impeded. In fact, to the extent that horizontal alliances are developed, market power could shift towards producers.

14. Concerns about industry concentration are not warranted given the limited extent of concentration to date and the fact that no adverse effects from concentration have been shown in the US where it is already at a much higher level.

15. Concerns about foreign ownership of processing facilities and feedlots need to be placed in context. In fact the levels of foreign ownership are not as high as in other sectors of the Australian economy such as mining and manufacturing and are no higher now than they were in the past. There has been a change in owners (from British to Asian and American) rather than a change in ownership levels.

16. The ultimate purpose of all strategic alliances will be strictly commercial and therefore, in principle, the benefits from the development of such alliances will largely be private. As such, there would be little justification in using industry levies and Government funds to develop alliances that could be expected to develop without assistance. This suggests that MRC support for alliances needs to be clearly targeted to deal with aspects of alliances that are likely to generate industry-wide or public benefits

17. The aspects of alliances that appear to warrant MRC support are those designed to:

    - enable research into forms of alliances that might provide greatest overall benefit to industry;
    - develop better strategies for generating trust between the participants in the alliance;
    - enable research into 'tools' that could be used in conjunction with strategic alliances to improve efficiency eg tools for value based marketing;
    - provide information that would ensure that all parties (particularly producers) were aware of the potential benefits from alliances;
    - help demonstrate the practicality of alliances and thus encourage their wider use by providing support for establishment of a range of alliances including horizontal alliances amongst producers and vertical alliances that may not all extend all the way to the final consumer;

- address any area of clear market failure associated with the further development of alliances

18. The MRC support for alliances should give emphasis to the development of a "best practice" process for developing administering and monitoring alliances. This would provide greater industry benefit than other approaches that concentrated on developing alliances with a narrowly defined purpose such as value adding or developing new niche market products. Such alliances should only be supported if they were considered essential to the overall objective of developing a best practice process.

19. In the present climate of low beef prices and widespread concern about foreign ownership and transfer pricing, there would be merit in focussing attention on potential alliances that were seeking to establish retail level linkages into countries which permitted such linkages or investment such as Indonesia, Malaysia and the Philippines in contrast to countries such as Japan, Korea and China that do not permit it

20. Good quality market information is important in economic decision making and producers do not have such information at present. A strong case could be made for expanding the Information and Education component of Marketlink II to provide such information.

21. Success of Marketlink II will depend to a large extent on having available all the tools needed for implementing value based marketing (objective measurement techniques, price determination methods, product description or grading etc). It would be important to continue to monitor the availability of these various tools or facilities and if necessary to make additional investments to ensure that they become available to the industry.

22. The support needed to facilitate the establishment of new alliances needs to be carefully defined and managed to ensure that it:

    - helps bring about the necessary changes in attitude and culture and leads to general industry-wide understanding and support;
    - focuses on those functions that cannot be performed by industry operators acting on their own initiatives and does not 'crowd out' initiatives that will occur without external support;
    - provides the 'tools' needed for effective operation of the alliances;
    - is able to be accessed by all suitably qualified operators through a process that ensures cost-effectiveness, accountability and a minimum of bureaucracy.

Summary of Findings

Key Issue	*Findings*
Impact on Production Sector	
	• Improved competitiveness for producers participating in alliances
	• Improved market information flow to participating producers
	• Producers have a targeted market and targeted specifications - this provides the opportunity to tailor their production system to specific markets to become more efficient
	• Horizontal alliances will strengthen production sector
	• Improved financial position of participants as a result of better market risk management
Impact on Market Forces	
	• Alliances are a response to market forces—they offer a means to respond to more demanding and discerning consumers and to create more efficient and responsive forms of agribusiness
Impact on Price Discovery	
	• Compared to direct sales, volumes handled through vertical strategic alliances will remain small
	• Some horizontal alliances may choose to continue to use public systems provided they provide elements of value based marketing
	• Most producers will continue to sell through several channels and hence will be able to monitor prices in those channels
Shift in Balance of Power	
	• Apart from short term fluctuations there has been no significant change in the margin between wholesale and saleyard prices over recent years
	• The expanding margin between wholesale and retail reflects the additional marketing costs (Packaging, branding, quality assurance etc) now being demanded
	• Continued turnover of meat processing companies indicates continued competition and that entry barriers are not excessive
	• Although there has been contraction in numbers of firms in meat processing and retailing, this is part of a worldwide trend and the contraction at the farm level has been greater than that at processor or retail level.
	• Concentration (share of market output held by largest firms) in meat processing in Australia is relatively minor compared to the US

1. INTRODUCTION

The MRC Marketlink program has been testing the use of strategic alliances to overcome problems of industry fragmentation, intersector conflict and a commodity trading culture which lead to inconsistent product delivery and supply to consumers. The alliance concept is well received by many but others fear that it will result in the loss of the price discovery mechanisms for livestock provided by the auction system (saleyards and CALM). It is also feared that strategic alliances may lead to market domination by a few foreign owned companies. MRC commissioned VCG Australia to carry out an independent investigation of the cases for and against strategic alliances in the red meat industry.[1] This report presents our findings and provides recommendations to the Marketlink Steering Committee on future operation of the Marketlink II "Consumer-Driven Marketing Partnerships" Program on the basis of those findings.

These findings are based on careful and critical examination of the theory and practice of strategic alliances and closer relationships in the meat industry in Australia and overseas. They have been developed by a team of independent and experienced specialists with a good understanding of all sectors of the meat industry, agricultural marketing, business marketing and marketing in other food industries.[2]

In examining the role of alliances in the meat industry, it is important to recognise that this role has been evolving over time and it is therefore difficult to separate the influences and effects of alliances from those of other changes. Our approach has been to draw on information from a wide variety of sources to assess the impact of alliances. As far as possible we have sought to provide statistics and examples from Australia but we have also drawn on experience in the US where the role of strategic alliances has been closely studied for some time. Although we have always attempted to provide hard facts to support our conclusions, where these facts were unavailable we have presented our own judgements based on our experience and the best available evidence.

In order to make sure that we have understood the benefits and costs of alliances from a wide perspective, we have also contacted and discussed the issues with a wide range of people working within the industry. The assistance and contributions of all those contacted is gratefully acknowledged.

The report is presented in ten sections as indicated below.

1. Introduction
2. Background to Strategic Alliances
3. Industry Structure and Performance
4. The Fundamentals of Meat Marketing
5. Cooperative Business Relationships and Strategic Alliances
6. The Case against Strategic Alliances
7. The Case for Strategic Alliances
8. Current Alliances in the Red Meat Industry

[1] See Appendix 1 for the Study Brief

[2] See Appendix 2.

9. The Scope for Strategic Alliances in the Red Meat Industry
10. Conclusions and Implications for Marketlink II

2. BACKGROUND TO STRATEGIC ALLIANCES

Summary

This chapter briefly explains what strategic alliances are, why firms might choose to become involved with them and why they are becoming more common. It suggests that strategic alliances are becoming a feature of most agribusinesses because they offer an effective means to provide value to customers who are becoming more demanding in the food that they purchase.

What is a Strategic Alliance?

Strategic alliances refer to closer relationships and agreements amongst independent firms within a supply chain to co-operate to achieve some strategic end. To understand the fundamental difference between this arrangement and the present situation we need to consider first how red meat is normally marketed.

The traditional relationship amongst the independent firms in the supply chain is one of competition based on price in an open market—each firm along the chain tries to purchase the input at the lowest cost and to sell it at the highest price. Firms at the same vertical stage within the chain (eg meat processors) compete with each other by varying buying price (or terms) in order to secure supply and by varying selling price and services (which ultimately are built into the price) to secure sales. Traditionally, firms have operated at just one vertical stage in the supply chain. The 'boundary' of the firm can be thought of as the extent of its control and influence. Traditionally the firm's boundary was limited to its market share of one stage in the meat industry value chain.

Under the traditional arrangements outlined above, marketing is largely based on price competition within and along the supply chain. Independent firms compete with each other as buyers of inputs and sellers of output. At present nearly all red meat produced in Australia is sold under these arrangements.

If meat (or any product) is marketed using a strategic alliance amongst one or more stages in the supply chain, the traditional price competition between firms in the alliance is replaced with a negotiated cooperative relationship. The input supplying firm agrees to supply not only based on price but on a previously negotiated agreement. This firm has decided to forgo its some of its independence to sell this part of its output wherever it chooses in favour of selling it under an agreement. Similarly, the purchasing firm has decided to forgo some of its independence to purchase wherever it chooses at the lowest price in favour of buying under an agreement.

In effect, the strategic alliance has shifted the boundaries of the firms. The buying firm now has influence, and possibly even control over the supplying firm. To a much lesser extent, the supplying firm also has some influence over the buying firm. This situation is described as 'vertical coordination' which is a form of vertical integration without the change in ownership of assets associated with vertical integration. Strategic alliances offer the means to achieve both vertical and horizontal coordination.

Why do firms enter Strategic Alliances?

There can be a wide range of reasons why firms might decide to operate under strategic alliances and these are discussed in more detail below. In general, however, the motivation for the buying firm's use of strategic alliances is to create additional 'customer value' and to use this as a basis for competing with other firms to improve overall profitability. Additional customer value can be created in a number of ways—providing meat that is produced using 'animal friendly' production systems is one example, simply providing the product a customer requires is another. The other important motivating feature of strategic alliances is that they are used to create customer value that either cannot be created outside an alliance or that it would be more costly to do so outside an alliance. The motivation for the supplying firm is similar. They decide to participate because firstly they can create customer value for the buyer and hence can expect more secure outlets and sometimes higher prices for their production. Secondly, they participate because by so doing they can lower their own costs. One example of such cost reduction is the cost of getting information about what the customer (or sometimes the ultimate consumer) really wants: the suppliers in an alliance can obtain clear and reliable market signals much more cheaply than they would if they were not in an alliance.

In the language of economics, the alliance offers the opportunity to exploit the complementarities between firms which contribute different component parts to the production and marketing system. Ultimately, the aim of both parties is to manage risks and contain transaction costs. As in all business decisions in the marketing area, what is appropriate depends critically on the precise nature of the product in question.

Why are Strategic Alliances becoming more common?

Strategic alliances are being used to achieve both vertical and horizontal coordination and since the motives for these alliances often differ, it is better to consider them separately.

Vertical Alliances

Strategic alliances designed to provide increased vertical coordination are becoming more common in agriculture generally because they are better suited to the changing market situation. In the US, seven key factors have been identified as the basis for this trend. [3] These are summarised below:

- ◊ ***Consumer Characteristics.*** Consumers' needs have become more specific and the customers more demanding. Above all else, consumers are searching for greater convenience in the foods they buy but there is also more concern about nutrition and health. Nutritional labelling requirements are increasing and processors are more concerned about quality specifications.
- ◊ ***Institutional Changes.*** The larger food processors and retailers can compete by targeting market niches for their often new food products which they identify through market and taste panel research. These markets are then reinforced through advertising and branding. The consumers' preferences have become more specific than traditional price signals in open markets can convey, so

[3] See Peter J Barry (1995) "Industrialization of US Agriculture: Policy, Research and Education Needs" Agricultural and Resource Economics Review, April 1995.

retailers use vertical coordination to ensure that product specification meets consumers' demands.

◊ *New Production Technologies.* Some industries such as poultry and pork have developed technologies that provide greater control over product specifications and thus help retailers meet consumers' needs. These technologies include: reproduction; nutrition; health management; product measurement; and biotechnology. These technologies are often only economically justifiable with larger production facilities and hence the trend to fewer larger farms. These technologies provide a means to reduce production and marketing risks but they are only available to those industries or operations that achieve a certain level of scale. The red meat industry rarely achieves this level of scale unless it is operating within some form of alliance.

◊ *Importance of Information.* Information about consumers' needs and product attributes has become more important and more valuable and hence more closely guarded. It has become commercially valuable to be able to track product through its production and to maintain product identity.

◊ *Improved Efficiency.* Increased competition and increased capital costs associated with larger firms has provided impetus for further improvements in efficiency and especially for greater utilisation of processing capacity through improved security of supply.

◊ *Reduced Risks.* Risk management is becoming one of the key determinants of profitability in the modern business environment where markets are more dynamic, capital investments are greater and margins are smaller than those of the past. Some trends such as greater specialisation and increased capitalisation increase the costs incurred if processing firms are unable to obtain supplies at critical times and hence processors seek to reduce that risk by securing supplies. Similarly, suppliers who have invested heavily in production facilities and who have produced products suiting particular markets, will go to some length to ensure that they have access to a suitable market even if this means selling forward at a discount to the spot market. Vertical coordination offers a means to reduce these risks for both processors and producers.

◊ *New Financing Arrangements.* Producers faced with the need for additional capital expenditure find it easier to raise funds if they have more secure marketing arrangements in place in the form of contracts or closer relationships. Similarly, some processors may find that provision of finance to suppliers within a strategic alliance is a cost-effective means of securing supply.

Horizontal Alliances

Strategic alliances designed to provide increased horizontal coordination amongst producers have always been common in the dairy industry where producer cooperatives prevail. It has been in the interest of both the producer and processor to form such horizontal alliances. Successful horizontal alliances have been rare in other areas of agriculture but they are becoming more common because they are better suited to the changing market needs. Horizontal alliances are a natural corollary of vertical coordination since they provide the means for producers to collaborate with other producers to expand their marketable output so that they can offer significant volumes to processors and others down the value chain. Horizontal alliances are often promoted as a means to improve marketing power and thus offset

the power of large, vertically coordinated processors and retailers. This view needs to be tempered with the realisation that such alliances will have no effect on the balance of power unless they actually create additional value for their customers eg by reducing the transaction costs associated with obtaining supply or by improving the quality of product supplied.

Horizontal alliances are also popular as an approach to learning new technology and providing opportunities to benchmark against other producers thereby increasing efficiency and the ability for the whole group to meet the same standards of output. These production-based alliances have a tendency to eventually focus on marketing as another way of increasing their profitability.

The forces that are leading to increased interest in horizontal alliances are thus part of the general industrialisation of agriculture. Producers recognise that in order to maximise their returns in this new market environment they need to operate on a larger scale. In the US, this is leading to renewed interest in producer-owned cooperatives as beef producers seek to extend their ownership of the product further down the marketing chain. It is leading to the development of new forms of cooperatives where producers pledge both capital and product to help ensure the success of the venture.

3. INDUSTRY STRUCTURE AND PERFORMANCE

Summary

This chapter examines the major factors influencing the performance of the red meat industry and assesses their impact to explain why red meat marketing arrangements are likely to change. It suggests that the major factors are changes in demand, markets and prices. It then discusses how those changes are leading to increased concentration in all sectors of the industry, changing shares along the value chain, changing methods of livestock marketing and to changes in foreign owners but not in the level of foreign ownership. It also suggests that these changes are occurring at a time when there is still widespread distrust amongst industry participants and that this creates particular difficulties for the red meat industry.

Major Factors Influencing Performance

Demand for Red Meat

In the domestic market red meat is losing market share to pork and poultry and to other foods for a variety of reasons. This suggests that red meat in its present form is not performing as well as other foods in meeting the needs of the domestic consumers. Research has shown that part of the reason for this is that red meat is considered less convenient than other foods but it also shows that red meat is regarded as less reliable in its eating quality and that there are problems with inconsistency in supply. Another major problem is the consumer's perception of the health value of meat with many perceiving it to be fatty and less able to meet their demands for nutritional excellence. Recent food safety "scares" involving E. coli, BSE, salmonella and chemical residue contamination have also led to a public perception that red meat is less than a desirable food product. Finally, economic factors which affect the cost of red meat relative to other potential substitutes are of major importance.

In the export market Australian red meat is predominantly serving the lower price segments of the markets and has not significantly expanded its share of the higher priced segments. Research has shown that part of the reason for this is that Australia has a comparative advantage in production of lower priced red meat (manufacturing beef and mutton) and that the current global oversupply and reduced demand situation has led to lower prices for those products. While Australia's greatest comparative advantage may lie in this sector of the export market, research has also shown that Australia can compete in the production of higher value and therefore higher priced red meats provided that production inefficiencies are overcome and that production is directed to meeting the specific needs of customers in these markets. Hence it is likely that the total returns from industry could be increased by supplying part of the higher value markets in addition to the mainstream existing markets.

There are a range of industry initiatives underway to address these domestic and export marketing issues. A common theme for many of the initiatives is the need for those operators interested in participating in these markets to become more

responsive to their customers' needs. Strategic alliances are seen to be one of the most effective means of helping achieve greater customer focus.

Changes in Markets

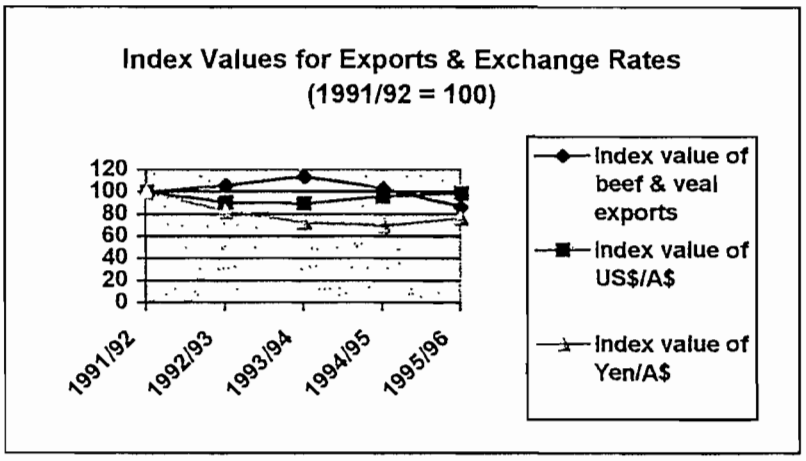
There have been dramatic changes in the markets for Australian red meat since the 1970s as outlined in Appendix 3. Sixty per cent of Australia's beef is now sold on overseas markets. Less than 15 per cent of world production is traded internationally. Australia accounts for less than 4 per cent of world beef production but is one of the largest exporters accounting for about 20 per cent of world exports. Australian beef exports have grown steadily by around 3-4 per cent per year over the past decade. The main importing regions in the world are the EC and the USA which together import around 80 per cent of the internationally traded beef. Australia-wide, 46 per cent of meat is sold through supermarkets and 54 per cent is sold through butcher shops. The supermarket share of red meat sales has been growing rapidly and this is introducing a totally different emphasis in marketing of red meat.

The beef industry has tended to be unstable in the past as more than half the total output is exported. Producers' plans are based on expected prices so that if overseas countries close their markets, or the exchange rate rises, a difficult period of adjustment must be endured whilst more of planned output is disposed of on the Australian market. Similarly, Australian consumers have to adjust to higher prices if foreign markets are restored. There is very little government intervention in the economic activities of the Australian beef industry, which is still largely co-ordinated by the price mechanism.

Although the majority of Australian red meat traditionally has been directed into relatively low value segments of the market, consumer research has indicated considerable potential for expanded sales into higher value segments both within Australia and overseas. However, in order to capture and secure these market niches, there needs to be an improvement in the quality and consistency of the beef and lamb supplied.

Prices Received

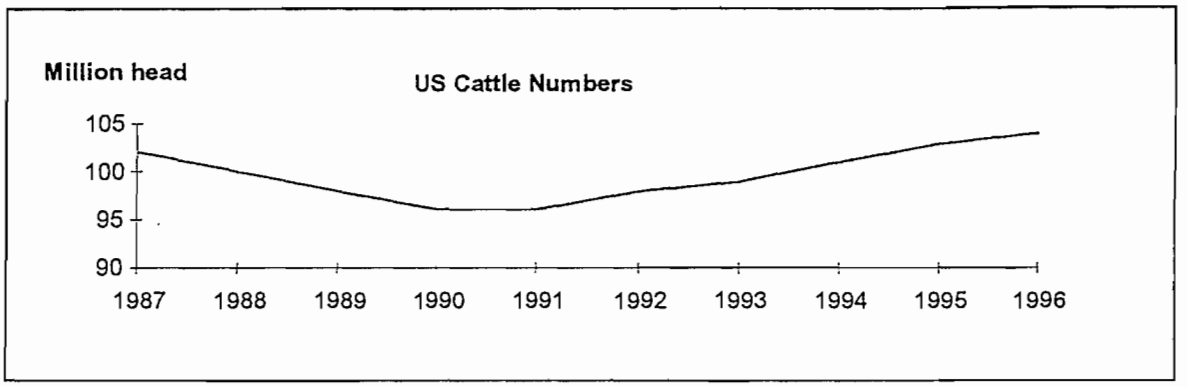
There is no doubt that while other factors are important, the price received for red meat will remain the major determinant of industry structure over the medium to long term. Owing to Australia's export orientation and to the fact that Australia is largely a price-taker in global meat markets, the strongest influence on prices received comes from the international market. Within that market, the US has had the dominant impact. The dependence of the Australian red meat



industry on the export market brings with it vulnerability to shifts in exchange rates. This is indicated in the figure above that illustrates the reverse relationship between the value of beef and veal exports and the exchange rate of the Australian dollar.[4]

The US beef industry produces 11 million tonnes of beef per year from a national herd of around 100 million head. The US industry follows a relatively well-established cattle cycle which reached a low point in 1990. Since 1990 cattle numbers and production has steadily increased (Figure 1) but it appears that the cycle is now entering its reduction phase.[5]

Figure 1. Changes in US Cattle Numbers-Source: USDA



The impact of US production on Australia is shown in Figure 2. As US exports grew from the late 1980s Australian exports to the US declined. When US imports (from all sources) declined sharply in mid 1994, the price of Australian manufacturing beef exports to the US declined almost 50%. Australian domestic prices derive directly from world prices and have fallen in corresponding manner as indicated in Figure 3 which shows real saleyard prices.

[4] Clearly there have been other factors affecting the value of exports over this period, however, the figure gives some indication of the importance of exchange rate. The source for this information is "Australian Commodities. Forecasts and Issues" ABARE, December 1996

[5] Part of this picture is the number of females in the US herd. The high numbers in late 1995 showed an inevitable problem for beef marketing throughout the world. Whilst the reduction phase is beginning there is evidence that in the current climate the US number of females is not diminishing very quickly. The reduction phase could be protracted.

Figure 2. Trends in US Imports & Australian Exports - Source: Derived from AMLC & ABS by VCG Australia.

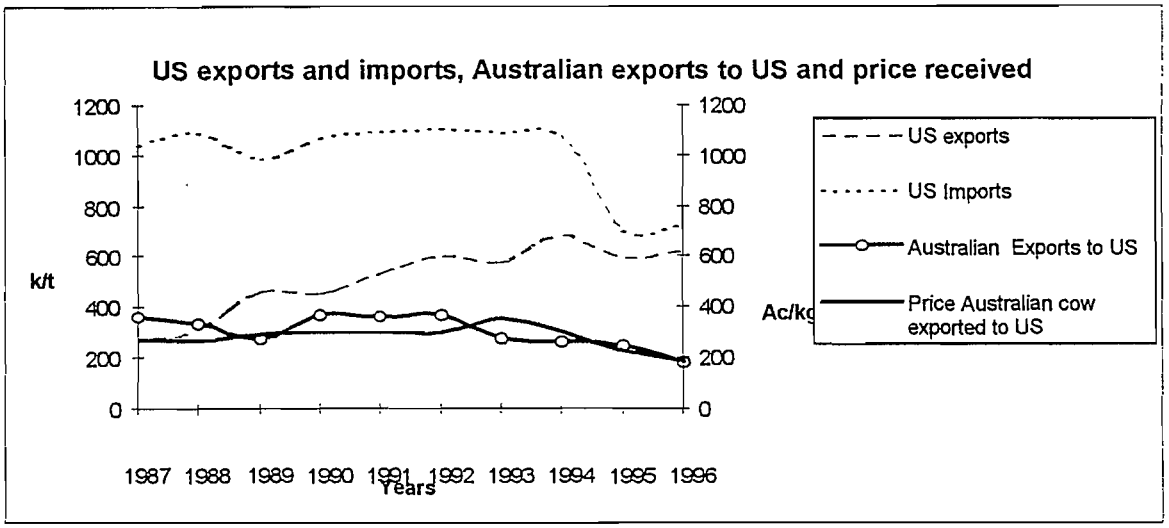
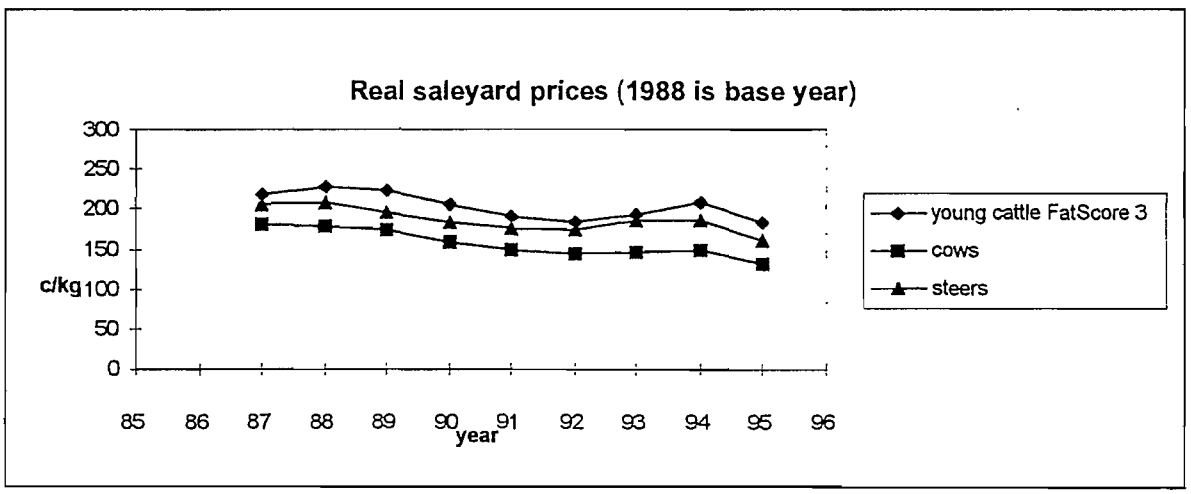
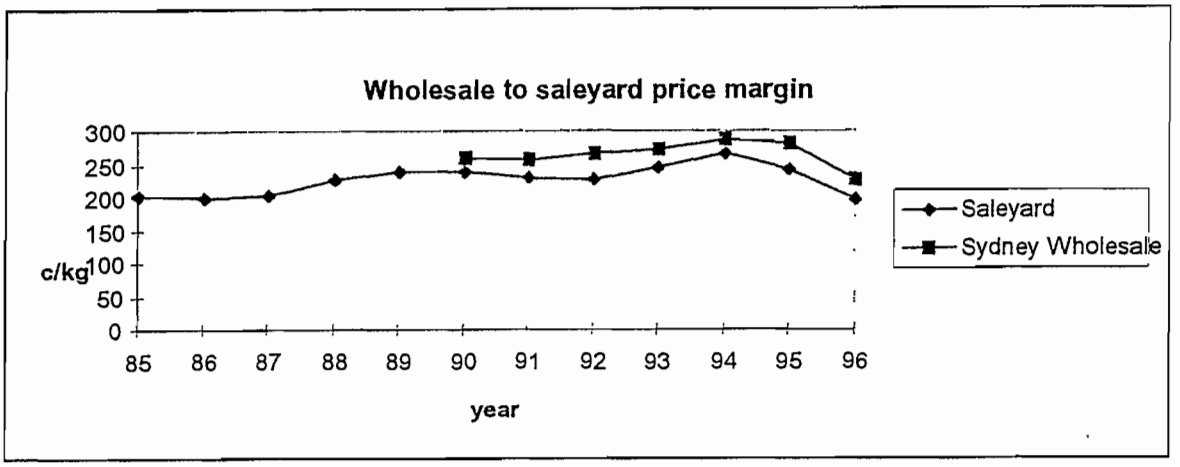


Figure 3. Real Saleyard Price Movements -Source: Derived from AMLC & ABS by VCG Australia.



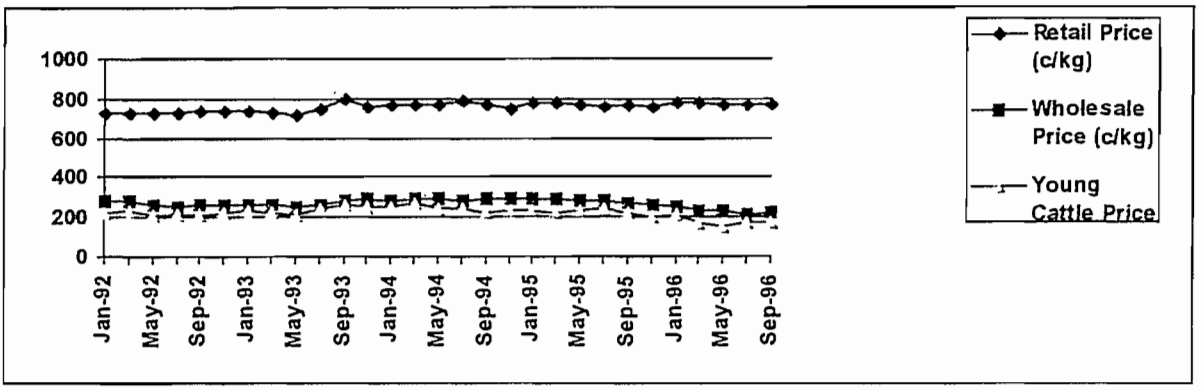
Wholesale prices have displayed similar movements to the saleyard prices, with the wholesale-saleyard margin for yearling cattle shown in Figure 4 remaining relatively stable over the longer term.

Figure 4. Price Margin (Wholesale to Saleyard)-Source: Derived from AMLC & ABS by VCG Australia.



In the case of domestic sales of beef, the relationship between saleyard prices and retail prices is less well-defined with retail prices tending to remain stable while saleyard prices vary as indicated in Figure 5. This demonstrates the well known features of retail pricing of price averaging (across species and cuts) and price levelling (over time).

Figure 5. Relationship of Saleyard to Retail Prices-Source: Derived from AMLC & ABS by VCG Australia.



Meat value chain

Businesses involved in meat processing and marketing transform livestock into meat or meals. Transport, processing, financing, distribution, and selling are essential functions performed by people in the marketing chain. A characteristic of livestock is that on a single farm basis they are mainly produced in batches rather than continuously. To convert livestock produced at intervals into a continuous stream of meat by coordinating supplies from many farm batches over a period of time involves the risk that prices will fall in the interim, so specialised risk takers, speculators, play an important role in the marketing of meat. The complexity of livestock and meat marketing services is increased because the products are bulky and perishable. An efficient market channel enables consumers needs and wants to be met as cheaply as possible and is able to respond rapidly to changes in what consumers want and the form in which they want it. As those needs become more specialised and the range of products demanded increases, new marketing channels are developed to cater for the demand.

Table 1 below considers the relative contributions to value adding of stages in the meat marketing chain using indicative estimates of costs associated with individual stages in the transformation. By way of example some indicative estimates of costs associated with individual stages in the transformation of livestock into retail meat cuts and by-products are shown in Table 1. These estimates are indicative only, because in reality the breakdown of marketing costs between different marketing functions varies greatly between firms and products and through time. The activities, products and costs of each firm are unique. The estimates shown in Table 1 will vary for any particular meat processing firm depending on many factors, including (but not only):

- type of livestock
- market destination
- type of retail cut
- processing technology
- extent of integration between marketing/processing stages
- mix of by-products produced
- time of year
- level of market demand for meat and by-products.

Table 1. Indicative Value Chain for Domestic Sales –Data collected by VCG Australia

Breakdown of representative marketing costs and revenues for domestic meat:			
Costs			
Component Percentage of Total Costs		%	
Farm Sector			
Purchase of livestock at saleyards /direct cost of purchase		65	
	Total		65
Abattoir Sector			
Freight to abattoir		1.5	
Labour		4.5	
Overheads		1	
Materials		1	
Meat Inspection		0.5	
AMLC		0.5	
Services		1.5	
Transport to wholesaler		2.5	
	Total		12
Wholesale Sector			
Boning labour		4.5	
Overheads		1.5	
Materials		1.5	
Services		1.5	
Cold store		1	
Transport to retailer		2	
	Total		12
Retail / End User Sector			
Labour		6	
Overheads		3	
Services		1	
Materials		1	
	Total		11
Gross Revenue			
Meat cuts		92	
By-products			
skin/hides		7	
Offal		1	
Rendered products		1	
	Total		**100**

The value chain for meat exported to the US is substantially different. The Farm sector cost for livestock purchase is the same, around 65-70%, processing is 20-25% and transport to CIF around 8-10%.

Impact on Industry

Changes in the demand for red meat, the markets for Australian production and the prices received have helped shape the structure and performance of the red meat industry in Australia. These forces will continue to influence the structure and performance of the industry in future since they fundamentally determine the potential returns for the industry. The way in which operators in each segment of the industry react to these forces will determine their individual business success and collectively the overall competitiveness of the Australian industry. The impacts of these forces which are already evident, or are likely to become more evident in future, are discussed below because they provide the context for our consideration of strategic alliances.

Increasing Concentration in all Sectors

One of the impacts of changes in demand, markets and prices (along with pressures for improved efficiency) has been for smaller firms at all stages of the value chain to become less competitive and for many to leave the industry. As a result the red meat industry in Australia (and throughout the world) is becoming more concentrated—fewer firms accounting for more output and a few large firms accounting for a large share of total output.

As Table 2 shows, it is difficult to measure changes in concentration over time because the data needed are generally not available. Nonetheless, there is evidence that the trend is towards increasing concentration in all sectors, not just meat processing. The Australian Bureau of Statistics [6] reported that the number of establishments with meat cattle declined 57% from 77,012 in 1974/75 to 33,430 in 1992/93. This is the only estimate we have found which extends over 20 years or more. It suggests that the number of establishments may have more than halved. Over a similar period, the number of export processing establishments declined from 108 to 62 ie by 43% according to a recent MRC report.[7] By this crude measure of concentration, there has actually been more concentration in the farm sector than in the processing sector. Concentration in the number of beef producers is probably even greater than this because it is masked by the large numbers of non-specialist producers. ABARE [8] has estimated the number of specialist beef producers totalled only 17,400 in 1993/94 and these producers accounted for 61% of total beef production. Despite the fact that concentration in the farm sector is increasing, it is

[6] Personal communication.

[7] MRC 1997. Changing ownership in the Australian Meat Processing Industry—A perspective over two decades. Project Number FCCD 002.

[8] The Australian Beef Industry September 1995.

still at a very low level in comparison with other industries. We have estimated the HHI for beef producers using Ausmeat data for 1995 to be only 2.1 [9]

The meat processing sector in Australia is much more concentrated than meat production. Our estimate of the HHI using Ausmeat data for 1995 gives an estimate of 238 which is more than 100 times the concentration of the meat production sector.[10] Nonetheless, with a HHI value of only 238, the level of concentration in the Australian meat processing industry is insignificant according to US standards which suggest a level above 1800 as warranting some investigation on the grounds that it may represent an uncompetitive market.

Although we do not have the comparable HHI figures for the US, it is of interest to compare the situation in Australia with that in the US to put concentration in meat processing in perspective. In 1994, the four largest processors in the US accounted for 82% of beef slaughter [11] whereas the four largest in Australia accounted for 25% of all meat produced [12]. When the top-four firms control more than 50 percent of a market, or the top-eight firms account for more than 70 percent of a market, undesirable concentration or control is said to be evident. The growth in concentration has been rapid in the US since 1980 when the four largest firms accounted for 36% of total production. Although exactly comparable data are not available for Australia, the rate of growth in concentration appears to have been much lower—in 1988 the four largest Australian processors accounted for a similar proportion of all meat produced.

Concentration in the processing sector of the Australian red meat industry has arisen through a process of rationalisation of processing facilities coupled with mergers and takeovers of companies. One of the potentially adverse consequences of that process is that within some of the more remote areas competition can be reduced (or even eliminated) with the result that prices paid for livestock fall to lower levels than in other regions where there is more competition. Although it is beyond the scope of this study to review such matters, it appears that those regional disparities in livestock prices that have arisen are not very large.[13]

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[9] The HHI was based on Ausmeat Feedback statistics assuming that, apart from the top 16 producers listed in Feedback, there were 18,000 specialist beef producers accounting for 61% of throughput with equal market shares and the remaining 67,000 non specialist producers accounted for the remaining balance of throughput again with assumed equal market shares. These assumptions will under-estimate the degree of concentration but other data were not available. Concentration indices of less than 1000 are considered low in US agribusinesses.

[10] This value was derived using the 1995 Ausmeat Feedback survey results for the processors and assuming that all processors other than the top 25 had equal market shares.

11 Concentration in the Red Meat Packing Industry.

12 Data from Feedback July/August 1996. The top four processed 645,140 tonnes carcase weight out of a total of 2,612,000 tonnes for 1995.

13 See Williams and Bewley (1993)

Table 2. Concentration in the Meat Industry

	Number of Beef Producers	Number of Processors
1974 (ABS) All meatworks		560
1974/75 (ABS) Establishments with meat cattle	77,102	
1976 (MRC) Export only		108
1986 (MRC) Export only		86
1988/89 (ABARE)	78,064	
1992/93 (ABS) Establishments with meat cattle	33,430	
1993/94 (ABARE)	72,863	
1995 (Ausmeat) All beef processors		223
1996 (MRC) Export only		62
1996 (ABS) All meatworks		300
Concentration Index (1995)[14]	2.1	238

Changing Shares in the Meat Value Chain

One of the consequences of changes in consumers' preferences (demand) for meat is that there will be changes in the distribution of costs along the value chain representing changes in inputs such as packaging, further processing or advertising. The retail or base price for red meat is set by consumer preferences and is therefore influenced by the cost of possible substitutes. The farmgate price is set by the retail price less the cost of services involved in converting the farmgate product (livestock) into the retail product (part of a meal).

In wealthy countries the demand for food increases little with an increase in income levels, but the demand for market services has tended to increase continually. If wages rise over time, the labour cost component of processing and marketing costs tend to rise too, causing marketing margins in labour intensive processing activities to rise. In consequence, as incomes in the economy rise in general, the costs along the marketing chain rise accordingly, as businesses involved in the marketing chain have to compete with the businesses in other parts of the economy for their supply of labour. This leads to a rise in marketing margins over time and the producer's share of the consumer's food dollar tends to fall. However, provided that neither the price paid for livestock nor the number of livestock sold fall, farmers' incomes will not be affected by this trend. In fact farmers' incomes may rise if demand for meat

14 The figure used to measure concentration is the Herfindahl- Herschman index (HHI) which is the sum of squares of the market share (expressed in % terms) of all industry operators. Thus many small players with a small % share will have a low number. The extreme figure would be one player with all the market share (a monopoly) which would have a value of 100 squared or 10,000. A market in which four firms each had 25 percent market share would have a score of 2,500 The HHI is generally used by U.S. Department of Justice and National Association of Attorneys General as a benchmark to assist firms in determining whether a proposed acquisition or merger places them at risk of enforcement and in determining whether government agencies will intervene with antitrust actions. If the HHI is below 1000 it is regarded as of no concern.

increases as a result of the additional marketing services that are provided since more livestock will be sold.

The consumer purchases a bundle of attributes when buying meat—some of these attributes such as taste, tenderness, colour etc have been provided by the producer—other attributes such as packaging, further processing, convenience, advertising etc are provided by the processor and retailer. There are costs associated with the provision of each of these attributes and those providing the attributes will not continue in that business unless it is more profitable for them to do so than become involved in any other activity. Over time, consumers have tended to buy meat which is further processed and thus they have increased their purchases of the attributes that are added after the farm gate. As a result, the producer's share of the dollar spent on meat at the retail level has declined.

Change in the size of marketing margins over time therefore does not provide any indication of efficiency in marketing nor indicate whether producers are being exploited. Rather, the marketing margin reveals the extent to which consumers are purchasing marketing services beyond the farmgate.

The best indicator of both efficiency and exploitation in the marketing chain is the degree of competition in the provision of marketing services. If there is open competition then there will be continued turnover of firms—new firms will enter the industry from time to time and existing firms will go out of business. Another indication of competition is that the prices paid by operators at any one point in the value chain are similar after accounting for differences in product quality, form, location and utility. At present there is circumstantial evidence of strong competition at all levels of the meat industry—farms, feedlots, livestock marketing, processing, distribution, exporting and retailing. It is difficult if not impossible to prove whether the current level of competition is in some way 'optimal' but this is largely an academic question since there is little that any group can do to influence the level and form of competition in the red meat or any other industry.

Changing Methods of Livestock Marketing

Another major change in the industry concerns the methods used by producers to market their livestock. As competitive forces on the production sector increase, and margins are narrowed, producers seek ways to improve their returns. The changes in livestock marketing that are taking place in Australia are largely driven by two objectives. The first concerns the desire of producers and others to reduce the transaction costs associated with marketing. This has led to greater use of paddock sales, sale by description (CALM), liveweight selling and over the hooks sales. The second concerns the desire of producers and some processors to ensure that prices paid reflect the value of individual animals rather than an average value of a pen of cattle or lambs. This has led to a range of changes which are attempts to move towards a Value based Marketing (VBM) system. Most of the changes in livestock marketing seek both to reduce transaction costs and to move towards VBM.

In 1993/94, at the national level,[15] the distribution of sales was as follows:

- 53% of cattle were sold at auction (including 10 per cent over scales in saleyards and about 1% through CALM[16]),

[15] ABARE Farm Survey 1995. Percentages adjusted by removing farm transfers.

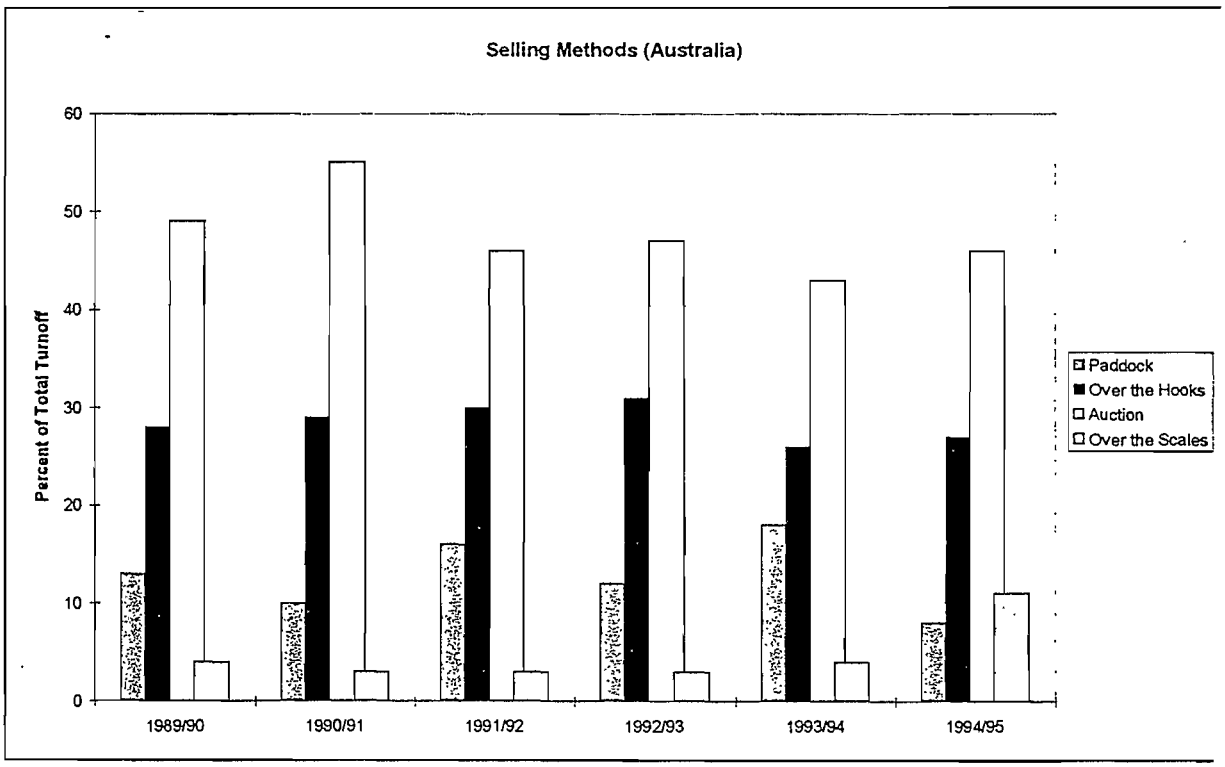
[16] VCG estimates

- 26 per cent were sold 'over the hooks,'
- 6 per cent were sold over scales outside the auction system,
- 13 per cent are sold in the paddock; and
- 2per cent of cattle are sold by other methods.

The large proportion of small herds in Southern Australia means that most cattle in the south are sold in small lots. In the case of sheep and lambs, around 50 per cent are sold in the paddock, another 45 per cent are sold in the saleyards around 3 per cent are sold 'over the hooks' whilst around 1 per cent is sold through CALM.

Figure 6 below indicates the change in methods of marketing beef cattle between 1989/90 and 1994/95[17]. The major change since the late 1980s in selling methods for beef has been an increase in sales over the hooks, from 20 per cent to 26 per cent of all beef sold accompanied by a corresponding decline in auction sales.

Figure 6. Beef Cattle Selling Methods



Source: ABARE. The Australian Beef Industry 1996

Changes in Profitability

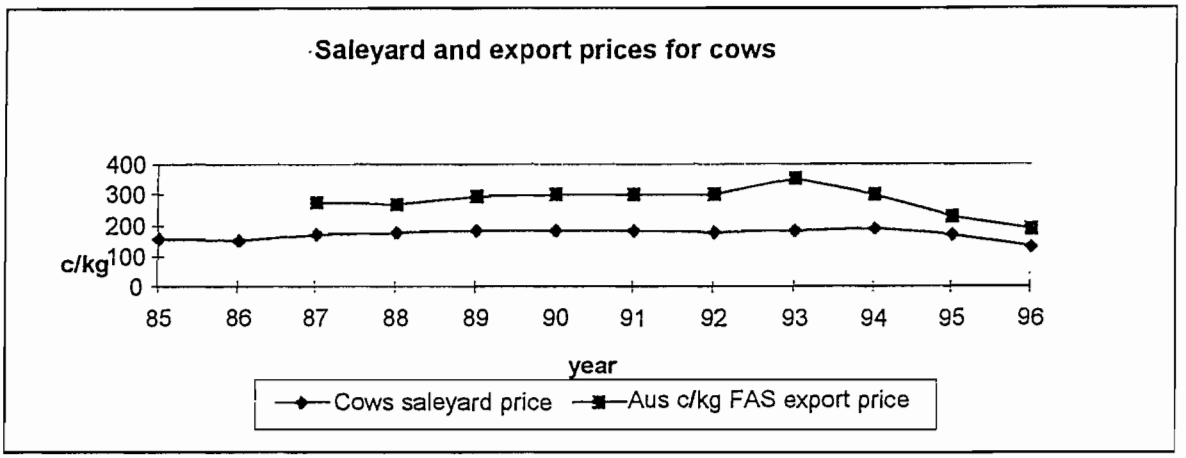
The factors outlined above all ultimately interact to change the profitability at the various stages of the value chain. It is beyond the scope of this study to examine those changes in any detail but one example is given below to show the change in profitability of manufacturing beef exports to the US over the past decade.

As shown in Figure 7 below, the fluctuations in the differential between Australian saleyard prices for cows and US export prices for cow meat has declined markedly

[17] Note that the figures refer to all livestock sales and not just to sales of slaughter cattle since there are no separate figures kept for slaughter stock.

from the historically high levels in 1992-1994 to a much smaller differential 1996. This export price-saleyard price differential is a guide to the changes in profitability in export meat processing over the period.

Figure 7. Trends in Price Differential (Saleyard - Export Price of Cow Meat) - Source AMLC



Changes in Foreign Ownership

The meat industry in Australia has a long tradition of attracting overseas investment with most of the investment going into meat processing and relatively little direct investment in meat production. A feature of foreign ownership in both processing and production sectors has been the change in ownership in parallel with changes in markets. Historically, the major foreign owners were British companies such as Vesteys and their investments were located in export works and cattle holdings in northern Australia. Prior to 1960 the UK accounted for more than 90% of all beef exports and UK interests owned the major share of export works in Australia. By 1965, following the closure of markets in the UK and emergence of new markets in the US and Asia, the US emerged as the major market taking 80% of beef exports and 50% of mutton exports. This change in markets coupled with the need for expanded investment in meat processing led to a change of foreign owners without significant change in the level of foreign ownership. The major new owners have been Japanese companies and more recently there has been further investment from the US (Con Agra), China and Korea.

At present, four of the five largest beef processors in Australia are foreign owned: SBA Foods (Sumikin Bussan Corporation-Japan); AMH (Con Agra); Metro Meat (China International Trust and Investment Corporation); and Nippon Meat Packers.

In 1995 foreign owned meatworks accounted for 44 per cent of the meat production of the largest 25 meat processors [18] With the recent purchase of R. J. Gilbertson by SBA foods, similar total production figures and production of the largest five processors in the future would mean that foreign owned processors would account for around 50 per cent of the meat processed by the 25 largest meat processors. The meat production of the largest 25 meat processors represented 60 per cent of total production in Australia. On this basis, the major foreign owned meat processors account for around 25-30 per cent of total Australian meat production. This is

[18] Ausmeat Feedback. July/August 1996

similar to the proportion of the Australian kill carried out by foreign owned companies in the 1960s and 1970s. Compared with foreign control in other industries in Australia, the level in meat processing is still modest as indicated in below.

Industry	Foreign Control in 1984/85[19]
Agricultural land	< 10%
Food, beverage & tobacco	35-40%
Meat processing	20%
Manufacturing	32%
Mining	45%
Mineral processing	45-50%

When only the export sector is considered, the foreign control in the processing sector is somewhat larger. MRC estimate that the foreign-owned meat processing works accounted for 39% of the national beef and veal exports in 1996.[20]

Although there is still relatively little foreign investment in broadacre meat production in Australia, there has been extensive foreign investment into feedlotting. Foreign ownership is estimated to account for about 50%[21] of current feedlot capacity in Australia with the major investors being Japan, the US and Korea. The primary impetus for such investment stems from the fact that it provides the opportunity for exporters to control a larger portion of the value chain and thus to ensure the quality and secure supply of the product for their customers. A secondary driver is that such investment provides an opportunity to generate greater profits provided that they are able to carry out the production, processing and marketing functions more efficiently than other operators in the industry. (If this were not the case it would pay the foreign company to purchase the meat from other feedlots or processors).

Continuing Distrust amongst Participants

Although there have been changes in demand, markets and prices in the red meat industry there has been little change in the fact that there is widespread distrust amongst industry participants. Some producers feel that livestock buyers and processors are taking advantage of them and paying less than the real value of their stock. Some feedlot operators feel that producers are unable to supply stock that perform well in the feedlot owing to shortcomings in structure or breeding or previous management. Some processors feel that producers are unreliable suppliers and that the stock they seek to purchase may be bruised, stressed, contaminated or sold elsewhere despite some form of agreement. Some retailers complain that the meat supplied is not as ordered and may be tough, too fat or too lean, or may not be supplied in the quantities ordered.

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19 Industries Commission Report No. 38, April 1994. Foreign control estimate is based on the proportion of value added by the industry

20 See MRC 1997 op cit

21 VCG Australia estimate

More fundamentally, many producers are concerned that there has been a shift of market power and that they are now more vulnerable to exploitation by large meat processors, retailers and exporters. These concerns are exacerbated when they observe increasing foreign ownership in feedlots and meat processing and when it appears that some of these operators are using transfer pricing arrangements to 'export producers' profits'.

This level of distrust has been regarded as simply 'the way things are in the meat industry' in the past and its impact on the overall industry performance has not been considered. However, one of the consequences of this distrust is that each group in the value chain has tended to adopt a fiercely independent cannibalistic approach which rules out any opportunities for collaboration and joint action or strategic alliances along the chain. This situation of low level of trust is commonly observed in commodity-oriented industries. In the absence of trust and subsequent collaboration, it is likely that the red meat industry will find it increasingly difficult to meet the needs of its more discerning customers and particularly those who are willing and able to pay higher prices for meal ingredients. One the other hand it is equally clear that collaboration along the chain will lead to reduced independence of producers and this may be perceived as increased vulnerability to exploitation. The dilemma for producers in the meat industry is clear—they need to find a way to ensure continued sales of red meat in the most profitable forms without transferring an excessive share of their profits to others in the marketing chain.

4. THE FUNDAMENTALS OF RED MEAT MARKETING

Summary

This chapter outlines the fundamental considerations associated with the marketing of red meat. It briefly describes the markets for Australian red meat and considers which of those markets offer scope for alliances. It indicates that there is a real diversity of product and that different marketing approaches are needed to deal with the diversity. It also points out the fundamental difficulties associated with achieving 'value based marketing'. It concludes that no single approach will be appropriate and that (given access to good objective information) individuals will choose their own way of marketing depending on their circumstances.

Markets for Australia's Red Meat

Export Markets

The international trade in meat accounts for only 10% of meat production and hence international trade in meat is subject to large year-to-year fluctuations—a 10% decline in world production would almost double the volume of international trade. Australia produces about 2.3 million tonnes (carcase weight) of red meat (beef, veal, mutton and lamb) and exports about 55% of this.[22] Beef accounts for about two thirds of the export volume. The largest competitor for our export markets in Asia is beef from the USA. The price received for red meat is largely determined by the world market and exchange rates.

About 60% of Australian beef is exported as primal cuts or table beef and the remaining 40% is exported in a semi-processed form mainly as hamburger meat. Historically, the US has imported most of the semi-processed manufacturing meat and the primal cuts and table beef have mainly been exported to Japan and Korea. In recent years North America has accounted for about 42% of total exports and Japan for about 41%. With the recent slump in exports to the US, Japan now accounts for about 40% of total beef and veal exports and the US for 26%.[23]

Access to the major beef markets is highly regulated by importing countries and this limits opportunities for Australian firms to vertically integrate (or coordinate) their operations into distribution and retail networks in overseas markets. It also limits the scope for understanding and focussing on the requirements of the final meat consumer and means that it becomes more important to understand the immediate customer who will be further up the chain. Most of the foreign-owned firms operating in Australia are vertically integrated into the distribution networks in their country of origin. These firms and the Australian firms marketing overseas must provide the customer focus for producers wanting to service the export trade.

22 These are approximate figures based on the past three years.

23 AMLC Forecast. Data for 1996 calendar year.

The opportunities for "through-chain" vertical alliances [24] in relation to export trade lie in three main areas:

- ◊ Supply of high-value product to foreign- or Australian- owned marketing firms that do not want to expand their involvement in meat production.
- ◊ The traditional "wet" market in Asia was identified as being a potentially good market for Australia to tap into with supplies of fresh meat. This market is still by far (90%+) the largest market for red meat in Asia although it is not as high value as some others
- ◊ Supply of niche markets in countries with minimal entry barriers through vertically coordinated Australian firms

In contrast to the limited opportunities for through-chain vertical alliances to serve the export market, there are many opportunities for horizontal alliances of producers to serve customers who are servicing the export markets.

There are a range of opportunities for alliances between operators at two or more stages in the value chain without extending along the entire chain. The major limitation on such alliances will be the difficulty in matching the scale of operations of alliance partners at each stage. However, in the event that this difficulty can be overcome, for example, through the use of horizontal alliances, scope exists for further alliances between processor and producer groups and between processors and retailers or exporters.

Domestic Market

The domestic market accounts for about 87% of lamb production, 37% of total beef production and 31% of mutton production.[25] Around 46% of red meat is marketed through supermarkets and the balance through butchers shops. Per capita consumption of beef has fluctuated with prices around an average of about 38 kg since 1960 while consumption of lamb has halved to 11 kg per capita and mutton has decreased to about one fifth of their 1960 values. Poultry consumption has increased six-fold and pork consumption has doubled over the same period.

Although supermarkets may not yet account for the majority of red meat sales in Australia they are the dominant forces setting the standards for red meat marketing and are likely to remain so with the changes in trading hours and deregulation of red meat trading. This situation is a reflection of the concentration in the retailing sector with the major supermarket chains accounting for perhaps one third of total red meat sales. This provides the larger supermarkets with the opportunity to capture economies of scale and gives them an incentive to create new supply arrangements that will secure their supplies while minimising transaction costs. Smaller retail groups and individual retailers will not have the same incentive to develop new supply arrangements because they are dealing with much smaller volumes. An exception to this generalisation may apply to small but specialised retailers or food service sector operators that seek to supply specialised niches in the market on the basis of a differentiated product where the basis for differentiation rests on through-chain product identification.

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24 A through-chain vertical alliance refers to an alliance that operates all the way from the consumer to the producer.

25 VCG Australia estimate from various sources

The opportunities for through-chain vertical alliances in relation to domestic trade lie in two main areas:

◊ Coordinated supply of highly-specified product to larger supermarket chains or retail groups

◊ Supply of niche markets where product differentiation requires the capability to identify the ultimate source of all product through the entire value chain.

As in the case of the export markets, there may be only limited opportunities for through-chain vertical alliances to serve the domestic market in the near term, but there are will be many opportunities for horizontal alliances of producers to serve processors and retailers in the domestic market.

Similarly, as outlined above for the export market, there are a range of opportunities for alliances between operators at two or more stages in the value chain without extending along the entire chain.

Marketing Functions and Red Meat

Red meat provides some special marketing challenges as described in Appendix 4. However, as with other agricultural products, there are three basic functions associated with marketing:

◊ The exchange functions of buying and selling

◊ The physical functions of transport, processing, storage and distribution

◊ The facilitation functions of standardisation, finance, risk management and market intelligence

Exchange Functions

Much of the discussion about meat marketing concerns weaknesses or inefficiencies in the mechanisms for exchange functions. In order to have efficient exchange functions, it is necessary to have an effective method of price discovery. Price discovery refers to the process by which buyers and sellers arrive at the price and other terms and conditions of sale. The price refers both to the product and to the marketing services that are included with the product at the point of sale.

At present, the price discovery process for livestock is largely based on the auction system since this provides the reference point for other systems which involve informal negotiations between buyers and sellers (eg paddock sales) or pricing via formulae (eg sale on grid basis) or pricing through formal discussions in an alliance. There is concern in the industry that any reduction in the use of the auction system (eg through wider use of paddock sales or sales through alliances) will make it more difficult to establish a reference price and thus impede the price discovery process and leave producers vulnerable to exploitation. Our response to this concern is addressed later in this report. At this stage, however, it is important to note the following:

◊ Although throughput via the auction system has declined there is no sign that the system will cease operation. The persistence of the system is a reflection in part of the fact that it still serves a valuable purpose. Auctions will always be needed for sale of store stock and breeding stock. Trade in these intermediate inputs is

fundamental to specialisation in production and management of climatic risk under Australian conditions.

- ◊ The auction system does provide a good 'absolute' or 'floor' price reflecting overall supply and demand but it cannot provide good estimates of the marketing margins for particular attributes associated with quality or consumer satisfaction.
- ◊ While there is no doubt that the auction system is used to provide a reference price, the accuracy and usefulness of that reference price is questionable because the price setting process is not transparent and cannot be observed or understood by the seller.
- ◊ One of the reasons that the price setting process at auction is not transparent is that the uncertainties associated with the estimation of value coupled with other considerations of buyers such as the need to meet particular orders or to maintain throughput make the decisions of buyers highly subjective and necessarily variable over space and time.
- ◊ Pens of animals, particularly sheep and lambs, have a wide range of animal types present but there is no objective basis for describing each animal or the pen as a whole. As a result, the auction price for the whole pen provides no information about any particular animal in the pen. It is an averaging system, and a method of disposal. It generally "clears" the market, which is a valuable function, but even in this mode it provides evidence of scarcity or oversupply rather than a potential end product value.
- ◊ Because the auction system has no means of describing the product in customer-value terms, it provides poor signals to producers about the type of product each market wants.[26]
- ◊ Ideally the reference price should be set by deducting the marketing services costs from the ultimate retail sale price to a domestic consumer or export sale price to an overseas customer. The fact that the transformation process between the live animal and the final sale is substantial and also that it varies over time (eg different carcase cuts and trim sold to different markets) makes it difficult to generalise about the process and therefore the reference price. The option of monitoring actual outcomes of the process (what was sold where and for what value) would be theoretically possible but extremely costly.
- ◊ An alternative method of setting a reference price through a process of informed negotiation within an alliance may prove more cost-effective than any other process even though it would never be objectively verifiable.

Physical Functions

The physical functions involved in domestic meat marketing have traditionally been carried out by separate firms with little vertical integration. Historically, there were large numbers of small abattoirs which killed stock and sold carcases to numerous wholesalers or to butchers who broke the carcases down into cuts and sold direct to their customers. There was little scope for feedback of consumer reaction along this

[26] If the product could be described in terms of its value to the customer, it would be possible to have a value based trading system for our commodities (VBT). Trust is the ingredient that overcomes the lack of a measurement system in an alliance. VBT (commodities) and VBM (marketing a differentiated as opposed to a commodity product) is about price signals from consumers who set the price level according to the supply and their perception of value.

multi-entity chain. The emergence of supermarkets with vertically integrated operations has opened new opportunities for improved feedback especially when coupled with more sophisticated mechanisms for monitoring customer buying patterns. This provides large vertically integrated firms with a potential competitive advantage over other smaller non-integrated firms.

The physical functions involved in export meat marketing have traditionally been carried out by firms with a greater degree of vertical integration often extending to direct distribution in the overseas market in the case of foreign-owned or controlled firms. Recent trends continue this pattern but in future there may be less importance on foreign ownership for market access as the market liberalisation process continues under WTO and APEC agreements.

The manner in which the physical functions associated with meat marketing are presently carried out has some implications for consideration of strategic alliances as outlined below:

- ◊ The existing linkages or alliances are much stronger between processors and retailers or exporters than between producers and processors. This reflects the commercial usefulness of closer relationships suggesting that while it has been commercially valuable to have closer linkages between processors and retailers it has been perceived to be less valuable to have closer linkages with producers.
- ◊ It appears that the supermarkets and larger chains have the most to gain from strategic alliances and increasing vertical coordination because they are able to capture economies of scale and utilise consumer information more efficiently than smaller firms. These larger operators have most of the resources needed to develop strategic alliances.
- ◊ The lack of closer relationships between producers and processors is probably more a reflection of the mismatch in size of operation than any other factor. This mismatch in size could be addressed by further development and support of horizontal alliances which could offer significant benefits to processors (eg more secure throughput) although the benefits to producers are not as readily evident unless the alliance also becomes involved in downstream marketing to secure throughput or higher value sales.

Facilitation Functions[27]

Apart from the provision of physical facilities in the form of saleyards and entities such as CALM, the facilitation functions associated with meat marketing are poorly developed in comparison with other meats such as poultry and pork. To some extent this may represent failure on the part of entities within the industry to develop the functions; to a greater extent it reflects the difficulties associated with marketing a product as variable and complex as red meat. The main facilitation functions are discussed below along with their implications for consideration of alliances.

Standardisation of product is essential for efficient marketing because it allows buyers and sellers to know exactly what they are buying or selling. Unfortunately red meat is extremely difficult to standardise as revealed by the long history of

[27] Facilitation functions refer to the activities that are needed before markets can operate efficiently. They commonly include: the standardisation of product or its classification into classes; provision of finance; management of price and supply risks; and provision of market information.

discussions on grading and a descriptive language. It is beyond the scope of this paper to comment further on this aspect except to note that the absence of an objectively verifiable basis for describing red meat is a major constraint to value based marketing.[28]

◊ To encourage the effective uptake of the existing description language and in the absence of a better, more objectively verifiable description system, alliances offer one method of reaching a potentially better basis for price determination than the present arrangement which separates each stage of the value chain and reduces the flow of information along the chain.

◊ In the absence of an affordable objectively verifiable description system, alliances offer one method of reaching a potentially better basis for price determination than the present arrangement which separates each stage of the value chain and reduces the flow of information along the chain.

Provision of finance is often used as a part of marketing although in the case of the red meat industry each party has generally been responsible for financing their own operation. This is in contrast to pork and poultry operations where it is common to find that the marketing agent will finance much of the operating and even capital costs of its contracted suppliers. One area where financing is provided for red meat producers is the so called del credere system where livestock agents independently finance (or underwrite) the purchase of livestock sold through the agent to other parties.

◊ The provision of finance does not appear to be an important part of the operation of red meat markets but the development of some alliances (eg horizontal alliances) will require that funds be raised and if agents are not involved there will be a need to replace the del credere system.

One of the functions that marketing arrangements need to perform is the management of risks, although this is a poorly understood and rarely considered aspect of financial management in the livestock industries (eg producers carefully try to manage risk of bad weather but rarely if ever try to manage risk of price variability).

The risks in meat marketing are substantial and there appears to be few formal approaches to risk management. There are no well-established mechanisms for dealing with price or supply risk to any party in the chain. Some production is forward contracted but there are great difficulties associated with the process and it appears that operators have judged that the benefits to either party are not large enough to warrant incurring the costs. By their nature, forward contracts always result in the perception of one party 'losing' in terms of the price they received (or paid) even though they presumably gained an offsetting benefit of risk management, the forward knowledge of the price. These reasons may explain why forward contracting has not really developed, although in the lamb industry there is a developing interest in forward prices which have a baseline with a potential to increase if auction prices go higher. This has some attraction in terms of risk management and the market clearing functions.

Although a futures exchange for beef operated for some time it was closed apparently because the small volume of throughput made it vulnerable to

[28] It is likely that alliances would provide a means for making better use of the Ausmeat language which would go some way to addressing this problem.

manipulation. One common form of risk management for producers has been to diversify their production and this is one reason why there are so many non-specialist beef producers. There are considerable risks associated with buying livestock in the absence of objective yield and value information. Buyers have traditionally dealt with those risks by averaging and hoping that there are enough animals that yield above average to offset those that yield below average. This practice has significant costs to industry in that it obscures signals about the value of individual animals. As discussed elsewhere, much of the information on the value of individual animals is at best unknown and possibly unknowable with current technology. However, it is likely that there remains some information on the value of individual animals that is in fact known but that is not being provided because of the widespread use of averaging. The use of alliances could create opportunities to make use of such information.

◊ Alliances offer scope for developing practical and mutually beneficial methods of risk sharing.

Provision of market intelligence is catered for in various ways in the red meat industry. Agencies such as the AMLC and state meat industry authorities as well as the industry organisations generate considerable information on past and current market conditions at least as far as the public auction systems (including CALM) are concerned. Informally, livestock agents convey information about market conditions and their expectations about future conditions, albeit on a generally subjective basis. All this information is associated with market averages and is nearly always only provided at one point in the value chain. There is very little information that attempts to link values at different points in the chain and it is very difficult to derive such information because of difference in the way prices are recorded (eg carcase weight and shipped weight). Apart from a few detailed studies, there is no information that links individual livestock value to yields and values at the retail or export sale level.

Alliances have the scope to develop market intelligence which is specific to their program. Market requirements and supplies and the ability to meet the product specifications can all be carefully evaluated and the information made available directly to suppliers. This market information is more targeted and therefore more useable.

◊ Alliances offer a forum in which the members would have the means to generate greatly improved market intelligence and more importantly to use the information to provide overall benefits to the whole alliance.

5. COOPERATIVE BUSINESS RELATIONSHIPS AND STRATEGIC ALLIANCES

Summary

This chapter outlines trends towards new forms of business relationships that involve increasing collaboration amongst operators along the supply chain rather than the traditional adversarial relationships. It explains that these trends provide the basis for interest in strategic alliances. It also outlines the implications of closer business relationships for participants in the alliance and for those outside the alliance.

Introduction

In most agribusinesses, companies are trying to develop integrated supply chains involving closer relationships with their customers and suppliers in an effort to build more flexible and responsive business systems. There is a recognition that customer value is created by systems of firms working together, and not just by a single firm or corporation. For example, a Queensland beef producer does not compete against a Victorian broiler producer, but rather ideally the chicken meat system managed by (say) Ingham competes against (say) AMH's beef system or currently against the existing fragmented red meat industry.

A common feature of these developing integrated supply chains is that the integrator deals with a reduced number of suppliers but develops closer relationships with those suppliers. However, in the food industry, the relationship between a small number of retailers or processors and a large number of producers is a difficult one to manage. It is generally not possible to dramatically reduce the number of farmer suppliers and so managing this relationship can be an important constraint to developing the international competitiveness of some agrifood industries. Red meat appears to be particularly disadvantaged in this regard in comparison to the more intensive pig and poultry industries.

The Role of Closer Relationships

Creating Customer Value

In some business-to-business relationships two games are being played simultaneously. The first is an adversarial win-lose game whereby the "pie" is divided between the channel participants. The second is a win-win game in which the participants can work together in order to reduce costs or to create more customer value. In successful relationships these two dimensions are both carefully managed to provide results.

Business systems create customer value and the competitiveness of systems depends on both the performance of the individual firms and the strength of the linkages or relationships between those firms. It is important to note that linkages are an integral component of competitiveness. Global firms such as Nike, Benetton, Compaq Computers and McDonalds have been successful due to their ability to

break down existing boundaries of firms along the supply chain and to create seamless systems right through the chain.[29]

The relationships needed to create additional customer value could take various forms including partnerships, alliances or joint ventures. Linkages or closer relationships between firms in a business system will not always be appropriate, however, they are appropriate in situations where they create additional 'customer value' that could not be created as efficiently in any other way. One example of this concerns quality assurance or QA in relation to say food safety. Food safety provides customer value and it relies on adoption of sound procedures and being able to trace back product through the supply chain. If a retailer can demonstrate that all their product comes from members of an alliance and that all members of the alliance follow sound food safety precautions this provides the retailer with a competitive advantage over others who cannot trace the origin of their products.

Developing Business Systems or Networks

The modern view of business strategy is that customer value is generally created by a business system or network rather than a single corporation. It therefore follows that the focus of competition is network against network, and not just firm against firm. (See Table 3) Similarly, the traditional view assumes that the firm has discrete boundaries whereas the modern approach, with the emphasis on coordinated supply chains, attempts to break down these boundaries, both within and between other firms. Nike, the successful sports footwear company for example does not own any shoe manufacturing plants or retail outlets, but still coordinates the total supply chain. Trying to determine Nike's boundaries is a pointless exercise.

The strategic network approach, which tackles how firms develop seamless value creation systems, views the ability to generate trust as the key entrepreneurial skill that makes the network possible. The marketing focus in the 1980s was on transactions where-as the 1990s view recognises that especially in business-to-business marketing along a supply chain, the relationship context within which the transaction occurs often becomes more critical than the individual transaction. In this situation, commitment to the relationship becomes a more powerful performance measure than simple customer satisfaction with the transaction. Relationships are best understood in terms of interdependence which is a two-sided concept rather than power, which is a one-sided view.

This view of business strategy emphasises the need to take a whole chain perspective. Monash's Agribusiness Research Unit (ARU) has been involved in setting up alliances in horticultural industries and has found that grower-packer relationships will not develop without the active involvement of the rest of the chain. The emphasis must be on creating more value for the end consumer and this requires a total chain perspective. Ideally this will mean that the retailer is involved, however, where this is not practical, at least there should be some clear linkages through to the consumers.

[29] An example of this is that McDonald's who not only tell equipment suppliers of their plans but provide finance so the company can also meet its requirements for expanded output.

Mistrust and Commodity Markets

In so-called commodities markets, where the size of the 'pie' is fixed, the only game played is an adversarial win-lose game to divide the pie between channel participants. If one party wins it is at the expense of the other. It must therefore be expected that the channel participants involved in such markets will be deeply suspicious of each other and show a low level of trust.

In contrast to the red meat industry, various forms of alliances are common in manufacturing industries where the partners already have a high level of trust.

As efforts are made to move the red meat industry away from commodities and towards greater product differentiation, the scope for alliances becomes evident. However, the past history of operations in a commodity market will mean that all parties will have to overcome a tradition of suspicion and mistrust. This will be a major challenge for the red meat industry.

Situations where Closer Relationships Work

Closer relationships only make commercial sense where they create more customer value. In commodity markets, where suppliers are unable to differentiate their product or service and hence the purchase decision is price based, closer relationships do not make sense. In these markets the total amount of consumer value - the size of the pie - is fixed and auctions systems provide an appropriate mechanism for transmitting market signals and apportioning the benefits between channel participants. (See Box—Mistrust and Commodity Markets)

As will be discussed later, there are real costs to developing closer relationships and extra value must be created on a sustainable basis in order for partnerships to work. Driving out costs does provide short term benefits but extra value must be created for long term benefits.

Closer relationships make sense in fragmented or highly segmented markets such as automobiles, fashion clothing and sports footwear. In these markets the whole chain can work together to develop tailored offerings for specific and ever changing target segments.

In the meat and horticultural industries, the pressure for closer relationships or supply chain management is driven by the needs of supermarkets for quality consistency, reliability of supply and to ensure safety. Consumer concerns for safety, which is now reported in consumer surveys as their number 1 issue, require a total chain perspective involving processors, feedlots or finishers, breeding herds and studs. Consumers are increasingly electing to buy their meat from supermarkets and the needs of supermarkets, as the consumers' agent, will continue to provide pressure for closer relationships in the meat industry.

Table 3: Business Strategy for Competitive Advantage

	Traditional 1980s view	Modern 1990s view
Value creation	by the corporation	by business or value creation systems
Competition	corporation against corporation	system against system
Firm	has discrete boundaries	has fuzzy boundaries
Marketing focus	transactions	relationships
Marketing performance	satisfaction with the transaction	commitment to the relationship
Business relationship perspective	power	interdependence

Closer Relationships in Agriculture

The attributes of agricultural product such as perishability also play a role in the development of the nature of the linkages and relationships. For example, it is no accident that alliances in the form of farmer cooperatives play a dominant role in milk processing and marketing around the world since milk is produced and marketed daily. On the other hand, the highly storable nature of grain means that closer relationships may not play a significant role in the grains industry.

Although livestock slaughter can be deferred, once slaughtered meat itself is a perishable product. This suggests that closer relationships are likely to play an increasingly important role in the meat industry. Closer relationships also provide a basis for transmission of market signals and so they are favoured for those products where existing mechanisms for transmitting market signals are ineffective or particularly costly. Meat certainly qualifies on these grounds since it involves major transformation to move from the carcase to the meat cuts and it is difficult to follow the product through the chain.

This implies a greater role for producer groups or cooperatives in the marketing chain in order to protect against opportunistic behaviour from the processor who may be tempted to distort the market signals going back to the producer. We maintain that the transmission of market signals cannot be divorced from the relationship context in which the signals are communicated. Adversarial relationships block information flow.

In general terms we expect that closer relationships are likely to play an increasing role in that part of the red meat industry that focuses on creation of a higher value, differentiated product which requires a different marketing focus. In parallel to this,

we expect to see the traditional relationships and auction markets operate in that part of the red meat industry that uses price as the coordination mechanism.

Producers and others will become frustrated and disappointed if they try to develop closer relationships to supply non-differentiated lower value commodity markets. In these situations the market and auction system provides the most effective and efficient coordinating mechanism.

In general, closer relationships work best when the 'size' of each of the participants is similar. A number of studies have found that relationships with a size imbalance simply do not work well, they tend to have lower levels of trust, exhibit higher levels of conflict, are less cooperative and are more unstable. It is difficult and costly for manufacturing and retailing firms to develop close relationships with a large number of primary producers. Thus, in agribusiness it is usually pointless to talk about closer vertical relationships between a (usually) small producer and large retailer or processor. Some horizontal coordination mechanism is usually required as a pre-requisite although even then this increases the complexity and lowers the chance of success of the relationship. In the red meat industry there is a serious size imbalance between producers and processors or retailers. Unless carefully managed, such unbalanced relationships lead to continued conflict and lowered levels of trust. This suggests that an early priority for the red meat industry will be to help establish horizontal alliances as a basis for subsequent closer vertical relationships with processors and retailers.

Implications of Closer Relationships

Closer relationships and alliances are not costless. The two most important costs are those related to the loss of some control for suppliers and to the operation of a mechanism to share profits equitably (not equally) and to keeping the relationship functioning efficiently.

Shifts in control

One of the underlying issues in implementing a network or business system approach is that closer relationships result in a change in control. The supplier invariably loses some independence or control. This can be managed relatively easily when two large organisations are dealing with each other because there is already a level of interdependence. Successful relationships are not built on a basis of power, but by creating a dependence on each other. This requires trust.

In the meat industry, interdependence will be virtually impossible to achieve unless individual producers combine in some form of horizontal alliance to provide a balance between retailers/processors and suppliers. Producers are generally proud of their independence and will be extremely cautious about developing closer relationships when it implies a loss of some independence or control. As one beef producer commented to us "we'd like to develop closer relationships with the processors, but how do you do this without being in danger of getting gobbled up by a shark". The loss of control exposes the producer to opportunistic behaviour by the retailer or processor.

Conversely, many processors, agents or retailers would like to develop closer relationships with their farmer suppliers but find it difficult to manage the relationship with large numbers of small primary producers.

The flip side for farmers is that there is a high price to pay for independence. When farmers use an auction system and their independence is at a maximum, they are exposed to the most risk (such as severe price fluctuations) and they do not receive clear and strong market signals. The independent farmer is the most isolated player in the global food system. Markets could change and farmers may not be aware of the magnitude of the changes.

In contrast to the situation facing beef producers, pork producers can decide whether to remain "independent" or to align themselves with one of several integrators or business systems.

Do suppliers benefit from alliances?

Closer relationships tend to result in a shift in control to the firm closest to the final customer. In the red meat industry, the benefit of alliances to suppliers will come from their opportunity to understand what the customer really wants and to adjust their operations so that it can provide product with those attributes.

Suppliers will benefit from alliances provided that they can increase profits by changing their operations in the light of the improved understanding of customer requirements that will arise through the alliance.

Sharing the benefits

The second major challenge is how to equitably share the benefits from the closer relationship and to keep the relationship functioning cost-effectively. Before developing a closer relationship it is important to consider how the benefits will be shared. It is one thing to drive out costs or to create more customer value but another to decide how to share the benefits. The ARU has found that excellent costing systems are required as a foundation for tackling this challenge.

The general theme in successful alliances is that the dominant party's (eg: the retailer) need for consistency and reliability of supply is greater than their incentive to act opportunistically. In successful alliances both parties are able to manage the transition from independence to interdependence and not from independence to dependence. The Japanese automobile manufacturers such as Toyota actually place themselves in a position where they are (somewhat) dependent on their suppliers, thus creating an interdependent relationship.

6. THE CASE AGAINST STRATEGIC ALLIANCES

Summary

This chapter considers the case against strategic alliances and presents the available evidence or opinion in relation to each major concern. The major element of the case against strategic alliances is that they provide the means for greater vertical coordination of supply which could shift power to the retailer or exporter at the expense of the producers. The factors that are seen as facilitating this power shift include: further concentration in production, processing, retailing and exporting; opportunities for price discrimination; interference with price discovery; growth of multi-national companies; and loss of control to foreign owners. The perceived consequences of this shift in power include: loss of independence; loss of the family farm; decline of rural communities; and increasing adverse environmental impacts.

Changes in Market Power

Through-chain, or vertical, strategic alliances require suppliers to move from a position of independence to one of inter-dependence on the lead firm within the alliance. Through a variety of contractual mechanisms, suppliers agree to supply product under negotiated conditions. They are no longer free to supply other markets and they may be obliged to change their production practices in various ways. As mentioned earlier, if the supplier is of a similar size to the lead firm, there is no shift in market power because the lead firm needs the supplier just as much as the supplier needs the lead firm. However, this is not the situation in the red meat industry where even the smallest processor or retailer likely to be involved in an alliance will have a throughput that is probably at least 100 times larger than the throughput of the largest supplier. It appears, therefore, that such strategic alliances would indeed tend to shift market power away from producers into the hands of the lead firm.

If the lead firm is large and has relatively little competition from other firms it could exploit its power (and any technical efficiency or scale economies that arose from its scale) to obtain an even larger proportion of total supply. (Alternatively, it might collude with a few other large firms to create an oligopsony [30]). At some point its power might be such that it could effectively control the market and set prices. At the extreme this could lead to a misallocation of resources through reduced pricing efficiency—artificially low livestock prices would lead to a shift out of livestock production even though this was theoretically the most economical use of the land. In practice, it may not progress this far but producers would effectively be transferring profit to the lead firm.

In theory, strategic vertical alliances involving a large integrator and many relatively small suppliers creates the opportunity for exploitation of those suppliers and all other suppliers through the price setting effect of a large alliance. In practice, it has generally been found that such exploitation has not taken place since commercial

[30] An oligopsony is a market where few buyers face large numbers of sellers. It is comparable to an oligopoly but it need not be the same if the firms do not perceive interdependence in terms of their own decisions on pricing and investment.

reasons always limit such behaviour because it would ultimately lead to the loss of supply.

Effect on Concentration

The benefits of supply integration that are made possible by use of strategic alliances are generally more likely to be captured by large retailers or exporters than by smaller ones.[31] Since strategic alliances are only established when all parties to the alliance can gain an advantage from their formation, it is likely that larger firms will use strategic alliances more than smaller firms. To the extent that strategic alliances confer a comparative advantage to larger operators, they can be seen as encouraging the big to get bigger and the small to be squeezed out. This will lead to increasing concentration in downstream processing and marketing or in any segment where the strategic alliances confer a particular advantage.

It is clear that strategic alliances are not in themselves necessary for industry concentration since this trend started well before there was any vertical coordination. However, strategic alliances may further accelerate the process of concentration because they particularly suit larger firms. What is not clear is whether industry would be any less concentrated if strategic alliances were in some way banned. As noted earlier, the level of downstream concentration of the Australian meat industry is not presently a matter for concern.

Strategic alliances could lead to more rapid concentration in downstream processing and marketing but in Australia this is unlikely to reach levels which would be of concern to suppliers.

Evidence from the US

There have been extensive investigations into exploitation arising as a result of concentration in the US meat packing industry where the level of concentration is about three times higher than in Australia. These studies have not attempted to establish any cause and effect relationship between vertical coordination (strategic alliances) and concentration but rather have simply assessed the impact of concentration.

The results of a 1991 investigation into concentration in the meat packing industry [32] carried out by the USDA at a cost of over $500,000 are summarised below:

- ◊ Cattle purchased through forward contracts bring lower prices than cattle delivered on the spot market while cattle purchased using market agreements bring higher prices. [33]
- ◊ Larger meat packing plants pay higher prices than smaller plants in most but not all regions but the difference was very small.

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[31] See USDA 1991 op cit, USDA 1996 op cit, Boehlje et al 1995 and Globalisation and Agri-food Restructuring. Prospects for the Australasia Region. Ed David Burch, Roy E Rickson and Geoffrey Lawrence. 1996

[32] USDA 1991. See Concentration in the Red Meat Packing Industry. Packers and Stockyards Program. Grain Inspection, Packers and Stockyards Administration. USDA

[33] Forward contracts reduce the feeder's price risk but the trade-off is a lower price. The price reduction averaged about 1.4%. The marketing agreements increased prices paid by about 0.4%

- ◊ As plant utilisation increases, the use of 'captive supply' increases but the overall effect of increased use of captive supply on short run prices paid for cattle in the cash market appears to be negative and very small.[34]
- ◊ Despite a detailed study it was not possible to show that large meat packers use market power to exploit suppliers.[35]
- ◊ Different pricing and procurement arrangements (including captive supply and contracting) and structural characteristics were found to affect the conduct and performance of the meat packing industry.
- ◊ Given the rising trend in concentration and the fact that quick answers to complex market structure and behaviour issues are not available, it was concluded that there was a continuing need to monitor and analyse behaviour and take corrective action when necessary.

The testimony of respondents to a 1996 USDA Advisory Committee study on Agricultural Concentration is summarised below:

- ◊ Producers feel powerless to address their problems in the closed concentrated systems with which they must deal. Although they recognised that the cattle cycle was part of the problem, producers felt that they were bearing losses while others in the chain made record profits.
- ◊ Distrust of the current procurement system is real and significant, and particularly at the meat packer (processor) level.
- ◊ A significant number of producers testified that they believed that formula pricing[36] , captive supplies, and various forms of vertical integration lead to thin markets and the potential for price manipulation.
- ◊ Some contract producers testified in favour of vertical coordination saying that it reduced their risks by providing financial stability. It appeared that production contracts were more generous in regions where more than one integrator was operating
- ◊ Many producers testified that the level of information on prices and terms of trade was insufficient

The findings of the 1996 USDA Advisory Committee study on Agricultural Concentration[37] are summarised below:

- ◊ The issues associated with concentration are complex and highly charged, eliciting strong views and concerns about the balance of economic power, use of government power and personal freedom.

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[34] For each 1% increase in the proportion of supply coming from 'captive suppliers' (ie forward contract or marketing agreement cattle), there was an observed 3-5c/cwt (about 0.02%) fall in the price paid in the cash market.

[35] The level of concentration of buyers in US cattle producing regions is very high by Australian standards. Seven of the nine regions investigated had HHI values of between 3000 and 5000 and one region had only one packer. Despite this, an increase of 1185 in the HHI only decreased the price paid by 0.2%

[36] Price based on a formula such as the packer's weekly average price paid or the average of several public price reports.

[37] USDA 1996. Concentration in Agriculture. A report of the USDA Advisory Committee on Agricultural Concentration. June 1996

- ◊ The lack of suitable data and information on these issues contributes to unsatisfactory studies and to distrust and hostility towards larger entities.
- ◊ The committee unanimously recommended a policy to support and improve market information as a vital component of a competitive marketplace, however, there were differences of opinion in how to implement this policy.
- ◊ Concentration is at a historically high level and is continuing to grow with four firms now accounting for 82% of cattle slaughtered up from 36% in 1980. Three firms account for 70-75% of the lamb industry.
- ◊ The drive towards more (vertically) coordinated production to ensure product diversity that meets consumer demands is likely to increase. It has already transformed the poultry industry into a very efficient system and has increased horizontal concentration in that industry. Vertical integration is expected to affect a large share of hog production within the next decade.
- ◊ Coordination is being used to manage risk, plant utilisation, quality, safety and health.

In summary, there is no conclusive evidence that concentration has led to exploitation of producers in the US. This is despite the fact that concentration is at a high level in the US and that many people feel that exploitation is occurring. The USDA and other independent economists have gone to considerable effort to try to measure the impact on consumers and producers of changes in concentration and the use of vertical coordination. Almost all of these studies have concluded that concentration has had little if any impact on prices. A detailed study by Grain Inspection, Packers and Stockyard Administration (GIPSA) in Kansas found no evidence to support claims of price manipulation or collusion by meatpackers. At least some independent observers suggest that the concern about industry concentration is largely driven by frustration with currently low cattle prices which are the result of oversupply.

Evidence from Australia

There have been no detailed studies conducted in Australia to assess the effects of concentration or marketing efficiency on the red meat industry. These types of studies are extremely costly and difficult to perform owing to the complexity of the industry, the scarcity of data and to the variation in production and marketing arrangements over time and place. Even in the US where data are much more readily available (firms are obliged by law to provide information), where the industry is relatively less complex and certainly subject to less seasonal effects, economic analysis is very costly and largely inconclusive.

The Industry Commission report on Meat Processing[38] commented that the degree of concentration in meat processing was not large and had not changed significantly since the early 1970s. In 1987-88 the four largest enterprises owned 22 establishments (5.6% of the total), employed around 24% of the industry's labour force and accounted for 27% of industry turnover. In 1995 the four largest

38 IC 1994. Meat Processing. Report No. 38, April 1994

processors owned 24 establishments and accounted for 25% of the industry turnover.[39]

There is no evidence that concentration has had any adverse effects on the red meat industry in Australia but it must be accepted that it is very difficult to assess such effects as indicated below.

Opportunities for price discrimination

There is concern that strategic alliances will transfer market power to the large firms which will use this power to discriminate in their dealings with suppliers operating outside alliances. Such price discrimination would mean that they offer different payments for the same products but from different suppliers. For example, if a buyer is operating in an area where there is no effective competition, they may offer less for supplies than they would offer in another region (with comparable transport costs) where there is more competition. (This example shows that it is very difficult to measure price discrimination in the red meat industry because of the difficulty in ensuring that the price is being offered for an identical bundle of attributes in the product).

Strategic alliances could provide opportunities for price discrimination.

Evidence from the US

- ◊ Although studies[40] have shown that price discrimination is limited to not more than 5%, it is possible that some sellers are receiving prices that are below those received by better informed sellers
- ◊ Packers with forward contracts may have a competitive advantage over sellers (particularly smaller sellers) entering into price negotiations for open market delivery.[41]

Evidence from Australia

There has been consolidation of meat processing plants [but perhaps not concentration] in Australia in recent times. Concurrently there has been growth in the number and size of feedlots that are close to processing plants and contracts between processors and lot feeders are increasingly common. Such structural changes suggest price discrimination between different markets in different regions may be possible, arising from different degrees of competition possibly existing at different locations.

There is some anecdotal evidence of price discrimination already occurring from time to time. Buyers in remote regions offer different producers different prices and then a few days later may offer different prices again. This practice is clearly discriminatory against someone who has little market information on which to make a choice about accepting the price offered.

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39 Based on turnover given for top 4 processors in Ausmeat Feedback, July/August 1996 and total throughput for 1995 of 2,612,000 ETCW.

40 See USDA 1991 op cit

41 This situation only arises where the packer exerts a major influence on the market such that their knowledge of the forward contract price can be concealed from the seller because there are no competitive buyers who will reveal the price.

Williams and Bewley (1993) in a study of price integration between Rockhampton, Townsville and Toowoomba saleyards concluded that the strength of price integration was a declining function of distance from the dominant centre ie the differential in prices paid in different markets was likely to be greater in markets more remote from the main market. It is a well recognised phenomenon that prime stock markets separated by long distances are linked less directly than markets in close proximity. This is, in part, because the high costs and risks with transporting prime stock over long distances can mean that markets widely separated can have prices which diverge from one another for some time. Such divergence may be warranted by market conditions and may not be large enough to permit profitable trade between regions.

No unambiguous conclusion can be drawn from evidence about price differentials between markets and the degree of concentration. As concentration increases the price differentials between markets might become greater if the remaining firms were less efficient than those they replaced or it might become less if the remaining firms were more efficient than those they replaced.

Interference with price discovery

The price discovery process relies on maintenance of throughput via the public auction system and hence any change in marketing arrangements that reduces the volume sold in this manner will interfere with price discovery. Although it can be argued that the volume by-passing the public system is likely to be small, it must also be recognised that the product that bypasses the public system will also tend to be the higher value product. This will mean that the public price refers to the less valuable product and this could be used by unscrupulous operators to drive down the price paid for all product, including eventually the product that is sold within an alliance.

Strategic alliances could interfere with the price discovery process, particularly for the higher value cuts.

Evidence of price discrimination from the US

- ◊ Public testimony in the US has claimed that captive supplies and other forms of vertical coordination can be potentially detrimental to both competition and price discovery because they can 'thin' market price reporting, shorten the weekly marketing window and distort reported prices downwards.
- ◊ The overall effect of increased use of captive supply on short-run prices paid for cattle in the cash market appears to be negative but very small.

Evidence of price discrimination in Australia

There has been no attempt made to determine whether the small volume of product passing through alliances is having any effect on price discovery. It is likely that 30-40% of stock sold over the hooks or via direct sales would be a more significant factor.

It seems unlikely that alliances would lead to price discrimination in Australia.

Loss of control to foreign owners

Strategic alliances could serve to strengthen the position of foreign operators of meatworks and thus provide additional opportunity for transfer pricing. If foreign-owned meat companies entered into a high proportion of the alliances it would provide them with additional means to influence the prices paid for livestock by all operators. It is possible that Australian-owned meat companies would not be interested in establishing strategic alliances because they were less able to capture the benefits from such alliances than foreign-owned companies. Any subsequent effort by Australian companies to regain control could be effectively thwarted by the foreign-owned companies if they continued to control access to the most profitable overseas markets.

Strategic alliances could lead to loss of control to foreign owners.

Evidence from Australia

At this stage the foreign-owned companies have not shown a high level of interest in strategic alliances but they have been more involved in direct purchase of feeder stock. No analysis has been carried out to assess the impact of these companies buying operations nor to investigate the extent to which transfer pricing has been taking place.

There is no evidence at this stage that foreign-owned companies are using strategic alliances to gain greater control of the supply. The situation could be easily monitored.

Social Consequences

Loss of independence

Opponents of strategic alliances argue that they weaken the position of producers by making them dependent on processors or retailers with whom they have reached an agreement. Although the alliance may have commenced on the expectation of mutual benefit there is no guarantee that it will provide benefits into the medium term. If producers have raised additional finance on the basis of the contracts entered into as part of the alliance, they may be unable to leave the alliance without jeopardising the financial arrangements.

Producers need to have access to full information so that they are able to make sound business decisions concerning their involvement in alliances.

Loss of the family farm

Strategic alliances are better suited to larger operations and some suggest that strategic alliances will mean that family farms will be placed under greater threat from corporate farms . They argue that the loss of family farms will lead to an accelerated decline in rural communities as families sell out and look for work elsewhere.

Strategic alliances may offer family farms scope to 'act big' even if they are not big and hence improve their longer term prospects.

Adverse environmental impacts

Strategic alliances are an important part of the industrialisation of agriculture and this will inevitably lead to larger farms. In many cases these larger farms will be operated more intensively and geographically concentrated. This could lead to additional environmental pressures. Some argue that industrialisation in agriculture will lower the overall cost of production to the benefit of consumers but it may also have contributed to environmental issues.

It will be important to monitor the environmental impact of alliances along with their financial and social impact. Larger and more profitable farms are likely to have greater capacity to address environmental issues than smaller farms that are unprofitable.

7. THE CASE FOR STRATEGIC ALLIANCES

Summary

This chapter outlines the major elements of the case for strategic alliances. It suggests that strategic alliances will contribute to improved efficiency in a number of ways including better risk management, facilitating customer focus, quality assurance and value based marketing. It also suggests that strategic alliances are consistent with the emerging business environment and thus will make it more likely that red meat production responds to customers' requirements and remains profitable. Several of the main concerns raised by opponents of strategic alliances are judged to be over-stated. The concern that strategic alliances will lead to 'thin' markets and that they will weaken the price discovery process is overstated because it is unlikely that strategic alliances will extend beyond a relatively narrow sector of the red meat industry. Similarly, the concern that strategic alliances will lead to greater market power being shifted away from producers to processors, retailers, or exporters appears overstated in that strategic alliances will remain relatively minor, some offsetting producer power will be generated by horizontal alliances and because there is no conclusive evidence that changes in market power have led to any forms of exploitation in the US where the extent of concentration is more than three times that in Australia.

Improved Efficiency

All firms along the value chain in the red meat industry are under competitive pressure to improve their efficiency. Any changes in production or marketing arrangements that will reduce the cost of production will help improve efficiency. Some changes may only be possible through a collaborative approach and hence those parties that choose to collaborate will be able to use their improved efficiency as a basis for competition with other firms or business systems. Closer relationships or alliances could contribute to improved efficiency in a number of ways as indicated below.

Impact on Alliance Participants

We expect that the use of strategic alliances by the red meat industry will improve the competitiveness of participants and the industry overall. The process that we envisage will lead to that result is as follows:

- ◊ Producers are likely to participate in alliances through two avenues. First and most commonly we envisage that producers will increasingly become involved in horizontal alliances.
- ◊ Horizontal alliances will foster a marketing culture with a customer focus. Members will become aware of what the customer wants and focus their efforts on producing these products. This will influence the production and marketing practices of individual operators and the group as a whole. Those changes in production and marketing practices will help participants become more competitive. Their improved performance will set an example that others in the industry will want to emulate.

- ◊ Some horizontal alliances will choose to be associated with and participate in vertical alliances. Some vertical alliances will be through chain—from plate to paddock. Some vertical alliances will be more limited in scope—from processor to horizontal alliance or from wholesaler/marketing agent to paddock.
- ◊ The participation of producers in vertical strategic alliances will further improve their competitiveness by developing a better appreciation of customer needs and improving the efficiency of overall red meat production—more production meeting specifications and hence less downgrading; more product sold per participant; and, in some situations, more product sold at higher value.

Customer Focus

Strategic alliances could provide a relatively low cost means of putting the producer in contact with the customer or, in some cases, the final consumer. The feedback provided through such an alliance is unlikely to be available from any other source. This is because although it may be technically possible to provide feedback when product is provided through the existing chain, the cost of tracking the product through the system would almost certainly be greater than the benefit that it could provide to any producer. In the UK and Europe, such product tracking capabilities are being implemented by retailers as part of a program to re-assure consumers that the meat has not been contaminated with BSE or E. coli.

Apart from the direct value of the information available about the customers' requirements and the extent to which product was meeting those requirements, closer relationships between producers, processors and retailers will provide all participants with a better understanding of the red meat industry which may lead at least to improved trust and at best to further efficiencies along the chain. It will also help the industry to present a coordinated approach to the public or to government on the occasions that this may be required.

Strategic alliances offer a relatively low cost approach to improving customer focus to participants in the red meat industry. This is likely to generate benefits at several levels.

Value Based Marketing

The introduction of value based marketing (VBM) has proved extremely difficult in the meat industry in part because of the prohibitively high costs of attempting to maintain some level of product identity through the value chain. While there are other reasons which have made it difficult to introduce VBM, strategic alliances would reduce the product identity problem provided that the product handled by the processor or retailer was predominantly obtained from a small number of strategic alliances.

Alliances will help provide the environment for VBM with meat prices set at the retail or export level and livestock prices determined by the costs of transformation. Under alliances with VBM, producers supplying livestock with higher potential retail value or lower transformation costs will be rewarded because they are providing greater customer value. This will improve the competitiveness of those producers participating in alliances.

Strategic alliances will greatly facilitate the introduction of value based marketing and may prove to be the only way that the benefits of VBM can be demonstrated.

Quality Assurance

Strategic alliances may prove to be one of the most effective ways of demonstrating to customers that particular QA procedures have been followed. As consumers' concerns about food quality and safety become more common, QA systems will increasingly become a basis for product differentiation.

Strategic alliances will similarly be useful in demonstrating particular attributes of product such as 'animal friendly', 'environment friendly' or 'antibiotic free' production technologies.

Strategic alliances could facilitate the introduction of QA systems and ensure that those participating obtained full benefit from their participation.

Improved Risk Management

Strategic alliances offer the prospect of reducing the cost of dealing with risk for both producers, processors and marketers. Risks would not be eliminated but could be reduced in a range of ways as suggested below:

- ◊ By providing producers with a more secure and certain forward price for their output they allow the producers to budget more accurately and to embark on other efficiency enhancements on their holdings
- ◊ By securing a specified level of supply at a certain forward price processors would be more assured of throughput and could: invest in other efficiency enhancements in their works; forward contract sales to reduce their own price risks; schedule throughput more efficiently.
- ◊ By securing a specified level of supply at a certain forward price retailers or exporters would be assured of throughput and could: invest in other efficiency enhancements in their stores; develop more secure marketing programs; promote the particular brands or types of meat supplied by the alliance.

Strategic alliances could reduce price risks to producers and price and supply risks to processors, retailers and exporters. These reduced risks could be expected to generate other efficiency improvements by reducing uncertainty.

Changing Business Environment

As discussed elsewhere in this report, the business environment in which the red meat industry must operate and compete for market share is changing.

- ◊ Existing red meat consumers are becoming more discerning and demanding and potentially new consumers with different tastes are emerging domestically and in Asia.
- ◊ Business is becoming globalised and old ideas about comparative advantage are being replaced by the concept that (large) firms or business systems can create their own so-called competitive advantage
- ◊ World trade is becoming more open but market access is still closely guarded and the terms on which access is granted depend on the political and commercial alliances that are created

- ◊ Food companies are seeking closer relationships with their customers and suppliers to provide them with a competitive advantage in the form of an integrated supply chain
- ◊ Food companies are seeking to establish more flexible and responsive business systems than those of the past to suit the more dynamic market of the future
- ◊ Food companies are extending their boundaries so that they can operate as business systems and compete with other business systems
- ◊ Retailers are becoming less dependent on meat and, as consumers increase their range of purchases, they are happy to replace an uncompetitive meat product with a non-meat alternative.

Most if not all of the forces bringing about these changes have their origins outside Australia and are beyond the control or influence of producers or processors in the Australian red meat industry. These changes can be ignored but at a cost to the industry because it may mean that red meat continues to lose market share to other foods and is relegated to the discount price outlets of the world and domestic markets.

The key implication of this changing business environment for the red meat industry is that a significant part of the 'higher value' trade in meat in the future is likely to be directed through business systems relying on integrated supply chains to create 'customer value'. These integrated supply chains will be characterised by reduced numbers of suppliers probably in the form of well-coordinated supplier groups. For those operators in the industry who are interested and able to make greater profits from this 'higher value' trade than from other trade in red meats, it will be essential that they are involved in some form of alliance ie that they collaborate with processors and retailers or exporters to create an integrated supply chain.

Changes in the business environment will require that the higher value segments of the red meat trade are serviced by firms or business systems operating integrated supply chains. Strategic alliances offer the best means of participating in such trade.

Limited Risks

The risks associated with greater use of strategic alliances appear very limited. Nearly all the concerns raised by opponents relates to through-chain vertical strategic alliances and we suggest that these will only have limited scope in the red meat industry in the foreseeable future. They will be restricted to the higher value segment where the costs of establishing and maintaining the alliance can be offset by the substantial additional customer value that they can create. While this segment is important and will be a valuable addition to the red meat industry, it is still only likely to account for a small part of the total industry.

The other risks associated with strategic alliance is that they could result in loss of the price discovery system and to market domination by a few, possibly foreign-owned, companies. These concerns are considered below.

Likely Impact of Alliances on Price Discovery

Provided that industry ensures at least the continuation of current market reporting services (and ideally, with improvement in the services) we expect that strategic alliances will have little or no significant adverse effects on the production segment

as a result of effects on the price discovery process. For those producers making use of alliances, we base this judgement on the following consideration:

◊ At present, the price discovery process for red meat is almost entirely based on reports from the public auction system.[42] This system does not provide clear market signals linking price with specific meat quality and yield characteristics except in the most general sense (Liveweight, fat cover, age and sex). Both systems are based on averages. Hence the current price discovery process is largely ineffectual in providing practical short or longer term price signals to producers concerning the value of individual types of livestock.

◊ The retail and export prices are the real benchmarks for price discovery and those in alliances will receive prices that are based on those prices less the costs of transformation. The costs of transformation will be disclosed to alliance members through 'open book accounting'.

◊ Most producers who choose to become involved in alliances will initially sell only part of their output through that channel and will therefore be able to compare prices and values from different channels. Once they have developed trust in the alliance they may sell all their output through the alliance.

For those producers remaining outside alliances, we base the judgement on the following considerations:

◊ The volume of product that is likely to be diverted from the public auction system to private trade through any sort of alliance is envisaged to be less than 5% of throughput in the period to 2000. This is relatively minor compared to the situation in the US where at least 18% is traded in this way.[43]

◊ Even in US where a relatively large proportion of throughput is supplied outside the public auction system, detailed studies have been unable to demonstrate that this has led to adverse effects on the production sector. (Nonetheless, it needs to be acknowledged that many producers are concerned about the effects of non-public market transactions on price discovery and price formation).

◊ The price difference in the US between cattle procured under marketing agreement and spot markets was only about 1%

An expansion of the use of horizontal alliances and particular of those extending members' control further down the chain eg through custom feeding and processing would significantly assist the price discovery process. We base this judgement on the view that:

◊ Horizontal alliances will increase market lot sizes and reduce transaction costs thus attracting more bids from buyers. This will provide better market intelligence information and further strengthen the position of sellers in horizontal alliances.

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[42] Including CALM

43 See Concentration in the Red Meat Packing Industry. Based on a survey of cattle procurement over a 12 month period (1992-1993) involving 200,616 transactions covering 23 million cattle. The survey revealed that 82% of cattle were procured from spot markets (ie purchased when required but not necessarily in open transactions); 8% from marketing agreements; 7% from forward contract; and 3% were already owned by the packer. The proportion of the purchases on spot markets that were open transactions was not given and hence the figure of 18% for non-public procurement is a minimum.

Strategic alliances are not likely to interfere with price discovery and may in fact improve the process.

Limited Impact of Alliances on Balance of Power

In our view it is extremely difficult to attempt to establish cause and effect relationships in relation to changes in the balance of power of different sectors in the value chain. There is no reliable basis available to determine whether there has been any shift in the balance of power or profit share amongst the various segments of the red meat industry in the recent past. Livestock production is subject to very large fluctuations in response to seasonal conditions, markets and profitability of alternative enterprises. Profits from feedlotting vary with changes in livestock prices, grain prices and international market prices. Meat processing profits also fluctuate widely with intermittent periods of high throughput and high profits followed by periods of low activity with low profits. Profitability in the meat processing industry depends largely on market prices for livestock and meat, on capital costs and capacity utilisation, and to a lesser extent on non-capital inputs to the processing works.

The balance of power depends to a large extent on industry structure but this in turn depends on a whole range of factors. The four major changes in the red meat industry structure over the past 20 years have been:

- ◊ A reduction of more than 50% in numbers of establishments involved in producing or processing red meat[44]
- ◊ The establishment of a lotfeeding sector that now accounts for about 30-35% of total beef production, more than one third of domestic consumption and more than 20% of exports[45]
- ◊ The transfer of foreign ownership of meatworks from principally British companies to Japanese, American and Chinese companies.
- ◊ The emergence of supermarkets as the driving force in meat retailing in Australia.

These changes have arisen as a result of a variety of influences quite independent from the evolution of strategic alliances.

In our view, wider use of strategic alliances in the future will not contribute significantly to any adverse changes in the balance of power.

Minimal Impact on those outside Alliances

We expect that those producers who do not participate in the alliances will not be adversely affected compared to the situation that would apply if there were no alliances. We base this judgement on the following:

- ◊ At least for the next 3-5 years most of the red meat will be marketed outside alliances and hence non-participants will be the overwhelming majority of producers. Our judgement is that by 2000 perhaps 6,000 producers accounting for

[44] ABS indicates that the number of establishments with meat cattle declined from 77,012 in 1974/75 to 33,430 in 1992/93. Later statistics are not comparable owing to changes in classification. Meat processing establishments declined from 550 in 1972 to 223 in 1992.

[45] Estimates based on 1994 from "Input Requirements for Cattle Feedlot Industry" MRC Project Number M.544. These figures have fallen with the price slump and are not currently so high.

up to 10% of red meat production might be operating in horizontal alliances of some sort and less than half their production (5% of total red meat production) would be marketed through various vertical alliances. This would mean that at least 95% of all red meat is still marketed outside alliances.[46]

- ◊ Although alliances are expected to deliver more value for customers and greater profits for participants inside alliances they are not likely to have any impact the prices of meat traded outside alliances.
- ◊ Although alliances are expected to help increase the supply and demand for table eating quality red meat, there would be insignificant effects on the prices for these or other red meat products. Hence producers operating outside alliances would not be affected by changes in price or demand.
- ◊ Those producers outside alliances who make no changes in their production and marketing practices are likely to become progressively less competitive in the future regardless of whether alliances are established and operated.

46 The 6000 producers is based on about 7% of 85,000 total producers.

8. CURRENT ALLIANCES IN THE RED MEAT INDUSTRY

Summary

This chapter outlines the experience to date with alliances in the red meat industry. It indicates that there have been considerable successes and that horizontal alliances are already well established with over 120 alliances operating in the beef and lamb industries. The formation of alliances appears to have benefited from external support and some important ingredients for success have been defined. Most importantly, successful alliances are those that have developed trust in their partners and a commitment to success through the alliance.

Introduction

The use of alliances in the meat and livestock industries is not new—industry organisations have been formed in most sectors of the industry with organisations representing producers, processors, retailers at local and national levels working together for many years. These organisations were developed to provide political power rather than market power. They provide a body to represent people who would be in a relatively weak position if they argued for their various causes alone.

In the last few years businesses dealing with lamb and beef have shown an increasing interest in forming business relationships or alliances for marketing purposes. While it is not clear what catalyst drew the alliance partners together or what convinced them that this was a direction they should take, it appears that the major drivers have been their awareness of changes in consumer behaviour including a disenchantment with red meats. Consumers have become better informed, less loyal and more demanding. They now require a guarantee that their food is quality assured and safe to eat. They purchase what they want rather than accept what is available. The people involved in alliances show a strong desire to meet consumers' needs and they want to develop a direct link with consumers to achieve this.

Various operators in the red meat industry have often claimed to be meeting consumers' needs while providing products that research showed were not what consumers wanted eg lambs that were overfat and outside the weight specifications. These producers commonly sell at saleyard auctions which provide no links between producer and consumer and therefore preclude quality assurance.

The alliances vary in the linkages that are created amongst operators along the value chain. Figure 8 shows the various stages of the value chain and highlights the complexity of production and marketing of meat. This complexity creates difficulties for alliances since the product changes form and ownership several times before the meat is ultimately consumed. It also shows why the principles and technologies of value based marketing have been difficult to develop and implement—the many changes of ownership and product form create difficulties for product description and feedback. Equally important, the figure gives an insight into the many different interest groups that need to collaborate to make value based marketing work. It is clear that there are people who will be marginalised in the future because they play no part in adding value and it is these people who have impeded implementation of value based marketing.

Formation of Alliances

Experience has shown that there is no recipe for forming successful alliances but that formation is made easier and faster if some support is provided to the group. The

Figure 8. Processes Necessary to Deliver Lamb or Beef to the Consumer

Value Chain	Product
seedstock	semen
↓	
birth	embryo
↓	
growth	live animal
↓	
store sale/transfer to feedlot	live animal
↓	
growth to finishing	live animal
↓	
saleyard auction	live animal
↓	
slaughter and process	carcase
↓	
wholesale	carcases/primals/cuts
↓	
packaging/distribution	carcases/primals/cuts
↓	
transport export/domestic	carcases/primals/cuts
↓	
retail	primals/cuts
↓	
food service	cuts/meals
↓	
consumption	meals

key support requirements seem to have been: the provision of a basis for people to work together; assistance with planning and negotiations; identification of support needs; and, above all, provision of sound information about industry structures and functions.

Some of the ingredients that appear to be needed for a successful alliance are:

- customer focus (particularly the consumer),
- value based marketing - transparent pricing and product performance feedback,
- commitment to the alliance,
- trust - both with horizontal alliance partners and with downstream partners,
- a secured market,
- a secure supply
- open communication to build trust,
- a clear organisational structure where everyone feels represented.

There may also need to be a new culture which recognises the value of the information sharing between alliance partners and the need for a new level of trust between partners.

There is also a need to respect the confidentiality of information. The commercial-in-confidence information exchanged between the exporter/domestic end-user and the producers should be privy only to alliance partners not to other businesses, newspaper reporters or public agencies.

Training is another requirement which is commonly needed to establish a successful alliance. People cannot just enter an alliance, they must understand the way it works and particularly must be able to play their part in delivering the product the alliance needs. The alliance needs to be sure its recruits are willing and able to perform before allowing them to be involved.

Another feature of successful alliances appears to be a commitment to continuing improvement using all the support services available including those provided by other segments of the industry which had traditionally been regarded as adversaries.. Some less successful alliances have put their efforts into trying to save inputs, eg. to operate without an agent, and have achieved little. They have not embraced the concepts of working in an alliance but simply modified the traditional approach.

The best way to maintain loyalty in an alliance has yet to be identified. Several alliances have commenced their program with good planning and strong direction, only to find that some producers try to by-pass the alliance and deal direct with the processor/wholesaler partner. Similar accusations of lack of loyalty are levelled by producers at processors who pay more for stock in the saleyards than they are willing to pay in sales over the hooks. The level of loyalty and how to retain it are still unknown features.

Horizontal alliances need to develop a critical mass before they can become part of a vertical alliance. In some cases it may be expected that an alliance can supply for 365 days each year and hence alliances may have to consider co-opting other suppliers from regions where the production cycle is different and time of

The *Heywood Advanced Breeders Group* are a group of 7 prime lamb producers extremely interested in sheep breeding. They work together to ensure their breeding programs are working towards the large and lean lambs they believe are required, particularly by export markets. They use the best genetics they can find to produce cross-bred sires and dams in a carefully controlled cross breeding program.

Between them they now sell over 40,000 large lean lambs on CALM, one of their number is an expert lamb assessor who provides processors with an assured even line as described.

They are making excellent gains through breeding and their sales data shows they are obtaining premiums. In addition, they are part of a benchmarking group which actively strives to measure and increase profitability. Last year one member earned a gross margin of well over $1000 per hectare from lamb.

This is an extremely successful horizontal alliance, it deals with a product which is well specified and guaranteed to be consistent.

Part of the success of this alliance is that is composed of very large producers who have are able to make the capital investments necessary. The challenge is to achieve the same success from alliances of much smaller producers who are the basis of the family farm.

supply can be coordinated to enhance the ability to supply year around. Lamb alliances in the United Kingdom have achieved year-round supply with large supermarkets coordinating supply groups to ensure their stores can display lamb and beef products all year around.

Perhaps the most difficult problem alliances face is that of paying an appropriate price for the product to all participants. Most producers are firmly focused on saleyard auction prices and feel that they also need to receive an additional return for the additional effort required to be involved in an alliance. Hence producers may argue they are "underpaid" if all they achieve is parity with the auction price. On the other hand, involvement with the group provides them with information on consumers' needs, benchmark results, knowledge of progress in developing and meeting markets and likely change in requirements, amongst other things. Most producers can turn this information into greater profits over the longer term.

Alliances are developing in part as a response to the changing market requirements. As consumers become more specific about their requirements markets need to change so that they can provide information about consumer appreciation of a particular carcase and pay accordingly. There is a need to move away from marketing systems that reward all products equally by paying average prices. This has led to the need for a value based marketing system to replace traditional marketing systems. Many people in the industry now accept that a commodity auction in the saleyard with un-described live cattle, sheep or lambs does not provide returns to producers that are based on the value of the product to consumers.

Although awareness of the need for value based marketing is developing, it is proving difficult to introduce the concept in practice. Alliances provide real opportunities to put value based marketing into practice. The MRC's Lamb Consistency Program has developed the concept of product branding with strong alliance support for the product to assist the introduction of value based marketing. This product branding approach was used in preference to efforts to implement value based marketing in already existing alliances where traditional practices are already in place and therefore provide obstacles to change.

Beef production and quality is more fragmented and diverse than for lambs and beef producers have not yet formed effective horizontal alliances. Monitoring the eating quality of beef is an important part of coordinating the supply of beef and this is a specialist skill unavailable to potential beef groups. For this reason, initial beef alliances have tended to be vertical rather than horizontal.

Lamb producer groups have initially developed horizontal alliances and are now attempting to further ally themselves to a processor to ensure they are targeting a particular market. This is an ideal opportunity for an enterprising livestock agent to become involved. These groups need good skilled assessors with ready access to the livestock markets. By and large the agency movement has missed this opportunity at this stage.

Pastoral Prime is an alliance based in Canberra and takes the name of the lamb product provided by a wholesaler, the lead agency. The alliance image is of quality and service.

The alliance includes businesses right across the value chain from producers to retail butchers. The retailers and producers are screened and producers who cannot deliver and retailers who do not implement the changes required in the butcher shop to enhance the quality image are not allowed to join.

Prices are set by the producer coordinator, a livestock agent, with the wholesaler. They confer and provide a premium for producers to cover additional costs of complying with rigorous specifications.

The emphasis on quality of product and of process appears to be the strength of the alliance and provides its unique culture.

There are some exceptions to this. In a number of alliances the price formation process is by negotiation between the agent for the producer group and the processor or wholesaler. Price is determined using a knowledge of local markets and of current wholesale prices. Often producers are achieving a premium over saleyard auction, the benchmark many of them use to show success of their program.

Reports from the USA examining alliances begin to question the price setting mechanisms when numbers sold at auction reach very low numbers. In one report it was stated that only 2% stock were sold this way and they now have concerns. In Australia the latest research in this area (ACIL 1991) showed 72% of prime cattle and 63% of prime lambs were sold in the saleyard. Sales over the hooks accounted for 16% of cattle and 6% of lambs. It is unlikely that there has been major change since that time.

CasMark, a direct supply program operated by Castricum Bros in Victoria, is based on links to individual producers rather than groups. It developed for lamb but will expand to include cattle. The producers deal directly with the processor. Whilst the producers often come from similar regions, they are not a horizontal alliance although some belong to a local producer group unrelated to the CasMark program.

They receive special benefits for being part of the program and go through a training program to allow them to ensure their fit with the program before they join.

Casmark is the only alliance with forward contracts and at times these are only available to Casmark suppliers. The contract guarantees suppliers will not be worse off than they would have been in the auction market. This is a concession to the difficulty of forecasting markets 4 to six months in advance.

The alliance shows how valuable livestock agents can be in these programs. The agents coordinate regional cells of producers and provide continuous contact with the processor with this communication providing the foundation for the alliance.

The use of forward contracts in the beef and lamb industries has been advocated for some time as a way to encourage out-of-season production but more work is needed to find a basis for setting a forward price. Forecasting of production is not accurate and quite often

the price as the contract expires is vastly different from the auction price which is the recognised benchmark price. Idealists argue that this should not concern anyone and that the price struck was acceptable for both parties when set and should remain that way. On the other hand, other commodities with spot auctions and forward contracts use a mechanism to bring the prices into alignment at the time of delivery. Another dimension of this problem of forward pricing concerns the need to relate price to value of the final product—the ideal reference price would be the retail value less the costs of transformation. This is one of the challenges being addressed under Marketlink II.

Types of Alliances

Producer groups have become much more common in recent years. Nationally there are at least 37 Beef Producer Groups and over 50 Lamb Producer Groups. The degree of sophistication varies; some groups are highly structured with paid coordinators; some focus strongly on benchmarking programs to provide information to improve their production systems; others simply hold meetings to hear from "experts" without any expectations other than to listen.

The purpose of forming an alliance may not only relate to production or marketing but to other purposes. They could form a buying group to gain discounts by buying larger quantities of products, they could be a discussion group, they may be a benchmarking group and they may be a marketing group.

The alliances in place across the value chain are quite varied in the businesses they align. Whilst some claim that alliances are formed by processors to obtain "captive" suppliers, the evidence provided by existing alliances does not support this. Some alliances are indeed led by processors but many are led by producers. These include breeders and some producers with feedlot operations. Some alliances are led by retail interests and some by wholesalers. Often "downstream" businesses remark that they do not wish to be the alliance leader since their only interest is in being able to obtain the product they want, anytime, all the time.[47]

Horizontal alliances are often likely to be the precursor to the development of vertical alliances. Horizontal alliances provide the basis for a scale of operation that can attract the interest of downstream processors or retailers. They also provide the means for capturing benefits from total quality management (TQM). Some producer groups have developed a focus on the implementation of TQM and need the linkage with the market to be able to measure performance. This approach ensures greater production efficiencies at the same time as achieving some internal self-regulation.

QA measures—the beef feedlot industry, for example, uses ALFA/Ausmeat quality assurance and their abattoir's AQIS/DPIE HACCP programs.

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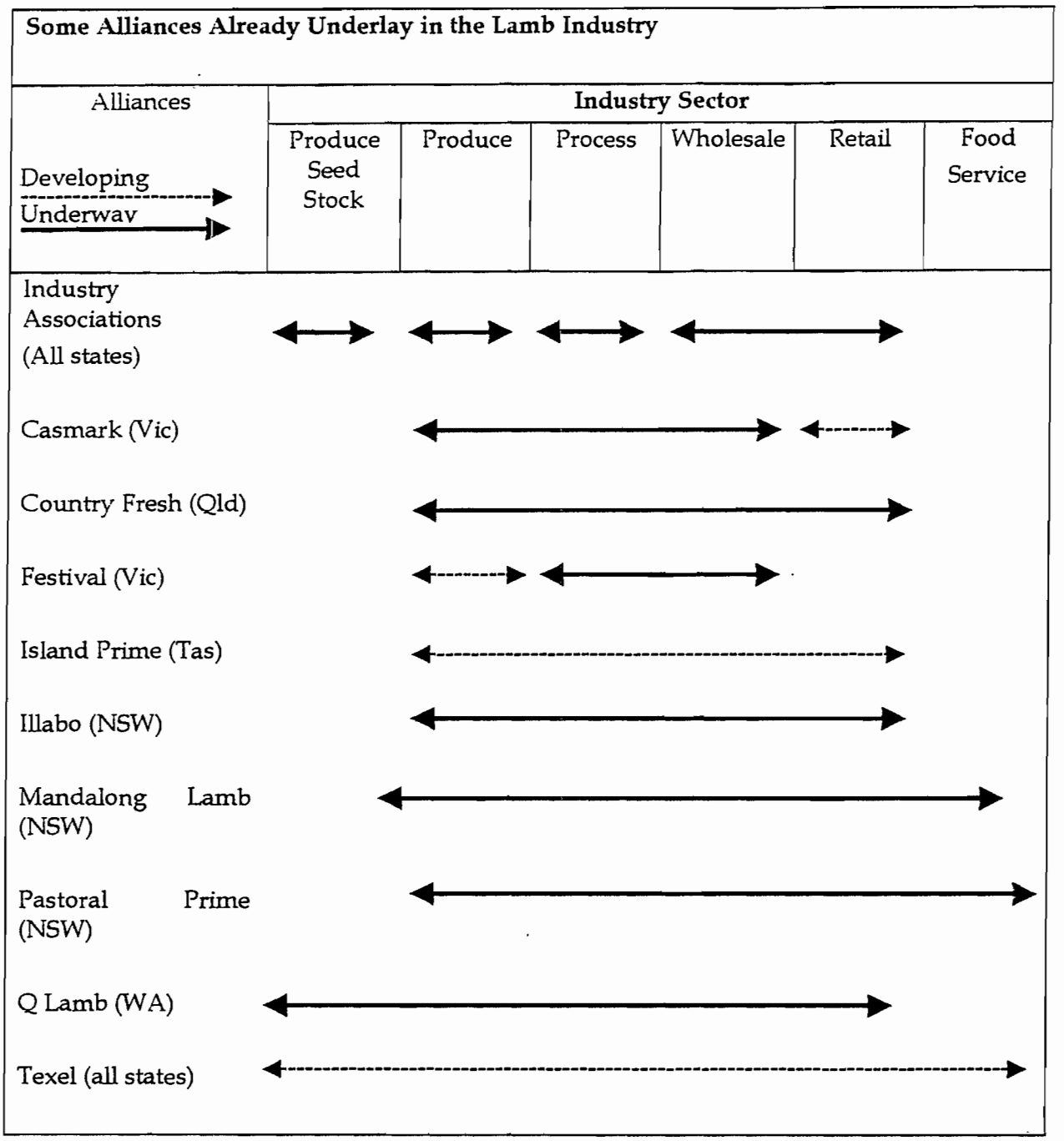
47. Horizontal or vertical alliances- which first? This is a key issue for the industry The meat industry has long been considered by marketers as a production driven industry. The marketers' way to form an alliance is to start with the market (the consumer) and develop the supply system second ie vertically integrate first. This is especially important with beef which is much more variable than lamb in the range of products available and in eating quality and is why beef producers have been slower to establish horizontal supply alliances than lamb producers. The lamb industry has done the reverse - it has formed horizontal alliances first and through the branded lamb program is trying to tried to vertically integrate. Either way it is essential to monitor the market and ensure an adequate supply of product to meet it.

Figure 9. Linkages in Existing Alliances



Recent consumer research conducted by AMLC in Melbourne for a lamb test marketing program found consumers in focus groups suggesting they would pay up to 20% more for consistently obtaining exactly the product the want - both in appearance and eating quality.[48]

The other gain many producers see for their alliance is not a loss in power as is often argued for producers with a processor, but a gain in power because they feel they have greater strength in competing against other products as part of the alliance. Working within a branded product alliance they have a lot more specific information

[48] This is in contrast to the experience that market researchers report for beef.

about market requirements, product meeting specification, future developments which might occur.

This increase in power may be perceived or it may be real. It may be the very approach that provides strengthened Australian competition for large meat companies owned and operated overseas.

It is pertinent that some of the criticism of alliances is misplaced, the problem may be outside the control of any alliance partner.

Producers often complain that they cannot obtain forward contracts in alliances, particularly those with export markets. In fact, exporters are rarely able to obtain any guarantee of prices, which could underpin the contract. Processors generally only have a guarantee the market will take the product, the price is set only in the final 10 days before delivery.

The Festival alliance is underway in Victoria for beef and lamb. It may soon be introduced into other states. In Victoria it is an alliance between 4 processors, Festival stores and producers. The program aims to deliver similar product from all retail outlets, most of which are in country Victoria.

The Festival program is a clear demonstration of the priority training must take as the meat industry moves in this direction. Rigorous training programs are necessary to ensure all butchers, producers and processors produce and present a common product. With so many independent businesses involved, many steeped in traditional practices, it takes very strong leadership to ensure all participants introduce the changes necessary. The program is only as strong as its weakest link.

Conclusion

Despite being only a recent innovation in any widespread usage, alliances for marketing are already a common part of the red meat industry. Those already in place are providing valuable lessons for newer ones as they are developed.

As discussed there does not appear to be any recipe for developing a successful alliance. However, there are a number of important steps in the process of bringing businesses together that cannot be overlooked.

The culture of each alliance—the way people work together, trust their partners and their commitment to the alliance— is unique and this element seems to be the most important in determining success.

9. THE SCOPE FOR STRATEGIC ALLIANCES IN THE RED MEAT INDUSTRY

Summary

This chapter presents our views on the scope for strategic alliances in the red meat industry.

The Most Likely Types of Alliances

Based on our review of strategic alliances in the red meat industry we expect that a range of alliances will develop in response to market forces. Action by industry through Marketlink II or other means could accelerate the development of some of these alliances and lead to improved competitiveness of the red meat industry overall. The alliances that we regard as most appropriate for the red meat industry are briefly outlined below.

Horizontal Alliances of Producers (Type 1)

There is already a strong level of interest in horizontal alliances amongst producers. The motivation ranges from well-planned strategies to improve customer focus through to a general desire to attempt to operate on a bigger scale and thus offset what is seen to be a problem of being a weak seller.

We regard horizontal alliances as the starting point for more ambitious and complex vertical alliances. Without first forming a horizontal alliance it will be unlikely that many producers will be able to become involved in any closer links with the customer or ultimate consumer of their products. Processors or retailers will generally not be interested in dealing with individual producers or going to the trouble and expense of creating producer groups and would prefer to deal with horizontal alliances provided they were properly constituted and directed.

Although horizontal alliances have been established without external support it is likely that better alliances will be formed and more producers will be able to join effective alliances if external facilitation is provided.

It is our assessment that all horizontal alliances will require professional marketing assistance and that this may be obtained through the use of existing service providers including agents or by use of consultant advisers.

Vertical Alliances (Type 2)

The range of vertical alliances considered likely is presented below along with an indication of their particular features. In addition to the specific benefits listed against each, all vertical alliances would provide customer value in the form of ease of traceback for quality control purposes and varying levels of reduced transaction costs associated with obtaining supplies of the desired livestock.

Producer Group – Agent (Type 2a)

The simplest vertical alliance is one between a producer group and an agent. Storelink is such an alliance and other examples already exist. Nonetheless, the culture of distrust and the tendency for agents to follow traditional marketing methods has generally limited their incidence.[49]

The customer for these alliances would be the processor or feedlotter. The additional customer value that they would create would include:

- ◊ Greater security of supply of specified stock

The benefits likely to flow to members of such alliances include:

- ◊ Improved understanding of customer's needs
- ◊ Lower selling costs through negotiated rates
- ◊ Scope for value based marketing
- ◊ Increased throughput and greater security for agent
- ◊ More secure market outlets for stock meeting specification and hence reduced risks for producers

The development of these vertical alliances would be assisted by better information about their potential role and benefits. Standardised agreements and approaches could be developed and provided in a kit form with access to a trained facilitator to assist groups become established.

Producer Group – Feedlotter and/or Processor (Type 2b)

Well-established producer groups (or a network of producer groups) may form an alliance with a feedlotter or a processor to supply stock meeting their specification. The MRC Storelink program already supports this type of alliance.

The customer for these alliances would be the exporter or retailer. The additional customer value that they would create would include:

- ◊ Greater security of supply of specified stock
- ◊ Opportunities for differentiation of the product on the basis of region or quality assurance process etc

The benefits likely to flow to members of such alliances include:

- ◊ Improved understanding of partners (producers, feedlotters and processors) and customer's needs
- ◊ Improved feedback on the match between carcase attributes and customer requirements
- ◊ Opportunity to negotiate basis for value based marketing
- ◊ Lower selling costs through reduced number of transactions
- ◊ Greater security of throughput for processor and feedlot operator

[49] The agent would need to be sympathetic to the approach and keen to learn how to provide a continuously improving service. Potential agent cooperators would need to be carefully screened to ensure they have appropriate customer focus

◊ More secure market outlets for stock meeting specification and hence reduced risks for producers

The development of these vertical alliances would be more demanding. It would be assisted by better information about their potential role and benefits but in addition it would require facilitated planning and phased negotiation with partners to the alliance. In view of the more substantial costs involved in establishing and operating such alliances it would be important to raise a significant proportion of the working capital required directly from participants early in the formation stage.[50]

Processor Group—Retailer or Exporter (Type 2c)

It is possible that some independent meat processors may be interested in forming an alliance involving other processors and a retailer or exporter. Some existing exporters or new entrants may see such an alliance as providing a lower risk and lower cost entry into a new market area or as a means to drive out costs that are currently being incurred.

The customer for these alliances would be the final consumer or the overseas importer. The additional customer value that they would create would include:

◊ Greater security of supply from diversified sources thus reducing risk of season and location

◊ Lower transaction costs associated with obtaining supplies from decentralised distribution arrangements with many processors

◊ Opportunities for further product differentiation

The benefits likely to flow to members of such alliances include:

◊ Improved understanding of consumers' or importers' needs

◊ Lower marketing costs

◊ Opportunity for specialisation of function—processors specialise on processing and leave marketing to others

◊ Increased throughput for processors and more secure outlets

◊ Greater security of supply for retailers or exporters

◊ Ability to encourage higher levels of production if markets expand

The development of these vertical alliances would be driven by commercial decisions by the participants. Although there would be some assistance that could be provided by external facilitators, this would be minimal in most cases. Some assistance in provision of information on new product development or market access may be needed.

Producer Groups—Retailer or exporter (Type 2d)

Large and well-established producer groups or a network of producer groups may decide to enter into a through-chain alliance with a retailer or exporter as a means of improving their longer term business prospects by getting closer to their ultimate

[50] This could involve arrangements to use levy contributions under specified conditions.

customer. This would require the group to maintain ownership of the carcase through the processing stage and to use a service works for processing and boning.

The customer for these alliances would be the final consumer or the overseas importer. The additional customer value that they would create would include:

- ◊ Greater security of supply and reduced seasonality through dealing with larger supply group
- ◊ Lower transaction costs associated with obtaining supplies from fewer suppliers

The benefits likely to flow to members of such alliances include:

- ◊ Improved understanding of consumer's or importers' needs
- ◊ Improved feedback on the match between carcase attributes and customer requirements
- ◊ Scope for additional returns as a result of additional value added through processing
- ◊ Lower marketing costs through single sale direct to retailer or exporter instead of two sales
- ◊ Greater opportunity to improve security of supply and to reduce seasonality of supply for retailers or exporters

This form of alliance would be one of the most challenging because it would require that producers develop a range of new skills. The development of these vertical alliances would be driven by commercial decisions by the participants but would require significant levels of outside assistance both in planning and implementing.

Projected Numbers of Alliances

Until more work has been done to assess the level of interest in different types of alliances it is impossible to make any sound projection of number or types of alliances. Our preliminary judgement is that by 2000, assuming the support of industry and Marketlink II, new alliances might be handling about 150,000 tonnes of carcase weight of red meat per year. Our estimate of the likely contributions of each type of newly created alliance is indicated in Table 5 below.[51]

[51] These projections need to be related to the objectives of other MRC programs such as the Lamb Consistency Program & Southern Beef Consistency Program. We are aware that the Lamb Consistency Program has a target of 2.6 million lambs through alliances by 2001 which would represent approximately 28,000 tonne carcase weight.

Table 5. Projected Contributions from Beef Alliances

Alliance Type	Volume Handled (Tonnes Carcase weight)	Percent Share of Total Alliance Volume	Number of producers involved
Type 1	82,500	55%	1500
Type 2a	7,500	5%	150
Type 2b	37,500	25%	750
Type 2c	7,500	5%	150
Type 2d	15,000	10%	300

Key Determinants of Success of Alliances

Experience with alliances in other agribusiness areas has suggested that there are 10 major determinants of success in alliances and these are indicated in Table 6 below.

Table 6: Ten Relationship Dimensions

Relationship variables	**Views held by potential partners in the alliance**
1. Customer value creation	We can create more value by working together than by working independently
2. Core competencies	Our competencies are complementary and are of real relevance to our target markets
3. Goal compatibility	The goals of our two organisations are well aligned and are unlikely to be in conflict in the future
4. Shared strategic information	Both parties do, and will continue to share strategic information
5. Investments	Both parties are prepared to invest specifically into this relationship
6. Dependency	Both parties are interdependent and aim to further grow the interdependent bonds betweens the two organisations
7. Alternatives	Finding an alternative of equal quality would be difficult
8. Sharing of benefits	We are comfortable that the benefits of this relationship will be shared equitably
9. Opportunism	We are confident that the other party would not act opportunistically, even if they had the opportunity to do so
10. Cultural fit	Both parties have similar values on how customer value will be created

11. Price discovery processes for the industry will not be adversely affected by greater use of strategic alliances and in fact the present rather ineffective system could be improved if strategic alliances serve as a vehicle for introducing value based marketing.

12. Marketlink II has a critical role to play in creating an environment in which value based marketing can be implemented.

13. The further development of alliances is not expected to shift market power to processors and retailers to any greater degree than would apply if the formation of alliances were impeded. In fact, to the extent that horizontal alliances are developed, market power could shift towards producers.

14. Concerns about industry concentration are not warranted given the limited extent of concentration to date and the fact that no adverse effects from concentration have been shown in the US where it is already at a much higher level.

15. Concerns about foreign ownership of processing facilities and feedlots need to be placed in context. In fact the levels of foreign ownership are not as high as in other sectors of the Australian economy such as mining and manufacturing and are no higher now than they were in the past. There has been a change in owners (from British to Asian and American) rather than a change in ownership levels.

16. The ultimate purpose of all strategic alliances will be strictly commercial and therefore, in principle, the benefits from the development of such alliances will largely be private. As such, there would be little justification in using industry levies and Government funds to develop alliances that could be expected to develop without assistance. This suggests that MRC support for alliances needs to be clearly targeted to deal with aspects of alliances that are likely to generate industry-wide or public benefits

17. The aspects of alliances that appear to warrant MRC support are those designed to:

    - enable research into forms of alliances that might provide greatest overall benefit to industry;
    - develop better strategies for generating trust between the participants in the alliance;
    - enable research into 'tools' that could be used in conjunction with strategic alliances to improve efficiency eg tools for value based marketing;
    - provide information that would ensure that all parties (particularly producers) were aware of the potential benefits from alliances;
    - help demonstrate the practicality of alliances and thus encourage their wider use by providing support for establishment of a range of alliances including horizontal alliances amongst producers and vertical alliances that may not all extend all the way to the final consumer;
    - address any area of clear market failure associated with the further development of alliances

18. The MRC support for alliances should give emphasis to the development of a "best practice" process for developing administering and monitoring alliances. This would provide greater industry benefit than other approaches that concentrated on developing alliances with a narrowly defined purpose such as value adding or developing new niche market products. Such alliances should only be supported if they were considered essential to the overall objective of developing a best practice process.

19. In the present climate of low beef prices and widespread concern about foreign ownership and transfer pricing, there would be merit in focussing attention on potential alliances that were seeking to establish retail level linkages into countries which permitted such linkages or investment such as Indonesia, Malaysia and the Philippines in contrast to countries such as Japan, Korea and China that do not permit it

20. Good quality market information is important in economic decision-making and producers do not have such information at present. A strong case could be made for expanding the Information and Education component of Marketlink II to provide such information.

21. Success of Marketlink II will depend to a large extent on having available all the tools needed for implementing value based marketing (objective measurement techniques, price determination methods, product description or grading etc). It would be important to continue to monitor the availability of these various tools or facilities and if necessary to make additional investments to ensure that they become available to the industry.

22. The support needed to facilitate the establishment of new alliances needs to be carefully defined and managed to ensure that it:

    - helps bring about the necessary changes in attitude and culture and leads to general industry-wide understanding and support;
    - focuses on those functions that cannot be performed by industry operators acting on their own initiatives and does not 'crowd out' initiatives that will occur without external support;
    - provides the 'tools' needed for effective operation of the alliances;
    - is able to be accessed by all suitably qualified operators through a process that ensures cost-effectiveness, accountability and a minimum of bureaucracy.

THE STUDY BRIEF

1. Review the evidence for and against the use of strategic alliances by the meat industry, particularly those using the lead firm model. Are strategic alliances likely to lead to a production industry which is weakened and with a reduced status? Will they distort normal market forces to the detriment of the industry? What effect will alliances have on price discovery systems with particular reference to CALM.?

2. Document evidence which suggests that the balance of power and profit distribution between the major meat industry sectors has changed.

3. Review the operations of the Australian Dairy Industry as a model for future alliances in the Australian Red Meat Industry

4. How can the production sector maximise their returns and influence in an alliance? What should the MRC's role in this process be?

5. Provide reasonable follow up advice on the implications for the future operation of the Marketlink II " Consumer Driven Marketing Partnerships" program.

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CHANGES IN AUSTRALIAN BEEF MARKETS

Until the 1970s, beef production in Australia was a minor activity except in Northern Australia where largely foreign-owned (mainly British) companies operated large holdings. The US was Australia's major customer for beef in the early 1970s but Japan started to import more beef which lead to a cattle boom in southern Australia as producers switched from wool and wheat into beef. By 1976 the beef herd had reached a record 33 million head but access to the Japanese market was halved, sales of beef to the United Kingdom market fell after the UK joined the European Community and increased US beef production led to a sharp reduction in demand for imports. As a result, cattle prices in Australia halved and the cattle herd was greatly reduced.

In the mid-1980s improved access and sales to Japan and South Korea led to increased prices and the national herd started to rebuild. Improvements in production efficiency at the farm level meant that more beef could be produced from a smaller national herd. The new markets required specific high quality grain-finished beef or high quality grass-fed beef, in contrast to the US market which takes manufacturing beef from Australia. These markets provided opportunities for beef producers in southern Australia and encouraged further development of the large specialist beef businesses in Northern Australia along with the development of feedlots. Apart from Queensland and the Northern Territory which account for almost 55% of total beef production, the balance of Australia's beef is produced from small herds which are often a sideline activity to another grazing activity, such as sheep for wool or meat.

The major recent development in the Australian beef industry has been the increased access to markets in North Asia, particularly Japan and South Korea, plus a growing market for live exports to South East Asia and the Pacific. The growth of the North Asian beef market has been accompanied by a great increase in the proportion of the national beef herd which is 'finished' in feed lots before final sale. Feedlot capacity increased by over 50 per cent between 1990 and 1994, though since then numbers of animals on feed has fallen and feedlot capacity utilisation has fallen to below 40 per cent. The increase in the number of beef feed lots reflected increased access to Asian markets, low exchange rates, high beef prices and low grain prices. Similar combinations of circumstances in the past have also seen increases in beef feedlot production. Falls in beef prices and rises in the exchange rate and grain prices causes reversals of the expansion of feed lotting. The feedlots are mainly concentrated in south-eastern Queensland and in NSW.

Special Features of Red Meat Marketing.

Red meat is a complex food product to produce and market, particularly under the conditions in which the industry operates in Australia. It is important to recognise this complexity when considering arrangements for meat marketing.

The complexity arises for many reasons as discussed below.

1. Red meat is a perishable product causing great difficulty in providing consistent quality and supply through storage arrangements.
2. The product traded goes through a number of different forms between birth and consumption and several changes of ownership. Producers in Australia are more remote from the ultimate consumer than in most overseas systems. Consequently it is difficult for producers to obtain some form of "direction" from the consumer.
3. Red meat is produced under a number of quite different production systems most of which are pasture-based and subject to great variability. As a consequence the supply and quality of livestock turned off in Australia is highly variable.
4. Within the beef segment only about one fifth of the operators are beef specialists and the balance regard beef as a sideline to other enterprises. These non-specialists have small herds and are unable to capture economies of scale in breeding, production or marketing.
5. The northern beef industry produces different cattle and serves different markets to those served by the southern beef industry.
6. Mutton is a joint product of the wool industry and hence its production varies with the profitability of wool.
7. Although there are a growing number of specialist lamb producers there are also much larger numbers of wool growers who swing into and out of lamb production on an opportunistic basis thus dramatically changing the supply and price of lamb.
8. Veal is to some extent a joint product of the dairy industry and its production is influenced by changes in profitability in the dairy industry.
9. Variations in seasonal conditions often necessitate variation in the form and timing of turnoff thus making it more difficult to forecast future supply.
10. Because of the small domestic market and heavy export dependency of beef production, intensive forms of production (feedlotting) are inherently more risky than less intensive forms. Lot feeding in Australia is subject to highly volatile grain prices as a result of seasonal variations in grain production and the restrictions on grain imports at times of major drought-induced shortages.
11. Compared with other agricultural products it is much more difficult and costly to assess the potential quality and yield of meat in either the live animal or the carcase. This makes it more difficult and costly to operate objective measurement and VBM systems for red meat than other food products.
12. Compared with other agricultural products there is more scope for loss of quality and value in meat after it leaves the farmgate. This makes 'arms-length' marketing arrangements and payment schemes designed to provide producers with returns based on final retail value difficult to implement and favours the establishment of closer relationships along the chain.

13. Owing to the variability in production systems, forms of output, market requirements and to the difficulties of establishing objective measurement systems as a basis for value based marketing, there is a wide range of livestock marketing methods still in operation. Unless the fundamental variability is reduced in future, it is likely that there will remain the need for a range of marketing systems.

Another perspective on red meat marketing is provided by considering the information available to allow buyers and sellers to make decisions about red meat sales and to contrast that with the information available for poultry. Information has been considered in three classes—known; unknown (but able to be obtained at a cost); and unknowable. The table below summarises the situation for red meat and poultry. It is important to recognise that poultry production in Australia is almost entirely consumed on the domestic market.

	Known	Unknown	Unknowable
Red Meat	• Current & past prices • Past supply • Past demand/use	• Current supply • Current demand • Livestock value • Food safety	• Future supply • Future price • Future demand •
Poultry	• Current & past prices • Past supply • Past demand/use • Current supply • Current demand • Livestock value • Future supply • Specific customer requirements	• Food safety	• Future price • Future demand

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