

11.0 VALUE CHAIN ASSESSMENT

Typically, “value chain” describes the full range of value-adding activities required to bring a product or service through the different phases of production, including procurement of raw materials, processing, product development, acquisition of required services such as transport or cool storage, and ultimately delivery to the final consumer. A value chain entails the addition of value as the product progresses from raw input to consumption.

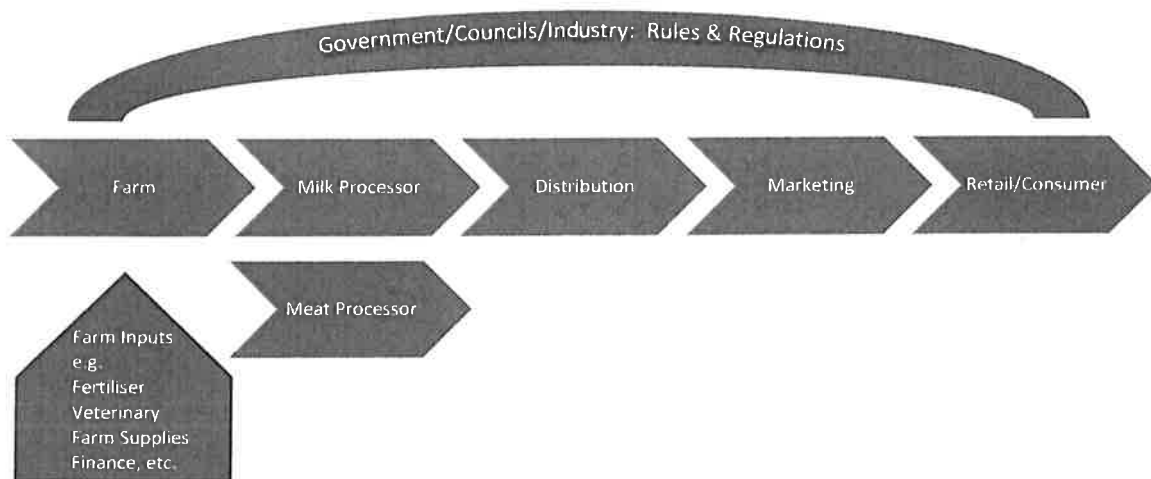
All firms are part of a value chain, each adding value to the end product as it passes through.

Figure 2: Representative Value Chain



This concept is just as valid in the agricultural arena, which usually refers to the whole range of goods and services necessary for an agricultural product to move from the farm to the final customer. This in turn incorporates “horizontal” inputs such as the provision of services, e.g. financial, advice, certification.

Figure 3: An agricultural value chain

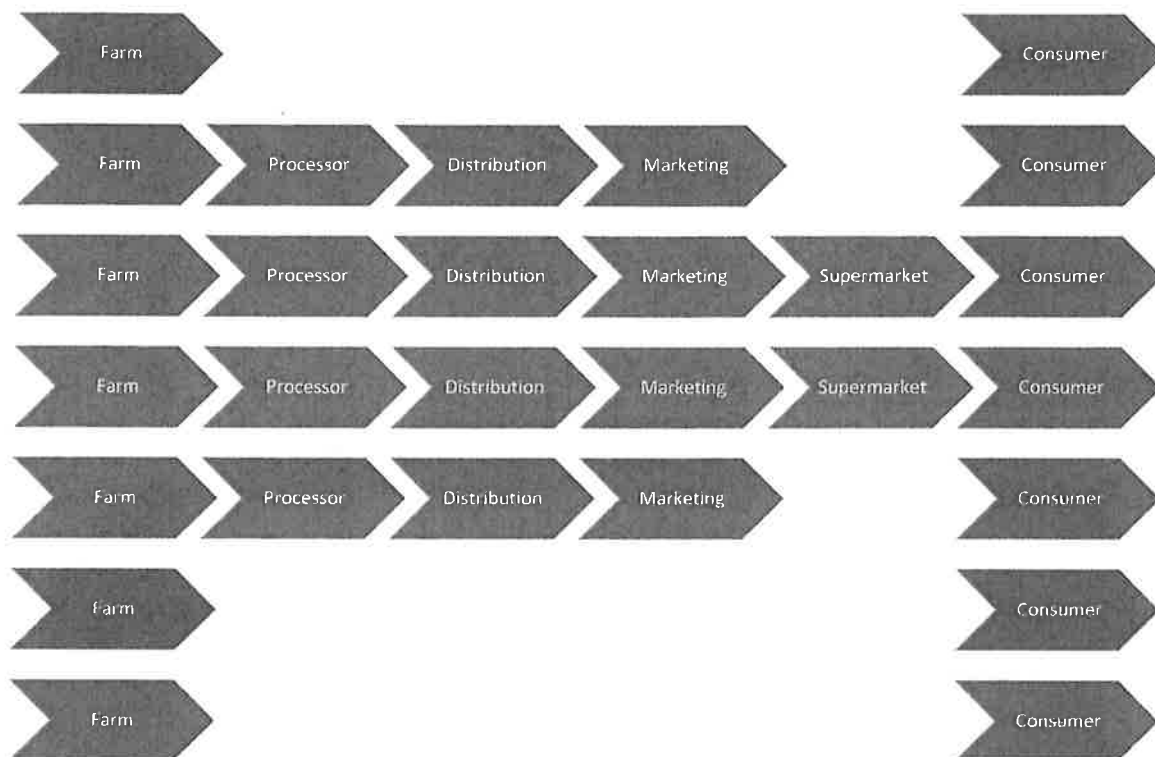


Once a firm has identified its position in the value chain it has several choices:

- (i) Accept the status quo and stay as is.
- (ii) Vertically integrate – by acquiring a competitor to increase market share, to increase market presence, or gain economies of scale.
- (iii) Horizontally integrate – by acquiring a supplier or customer, thereby moving up or down the value chain, and acquiring a greater share of the value of the final product.
- (iv) Parallel integration – acquiring a firm for their distribution channels.

The nature of value chain determines where the power lies in the industry, and essentially this lies with the firm that has the least competitors. If a firm has power within a value chain, it can exert this both upstream and downstream in a number of ways; for example, by imposing quality standards, by imposing delivery schedules to minimise its own inventory, or by altering the amount it pays for supplies, or the amount it charges for its services or products. So who has the power in the following value chain?

Figure 4: Stylised value chain



Answer = the supermarkets, as they face the least competition.

For the average family farm, their power in the value chain is minimal – in the vast majority of cases around the world they receive the residual amount from the remainder of the value chain, which is why farmers often organise themselves into co-operatives as a means of developing a degree of power within the value chain.

This approach at least reduces the competition between individual farmers, and, as often seen in New Zealand, has resulted in horizontal integration up the value chain as a means of capturing a greater degree of the value of the final product. The end result is a company such as Fonterra, where the farmers own their own farms, plus a company that processes/distributes/markets their products. This approach also gives Fonterra the ability to better control the quality of the product, but also have more influence of the actual price the consumer pays for the product, as Fonterra are dealing directly with retailers.

OUR MILK TO THE WORLD

Our milk ends up in dairy products in more than 140 countries around the world and we have stringent quality standards from the farm to the consumer.



GRASS

High quality dairy products start with high quality grass.



FARM

Our farmer families are committed to the strictest standards of quality control through regular on-farm testing and independent farm and environmental assessments.



TANKER

Our Fonterra tankers use cutting-edge milk testing technology to ensure only milk of the highest standard is processed.



PROCESSING

Our processing sites are all internationally accredited with world-class quality and safety systems that include stringent process control and final product testing.



PACKING AND STORAGE

Our products are securely packaged and we use tamper evident seals to minimise the risk of contamination during shipping. All food packaging is coded, enabling us to trace any item through our supply chain and back to the source.



SHIPPING AND SALES

Before our food is exported, we carry out a range of quality assessments specific to the destination country's regulatory authorities and customer requirements.



Shipping containers are all cleaned, inspected and tested before being packed and then security sealed for their journey to one of the 140 countries we export to.

The supply chain for beef, lamb and wool is very different with little horizontal integration. This gives farmers no say in the quality or final price of their product to consumers, nor is there any market information supplied back to them such as customer requirements.

Farmers choose which processor to supply their meat and wool to, with little contracted or guaranteed supply. Processors compete with each other to source product from farmers when supply is limited, and farmers compete with each other when supply exceeds processors requirements. In overseas markets processors compete with each other to sell New Zealand product.

For processors it is difficult to optimise value as they do not have guaranteed supply, and are competing with other processors selling a similar product, this leaves the power in the value chain with the consumer.

The number of links in the value chain significantly reduces the value able to be retained by the farmer as profit is being taken out on multiple of levels

Red Meat Sector Supply Chain

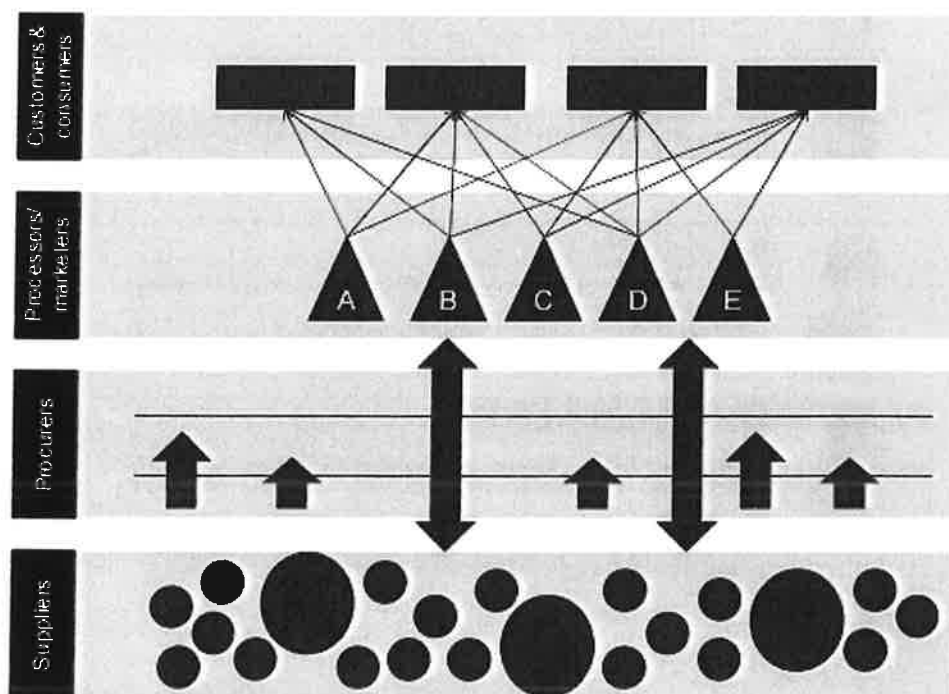


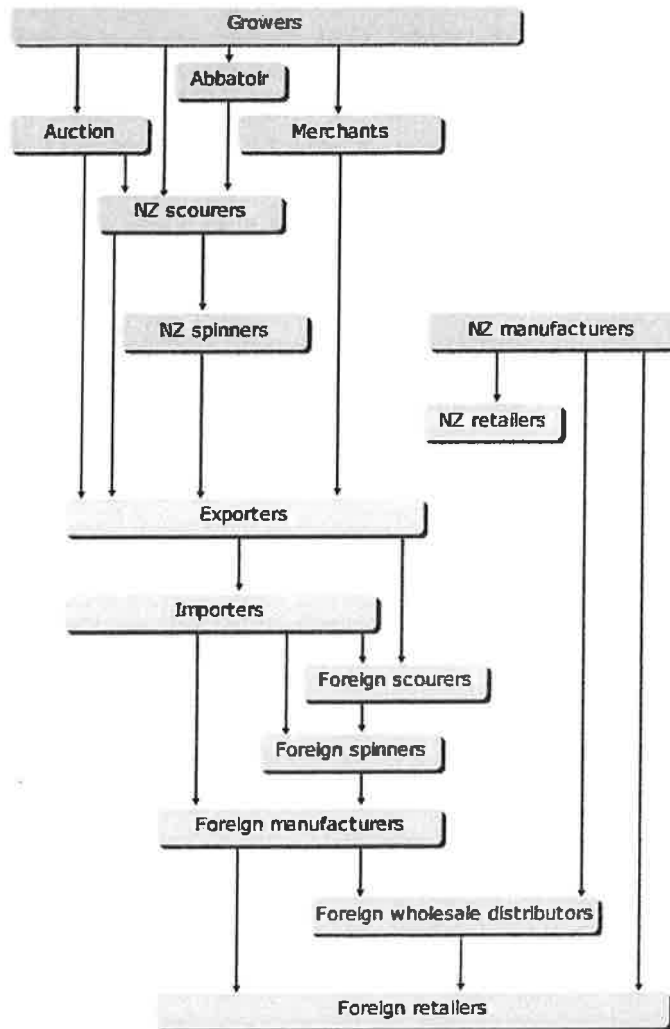
Diagram sourced from the Deloitte Red Meat Sector Strategy Report

Beef + Lamb New Zealand and the Meat Industry Association of New Zealand initiated the development of a sector strategy for New Zealand red meat, a copy of this strategy can be viewed below.

<http://www.beeflambnz.com/news-events/campaigns/red-meat-sector-strategy/>

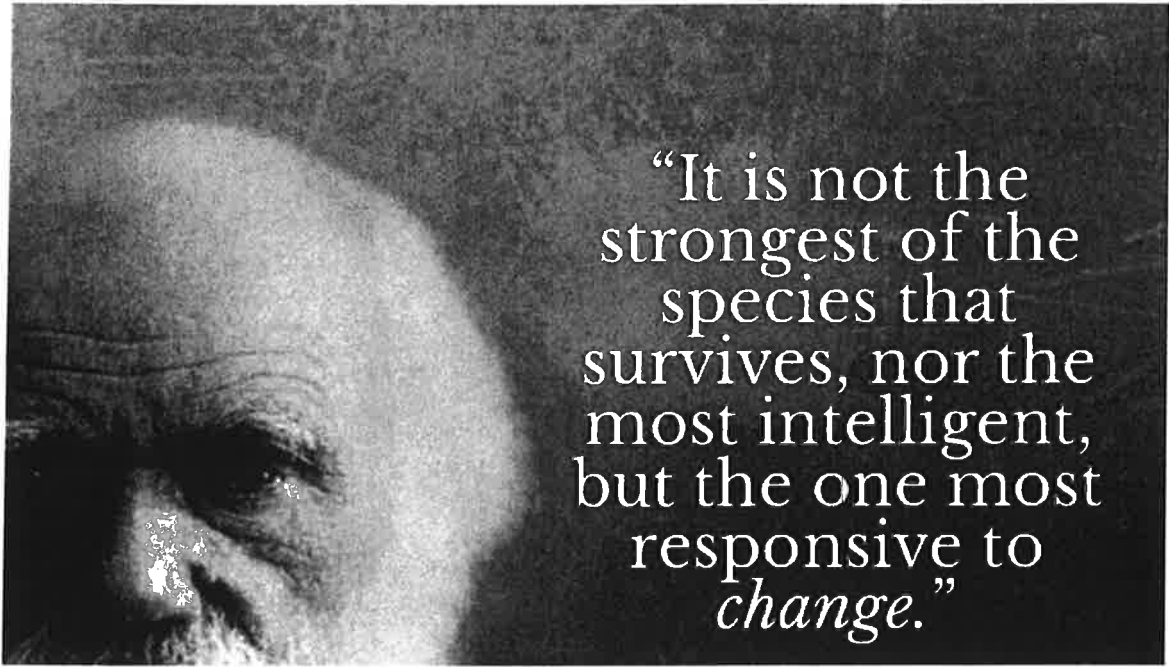
In some cases wool can move through over 10 different entities before it reaches the consumer. However this industry has attempted to get around this issue with the creation of brands such as icebreaker, which control the supply chain from farm gate through to retailer.

Flow of New Zealand strong wool through the supply chain



Further Reading

Michael E. Porter (1985) Competitive advantage: creating and sustaining superior performance. The Free Press.



“It is not the
strongest of the
species that
survives, nor the
most intelligent,
but the one most
responsive to
change.”