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Review of Kiwifruit New Zealand

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Review of Kiwifruit New Zealand

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Disclaimer

Views expressed in this document are not those of MPI or the New Zealand Government. This is an independent review, and the views expressed are based on industry interviews and associated analysis.

List of acronyms

CM	Collaborative Marketer
CMA	Collaborative Marketing Arrangements
FDI	Foreign Direct Investment
FOBS	Free on board ship
KNZ	Kiwifruit New Zealand
MPI	Ministry for Primary Industries
NZHEA	New Zealand Horticulture Export Authority
NZI	New Zealand Kiwifruit Growers Incorporated
OIA	Official Information Act
Psa	<i>Pseudomonas syringae</i> pv <i>actinidiae</i>
SPE	Single Point of Entry
SSI	Statement of Strategic Intent
SLA	Service Level Agreements
ZGL	Zespri Group Limited

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Review of Kiwifruit New Zealand

Executive Summary

Introduction

This report reviews key aspects of Kiwifruit New Zealand (KNZ) consistent with best practice in industry regulation.

Current Regulations were promulgated 15 years ago and require revision for a significantly different economic setting. The self-regulation with statutory sanction is no longer appropriate as many wider stakeholders are now impacted.

Scope of report

The analysis focuses on four issues: balancing accountability to Government and the industry; supporting the take up of collaborative marketing; supporting innovation; and monitoring the impact of internationalisation.

Globally there is demand for greater accountability and transparency. Criticisms relating to perceived collusion and vested interests are a fact of commercial life and a regulatory framework needs to reflect best practice to assure all stakeholders of its robustness.

Principles of industry regulation and governance

Economic, finance, legal and strategic approaches to regulation and governance inform the interpretation of data analysed and information received from interviewees.

Best practice in regulation requires clarity of purpose and an impartial regulator, that it is adequately resourced, and has its performance monitored and reported to stakeholders in a timely manner.

The current state of the kiwifruit industry

The New Zealand kiwifruit industry is the largest horticulture export industry in New Zealand with its success derived from the investment of orchardists, packhouses, Zespri, collaborative marketers and other stakeholders.

The New Zealand kiwifruit industry is an iconic industry. It has successfully established itself as a growing sector having overcome the challenges associated with the Psa disease. However, the industry has many overlapping segments which are often in tension with each other.

Interpretations of the current business context

KNZ, Zespri and the majority of kiwifruit growers are sympathetic to an update to the Regulations but this unity of view hides divergent views about the nature of changes that are appropriate.

In order to facilitate industry success it is essential KNZ understands the broader ecosystem, including the global position.

Improving governance and accountability

Opportunities have been identified to improve the governance and accountability through amending the Regulations pertaining to the role and function of the Board.

KNZ accountability can be improved by its transformation into a Statutory Authority with enhanced expectations. The Board needs to be fit for purpose. This necessitates a broad level of expertise, and staff to undertake roles which are not clearly governance/board member functions.

Improving collaborative marketing

Opportunities have been identified to improve collaborative marketing.

Given a Zespri willingness to engage more proactively with CMs, KNZ has the opportunity to facilitate development of priority areas for collaborative marketing, which do not conflict with Zespri strategy, with terms which are appropriate to the risks involved.

Determining the scope of KNZ oversight

The scope of KNZ oversight should be consistent with the needs of multiple stakeholders, while also being cost effective and addressing the specific needs of growers.

KNZ should, in consultation with MPI, develop a clear strategic outlook and performance agreements on a rolling three-year basis. These should recognize the breadth of stakeholder needs, including the specific needs of heterogeneous growers.

Regulation in the context of globalisation

KNZ responsibilities for regulating Zespri's international activity has been identified as a priority given the impact of international activities on both growers and other stakeholders, especially the New Zealand Government.

As Zespri continues to move from being an "exporter" to a "brand" with 12 month sales KNZ's role in soft regulation requires enhanced capability in risk assessment and strategic analysis.

Regulation and Innovation

Innovation occurs on the orchard, in packhouses and across the kiwifruit value chain. Innovation is constrained by the Regulations but the fundamental question is do the regulatory constraints enhance or harm New Zealand economic welfare.

KNZ needs to be proactive in its approach to innovation. Considerable innovation in terms of varieties, and productivity have occurred and will continue. The global migration of varieties is part of the evolving ecosystem that requires monitoring.

Conclusions

Regulatory change is recommended to directly improve accountability and governance; and collaborative marketing. Regulatory change is recommended to indirectly improve outcomes through enhanced KNZ oversight of industry information, international activities, and innovation activities.

Changes can readily occur without excessive industry tension. However, there needs to be commitment to a regular review of the regulatory framework based on dialogue with stakeholders on, say a 6-yearly basis.

Summary of Recommendations

A list of key recommendations are made to ensure the Kiwifruit Export Regulations are fit for purpose for the immediate future.

The regulatory and non-regulatory recommendations all have the potential to enhance performance. Further changes are likely to be necessary over time as the economics, science and politics of the industry evolve.

Review of Kiwifruit New Zealand

Introduction

Kiwifruit New Zealand (KNZ), established under the Kiwifruit Export Regulations 1999 (New Zealand Government, 2014) is the regulator of the New Zealand kiwifruit industry. In the 15 years since establishment, KNZ has diligently fulfilled its role but has received criticism from both supporters and critics of the current institutional relationships and responsibilities. During this period, the industry has changed significantly in terms of varieties produced and commercial practice. Given the length of time since the regulator was established and the occurrence of an industry led strategic review during 2014-2015 (KISP, 2014) it is appropriate to consider if KNZ's functions, powers and operation are fit for purpose given the changes that have occurred in the industry and those that are anticipated. Hence, this report reviews key aspects of KNZ consistent with best practice in industry regulation.

Following the introduction and scope section, the report consists of ten sections: background industry information; principles of industry regulation; the current situation; governance and accountability; collaborative marketing; the scope of KNZ oversight; innovation; conclusions and a summary of recommendations. Attention is paid to existing success, challenges and concerns, and potential solutions when addressing each of the four key issues:

1. Balancing accountability to government and industry
2. Supporting the uptake of collaborative marketing
3. Supporting innovation
4. Monitoring the impact of internationalisation.

Scope of Report

Given the brief for this report, the analysis focuses on four issues: balancing accountability to Government and the industry, supporting the take up of collaborative marketing; supporting innovation; and monitoring the impact of internationalisation.

Balancing accountability to Government and the industry requires an understanding of: the roles of government and industry with respect to regulators in other sectors; whether the balance of government and industry involvement in KNZ is in line with best practice; and what regulatory and non-regulatory changes might be required.

Supporting the take up of collaborative marketing requires understanding any barriers current regulatory or KNZ operational settings may present to achieving an increase in collaborative exporting of New Zealand-grown kiwifruit and what regulatory and operational changes might be made to address these.

Supporting innovation requires an understanding of any risks and rewards to the New Zealand industry and individuals associated with Zespri's dominance as the monopsony exporter and dominant investor in industry research and development. This includes identification of any potential risks and rewards; the potential implications for non-Zespri lead investment in innovation and potential changes to KNZ's functions and powers to enable Government to monitor and manage these risks.

Monitoring the impact of internationalisation requires understanding the potential risks and rewards to New Zealand kiwifruit growers from Zespri's internationalisation and any potential changes to the Regulations and the functions and powers of KNZ to ensure Government and other stakeholders are able to obtain information to understand and evaluate the impact of Zespri's international activities.

The report excludes consideration of the Government's position on Kiwifruit Industry Strategy Project (KISP) proposals requiring regulatory change; consideration of KISP proposals other than those relating to collaborative marketing and KNZ; and the extent to which the success of attaining the objectives sought by KISP is dependent on factors other than the operation of the Regulations.

Background Industry Information

Kiwifruit is the largest horticulture export industry in New Zealand. Since its beginning in the 1970s it has survived numerous production, marketing and political shocks whilst establishing its place as an important and iconic New Zealand industry. Historical developments have been well catalogued elsewhere (Kilgour, Saunders, Scrimgeour, & Zellman, 2008), (Brash, 2014), (Milne, 2014). The most recent shock was the impact of the Psa disease. This can be seen in the reduced gold kiwifruit production from 2012 to 2014 and the significant industry stress during this period. After emerging from the impact of Psa, the industry is back on track for growth. Contemporary performance as viewed by external sources can be seen in the Annual Review of the World Kiwifruit Industry (Belrose Inc., 2014).

It is important to recognise the industry consists of multiple firms and organisations that have many interrelationships. Orchardists produce the fruit. However many orchards make extensive use of contract labour and management or advisory expertise to operate their orchards. Fruit from the orchards are prepared for export by postharvest processors. Zespri is responsible for marketing approximately 98 percent of the global export crop, other than to Australia, with the other 2 percent handled by collaborative marketers. It is estimated there is approximately \$4,000m invested in orchards, \$310m in post-harvest firms and \$460m in Zespri.

As the dominant marketer, Zespri has a major influence on industry behaviour and outcomes. It seeks to preserve and build the position of category leader, delivering high-quality product through a premium branded strategy, and has created one of the most recognised fruit brands in the world (Zespri Group, 2014). Despite Psa the industry has over the past 15 years experienced significant growth. There is some evidence kiwifruit orchardists receive a higher proportion of the export price than other horticulture export growers receive (Scrimgeour & Locke, 2015).

Industry forecasts project strong growth, with total New Zealand-grown volumes increasing from approximately 95 million trays in 2014/15 to around 130 million trays in 2019/20.

Principles of Industry Regulation and Governance

The Regulations and the role and performance of KNZ need to be considered in the context of both the principles and practice of industry regulation. This can be considered through a range of disciplinary lenses.

Economic approaches to regulation and governance

The economic approach to market regulation in primary industries was historically driven by ambitions to manage supply, market failure arguments and equity concerns about outcomes for farmers and

orchardists and particular groups of farmers and orchardists (Helmberger, Campbell, & Dobson, 1981) (Scherer & Ross, 1990). Williamson advanced thinking by emphasising the importance of transaction costs and how they influence behaviour (Williamson, Oliver, 1987). This has been taken even further in recent times as researchers examine public and private interests in primary industry chains and networks where an important focus is on co-ordination costs (Baker, Scrimgeour, Griffith, Hamza, & Parker, 2015).

Finance approaches to regulation and governance

Governance is concerned with strategies, policies and monitoring management to create performance that rewards stakeholders for the risks they bear. Stakeholders have a diversity of aspirations (Freeman, 1984). Agency theory suggests there will be a lack of goal congruence between stakeholders and managers and stakeholder theory suggest divergent interests will be present and that some stakeholders will endeavour to expropriate other stakeholders' interests (Jensen & Meckling, 1976). From a national perspective the tension between sectoral interests of stakeholders and the directions management may wish to take an organisation are not uncommon.

Legal approaches to governance

Legal approaches to governance and regulation address the concepts of the "corporation", "corporate control" and associated constitutional and legal actions, and related issues of risk, authority, and liability (Farrar, 2008). The legal core focuses on division of power between the board of directors and the general meetings, meetings, and the legal role of the board of directors, delegation and reliance and duties below board level. Definition of directors and officers; appointments, retirements and removal of directors; rights of access to information are critical in law. Further, duties of directors and officers are prescribed. The basic duties are to act in good faith in the best interest of the company and for a proper purpose. Further, there is the duty to avoid self-dealing, and duties of care. Ultimately, corporate governance forms are constituted within legal frameworks that are a combination of prescribed courses of action or prescribed approaches to actions taken.

Strategic approaches to governance

A strategic approach to governance and regulation focuses on the impact of governance and regulation on competitive advantage. A competitive advantage can be achieved when a strategy is value creating, and not currently being implemented by present or possible future competitors. A competing firm can enter the market with a resource that has the ability to invalidate the prior firm's competitive advantage, which results in reduced returns. The resource-based view is that the basis for the competitive advantage of a firm lies primarily in the application of a bundle of valuable tangible or intangible resources at the firm's disposal (Barney, Right, & Ketchen Jr., 2001).

General

During the last decade there have been numerous attempts to enhance the quality of governance of private sector firms, industry sectors and government entities. The New Zealand Treasury and the New Zealand Productivity Commission (New Zealand Productivity Commission, 2014) work-streams on improving governance and accountability are visible and relevant examples. Arguably, these public sector initiatives are significantly influenced by the four approaches identified above.

The Current State of the New Zealand Kiwifruit Industry

The current institutional arrangements for the industry derive from the policy intent that Zespri act as a single point of entry (SPE) into markets for all New Zealand grown kiwifruit, other than that exported to Australia. This right conferred on Zespri is balanced by the opportunity for other firms to work in collaboration with Zespri in exporting kiwifruit, and the establishment of Kiwifruit New Zealand (KNZ) as the industry regulator.

The Kiwifruit Industry Restructuring Act 1999 (the Act) and the Kiwifruit Export Regulations 1999 (the Regulations) provide a monopsonistic privilege to Zespri, but the Regulations specifically prohibit discrimination between kiwifruit growers on non-commercial grounds. Further, regulatory constraints also limit the activities Zespri may undertake, requiring majority capital holder approval before Zespri may undertake activities in addition to the export marketing of fruit. These constraints attempt to balance private and industry good by managing Zespri's dominance and impact on competition within the industry.

KNZ's primary functions are to cost effectively: authorise the export of kiwifruit at the point fruit is on board the transport ship and set the terms of authorisation in accordance with the Regulations; monitor and enforce the non-discrimination and non-diversification rules, and the information disclosure and collaborative marketing requirements; and determine collaborative marketing applications in accordance with the Regulations.

KNZ must carry out its functions to best achieve the purpose in regulation 8, which is to mitigate the potential costs and risks arising from the monopsony, by—

- (a) encouraging innovation in the kiwifruit industry while requiring that providers of capital agree to the ways in which their capital is used outside the core business;
- (b) promoting efficient pricing signals to shareholders and suppliers;
- (c) providing appropriate protections for Zespri's shareholders and suppliers; and
- (d) promoting sustained downward pressure on Zespri's costs.

KNZ has five Board members comprised of: three growers (elected by growers), one appointed by New Zealand Kiwifruit Growers Incorporated; and an independent Chair appointed by the four Board members.

Interpretations of the current regulatory context

It is not clear to the reviewers (and a number of respondents) that Government was sure of what it wanted with the Regulations beyond the SPE outside of Australia and collaborative marketing to operate in parallel with Zespri across global markets. KNZ was formed with limited duties and guidance but with no substantive specification of its relationship with Government. However, the industry can claim success with the existing institutional and governance arrangements. These have proved to be reasonably durable despite some contesting of their political framing. The industry has coped with the Psa outbreak and has largely got to the other side. An economically viable industry is in place and it is consistently investing in marketing and innovation. It can be claimed the Regulations work. Zespri has established itself on the global stage and the CMAs have resulted in a number of participants entering the global market place. Further, the CMAs provide a pressure release valve where individuals and subsectors wish to pursue alternative strategies to the wider collective.

Despite the success, regulatory tensions remain due to multiple reasons. Some of these are inherent in that any regulatory regime imposes constraints that inhibit individuals' choices. Multiple and interrelated organisations and committees can build engagement and bring relevant industry knowledge to the table. It can also result in conflicts of interest. Evidence of tension can be seen in the Turners and Growers legal and political attack on KNZ (High Court of New Zealand, 2011) and the ongoing OIA requests KNZ has to face. The majority of kiwifruit growers want an update to the Regulations (Richardson, 2015) but this unity of view hides divergent views about the nature of changes that are appropriate. A minority of growers dislike the SPE and the challenge is how to address their concerns appropriately so that they may have maximum freedom consistent with the Regulations. KNZ has signalled a commitment to process improvement with respect to CMA, and has signalled its intention to focus on enhanced grower and government relations (Scrimgeour & Locke, 2015). Zespri has signalled a more proactive approach to CMA.

There is evidence of innovation and new investment in the industry but developments are also emerging in several southern hemisphere countries. Suggestions have been made that New Zealand industry participants are importing new varieties into Australia due to anticipated difficulties with New Zealand export arrangements and limited opportunity to market new fruit varieties from New Zealand into global markets. International competition is a potential threat to New Zealand growers, especially when combined with the ease with which new varieties can be sourced from China. On the positive side FDI is occurring in the sector as in Japanese interests in Seeka and German ownership of Turners and Growers which suggests some foreign investors have confidence in the New Zealand arrangements. Issues may arise as companies based in other countries invest directly into growing kiwifruit in New Zealand to export back to their home country. Exporting in this way requires firms based in another country to enter into a CMA in the same way as a New Zealand based exporter.

Despite these observations, there are many challenges when considering reform. These include the multi-layered industry connections where many people have multiple roles as orchardists, in KGI, Zespri, packhouses and related organisations. Further, it is a challenge to be clear about the counterfactual assumptions and arrangements people are assuming when they comment on the current arrangements. Claims need to be interpreted. Some argument appears to be competitive positioning. Some arguments are not heard because the proponents support different political arrangements than those currently in place. Further, the interpretation is of both institutional and commercial arrangements and commercial choices as marketing decisions, although informed by principles and evidence, are ultimately a matter of judgment.

Improving Governance and Accountability

The success of governance and accountability performance to date is evidenced by KNZ fulfilling its legal requirements and the regular and timely preparation of an annual report (Kiwifruit New Zealand, 2015). It has consistently fulfilled its reporting requirements under the Regulations and it has provided feedback to growers about its activities (Elwood et al., 2015). It has met with Government officials when requested and provided information.

Challenges:

However, challenges are evident in feedback received from within the industry. KNZ is a creature of Statute yet it is perceived and sometimes referred to as being answerable to growers. KNZ is not held to

typical accountability mechanisms such as reporting to Parliament or the relevant Minister. KNZ is weakly connected to Government Ministers and the Ministry for Primary Industries. Perceptions with respect to accountability are not helped by the Kiwifruit Export Information Disclosure Handbook last being updated in 2004. Similarly, KNZ has not been subject to significant external review. Further, despite having a significant regulatory role it is perceived by some to lack independence and be beholden to growers through the composition of directors and is also perceived to be beholden to Zespri through its physical location and dependence on Zespri for the majority of its funding.

A wide range of stakeholders perceive KNZ reporting to be limited. Many industry participants have limited understanding of its role and performance. Its Annual Report is limited and incorporates opinions as well as matters with a clear factual basis. This is appropriate for a company or political body but not appropriate for a regulator.

The role of the OIA is debatable when it comes to KNZ. KNZ is not a Crown entity. However, the large number of OIA requests to KNZ suggests this is of importance to some participants in the industry. The issue of concern is the number of people that are committed to seeking information in this way. Are they seeking information about process that should routinely be disclosed or are they seeking commercial or political advantage? OIA requests cost money and may adversely impact the organisational focus of KNZ.

Potentially there are two alternate models. KNZ could be transformed into a Crown Entity which would add accountability but would come at the expense of the potential for inappropriate government intervention. The other option would be transformation into a form similar to the New Zealand Horticulture Export Authority (NZHEA). In mentioning NZHEA it is noted that despite its successes there have been proposals to amend its enabling legislation and comments that the quality of engagement between NZHEA and MPI could be improved. Rutherford, McGimpsey, & Narayan, (2013) address a number of related issues. An appropriate form should be “efficient” in terms of institutional responsibilities within a more global system of governance, “effective” in its operation and “contextually” appropriate. Independence, transparency and accountability are essential.

Potential *solutions* are:

1. MPI consider the transformation of KNZ into a new legal form. A Statutory Authority with obligations similar to part IV of the Crown Entities Act (2004) would be more consistent with its role as industry regulator.
2. To amend the Regulations so that KNZ is explicitly accountable to the New Zealand Government for the Regulations via Statement of Strategic Intent (SSI) approved by the Minister for Primary Industries. A three yearly SSI would be appropriate, allowing for significant revisions at short notice should matters necessitate such action.
3. For KNZ to be annually monitored by MPI to evaluate performance against the SSI and the Regulations, or at least there is an annual engagement between KNZ and MPI for this purpose.
4. For KNZ and the Regulations to be externally reviewed every six years to both evaluate KNZ performance and the appropriateness of the Regulations.
5. To amend the Regulations so that KNZ is explicitly to act in ways that maximise benefits to the New Zealand economy whilst also paying particular attention to the interests of New Zealand kiwifruit growers.

6. To amend the Regulations to enlarge the KNZ Board so it is fit for purpose with a greater level of expertise in key areas. It is proposed that the Board retain the power to appoint an independent chair subject to there being agreed criteria for the appointment, in consultation with the Minister for Primary Industries, ensuring the criteria are consistent with KNZ's SSI. It is proposed that the KGI nominee be replaced by three non-grower members with expertise in international business, marketing, law or policy appointed by the Minister after consulting with the Chair and NZKGI. It is proposed that the Board retain the three grower representatives.
7. Consideration be given to KNZ receiving a limited or partial exemption to OIA requirements after a three year period of increased public reporting by KNZ.

Improving Collaborative Marketing

The success of collaborative marketing to date is evidenced by the CMA that are functioning well and producing increased revenue to New Zealand. A robust CMA process is in place and these KNZ processes result in approvals that Zespri support and approvals that Zespri does not support. There is evidence of learning from experience as better quality CMA applications are being received. Operational issues pertaining to commercial sensitivity appear to have been managed well on most occasions. During the period 2011-2012 to 2015-16 166 applications were approved by KNZ. Ninety three percent of the applications were approved resulting in 11.0 million trays exported by CMA or approximately 2 percent of exports to countries other than Australia.

Challenges

Industry participants identified numerous challenges pertaining to CMA. There are commercial differences between Zespri and CMA marketing processes. Much of Zespri's crop is under "consignment" (i.e., Zespri retains ownership) in contrast to collaborative marketers who contract at the grower return price by market (i.e., at FOB) for the trays purchased, which, exposes the collaborative marketer to higher risk. This does not encourage participation.

There are only a small number of CMAs in place. There were no large CMAs in place between 2001 and 2015. There is implicit tension between Zespri as collaborator and Zespri as competitor and this inhibits information sharing. Zespri has identified markets of strategic importance and this leaves little opportunity for CMAs. CMAs must be consistent with Zespri market strategy but if CM firms do not adequately understand the strategy it is hard for high quality CM applications to be developed. From a Zespri perspective, it is seeking to maintain top-end market positioning and a number of CMA applications have been inconsistent with this criteria.

Process challenges are perceived to be significant. Fees associated with CMA are calculated on the basis of a KNZ model but arguably they are not as nuanced as they could be. A repeat CMA application which Zespri supports is not the same as a new application. A CMA in a time of high crop volumes relative to demand is not the same as a CMA in a time when crop volumes are low relative to demand.

From a CM perspective applications involve complicated CMA forms and processes with constrained timelines such that appeals are high risk and largely impractical. Market development is usually a multi-year activity and to date the vast majority of CMA investments are for only one year. Further, when they end the CMA investments have zero value, as they may simply be not approved for a future period. The approval processes involving KNZ directors have limited access to marketing expertise and potentially

may involve conflicts of interest. The likelihood of missing opportunities for innovation and opening new markets needs to be considered carefully for the long-run future.

Even the best educated and most independent director has to wrestle with challenges associated with optimal CMA activity varying with fluctuations in New Zealand and international supply and demand. Should a season of significant supply shortage arise it is appropriate for potentially profitable initiatives to be rejected. Likewise, should a season of significant excess supply arise it is preferable that Zespri not be seen as dumping product and a strong cohort of collaborative markets lowers the national risk. Finally, it is not clear that there is adequate end of season CMA evaluation, particularly with regard to complaints about behaviour by either a CM or Zespri. There is evidence that in market distributors appointed by Zespri have at times sought to undermine approved CMAs.

The challenges suggest that despite the platform of existing knowledge and practice significant change is necessary if CMA are to achieve their purpose. Some in the industry recognise this and are seeking this change. Some do not recognise this and see minor changes as being effective. Others see the system as “broken” and requiring a more substantial change.

Potential *solutions* are:

1. KNZ via its authorisation of Zespri require Zespri to proactively map out CMA opportunities and make them available in a timely manner.
2. That KNZ (in its SSI) be required to review on an annual basis its CMA processes in order to improve them by a process which includes input from CMs, Zespri and other stakeholders and publicly report the issues considered and the changes if any that are to be made.
3. That KNZ proactively communicate its CMA approval principles and criteria and expectations regarding applications. For instance it would be helpful to know when it is appropriate for a CMA to use the Zespri brand and when it is inappropriate.
4. That KNZ advise Zespri and CMs that CMA approval will be a term appropriate for the project and terms of 3-5 years and rights of renewal arrangements will be considered favourably, noting that NZHEA has 5-year terms.
5. That KNZ advise Zespri and CMs that CMA termination where ongoing business advantage has been created and tangible assets are in place as part of the CM effort, then Zespri will buy these at fair market valuation or engage in a joint venture with the CM, or KNZ will approve a renewal of the CMA.
6. That KNZ review all CMA at the end of each season with the opportunity for the CM and Zespri to provide feedback. Any complaints of abuse of the CMA by any party would be referred to an independent expert who would review the claims and recommend remedies to the KNZ Board.
7. That the Minister specify CM goals for KNZ that are included in the KNZ SSI.

Determining the Scope of KNZ Oversight

Determining the scope of KNZ industry oversight is difficult given that the normal commercial disciplines associated with corporate behaviour are in place and constrain both Zespri and CMs. Further, significant activities occur outside of New Zealand jurisdiction and which are difficult to monitor. Oversight costs money and it is challenging for KNZ to fund its existing activity. However, these factors must be balanced with the interests of growers, other industry participants, and other stakeholders including the New Zealand people and Government.

Industry oversight activity to date is evidenced by KNZ's monitoring of the non-diversification rule; monitoring of the non-discrimination rule; reporting on CMA; and publication of an annual report. Every year Zespri writes to KNZ regarding the annual supply agreement and request exemption from disclosure of information that "would be likely to prejudice unreasonably the commercial position of ZGL." They also apply during the year for exemption around Service Level Agreements (SLA) which relate to specific confidential information that is often product or market specific. For example this year (2015) ZGL requested exemptions on 40 specific SLAs. In 2014 they applied for exemption on 61 SLAs. It does seem there is room for further disclosure about what is occurring here without having to disclose the individual SLAs.

Having determined the scope of KNZ oversight, funding arrangements have to be in place to enable the oversight to occur. To date KNZ has pursued a limited approach to oversight based on a narrow interpretation of the Regulations and a commitment to limiting costs. If an expanded role is undertaken due to a broader reading of the Regulations or an expansion of the Regulations the funding of these activities will need to be clearly specified. The expansion of the Board membership to enhance fitness for purpose and the need for expert staffing will not be fiscally neutral though it is likely that director related expenses would reduce if the Board's role moves to more of a governance role and staff assume more operational responsibilities. Transparency in funding of KNZ is important as is an approach linking outcomes with resourcing. Optimal funding of KNZ (like the funding of Zespri) is challenging. Stakeholders want such entities to perform their obligations to a high standard and the responsibilities to be fulfilled in an efficient manner. Both KNZ and Zespri benefit from consistent funding and low transaction costs. On the basis of the limited evidence seen the appropriate level of balance can be achieved by funding with a fixed levy subject to appropriate budget scrutiny.

It is appropriate that costs continue to come from growers but this cannot be open ended. The preferred option is to fund from the grower pool and direct cost recovery from partners in collaborative marketing proposals, i.e. Zespri and CM. Pool based funding should be based on a budget brought forward well in advance of the financial year and approved after consultation with stakeholders. This consultative process will benefit KNZ in terms of feedback from growers and government.

An enhanced level of reporting and continuous disclosure will promote a more transparent environment and remove doubts about undue influence over activities from major funding bodies and charges levied for services provided.

Regulation in the Context of Globalisation

Zespri sells both New Zealand produced and non-New Zealand produced fruit into global markets. This is part of a Zespri strategy of brand development to ensure it is recognised as the leading brand 12 months of the year. This strategy is seen by Zespri as an essential component of maintaining returns to New Zealand growers in the longer-term. However, it does have risks associated with it as does any strategy and therefore raises questions as to the benefit of this activity for New Zealand and New Zealand kiwifruit growers in particular.

Operational success to date is evidenced by Zespri providing 12 month supply without significant offshore investment in production and supply chains, and also reporting positive returns to shareholders associated with off-shore production.

Challenges

International activity by Zespri and CMs has the potential to have significant impact on New Zealand kiwifruit growers, the New Zealand economy and the New Zealand Government. When things go well there are limited arguments for regulation. When things go badly the questions concerning why this was allowed to happen are resounding. This creates angst about the sources of risk and how they are monitored and mitigated. There needs to be an overt recognition that the international activities of Zespri and CMs impact New Zealand trade position, international relations and Government resources. Hence, it is appropriate to consider how adequately Zespri and/or KNZ report on the global activities of New Zealand kiwifruit entities. In considering these activities it is important to be clear about what information should be regularly collected and made public.

In its reporting Zespri highlights orchard gate returns per hectare. This is valuable information but it incorporates both orchard activity and post orchard activity. This makes it difficult to evaluate the performance of Zespri. KNZ could be more active in defining appropriate reporting metrics and in reporting KNZ audits of pooling practice and market expenditures.

Further, it is important to be clear about what investigative capacity and responsibility should be in place to investigate production, marketing, financial or other matters associated with alleged incompetence or dishonestly which may adversely affect New Zealand kiwifruit growers, the New Zealand economy or the New Zealand Government. Several parties have interests in key matters, including the shareholders of Zespri, NZKGI, and Government. This is not just a matter of marketing issues. For instance, the extent that seasonal labour from the Pacific is employed impacts on New Zealand international relations and hence Government interests. On balance it seems preferable these parties should be recognised as stakeholders whose interests can be protected by KNZ.

Potential solutions are:

1. KNZ should exercise oversight of the 12 month supply programme and needs to be resourced to achieve this task. It should pay particular attention to contracts, marketing expenditures and cash flows and how they impact the industry as a whole and subsectors within the industry. KNZ should alert MPI if through its monitoring processes it detects activities which be deemed not to be in the best interest of New Zealand.
2. KNZ require Zespri to provide a public reporting framework incorporating appropriate data on global activity with regular updates on performance.
3. KNZ be resourced with staffing necessary to ensure compliance with its regulatory functions consistent with the standards in its SSI.
4. That KNZ be funded on the basis of a levy on all kiwifruit exported subject to a forward looking rolling 3-year budget approved by KNZ after consultation with MPI, NZKGI and Zespri.

Regulation and Innovation

Innovation in the kiwifruit industry occurs on orchard, in packhouses and along the value chain. This report focuses on innovation pertaining to PVR and along the chain.

PVR innovation success can be seen in ongoing investment in PVR by Zespri, by a PVR development system connected to the market place with appropriate market evaluation of outputs. This has complementary public investment associated with it.

Challenges

PVR development is expensive and requires long term investment. Owners seek to recoup their investment but PVR are of limited duration and over time rights become contestable. A major challenge is determining the optimal development and use of PVR by the New Zealand industry. PVR development occurs in New Zealand and overseas. This suggests the New Zealand industry should aim to respond proactively wherever and whenever a new variety emerges that has commercial potential. Zespri through its ownership of PVR and its relationship with Plant and Food Research limits access of others to PVR. Non-Zespri owners of PVR have to obtain export approval via a CMA with Zespri. This raises the question of whether this is best for the industry and the New Zealand economy. Concerns about PVR innovation are focused around Zespri locking up genetic resources that would have value to a firm with a different risk profile; Non-Zespri New Zealand owners of PVR working offshore given their perception of limited opportunities in New Zealand; and Non-Zespri New Zealand firms being reluctant to invest in PVR research given there is limited opportunity to capture benefits from that research. Zespri shareholders have rights from their investment in PVR research but to the extent there has been a public contribution to the research this right must be qualified. Also given the claim of other stakeholders it cannot be considered an absolute right. The balance between intervening in the rights of Zespri to pursue its commercial objectives and increasing innovation opportunities needs to consider both the non-diversification issues and the impact on CMs. Comments received from the industry demonstrated a wide diversity of views on these matters.

Potentially, the issue is about monopsony rights in terms of sale for export, other than Australia, being used to control what can be grown for export. If this power of monopsony reduces good science in New Zealand, and lowers innovation then there is a case to ensure those who commercially take risks in the PVR space can take these to market. However this case needs to be balanced by the impact of any new variety in the market place on the overall portfolio of kiwifruit exported. This suggests a KNZ responsibility rather than a Zespri responsibility. A responsibility that includes jointly determining both optimal PVR ownership arrangements and optimal CMA.

PVR research is not a straight-forward way to generate increased returns. It requires scale, market connections, and a recognition that the ultimate portfolio of kiwifruit in the market is probably quite limited – perhaps Green, Gold and Red plus organic variants. Appreciation that PVR research is undertaken on a large scale internationally, especially China, requires a strategy going forward that includes clear recognition of the national interest. In contrast to apples, all kiwifruit look very similar in the supermarket.

The optimal marketing arrangements for kiwiberry and other related fruit is not clear. It may be appropriate for oversight of this subsector being undertaken by the NZHEA given the absence of synergies with Zespri activities.

Perhaps as important as the specific issues pertaining to PVR, research and knowledge transfer, is the role of Zespri in these activities. A case can be made built upon linkages from the orchard to the

customer. However, it is unusual for a fruit exporter to be involved in this way. For example, in the New Zealand dairy industry, Fonterra does not own DairyNZ.

Potential *solutions* are:

1. KNZ's authorisation of Zespri include the obligation to maintain a five-year research strategy which is approved by KNZ.
2. The Regulations are amended to require KNZ to review Zespri's PVR strategy every three years against maximising the benefit to the New Zealand economy in the long run.
3. Zespri be required by law to make PVR available in New Zealand unless Zespri submits a proposal to de-commercialise a PVR which is approved by KNZ. KNZ would assess the proposal against it being in the best interests of the New Zealand economy.

Supply chain innovation success can be seen in Zespri adapting its supply chain and modifying its contracts in response to changing business opportunities.

Challenges

The challenges are framed by the one firm operating between FOBS and global customers for 98 percent of the exports, excluding Australia. Two challenges associated with Zespri are the FOBS supply point arguably leads to high peak-load storage requirements in New Zealand and Zespri not having the capacity to pursue all the supply chain innovation opportunities that exist in the market place.

Challenges associated with the growers and packhouses is their control can mean they are reluctant to approve changes that are associated with delivering higher quality fruit. If there is payment reallocation in this way those growers who lose will have incentive to oppose the change as will pack houses who will face higher costs. In an endeavour to overcome problems of this type Zespri has used specific SLA. However, it appears neither KNZ nor Zespri publicly report the volume and nature of SLA, though they did provide information to this review (see p13).

The controlled atmosphere investment is on shore within New Zealand and then when fruit becomes FOB is imperative to get it to market as fast as possible. Alternative possibilities such as shipping direct to offshore controlled atmosphere facilities and packing in a lower cost environment may generate significant gains in the value chain. The economic appraisal of such options may identify benefits for New Zealand.

Potential *solutions* are:

1. Amend the Regulations to include in KNZ's responsibilities to review the FOBS rule to assess whether it reduces economic benefit to New Zealand.

Conclusions

Kiwifruit is the largest horticulture export industry in New Zealand with its success derived from the investment of orchardists, packhouses, Zespri, collaborative marketers and other stakeholders. The industry is substantially shaped by the Kiwifruit Export Regulations 1999 and the industry regulator KNZ. KNZ, Zespri and the majority of kiwifruit growers are sympathetic to an update to the Regulations but this unity of view hides divergent views about the nature of change that are appropriate. It is important

to note that so long as there is an SPE there will probably be a minority of industry participants who will continue to oppose the single-desk by a range of mechanisms. It remains important for KNZ to fulfil its role under the law. This excludes addressing concerns outside of its scope. However, it is important that KNZ be seen not to be prejudiced against firms and individuals with minority views when it addresses matters that are within its scope.

Opportunities have been identified to improve the governance and accountability through amending the Regulations pertaining to KNZ responsibilities, objectives, Board appointments and related matters. Opportunities have also been identified to improve collaborative marketing through improved processes for all parties involved. Analysis suggest expanding the scope of KNZ oversight of the industry. The scope of KNZ oversight should be consistent with the needs of multiple stakeholders, while also being cost effective and addressing the specific needs of growers. KNZ responsibilities for regulating Zespri's international activity have been identified as a priority given the impact of international activities on both growers and other stakeholders, especially the New Zealand Government. Likewise, innovation benefits in some ways from current industry organisation but is constrained in other ways. Hence, it is appropriate for KNZ to explicitly maintain oversight of industry PVR and other innovation practices against explicit regulatory criteria as to whether the practices enhance or harm New Zealand economic welfare. Despite the general success of the Regulations to date regulatory change is recommended to directly improve accountability and governance, collaborative marketing, and enhanced KNZ oversight of industry information, international activities, and innovation activities.

Recommendations

Recommendations are made pertaining to both changes to the Regulations and recommendations that do not require changes to the Regulations.

Recommendations requiring regulatory change that could be included in the current review of the Regulations

1. Legal Form. That KNZ be transformed into a statutory authority with responsibilities corresponding to those of a Crown Owned Entity but differentiated to remove the possibility of Ministerial direction.
2. Accountability and reporting: KNZ to be explicitly accountable to the Government through a three-yearly Statement of Strategic Intent (SSI) approved by the Minister, and monitored by MPI with a six-yearly independent performance review of KNZ to both evaluate performance against the SSI and the appropriateness of the Regulations. This should occur in the context of immediate revisions to update KNZ's purpose and KNZ's reporting obligations. Information which KNZ must make publicly available being available on the KNZ website for a period of ten years.
3. Board composition and responsibilities: The Board consist of seven members with the appointment of independent directors to complement grower expertise. KNZ Board appoint an independent chair subject to there being agreed criteria for the appointment that are consistent with the KNZ SSI and in consultation with the Minister. The NZKGI nominee be replaced with three independent members with expertise in international business, marketing, law or policy appointed by the Minister after consulting with the KNZ Chair and NZKGI. The three grower-elected representatives would be retained. The Board should be clearly charged with governance roles and provide clear oversight of an expanded operational staff.

4. Funding: That KNZ be funded on the basis of a levy on all kiwifruit exported subject to a forward looking rolling 3-year budget approved by KNZ after consultation with MPI, NZKGI and Zespri.

Recommendations not requiring regulatory change

1. Collaborative marketing: KNZ via its authorisation of Zespri require Zespri to proactively map out CMA opportunities and make them available in a timely manner and KNZ advise Zespri and CMA that CMA will normally be approved for multiple years, and will be potentially renewable with the terms being confirmed in the approval and on terminations will normally result in commercial compensation.
2. That the KNZ SSI include a strategy to make greater use of professional staff and the Board focus on review of and approval/decline of staff recommendations with appropriate reasoning.
3. That KNZ move to a separate building from Zespri in order to enhance perceptions of independence.
4. That MPI act to ensure the Kiwifruit Export Information Disclosure Handbook is revised during 2016, with regular updating to be a responsibility of KNZ in consultation with MPI.

Recommendations for further analysis by MPI to address other issues

1. That MPI evaluate alternative approaches to PVR policy and management to ensure conceptual clarity and appropriate practice which benefits the New Zealand economy. This could include the KNZ authorisation of Zespri including the obligation to maintain a five-year research strategy, KNZ undertaking a three-yearly review of Zespri's PVR strategy against maximising the benefit to the New Zealand economy in the long run, and Zespri be required by law to make PVR available in New Zealand unless Zespri submits a proposal to de-commercialise a PVR which is approved by KNZ.
2. That MPI undertake analysis to review the FOBS rule to assess its optimality given challenges associated with supply chain optimisation and determining the optimal level of capital investment in New Zealand.
3. That MPI request KNZ to investigate claims against Zespri or CM when these are deemed to be of national importance in order to ensure appropriate oversight and reduce misinformed speculation.
4. That MPI engage with KNZ on issues such as when it is appropriate for a CMA to use the Zespri brand; and defining appropriate public performance metrics for Zespri.
5. That MPI evaluate whether kiwiberry exports should be regulated by KNZ or NZHEA.

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