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ANZCO Foods Limited: Pursuing the Chinese Market¹

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Abstract

ANZCO Foods Limited is a dynamic, multi-national group of companies which procure, process and market New Zealand beef and lamb products. ANZCO is one of New Zealand's largest exporters of beef and sheep meat worldwide. The Chinese market is growing rapidly. ANZCO is looking to decide whether to further pursue the Chinese market and analyze its potential for sheep meat. This case provides an opportunity to analyze a large, fragmented and varied new market offering substantial growth potential. The case content and analysis is particularly relevant for courses focused on international business, marketing, supply chain management, strategy, entrepreneurship, management, and the food and agribusiness industry in general. It is relevant for use in undergraduate and graduate level courses as well as a problem solving exercise with industry professionals.

Keywords: Case study, meat, lamb, New Zealand, ANZCO, China, international business, marketing, supply chain management, strategy, and food and agribusiness industry.

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IFAMA Agribusiness Case 16.1 A

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¹ This case was written exclusively for IFAMA's 2012 International Student Case Competition which occurred in Shanghai, China.

Introduction

Graham Parker, CEO of ANZCO's lamb division, and Alan McDermott, the Agricultural Manager, were sitting in the company's headquarters in Christchurch, New Zealand. ANZCO is one of New Zealand's largest exporters, marketing beef and sheep meat around the world. Since its founding in 1984, it's made an operating profit every year, but one. ANZCO earned NZ\$1.1 billion in sales in 2010. The division sold little product in China and was anxious to pursue the tremendous opportunities they saw in that market.

Parker brought considerable experience to formulating a marketing strategy for China. He has a background in finance and many years in the industry. He joined ANZCO Foods in 2001 as Operations Manager of Canterbury Meat Packers' processing site in Canterbury. He then became the General Manager of the CMP Canterbury Ltd., and finally CEO of ANZCO Lamb.

But the decisions were not easy ones. Many factors were involved: How fast should ANZCO seek to grow the business? Moreover what should the product, price, channel and promotion be? Finally, how much of ANZCO's supply should be sent to China? This last decision was constrained by the need to balance what it might do in China with the other international markets it served and the availability of stock in New Zealand. ANZCO's approach was to optimize overall performance by using different prices on different products in different markets at different times as it sold the meat available to it.

In seven days Parker would present marketing options for the Chinese market to ANZCO's board. He wanted a marketing strategy that would contribute to the company's success. He kept this in mind as he started collecting and analyzing the material he had on the Chinese market for sheep meat and discussed the supply situation with McDermott.

New Zealand's Sheep Industry

Sheep Farming

Sheep farming plays a major role in New Zealand's economy as the country's climatic conditions allow sheep to be raised at low cost on natural grass fed pasture systems. There are 12,250 sheep and beef farms in New Zealand. This number had declined from 22,000 in the 1980's due to the removal of government subsidies and farm land was moved into other agricultural enterprises; mainly dairy production. Consequently sheep numbers fell from 70 million in 1982 to 55.2 million head in 1990 then to 31.9 million in 2011. While the national flock declined, productivity increased and, as a result, production volumes declined at a slower rate than sheep numbers.

The ownership structures of farms range from larger corporate farms and multi-farm enterprises with complex partnership arrangements, to smaller sole operator farms also known as family farms. When farmers want to sell their stock, they can sell directly to the meat processing company. Alternatively they can sell to procurers or stock agents who move stock between the farmers and processors. Two large independent rural services firms dominate the procurement business—Elders Rural Holdings and PGG Wrightsons.

Sheep Meat Processing

Around 100 processing, manufacturing and meat exporting companies are located throughout New Zealand. Four Companies (Alliance Group Limited, Silver Fern Farms, AFFCO, and ANZCO Foods) dominate the industry with around 75% of the market. The processing sector is highly competitive due to excess capacity and the seasonal characteristic of production (see **Exhibit 1A**). While the pasture based production system offers a cost advantage at the primary producers level, its seasonal nature creates excess capacity at the processing level during certain times of the year.

The continuing decline in total sheep numbers has also created excess capacity in the processing industry which has depressed its profits. Packers have reacted in various ways to this problem. Some initiated diverse value adding and quality programs at the processing and marketing levels of the value chain so they could get higher prices. Others allied and partnered with international retail and foodservice customers to develop specialty products. Some of these initiatives required specific production and supply programs with farmers to assure consistent and timely supply of finished lambs.

In conjunction with these challenges is the age old dilemma of disassembly; that the disassembly of an animal produces a particular set of parts or cuts (see Exhibit 1B for a breakdown of an average sheep carcass by cut). Given the competitiveness of the industry, all these cuts as well as the by-products need to be sold if the processor is to operate profitably.

Sheep Meat Trade

New Zealand only produces 6% of the world's sheep meat, but accounts for 38% of the global trade. It plays such a big role because over 90% of the sheep meat produced there is exported. In 2011,² the exports of sheep meat were worth US\$ 1.9 billion contributing to 6.3% of New Zealand's merchandise exports. This close and direct dependency on international trade keeps New Zealand's exports exposed to exchange rate risk and fluctuations in international commodity prices.

The price of many commodities traded are set in US dollar so constant variation and volatility on the exchange rate alters export price signals in New Zealand dollar terms. When the local currency is weak, exporters (along with farmers) are at an advantage. However, if exchange rate of New Zealand dollar strengthens then exporters are at a disadvantage unless product prices have also risen.

Industry participants attempt to move lamb away from the commodity market by value adding initiatives and fixed price contracts with suppliers to minimize this risk and optimize the greatest return they can receive for their product.

² 2010-11 (Sept. Yr.)

New Zealand's reliance on exports highlights the importance of international relationships and trade agreements for the New Zealand economy. New Zealand had worked for preferential access to markets through Free Trade Agreements and closer Economic Partnerships.

The EU was New Zealand's largest market for sheep meat export. One reason for this was because New Zealand historically received 80% of the tariff-free quota for the EU. The amount of the quota has dropped over time and for 2010-2011 was only 30,000 tonnes. In recent years, however, New Zealand has not met its quota limit because it was able to sell meat in other markets at prices that were as good as or better than in the EU. (See Exhibit 2A for price per tonne received for sheep meat for New Zealand's major markets from 2000-2009).

Sheep meat exported to China increased from 17,876 tonnes in the 2000-2001 year to 34,919 tonnes in 2010-2011 (an overall increase of 95 percent). In the same period, the price paid for New Zealand lamb increased from \$1,948 per shipped tonne of lamb to \$4,573 (more than by 135 percent). The trade with China surged after a Free Trade Agreement with that country came into effect in 2008. By 2011, China was New Zealand's second largest export market for sheep meat, buying NZ\$195 million.

The compound annual growth rate (CAGR) in percent for major markets for New Zealand's sheep meat from 2000 to 2009 is shown in the following table.

Table 1. Growth of New Zealand's Major Sheep Meat Markets from 2000-2009

	Volume (%)	Value (%)	Price per tonne (%)
<i>China</i>	8.1	21.8	12.7
<i>France</i>	-0.9	9.5	10.6
<i>Germany</i>	-2.7	7.3	10.3
<i>United Kingdom</i>	-0.3	8.4	8.6
<i>United States</i>	0.3	5.9	5.6

Source. Data sourced and analyzed from FAO (faostat.fao.org).

The future markets for sales (by value) of sheep meat are estimated as follow:

Table 2. Expected Proportion of Sheep Meat Exports by Value in 10 to 15 Years

Proportion of Total Sheep Sales	Current (%)	10-15 Years (Average %)	Standard Deviation*
<i>European Union</i>	64	55.1	8.6
<i>Middle East and North Africa</i>	6	15.8	3.6
<i>China</i>	3	7.3	2.9
<i>North America and Mexico</i>	14	9	3.1
<i>Japan</i>	2	2.6	1.2
<i>Other (including Russia and India)</i>	12	10.2	5.0

***Note.** Standard deviation is a measure of the dispersion of individual answers from the mean. Generally speaking, the higher the standard deviation, the lower the degree of certainty.

Source. Meat: The Future," Ministry Of Agriculture And Forestry, Wellington, New Zealand, 2009, www.maf.govt.nz

Since the mid-1980s, packers shifted away from shipping whole sheep carcasses. In 1971 over 90% of sheep meat was exported as whole carcasses; in 2006 this dropped to 3.9%. The export of lamb as cuts has increased from less than 10% in 1971 to 81.5% in 2006. A further change is an increased volume of chilled exports which have sold at higher prices than frozen meat. They have grown since 1988 when Captech packaging, which uses carbon dioxide to extend the life of chilled red meat, became commercially available. Chilled products made up just below 15% of total export tonnage from 2002 to 2005, while over this same period the value of chilled exports fluctuated at around 20% of total sheep meat exports, peaking in 2004 at 25%. The percentage of chilled products was still around 20% in 2011.

While disassembly of an animal produces different cuts, each market prefers particular cuts. Exporters in New Zealand recognize these preferences by sending the appropriate cuts to each market. For example, Chinese consumers consider mutton a premium meat, while Americans and Europeans consumers consider it of lower value. Saudi Arabia consumers prefer forequarter cuts, while France, Germany and UK consumers prefer racks and legs. US consumers provide New Zealand with its main market for racks.

The majority of sheep meat sent to the North Asia region (which includes China, Hong Kong, Japan, Korea and Taiwan) still have the bone in, and around 98% are frozen, indicating lower value cuts such as forequarters (see Exhibit 2B). There it is reprocessed into lamb rolls and other products, which are sold to local 'hotpot' restaurants and retail outlets. Currently the majority of the lamb products exported to China from New Zealand are frozen in-bone lamb flaps. When received in China, the flaps are thawed and deboned, then rolled up and refrozen—ready to be shaved for hot pots (see Exhibit 3).

New Zealand and other competitors such as Australia and Uruguay prefer to sell in medium to high-value markets where products receive higher prices.

ANZCO Foods Limited

In 2010, ANZCO Foods had sales of NZ\$1.25 billion (see Exhibit 4 for ANZCO's financial reports) and employed 3,000 staff worldwide. It is a private investor-owned company with three ownership groups: Itoham Food Inc. (Japanese with 48% ownership), Nippon Suisan Kaisha Ltd. (Japanese with 25% ownership), and the directors and management of ANZCO Foods Ltd. who hold the rest of the ownership. The company's organizational structure is found in Exhibit 5.

ANZCO was originally established in 1984 to market beef and sheep meat but over time it integrated backward into the packing of meat products with seven processing plants. It has businesses that market and distribute its products in New Zealand (My Butcher, New Zealand Meat Marketing (NZMM), and Westmeat). Worldwide, ANZCO Foods is in: Australia, Europe, Japan, North America, Taiwan, and the United Kingdom, and The Lamb Company in Canada and the USA. These businesses are tasked with finding the best markets for ANZCO's products and for the day-to-day management of its customers to ensure long lasting, mutually beneficial partnerships. ANZCO's brands include: Canterbury, Maori Lakes, Kumanu, Angel Bay, Wakanui, Ocean Beef and Riverlands. Additional activities of the company include a Food and Solutions division which develops value added products that fit with the latest consumer trends.

The company also produces a large number of other products using the by-products of slaughter including: pelts, skins, casings, wool, rendered products including tallow, meat and bone meal and blood meal as well as pharmaceuticals/nutraceuticals, extracts and ingredients.

To supply its processing plants, ANZCO contracts with farmers through forward fixed price contracts and individually tailored contracts. In general these contracts are linked to specific customers such as Waitrose in the UK. Under these contracts, farmers commit to supply a certain amount of stock to ANZCO, although some flexibility is built in and in return, they are guaranteed killing space. To fulfill its other supply requirements, ANZCO also purchases stock at spot markets. The company acquires stock of a quality that meets its marketing requirements and works with its farmers so they are aware of what its customers want. ANZCO’s philosophy had always centered on being close to the end user. Parker explained, *“Having a direct presence in the marketplace is an important part of our business model. It allows us to be closer to the customer, and we can get a more realistic and greater insight to the market”*.

The ANZCO reputation, Parker explained, *“is earned through producing healthy, superior beef and lamb, using our quality assurance programs, which include traceability and sustainable farming practices. This protects the integrity of our animal welfare, our food safety programs and our products. This means that our partnerships throughout our value chain and within the industry are important to the success of our business”*.

ANZCO is New Zealand's fifth largest exporter. It supplies lamb under the Canterbury, Maori Lakes and Kumanu brands to around 53 countries worldwide. Its main markets include: the UK, Europe, US, Canada, China, Japan and the Middle East (see Exhibit 6 for breakdown of ANZCO’s markets in detail).

Table 3. ANZCO’s Export Markets for Sheep Meat by Cut

Cut*	Main Market(s)	Minor Market(s)
Leg	UK/ Europe	US/ Canada
Rack	US/ Canada/ Europe	Japan
Loin	Europe / UK / USA/ Canada	
Shoulder	UK/USA/Japan/Mexico/Middle East	Europe/Caribbean
Flap	China	Pacific Islands

Source. ANZCO

By volume, 35% of ANZCO’s product is chilled, and around 66% is sent to the UK and US.

China’s Value Chain for Sheep Meat

Sheep Meat Production³

China is a major producer of animal protein. It was the largest producer of sheep meat in the world, producing 2,070,000 tonnes in 2010, the largest producer of pork, the second largest

³ Statistics retrieved from FAO

producer of poultry and the third largest of beef. China's number of sheep has remained stable since 2000 and the flock is concentrated more heavily in the north western regions.

China consumes much of the sheep meat it produces and is a major importer. In 2009, it was the fourth largest sheep meat importer by quantity and seventh by value in the world, importing 82,223 tonnes; up from 39,490 tonnes in 2000.

Imported Meat

Amongst all the countries that have bilateral agreements with China, only Argentina, Australia, Brazil New Zealand and Uruguay are allowed to supply China with beef and lamb, due to the strict quarantine regulations at the Chinese border. Under New Zealand's Free Trade Agreement with China, tariffs on sheep meat will be eliminated by 2016. New Zealand was the first and only OECD country to have secured a Free Trade Agreement with China.

Australia and New Zealand are the main suppliers of sheep meat and beef to China, with Uruguay having increased the amount of beef and sheep meat it supplied to China since 2007. Premium chilled lamb accounted for 6% of all sheep meat imported, of which Australia supplied 99 percent. Products from New Zealand sold in China are mostly lamb rolls and shoulder chops in selected retail outlets and in the food service industry, particularly the hot pot restaurants. Exhibit 7 shows the distribution flow of sheep meat imported in China.

Distribution

In 2010, the distribution system was developing but still had serious weaknesses. China lost \$9.25 billion of food products during transportation according to an estimate in 2008; and 90% of the meat products were shipped without cold chain facilities. Few food companies own or operate their own truck fleets. Most outsource this service to companies that operate out of regional distribution centers. Ownership of product changes hands many times before it reaches the final client due to many stages in the value chain. Some food companies appear to be increasing their investment and capability in cold store development.

More recently, some large Chinese sellers/processors and manufacturers sourced directly from exporting countries. This practice, which reduces costs and enhances product traceability, is spreading.

Food Processing Industry

The processed food market grew between 2007 and 2011 at a CAGR of 13% reaching US \$140.4 billion in 2011. This market was expected to grow at a CAGR of 10% between 2012 and 2016. The majority of China's 36,000⁴ major food processors were focused on primary processing of agricultural products (which included animal slaughter and refining) and accounted for 63% of the total industry⁵. Major centers of processing were in the most developed regions such as

⁴ Firms with annual sales in excess of RMB 5 million

⁵ This is both in terms of number of firms and sales revenue

Beijing, Shanghai and Guangdong. The processing industry was developing rapidly in the top emerging city markets in Southwest China: Chengdu and Chongqing.

Two major processing companies were Shuanghui Group in Henan Province and China Yurun Food Group Limited in Jiangsu Province. Both corporations focused on processing pork, and had industrial scale production chains, from slaughtering through to final packaging. Shuanghui Group slaughtered 10 million pigs per year, and produced 1.8 million tonnes of fresh and processed meat product every year (www.shuanghui.com.cn). China Yurun Food Group also had its own transportation fleet. Its annual turnover increased from HKD 13.9 billion in 2009 to HKD 21.5 billion in 2010.

The quick-frozen products industry had developed rapidly in China due to improvements in the cold chain infrastructure and rising domestic refrigerator ownership. Dominated by domestic brands, in 2009 there were 3000 quick-frozen processed food manufacturers in China.

Country-of-origin branding tended to be lost when imported raw materials were incorporated into further processed products or used in the food service sector⁶.

Final Markets

Retail

The vast majority of consumers bought fresh food including meat from traditional local markets known as ‘wet markets’. These markets were unregulated and a source of food safety concerns because of doubtful hygienic standards. The markets had been affected by food epidemics such as SARS in 2003 followed by avian influenza.

Supermarkets, hypermarkets, convenient stores and boutique stores were fast replacing wet markets in cities such as Beijing, Shanghai, Guangzhou and Shenzhen, especially amongst affluent shoppers. They had better food health and safety standards, an increased range of high-value products and better quality products. Various global food retailers such as Carrefour, Wal-Mart, Metro, Tesco and Makro had introduced these retailing concepts to China. Consumers in these cities now relies more on these outlets for fresh food than from traditional ‘wet markets’ according to a report by The Nielsen Company.

In 2011 the grocery retail sector in China had sales of US\$504.4 billion. Growing at an expected rate of 7% per year, by 2016 it sales would be US\$707.2 billion. In 2011 supermarkets held a market share of 44%. Of the top 10 grocery retailers in 2010, Chinese supermarkets accounted for around 40% of the grocery sales and 80% of the number of outlets.

Most imported products have their greatest success in the specialty stores and hypermarkets. Specialty supermarkets have a higher proportion of imported food products, ranging from 10% to as high as 80%. Major players include City Shop Supermarket (Shanghai), City-Super, CRV Ole, BHG (Beijing Hualian Supermarket), Hisense Plaza (Qingdao) and Jin Bou Da

⁶ Knight et al. 2007

(Zhengzhou). They are situated in first tier cities and some second tier cities and located near high-end department areas and fashionable business centers.

The major hypermarket players in China were Carrefour, Wal-Mart, Metro, Lotus, Auchan and Tesco. Foreign operators tend to dominate this sector; in Shanghai, 82 foreign hypermarkets account for 79% of hypermarket sales in 2008. Furthermore, the foreign operators are planning further growth. For example, Tesco, a British company, plan to launch 80 shopping centers in China by 2016. The very distinct regional differences in China could potentially limit the spread of foreign grocery retailers, however.

Most hypermarkets have a reputation for offering high quality products (such as meat products), greater convenience (important to those who are busy), better quality control and traceability (which appeals more to the affluent Chinese consumer concerned with food safety). They have a greater range of imported products, so are more familiar with merchandising imported food items. They draw their merchandise from favored distributors; the majority of lamb sold in supermarkets was from China or Australia.

Private food labels only have one percent share of the market within all fast moving consumer goods, but their role is expected to grow because consumers believe that branded products are superior. To date, local domestic brands dominate but this is changing as leading global food retailers such as Carrefour, Great Value, Metro's IKA, Tesco and Lianhua offer their own private label lines on every day products.

Food Service

The food service sector in China was worth US\$366.9 billion in 2011 and is forecasted to be US\$494.8 billion by 2016. In 2010 there were 5.1 million foodservice outlets. Full service restaurants held 72% of the market share while fast food restaurants held 25% of the market. Additional facts of interest were that the top 100 restaurants only held 6% of the market, while in the four main urban cities of Beijing, Shanghai, Guangzhou and Shenzhen there were 200,000 foodservice outlets serving more than 20 billion meals per year⁷.

Medium to high-end full service restaurants are growing in numbers due to rising consumer spending power, increased frequency of dining out, and business events. From 2006 to 2010 the full-service restaurant sector rose from RMB 1,010.9 billion to RMB 1,613.5 billion. Restaurants tend to be located in well-connected business districts and areas where stores sell luxury fashion brands, and in historic areas such as the 'Bund' in Shanghai. They offer greater quality and a more sophisticated, fashionable and luxurious dining experience. Premium lamb is rarely found in China's restaurants and, when it is, it has only a limited selection of the high-end cuts found in upscale western and five star hotel restaurants.

The Xiao Nan Guo Group (www.xnggroup.com), owner of restaurant brands Shanghai Min and Maison de l'Hui is an example of the expanding restaurant chains which are targeting the higher end of the market. Its revenue increased from RMB 592.9 million in 2008 to RMB 872.5 million

⁷ MLA Market Information report 2010

in 2010. In 2010, Xiao Nan Guo launched its top-of-the-line concept, Maison de l'Hui, at the Shanghai World Expo. It expanded to eight outlets in Shanghai and plans for more elsewhere in China.

The growth of 'hot pot' restaurants also has stimulated a demand for sheep meat as it is a main ingredient. A meal starts with a pot filled with hot water. Shaved sheep meat is added to flavor the hot water, then vegetables are added. The fat in the meat is an important source of flavor.

Various hot pot restaurants have sprung up. Some of the less expensive are like those of the Little Sheep—a hot pot restaurant chain with 3,000 restaurants across China. A hot pot meal costs between 63RMB to 95RMB per dish. Little Sheep was the largest full service restaurant chain in the country accounting for 6% of the market and using 30,000 tonnes of sheep meat a year. It reported annual revenues of 2 billion RMB (US\$315 million), in 2010. It is owned by Yum! Brands Inc. which also owns 3,500 KFC restaurants and 560 Pizza Hut restaurants in China. Recently, expensive hot pot restaurants have emerged in major cities across China such as Shanghai, Beijing and Guangzhou. The dishes in these restaurants are priced above 100RMB per dish, and at the very high end, greater than 400RMB per dish.

China's Consumers

China's total population in 2011 was 1.3 billion⁸ and is increasing by over six million people each year. Several trends are noteworthy in the Chinese economy: increased urbanization, higher incomes and higher living standards. The rapid urbanization of China had meant that 607 million (over half the population) live in urban areas and by 2025, 822 million will live in them. If China's GDP growth continues, by 2025 approximately 485 million people (59%) will be upper middle class (classified as earning 40,000 to 100,000 RMB per year). Higher incomes suggest that people are able to raise their standard of living. They are more likely to pay premium for high-value products and to try new things. They are health conscious, care about the environment and consider product quality more important than brand. Thirty percent of the wealthiest 1%, or 1.6 million live in China's four largest cities: Shanghai, Beijing, Guangzhou and Shenzhen. Associated with these changes in the economy are changes in expenditures on food.

High-value, quality foods Chinese consumers with higher incomes are demanding more variety and better quality products, and are willing to pay for it. They are spending more on better cuts of meat. Of all households surveyed, the average at-home meat expenditure was 1050 RMB. Of this, 37% was spent on pork, 22% on aquatic products, 19% on poultry, 12% on beef and 10% on sheep meat. This demand for quality is also motivating Chinese hotels to buy imported produce from developed countries because it is considered to be of higher quality.

Food Safety Ninety percent of Chinese consumers are worried about food safety. Over time there has been many food scares, epidemics and contamination within China. These problems are often traced back to the farm level but implementing food safety systems at the farm level is

⁸ This includes 31 provinces, autonomous regions, municipalities and CPLA but excludes Hong Kong SAR, Macao SAR, Taiwan Province, and overseas Chinese - National Bureau of Statistics of China

difficult. The farm sector consists of 200 million farm households with, on average, 1-2 acres of land divided into 4-6 plots that are not adjacent to one another. This makes monitoring and standardizing production practices difficult.

Environmental awareness and the emergence of green food A segment of Chinese consumers are more aware of the environment and the Chinese government had introduced new environmental laws and regulations that limit chemical inputs and set minimum levels for soil air and water pollutants. Food grown accordingly is called ‘green food’ and has been viewed as safer. However, the majority of Chinese consumers are not yet willing to pay a premium for green products or are willing to shoulder the cost for certified traceable food. Meanwhile Chinese consumers know little about organic foods. Robert Oliver, Consulting Chef for New Zealand Trade and Enterprise in China, was skeptical of foods classified as organic in China. “There is such a maze of middlemen and confusing certifications between the organic producer and the end user. You just can't be sure it really is organic! And, it is very unclear what organic even means here.”

Convenience Chinese consumers are interested in more convenience foods for the same reasons that westerners are: they have less time to prepare meals, more women are in the workforce, and they want more time to pursue leisure activities. In urban China, the 20 to 40 age group in particular, tends to be more heavily influenced by western lifestyles. Consequently this group tends to eat out more frequently and, when eating at home, prefers cooked, semi-prepared and packaged foods. Frozen processed foods are becoming more popular. Products that performed best within the frozen red meat category in 2009 were seasoned mutton bunch, seasoned beef, meat balls and sausages. Ninety percent of all quick frozen food products are purchased through retail distribution channels.

Eating out Consumers are spending more money eating out. McKinsey reported that China's new class of wealthy consumers spent 17% of their household income on eating out, compared with mainstream consumers who spent 7% of their household income on eating out. When eating out, they were more likely to spend money on meat, in particular on sheep meat followed closely by beef. On average, 109 RMB was spent on mutton and 100 RMB on beef, compared to 79 RMB on poultry and 66 RMB on pork. This may be as a result of willingness to try different things when they ate out, and the unfamiliarity of preparing dishes with beef or sheep meat at home.

Chinese Consumption of Sheep Meat

Of the total meat consumed in China in 2009, pork accounted for 64%, poultry 23% while beef and lamb together only accounted for 13%. The overall consumption of sheep meat was 3,890,000 tonnes of sheep meat (3.0 kg per capita consumption).

Overall consumption hid regional differences in consumption. However, there is a difference between the Northwest and the East. Sheep meat is a major part of consumer diets in the northwest areas due to the influence of Muslim and Mongolian cultures. Eating sheep meat is less common in eastern China where many of the tier one and tier two cities are located. There is also a difference between urban and rural areas. Sheep meat is more popular in urban areas

compared to rural areas. In rural areas, consumers tended to spend proportionally more money on pork because it is cheaper. In rural China eating habits are more strongly influenced by traditional culture and use of traditional Chinese recipes.

Chinese preferences are also reflected in how sheep meat is bought and cooked. All sheep meat and even goat meat is referred to as “yang rou” (羊肉). No distinction is made between the age of the animal or quality of the sheep meat. In China older meat is considered more nutritious and delicious. In many cases, mutton flaps are seen as a premium product, in particular above pork and chicken. Generally the, low-end cuts of domestic and imported sheep meat are hidden in complex dishes. As a result Chinese consumers are unfamiliar with lamb as a main stand-alone menu item.

Chinese, particularly those in the north, have developed many sophisticated ways of eating sheep meat. A simple search of “sheep meat recipes” in Chinese on Baidu (an equivalent search engine to Google in Mainland China) revealed 3,370,000 relevant results. Of these results, many came from Chinese recipe websites. One website alone offered 71 recipes for cooking sheep meat⁹. These recipes are vastly different from western ways of cooking lamb or mutton. Many spices and other accompaniments are used to achieve the colors, the aroma, and the taste by which the Chinese judge a dish. Overall low-end cuts of sheep meat are popular.

Oceania Efforts to Develop the Chinese Market

Australia's Market Development Initiatives

Meat and Livestock Australia has had numerous programs to increase the sale of Australian beef and sheep meat. First it provided retail training of staff for four outlets from CityLife and Lianhua supermarkets, both part of the Hangzhou Lianhau Huashang Group of supermarkets. In these stores its cutting and cooking demonstrations showcased Australian beef strip loin and knuckle. Customers were given samples to taste. Sales of beef knuckle were eight times greater than when no promotion or sampling was provided. Second, it conducted a series of chef programs targeting second tier cities where Australian beef and sheep meat were incorporated into the modern Chinese cuisine. This included a training workshop in Tianjin for chefs of the Starwood Hotel Group. Third, it participates in culinary contests including the 98th Black Box Culinary Challenge, held at the Renaissance Hotel in Beijing on February 21, 2012, in which the secret ingredient was lamb neck fillet. Fourth, it exhibits at popular food trade shows such as the Food and Hotel China tradeshow. The three-day event based in Shanghai attracted where 30,000 visitors. Fifth, it produced a website targeting the Chinese market with its beef and lamb (see Exhibit 8).

New Zealand's Market Development Initiatives

New Zealand industry organizations such as Beef + Lamb New Zealand and New Zealand Trade and Enterprise are involved in generic marketing. Beef + Lamb promotions in China centered on

⁹ www.allrecipes.cn

creating awareness and demand for New Zealand grass-fed beef in the hotel and restaurant sector. Attributes promoted are natural, nutritious, and safe to eat.

These organizations also taught chefs the best way to cook grass-fed beef, run seminars for food industry professionals in Beijing, Dalian and Shanghai, have point of sale materials to support the food service sector, and participate in joint promotions with hotels, restaurants and importers.

New Zealand Trade and Enterprise has renowned Chef Robert Oliver serve as a Consulting Chef in China. Robert's role includes establishing relationships with the Hotel and Restaurant Institution (HRI) and other food industry professionals. He has developed menus and recipes highlighting New Zealand food and beverage products. He is also a regular contributor to the "New Western Cuisine Magazine," the most influential bi-lingual food magazine in China with a significant reach into the Chinese food industry. In his travels, he found a company that was aware of produce from New Zealand and chose to deal with a large supplier. Unfortunately, the leaders of this company got confused after being approached by many different suppliers from New Zealand. "This doesn't help the national brand," commented Robert Oliver.

New Zealand's Reputation for Sheep Meat

New Zealand is well recognized as a source for sheep meat. A search of "New Zealand sheep meat" in Chinese on Baidu, reveals 1,690,000 relevant results, many of which are websites providing information on New Zealand sheep meat suppliers.¹⁰ On one particular website, 32 suppliers were found.¹¹

Food safety is one of New Zealand's major national assets, according to Robert Oliver, "New Zealand foods and beverages are famously clean and safe." New Zealand sheep meat has a good reputation in terms of quality and safety. This has led counterfeiters to produce "fake" New Zealand lamb rolls using locally produced sheep meat, or even other animal meat (including pork and duck meat). Reports appeared on the internet regarding investigation into false New Zealand sheep meat.¹² This called into question the authenticity of New Zealand lamb rolls observed on shelves in supermarkets in China. (See Exhibit 9 for packaging and branding of New Zealand lamb in Chinese retail outlets). Although China was New Zealand's second largest market for sheep meat, New Zealand has little visibility in the Chinese market.

Supplying the Chinese Market with Imported Sheep Meat

Amongst the Chinese importers of beef and sheep meat, there were three Australian firms and one firm from Uruguay operating in China. Many distributors in China also act as importers. No New Zealand-based companies have a business based in China that are importing sheep meat. Rather, the New Zealand companies rely on importers to sell their meat in China. The largest importer of New Zealand sheep meat for 11 years was Northern Chinese meat processing company Heilongjiang Grand Farm Group (Grand Farm). It had been buying its meat from Alliance, New Zealand's biggest meat processing company, since 1999. It advertised New Zealand products on a separate 'international trade' webpage on which the claim was made that

¹⁰ www.baidu.com

¹¹ www.21food.cn

¹² http://news.ycwb.com/2011-05/24/content_3443434_3.htm

New Zealand is a place ideal for livestock farming, with no pollution or epidemic disease for over 200 years.¹³

Those distributing and selling imported meat targeted the major cities on the eastern coast. One reason was that China's fragmented logistics industry has hindered cold-chain development for high-value, temperature sensitive products. Another reason was that the more affluent people lived in north-eastern cities, such as Dalian and Harbin. These areas were hubs for large volume importation.

The average price for sheep meat in the market was RMB 53.08 per kg (leg) at the beginning of 2012.¹⁴ The cost of supplying the Chinese market with specific cuts from New Zealand is found in the table below:

Table 4. Lamb Value Chain

	1kg Lamb Rack		250gm Lamb Rack	
	USD	RMB	USD	RMB
Retail Price	66.18	450.00	24.71	168.00
Retailer Gross Margin (currency)	41.69	283.50	18.53	126.00
Retailer Gross Margin (% of retail price)	63%	63%	75%	75%
Distributor Selling Price	24.49	166.50	6.18	42.00
Distributor Gross Margin (30% of dist. sell. price)	<u>7.35</u>	<u>49.95</u>	<u>1.85</u>	<u>12.60</u>
In Country Price	17.14	116.55	4.32	29.40
Exchange rate (1USD = 6.80 RMB)	1:1	1:6.80	1:1	1:6.80
Landed Price	<u>17.14</u>		<u>4.32</u>	
Duty Clearance (1% of CIF)	0.14		0.04	
Total Import Tax (22.04% of CIF Price)	3.07		0.77	
CIF Price	<u>13.93</u>		<u>3.51</u>	
Cost of Air Freight	2.00		0.50	
FOB Price	11.93		3.01	

Source. Based on a report produced by RedFern Associates for New Zealand Trade & Enterprise 2010.

ANZCO Looks Forward

ANZCO was working with Chinese importers: Heilongjiang Tianshunyun Muslim, Dalian Elite, Advance Marketing and Fern Ridge Ltd (see Exhibit 10). Traditionally it priced its products on an FOB (Free on Board) basis but had moved 64% of its sales to a CIF (Cost, Insurance and Freight) basis, so 36% was still FOB. The products it sent to China were on the low end.

Sitting in ANZCO's headquarters in Christchurch, Graham commented on the situation,

"The Chinese market has tremendous potential but we have to figure out what we want to sell there, where and how. Right now premium cuts of lamb are in the high-end and expat hotel chains rather than targeted at the general population. Sheep meat is generally not widely known

¹³ www.dazhuangyuan.com

¹⁴ Source: National Bureau of Statistics of China. The price of mutton was taken from 50 cities in China as of 1-10 of January 2012.

in areas situated further south like Shanghai. Beef is more widely known. How do you market lamb into those markets which have potential and don't currently know about it?"

Parker added,

"China provides an alternative to our traditional markets. We are trying to decide what our market strategy there should be so that we can optimize the value of the whole lamb carcass. Our business in Taiwan provides us with a great platform to grow a direct presence in the Chinese market, but the question is: what should our marketing strategy be?"

These were the questions that Parker needed to address as he developed his recommendation for the board.

Acknowledgements

The authors would like to fondly acknowledge the lead author of this case, our friend and colleague, Daniel Conforte, who initiated this project but unexpectedly passed away before it was completed. A special thanks to ANZCO Foods and Alan McDermott for providing interviews, data and approving the final document. Lastly, we thank Dr. Kenneth Harling and Dr. John Siebert for their invaluable expertise, serving both as case reviewers and content editors. Their significant contributions enabled us to meet the stringent timeline of completing this case for use in the IFAMA 2012 International Student Case Competition held in Shanghai, China and they further helped refine it for this publication.

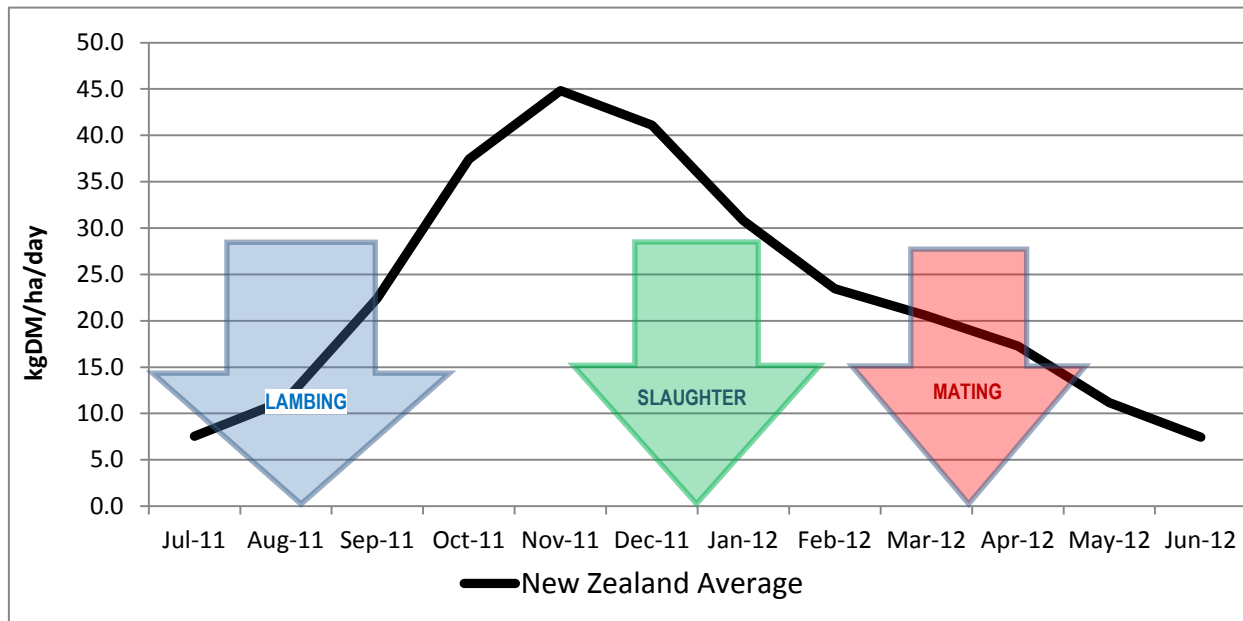
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Exhibit 1A. Pasture Growth and Major Farming Seasons – REGULAR



Source. FARMAX (Hamilton)

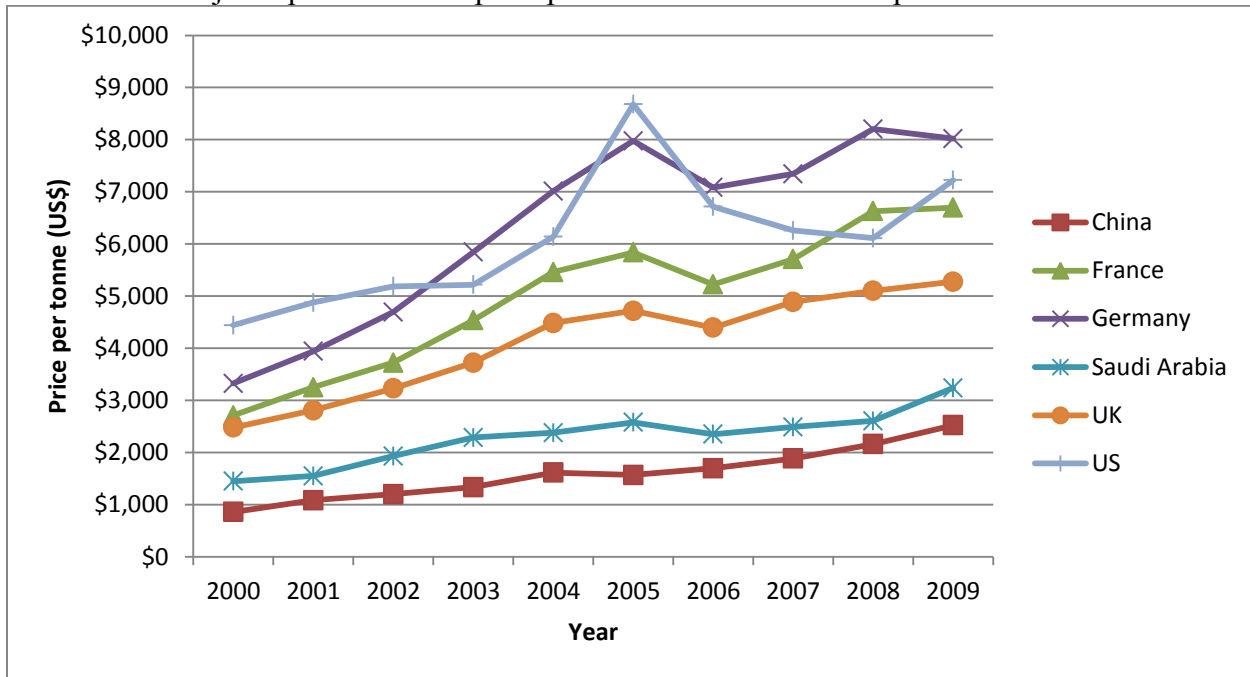
Exhibit 1B. Breakdown of a sheep carcass by cut



Source. alibaba.com.cn

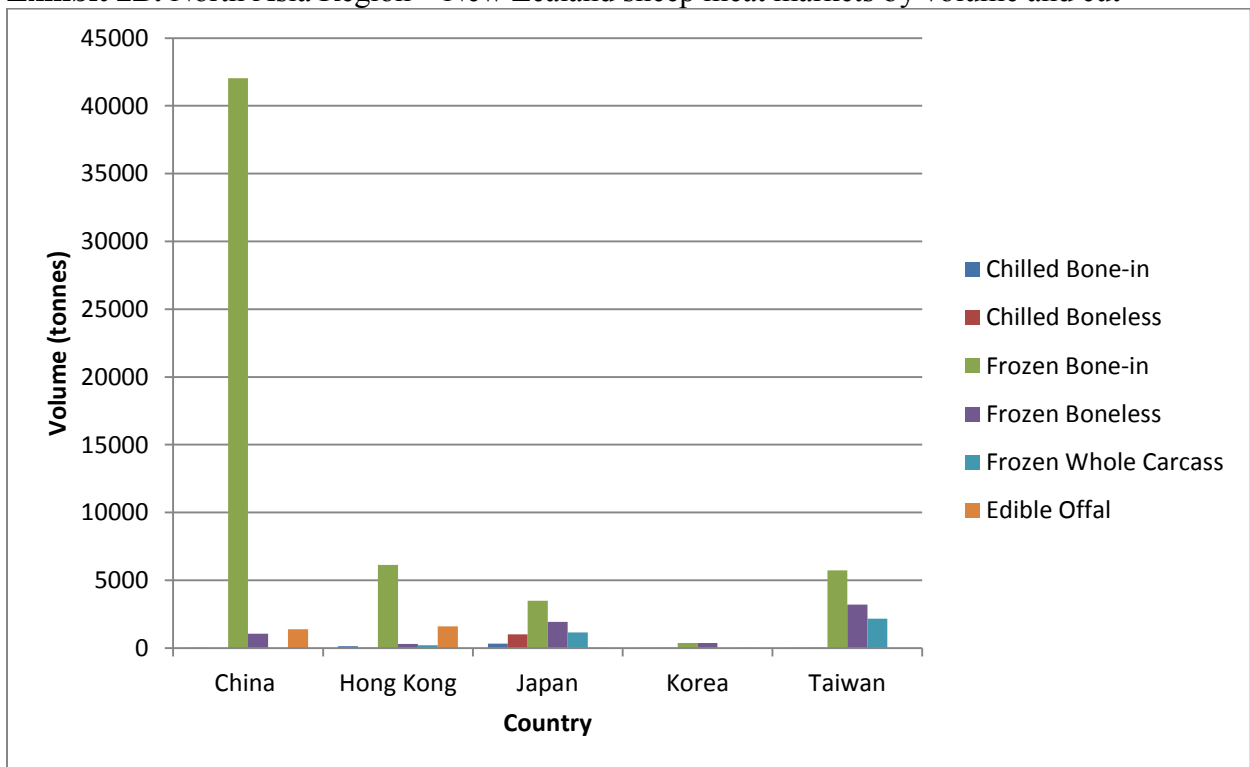
Note. This case refers to sheep meat in general but also differentiates sheep meat. The terms lamb and mutton are regularly referred to indicating a difference. Both are sheep, but have distinct differences, mainly in age. Lamb is a sheep less than a year old and is generally slaughtered between the ages of four and twelve months. Because of this lamb is tenderer than mutton and considered a better product. Mutton is an older sheep and is tougher meat with a much stronger flavor.

Exhibit 2A. Major export markets - price per tonne received for sheep meat



Source. FAO

Exhibit 2B. North Asia Region – New Zealand sheep meat markets by volume and cut



Source. Beef + Lamb New Zealand Economic Service and New Zealand Meat Board.

Notes. Figures are from 2010-11 (Sep Yr) and include mutton and lamb markets

Exhibit 3. How sheep meat products are packaged for export from New Zealand to China.



Source. www.dazhuangyuan.com

Exhibit 4. Financial Reports for ANZCO, 2010.**ANZCO FOODS LIMITED****STATEMENT OF COMPREHENSIVE INCOME****FOR THE YEAR ENDED 30 SEPTEMBER 2010**

	Notes	Group		Parent	
		2010 \$000	2009 \$000	2010 \$000	2009 \$000
Revenue	3	1,167,477	1,190,485	30,255	55,323
Expenses	3	1,151,650	1,171,395	17,657	16,556
Operating Earnings Before Interest & Tax		15,827	19,090	12,598	38,767
Share of Profit/(Loss) of Associates	10	(2,217)	2,133	-	-
Earnings Before Interest & Tax		13,610	21,223	12,598	38,767
Finance Costs	3	8,269	10,487	7,722	9,671
Profit from Continuing Operations Before Tax		5,341	10,736	4,876	29,096
Tax Expense/(Benefit)	4	3,463	3,435	(291)	(1,366)
Movement in deferred tax relating to legislative changes to tax depreciation on buildings	4	1,472	-	-	-
Profit from Continuing Operations After Tax		406	7,301	5,167	30,462
Other Comprehensive Income					
Liquidation of Subsidiary		-	-	2,111	-
Net movement on Cash Flow Hedges		(912)	2,014	-	-
Net movement on Hedge of Net Investment		(1,422)	426	(1,422)	426
Foreign Currency Translation		1,248	(515)	547	(1,869)
Revaluation of Land & Buildings		-	16,428	-	-
Depreciation transfer on De-recognition of Assets		-	(268)	-	-
Assets Revaluation – disposal of Assets	4	-	(496)	-	-
Income Tax on items of Comprehensive Income		190	(797)	-	-
		(892)	16,792	1,236	(1,443)
Total Comprehensive Income for the Year		(486)	24,093	6,403	29,019
Profit for the year is attributable to:					
Equity Holders of Parent		406	7,301	5,167	30,462
Non-controlling Interests		-	-	-	-
		406	7,301	5,167	30,462
Total Comprehensive Income for the year is attributable to:					
Equity Holders of Parent		(486)	24,093	6,403	30,462
Non-controlling Interests		-	-	-	-
		(486)	24,093	6,403	30,462

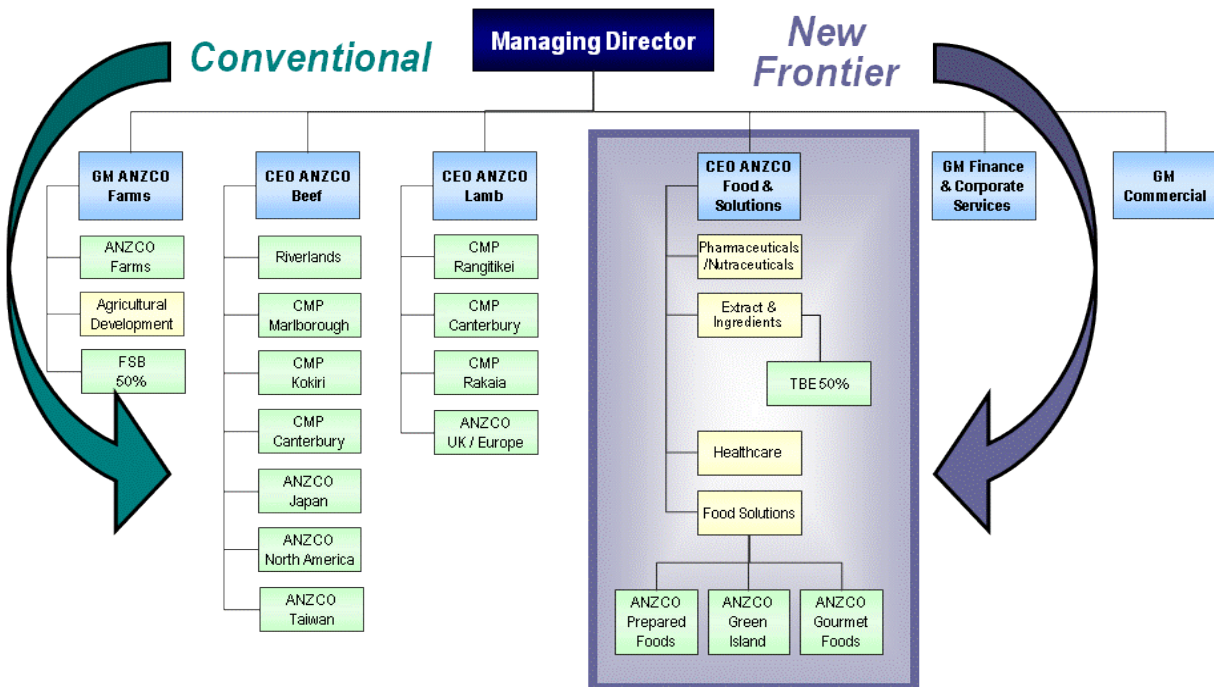
ANZCO FOODS LIMITED**STATEMENT OF FINANCIAL POSITION****AS AT 30 SEPTEMBER 2010**

	Notes	Group		Parent	
		2010 \$000	2009 \$000	2010 \$000	2009 \$000
Non Current Assets					
Property, Plant & Equipment	6	230,242	231,922	2,344	2,536
Shares in Subsidiaries	7	-	-	81,061	84,711
Intangible Assets	8	966	-	-	-
Financial Assets	9	631	704	627	700
Investment in Associates	10	34,850	35,863	20,559	17,142
Other Investments	11	830	1,365	-	-
Deferred Tax Asset	4	8,849	7,177	321	399
Total Non Current Assets		276,368	277,031	104,912	105,488
Current Assets					
Cash & Cash Equivalents	12	13,461	9,741	-	958
Receivables, Advances & Prepayments	13	88,580	74,000	181,262	184,193
Inventories	14	85,518	100,777	-	-
Contracted Livestock	14	29,524	21,132	-	-
Biological Asset	15	1,006	2,082	-	-
Other Financial Instruments	23	1,445	6,269	-	-
Income Tax Receivable	4	1,269	443	6,356	1,215
Total Current Assets		220,803	214,444	187,618	186,366
Total Assets		497,171	491,475	292,530	291,854

	Notes	Group		Parent	
		2010 \$000	2009 \$000	2010 \$000	2009 \$000
Equity					
Share Capital	16	59,364	59,364	59,364	59,364
Retained Earnings	17	114,405	118,432	69,978	67,133
Reserves	18	70,409	71,300	(5,219)	(4,344)
Total Equity		244,178	249,096	124,123	122,153
Non Current Liabilities					
Interest Bearing Loans	19	34,230	56,099	26,080	48,337
Provisions	20	2,532	2,089	-	-
Deferred Tax Liabilities	4	8,813	6,373	435	128
Total Non Current Liabilities		45,575	64,561	26,515	48,465
Current Liabilities					
Interest Bearing Loans	19	147,390	129,252	130,171	114,350
Accounts Payable, Advances & Accruals	21	58,057	46,156	11,721	6,886
Provisions	20	1,971	2,410	-	-
Other Financial Instruments	23	-	-	-	-
Income Tax Payable	4	-	-	-	-
Total Current Liabilities		207,418	177,818	141,892	121,236
Total Equity & Liabilities		497,171	491,475	292,530	291,854

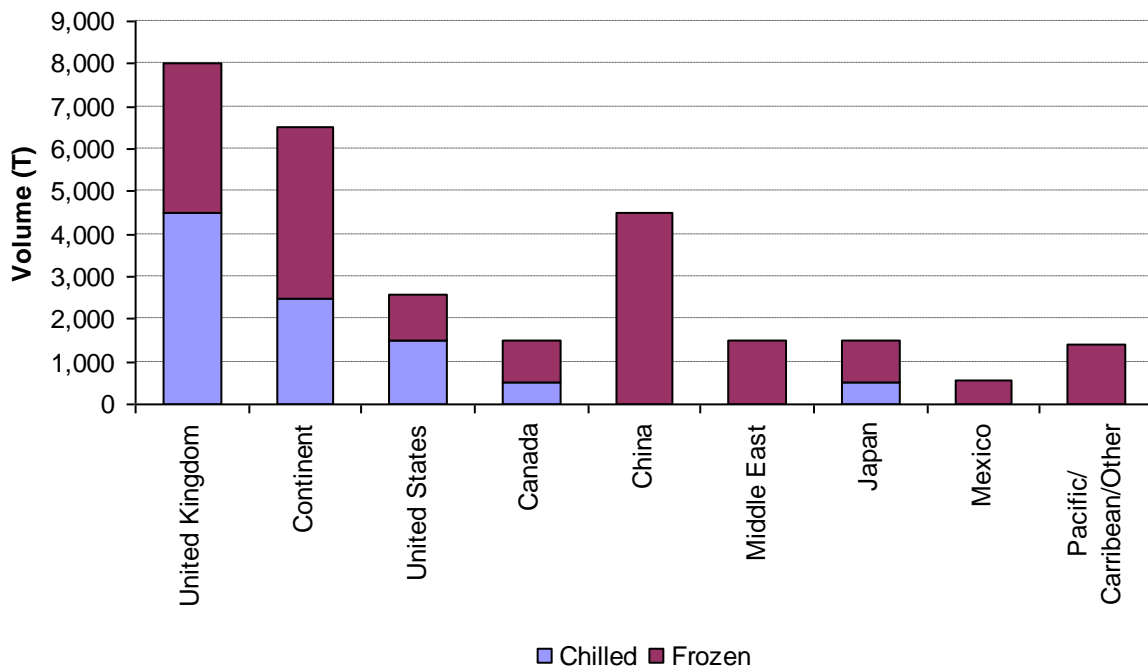
Source. ANZCO

Exhibit 5. ANZCO Foods Limited: Company Structure



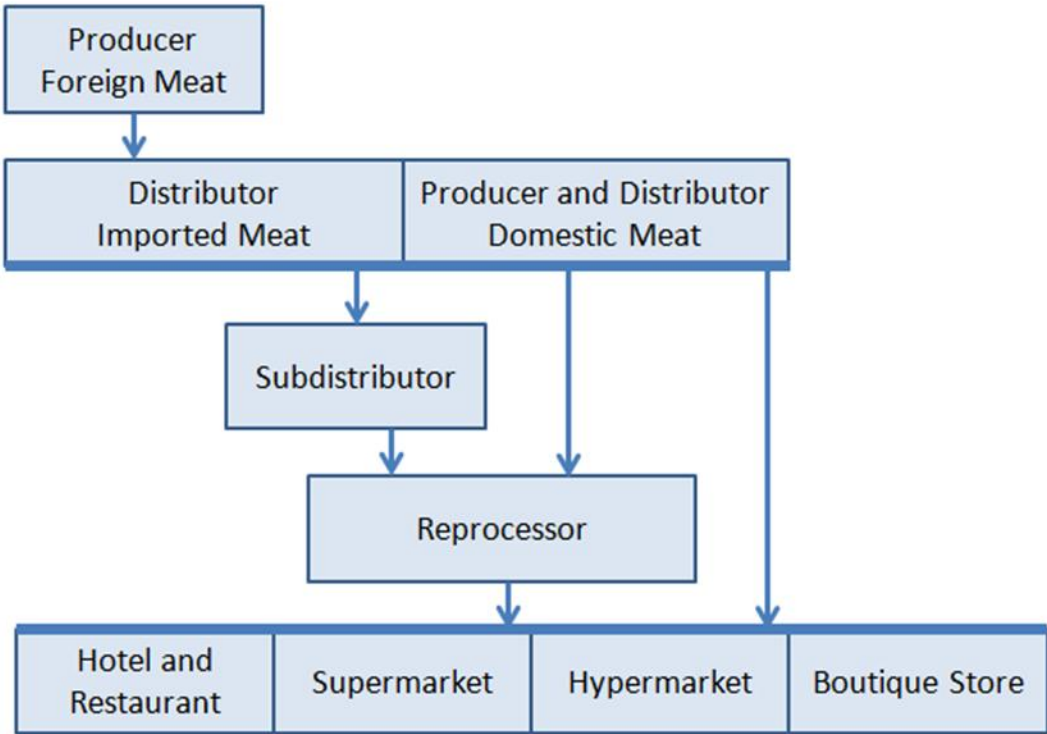
Source. ANZCO

Exhibit 6. ANZCO Chilled & Frozen Lamb Sales



Source. ANZCO

Exhibit 7. Distribution flow of imported sheep meat in China



Note. The heavy lines indicate that all industries associated with that line are involved.

Source. Based on diagram in Report for New Zealand Trade & Enterprise produced by RedFern Associates 2011

Exhibit 8. Meat and Livestock Australia (MLA) website promoting Australia beef and lamb to Chinese consumers and trade



Source. www.loveaustralianbeefandlamb.com

Exhibit 9. Packaging and branding of New Zealand lamb in Chinese retail outlets



Exhibit 10. ANZCO's current business in China

DALIAN ELITE TRADING CO LTD	\$ 4,659,749.94	23.32%	
HEILONGJIANG TIANSHUNYUAN MUSLIM	\$ 8,062,785.38	40.34%	63.66% CIF
FERN RIDGE LTD	\$ 4,123,909.40	20.63%	
ADVANCE MARKETING LTD Total	\$ 3,139,022.87	15.71%	36.34% FOB
TOTAL	\$ 19,985,467.59	100.00%	

Customer	Level				Total Invoice Value in Business Unit Currency	Total FOB Value in Business	Total Invoice Qty	Inventory	UOM
	Level 1	Level 2	Level 3	Level 4					
ADVANCE MARKETING LTD	SALEABLE	OVINE	LAMB	LAMB FORES	\$ 132,386.19	\$	132,386.19		38,679.05
				LAMB MIDDLES	\$ 2,601,840.30	\$	2,601,840.30		529,775.00
				LAMB MIXED	\$ 421,433.43	\$	416,044.39		243,269.82
ADVANCE MARKETING LTD Total					\$ 3,155,659.92	\$	3,139,022.87		811,723.87
DALIAN ELITE TRADING CO LTD	SALEABLE	OVINE	LAMB	LAMB MIDDLES	\$ 4,471,584.96	\$	4,281,199.71		906,240.00
				LAMB MIXED	\$ 307,663.71	\$	283,466.83		116,239.41
DALIAN ELITE TRADING CO LTD Total					\$ 4,879,636.20	\$	4,669,749.94		1,048,941.41
FERN RIDGE LTD	SALEABLE	OVINE	LAMB	LAMB FORES	\$ 51,875.00	\$	51,875.00		41,160.00
				LAMB MIDDLES	\$ 3,823,991.75	\$	3,823,991.75		781,965.00
				LAMB MIXED	\$ 248,042.76	\$	248,042.76		128,961.16
FERN RIDGE LTD Total					\$ 4,123,909.40	\$	4,123,909.40		1,074,625.07
HEILONGJIANG TIANSHUNYUAN MUSLIM	SALEABLE	OVINE	LAMB	LAMB LEGS	\$ 468.39	\$	403.17		272.64
				LAMB MIDDLES	\$ 7,796,765.47	\$	7,346,262.55		1,471,760.00
				LAMB MIXED	\$ 715,427.40	\$	614,505.79		324,445.68
HEILONGJIANG TIANSHUNYUAN MUSLIM Total					\$ 8,622,000.93	\$	8,062,785.38		1,826,800.89
Grand Total					\$ 20,781,205.00	\$	19,985,467.00		4,762,091.24

Source. ANZCO

