Competitive Strategies Used by the New Zealand Dairy Board to Compete Effectively in the Global Market for Dairy Products

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The New Zealand Dairy Board is the exporting organization for New Zealand's dairy farmers and the country's cooperatively-owned dairy products manufacturing companies. The Board is one of the most successful agricultural cooperatives in the world. It is distinguished by its marketing efficiency, the cooperative structure on which it is based, the industry's unsubsidized nature and the 18 percent ($5.5 billion) contribution it makes to the nation's export earnings. With 95 percent of all dairy products manufactured in New Zealand each year being sold in the global market, the New Zealand Dairy Board is the country's largest single exporter. To achieve this success, the Board works with the dairy companies, who are effectively the Board's owners, and the dairy companies are owned by the dairy farmers of New Zealand. The Board determines the corporate strategy pertaining to the markets to operate in, how the marketing efforts of individual regions and countries are co-ordinated, how capital and human resources are allocated, and how production and shipping logistics are synchronized on an industry level. The competitive strategy is conceptualized and implemented on a country by country, subsidiary by subsidiary basis. The exception is the domestic market, which is not controlled or co-ordinated by a central body as it is a competitive market in which each dairy company fights for its own niche and for its own benefit.

This paper examines the strategy that the New Zealand Dairy Board has used to transform itself into an organization that has the features of a multinational food company, since its inception in accordance with the Government Dairy Board Act of 1961. The analysis is based on information obtained from interviews with dairy board officials, dairy company managers and dairy farmers, as well as from secondary research.

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Factors Influencing the New Zealand Dairy Board's Strategies

Strategies throughout the 1980's and 1990's have been influenced by numerous structural variables. Key political and competitive variables are the New Zealand government policies establishing the Dairy Board (1961) and the amendment (1996), the elimination of government subsidies to the dairy industry in 1984, government policies in other major dairy producing countries that subsidize exports, and competitive conditions in global markets that are influenced by governmental intervention and large multinational companies. Other variables are the nature of dairy farming in New Zealand, the small size of the domestic market, evolution of the dairy companies in New Zealand and throughout the world, and the preferences of dairy farmers and the managers of the numerous cooperative manufacturing facilities.

The mission of the New Zealand Dairy Board is another important factor influencing strategy and that is to maximize the sustainable income of New Zealand dairy farmers through excellence in the global marketing of New Zealand-origin dairy products. All of the organization's activities have been directed toward this purpose. This means that as a multinational dairy products marketer operating through a worldwide network of subsidiary and joint venture companies, the New Zealand Dairy Board is market-driven with the objective of being totally responsive to customer requirements.

With 80 wholly or partly owned companies in 30 countries and marketing products in more than 100 countries, the Dairy Board has a strong competitive position in the global market. This has allowed the Board to have the market presence necessary to support strong brands and develop close responsive relationships with

industrial and retail customers, and consumers. This global network of operations also has allowed for the rapid transfer of market, product, and commercial intelligence between the different regions of the world and back to New Zealand. This is a very important factor in shortening the product development process and in transferring successful marketing practices.

The Board is formally a single desk monopoly seller in global markets, but marketing practices are carried out by a large number of subsidiary companies. The strategies vary depending on the opportunities, demand and competition in the various markets in which the companies operate. This structure has allowed all profits to be captured by the Dairy Board and distributed back to the farmers producing the fluid milk, and also invested for the future growth of the overall operations as the Board decides how to allocate earnings to the companies for new facilities and for research and development.

New Zealand Milk Production And Manufacturing

New Zealand's 14,500 dairy farmers are the lowest-cost milk producers in the world. This is due to the low housing and feed expenses (primarily pasture) associated with large herds averaging 200 cows per farm, and a very productive use of labor. These pasture-based dairy farms have average costs which are only about one half those of the average United States dairy farm, and the U.S. dairy farm operations are considerably more efficient and lower cost operations than many other countries' dairy farming operations. This low cost milk is the primary raw product which goes into New Zealand Dairy Board manufactured exports. However, the organization also purchases dairy products from other countries when trade restrictions prevent, or in some cases makes it prohibitively expensive to use New Zealand dairy products, or when New Zealand products are not available. Due to these market conditions the New Zealand Dairy Board has to use non-New Zealand dairy product sources for almost 20 percent of their global business.

The number of cooperative manufacturing dairy companies operating in New Zealand dropped from 180 in 1960/1961 to 17 in 1995 due to consolidations and the necessity to build new, more modern and efficient manufacturing facilities. The New Zealand companies have some of the largest, technologically modern, and most efficient milk processing plants in the world. These advantages are not as great as they appear because New Zealand's pasture-based farming system raises milk processing costs. This is because there is very little milk processing during the two winter months of June and July when pasture growth is minimal and farmers dry off their cows. Then, in October and November, milk processing rises about 75 percent above the monthly average for the year. Therefore, the manufacturing milk plants are built to handle peak seasonal production and there is a need for the injection of more capital than would be required for an even pattern of production. Consequently, costs are not as low as they could be due to plants being underutilized for about ten months of the year. One study comparing manufactured milk processing costs for New Zealand and West Germany concluded that, "seasonality probably makes New Zealand processing less efficient than that of West Germany, but this is more than offset by greater efficiency in the farm sector which results in an overall competitive advantage for New Zealand dairy production."

World Trade And Prices For Dairy Products

Even though New Zealand produces less than 3 percent of the fluid milk in the world, the New Zealand Dairy Board is the world's largest dairy product exporting firm with 26 percent of the international trade in dairy products. The major markets for New Zealand dairy products are also major dairy producing countries themselves and these are the European Union countries, United States and Australia. Major secondary markets, such as Asia and South America, offer substantial growth potential for the future.

Exporters from different countries within the European Union collectively account for approximately 46 percent of the world trade in dairy products and represent the primary competitors. These exporters continue to be the dominant power in the global dairy market due to their collective size and also the export subsidies that they receive. New Zealand is the only dairy exporting country in the world that does not have production subsidies or a protected domestic market.

World trade in dairy products is distorted by export subsidies and other government measures such as tariffs, quotas, etc. All of New Zealand's primary country competitors operate subsidy

schemes to support farmers' incomes and attempt to protect their domestic dairy industry by using import restrictions, making it difficult for imports to compete effectively. This results in artificially high prices above market clearing levels, stimulates fluid milk production and reduces consumption. Consequently, often there is a substantial surplus of dairy products in different markets. These are frequently disposed of as exports, and sometimes sold below the cost of production. Subsidies and other government assistance measures are used by several countries to bridge the gap between export prices and protected domestic prices.

An example of the impact of government assistance measures is that the subsidized exports of the European Union dairy products have been the primary cause of widely fluctuating prices in the world dairy products market in the 1980's and 1990's. This fluctuation of prices impacts the payout to New Zealand dairy farmers. The payout measured in 1988/1989 prices fell from New Zealand $6.00/kg of milkfat in 1984/1985 to New Zealand $3.60/kg of milkfat in 1986/1987, a decline of about 40 percent. Although prices recovered in the early 1990's, they have continued to fluctuate. There was a payout of $3.18/kg in the 1996-1997 season. The Board estimates for 1997-1998 the payout will be in the range of $2.90 - 3.05/kg. World dairy product prices fluctuate considerably and a key factor is the volume of exports from the European Union.

It is important to note that only 5 percent of total world production of milk per year (about 25 million tons) actually enters international trade. However, only 60 percent of that international trade (equivalent to about 15 million tons) is open to competitive supply, and this means not controlled by quotas or other trade measures. New Zealand is the only supplier to the international dairy market whose producers earn a living from market returns alone. Consequently, the need to maximize dairy farmers' incomes is an important spur to the overall efficiency of the dairy manufacturing sector and the Board's activities in global markets. The Board continues to be successful in this heavily subsidized competitive and hostile environment by modifying and adapting strategies. Key elements of the overall strategy have been the establishment of companies throughout the world and the development of highly specialized products for niche markets.

New Zealand Dairy Industry And The Global Market

It was mentioned previously that the international dairy market is a distorted environment and remains cyclical and highly sensitive to economic and political pressures. Also, currency values are volatile and difficult to predict, and New Zealand's recent relatively high exchange rate has been a problem. Despite recent commitments by countries and major dairy trading companies to liberalization, the use of both subsidies and market access restrictions continues to be a dominating influence on world trade and competition for dairy products. Therefore, export subsidies effectively control price in the international marketplace which means the competitive market in which the New Zealand Dairy Board operates is an artificial arena where the normal laws of supply and demand are grossly distorted. Governments and the large firms who hold most of the market power are the main determinants of international dairy prices rather than the purely competitive market forces which would determine the equilibrium market clearing prices. Consequently, the concept of a "global dairy market" is meaningless as there is no single market in which producers are connected to consumers through the measure of changing relative prices. There is a mix of distinct individual markets which operate independently of one another, and they are subject to substantial differences in government supports and subsidy programs and have their own independent price structures. In this type of global market environment, the unsubsidized suppliers are at a major disadvantage.

The competition among the major international competitors in the global market, such as Nestle, Kraft General Foods, the New Zealand Dairy Board Companies, etc. is fierce. Also, there are large domestic competitors in many of the markets. It should be noted that both Nestle and Kraft General Foods are more than ten times larger than the New Zealand Dairy Board. However, all of the Dairy Board's business is in dairy products as compared to their major international competitors that market several different types of food products. This has allowed the Dairy Board to compete effectively by using a focused concentration strategy.

The New Zealand dairy industry, therefore, is considerably handicapped because its product

pricing is based purely on commercial and not political considerations. Furthermore, there is a natural competitive disadvantage in that New Zealand is farther away (shipping cost) from the major markets than all of their competitors except Australia.

The major markets for New Zealand dairy products are also major dairy producing countries themselves such as the European Union countries, United States and Australia. When considering the market shares of the internationally traded dairy products market, the European Union countries have 46 percent, New Zealand 26 percent, Australia 10 percent, United States 8 percent, and all other countries of the world, 10 percent. Australia's dairy production is increasing rapidly and they are becoming a very important competitor in the global market.

Environmental Changes Affecting The Future Of The Dairy Industry

Based on the Uruguay Round Agreement, there is an international commitment to increased market access and to reduce subsidies. It is estimated that by the year 2000, subsidized exports will be reduced approximately 21 percent in volume. The reductions in government domestic support, such as subsidies for agricultural products in many developed countries, is taking place due to the decline in the political influence for agriculture.

It is predicted that with a reduction in its subsidy system and a reduced export focus, there will be a gradual decrease in the export dominance of the European Union countries. This will ultimately mean better access for New Zealand's butter and cheese into the United Kingdom and other European countries. Furthermore, the change in the subsidy system will boost the Dairy Board's opportunity in markets presently supplied by European Union countries.

There is increasing dairy product consumption in many of the rapidly developing economies, particularly in Asia. Due to the small size of their local dairy industries, these Asian countries always will be net importers of dairy products. New Zealand's location on the Asian Pacific Rim is a major advantage in these markets, but Australia, who is becoming a major competitor, also has the same location advantages.

It seems the New Zealand Dairy Board will have excellent opportunities to grow its value-added business. The global environment is constantly undergoing change, but the present trends seem to be positive for the New Zealand dairy industry.

Primary Strategies of the New Zealand Dairy Board for the 1990's

Until 1973, the Board's primary business in the global market was to supply butter and cheese to Great Britain. When Great Britain joined the European Union (1973), severe restrictions were placed on the quantity of food products including dairy products that Great Britain could import from New Zealand. This brought about major changes in the thrust, operations and strategies of the Dairy Board in the global food marketplace. The result has been reducing the dependence on the traditional markets and the sales of bulk commodity products. An indication of the Board's change in strategy is that standard dairy commodities in 1982 accounted for about 55 percent of sales, and by 1996 standard commodities had dropped to slightly more than 20 percent of total sales. Branded consumer products increased to about 30 percent. For example, the Anchor brand is the world's leading butter brand and is the number-two brand in global branded milk powder sales.

The selling of nutritional benefits is of primary importance for the Board's latest brand Anlene, the high-calcium, non-fat milk powder which has been sold to the Board's numerous markets from South East Asia to Latin America. Another change has been the pursuit of strategies to develop sales for specialized industrial markets that require sophisticated dairy by-product ingredients that possess specific functional properties. Whey protein concentrates used in infant formulas and sports beverages are the result of this effort. A number of new functional specialized ingredients are being developed each year using technology available within the New Zealand Dairy Board network. The growth in the ingredient market also has resulted in the development of close alliances with some of the world's leading food manufacturers and users of dairy-based ingredients such as Kraft, Pillsbury, McDonald's and Pizza Hut. Relationship marketing and working together on product development has brought about a better understanding of the needs of customers. This is a

driver of pro-active research and market-led new product initiatives.

Key Requirements For Success

A major requirement is critical mass, which means the Dairy Board needs to have the sales volume, control and the resources required to make the types of long term investments needed to compete effectively with large competitors in the global market. Due to the rapid change in the political and competitive environment, flexibility and adaptability is extremely important for the Board's operations. Relationship marketing and securing leadership in the consumer, specialty ingredient, and food service market segments is necessary in order to continue to ensure the on-going reputation and success of the Board's industrial products and well-regarded consumer brands. It is necessary to have a major commitment to research and development as this is imperative for developing new products and for technological improvements in production, processing, and distribution. A strong management information system is needed as information needs to be treated as an asset and a set of organizations as a learning global network. The Board must continue to be successful with strategic analysis and management, and developing corporate strategy that provides a clear vision of the future and how to implement strategies to achieve the vision. Finally, a major requirement is to maintain control over the entire production and marketing infrastructure and continue to improve the efficiency and effectiveness of all the components of the industry.

Core Strategies For The Future

The Dairy Board plans to continue major investments in research and development which will provide new technology for on-farm production improvement, dairy company processing quality and efficiency, and for new product development. There is a refocus of the research and development effort with the dairy processing companies and the New Zealand Dairy Research Institute to develop new value added products. Presently, approximately 1.1 percent of total sales revenue is spent for research. The research efforts have been productive and more than 20 percent of present sales are derived from products developed in the 1990's. Continued innovation and new product development is essential if the Dairy Board is to survive and prosper in the very competitive global environment. The research and development effort is very pro-active, and is customer-driven through decentralized research centers at various sites in the world.

There is a desire to maintain the single desk monopoly seller position and the vertically integrated industry in order to compete with the large global companies such as Nestle. Also, approximately 30 percent of the milk currently is sold as value-added differentiated product and the Board wants to lift this as close to 100 percent as possible. The Board will continue to be involved in bulk commodity production, but does not want to sell it that way. The bulk product is shipped to overseas subsidiaries who will pack it, reprocess it or add value to it, and market it in a multitude of different presentations.

The plans are to maintain strong marketing operations in global markets, and the Board's role is to concentrate on coordinating marketing policy and investment strategy. The primary marketing expertise will continue to be developed internationally, close to the market action. Therefore, marketing activities are coordinated by the Board, but the groundwork and implementation is done by the local companies at the different sites in the global market. Also, there will be a thrust towards improving the returns where import restrictions impede the expansion of sales. This will be done by moving into higher return products or by acquisitions moving further downstream in the distribution chain. Furthermore, the business will be spread over a wide range of countries without excessive exposure in any one country. The Board however does take significant risks in potential future large markets. An example is the establishment of the Anchor butter brand and the Ferndale brand of small natural cheese as the leading imported consumer dairy products in Russia. This was an outstanding achievement as the Board created and implemented a successful marketing campaign which was very effective in this high-risk market. This should give these two brands a major competitive advantage as Russia continues to develop.

There will be major additional expenditures for brands and market infrastructure. Over the next five years, the Dairy Board plans to spend $1.5 billion dollars on brand investment activity. This focus will be on expanding sales of branded consumer, food service, and specialty ingredient

products to selected markets. The food ingredients division is being utilized to develop and increase the international sales of specialized food ingredients by working closely with bakeries, ice cream manufacturers, chocolate manufactures, food service companies and food processors to better meet their needs for specialized products.

The Board has been very successful in using a strategy to capitalize on the "green" New Zealand image. Promotional materials have stressed that New Zealand dairy products are produced in an ecologically pure environment. The green image will continue to be an important part of the Board's promotional strategy in the future and is particularly effective in the Asian and a few other markets.

The New Zealand Dairy Board is a single desk monopoly seller and this is an unusual phenomenon in the present era of anti-regulation and open market economies. However, there have been numerous mergers and acquisitions in the New Zealand dairy industry in recent years. One single company, The New Zealand Dairy Group, now accounts for over 50 percent of production. The future role of the Board is under review by the government and plans are being considered for the industry to move to a self-managed basis. If this occurs, the Board's direct responsibility for the implementation of marketing strategies would be reduced and possibly eliminated. This change would have considerable impact on the Board's plans and operations in the future, and the consequences for the New Zealand dairy industry will not be known for a few years. The future, however, will be different than it has been in the 1990's if this change takes place.

Conclusion

The New Zealand Dairy Board utilizes a concentrated focus strategy and has been very successful in the past competing in a hostile political and competitive environment. The overall core strategy is to increase revenue and reduce risk by being more than a commodity producer that can be easily dropped by a customer or market. Strategies have been developed to increase exports of low cost, specialized, value-added, high quality products; increase consumer branded products and specialized food ingredient sales through foreign subsidiaries; and diversify across products and countries. The strategies are designed to balance sales in low-risk countries with sales in more risky, but potentially high-growth markets in developing countries. Channel control considerations will continue to be important to the Dairy Board as this allows their global marketing companies to get close to customers and sell more of the branded and specialized products which results in more channel power and profit. The overall strategy is supported by large, technologically modern, very efficient dairy processing plants, and raw milk supplied by the world's lowest cost dairy farmers. If the other dairy-producing countries continue to reduce subsidies and if there is continued improvement in market access, the New Zealand Dairy Board is positioned to take advantage of opportunities to substantially increase sales and profit in the future. What happens, however, depends on what the New Zealand government decides concerning the future role for the Board.

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