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Driving a Fishery along the Bumpy Ride of Today's Globalization: The Case of the Australian Southern Rock Lobster Association

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Abstract

The case of the Australian Southern Rock Lobster Association describes real issues faced by the Market Development Manager of a collective agri-food organization (SRL) representing all the southern rock lobster fishermen in Victoria, South Australia and Tasmania. The case deals with recent globalization issues faced by the Australian rock lobster industry: the rise of China as a vital and risky market of high-end food products; the financial crisis that affected the US starting from 2006 and the rise of sustainability issues that constrained the rock lobster supply. This case is designed for advanced BSc and MSc in agribusiness and international business. It is relevant for both for strategic management and supply chain management courses. In this case, managers, policy-makers and academics find challenging questions that are still open and can be similarly posed to other agribusiness industries worldwide attempting to compete collectively in international markets.

Keywords: lobsters; seafood; Seafood CRC; China; Australia; US market.

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IFAMA Agribusiness Case 15.4

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“I am young and intend to be in this business for long time. I think about where this industry is going in the future—not only next year—but more importantly, where we will stand thirty years from now.”

Matthew Muggleton, Market Development Manager, Southern Rock Lobster Limited

Introduction

Matthew Muggleton, is the Market Development Manager of Southern Rock Lobster (SRL) Limited, an organization representing the fishermen’s associations in the states of Victoria, Tasmania and South Australia. Matthew is a charismatic self-starter who has been working with SSL Members since 2003 to raise awareness on the following key points:

1. Selling the most precious product category (lobsters weighing 2 kg or less <2kg) to one single channel (importers in Hong Kong) and to one single market (China) was too risky. Therefore, *diversifying into new markets* with complementary products through other channels was necessary.
2. Helping members see how they are better off working together rather than competing to develop *a collective brand* on Australian Southern rock lobsters in a highly differentiated market designed to move the fishermen from commodity suppliers to marketers.
3. Linking Australian fishermen and the *lobster supply chain* to new markets must be adapted to fit the collective brand strategy. Moreover, changing market conditions may require further adaptive changes in the supply chain.

Supported by the financial backing of SRL members and the public Research & Development (R&D) agencies at the state and national level, Matthew connected their product (lobsters larger than 2 kg, >2kg) with the market channel: the Super-Premium Fine Dining (SPFD) sector in the US in 2006. He spearheaded the logistics, brand-marketing process and established the market channels into the US between 2006 and 2009.

Yet, things did not go exactly as Matthew expected. Until 2009, the revenues yielded from the US SPFD sector did not cover the costs of transporting and distributing live lobsters to the West Coast restaurants. At the same time, increasing the quantity supplied in order to lower the average costs was not an option for the following reasons:

1. A progressive reduction in the harvesting quota to prevent depletion of the existing lobster population was self-imposed by SRL members since 2008 (see detail on SRL harvesting quotas in Section 2 below) and;
2. All the lobsters below 2kg were already sold to Chinese importers in Hong Kong, which was guaranteeing enough profit margins to fishermen. So there were not enough lobsters available to be sold in the US market. When in 2009 he founded his own distribution company in the US acting as market platform for SRL and selling a basket of seafood products to a broader range of customers, the number of Matthew’s detractors increased, accusing him of pursuing his own interests rather than the interest of SRL.

Responding to these pressures and complaints, Matthew responds adamantly, “Opening up an alternative market channel to China was crucial for our lobster industry, and we did it. So far we made little money, but we secured an alternative market channel for our lobster supply.” And looking towards the future: “We need to keep the channel open. If we have no lobsters, we keep selling other selected products from our basket. The important thing is to maintain the relationships built with customers. Shutting the channel down would be a real waste of money.”

Although most of the Australian lobsters are currently bought by the Chinese market, Matthew believes that an alternative channel in the US needs to be ready to absorb the Australian lobster supply should future shocks occur in the Chinese market, (see detail on historical trends of Chinese demand for Australian lobsters in Section 2).

According to Matthew, a further investment in relationship-building and brand communication is needed with continuous support by the public R&D institutions and by the SRL members to keep this second US SPFD channel open. Today, Matthew is willing to consider alternative opportunities of market diversification along with the US SPFD sector. He knows that he could have made better and decisions in the past and is willing to learn from past mistakes. He must now make strategic decisions for his future and that of the Australian lobster industry.

The case study is organized as follows: the next section provides background information on the southern rock lobster, the Australian Fishermen Association and its status in the early 2000s. Details are provided on the SRL between 2003-present and final section discusses the problems currently faced by Matthew, SRL and their stakeholders.

Southern Rock Lobsters and the Australian Industry

The southern rock lobster (*Jasus edwardsii*)—also called red rock lobster or spiny rock lobster, is a species of spiny lobster found throughout the coastal waters of southern Australia and New Zealand. Rock lobsters resemble common lobsters (*Homarus Americanus* and *Gammarus*), but lack the large characteristic pincers on the first pair of walking legs (Figure 1). Mature Southern rock lobster can weigh from 800grams up to 10 kg, although the most valuable are considered the ones below 2 kg. Chinese restaurants value lobsters below 2 kg more since they are easier to stock and serve in plates. Also, Australian consumers can freeze smaller lobsters in their houses especially for use at Christmas dinner or similar events.



Figure 1. a. The American Lobster (*Homarus Americanus*). b. The Southern Rock Lobster (*Jasus edwardsii*)

Internationally, Southern rock lobsters represent a narrow minority of world lobster production and therefore a rare and highly valuable crustacean. The world production of rock lobsters (including both western, southern and eastern rock lobsters) was equal to 26,000 tons, which is around 6% of the total world production of all lobsters equaling 430 million tons in 2006 (SRL 2012). Australia catches more than half of the rock lobster production, with 16,000 tons in 2006 and the remaining 10,000 tons caught in New Zealand. Out of these 16,000 tons, only 4,500 tons are Southern rock lobsters: they represent a well-defined niche, with a slightly harder meat due to the colder ocean water which is widely recognized by its *habitué* consumers. While the average price across all types of lobster equaled 15 AUD/kg for frozen and 20 AUD/kg for live in 2006, the average price of southern rock lobster equaled 25 USD/kg for frozen and 33.3 USD/kg for live. However, the price of southern rock lobsters varies significantly depending on the color, size and seasonality. Specifically, prices decrease during the harvest season (from November to April) as there is more availability. The days preceding Christmas are an exception, since prices rise sharply due to increased demand. In contrast, prices increase when supply decreases between April and October.

Because of its high value, the southern rock lobster industry is the most valuable wild-catch fishery in Australia, making up 54% of the total value of exports of crustaceans and mollusks. The southern rock lobster industry in Australia comprises around 700 small owner/operator businesses across three states: South Australia, Tasmania and Victoria (Figure 2 and 3), plus only a few operators in Western Australia. The impact of the southern rock lobster industry extends beyond the initial effects of the income received by the fishers at the wharf, flowing on through the purchases of inputs such as fuel, bait, boats and services. It is estimated that for every fisher catching southern rock lobster, another seven jobs are created (Seafood CRC 2012).



Figure 2. The catching area of Southern Rock Lobsters in Australia

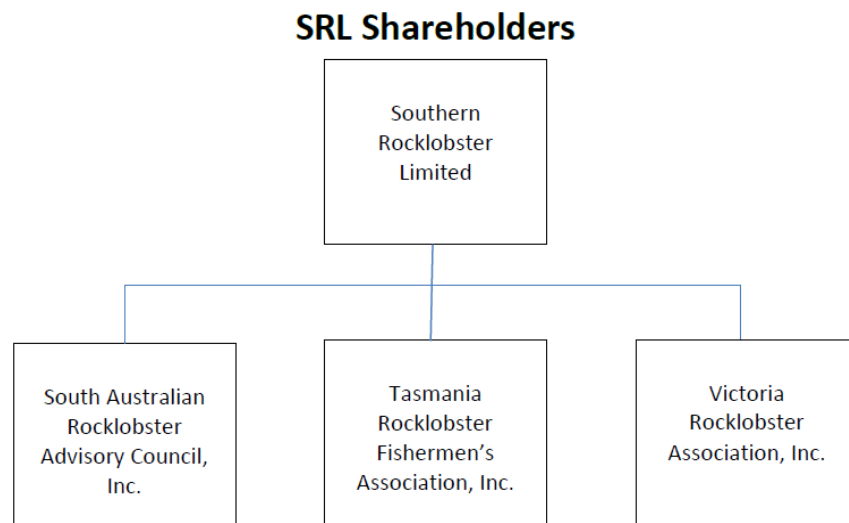


Figure 3. The structure of the Southern Rock Lobster (SRL) Association in Australia

Despite its high value and importance for Australian economy, both the quantities produced and the price of southern rock lobster have been strongly fluctuating in the latest ten years, creating problems for the sector and for the entire upstream chain (see Appendix, Exhibit 1). Production volumes of rock lobsters were highest in 1999/2000 at 20,000T. They reached a low of 14,000 T in 2001/02, came back to almost 20,000 T in 2003/04 but have dropped back to under 14,000 T in 2007/08.

Southern rock lobster prices have also been fluctuating strongly since the late 1990s. Nearly 30% of these were southern rock lobsters. The value of southern rock lobsters was highest at the start of the 2000s with 633 AUD million in 1999/2000. Then the value dropped to its lowest point of 516 AUD million in 2003/04. It stabilized to reach 560 AUD million in 2005/06 but dropped down to 512 AUD million again in 2007/08. Consequently, the lives of fishermen and their employees become difficult and uncertain when the production value of southern rock lobsters and the related profit shrinks.

Starting from 1993 and 1995, the South Australia, Tasmania and Victoria introduced a harvesting quota on southern rock lobsters, which is commonly referred to as Total Allowable Commercial Catch (TACC). TACC was part of a fishery management system including a combination of input and output controls to avoid the depletion of marine biomass. Along with the TACC, these controls include limited licenses, restricted seasonal harvests (depending on the year, around 100 days sometimes between November and April), equipment gear restrictions and requirements, a minimum size limit of 0.8 kg (but no maximum size limit) and a monitoring system requiring documentation and real time reports to license holders. Year-by-year, the state governments in consultation with the industry agree on TACC increases or reductions. Based on the recommendations of the local university, Tasmania voluntarily reduced TACC in recent years, from 1,524 tons in 2008/2009 to 1,103 in 2011/2012 (Gardner et al. 2011). This was mainly a decision taken to reduce the increasing harvesting costs (measured in terms of catch per unit of effort, CPUE), which increase as the number of lobsters in the ocean is decreasing

(Appendix, Exhibit 2). On the other hand, South Australia maintained the TACC at 1,900 tons/year throughout the 2000s.

There appeared to be a slightly negative correlation between the quantity of catch and the price of southern rock lobsters, although, catch volumes were not the only factor determining price fluctuations. China represented around 90% of the total market of Australian southern rock lobsters and 99% of exports. Importantly, China imported the most expensive and demanded they be: live, of intense red color and only smaller than 2kg. As a result, price and revenues from Australian southern rock lobsters strongly depend on factors affecting China. For example, SRL managers and industry experts are convinced that the SARS outbreak in China in 2002 was the major cause of a 50% collapse in the price of live lobsters in China. According to SRL managers, the decreased consumer spending and the fear of food contamination led to the collapse of the restaurant trade in Hong Kong and China which in turn impacted the industry. Such a market shock in China provoked a drop in the international price for live lobsters from 38 AUD/kg to 25 AUD/kg, with an estimated fall in the value of export revenues to 50 AUD Million, in 2003/ 2004. After the market shock, in 2004 SRL members asked that something be done at the national level to stabilize their lobster price in the years to come. In particular, a market for the lobsters larger than 2kg which were not demanded by the Chinese market—could be a product receiving better prices than in the domestic Australian market.

In light of these events, Matthew decided to take the lead in driving a change process in the marketing of the Australian lobster industry. In a strategic meeting with SRL in late 2003, he presented his challenge to the members: “We need to make a choice,” said Matthew. “Do we want to remain disorganized victims of food-industry globalization at the mercy of price setters who control the market by offer buyers a cheaper generic product?”

He was referring to the status quo, where one hundred competing small exporters were individually selling all their lobsters to China with no incentive or need to develop markets. And then he suggested his vision: “Or we can become organized and develop markets and new value-added products thereby creating upward price pressure and further growth for our industry.”

In his view, industry development was contingent upon coordinated investment at the whole of industry level to enter an alternative market channel with a currently undervalued product (lobsters >2kg).

The route identified by Matthew, although still vague, found a broad consensus among the SRL members and its Executive Director. The Executive Director said, “Over 90% of SRL product is exported live into the Asian region, with the majority sent to Hong Kong and China, however we recognize that we have the potential to secure ourselves as a super-premium fine-dining product in other countries.”

The SRL association was funded for research projects by the Fishery Research and Development Corporation (FRDC) and the Department of Agriculture, Forestry and Fisheries (DAFF), a national public R&D body and the Ministry—to explore opportunities for alternative export markets (Appendix, Exhibit 3). The goal of the project was to identify a viable strategy to diversify the portfolio of SRL markets and so to reduce the risk of dependency on the Chinese customers.

Juggling Lobsters in the Global Market

Exploring and Entering the US Super-Premium Fine Dining Sector (2004-2007)

With the support of the Market Development Program research funded by FRDC in 2004 and conducted by one university and one consulting company, SRL selected the US SPDS as its target to market southern rock lobsters >2kg. “It is hoped that the success of the trial will lead to a ‘trickle down’ effect amongst the Australian southern rock lobster industry, and increasing utilization of the system will benefit the whole chain,” said an authoritative SRL member, in 2004.

The US market was chosen because: 1) data showed evidence that high-end US consumers would highly value Australian southern rock lobsters relative to local varieties in super-premium restaurant settings. In particular, the research concluded that the high-end segment of US consumers would give value to lobsters having a brand identity based on place-of-origin, sustainability, traceability, guaranteed top quality, freshness and a perception of direct links with the fishermen. 2) the super-premium fine dining sector would probably not be affected by the possible negative trends in the US economy; 3) the US market, especially the West Coast, is relatively closer to Australia both geographically and culturally. The US market was assessed as culturally closer than China and South and South-East Asia.

The results of this market research led to the implementation of a second R&D project, which was funded by Seafood Cooperative Research Center (CRC) between 2006 and 2009. The project aimed at developing the concept of an SRL commodity brand in the US market and to test the feasibility of establishing an efficient distribution platform to serve restaurants, casinos and deli stores on the West Coast. Based on the opportunity sought and assessed by SRL, the Executive Director of the Seafood CRC funding the project claimed, “The Seafood CRC project is expected to contribute AUD\$ 45-50m per annum towards the AUD\$ 90 Million target. “Not bad for an investment of AUD\$ 1.78 Million over the next three years.”

To reach their goal, the SRL directors and Matthew first designed a product which was expected to match the demand of the US market. First, SRL coined and registered the label Clean Green Australian Southern Rock Lobster (Appendix, Exhibit 4). To strengthen US consumers’ perceptions of sustainability, SRL also applied and obtained the Marine Stewardship Council (MSC) certification. MSC is a global non-governmental organization (NGO) which has developed standards for sustainable fishing and seafood traceability. Both standards are based on independent third-party assessments by accredited certifiers. The MSC’s fishery certification program and seafood labels aim at recognizing and rewarding organizations adopting sustainable fishing practices.

Roger synthesized for the SRL members, “The MSC label provides an immediate branding solution and product awareness in numerous international markets,” said Roger. “Our organization is investigating various means to increasing demand for our lobster and spread market risk. Certification of our fishery by the MSC is a potential tool for achieving this.”

Moreover, Matthew and his SRL partners developed a traceability system. “Field trials have confirmed the practicality of the horn tag as part of the project when used in conjunction with a prototype mechanical tag applicator,” said Matthew. “The chefs have reinforced that traceability is an essential element for such a high value product,” he added. Through such a traceability system, consumers in restaurants and deli stores would be able to know exactly where their lobster was fished, and by whom. This would create a consumer perception of a fresh, authentic product which is directly transferred “from the pot to the plate” (the pot is the tool used to fish lobsters). Working jointly with such a traceability system, Matthew established a method of guaranteed quality with for their potential US customers: only the best lobsters were actually sold, while damaged ones were excluded from the deal (Appendix, Exhibit 5).

Finally, Matthew and the R&D project team organized workshops and meetings with chefs and restaurant owners in San Francisco and the Napa Valley, Los Angeles and Las Vegas. These meetings allowed them to test whether the designed product would work. In commercial jargon used among chefs and restaurants in the US, Matthew and Roger defined the >2kg lobsters that were going to the US as live, porcelain Southern Rocklobster jumbos. “SRL is committed to achieving its goals through an extensive education and development program designed to facilitate relationships with US chefs and reinforce the premium product quality message,” claimed Roger, in late 2006 (Appendix, Exhibit 6).

However, by the end of 2007, although much relationship-building with US customers was realized, only 18 restaurants started regularly procuring an average amount of 10kg of live lobsters per week. To some extent, this is not surprising as Matthew commented, “These R&D projects could only fund the pilot launch of the commercialization project, not the full scale rollout phase; and this is what we did. Now, we need to move on and reach our distribution target in this market.”

However, he also recognized that dealing with celebrity chefs and customers in the SPFD sectors was more challenging than he expected. “The market goggled,” said Mathew. “I have been requested to provide samples, samples and samples, but not often has this turned into a signed contract.”

Part of the difficulty of closing contracts depended on the fluctuating exchange rate conditions (from 0.68 in mid-2004 to 0.95 in mid-2008), which made Australian products sold in the US significantly more expensive (see historical trend of AUD/USD exchange rate in Exhibit 7).

Australian Lobsters to US: Transformations in the Supply Chain (2006-2010)

In order to sustain such a commodity brand strategy for market diversification, Matthew and the SRL leaders had to drive a number of changes in the supply chain between 2006 and 2009. These changes took place after the market research in the US was conducted starting from the negotiation process with targeted US customers (2006-2007). Based on the market trials, further changes in the US lobster distribution platform were made (2008-2009).

First, Matthew led the implementation process of the *Fisher direct program*: SRL license holders maintained product ownership and therefore commitment through to the customer. Along with SRL leaders, the Executive Director of the Seafood CRC believed that this would generate real

industry impact: “What makes this project innovative is that fishers will retain ownership of the product through to its final sale,” said, Matthew. “Consequently bringing higher wholesale returns back to Australia for the fishers and processors to share,” he claimed in late 2006.

SRL leaders were aware that this was a “high risk and high reward” game for their members. It utilized a different model than the chain into the Chinese market (taking 99% of exports), where importers become owners and bear the risks on the product. Live lobsters were distributed by SRL industry-managed distributors contracted by Matthew instead of large importer gatekeepers as in China. In such a way, Matthew could monitor the transport process and the quality of the live lobsters arriving from Australia into the West Coast ports.

Yet, in the first months after operations to the US started, it turned out to be difficult to assure that no damages would occur to live lobsters transported and distributed to the US. This generated controversies between the SRL fishermen and the distributing companies. To solve the controversy, Matthew established an SRL trade facilitation division (including tanks to conserve the live lobsters and issued the necessary insurance contracts) in California to guarantee the promised quality by facilitating transport until the product arrived at the US customers’ door. Moreover, SRL issued insurance against the risk of damages to live lobsters during transport.

A second change in the supply chain was attempting to redirect the available volume of live lobsters to the US market. Supplying lobsters >2kg in the US market was a voluntary initiative left to the license holders. In any case, fishermen were encouraged to support the strategy in the US market. Therefore, once the US SPFD channel became a marketing option for the fishermen, each SRL member had to choose whether to continue harvesting and selling only <2kg lobsters to China or to attempt harvesting and selling >2kg lobsters to US. On one hand, <2kg lobsters to China could guarantee an established high price for a smaller per unit quantity sold. On the other hand, supplying >2kg lobsters to US offered a possible (although still uncertain, since the market was under development) higher price for a larger per unit quantity sold (since the lobsters are bigger, so more kg are sold). So the US market offered an appealing alternative to the SRL license holders: with a fixed licensing quota limiting the number of harvested lobsters, they could sell more kg of lobsters in the US by simply selling larger animals. Plus, to make the US SPFD channel run and expand, the SRL marketing manager really needed a sufficient quantity of lobsters to be redirected from China to US.

“Success will depend on industry commitment to supply,” said Roger in early 2007. “Adopting such market approach represents a major and fundamental change for the industry from a catching mentality to that of a niche marketer,” he added. Another SRL member said in 2007: “I am now convinced that commercial market alternatives are available to the industry, but to develop and secure them will require long term industry commitment to guarantee supply. Indeed the international market development program success depends on industry commitment to supply new markets, in spite of large fluctuations in beach price as we have once again experienced this season.” This was indeed an issue for SRL lobsters.

Many fishermen perceived the incentive to sell lobsters to the US as too uncertain weighed against the risk of having their lobsters damaged in the transport to US. Therefore, a number of SRL members preferred to fish and continue selling their lobsters <2kg to China and direct the

lobsters >2kg to the domestic market or to keep them under water to minimize risks. This was a point of lively debate among the SRL members. In favor of keeping the US channel option open.

“If the potential is to supply, say, 10% or 500 tons of live large porcelain lobster into the USA, how do we guarantee the chefs we will meet the supply when they want it?,” Roger asked. “Is it the usual volunteers committing part of their catch (...) or is it partitioning part of the quota?” Roger concluded, “Whatever the answer, innovation is needed immediately and my challenge and request to you is to put forward ideas on how individually and as a whole industry, up to 10% of the catch can be secured for developing new markets and then maintaining them long term.”

By the end of 2007, Matthew and SRL leaders realized that the quantity of live lobsters sold was not sufficient to make per-unit costs of transport and distribution low enough. An independent review of the SRL market development program commissioned by Seafood CRC computed that - given the current per-unit costs the SRL must source at least 500 active restaurant customers in the USA to achieve the breakeven international sales volume in the following three years (from 2008 to 2011). This conclusion was based on the assumption, estimated with Matthew, that each active restaurant customer would buy an average of 500kg of Southern Rock Lobster per annum, or approximately 10kg per week (that is 250,000kg/annum = 250 tons). An average export value of approximately 72AUD/kg so far was achieved and a beach price paid to fishers of 35AUD/kg had also been achieved. Quite challenging, considering that the forecast total quantity sold by mid-2008 was around 14,000kg/annum.

According to an independent reviewer in order to reach such a scale the market development team of SRL would have been required to add an average increase of 3-4 restaurant customers per week, every week—for the next three years. The reviewers concluded that the commercialization of the market research will require a significant investment in market development over the next three years, and certainly a greater resourcing than has currently been committed to date is needed to achieve commercial success. The reviewers also commented that with the current business model and the current issues with the demand, reaching such full scale within three years was unlikely. Proposing an alternative business model was outside the scope of the review, but ultimately some radical changes were recommended to effectively enter the US market.

In light of the current challenges affecting both the demand and supply of live lobsters, Matthew, with the consensus of the SRL board, decided to undertake a swift change in the business model. Matthew’s decision was also influenced by the impact of the financial crisis on the US food service sector: he estimated that the sector would decline 30-40% within the two following years (2009-2010). At the same time, the beach price of live lobsters reached its peak due to increasing demand from the Chinese market. Considering the unfavorable market conditions for the live lobster business in the US, he felt it would be difficult to increase the number of customers consistently in the next three years.

By early 2009 Matthew was ready to change the business model again. He needed to find a way to make the market channel in the US financially sustainable, as the financial support by public R&D agencies was coming to an end. As the live lobsters were not profitable enough under the

current market conditions, he switched to exporting processed lobsters. In agreement with the SRL leaders, Matthew decided to expand the product range: along with live lobsters, SRL started exporting lobster ravioli, bisque, frozen steaks and portions. To create enough scale, he also diversified the basket of seafood products, including processed Australian kingfish, mulloway and tuna and New Zealand shellfish.

Product diversification created the need for further changes in the supply chain. Matthew started exploring alternative channels to the SFPD sector, including deli stores, local retailers and the traditional Chinese food service sector in the US. He created SRL Marketing USA, a distribution company owned by himself in which SRL Australia held a purchase option of 50%.

He acted as both the SRL marketing manager and an independent distributor of Australian seafood products in the US market. According to Matthew, this allowed SRL to capture the commercial benefits and provided a mechanism to provide a self-funding model to undertake market development and promotion beyond the life of the CRC. While the other seafood products were only distributed rather than processed, SRL contracted with an Australian company to process lobsters into ravioli, bisque and portions.

However, selling processed lobsters as part of the product line was not a significant source of profits for SRL members. Only 3.2 kg of lobsters were sold in the US by mid-2009. At the same time, 3,576 kg of other seafood products were sold. One year later, the business expanded to sell 7,300 kg but lobsters represented still around 40% of the quantity sold. From Matthew's perspective, this could be considered a first success. Within three years, he was close to establishing a self-financed distribution system of Australian live and processed lobsters in the US (Exhibit 8 and 9).

At the same time, in front of a large public and private investment made since 2006 without return to the lobster industry, some SRL members and public R&D agencies started criticizing Matthew's strategy. Some SRL members commented that SRL Marketing in the USA became nothing more than another export-import private company dealing with the US. Others expressed concerns regarding Matthew's ownership of the US distribution company and the benefits gained by himself rather than by the industry. In general, given the rapid changes which had occurred along the chain within a few months, some SRL members lamented a scarce flow of information about the most recent US activities. Matthew's detractors demanded to stop any public and private investment for lobsters in brand marketing and relationship-building activities in the US and to shut down the channel. Given that the quantity of southern rock lobsters sold in the US market— both live or processed – was never substantial, public R&D agencies considered the US market development program a major failure. Matthew's detractors demanded they stop any public and private investment for lobsters in brand marketing and relationship-building activities in the US and channels be shut down.

To these pressures and complaints, Matthew responds firmly, "Opening up an alternative market channel was crucial for our lobster industry, and we did it. So far we made little money, but this is just the start. At the moment, we have secured an alternative market channel for our lobster supply and started managing our market risks." And toward the next future, "We need to keep the channel open. If we have no lobsters, we keep selling other selected products from our basket. The important thing is to maintain the relationships built with customers. Shutting the

channel down would be the real waste of money.” By the end of 2010, he was busy again discussing the options to expand the US channel with the SRL members and the R&D agencies.

Australian Lobsters to China: A Need for Change?

The US market experience that Matthew Muggleton and SRL leaders experienced between 2004 and 2010 caused members to rethink the importance of the Chinese market. China and Hong Kong not only account for almost 80% of Australia’s annual exports of rock lobster and 97% of Australian southern rock lobsters, finding alternative markets and new channels such as in the US may be an expensive, long-term, and uncertain.

Many SRL members that lamented Matthew’s strategy in the US argue whether developing new markets provide a true advantage over the current Chinese export market. Is it worth trying to develop new markets for the Australian southern rock lobster industry? A number of SRL members exporting directly to China are convinced that other markets aren’t willing to pay more for lobster than the Chinese because lobster is used as a celebration food for weddings, birthdays and the Chinese New Year. Furthermore, market trends show a booming growth in the food service sector in urban China which analysts forecast will eventually make the Chinese exchange rate for Australian products more competitive than in the US and Europe (see the historical trend of AUD/Chinese Yuan exchange rate in Exhibit 10).

These questions remain open as the status quo in China is continuously challenged. At the end of 2010, China banned the entire import of rock lobsters from Australia, including the Hong Kong ports. The import ban was intended to stop illegal trading of Australian lobsters from Hong Kong to China. According to current Chinese regulations, Australian lobsters shipped directly to mainland China are subject to an import tariff of 10% plus a value added tax (VAT) of 13%. Instead, Australian lobsters shipped to Hong Kong are subject to no tariff and no VAT. Moreover, since 2003, (when the Closer Economic Partnership Arrangement was signed) Hong Kong can sell goods produced exclusively in its territory to mainland China with no import duties. This implies that Australian lobsters sold to mainland China through Hong Kong ports could avoid the import tariff and VAT only through illegal trading. The unexpected ban could not have come at a worse time, during the start of the harvesting season (November) and close to Christmas, when Chinese demand sharply increases. Although the ban was subjected to further discussion between Chinese and Australian governments and then partially amended in mid-2011, the event re-confirmed the risks associated with the current export market through Hong Kong—although profitable in the short run.

The recent export ban of rock lobsters in China has encouraged SRL and its members to think about how to develop alternative and transparent market systems with customers in the food service industry of urban China. Is there an opportunity to brand the fish inside China? In the current export system through Hong Kong, Australian fishermen can only be price-takers as no brand is attached to the product and no relationships are built with the downstream chain. If import duties are not paid on the product, the origin of lobsters cannot be traced and certified downstream.

Perhaps the Australian abalone industry provides an example of how to brand a high-value Australian seafood product in China. The Australian abalone industry has also traditionally exported the majority of its live product through Hong Kong to avoid import duties. To diversify

risk, the Abalone Council of Australia with the support of a Chinese-based marketing company, started a 1.8 million AUD initiative funded by the Seafood CRC to develop a direct, long-term, sustainable, origin-certified abalone trade route between Australia and China meeting the Chinese import tariff of 10% plus 13% VAT. Similar to the southern rock lobster case in the US, the Australian abalone industry is in the process of building relationships with customers and market/sale partners in China. The process takes time and is the subject of controversy. Although, employing a similar strategy could also be a plausible direction for the southern rock lobster industry to follow.

Conclusions

It took Matthew more than three hours to present the entire story of how the SRL is building a collective brand in the US, transforming the chain, and looking for alternatives to the status quo both in the US and Chinese markets. In the past eight years, he played a major role in changing the Australian rock lobster industry culture and strenuously attempted to build consensus around the next actions to take.

Today, Matthew's execution plan remains the subject of controversy among SRL members and public R&D officers. On one hand, making fast action-oriented decisions and adapting to rapid change is the essence of entrepreneurship and innovation. Yet, when designing a strategy for an entire industry and building a collective brand, building consensus, timely and transparent communication is vital to achieving the goals the organizational goals. Matthew invested his energy and enthusiasm into making a difference for his association and their product. Yet, looking back, he realizes he could have done things differently. Several decisions would have had better outcomes if evaluated more carefully.

In the strategies Matthew pursued, could he have done something differently? He was accused of making swift changes putting his personality and energy in front of the doubts and critiques of a minority of SRL members and R&D officers, but isn't this the role of an entrepreneur? At what point should an entrepreneur facing a turbulent international market take the time to discuss the issues with stakeholders before making necessary changes? Which situations could have involved more experts, informed stakeholders and dialogue before taking decisions? "I am glad to discuss the details of what we have done so far," said Matthew. "The more I discuss this with people involved in this business, the more I learn from this story. It will help us do our business better tomorrow."

Looking back, some SRL members and R&D officers think that attempting to open a direct and transparent channel of southern rock lobsters with Chinese customers was the direction that should have been taken in 2004. But who could have forecasted the changing conditions in the US and the turbulent times of the last seven years back in 2004? Was the market research and the collective brand development strategy implemented in the US wrong? Where were the mistakes made in the supply chain transformation to adapt to such a changing context? Which decisions should have been taken in order to have a higher and less expensive penetration in the US market?

These are not rhetorical questions for Matthew. He is looking at his own story in order to make better decisions to design tomorrow's strategy for SRL and for his SRL Marketing Company in the US. Would it make sense, as some of his detractors suggest, to shut down the US channel now that investments are made, relationships with customers are built, and contracts with processors and clients are signed? Apart from his personal interest in it, shouldn't the US channel indeed be considered a risk management tool that diversifies from uncertain Chinese exports? With a duplicable prototype, Matthew can imagine opening other channels for SRL internationally. If a direct and transparent Chinese market alternative to the current sales through Hong Kong is the preferred option to follow, what are the next steps that Matthew should take? What should he do similarly to or differently from the US experience in terms of market research, collective branding and transformation of the supply chain?

Matthew is interested in hearing these questions discussed. The answers would be opinions and suggestions from international experts that have no vested interests in the southern rock lobster business.

Acknowledgements

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Note

The content provided in this case is based on authors' interpretation of primary and secondary data collected during interviews with the major stakeholders involved in this case. The interpretation reflects solely the opinion of the authors, who take full responsibility for the information and interpretation provided in this case.

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Appendix

Exhibit 1. Gross Value of Production (GVP), price and catch indices for the southern zone of Southern Australia Rock Lobster fishery (1990/91=100) (EconSearch 2011, 6)

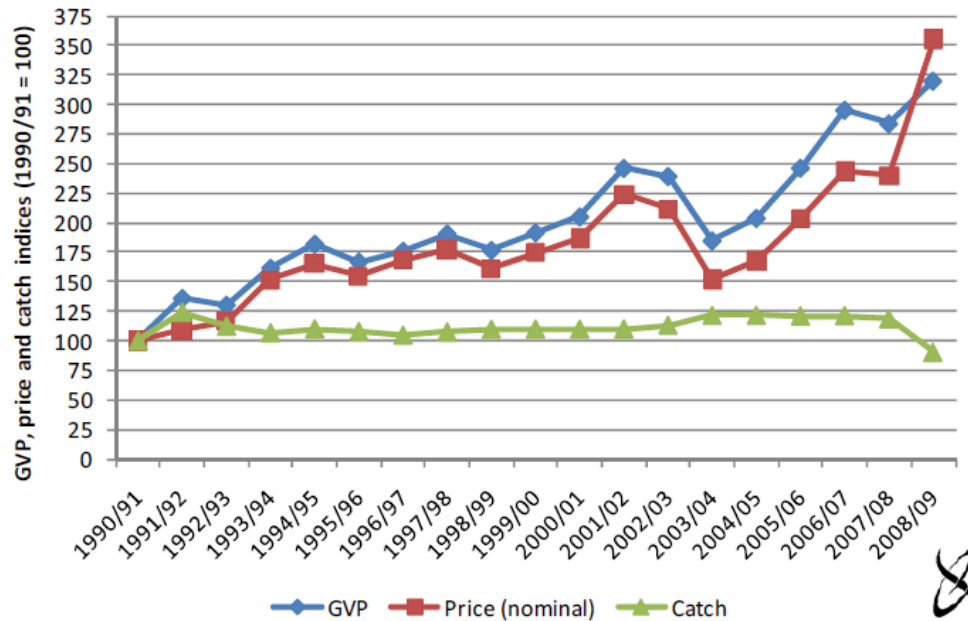


Exhibit 2. Historical trend of Total Allowable Commercial Catch (TACC) and Catch per Unit of Effort (CPUE) in Tasmania between 1970 and 2010 (Gardner et al. 2011, 9).

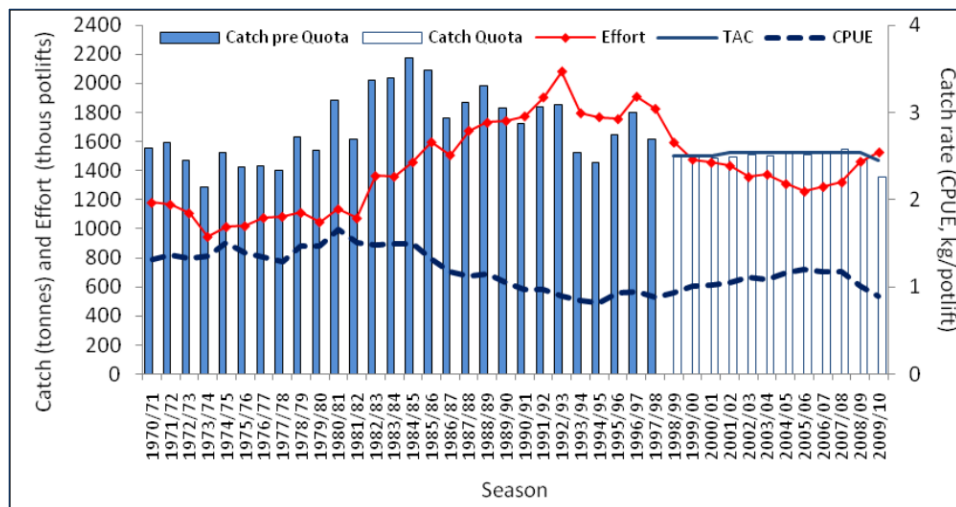


Exhibit 3. The list and outcome of projects funded by Australian public stakeholders to support SRL market diversification strategy (based on discussions with Matthew).

Date	Item	Outcome
1999	South Australia industry project: <i>Planning for Future Competitiveness</i> (Reld and Spawton, Univeristy of South Australia)	Set broad direction for development (“ <i>whole of species</i> ” and value chain analysis)
2001	Improved management of Southern Rocklobster R&D (FRDC Project 2001/072) Morgan	Recommended: National approached to industry R&D investment
2002-03	<i>Southern roc lobster R&D plan and subprogram development</i> (FRDC 2002/313) Coldhoun	Southern Rocklobster Strategic Development Plan Priority Investments: <ul style="list-style-type: none"> ▪ Establish industry R&D entity ▪ Market Development
2004	Southern Rocklobster Limited (SRL) Formed	Raised AUD\$ 240,000/annum for 5 years with 25% funded through levies from SRL license holders for new R&D investment
2005	FRDC Memorandum of Understanding (MoU)	5-year R&D planning and management agreement and extension program budget of AUD\$ 180,000/annum
2005	FRDC Project No.: 2004/251. Identification of new market opportunities for Southern Rocklobster.	
2006	Implement and establish the USA market development platform to enable trade of Certified Clear Green	Platform and Certified Clear Green delivered to industry
2007	Seafood CRC Project 2007/704: “Assessment of new market opportunities and development of effective market penetration strategies for Australian Southern Rocklobster in the USA, Middle East and Europe.”	To be determined

Exhibit 4. The Clean Green Australian Southern Rock Lobster label introduced in the US market since 2006 (from SRL Newsletter).



Exhibit 5. Specifications of the Guaranteed Quality Program in the US (from SRL Newsletter).

Product Specification - USA

Product Specifications

Product Name	Atlantic Porcelain Lobsters
Characteristics	Larger than specified lobsters
Example of Manufacturer	Atlantic
Origin	Canada
Colour	Specified (Shell) / Translucent (Meat) (See Example 1)
Branching	If any branch is visible, it is to be attached to the tail base above the first joint (See Example 2)
Tail	Female without scud
Size	2.5 - 3.5 lb. (European Long Tail Lobster - approx. 1.5 times)
Shell/Meat/Tail Strength	One pronged tail and/or spreading of appendages within 5 seconds (See Example 3)
Tail Shape	No notch allowed in shape between the top (directly below the Carapace) and base of tail (See Example 4)
Shell Hardness	Shell to be firm on touch
Harvested	Between Tail Emission and 1200 Temperature from South of 40°N, Louisiana to Alaska
Appendages	All appendages intact (See Example 5)
No Damage	No damage to Carapace, Legs, Terebra, Rostr. & Tail (See Example 6)

Colour 1

Branching 2

Shell/Meat/Tail Strength 3

Tail Shape 4

Appendages 5

No Damage 6

Labsters are tagged to be in premium condition

tail damage

shell damage

appendage damage

Clean Green Product Specs

Exhibit 6. An example of education and communication workshop on live porcelain jumbo lobsters taking place in California in late 2006 (from SRL Newsletter).



Exhibit 7. Historical trend of AUD/USD exchange rate between 1999 and 2011.

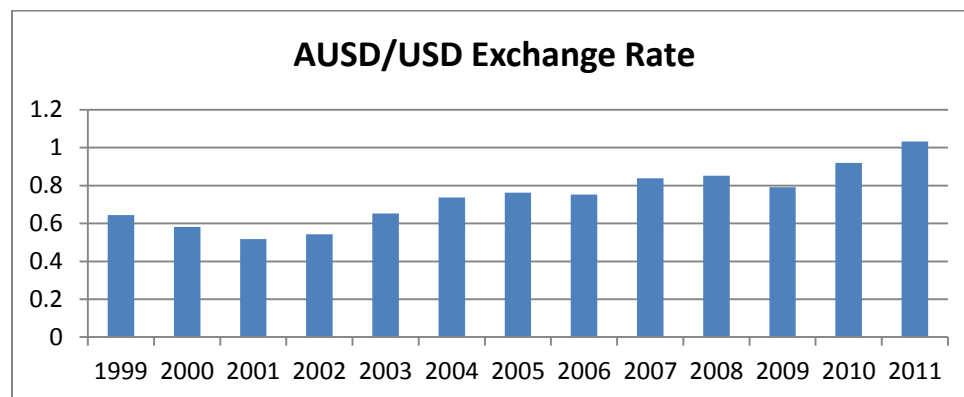


Exhibit 8. SRL processed lobster products sold in the US in 2009-2010 (Status as described by Matthew, elaboration based on discussions and reports to Seafood CRC).

Value-Added Item	Status
Southern Rock Lobster ravioli and bisque (food service package) made and packaged in the USA	Developed product received excellent customer feedback regarding taste, quality and flavor. Price point was restricting business.
Southern Rock Lobster ravioli (retail package, 7oz) and bisque (retail package, 7oz and 10 oz) made and packaged in the USA	The first commercial product was produced in February and March 2010. The next step is to seek a market feedback.
Southern Rock Lobster green raw leg and knuckle meat (500 grams) made and packaged in Australia	Market feedback from trails with customers in Australia was excellent based on taste, texture and quality. This product adds further value to the food service sector as it saves labor costs.
Southern Rock Lobster fresh (never frozen) tails (5kg package) made and packaged in Australia	Market feedback from trails with customers in Australia was excellent based on taste, texture and quality. This product is Rock Salt Frozen and produced only from live lobster. The outcome is high-end sashimi grade and optimal freshness.
Southern Rock Lobster stock package with green shells and tomalley (500 grams) made and packaged in Australia	Produced during the product yield trials, but limited market feedback to date.
Southern Rock Lobster frozen steaks (2-3, 3-4, 4-5 and 5.5oz) made and packaged in Australia	Product concept, but not commercially produced at this stage.

Exhibit 9. SRL financial and commercial results in US and Australia between 2007 and 2010 (status as described by Matthew, elaboration based on discussions and reports to Seafood CRC).

	2007/2008	2008/2009	2009/2010
SRL facilitated commercial sales	AUSD 749,475	AUSD 566,416	AUSD 1,334,942
Margin available to pay platform resources	AUSD 54,649,000	AUSD 76,836,000	AUSD 140,000
Margin percentage of total sales value	7%	14%	10%
Southern Rock Lobster volume traded (kg) inUS	4506	3191	7,300
Southern Rock Lobster volume traded (kg) in Australia	6007	1204	300
Other seafood volumes traded (kg) in USA	0	3575	37,000
Seafood CRC Project 704/2007 expenditure	AUSD 661,517	AUSD 674,772	AUSD 485,000

Exhibit 10. Historical trend of AUD/Chinese Yuan exchange rate between 1999 and 2011.

