Submission to the Agriculture and Food Policy Reference Group

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1. Background to RCS

Resource Consulting Services Pty Ltd (RCS) and its associated companies are the largest domestic agribusiness consulting group within Australia whose work is primarily focused on improving the performance of rural businesses.

The RCS system is based on providing high quality training and support programs to our clients in a structured format. The basis of this has been our core rural products: the GrazingforProfit™ and Bio-Business Farming™ farmer education programs. These holistic programs, initially designed in the USA, taught us about perfection in teaching processes and delivery, innovation in course content and, perhaps most importantly, how to successfully challenge individuals to exceed their own level of expectations.

However, we quickly saw that knowledge and attitude were not enough: changes in these two areas, important as they are, provided no guarantee of success: skills cannot be assumed. That led us to develop our ExecutiveLink™ program. This program operates in all the eastern states of Australia and, at any one time, has around 600 members who commit for a three year period. In 2003 our Supply Chain ExecutiveLink™ program, designed for Oneharvest, won the Logistics Association of Australia's Training and Education Award.

Over the years some 10,000 people have been through our system, which is outlined in Figure 1. The majority of these are in the grazing and broadacre industries. Our penetration into the grazing and cotton industries in particular is extremely high. Despite intense effort on our part, the horticultural industry has been reluctant to engage in such programs to the extent that the broadacre and grazing industries have. We believe that a lack of scale and "busyness" are two major yet interrelated barriers: the lack of scale prohibits many in this sector from having management support thus the need to be "on-site" is far more critical.

Given our strong focus on working on the key areas of business simultaneously (financial, human and technical), we have over the years collated the results of clients' business performance as they progress through the RCS system. Figure 2 shows the changes in Return on Assets for RCS grazing clients at various stages of their business improvement program. Level 1 is median business performance pre admission to the RCS program. Level 2 is based on business performance following the knowledge based component of the program. Level 3 is median business performance <u>during</u> the skill development process while Level 4 represents the progress after completing the full change program.

Figure 1: The RCS business improvement platform

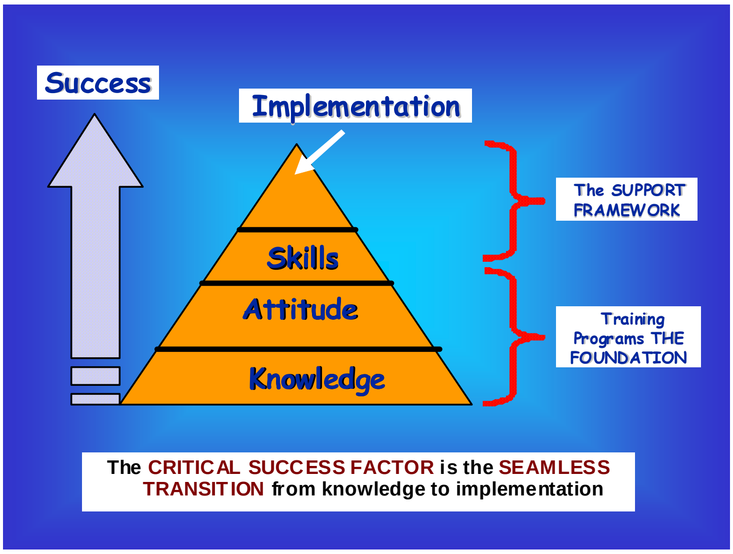
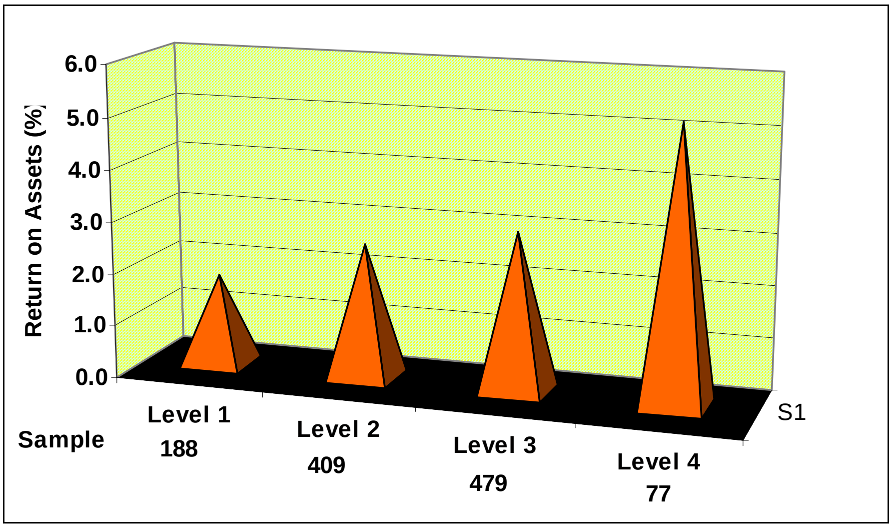


Figure 2: Improvements in the bottom line



So what does this chart mean? It shows that before coming to RCS our grazing clients (sample size = 188) averaged just under 2% Return on Assets. Not all clients wish to be benchmarked before joining programs. The first thing to note about this figure is that the sample sizes are significant. When we compare our data with the Australian Bureau of Agricultural and Resource Economics (ABARE) farm performance surveys we find the sample sizes ranging from 100 – 300. The second important thing to note is that the return on assets **before** joining RCS is around 1.7%. This is virtually **identical** to the ABARE average return on assets for the grazing sector.

2. This paper

In sustaining rural Australia, I believe we first need to address the competitiveness of our agricultural enterprises and their supply chains. Second, we need to address the manner in which we integrate natural resource management. In particular we need to establish new ways of monitoring and delivering NRM outcomes. Finally, our approach to encouraging and supporting viable businesses and communities within regional Australia requires adjustments to our policy and fiscal instruments to encourage “pull” rather than “push” mechanisms.

3. Competitiveness of Australian Agriculture

It has been a long-held belief that Australian Agriculture is competitive and this competitiveness is only marred by global distortions such as tariff barriers and subsidies. Whilst this is largely true in the majority of our extensive industries, it is far from the case in our intensive horticultural industries.

For the majority of our rural industries, there are three fundamental issues that drive our competitiveness. These are:

- Cost and efficiency of capital
- Scale
- Labour

Whilst these areas are discussed separately, they do overlap in terms of impacts.

Our intervention with respect to profitability has been dominated by programs that support the tail rather than growing those businesses which have potential to be competitive.

I believe there is insufficient attention given to competitor analysis and the resulting strategies to manage for these trends rather than reacting to them.

Consideration needs to be given to increasing privatization of service delivery to agriculture.

Cost and efficiency of capital

a) Cost of capital

Within Australia, our cost of capital (defined here as the cost of the investment in assets required to produce a unit of production; eg. dollars invested in land and plant to produce one bale of cotton) is among the highest in the world and for many of our industries it impacts severely on an enterprises ability to obtain scale. For example, our benchmark work in the sugar industry showed in 2002 that the cost of capital for our more competitive regions (eg. The Burdekin) was double that of Brazil. This was in both the growing and milling sectors of the industry. The cost of capital in the growing sector was driven by a rapid increase in land prices in the preceding decade (1993-2002). The result is growers who invested in land during the mid-1990s and later will not see any capital growth in the next 10-15 years (those whose land cannot be converted to horticulture or houses will most likely see a decline). More importantly, this high cost of capital makes expansion extremely difficult.

In that same year we saw a similar level of difference in Brazilian cotton compared to that of Australian cotton growers. More recently this sector has seen unprecedented increases in land and water values substantially increasing the gap between ourselves and our competitors. It has also come at a time when cotton has, we believe, moved from the fairly long peak of its commodity cycle into a decline.

Within the beef industry we have seen the cost of capital rise dramatically in the past 12-18 months on the back of continuing high prices. This has only served to heighten the differential between ourselves and emerging competitors in South America.

The relentless drive for land, regardless of price, is based on premise that money in farming is made through land banking and a confidence that land prices will continue to escalate at rates better than inflation.

b) Efficiency of capital usage

Within rural enterprises, there are vast differences in the level of capital investment per unit of output. Inefficiencies in capital usage occur in two main areas: unnecessary plant and equipment in the production of crops and small and inefficient packhouses. We see the average farming enterprise generally has poor plant usage efficiency ratios. Mostly this situation arises due to a failure to use contractors (seeing the cash costs only) and a rugged individualism that perpetuates a culture of independence. This is particularly the case in packing sheds in the horticultural industry; the majority of which add no value in the supply chain (and in fact may contribute to loss of value due to a low commitment to quality).

Scale

Our measures of scale are two-fold: units produced per full time equivalent (FTE) employed within the enterprise and gross dollars generated per FTE.

I believe that the impacts of economies of scale within the majority of our agricultural enterprises have been given insufficient attention. At one end of the spectrum small scale specialized farmers, who through effective niche marketing or off-farm subsidization of their business activities, will continue to prosper. However, there is a large majority of farmers' whose enterprises are simply not large enough to sustain a standard of living comparable to that of their off-farm cousins. Wealth has been sustained through a reliance on capital gain rather than through return on assets. For many in this category, the right to farm is seen as paramount, however the right to go broke is ignored and help frequently demanded of governments when incomes are scantly.

In particular, our horticultural industries are undersized resulting in difficulties in sourcing large volumes of consistent product, increasing the costs of doing business (these include quality and logistics support from wholesalers and marketers, consolidation costs for transporters and transaction costs for wholesalers and retailers).

Encouraging an ethos of leasing will take time, but the initiative is imperative.

Labour

a) Underemployment

Our competitiveness and long-term viability with respect to both industry and regional sustainability are impacted by the cost competitiveness of our labour and ensuring there is full employment of labour.

The size of many of rural enterprises results in both under- and over-employment of labour. Under employment is probably the most chronic with many rural business unable to generate comparable units of output as the larger businesses. Owners of these businesses do not have alternative sources of employment so effectively are "full-time" on the property. We have seen this across all sectors resulting in real returns to labour being far poorer than appears on the surface. This impacts on the entire value chain competitiveness as industry "negotiates" on the basis of average rather than best practice.

b) Competitiveness of pricing

It is generally well known that our labour rates are high when compared to developing countries however we are also high when compared to New Zealand and the USA. Within labour intensive industries our benchmarking has shown that labour costs for those industries relying on manual operations increased threefold compared to more mechanical operations (table 1). If we take the tablegrape industry which is competing against Chile for example where base labour rates are around A$11/day compared to our cheapest rate of around A$120/day.

Table 1: Comparison of labour costs in grape production

	Wine	Table
Growing labour	17%	40%
Harvest labour	9%	38%
	26%	**78%**

Source: RCS benchmark data

Whilst high labour costs can be addressed in part by scale (reducing the cost of overheads and overhead labour) we are unable to compete head on in these industries and increasingly we are seeing our export markets erode due to this factor alone. More recently our work in the processed salads industry has seen a blatant instance of expensive and short-term phytosanitary measures has processor seriously looking at imports: an action already taken adopted by the processed potato sector. In a world of free trade, we can expect more not less of these actions.

The need for R&D to ensure productivity improvements continue to be generated and technology advances enable capital substitution where ever possible are paramount to continued success of many industries.

Sooner or later, as a nation, we are going to have to face up to the fact that we need to improve the overall performance of labour competitiveness. The taxation rebates suggested in the NFF policy paper go some way to addressing this issue. However, the need to have a debate on the general "Green Card" concept is overdue.

Government support for agriculture

Far too many of our support programs in recent years have failed to address the domestic competitiveness of many rural sectors. The fact that many businesses get support when they fail to demonstrate an ability to make the type of living expected by a full-time manager helps to perpetuate the problems we see today.

a) Managing scale

As scale is one of the key factors in reducing overhead costs and in particular gaining efficiencies for labour, we are at a crossroads as to how to deal with it. Much of the horticulture within the MIA and Sunraysia regions are based on businesses that are simply too small to survive in tomorrows world. Programs such as Kickstart and the MIA PowerPACT program, whilst giving many growers a better understanding of their business, failed to address this issue. Similarly, the recent sugar program has failed to make significant in-roads on this issue. Yet we continue to provide support in many forms to a large majority of growers who simply do not have the where-with-all to make the quantum leap to change.

b) Encouraging scale

At our present land prices, the opportunities for many businesses to grow substantially are low. Leasing is not part of the Australian ethic yet, as indicated in the ABARE Farm Surveys Reports and reported in the Stocktake, the average performance of those industries benchmarked was extremely low and, in a number of industry sectors, negative. Whilst the third largest sector, horticulture, is not reported, one would expect similar results based on our work in the MIA and our recently completed competitiveness study of the Australian Tropical Fruit Industry. We believe that higher overhead costs due business size is a significant contributor to poorer performance.

As was the case in the 1970's the time has emerged where, as a matter of priority, we must seriously look at structural adjustment for smaller uncompetitive businesses out of agriculture. However, we must not shy away from the difficulties expected in getting such measures over the line.

Competitor analysis

I believe that much of our competitor analysis is adhoc and reactionary. For example, in 1995 after completing a major investment analysis in China on behalf of the Asian Development Bank, I approached both the then Australian Horticultural Commission and the Australian Apple and Pear Association with concerns about the potential threats that country posed to our horticultural industries; especially our apple and vegetable sectors. There was no interest at the time in such a proposal. Interestingly, the reason given for a lack of interest in the Chinese apple industry was that China had no infrastructure to properly handle to cool chain issues such as product quality and the industry's main concern was Chile which was exporting into our EU markets. Our own sector reports, written 1998, were prepared to raise the profile on China's potential competitiveness in their horticulture industries. Of interest, they were sold world-wide, however, very few were sold in Australia.

As a wake-up call to our clients we say watch Brazil.

In 1988, they moved the goal posts for ever in the citrus industry through its domination of the international market for frozen concentrated orange juice (FCOJ). The impact on our own citrus industry is still being felt as they have struggled to develop alternative competitive strategies. Compare our strategy of virtually doing nothing to that of the Florida industry who developed a very successful *"Not from Concentrate"* campaign to position their industry against the FCOJ threat.

In 1999, Brazil again moved the goal posts, this time in sugar. In perhaps one of the most comprehensive business analysis and benchmarking studies of this industry from 1993 to 1997, our analysis in 1995 showed few businesses could survive at prices of $250 per tonne of cane. With a price in that year of $392/tc the industry simply did not believe such prices were possible.

Over the past three or so years, we have been saying to our own clients in the cotton and beef sectors – watch out for Brazil! Yet there is no publicly available cost comparisons for these two industries let alone others.

When an industry is at the top of its commodity cycle is the most appropriate time to provide competitor analysis and for industry leaders to carefully assess what the impacts of a downturn in the cycle are: especially with respect to emerging competitors. The competitive matrix should examine the relative position within a range of global prices and exchange rates.

Privatisation of service delivery to agriculture

Agriculture has been one of the last sectors from which the public sector transfers a substantive part of its delivery to the private sector. In an era where we see private sector delivery of public sectors services: infrastructure (roads, bridges, etc) corrective services, management of health services, etc., it is timely to seriously ask why many of the R&D, NRM and training and education functions cannot be privatized.

In my opinion, continuation of substantive public sector service delivery creates inefficiencies, adds to distortions in the market place and prevents viable private sector suppliers from establishing in the market.

It is perhaps timely to remember when the first RIRF, the now MLA commenced. They put out many noses in the research establishment by demanding accountability in outcomes. We find the same in the training sector where programs like Future Profit, delivered at highly subsidized rates, effectively prevented a range of alternative service providers to develop innovative ways to undertake such work.

R&D providers like ServeAg and Australian Horticultural Research to name a couple, have the ability to compete on a tender basis for the delivery of R&D outcomes required by industry. But more could be done. In a similar manner, far more training and extension could be delivered on a competitive bid basis across the nation.

4. Natural resource management

Quite rightly we are giving far more attention to this issue than we have done in the past. We believe that NRM consideration should be separated into two parts: first, those impacts arising as a result of within enterprise activities and second, those that impact on the spatial landscape. Within enterprise impacts such as usage of nutrients, water and chemicals are more effective monitors of sustainability where as spatial measures such as farming on slopes, riparian zone management and habitat management are measures that reflect our more broader "whole-of-catchment" approach. Without an enterprise focus, NRM outcomes are less likely to be achieved in a sustainable manner.

Just who manages these and how resources are allocated requires a serious re-think. Catchment Management Boards are, I believe, a more appropriate organization to deliver unambiguous outcomes to society. However, we cannot fund both these bodies and various departments of agriculture and natural resource management concurrently. Exactly how much of the Telstra NHT funds went to full-time paid positions within Departments of Agriculture and NRM is difficult to assess, but my guess it is quite substantial. There is the need to reduce the size of these organizations to reflect their diminished role in servicing agriculture.

Payment to landowners for delivering environmental management outcomes that have a wider community benefit require serious consideration.

5. Supporting regional growth

Government push or fiscal pull?

Regional Development Officers are everywhere competing with each other to bring new business into their regions and towns. These RDO's spend a lot of time and money attempting to pick winners.

A more pragmatic approach is given in the 2001 NNF paper *Taxation Zones and City-Country Divide – a Discussion Paper* which recommends that a fiscal pull is more effective and I agree. It is timely this paper be revisited.

Engaging Indigenous Australians

In many regional towns; particularly those in remote Australia, the decline in the European population is reversed by the growth in the Indigenous population. The development of both rural enterprises and a labour pool within these communities that can service the immediate regions supports both the community and the region.

Yet, in areas where there is an acute shortage of labour, there is no engagement of Indigenous labour. Our review of Indigenous Training Needs in the Northern Territory Pastoral Industry some 10 years ago saw that community plans made no provision for engagement in the surrounding community despite opportunities. It is a mindset that needs addressing and despite some piecemeal attempts there is a lack of real commitment. Noel Pearson's wonderful initiative of taking Indigenous youth from remote communities to help with fruit picking along the Murray should be widely applauded by both government and industry alike and actively supported.

A commitment that needs the principal of mutual obligation clearly spelt out with realistic timeframes and support for transition programs that enable communities to engage in the wider economy.

Similarly, there are large tracts of land held by Indigenous groups that are effectively underutilized: frequently due to a volatile cocktail of short-term funding by Indigenous organizations and poor on-the-ground management. Partnerships to develop these opportunities require long-term and committed vision by all parties.