

Successful Strategies for a Global Marketplace

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▪ Introduction

It is a great pleasure to represent Saskatchewan Wheat Pool at such an important gathering. As one of Canada's major agricultural services and food processing companies, the Pool is obviously very aware of the swirl of issues and pressures driving our industry.

Like so many other players in the food business, we realize that today's market turbulence has the potential to swamp those companies that do not anticipate the economics of this new world. The companies that plan to surf the wave have already developed and implemented strategies that look out over the next several decades – strategies that will ensure they have a relevant and value-creating role.

Before launching into specific discussion of the hog industry, I would very briefly like to give you an overview of Saskatchewan Wheat Pool and the business environment in which it functions. It will help you to understand some of the unique issues and political considerations we face as we move into the red meat sector.

▪ Brief History of the Canadian Grain Industry

Founded in 1924, the Pool was a product of prairie populism aimed directly at grain merchants who were widely perceived as being in the business of robbing farmers. The fact of the matter was that the farmer did not have many marketing options and was captive to a small cadre of merchants who abused their oligopoly. Incidents of cheating on weights or unwarranted lowering of grain grades were commonplace. In Saskatchewan, grain traders were held in the same lofty esteem as Bay Street bankers or the presidents of rail companies.

The grain handling and marketing co-operative these disaffected farmers created functioned as an agent for the Canadian Wheat Board. Profit was extracted primarily through grain handling tariffs at the country elevator or tidewater terminal. For decades, the federal government subsidized grain transportation with the fabled Crow benefit that essentially made it possible to ship huge volumes of wheat into export position. The Crow was aimed at being a nation-building tool by a federal government that believed it was critical to quickly settle the prairies with immigrants and ensure that their farm commodities would travel east-west. Ottawa was rightly concerned that the appetite of our neighbors to the south was growing and Canadian sovereignty was somewhat precarious.

That is a brief snapshot of how the grain industry functioned for over six decades. The business was fairly predictable with weather and subsequent crop failure being the major variables.

Following the Uruguay Round of world trade talks only a few years ago, the federal government axed the freight subsidy which was deemed as trade distorting. It is no coincidence, however, that ending the Crow benefit came at the same time as Ottawa was on a crusade to end budget deficits and get its financial house in some semblance of order. Overnight, freight rates from Saskatchewan to Vancouver effectively doubled. The economics of shipping large volumes of relatively low-value commodities to the West Coast were suddenly and drastically altered.

The math is simple: Deduct \$45 per tonne for a commodity that reaps \$125 per tonne and the farmer cannot cover his cost of production. And while the farmer may have intended to grow a higher value crop of malt barley, the reality is that prairie weather doesn't always co-operate. Lack of rainfall, an early frost, or a host of other unpredictable factors all mean that we on the prairies are going to be looking at disposing of millions of tonnes of feed grain.

▪ **The Role of the Saskatchewan Wheat Pool**

As a co-operative, Saskatchewan Wheat Pool is traditionally closer to the farmer than most engaged in agriculture-related businesses. There is an expectation that we as an organization have an implied responsibility to fix problems, invest in rural communities, and keep individual producers on the land. There is no quick-fix solution to the enormous downward pressure on net farm income, but there are investments that we can make in commodity streams that improve the profit picture by eliminating onerous freight bills.

Obviously, we're talking about feeding those excess grains to a growing livestock herd located close to the production source. What you, the pork

producer, are aiming for is shipping a higher-value commodity such as processed pork versus a raw product such as feed barley.

When senior management placed before our Board of Directors a proposal to enter intensive hog production and pork as a commodity stream, we had to ensure that the optics of such a plan were correct. Remember, as a co-operative, our Board members are active farmers elected by fellow farmers who comprise the membership of Saskatchewan Wheat Pool. Traditionally, any talk of corporate farming is heresy within the family farm community and, hence, the Pool.

This is why we rolled out our program as a partnership with individual farmers and investors in rural communities. Each production unit annually producing 55,000 hogs for market would be subject to rigid review by the Saskatchewan Securities Commission. The key was to involve and engage producers at the local level, building facilities that are world-scale and take advantage of the inherent economy of scale.

Our plan has been condemned by the National Farmers Union as the thin wedge of corporate farming in which the individual hog producer will be squeezed out. Our response is simply this: There is always room for a small individual producer who is committed to quality and is mindful of issues such as nutrition, health and genetics. But we have also told the rigid traditionalists in farm politics that if we do not act to build a viable, world-scale pork industry, a U.S. multinational will be more than happy to move in and do just that. I do not believe it is in the best interests of our industry to have such a significant sector under foreign control. We at Saskatchewan Wheat Pool are determined to be masters of our own destiny, and that occasionally means you have to take a bold step.

▪ **Future Direction of Western Canadian Pork Production**

Saskatchewan Wheat Pool through its affiliated company, Heartland Livestock Services, is by no means the only organization that sees opportunity in pork production. A number of other entrepreneurs have been discussing large-scale production barns with nearly every Saskatchewan community located in a feed grain producing area. A number of factors are driving this rush: Projected world demand; the new transportation regime; and the folding of the marketing monopoly once held by SPI, or Saskatchewan Pork International.

Under this arrangement, every hog produced in Saskatchewan had to be marketed through SPI. The politics of such a monopoly run deep and can be emotional, but the fact of the matter is that significant players with the

necessary capital were not going to invest in major production units if they had no control over the product.

The Saskatchewan government faced political heat from certain factions who were determined to preserve a past that was hampering development and ensuring that the industry would not be competitive on the world stage. The province's agriculture minister did, however, follow through on his pledge to end the monopoly which he deemed as standing in the way of his department's own desire to double and then triple Saskatchewan's annual hog production.

Concrete is being poured across Saskatchewan as I speak. There are currently 25 major hog facilities situated in Saskatchewan and another 25 farrow to finish units on the books. The actual hog population in Saskatchewan has not taken any great leaps, however, and that perhaps isn't all that surprising. What we are witnessing in Saskatchewan and Western Canada is a consolidation as smaller individual producers are exiting production. The current slump in the market is accelerating some producers' decision to leave the business. It has also prompted calls from some producers for government to step in with subsidy money.

I do not recommend viewing the current hog situation through rose-colored glasses. That's simply ridiculous. But one should always view media reports on business with a healthy sense of skepticism. The fact is that very few reporters understand or particularly care about business and are completely comfortable being business water beetles. A water beetle never actually takes the plunge into the drink but is just a surface-skimmer. Unfortunately, the media has an enormous influence in creating and sustaining public perception. If you're in politics, you know that perception is reality.

Invest for the Long Term

I can assure you that at our production units, we are not losing \$60 per head on every hog that we market. But the impression has been left that pork is in the tank forever. If you follow the media's advice, you would conclude that any significant investment in the pork industry is the equivalent of flushing good capital down the toilet.

If you are involved in agriculture, you must accept the inevitability that you *will* face depressed prices for an individual commodity. In one of five years, the agricultural law of averages states that you will not cover your production costs. If that is an unbearable situation for some individuals, I can only hope for the sake of their nerves and their serenity that they find a nice job in a predictable environment. The calls for subsidies are understandable as individual producers are looking at dramatic drops in net farm incomes. There is a fear gripping much of the agricultural sector in Western Canada as grain prices fall well below production costs. Many farmers – especially the young – are faced

with the very real prospect of exiting the land. Many would have already done so if not propped up by the previous generation which is able to better sustain a down cycle.

Trade with the U.S.

But I also must caution those calling for full-fledged government bailouts that if we want to initiate a full-fledged border war, that would probably be enough to start one. As we witnessed this past autumn in South Dakota, some misguided politics is all it takes for the barricades to go up and for us to lose access to our most important market. I am not going to wade into the abject silliness we have witnessed in recent months. But I must note that a Montana farmer who condemns Canada for exporting supposedly subsidized commodities must not be prepared to take a share of the \$6 billion in farm relief the U.S. Congress approved last fall.

The United States continues to be Canada's most important export customer for pork and pork products. It accounted for 50 per cent of exports in 1997, down from 65 per cent in 1996, and 68 per cent in 1995. If you slam the door to that size of market, you will stunt the growth of the Canadian industry or perhaps choke off development. Realizing our full potential would be close to impossible if we were unable to continue determined, prudent growth.

Increased Pork Production in Western Canada

The size and scope of planned production units is a reflection of the new reality and builds on strengths that were previously under-utilized. In eastern Saskatchewan and western Manitoba, the cost of shipping feed grains is – as I previously noted – simply uneconomical. This has been the case for many years but the dramatic rise of freight rates has exacerbated the situation. Somewhat strangely, however, we in Saskatchewan have a grain-only mentality. Speaking generally, of course, we view agriculture as crop production and that has resulted in the rather unusual situation of the cattle business being located essentially in Alberta. So we in Saskatchewan ship feeder cattle westward and then ship hundreds of thousands of tonnes of feed grains. The economics of such an arrangement are bizarre – and yet we in Saskatchewan occasionally face fierce resistance to intensive livestock operations.

Developing one of these hog production units is therefore as much a case in issues management as it is managing finances. In Saskatchewan, we were faced with the extraordinary spectacle of two government departments feuding over who was responsible for the licensing of such a project. The agriculture and the environment departments couldn't agree on who should have final approval. It was a very public and somewhat disturbing exhibition of tax dollars at work.

Eventually, government has come to accept these units as viable operations that do not foul the environment. Pork production does not mean entire communities have to live with the smell of manure. But they came to this realization because we who were building the industry ensured that the latest methods and technologies were employed. We had to show the public that our lagoons weren't seeping into ground water and we continue to constantly monitor this. It is an additional cost, but nothing will shut down large-scale production in Western Canada faster than the public – and hence government – turning on the industry because of an avoidable environmental incident.

Future Competitors in Pork Production

Ramping up production in Western Canada at this time allows us to take advantage of what is occurring in major exporting countries now dealing with environmental fallout. In the Netherlands, for example, the government has mandated a 25 per cent reduction in the national hog herd by the end of this year. Reports from elsewhere in the European Union indicate that other member countries will also be faced with stronger environmental and animal rights regulations. We need only look at the influence the Green Party now exerts in Germany to understand why pork producers are increasingly nervous about the future of intensive operations.

Obviously, you cannot touch on this issue without mentioning the 1997 outbreak of foot and mouth disease in Taiwan. This effectively eliminated Taiwan as a pork exporter in the short term and it is expected that environmental constraints and high feed costs will limit growth. The U.S. Department of Agriculture projects Taiwan's net pork exports will reach 120,000 tonnes by 2007. That's about one-third their 1996 level. The implication for Western Canada is clear: Quality and health matter. In the minds of the offshore buyer, Canada is equated with the world's best standards in health, production, and processing. I need not remind anyone of the impact of the BSE episode and what it did to not only British beef but various other food exports from the U.K.

It has been suggested that China – which accounts for more than 50 per cent of current world production – could be a significant player in the export market. Strong internal demand will probably mitigate that: Demographers from the United Nations estimate that China's population will jump from 1.2 billion people today to 1.6 billion in 2030.

The other major issue facing China is fresh water. Although this past year's reports of record floods captured international attention, China's *lack* of water is actually a more serious threat to its economy and society. During the 1990s, floods cost China an average of \$10 billion a year, although this year's deluge destroyed \$20 billion in property. By comparison, the World Bank estimates

that water shortages annually cost China \$35 billion in lost crops and stunted industrial production.

Per capita water demand, meanwhile, has risen in step with living standards. Flush toilets, showers and washing machines are now standard in urban households. Chinese are also eating more meat, whose production requires vast amounts of water for alfalfa and other crops used to feed livestock. China's biggest water users are farmers; approximately 87 per cent of the country's fresh water is consumed by agriculture. Those farmers currently use about 400 billion metric tonnes of water per year and that is expected to rise to 665 billion by 2030. The country will face severe water shortages and place intensive livestock and processing under heavy scrutiny.

Water and land issues are not something we contend with in Western Canada. We in Canada often take this geographic vastness somewhat for granted, but hog production has to be land-based. The manure must be used to provide nutrients for the land and grain that is used to feed the animals. In many exporting nations, manure is leeching into ground or surface water systems because of a shortage of land on which to spread the manure. I can assure you this is not a problem in Saskatchewan.

With a herd of about one million spread over a farm land area of about 30 million hectares, Saskatchewan's density of 3.5 pigs per 100 hectares compares very favorably to North Carolina where the density is 258 per 100 hectares. In Denmark, the density is 438. In the Netherlands, that figure is 1,597. From that aspect alone, there is no other logical conclusion than Western Canada will continue to grow as a key production region.

▪ **Global Marketing Influences and Strategies**

At the same time as we are executing a pork growth strategy, some investors are concerned that many countries are experiencing a reduction in the value of their currency. Everyone here has contemplated the impact of the Asian flu that subsequently traveled to Russia and became full-fledged pneumonia. Southeast Asia – especially the emerging countries – has reduced buying power and that cannot help but have an impact on the agri-food industry as a whole.

From a grain perspective, we at the Pool are in a time when customers are trying to grind the margin out of every sale. Additionally, buyers who only last year wanted to lock up secure supply sources are now unwilling to commit to sales far into the future. It is understandable: If you are uncertain about the value of your currency, you are reluctant to commit to any transaction other than the immediate.

Like lumber or oil or grain, pork is a commodity, therefore, we in this industry are also enduring a severe price trough. Statistics Canada reports that exports to Japan have been steadily increasing from 48,000 tonnes in 1995, to 55,000 tonnes in 1996, and 85,000 tonnes in 1997. The short-term export prospects to Japan continue to be positive due to a variety of factors including the value of the Canadian dollar. But the downward pressure on margins has been huge. For Fletcher's Fine Foods – the pork processor of which Saskatchewan Wheat Pool acquired 45 per cent – the first eight months of 1998 starkly demonstrate this. Our actual volume of pork exported to Japan this year versus 1997 increased by over 11,000 kilograms. The margin on those sales, however, is down by about \$12 million.

The good news is that we are maintaining and in fact growing markets based on Japan's desire to buy Canadian pork, based on quality and competitiveness. The bad news is obvious. The same picture emerges when we look at exports to the U.S. and Hong Kong. Over the short-term, there are not a great number of immediate strategies that can be taken to counter these slim margins other than to ensure that your productivity remains high and your labor costs are competitive. But you can hedge somewhat effectively if you manage to structure yourself so you are less reliant on fresh pork. Fletcher's has concentrated on acquiring and building its branded processed business where shelf life is obviously longer. The price of packaged bacon, for example, is not determined solely by the commodities markets.

Survival strategies for the long-term will not come as a major surprise. Again, the industry must ensure labor costs allow us to compete on world markets. Recent labor agreements at Canada's processing operations have ensured labor stability and affordability during the upcoming period when this country stands to become a pre-eminent producer, processor and exporter. The new construction and upgrades at Canadian facilities are all clearly aimed at ensuring world-class capability. A world-scale plant is one capable of processing at least two million hogs per year and doing so at the highest health standards.

■ **Conclusion**

The Canadian pork industry faces the same challenges and advantages as does the rest of the agri-food sector in this country. We are an enormously productive country with a population of only 30 million. That means we have to export and transportation and logistics will always add to our overhead. It means we will occasionally have to deal with political interference such as what was witnessed last fall in the Dakotas where governors decided to single-handedly circumvent the North American Free Trade Agreement signed by their federal government.

But we are in a land of abundance at a time when even the most stolid traditionalists recognize that we must seek new strategies to serve today's business imperatives. Transporting feed grains is value destroying, so we have promoted – successfully, I believe – the development of a more livestock-friendly primary producer. Capital will continue to be a concern, especially during this current period when oversupply is resulting in the lowest hog prices in almost 30 years. Our natural advantages and high standards of quality, however, lead to the inescapable conclusion that we have a unique opportunity to become a dominant global player.

