

# Roadmap for a Competitive Pork Industry in Canada

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## ■ The Current Situation and Causal Factors

The Canadian pork industry has been in crisis for much of the past two years. Producer margins have been negative for much of 2006, most of 2007 and all of 2008. Losses are ongoing and have reached historic highs of \$70 per hog in late 2007.

The crisis is not limited to pork producers. Processor margins have been largely negative for the past two years. Additionally, input suppliers such as feed companies and veterinary practices are facing financial ruin, as producers are unable to keep their accounts current.

The crisis is due to the convergence of four key factors (Toma & Bouma, 2008a):

- The rapid rise of the Canadian dollar.
- Rapid rise of input costs – notably feed grains.
- New and intense competition from our major customer (the U.S.A.)
- The lack of processor competitiveness in Canada.

The Canadian dollar has risen in value relative to the U.S. dollar more than 20% in the past year and over 60% since 2002. This has had a two-fold effect: (1) the immediate reduction in prices paid for pork since all Canadian prices are based on the U.S. market and U.S. currency; (2) increased competition in all markets (domestic and export) from the U.S., which has become the world's largest pork exporter.

Feed costs have more than doubled in two years. World grain prices are at historical highs driven by new demands from bio-energy developments and

droughts in key grain producing regions (Australia, Argentina). While all pork-producing sectors around the world are affected, the relative rise of feed costs in Alberta has been greater than other North American pork producing regions. This is due in part on the fact that Alberta feed grains are tied to food grain demand, whereas U.S. corn is decidedly a feed grain. The two markets, while related, are not totally correlated. **Canada (and particularly Alberta) is now a high cost pork producing region in North America compared to 1998 when it was the lowest!** (Hayenga, M. et al. 1998).

Over the past 20 years, the U.S. pork industry has restructured in dramatic fashion. Most of this change has been led by the emergence, and now dominance, of large scale integrated pork production systems. Indeed, the changes have transformed the U.S. to become one of the most competitive pork industries in the world. To wit: U.S. pork exports have, without fail, steadily increased for 20 consecutive years.

The major constraint facing most Canadian processors is the lack of regional critical mass (hog supply) to enable double shifting – the common practice with major U.S. processors. Consequently, Canadian processors are at a cost disadvantage to their U.S. counterparts in a market where price is determined by the U.S. market. Thus the Canadian industry faces a double jeopardy – a higher cost structure and a discounted price. We estimate this cost disadvantage to be as high as \$12 per hog.

A recent UDSA study (USDA 2007) determined that production contracts can effectively reduce costs by as much as 23% compared to independent producers. The Canadian hog industry by comparison continues to operate largely as a set of independent producers working with processors on the basis of delivery contracts.

As a consequence, the Canadian pork industry found itself in an extremely uncompetitive situation. Prices determined by an external market – namely the U.S; therefore, the Canadian currency rise proved to be extremely damaging, particularly since the sector was largely built on the basis of a low valued Canadian dollar during the 1980's and 1990's. Western Canada now has the continent's highest cost structure; and the processing sector is uncompetitive relative to their U.S. counterparts.

## ■ **Global Outlook for Pork: Demand and Supply**

Three highly credible sources (FAPRI, 2007. GIRA, 2008.; OECD, 2007.) all predict that the demand for pork will grow annually between 1.6% and 1.9% per year for the next 10 years. Furthermore, the international trade for pork is

expected to grow by over 20% in the next 10 years (over 6.1 million metric tonnes).

China will be the biggest growth market. Overall demand is expected to grow by 17.1 million metric tonnes. Expert opinions suggest that China will need to increasingly rely on imports to meet this demand due to feed grain limitations, risk of diseases and decreasing land and water resources. Other potential growth markets include Russia, Korea and Mexico (Boal, F. 2006.)

In the short term, pork prices are expected to remain at current levels until the fourth quarter of 2008. This is the result of increased supplies in the US (up 4% over 2007). Long-term price forecasts suggest that prices will improve in 2010 to \$49.30 US per cwt (live) and remain at this level for the 2009 to 2016 period.

In terms of pork supply, the EU is expected to decline and the US, while supplies in Brazil and Chile are expected to increase. The EU faces serious land and environmental constraints; the U.S. will face feed cost challenges similar to Canada; Brazil is subject to disease issues; and Chile, while a small player on the export scene, relies totally on imported feed which is a constraining factor.

## ■ Comparable Value Chains

Five different pork value chains were examined. Each has a set of unique features including:

***Danish Crown*** – an example of a total industry sector strategy built on a cooperative model with a long history in Denmark.

***Smithfield*** – the highly integrated industry model that has redefined efficiency and cost competitiveness within the U.S. Financially this model has proven to be very successful although it may be facing environmental challenges due to livestock concentrations in specific regions.

***Seaboard-Triumph*** – a contractual model in which six large scale production groups built a large scale plant (Triumph) and contracted all product marketing to an established food marketer (Seaboard).

***Meadowbrook Farms*** – a small vertically integrated cooperative located in Illinois pursuing a value added, niche market strategy.

*Agrosuper* – an integrated model located in Chile that has been successful in developing preferred supplier relationships in Japan, Korea and China. These relationships are built on a quality-disease free platform and supported by the Chilean government in the pursuit of bilateral trade agreements.

All of the above are examples of well-organized and systematic approaches to production, processing and marketing.

## ■ Recovery Strategies

Our review of the literature and an analysis of four industries/businesses that have undergone major transformations (Forestry; Toyota; Wine; and New Zealand Dairy) provide the following insights to sector revitalization:

- Simple survival requires a competitive level of organizational efficiency and operational excellence.
- The choice of a single targeted strategy (such as least cost on the one extreme versus a totally differentiated product strategy on the other extreme) is high risk.
- The greatest likelihood of success is often found within the industry itself. Strategies may be built around undervalued business platforms; untapped customer insights; and/or underutilized capabilities (Zook, 2007).
- Committing to a long-term vision and strategy is imperative.
- Organizational excellence including the coordination of the supply chain and the formation of an associated business cluster are essential elements to industry success.
- Long term commitments to research, development and innovation are fundamental to success.

## ■ Implications for the Canadian Pork Industry

The Canadian pork sector finds itself in an extremely difficult situation. To summarize: it operates in a market where price is determined by its major competitor (who is also the low-cost supplier); it is now a high cost production region within North America; it is loosely organized as an industry; and it depends upon a processing sector that is structurally uncompetitive. **And**, the financial disturbance caused by the convergence of these factors, have been

further exacerbated by the untimely advent of low pork prices due to excess supplies of pork.

However, Canada at large has several fundamental advantages that are inherent to a competitive livestock industry:

- a large land base coupled with a low human population;
- a favourable climate for both the production of crops and livestock;
- the capacity to produce an abundance of feed grains;
- production management skills that are competent and can easily be adapted or upgraded; and
- relative proximity to the largest and fastest growing pork consumption market in the world, namely China.

Thus one can argue, with the exception of currency appreciation, that rebuilding a competitive pork industry is largely a management, organizational and financing challenge, not simply an economic challenge.

Building a competitive pork industry will require a dramatic overhaul of the entire industry if there is to be any probability of success. It is clear that the revitalization strategy must be founded on four core principles. These are:

1. The necessity of establishing new marketing capability built on product quality, supply assurance and customer focused strategies that are long term and of mutual interest. Canada cannot, nor should it, compete as a low cost supplier.
2. The need to organize and build a highly connected industry that links customers to processors and processors to producers. The Canadian pork industry must build a production-processing-marketing system that captures maximum value and drives out unnecessary system and hidden costs.
3. The ability to secure cost competitive inputs, most notably feed grains and labour, over the long term. Western Canada in particular must pro-actively establish a feed grain sector that can compete with U.S. corn.
4. The need to operate within a favourable business and political environment that facilitates market access, regulatory reform and long term financing. The Canadian pork industry cannot go it alone. It must have the long-term strategic support of both federal and provincial governments to make the transition necessary to become competitive.

## ■ A Case in Point: The Alberta Revitalization Strategy

In 2008, the Alberta pork industry under the leadership of Alberta Pork undertook to review the entire industry in response to serious concerns about long-term competitiveness (Toma & Bouma, 2008b). The following key elements outline the revitalization strategy that is currently in the process of being implemented. The Revitalization Strategy is comprised of the following elements:

### The Vision:

***A highly connected pork industry capable of delivering differentiated high quality, safe pork products in a sustained manner and with flexibility to respond to continuously changing markets and market conditions.***

The shorter version of this vision statement reads as follows:

***Deliver quality pork  
Respond to changing markets  
Act with urgency!***

### The Marketing Platform:

The Revitalization Strategy is built on market principles and begins with the establishment of a clear marketing platform that will guide and direct the development of the industry. The immediate focus (1 to 3 years) of this platform will be to:

1. Begin by further building on the Quality, Health, CQA, Animal Care and existing Environment Stewardship platform as defined by already established standards and programs. Alberta in particular has a 'geographic' advantage to further substantiate and 'brand' this quality position in view of its location in the western prairie and adjacency to the Rocky Mountains;
2. Simultaneously, begin building a new marketing, sales and business-to-business capacity to deliver 'unique' customer specifications to a targeted selection of existing customers and new customers.

Once this platform is established and validated, the strategy calls for a process of continuous improvement by strengthening existing attributes and/or adding new dimensions. One such possibility is to:

3. Extend the marketing platform with associated quality attributes in response to emerging market signals as these develop (within 3 to 5 years).

### **Strategic Initiatives:**

The vision will be achieved by the implementation of five strategic initiatives. The first four initiatives are immediate (within 1 to 3 years) and need to be addressed simultaneously. They are:

1. Establish system integrity (highly connected sector) – the design of pro-actively managed supply chain (or chains) between the processing sector and producers.
2. Develop new marketing capability – the establishment of new business-to-business skill sets that develop long term supply relationships with a set of targeted markets and customers.
3. Address cost challenges – develop new strategies to address the two major cost items facing pork production: feed grains and labour.
4. Facilitate a favourable business environment – ensuring that the Alberta pork industry has the necessary public and private services, tools and instruments to effectively compete in the global meat industry.

The fifth initiative is long-term in nature (within 3 to 5 years). This is to:

5. Further build the Alberta Brand on a market driven platform that adds value to Alberta pork based on attributes such as environmental sustainability. This can be achieved once system integrity is established and the market signals specific to this rapidly emerging area become clearer.

To be very clear, the strategy calls for two fundamental structural changes that are essential:

1. Establish indisputable system integrity in the production, processing and marketing of Alberta pork.
2. Create new marketing and business-to-business development capability that will establish long term customer relationships.

## ■ Conclusions

The major challenges set out in the Revitalization Strategy are to 'package' or systematize the marketing platform and to build the marketing capability which links production, processing and marketing in a highly connected manner.

This is not easy. Indeed this requires a set of industry investment strategies that create new business structures between producers and processors. However, the alternative is the continuation of a system that is clearly not functioning well in the present and certainly is not positioned to compete with well organized systems in other countries around the world.

If the fundamental challenges within the Canadian pork industry are not addressed, the conditions that have created the distress which is currently at play will only re-emerge in the future. At best, the Canadian industry may continue to supply the domestic market but lose its export markets. At worst, it may be unable to compete at all and Canadian consumers will rely totally on pork products that are imported from pork producing countries.

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