

Information asymmetry within the NSW poultry meat growing sector

The NSW Farmers Association argues that information asymmetry exists within the NSW poultry meat growing sector because the buyer of the growing service (the processor) knows more about the business of the seller of the growing service (the grower), than the grower knows about the business of the processor.

This is not characteristic of a competitive market. The Federal Government's National Competition Policy objective was to facilitate effective competition to promote efficiency and economic growth while accommodating situations where competition does not achieve efficiency or conflicts with other social objectives.¹

There are no apparent conflicting social objectives as described by the report and in fact retail prices for poultry have declined by 1% between March 1997 and March 2007.²

The NSW Poultry Meat Industry Amendment Act 2005 and the Trade Practices Act have acknowledged that authorisation for collective bargaining is necessary to counter the market power relating to growers sunk assets and processors reluctance to compete for growers.

However, the NSW Farmers Association believes that the Government needs to specifically consider the existence and impact of information asymmetry on competition in the poultry meat market and the need for additional mechanisms to promote more effective competition.

Cost of production influencing growing fee

The processor knows the cost of production of the growers because they either own their own farms or they request prices from growers. It is known with at least one NSW processing group that such a 2007 survey yielded a biased sample of low cost growers. Unfortunately, growers cannot verify the accuracy of the processors own farm costs and it is very difficult to make a case against the survey data collected by the processor as neither the processor's or growers' sample data is audited (as transaction costs are too high).

While the use of a "model" farm from the NSW Department of Primary Industries has become obsolete as each region and shed type has its own cost structures, the NSW Farmers Association has acknowledged the need to invest in increasing the accuracy of cost of production data collected by growers, however the cost of this is estimated at \$75,000 pa or approximately \$300 per grower per year.

Margins made by either party

The processor knows the costs of production in general terms and the income paid to the grower. Through their on farm access, the processor can also determine the lifestyles of the growers in terms of cars driven, residence types, requests for holiday

¹ Report by the Independent Committee of Inquiry into a National Competition Policy for Australia, Professor F Hilmer, August 1993.

² "The Australian" Thursday 12/7/07

time, ability to put on managers or employ non family member labour, the size and value of their land holding and whether they have borrowed from the bank (through “letters of intent” requested of processors by banks). The contract stipulates that processor servicemen routinely visit each farm during each growing cycle. From this they can infer (correctly or incorrectly) that growers can withstand price squeezes.

In contrast, the only monitoring growers have access to is the retail chicken price which undoubtedly is confounded by retail margins and wholesale margins. There may also be access to profit listings of successful companies in financial publications. However, the processors commonly own feed mills, have hatcheries, breeding and growing farms and have retail outlets in addition to processing live birds, therefore isolating profit made from price paid to the growing sector is impossible.

This dilemma is extremely difficult to resolve given business should have the right to confidentiality and processors can only make assumptions from the farm visits made. There is however, potential for greater transparency at the retail level which will allow growers to make an estimation of processor profits.

Confidentiality clauses within agreements

NSW has yet to experience growers agreeing to written confidentiality clauses as has occurred in South Australia, however, a verbal agreement of confidentiality of terms has been made with at least two very small collective bargaining groups since 2006.

While being aware of avoiding collusion, growers have in the past looked at the market conditions for price and contract terms, shedding quality and supply and growing efficiency and product demand. This information is used to forecast the likely return on investment in new facilities requested by the processor, renegotiation of loan repayments, the degree of demand for shedding capacity relative to shed quality and performance and the benchmarking of feed conversion efficiency.

The growers in NSW are fearful that collective bargaining alone will be insufficient to halt the spread of confidentiality clauses and that information asymmetry will be exacerbated. Growers appreciate that in order for processors to remain competitive, there are aspects of their businesses which should remain confidential and thus a balance needs to be found by Government. It could be that a market reporting mechanism be set up to publicise amalgamated information or that certain types of confidentiality clauses are deemed unconscionable.

Moral Hazard

The ignorant party, the growers, lack information about the performance of the contract and therefore lack the evidence to enable a retaliation for a breach of agreement by a processor.

Some of the current growing contracts in NSW show this asymmetry. The processors obligations to supply inputs to growers within written contracts are couched in terms of “supply broiler chickens”, “necessary for the proper raising”, “reasonable endeavours” and “competent serviceman”. There are no clauses covering how these obligations will be measured. In contrast, the growers contractual obligations are in

terms of “minimum standard required by the broiler growers’ manual”, “growers must keep and maintain production records and all such records to be an remain the property of the processor”, “processors servicemen or other employees or authorised agents free access to the broiler chickens at all times” and “processor will audit the grower’s premises”.

These contracts do contain clauses that enable the grower to “audit payments made to the grower by the processor under the terms of the agreement”. However, the terms of the agreement are restricted to clauses which “ensure each and every load of chickens are weighed... over the same certified weighbridge nominated by the processor”, “provide the grower a copy of the weighbridge ticket” and “count the chickens” on behalf of the grower. Unfortunately, there is no provision within the contract for the auditing for accuracy of these measurements made by the processor, therefore auditing of payments is reliant on processor supplied information only.

There is a provision in contracts to use a dispute negotiation mechanism for any of the above however it is rare that growers proceed to negotiation and it is rare that there is any challenging of the accuracy of the measurement tools used by processors as growers fear retaliation from processors for being trouble makers.

The processors stipulate these obligations on growers in order to control the use of processor owned inputs, monitor for efficient production and provide a financial incentive for efficient use of processor inputs. The growers also need to monitor processor efficiency as counts, weights and the quality of chicks, feed and management advice directly impacts on the efficiency of the grower and thus his income. The importance of these obligations is seen in the provision for both the processor and grower to terminate a contract if a notified breach is not rectified in 7 days. However, the grower lacks the information on the processors’ performance to ever collect sufficient evidence to retaliate for that breach, whereas the processor is continually monitoring the performance of the growers for efficient use of the processor owned inputs.

Mechanisms to resolve this asymmetry can be through guidelines for contract content such as the ability for growers to audit processors’ measurement of efficiency parameters. Other vehicles lie in State food safety legislation which could place quality control on chick and feed characteristics and live bird handling which will reduce the variability of inputs which growers cannot control that unfairly impact on their efficiency and thus their income.

Adverse selection of processors by growers

The ignorant party, the growers, lack information on the processors’ efficiency (as described above) while negotiating price or contract terms therefore the grower does not have the ability to accurately select the better performing processor ie they adversely select processors. The efficiency of a processor is important to growers as it impacts on the competitiveness of the product in terms of price per unit and product quality and that in turn impacts on the yearly turnover on growers’ farms and the income they receive.

This issue is very hard to resolve as often growers cannot select a processor because of geographical constraints or the tendency for processors to not to compete for another processors' grower in order to avoid "starting a range war".³

Conclusion

The NSW Farmers Association request the Government investigate the areas of information asymmetry identified in this paper, assess the impact on the competitiveness of the poultry meat market and canvass options on mechanisms to achieve efficiency where gaps are identified.

³ Australian Competition Tribunal, The VFF Chicken Meat Group Boycott Authorisation, 2006, Justice Heerey, paragraph 90.