

# Commodity production in to the future – how does it look?

A report for

**NUFFIELD**  
AUSTRALIA  
FARMING SCHOLARS



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#### **Jim Geltsch**

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# Foreword

This project was undertaken to examine the future sustainability of commodity production in the Western Australian farming system. Agricultural commodity production in Australia has long been questioned, with some stating that ‘commodity production is for mugs’. Following my research, I believe that commodity production may well be the best way for Australia to exploit its comparative advantage of relatively cheap land and good environmental standards. Commodity production with volume will continue to be viable for medium to large scale farmers who then create value add opportunities that are complementary to this core business of commodity production. Value adding enterprises must, in fact, add value not just add work. The value adding enterprises need not be production based, or even farm based, they may be off-farm investment opportunities or they may be opportunities further up their existing agricultural supply chain. When diversifying or value adding to your existing core business it will be important that people with appropriate skills and experience be bought in to optimise new opportunities for which current staff are illequipped. Invest in your own and your staff’s skills

# Acknowledgments

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Gillam Farms is my family farm and my other financial sponsor, so many thanks to them.

Lastly, thank you to my husband, Kristin Lefroy, who has been incredibly understanding and supportive of my travelling and learning this year.

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## Executive Summary

This Nuffield Australia Farming Scholarship was undertaken with the aim of investigating the future viability of the Australian agricultural commodity production industry. Further to this, to determine if value adding should form part of this future.

Commodity production is the mainstay of Australian broad acre agriculture however declining terms of trade are making the economic sustainability of commodity production unfavourable – this in turn affects the social and environmental sustainability of agriculture. Both within Australia and internationally farmers are looking to adding value to their agricultural produce as a way in which to improve sustainability. This study expanded the definition of value adding to include relationships with customers, diversifying and investing off-farm.

This research was conducted over a twelve-month period spanning from October 2005 through October 2006 and included four months of overseas travels. During this time visits to New Zealand, China, Canada, United States, Italy, France, Holland and the United Kingdom were carried out.

Australia's comparative advantage within world agriculture lies in producing significant and consistent volumes of commodity food products, with a heavy focus on exporting. Commodity production in itself must change such that commodities are produced for a specific market and meet quality specifications as required for the end-use. Products must have a market place before they are grown. Australian commodities must be grown under quality assurance guidelines addressing not only quality issues but also environmental, social and economic parameters. Australian farmers also need to look to expand their businesses to include value adding in some form, be that better alignment with end point processors, further involvement up the supply chain through investment or partnerships, investing off-farm or diversifying geographically to spread risk.

Commodity production as we currently know it must change to become more market driven and tailored for specific end-uses. As an industry it is important that Australia maintains its reputation as a producer of high quality food products for domestic and international markets. In addition to this Australian farmers need to hone their business skills so that they are equipped to seize new opportunities as they arise in the changing market place.

# Introduction

Can Australian producers continue to be commodity producers in a market where quality assurance and environmental performance are market access tools rather than opportunities for premiums? Should value adding form part of our future?

Setting out on my Nuffield travels my topic was primarily aimed at investigating environmental management and quality assurance systems for commodity food products and learning how these could be applied to the Australian agricultural industry. However, I soon learned from commodity producers, marketing bodies and customers that quality assurance (QA) and environmental management accreditation are market access tools rather than a technique by which premiums can be extracted for commodity products.

This led to the evolution of my Nuffield study topic; if QA and environmental management accreditation are not tools for improving the economics of Australian farming businesses, what are the tools? How do we improve our viability in to the future? Where does our comparative advantage lie? I guess the real question is ‘with an abundance of land and sunshine, what do you do’?

The revised study topic for my Nuffield scholarship to “Can Australian farmers continue to be commodity producers in a market where quality assurance and environmental performance are market access tools rather than opportunities for premiums? Should value adding form part of our future?”

It seems the most obvious answer is to look at value adding. Yet, looking around the world there is so much value adding that is not value adding but rather work adding. The most successful value adding examples in place are where the value adding is complementary to the core business. A model that seems consistently successful is that of a core business with production volume around which value add enterprises are built.

Before looking to diversify from the core business, it is important that the core business itself be viable, efficient and dynamic. The motivation for diversification must be explored and defined – is it to make more money; to maintain stimulation; to reach some altruistic goals or; is it in response to market demand? If responding to market demands when developing a value adding business, then there are some local and global trends that are an obvious springboard for business ideas.

In a grain production enterprise adding value to the core business can include involvement further up the supply chain, marketing directly to processors, taking grain through to the food retail level or investing off farm.

## **Australia's position in the world market**

Thinking about the positioning of Australian agriculture relative to, for example, European agriculture there are some distinct differences in where our advantages lie. Middle-sized European agriculture is stuck with subsidised agriculture, which means that traditional land uses will persist for as long as the European community values people living in the countryside. The larger agricultural operations are either utilising economies of scale to remain viable or have the capacity within their businesses to be involved further up the supply chain where they can wield some influence. An example of European farming businesses moving with demand rather than being purely production driven is the conversion to oilseed crops for biodiesel production and other biomass crops due to the realisation that the world will require more energy in the future.

## **Globalisation**

“Innovative businesses drive globalisation as well as responding to it” (Tim Hunt, Rabobank, *pers. comm.* 2006). It is important to take control of our future, rather than believing that events are happening to us, perhaps we can start thinking that these events are for us and are allowing us opportunity for change. Louis Chirside's experiences show the value of looking at events in our environment as an opportunity for change. As a tomato grower, a tomato processing plant closing down was a huge challenge for his business, yet he faced this challenge, learned from international peers and is now reaping the rewards as his business continues to thrive.

## **What is innovation?**

Innovation need not involve diesel, nor does it need to be production based. Innovations in thinking, in business planning and in marketing are where I feel there remains the greatest untapped potential in agriculture. It is the individual within the business who takes an innovation from an idea to making it a business success – to maximise the potential benefit from technology requires creative thinking and vision (*pers. comm.*, Tony Barker). The drive of the individual leads to success, not the innovation itself. Ultimately the key person within a business is more important than any single innovation. The human capital of any business is the driver.



## **Building success in business**

The importance of relationships in business dealings is high – within your business, the supply chain and with your market. It is also important to have the courage to know your strengths but also to know where you need assistance. Once you have recognised the strengths of your business concentrate on these and then develop mutually beneficial relationships with outside parties to bring new skills to your business (Lachie Hart, *pers. comm.* 2006). Rabobank are a key agricultural educator in Australia and remind us to allow others to have a stake in our success. They also remind us of the importance of investing in ourselves and developing our skills.

*“Challenges present us with the opportunity to change and innovate – let’s embrace our challenges and look to the future”*

## **Core farming business**

### **Commodity production – where to from here?**

Australian agriculture is founded upon commodity production of large volume and scale sold primarily to export markets. The tradable amount of commodity grain across the world is fairly constant – the price premiums lie in looking for opportunities through shortfalls in supply and niche markets. It is important Australian grain producers be nimble and responsive to seasonal opportunities.

Over time, terms of trade for agricultural commodities have declined – we all know this but what can we do about it? Some believe that quality assurance (QA) and environmental accreditation will provide Australian farmers with premium markets for their commodity products. However, commodity purchasers, marketing bodies and customers are telling us otherwise. QA and environmental accreditation are providing Australian commodity products with access to markets, but these are not necessarily premium markets.

QA has been part of the Australian agricultural landscape for a number of years in a bid to reduce the risk of contamination to exports. One of our key markets for export grain, China, seems almost to use Australia’s high standards against the product. Any additional quality specification is an avenue for docking commodity exports, rather than providing the premium commodity growers strive to achieve. Recent events with international disputes over maximum residue levels and false claims of disease and contamination against Australian grain undermine the QA cause. After all, if clean grain is being rejected, why spend more money making it cleaner (*Australian Farm Journal, September 2006*).

## **Look to the future reality**

It is important to position your business according to reality not according to where you wish the market to be. So often in farming circles you hear people lamenting about ‘the good old days’ and saying ‘if only prices were...’ – these attitudes are counter productive as they are grasping on to the past, not looking forward to the future. Farmers need to look out of their farm gate at their local and global situation and figure out the best way to position their business for the future, not try to return to the past. The future is ours to grasp.

Whilst in China, I met with the General Manager of Elders Asia, Nick Hunt who has a great understanding of both Australian agriculture and our export markets. Nick believes that at some point each individual farmer needs to make a decision – they either need to get out of agriculture or they reposition themselves within the market. Farmers will need to be able to adjust to the changing environment in which they operate. Nick believes that whilst the future for Australian agriculture is bright, there will be some blood shed along the way as some manage to change, others don’t. The message I got from Nick was that it is no longer get big or get out, but rather change or get out.

## **What is success?**

Before embarking on a value adding exercise, it seems important to me to learn to evaluate success and figure out why I am in the game in the first place. Questioning your place within your agricultural business is critical to planning, to setting goals and to measuring our success.

Ultimately the success of any business is defined by its ability to meet the objectives of its owners. A business’ success cannot be evaluated if it does not have clearly defined goals. The comparison of one business to another is not valid unless they are compared using the same value system. For example, my successes will be different to my neighbours’ because our goals are different.

### ***Case example – what is ‘success’?***

The owners of two organic farms each believe themselves to be successful. The first farm is a corporate organic farm based in California, America. They produce organic food on a large scale, capitalising on the market demand for organic food. They believe they are successful as they measure their success by profit margin per hectare farmed. Compare this with a small organic farm in Saskatchewan, Canada, where a married couple produce organic food for altruistic reasons. They believe they are successful as they are farming in a manner they believe to be environmentally sustainable and producing ‘healthy’ food. Yet, if these businesses, visited one another, they would not deem the other to be successful as they are making the comparison based on very different value systems.

*Success is in the eye of the beholder*

# Production of commodities for a specific market

Many requirements for QA are market-specific, with market specifications varying from one customer to another. The real issue becomes alignment of production with the end-point processor demands. There is an increasing awareness that growers need to remain relevant to their customers. Farmers remain relevant through producing commodity products that meet a market demand and specification.

An example of commodity production of food products for specific markets can be seen in pulses. The fact that Australia is a relatively small player in global pulse trade in some ways provides special opportunities for the Australian industry. But in order to exploit this situation it is imperative that everyone in the value chain has an understanding of our markets and also of the cultural differences that exist (*Australian Farm Journal, September 2006*). Growers have a key role in ensuring we grow, handle and deliver product that meets the quality requirements and expectations of our customers and this means understanding what our customers want.

It is absolutely imperative for the long term future of our industry that growers develop relationships not only with neighbouring growers, with whom it may be possible to develop more sophisticated market assessments and plans, and put together volumes of products that better meet market requirements, but also with reputable and experienced traders who understand the nuances of the market (*Australian Farm Journal, September 2006*).

Some new and relatively small markets will emerge for high priced specialist food and feed products based on pulses, but the traditional commodity markets will remain our main outlets for years to come (*Australian Farm Journal, September 2006*).

## Quality assurance systems

The reality is that regardless of industry and regardless of market, QA is becoming just the ticket to the game. All supply chain participants regardless of market, commodity or country will be affected because supermarket chains around the world are raising the bar on food safety and QA.

Given our heavy dependence on commodity food exports, Australian farmers cannot ignore quality assurance systems and their bearing on proving the safety of food. An excellent example of this is seen in Japan. In May 2005 new regulations came in to place to protect public health that banned distribution of foods that contain chemical residues over certain levels.

The 'Positive List of Maximum Residue Limits for Agricultural and Veterinary Chemicals' means maximum residue limits (MRL) for all agricultural chemicals are regulated. Japan is part of a worldwide trend towards greater food safety; with consumers demanding that food they buy is free of spray residues and other contaminants. Over the years Australia's reputation for food quality and safety has been maintained allowing access to lucrative export markets while our competitors in America, Europe and South America have fallen behind. It is our ability to respond to market demands for safe food that will ensure our future.

Quality assurance programs also capitalise on Australia's comparative advantage of being 'clean and green' producers of food. Compared to low-cost production nations such as China where environmental and social standards are very low despite alleged independent testing of businesses. Marketing food as Australian grown may mean that we gain entry in to markets that are more discerning about environmental and social parameters for food products. The added bonus being that Australian certification has meaning and credibility, whereas certification in some developing countries can be 'bought'.

## **Value-add businesses – what works?**

Once it has been established that the core business is sustainable, then it may be time to look at building a value adding enterprise around this core business. Firstly, value-add businesses should be complementary to the core business so that the two can run together and gain synergies from each other. The value adding business also needs to be able to respond to market signals and seize opportunities.

When value adding to a product it is important to think about the steps in the process of taking this product from (in the case of food) paddock to plate. There will be some steps that are value adding, some that are necessary but do not add value and some steps that are both unnecessary and do not add value. Value adding steps are those that the consumer is willing to pay for. The aim of efficient management is to minimise the non-value adding steps as much as possible.

When developing business ideas for value add enterprises it is important that the ideas be market lead not production driven. For grain farmers, this may well be the biggest hurdle to success.

***Case example – fully integrated value-add enterprises***

John Alvis of Lyecross Farms, Bristol, United Kingdom, has diversified and value-added to his business in a highly successful manner. The catalyst for John’s entry in to value adding was the challenge of very low milk prices in the United Kingdom. John looked for value adding that would be complementary to his existing core business of dairy farming.

John started his own cheese dairy, which he supplies from his core business of the dairy farm. Any waste from the cheese dairy was then fed to a new pig enterprise. The manure from the pig enterprise was spread on to the existing arable farming land that grew the pasture for the initial dairy farm. A fully integrated, value-adding, business.

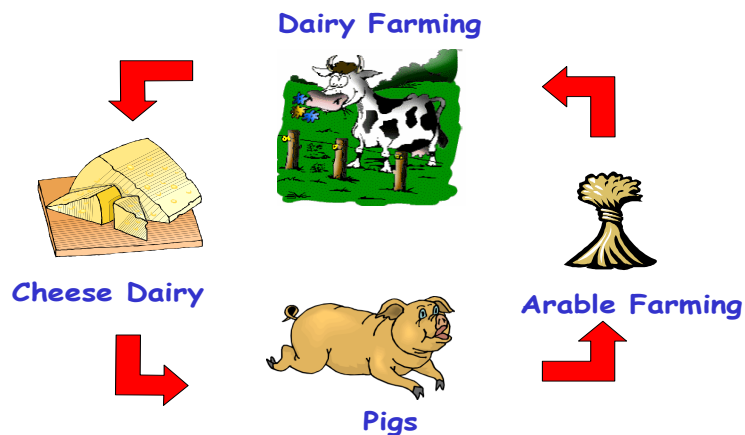
John’s business has grown to the point where he now supplied over sixty percent of the organic cheese in the UK organic cheese market.

John believes that his success is due to his ability to take managed risks, to change in response to his market and to employ expertise when needed. John is a firm believer that the best person for the job, takes the job and to “sod the name”. Here he is referring to the nepotism often shown within farming businesses where family members may be awarded positions that neither reflects their skills, their ability nor the best interest of the business.

*Growth is very much a learning curve – it is the speed at which you learn that is the critical factor – John Alvis, Lyecross Farms*



**Integrated West Country Farming Business**



## Seize opportunities

The ability to seize opportunities relies in part on knowledge of world and local trends in purchasing. Food is becoming more fashionable – people now talk about their food in a similar way to other luxury items. They want to be able to tell a story about its origin and its ‘goodness’. As food producers we need to capitalise on this new trend and align ourselves with the fashionable perception of food. One of the ongoing trends in higher end food retail is that of more expensive children’s food. Of the total UK food market, just 2% is organic with most stating expense being one of the prohibitive factors of purchasing. Compare this with 60% of the UK baby food being organic and you have some idea of just how much more people are willing to spend on their children.

*Case example - Value-adding: seizing opportunities through trends in food purchasing*

The Greenery in Holland seized an opportunity in a year when apples being delivered to their distribution were smaller than usual. Many of their regular customers were rejecting the apples on the basis of size. The Greenery then decided to repackage these smaller apples in to child-friendly boxes with puzzles on the side advertising them as ‘apples for children’. Suddenly the apples that were previously being rejected on size were now being purchased at a premium as they were destined for the highly prized children’s food market.

Agriculture and food production are just like any other industry – there are trends that we must follow in order to stay relevant to our customers. The current trend of food being fashionable is something that we need to capitalise upon. As farmers, why not align ourselves with this sexier image of food?

What is now known as the ‘foodie’ is a high spending consumer who is after something new in their food. These people are no longer satisfied with food that works; they expect that. They want an experience; a story – they want to feel good about their purchases. Food shopping has become a leisure experience – just head to London’s Borough markets at the weekend and you will see just how many people want to feel good about their purchases.

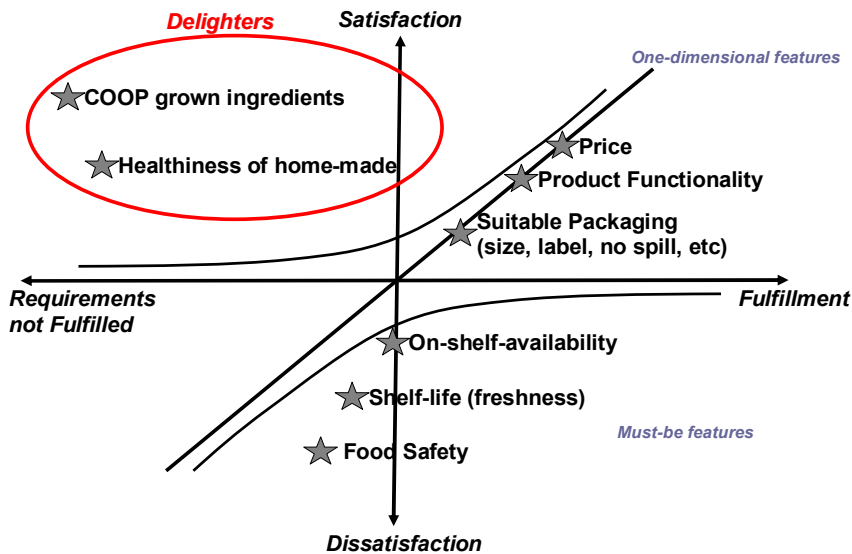
In addition to the foodies, there is a new demographic emerging, which is particularly prevalent in the United States. The LOHAS generation (lifestyle of health and sustainability); are people are not unlike the foodies in that they care about how they feel. The intangibles of sustainability are important to these thirty something’s with young families.

The LOHAS are the post functional age, everything in their world works, now they are looking for things that make them feel better about their choices.

The LOHAS generation has been seized upon by the New Zealand Company, Ice Breaker. Ice Breaker wraps a feel good story around their wool clothing and does it very well. Ice Breaker has done what market driven companies are very good at doing – they have created an opportunity for their products based on responding to market trends.

A passage from the Canadian Farmers Independent Weekly summed up the minimum that people now expect from their food “*quality parameters are increasingly focused on selling food that makes people well, as opposed to not making them sick*”.

### Attributes of value-added products



**Figure 1:** a graphical representation of the factors associated with food products that customers expect and those factors that ‘delight’ customers. Value-added products may possess some ‘delighters’ in order for customers to seek out the food product. Source: The Coop, United Kingdom.

The Coop is a cooperatively owned farm in the United Kingdom that took some wheat from its local farm, processed it into flour and marketed it as locally grown in Coop supermarkets. The Coop then looked at the satisfaction factors associated with this flour - the delighters for their customers were that it was coop grown and had the healthiness of homemade. Customers are willing to pay more for food products that have some of the ‘delighters’ attributes.

## **Business structures**

When setting up a business structure, or possibly clarifying one, it is important there are no grey areas of responsibility. Everyone needs to have a clear understanding of their area of responsibility. John Alvis of Lyecross Farms encourages business people to be ruthless about the selection of people for jobs and to ‘sod the name’. Day to day running of the business must be optimal without regard for family issues; ownership of the business is when family relationships come to the fore.

As a rule, successful businesses tend to use more outside expertise. Successful businesses are aware of their strengths but are also aware of the need for additional skills that may not exist within the business.

Agricultural business consultant Rob Napier encourages farmers to have one major business growth project every ten years to keep a business growing and dynamic. This business growth need not be production based, nor does it even need to be based on-farm. In fact, Rob Napier encourages farmers to have off-farm assets equal to or greater than one year’s farm income. Business needs to be diversified either in enterprise, off-farm or geographically to spread risk and increase returns.

### **Is “going organic” a way of value adding?**

A significant part of value adding is to produce a product that the market place demands. The demand for organic is increasing amongst the wealthy urban population who believe that organic food is better for them and, in some cases, believe that organic food is higher in quality than conventionally produced food. A word of caution here as sometimes ‘going organic’ does not add value.

*Case example – organics do not suit every market: TipTree Jams*

A well-established English jam label TipTree Jams decided to follow market signals and launch a line of organic TipTree Jams. In contrast to what they expected, this line of jams did not sell well. Rather than the organic label enticing customers, it turned them away as customers already believe TipTree jams to be of the highest quality and customers were nervous that organic jams would not have the taste that the English love in their TipTree jam.

*Not understanding your market is the biggest mistake a business can make*



In some markets there is a fear that the use of the term 'organic' on a product label is not even relevant to the product. They do not believe that 'organic' is a reliable indicator of quality as it relates to that product. There are fears that labelling food as organic will lead to a false sense of security amongst consumers when other basic issues may not be up to a quality parameter. Some non-organic producers are finding that other food qualities are being ignored and papered over in organic produce.

## **Where to from here?**

The future of Australian broad acre agriculture will continue to rely primarily on commodity production. In the future commodity production needs to become focused on specific end markets, with quality specifications and expectations met. Commodity markets will include Australia's traditional markets, whilst also embracing new markets as based on seasonal opportunities and growing nations.

Whilst remaining true to the core business of commodity production, Australian farmers will also need to value add to their existing businesses through involvement up the supply chain, more direct alignment with consumers or off-farm investment. It is important in striving for value adding that we do not lose site of our core business.

In developing value-adding businesses, farmers must look for opportunities to value add by being aware of local and global trends. Successful value adding businesses are those that look outward and develop products to suit the market place. This is in direct contrast to traditional primary production, which grows a product first, then looks for a market. When investigating a value adding opportunity it is important to conduct thorough market research.

Farmers will also need to take a range of managed risks in order to move forward in a business. Keep ideas simple and remember that the level of risk taken must be proportionate to the potential gain.

## Plain English Compendium Summary

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<b>Objectives</b>	To investigate the future viability of the Australian commodity production industry. Further to this, to determine if value adding should form part of this future.
<b>Background</b>	Commodity production is the mainstay of Australian broad acre agriculture however declining terms of trade are making the economic sustainability of commodity production unfavourable – this in turn affects the social and environmental sustainability of agriculture. Both within Australia and internationally farmers are looking to adding value to their agricultural produce as a way in which to improve sustainability. This study expanded the definition of value adding to include relationships with customers, diversifying and investing off-farm.
<b>Research</b>	This research was conducted over a twelve-month period spanning from October 2005 through October 2006 and included four months of overseas travels. During this time visits to New Zealand, China, Canada, United States, Italy, France, Holland and the United Kingdom were carried out.
<b>Outcomes</b>	Australia's comparative advantage within world agriculture lays in producing significant and consistent volumes of commodity food products, with a heavy focus on export. Commodity production in itself must change such that commodities are produced for a specific market and meet quality specifications as required for the end-use. Products must have a market place before they are grown. Australian commodities must be grown under quality assurance guidelines addressing not only quality issues but also environmental, social and economic parameters. Australian farmers also need to look to expand their businesses to include value adding in some form: be that better alignment with end point processors, further involvement up the supply chain through investment or partnerships, investing off-farm or diversifying geographically to spread risk.
<b>Implications</b>	Commodity production as we currently know it must change to become more market driven and tailored for specific end-uses. As an industry it is important that Australia maintains its reputation as a producer of high quality food products for domestic and international markets. In addition to this Australian farmers need to hone their business skills so that they are equipped to seize new opportunities as they arise in the changing market place.