Why the divorce? Examining the Fleet Separation Policy – Risks and Opportunities

Tom Cooper Ph.D.
Assistant Professor – Strategic Management
Email – tcooper@mun.ca
Tel – 709 864 2302

Outline of the talk…

1. What is the fleet separation policy
2. What was the rationale for it?
3. What is vertical integration?
4. What are the advantages?
5. What are the disadvantages?
6. Is there a way to achieve the advantages of vertical integration while maintaining the fleet separation policy?

Fleet Separation Policy

- **Objective**
  - To separate harvesting from processing and disallow the issuance of new fishing licenses to corporations and processing companies.
- **Background and Key Elements**
  - Initially adopted in 1979.
  - Covers fisheries where license holders are restricted to using vessels less than 65 feet in length.

Fleet Separation Policy

- **Background and Key Elements**
  - Disallows the issuance of new licenses to corporations including the processing sector, for fisheries where vessels are less than 65 feet in length
  - Allows for the retention of licenses already held by corporations, including those involved in the processing sector.
- **Scope**
  - Applicable to all licenses held on fishing vessels less than 65 feet in length

What is a policy?

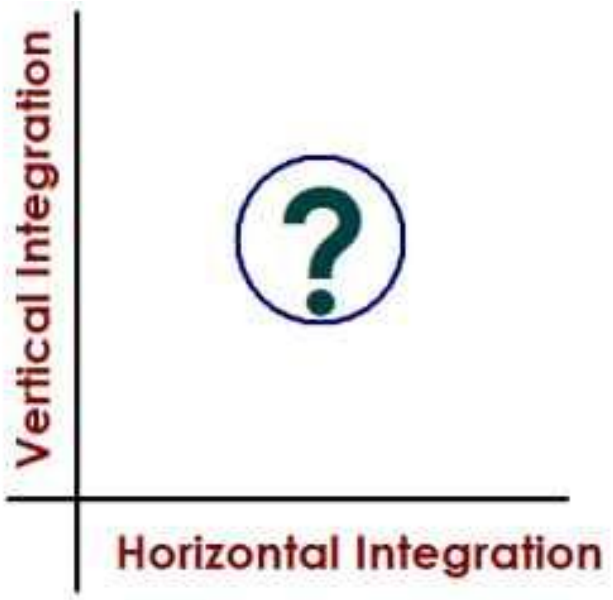
- Set of decisions which are oriented towards a long-term purpose or to a particular problem – essentially a form of control

Why the fleet separation policy?

- Reduce/eliminate corporate concentration of fishing licenses.
- Ensure the licenses/incomes were widely distributed.
- Ensure the long-term viability of rural communities.

Source: http://www.fao.org/wairdocs/ILRI/x5499E/x5499e03.htm

Vertical Versus Horizontal Integration



- **Vertical integration** is the process in which several steps in the production and/or distribution of a product or service are controlled by a single company or entity
- **Horizontal integration** (also known as lateral integration) simply means a strategy to increase your market share by owning a similar company.
  - Vertical Integration – example – oil and gas industry (Exxon)
  - Horizontal – example - tech industry (Google)

Principal advantages of vertical integration in the fishery…

- Avoiding the risk of uncertain supply,
- Enabling better control of the flow of products into the market to take advantage of opportunities not now available,
- Lengthening of the operating season, to provide better utilization of capacity and ROI, and

Principal advantages of vertical integration in the fishery…

- Better quality raw materials to facilitate production of higher-value products, and
- Avoiding the transaction costs related to buying from independent harvesters at many landing points and trucking the catch to a plant for processing.

Principal advantages of horizontal integration in the fishery

- Keep corporate concentration lower
- In an ideal world, better able to adapt to change
- Smaller, more flexible organizations
- Harvesters control licenses and quotas – more assurance and risk avoidance than in the processors held the quota

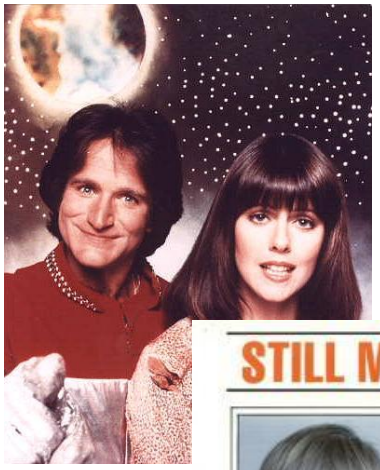
Did the fleet separation policy work?

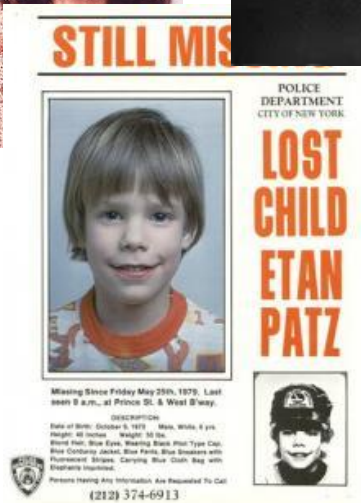
- **Demographic and Population Shifts (not just in NL):**
  - Rural communities in decline
  - Increased urbanization

- **Deloitte re harvesting (MOU 2011):**
  - "between one-third and two-thirds of the fish harvesting operations currently operating in NL are viable, depending on the viability measure employed"

- **Grant Thornton re processing (MOU 2011):**
  - "The level of profitability is well below the Canadian seafood processing sector norms and is considered unacceptable. The profitability level is not sufficient for the NL processing sector on average to make secure capital investments and achieve long-term viability."

The world has changed in the last 30 years....





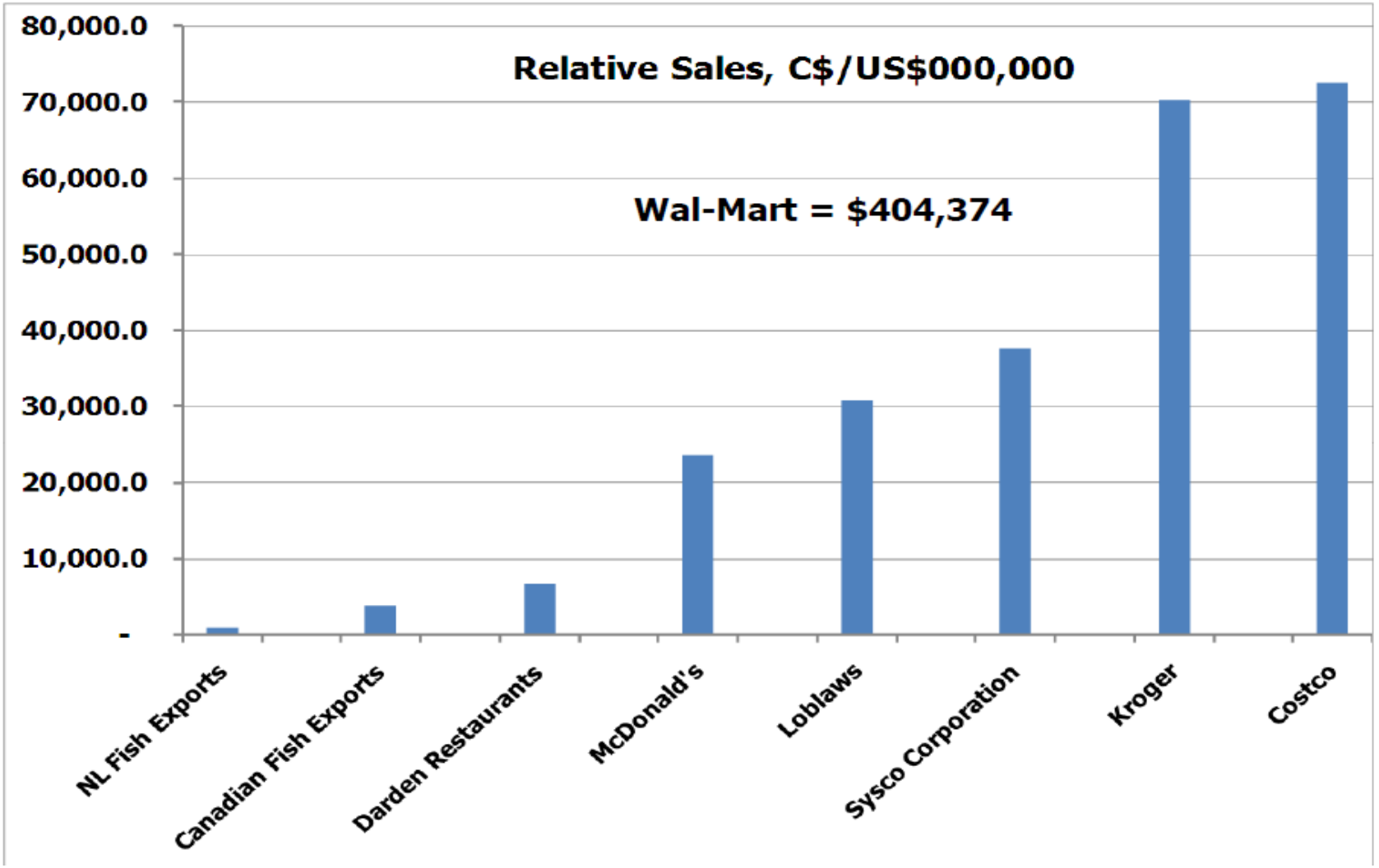
The world has also changed in the fishery since the 1970s.....

Changes in the Last 30 Years

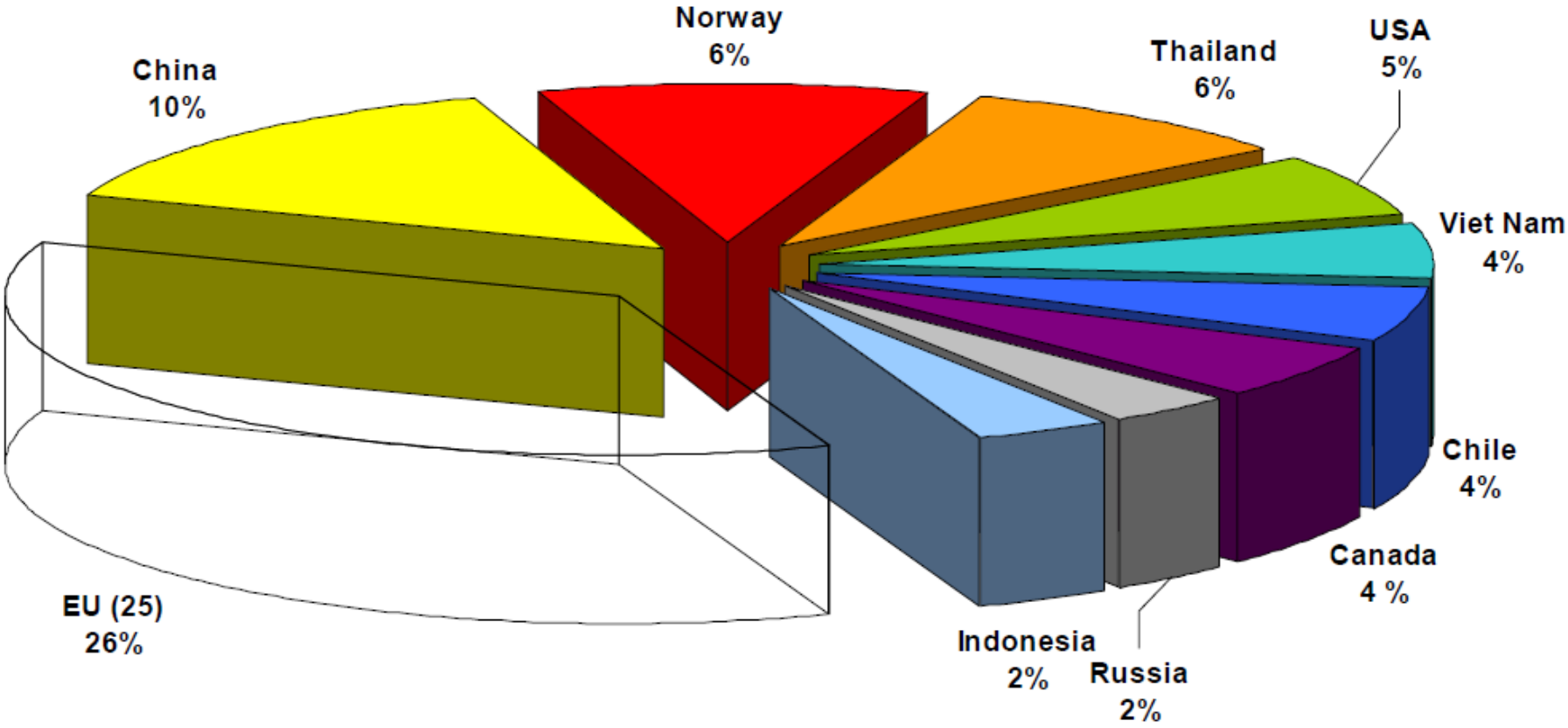
OLD	NEW
Dependence on groundfish	Dependence on shellfish
Resource abundance + growth	Resource scarcity → aquaculture
Primary market: United States; "mass"	Markets: US, Europe, Japan, China; niche
Inexpensive food for the middle class	Expensive food for affluent people
Growth in meals away from home	Growth in prepared foods for home consumption
Favourable currency exchange	Adverse currency exchange
Competitors in high-cost North Atlantic nations	Competitors in low-cost Asian nations
Cheap energy	Expensive energy
Baby boomers need jobs; high unemployment in rural areas	Baby boomers close to retirement; out-migration from rural areas
Natural resources should be exploited to maximize job creation; some concern re environmental degradation	Natural resources must be conserved; sustainability is increasingly important for access to markets, customers

Source: CCFI, Marine Institute

Relative Bargaining Power of Customers



Fish Exporters by Value - 2008



Problem: Goal (Mis)alignment

- **Industry participants' goals are not aligned ➔ want different answers to the fundamental questions**
  - Business vs. government vs. FFAW
  - Harvesters vs. processors vs. distributors vs. consumers
  - Harvesters vs. harvesters
  - Processors vs. processors
- **Decision-making is highly politicized – not a good environment for operating a business successfully**
  - But community viability ultimately depends on business
- **Competition must be refocused from internal to external**
  - We need a shared vision of the future and shared goals

Is the Fleet Separation Policy – the Cause or a Symptom?

Symptoms vs. the real issues

- Excess capacity – everyone is scrambling to get enough raw material
- Lack of an assured supply of raw material - uncertainty, risk, low ROI in both harvesting and processing
  - Effort is not coordinated throughout the value chain, leading to loss of output value – unlike aquaculture...
  - High requirements for working capital, and
  - Excessive cost
- Lack of cooperation between sectors to achieve coordination
- Ownership of the entire chain is one way to address these issues – but not necessarily the best –e.g. Kirby Task Force and the 1984 restructuring, Agriculture

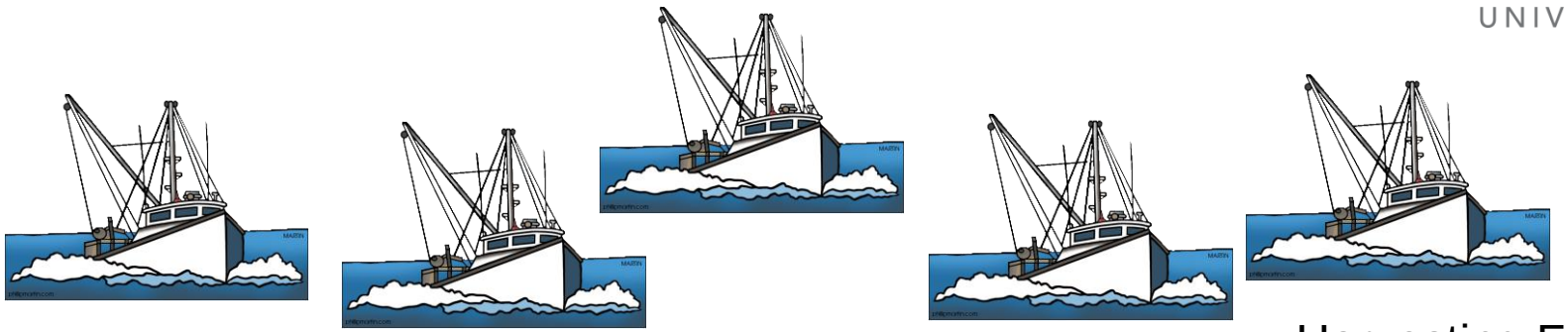
Policy Options

- **Status quo – keep the current policy**
  - Issues
    - MOU indicated that not many harvesters making adequate ROI (Return on Investment)
    - Living off previous investments
    - Political climate may shine spotlight on subsidies (such as EI programs)
- **Eliminate the Policy**
  - Issues
    - Slippery slope – “arm chair” fisherman and lowest cost crews

Policy Options

- **Hybrid Fleet Policy**
  - Open fishing licenses up to potential investment – including processors
  - Have harvesters still in control – investors can only have non-controlling share
  - Set parameters around investors and licenses - investors and harvesters still have to demonstrate ties to the province and (rural) NL
  - Focus on co-ordination, communication and driving up value in the supply chain

Scenario



Harvesting Fleet

Benefits:

- Keep supply constant
- More coordination and co-operation
- Sharing of information
- Better investment in fleet
- Less distressed selling
- Higher working capital
- Higher quality
- Lower risk

Shared Investment

- Harvesters still have control
- Processors and/or other investors involved
- Less reliance on debt financing – more equity
- Economies of scale on the administration side

Processor

So – what are the alternatives…

Options	Financial	Future Growth	Comm. Sustain.	Best Case	Worst Case
Status Quo - Keep the Policy	Poor ROI Financial issues – across the industry	Limited – mostly due to access to capital	Limited – continue trend	Fishery resource improves Significant investment emerges	Capture fishery disappears from rural NL
Eliminate the Policy	Better ROI for limited few	Limited – market consolidates	Limited	Market dictates - high value for a few	Slippery slope
Hybrid Alternative	More evenly distributed ROI	Medium – depends on resource and supply	Medium – some with thrive	Change in industry culture	Cost increases and lack of control

Potential for a Solution

- Change is happening – either industry takes ownership of the process or it will happen by default
- The industry has tremendous opportunities – but can't take advantage of them with the present industry structure including fleet separation policy.
- Change in the industry depends heavily on changes in public policy – including fleet separation policy
- The substantial opportunities available + changing demographics offer potential for change in public policy
- Re-examining the fleet separation policy – with all stakeholders involved – before the policy is enforced upon harvesters and processors alike – is the best way forward.

Thank you

- **Thank you for the opportunity to present**

- **Contact details**

Tom Cooper Ph.D.
Faculty of Business Administration
Email – tcooper@mun.ca
Phone – 709 864 2302

Risks and Opportunities

	Status Quo	Complete Fleet Separation	Hybrid
Industry Economics Collapse	High Risk	Medium Risk	Low Risk
Technological Obsolesce	High risk	Low risk	Low risk
Brand Erosion	Medium risk	High risk	Medium risk
Competitor (lack of response to..)	High risk	Low risk	Low risk
Customer	High risk	Medium risk	Low risk
Stagnation	High risk	Low risk	Low Risk