WHY THE DIVORCE?
Examining the Fleet Separation Policy – Risks and Opportunities

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THE TWENTY-SEVENTH IN A SERIES OF ARTICLES DEVELOPED FROM REGULAR PUBLIC FORUMS SPONSORED BY THE LESLIE HARRIS CENTRE OF REGIONAL POLICY AND DEVELOPMENT. MEMORIAL PRESENTS FEATURES SPEAKERS FROM MEMORIAL UNIVERSITY WHO ADDRESS ISSUES OF PUBLIC CONCERN IN THE PROVINCE.

Introduction

Local, national, and international commercial fishing industries the world over are in a fragile state as a result of abuse to the oceans. Research has shown that the remaining commercial stocks could become completely depleted by 2048.[1] This devastation puts commercial fishing industries, which are vital throughout the developed and developing world, in a perilous situation.

At the same time, demand for seafood has been increasing in recent years. Seafood has become well-recognised for its health benefits, such as being a reliable source of omega-3 fatty acids, and, coupled with the increased standard of living in many parts of the world, demand for it has skyrocketed.

With the predicted dramatic changes in both supply and demand will come increasing pressure to manage this resource effectively.

One of the traditional approaches to deal with resource allocation within the Newfoundland and Labrador and Atlantic Canadian commercial capture fishery has been the use of the fleet separation policy. The objective of the policy is to separate the harvesting from the processing and disallow the issuance of new fishing licenses to corporations and processing companies primarily to eliminate vertical integration and to lessen corporate concentration. In this article, we explore why the divorce between Newfoundland and Labrador harvesters and processors in the ownership of the inshore fleet happened, as well as what opportunities and risks are emerging.

Background to the Fleet Separation Policy

The fleet separation policy was initially adopted in 1979 and covers fisheries where license holders are restricted to using vessels less than 65 feet in length. At its core, it disallows the issuance of new licenses to corporations, specifically the processing sector, for fisheries where vessels are less than 65 feet in length. The policy applies to Newfoundland and Labrador as well as the rest of Atlantic Canada.

The policy does allow the retention of licenses already held by corporations, including those involved in the processing sector. For example, a seafood processing company would not be allowed to obtain a new license for company-owned fishing vessels less than 65 feet in length. Instead, they would have to purchase seafood, such as crab and shrimp, from inshore fishing vessels that are independently owned and controlled.[2]

What is a Policy?

In examining the fleet separation policy, it is important to address '*What is a policy*?' At its core, a policy is a set of decisions which are oriented towards a long-term purpose or to a particular problem. It is a form of control. Within most organizations, there are usually a number of policies; for example, an expenses policy for employees. Policies are put in place to give direction and to ensure specific risks are managed such as submitting an inappropriate expense claim.

Why the Fleet Separation Policy?

In the NL commercial capture fishing industry, there are essentially three main reasons why there is a fleet separation policy:

- to reduce/eliminate corporate concentration of fishing licenses;
- ensure the licenses/incomes were widely distributed; and
- ensure the long-term viability of rural communities.

When the fleet separation policy was formed over 30 years ago, there were concerns about the ability of large vertically integrated fishing enterprises such as Fishery Products Ltd, the Lake Group, and Nickerson and Sons to overwhelm the rest of the industry. Primarily due to the implementation of the fleet separation policy, the degree of corporate concentration has stabilized, the distribution of income has been more broadly based, and, as a result, a larger number of harvesters have experienced the type of income growth that benefits coastal communities. In essence the elimination of vertical integration, a phenomenon that is generally seen to be the product of increased corporate concentration, through the enforcement of the fleet separation policy was seen as a key approach to ensuring sustainability in the industry, most notably in the rural and coastal communities that had become so reliant on the industry for their survival.

Unfortunately, as the fish processing business became larger and more international in its scope, many of the world's fishing nations allowed for (and in some cases actively supported) the kind of corporate concentration and vertical integration in their fisheries that Canadian policy makers seemed so set against. The result in the international fish procurement, processing, and supply business is that it has become increasingly difficult for small independent Atlantic Canadian fishing companies to compete for and secure long-term supply contracts at advantageous prices.

Vertical versus Horizontal Integration

It is also important to examine what is meant by vertical and 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, in order to increase power in the marketplace. Horizontal integration simply means a strategy to increase market share by acquiring a similar company.

An example of vertical integration is in the oil and gas industry where a company such as Exxon would own upstream exploration and production subsidiaries. Horizontal integration is widely seen in the high-tech industry where a company like Google owns YouTube.

The principal advantage of vertical integration in the fishery would be to avoid the risk of uncertain supply, enabling better control of the flow of products into the market to take advantage of opportunities not now available. Vertical integration would also allow for lengthening of the operating season, to provide better utilization of capacity and better quality raw materials to facilitate production of higher-value products. Yet, as was seen in the 1982 Kirby Taskforce, a vertical strategy comes with specific risks and may not be ideal.

In comparison, the principal advantage of horizontal integration in the commercial fishery is to keep corporate concentration lower. In an ideal world, more horizontal integrated organizations are better able to adapt to change as they have a tendency to be smaller and more flexible, although traditionally they struggle with strategic thinking.

Fundamentally, the fleet separation policy creates seafood companies that are not vertically or even horizontally integrated. Corporations that act as processors are not allowed to control the supply of the product through owning fishing vessels. Harvesters cannot process the seafood they catch. This limits decision-making and poses specific operational risks, such as access to financing, for both processors as well as harvesters.

What Happened in the Last 30 Years?

Since the fleet separation policy was developed over 33 years ago, the worldwide capture fishery has undergone radical change. Adverse currency exchange, competitors in low-cost Asian nations, as well as expensive energy involved in transportation is now the norm. Business practices have changed dramatically in the last 30 years with the information technology revolution, global integrated supply chains, as well as the emergence of huge consumer markets in China and the rest of Asia.

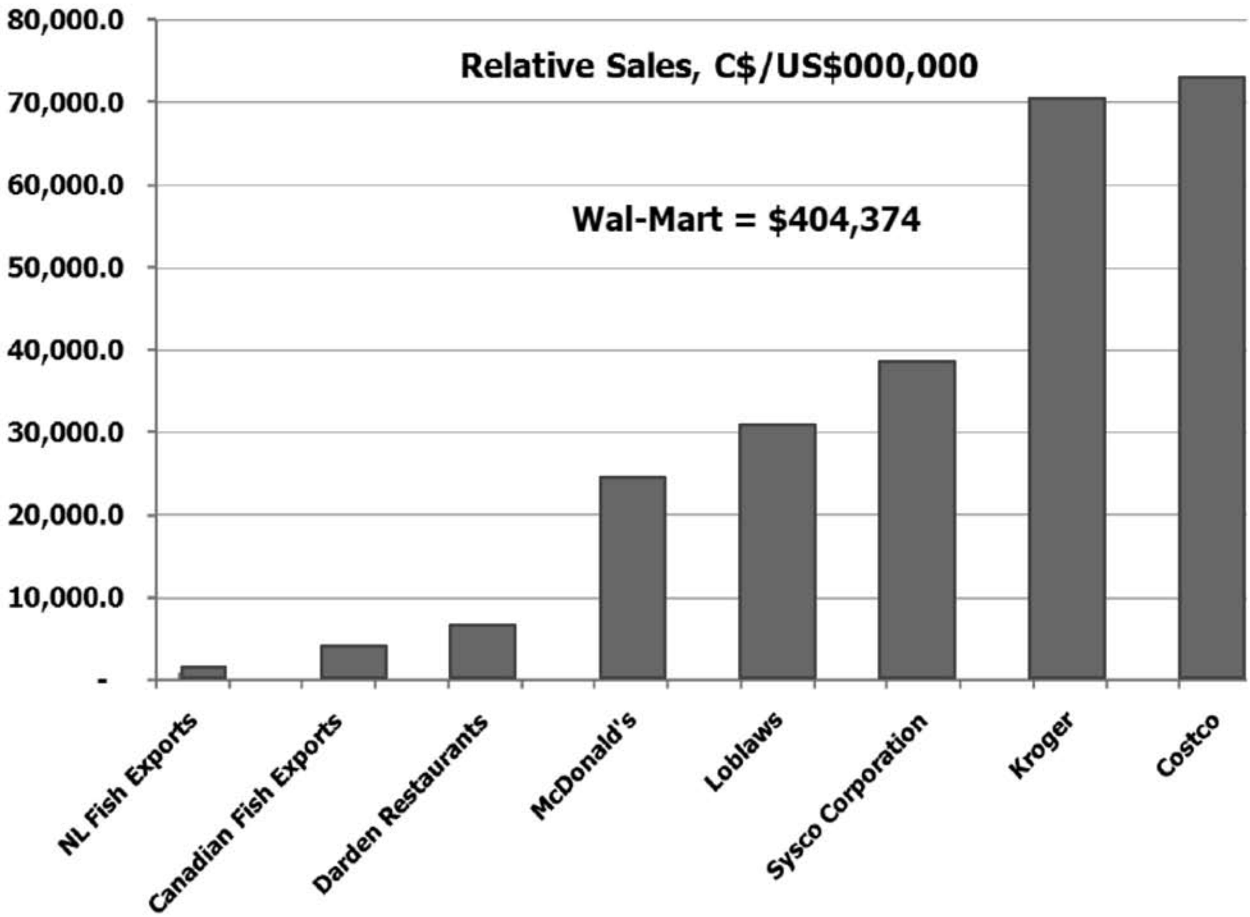
One of the main shifts has been the growth of customer power, particularly at the retail level. Consolidation in the retail food industry coupled with differences in the manner in which consumers now shop for perishable food stuffs means that seafood buyers have increasing amounts of power.

The graph on p 47 shows the relative power in terms of sales of NL Fish Exports versus companies such as Costco and Wal-Mart. Selling to large, multi-national customers is difficult as they have an incredible ability to bargain and negotiate not only price but also quality and delivery. Truly, the provincial fishery is a small fish in a very, very big pond when it comes to marketing and sales to customers.

Changes in Newfoundland and Labrador

The last 30 years have also seen significant changes in the province. Demographic and population shifts have occurred in most rural communities. Increased urbanization not only locally but elsewhere in the world has been the norm.

Table 1 – Relative Sales – Newfoundland and Labrador Fish Exports Compared to Customers
Source: Canadian Centre for Fisheries Innovation



The recent 2011 MOU report by the Department of Fisheries and Aquaculture (DFA) demonstrated that the financial viability of both harvesters and processors has been weakened. A report from Deloitte and Touche indicated that within the harvesting sector "between one-third and two-thirds of the fish harvesting operations currently operating in NL are viable, depending on the viability measure employed,"[2] while within the Grant Thornton report on processing it was explained, "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."[3]

The MOU process also demonstrated that the traditional provincial capture fishery was historically based on price competitiveness. The previous business model was seafood that could be frozen, relatively unprocessed, and shipped to customers primarily in the United States. The focus was on cost. Markets were predominantly North American and companies competed on price as they were able to take advantage of a favourable currency exchange and a large, young workforce. Given the changes in the province, the industry's historic business model can no longer work.

Fleet Separation Policy – the Cause or a Symptom?

In examining the fleet separation policy, a question emerges whether it is a symptom of a larger problem, or one of the real fundamental issues facing the industry. As indicated in the MOU process, the real issue facing the Newfoundland and Labrador seafood industry is one of excess capacity. Virtually all processors are scrambling to get enough raw material to satisfy their customers and pay their debts. The lack of an assured supply of raw material means significant uncertainty, risk, and a low return on investment (ROI) in both the harvesting and processing sectors. In the Newfoundland and Labrador fishing industry, efforts are not coordinated throughout the value chain, resulting in a loss of output value, stiflingly high working capital requirements, and excessive costs. At the same time, our major competitors have embraced vertical integration (or cooperation) and have subsequently put in place mechanisms to ensure product quality enhancements traceability and other product quality initiatives designed to maximize price and return for their investors.

At the distribution channel level, fleet separation also creates a lack of cooperation between sectors and effectively creates barriers to coordination and marketing. While ownership of the entire chain through vertical integration is one way to address these issues, it is not necessarily the best, as evidenced by the Kirby Taskforce. Yet, at present, industry participants' goals are not aligned. They want different answers to the fundamental issues such as resource allocation and the industry's future. It is a case of business (processors) vs. government vs. the Fish, Food and Allied Workers Union. Too much competition and not enough collaboration is the norm. Community sustainability ultimately depends on business viability. To survive, the Newfoundland and Labrador seafood industry needs a shared vision of the future and shared goals. The fleet separation policy is not the cause, but a symbol of a lack of a common vision and goals.

An Alternative to Fleet Separation

Allowing for investments, but not control, by industry participants in both the harvesting and processing sectors may be a way to enhance a mutual vision and goals. Harvesters and processors would still have management of their own sectors but it would allow for further collaboration and cooperation. Ideally, less reliance on debt financing and more equity would emerge as well as economies of scale on the administration side.

Through shared investments, with important parameters, there could be a more constant supply of seafood to the processors and a stable market for harvesters, and also better distribution of information resulting in less distressed selling, better investment in the fleet, higher working capital, and, ultimately, lower operational risk for all those involved. There should also be more coordination and co-operation for the betterment of the industry.

Conclusion

The capture fishery is a business that involves both harvesting and processing. The province exports its seafood products to compete in international markets. We sell to customers much bigger than we are. To have a better future, the industry must attract new investment. Collaboration is the only way to compete and the existing fleet policy facilitates separation not cooperation.

The provincial seafood industry can no longer compete on price. Our costs are much too high. There is a need to focus on obtaining more value from raw materials. Higher product yields, better quality, fresh, niche markets, by-product utilization and more coordinated marketing are required, along with less internally focused price-based competition, more working capital to carry inventories, and control of the flow of product. Investors want stable and sustainable communities and businesses. So do the people who want and choose to live in communities and engage in fisheries-related employment.

Change is happening in the seafood industry. Either industry participants take ownership of the process or it will happen by default. There is also a need to acknowledge the problem and its underlying causes; destructive competition among industry participants facilitated by a fleet separation policy is one of them. The industry has tremendous opportunities given the demand for the product, but change depends heavily on adaptation of public policy. Adapting the fleet separation policy to reconcile the divorce and bring participants together, would be an ideal change mechanism and starting point to assist the industry and rural communities throughout the province. NQ

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1 R Howes, "The Marine Stewardship Council Programme" in *Ecolabelling of Seafood: The Basic Concepts*, T J Ward and B Phillips (eds), 2008, p 81.
2 Fisheries and Oceans Canada, *Preserving the Independence of the Inshore Fleet in Canada's Atlantic Fisheries*, Government of Canada, Ottawa, 2003.
3 Department of Fisheries and Aquaculture, *Report of the Independent Chair: MOU Steering Committee. Newfoundland and Labrador Fishing Industry Rationalization and Restructuring*, Province of Newfoundland and Labrador, 2011.