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Australia China Food Summit
中澳农业高峰会

Premium Food & Wine Production

OPPORTUNITIES FOR AUSTRALIA-CHINA BUSINESS PARTNERSHIPS

BACKGROUND PAPER

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Executive Summary

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Enormous opportunities exist for commercial cooperation between Australian and Chinese businesses in the production, processing, distribution and sale of premium Australian food, wine and other beverages. Yet that cooperation is still in its infancy and the number of successfully completed and implemented deals remains modest. Numerous conferences, seminars and private meetings have been held over the past few years confirming the size and scope of opportunities. But now the time has come to move from the conceptual to the practical by identifying and, wherever possible, removing the obstacles to successful transactions being concluded. This is the purpose of the Australia China Food Summit being convened by the Australia China Business Council.

A common misconception is that Australia has a vital role to play in meeting China's food security needs. Another is that Australia can become the food bowl for Asia. Food security involves ensuring that the basic nutritional needs of a country's population are met at affordable prices. In pursuing food security, China will concentrate its efforts on domestic production of staples such as rice and wheat for its 1.4 billion people. Imports of these grains are likely to constitute only a small proportion of domestic consumption.

As to the food bowl claim, Australia's present food exports are sufficient for the needs of around 60 million people. Even if they doubled over the next few decades, as seems feasible, Australia's food exports would not be capable of meeting the dietary needs of a significant proportion of the population of Asia, which is already more than 4.3 billion people and is projected to exceed 5.1 billion by 2050.

But a second trend beyond regional population growth has been emerging: the rise of the middle classes of Asia, which are expected to number more than 3.1 billion consumers by 2030. In particular, as China's economic development and urbanisation continues, consumers will be increasingly demanding higher-protein food sources such as dairy products, beef, seafood and sheep meat. And as Chinese incomes continue to rise, so will demand for wines and other high-value beverages increase.

Here is where Australia's big opportunity lies: in the production, processing and distribution of premium food, wine and other beverages. But Australia faces stiff competition and its share of the premium produce market in China has been falling. Australia has competitive strengths in supplying China's demand for premium produce, including an abundance of arable land, an unsurpassed reputation for producing safe, clean, green food, a record of farmer innovation and adaptability to changing climatic conditions, a strong economy and stable political system and a transparent legal system. However, Australia also has competitive weaknesses, including vulnerability to drought, a high cost structure, an ageing farming population and associated rural labour shortages, and fragmentation of prime agricultural landholdings.

Remedying those weaknesses, including through farm consolidation, modernising and expanding food processing capacity and upgrading and expanding storage and transport infrastructure, will require large amounts of foreign investment. It is estimated that Australia will require A$1 trillion between now and 2050 to meet its potential to supply Asia's rising demand for premium produce.

Yet foreign investment in Australian farmlands is controversial, most of the opportunities to buy existing processing and distribution companies have been exhausted and potential local co-investors in rural infrastructure, such as superannuation fund managers, are difficult to persuade.

Different investment vehicles will need to be considered for the different parts of the premium produce value chain: food production, processing and distribution. Chinese investment in Australian farmlands is minimal and in prime agricultural land it is negligible. Opportunities exist for Chinese investment in leasehold rangelands in northern Australia and for minority equity investment to assist in the farm consolidation process already underway in southern parts of Australia. Farm off-take agreements for local processing and export to China appear to have strong commercial potential.

Most of the Australian-based food and beverage processing operations are already fully or substantially foreign owned. Opportunities for outright purchase by Chinese investors appear limited. But there is clear commercial potential for Chinese investment in greenfield processing facilities, including in dairy, especially by those businesses with established distribution networks in China.

Potential exists for Chinese equity participation in rural storage and transport infrastructure. It would be in the interests of China to assist in the funding of rural infrastructure upgrades, since some of the benefits of lower costs would be passed on in the form of lower delivered prices in China.

On a grander scale, the Australian Government is advancing thinking, through the preparation of a Northern Australia White Paper, on opening up arable but under-utilised land in northern Australia for premium food production. This would require major investments in water catchment and distribution infrastructure in order to retain for agricultural use a greater proportion of the very heavy seasonal rainfall in the north.

Australia's regulatory system – most notably in the form of the Foreign Investment Review Board and the Australian Competition and Consumer Commission – is capable of facilitating cooperative arrangements between Australian and Chinese businesses in meeting China's rising demand for premium food and beverage products. A free-trade agreement between Australia and China would improve market access into China and could further ease the Foreign Investment Review Board regulatory processes.

Ultimately, developing and nurturing friendly relationships between Chinese and Australian business partners is the key to enduring success. Adopting commercial policies and practices that are in sync with Chinese government priorities, such as helping develop agriculture in more remote Chinese provinces, can also help ensure long-term commercial success for Australian and Chinese business partners.

Facilitators experienced in forging Australia-China agribusiness deals, such as economic advisory and legal firms and financiers, can be very helpful both in making deals and ensuring their successful implementation.

The Australia China Food Summit will hear of case studies of successful cooperation between Australian and Chinese businesses in premium food and beverage production and export. It will discuss alternative investment vehicles in the production, processing and distribution of premium produce. And it will consider the impediments that need to be removed in order to convert opportunities for cooperation into commercial success and the measures that will need to be taken to remove these obstacles. This paper is a practical effort to help ensure that the boundless potential for commercial cooperation between businesses from the two countries is realised through the successful conclusion and implementation of commercial deals between Australian and Chinese business partners.

- Craig Emerson

Opportunity abounds

The global food supply challenge

In 2012 the world gained its seven billionth person. Of those seven billion, almost one billion go to bed hungry every night. By 2050 the world's population will have swollen to more than nine billion people. At the same time the middle classes of major emerging economies are expanding rapidly – by 2030 the middle classes of the Asian region alone are expected to number more than 3.1 billion consumers.

Very large increases in global demand for food over the next 35 years are inevitable. The FAO estimates food demand will increase by 70 per cent globally, with a doubling of demand within in Asia.[1]

The 2008 food riots in countries across Asia, Africa and the Caribbean, when world prices of rice, wheat, corn and soybeans had spiked, are a reminder of the potency of the food security issue. World food prices peaked again in 2012 at higher levels in real terms than those of 2008 (Figure 1).[2] Major food-consuming countries such as China, India and Indonesia are acutely conscious of the hardship and instability that can be created by food shortages and unaffordable prices of staples for their large populations.

> ***"Food security means much more than engineering a sustainable supply chain to meet demand, for China it also means political stability and national sovereignty"***
> *(KPMG 2012b, p. 1)*

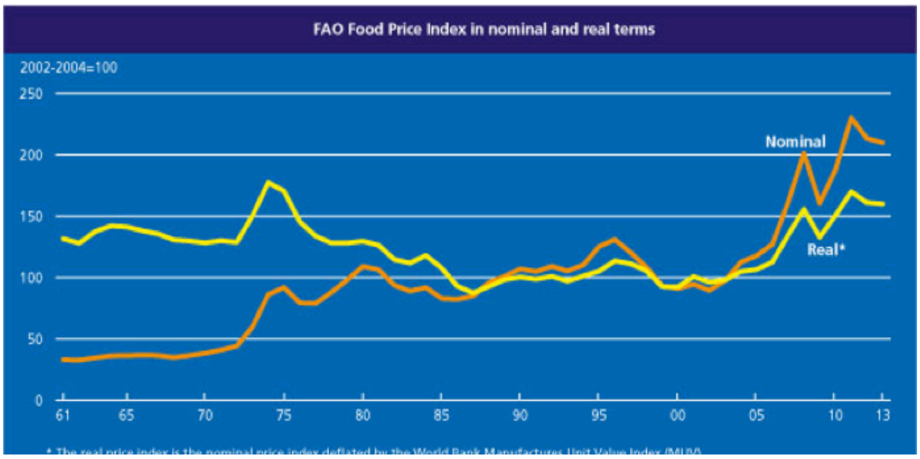

Figure 1

Big shifts in demand by the rising middle classes in favour of high-protein food sources such as dairy products, beef, pork, poultry, sheep meat and seafood are already underway.

Extensive methods of growing some of these high-protein meat and dairy products, such as rangelands and large tracts of lowlands, are in competition with grain production to meet the increasing demand for staples. Where intensive methods of producing meat and dairy products are used, such as feedlots and other factory-style farming methods, grain must be purchased as feed for the animals. This extra demand for grains can only put upward pressure on their availability and prices.

Either way, grain production and farm animal production are already in competition against each other and will become increasingly so. To the extent that national governments prioritise grain production to meet their basic food security goals they will inevitably limit their capacity to produce meat and dairy products.

China's food supply and demand

Since the mid-1990s China's total land area under cultivation has declined from around 130 million hectares to just over 120 million hectares. At the same time, the quality of cultivated land has deteriorated, with an estimated 70 per cent of China's land under cultivation being low-yield farmland.[3] China's per capita fresh water resource availability is only one-quarter of the world's average[4] and overall water quality has also been declining.

China has achieved a very high level of self-sufficiency in basic grains – wheat, rice and coarse grains – but in doing so has become more import-dependent for a range of other agricultural products that compete with basic grains for land.[5] China is expected to maintain very high levels of self-sufficiency in wheat over the next decade,[6] in accordance with its policy of achieving self-sufficiency in grains.[7]

China's rural population fell from 844 million at its peak in 1992 to 695 million in 2012, a net decline of 150 million people. UN population projections are for a further decline of 100 million by 2022. Average incomes of urban dwellers in China are around three times those of rural dwellers. China's urban dwellers consume much larger quantities of meat, vegetables and dairy products per person than rural dwellers.[8] China's future food import demand therefore will increasingly be in beef, sheep meat, dairy products, sugar and vegetable oils.[9]

China will also be looking for sources of feed for its rapidly expanding dairy herds. Sorghum imports will rise rapidly, along with imports of high-quality hay such as alfalfa hay.

Wealthy Chinese and China's growing middle class population are consuming increasing volumes of mid-range and high-quality wine. In 2013 China became the world's biggest consumer of red wine, consumption having grown by 136 per cent over the previous five years.

Chinese importer and investor interest in Australian agriculture is being driven not by a desire to attain food security but by market demand for premium-quality food.

> ***"We have observed that the underlying driver of Chinese ODI in Australian agribusiness is the market demand for diverse and high quality agricultural products, rather than to fulfil long-term food security objectives"***
>
> *(KPMG and University of Sydney 2013, p. 9).*

Can Australia help meet China's rising food demand?

Australia's food and wine production and processing industry

Australia's primary food production industry comprises more than 135,000 farm businesses, of which 99 per cent are Australian owned. Agriculture employs more than 300,000 people.[10] The majority of Australian farms are small, 55 per cent of them with an estimated value of agricultural operations of less than $100,000 per annum, and just 7,700 farms, or 6 per cent, having an estimated value of agricultural operations greater than $1 million per annum.[11] Australia, however, has 100 massive farms each occupying more than half a million hectares.

Over the last three decades the number of Australian farmers has declined by 40 per cent, to around 157,000, as small farmers have sold up to large-scale farming businesses and fewer young people have taken over the family farm.[12] The median age of farmers is 53 years, compared with 40 years for the general workforce. Almost one-quarter of farmers are over the age of 65, compared with just 3 per cent of the wider workforce. While the average weekly disposable income of farmers is almost 40 per cent below that of the general workforce, their average net worth of around $1.3 million is more than three times the net worth of other households.[13]

Australia's food processing industry is the country's largest manufacturing industry.[14] It comprises more than 13,000 businesses, of which almost 99 per cent are small and medium sized businesses. However, Australia's 50 largest food and beverage companies, most of them multinational corporations, generate almost three-quarters of industry revenue.[15] Australia has more than 2,000 wineries operating in more than 60 wine producing regions. Australia is the world's fourth-largest exporter of wine.

Faced with high costs and a strong currency, a number of large food processing plants in Australia have closed in recent years. To achieve reductions in unit costs, many existing food processing facilities need to modernise their plants and increase scale, but have struggled under the weight of a strong currency and relatively high labour costs to make a business case for this new capital investment.

Since the beginning of 2013 the Australian dollar has depreciated against the US dollar by around 13 per cent and wage growth has slowed to its lowest rate in at least 16 years. However, further depreciation of the Australian dollar will be necessary to improve the business case for new investment in food processing.

Australia's Competitive Strengths

Just as Australia and China have had complementary economies during China's period of metals and energy intensive economic development, the two economies will be complementary as China makes the transition to its next phase of development, based on rising consumer demand and spreading the benefits of growth from coastal cities to inland regions, as set out in the 12th Five Year Plan. The difference is that for Australia the China minerals boom lasted 10 years whereas the food boom could last for decades.

A rigorous methodology developed by Deloitte ranks 20 global industries according to their growth potential over the next two decades. It then ranks Australia's competitive strength in each of these industries compared with that of rival countries. By intersecting the two rankings of growth potential and Australian competitive strength, the Deloitte analysis identifies agribusiness as the standout opportunity for Australia: the number one future growth prospect for Australia among 20 global industries.[16]

While Australia has competitive strength in agribusiness, it is not the only potential source of food and wine imports for China. Brazil (beef and sugar), the United States (beef and wine), New Zealand (dairy products, sheep meat and wine), the European Union (beef, dairy products, sugar

> ***"China is not only Australia's largest trading partner, but also the largest trading partner of approximately 123 economies, many of which are competitors for agricultural trade and investment, including New Zealand"***
>
> *(KPMG and University of Sydney 2013, p. 1)*

and wine), Eastern Europe (dairy products), Thailand (sugar) and Chile and Argentina (wine) are strong competitors of Australia's.[17] These countries are aggressively increasing their capacity to supply the rapidly expanding Chinese market.

While Australia exports around 60 per cent of the food it produces, the country's current total production can contribute to the diets of only 60 million people, which is less than 1 per cent of the world's population and less than 2 per cent of Asia's population.[18] Australia ranks only 16th in the world as an exporter of food, with just 2 per cent of world food exports[19] and only eighth-largest source country of Chinese imports of agricultural products.[20]

> ***"Neither Australia nor any other country can directly act as the "food bowl" of the world or a large, populous region"***
> *(Office of the Chief Scientist 2012, p. 4).*

Australia has attributes that give it advantages over other countries in meeting China's rising demand for premium food, wines and other beverages. Australia shares with New Zealand an unsurpassed reputation as a safe, clean, green food producer. Australia has never experienced foot and mouth disease or bovine spongiform encephalopathy (BSE, or mad cow disease). Australia has no real history of meat substitution scandals. Australia's food production and processing facilities are expected to comply with high standards of cleanliness and food safety, and standards are rigorously enforced.[21] According to the OECD, Australia ranked equal first with Denmark and Great Britain in food safety performance in 2010.[22]

Australia is politically stable with low levels of sovereign risk. Its regulatory, legal and judicial systems are open and transparent. Australia has been ranked by credit ratings agency Dun & Bradstreet as equal first with Canada, Norway and Switzerland, among 193 countries, as a safe and secure destination for investment.[23] Australia is rated AAA and stable by all three international ratings agencies.

Australia is the second easiest country in the world in which to set up a business.[24] Australia has been ranked third, behind Hong Kong and Singapore, by the Heritage Foundation and Wall Street Journal index of economic freedom, just ahead of Switzerland, New Zealand and Canada, and well ahead of the United States, Japan, Germany and most other European countries.[25]

> ***"Australia is recognised by Chinese consumers as having a 'clean and green' environment with good quality products and brands"***
> *(Food Processing Industry Strategy Group 2012, p. 37).*

Australian farmers are not heavily subsidised, and as such are seen by Chinese importers and investors as efficient and innovative, capable of adapting to the vagaries of changing climate in a drought-prone continent.

Australia is geographically closer to China than South America and Africa and its infrastructure is generally more modern than that of developing countries, giving it transport cost advantages over many competitors.

Australia's Competitive Weaknesses

Australia has a number of competitive disadvantages too. Australia is the driest inhabitable continent on earth. Most parts of rural Australia lack the water storage and distribution infrastructure to insulate them against drought, increasing the risk of supply shortages for Chinese importers. However, Tasmania and parts of Victoria and southern New South Wales have good access to irrigation water.

Australia has a substantially higher wage structure than most of its rivals and can experience difficulty attracting skilled and semi-skilled workers to farming and food processing.[26]

While large sections of Australian farming are among the most efficient in the world, parts of the farming sector are unable to achieve economies of scale and lack the capital to modernise their production processes.

Though generally better than developing competitor country infrastructure, Australia's road, rail and port infrastructure is inadequate for transporting agricultural produce at low cost.

These cost disadvantages are adversely affecting Australia's competitiveness in higher-end food production, including against developed country competitors. While premium-quality Australian food products can command premium prices, the relatively high cost of producing and transporting them affects the commercial viability of exporting them to China. Many of these premium products are valued for their freshness and therefore must be transported by air, adding to the overall cost of getting them to final markets.

Foreign Investment in Australian Agriculture

Why foreign investment in Australian agriculture is needed

As the real, long-term prices of food, especially premium-quality food, continue to rise in response to rising demand, new sources of supply will become economically viable. Purchasers of this produce will want the maintenance of high quality, safety and reliable supply. New investment will be needed to meet these requirements.

Australia has always relied on foreign capital for its investment needs. Now is no different; the savings of Australians are inadequate for the country's total investment needs.

Australia has more than $1.7 trillion in superannuation funds under management. But superannuation fund managers have not favoured investing in Australian agribusiness. Chinese sovereign wealth fund managers point out that Australian superannuation fund managers tend to shift funds around in competition with other fund managers in an effort to produce superior shorter-term returns. This militates against cooperating with China's sovereign wealth funds such as China Investment Corporation (CIC), which is seeking long-term investment opportunities as minority shareholders in Australian agribusiness ventures.

Parts of Australian agriculture are highly efficient and utilise the most modern equipment and practices. However, other parts, especially where small and medium sized enterprises dominate, do not have access to the most modern equipment and techniques,[27] but could play an important role in meeting the increasing global demand for premium-quality food and beverages.

> ***"Without foreign capital inflows, investment in Australia would be limited only to that provided by domestic savings, resulting in lower production, employment, income and taxation payments"***
> *(RIRDC and ABARES 2011, p. 1).*

The ANZ has estimated Australia will require A$1 trillion in additional agribusiness funding to 2050.[28] That massive amount of finance will not come primarily from domestic sources; large amounts of foreign investment will be needed.

> *"Between now and 2050, around A$600 billion … in additional capital will be needed to generate growth and profitability in Australian agriculture … A further A$400 billion … will be needed … to support farm turnover, as ageing farmers make way for the next generation"*
> *(ANZ 2012, p. 3).*

History

Following European settlement, Australian agriculture was substantially founded on foreign investment.[29] In 1824 the British-funded Australian Agricultural Company purchased more than 200,000 hectares of land on the Peel River and Liverpool Plains of New South Wales. A year later the Van Diemen's Land Company bought 142,000 hectares in Tasmania and established Australia's first commercial cheese factory. Canadian brothers George and William Chaffey contributed to the early development of irrigation, subdividing 100,000 hectares at Mildura and supplying it with irrigation water. The British-Argentinian family Vestey was an early investor in the Northern Territory beef industry.

In the 1970s and 1980s American and Japanese businesses invested heavily in the Australian beef industry.[30] Many of those investments were subsequently sold to other foreign and local investors. For example, Vestey sold its properties in 1992 and the Tejas Land & Cattle Co (USA) sold its three Northern Territory stations to the Australian Agricultural Company in 2004.

In the last quarter century or so, foreign businesses have acquired major Australian food processing assets, some of them subsequently being on-sold to other foreign companies.[31] Tate & Lyle (UK) acquired Bundaberg Sugar Limited in 1991 and sold it to Finasucre (Belgium) in 2000. CSR sold its sugar business to Wilmar (Malaysia-Singapore) in 2010. JBS (Brazil) began acquiring meat-processing facilities in Australia in 2007. Cargill (USA) began investing in Australia in 1967. From the 1980s Nippon Meat Packers (Japan) has been active in Australia.

Recent trends

The most recent official estimates of foreign investment in Australian agricultural land were survey results released by the Australian Bureau of Statistics in 2011.[32] These estimates suggest that 99 per cent of agricultural businesses in Australia were entirely Australian owned in 2010. Of the total area of agricultural land in Australia, an estimated 89 per cent was wholly Australian owned, 5.5 per cent was majority Australian owned and 5.5 per cent was wholly or majority foreign owned. A follow-up survey was conducted in 2013 but the results have not yet been released.

Although these figures are low, there are community perceptions that foreign investment in Australian agriculture has increased sharply in recent years and has been directed at prime agricultural land. Qatar's state-owned enterprise, Hassad Food Company, has been reasonably active buying and aggregating agricultural land in various parts of Australia. But Chinese purchases of agricultural land have been minimal. New Chinese investment in Australian agribusiness in 2013 is estimated at only $95 million, just 1 per cent of total Chinese investment in Australia in that year.[34]

Some of the most publicised purchases of farmland by foreign companies have, in fact, been by mining companies[34] seeking a buffer zone around their mining operations. For example, Chinese company Shenhua bought 43 farms near Gunnedah, New South Wales, to explore for and develop coal resources. In 2010, an estimated 60 per cent (by value) of foreign farmland purchases in Queensland were by mining companies.[35]

> ***"Since 2006 only 12 significant Chinese investments have been made in Australian farmland with a total value of just over $1.1 billion"***
>
> *(KPMG and University of Sydney 2013, p. 5 and update from KPMG).*

Foreign investment in Australian food processing and distribution is much greater than in agricultural land. Foreign companies have acquired many local agribusiness companies in recent years, including Australian Meat Holdings, Tasman Group, National Foods, Dairy Farmers, AWB and Sucrogen (formerly CSR's sugar business).[36] In 2011, China's Bright Food Group acquired food logistics company Manassen Foods for $500 million and a 10.1 per cent of Goodman Fielder in 2012, while Chinese state-owned company COFCO Limited purchased Tully Sugar for $146 million.[37]

Around half of the milk produced in Australia is now processed by foreign-owned businesses: Fonterra (New Zealand), Lion (Japan) and Parmalat (France). Following wheat market deregulation in 2008, Viterra (Canada) acquired ABB Grain and Agrium (Canada) bought AWB Limited, later selling its grain handling business to Cargill (USA). Half of the 23 licensed wheat exporters operating in Australia are foreign owned.

Seizing Opportunities

Prospective commercial opportunities

Australia has been assessed as having a comparative advantage in the production of beef, sheep meat, dairy products, wine and wheat. New Zealand is an especially strong competitor in most of these products,[38] though New Zealand faces land availability constraints in seeking to greatly expand output of some of these products. As China continues to pursue self-sufficiency in basic foods, it will be looking to other countries for imports of premium-quality foods.

Under plausible assumptions, the real value of Australia's food exports could be 140 per cent greater in 2050 than in 2007, driven by increases in exports of beef, sheep meat, dairy products and sugar.[39] Competition, however, will be intense. Australia has been losing market share to rivals in the quest to meet China's rapidly growing demand for premium food and beverages. In recent years, France has more than trebled its share of China's food imports from 2 per cent to 7 per cent, New Zealand has sharply increased its share from 2 per cent to 8 per cent and Indonesia has increased its share from 2 per cent to more than 13 per cent. In contrast, Australia's share has halved from 6 per cent to 3 per cent.[40]

Based on market feedback,[41] the greatest interest shown by Chinese food businesses is in Australian suppliers of:

- Milk powder;
- Ultra High Temperature (UHT) milk;

"Actual ownership of land will likely be increasingly separated from the physical production of agricultural wealth as new business models are devised and adopted"
(KPMG 2012a, p. 4).

- Baby food (infant formula);
- Cheese;
- Butter and margarine;
- Seafood (oysters, live lobster, live abalone, live king crab);
- Fresh fruit;
- Frozen red meats (beef, veal, lamb);
- Wheat, barley and rice;
- Wine and beer;
- Fruit juice;
- Convenience and 'instant' foods; and
- Confectionary and snack products.

This list is by no means exhaustive. Chinese importers are seeking premium-quality chilled beef, such as Wagyu and Angus beef. More recently, interest in frozen beef appears to have waned, amid concerns within China about food safety and meat quality risks during the defrosting process. Chinese dairy producers wish to import large quantities of alfalfa hay to mix with sorghum as feed for their herds. Chinese demand for dairy breeding cattle continues to grow strongly.

> ***"Australia's family farming dominated sector is highly fragmented. Chinese investors are mostly interested in very large-scale investment opportunities and the largest companies are already largely foreign owned or not easily acquired. To date, we have not observed large-scale aggregation strategies successfully applied on behalf of Chinese investors"***
> *(KPMG and University of Sydney 2013, p. 5).*

Alternative Investment Vehicles

A variety of commercial arrangements are available for cooperation between Chinese and Australian businesses in meeting China's demand for premium-quality food and beverages. When evaluating alternative investment vehicles, it is useful to look separately at three stages in the supply chain of Australian agricultural produce: production, processing and distribution. The most commercially attractive investment vehicles might vary according to the stage under consideration.

Food production

Few sources of new equity capital are available to Australian farmers and Australian farm debt levels are already high. Domestic fund managers continue to underinvest in Australian agriculture for a combination of reasons including a lack of industry knowledge, perceived risks, long lead times and poor performance of listed companies (PPB Advisory 2013, p. 1).

Full foreign ownership of agricultural land might appear to offer the greatest certainty to Chinese investors, providing complete control over decision making to the owner. However, it has drawbacks. Purchasing large tracts of prime agricultural land would inevitably create community and political controversy.

Community perceptions about foreign businesses leasing agricultural land are much more benign than those of full foreign ownership. It is not widely appreciated that 50 per cent of the entire land area of northern Australia is actually leasehold while only 6 per cent is private freehold land.[42] Leasehold is a very secure form of tenure, with lease terms of 99 years including assured rights of renewal. To illustrate, the awarding of the Ord River Stage 2 development to Shanghai Zhongfu in 2012 was based on a 50-year lease.

"New structures for owning and operating farms need to be encouraged to attract investment from domestic and foreign investors and capital markets. These structures might include rapidly evolving equity partnerships, modern variants of share farming and use of off-take agreements, as used in the mining sector"

(ANZ 2012, p. 3).

Freehold, as a form of land tenure, is much more prevalent in southern Australia. Chinese businesses taking substantial minority or 50 per cent equity positions in businesses acquiring prime agricultural land would generate considerably less public controversy than full ownership.

These realities point to a consideration of less conventional investment vehicles for prospective Chinese investors. They could include partnering with major Australian-based agribusinesses and with regional landholders through a combination of equity participation and off-take agreements. Over the longer term, the process of farm consolidation, already well underway, will provide new opportunities for aggregation.

Off-take agreements would involve Chinese food purchasers entering into long-term contractual arrangements with groups of local farmers, possibly including farmer cooperatives, to purchase produce on the basis of an agreed pricing formula. The Chinese partner could be a good source of finance for farm modernisation and, where desired, farm consolidation.

Prospective Chinese investors seeking to secure long-term supplies of premium produce for importation and distribution in China have expressed anxiety about the reliability of off-take agreements. They would want security of supply to meet their contractual obligations in China.

In some parts of Australia mining and coal seam gas companies have purchased large areas of rural property instead of relying solely on reaching access agreements with landowners, enabling them more readily to undertake their mining or gas development activities. Coal seam gas companies in Queensland already hold title to large areas of farmland, with further major acquisitions expected to come. Since these properties have been acquired for extractive purposes, and since they are interspersed with properties on which access agreements have been reached with existing landowners, the holdings are not necessarily contiguous. Consequently, a consolidation task is required if the efficiency of food-producing operations is to be optimised.

"Australian agribusinesses need capital partners to co-invest in Australian primary production and integrated food processing industries to realise economies of scale. This model should drive Australian partners further up the value chain beyond primary production"

(KPMG and University of Sydney 2013, p. 22).

Chinese investors in food production might consider entering into joint venture arrangements for farming or grazing on these properties and settle off-take agreements with coal seam gas companies. Produce might include beef and stock feed for importation into China.

Food processing

In the last couple of years there has been a big increase in Chinese companies visiting Australia in search of attractive trade and investment partners in large-scale food processing. Their preference is in beef, sheep, dairy, wine and sugar.[43]

Most large food processing companies operating in Australia are already foreign owned. Fierce international bidding for dairy processor Warrnambool Cheese and Butter in the second half of 2013 demonstrated both the high level of interest in and scarcity of premium food processing assets for sale.

Smaller food processors, such as local dairies and fruit and vegetable producers, could benefit from equity injections to modernise their operations. However, it is unlikely that Chinese businesses would want to invest in very small operations, seeking instead to attain critical mass and improved efficiency of operations through a process of aggregation. Tasmania and Victoria have high-quality dairy potential and after a period of contraction dairy is expanding again in New South Wales. Tasmania has relatively high rainfall, together with a system of large and smaller water catchment structures and irrigation infrastructure. There might also be opportunities in Western Australia, which is closer to China than the eastern states.

It is expected that Chinese investment will eventually seek to follow the lead set by Bright Foods and move into the food company sub-sector where profit margins are attractive and stable.[44] Australian partners are most likely to benefit from cooperation with Chinese companies that can provide access to the Chinese market through integrated value chain operations.[45]

An alternative to acquiring existing food processing operations is for Chinese businesses to invest in new food processing capacity. The advantage of greenfield investment is that the new capacity would embody the latest technology and management practices. Further, it would not be seen to be diverting food from existing uses. Investing in greenfield processing capacity could be an ideal vehicle for dairy in particular.

Australia's beef processing and cold storage facilities accredited by China's quarantine authorities enjoy a good reputation for food safety in China. Although labour costs are much higher in Australia, Chinese importers of high-quality beef have preferred that processing take place in Australia so that the safe, clean, green, seal of approval can be used as a marketing advantage. One future possibility is for early-stage processing to occur in Australia with the preparation of individual cuts being done in a new Australia-China processing facility within the Shanghai Free Trade Zone.

Chinese investment in the Australian wine industry is already underway. Australia is already the world's second largest bottled wine exporter to China and the largest exporter of higher-priced wine.

Food distribution

If Australian food producers are to be competitive in supplying the Chinese and global markets, the distribution systems within Australia and the export facilities will need to be modern and efficient. Australia's road and rail transport systems need upgrading and airport infrastructure may need expanding if large quantities of fresh and chilled produce are to be air freighted to China.

> ***"New Hope Fund's investment in Kilcoy Meat Processing was a strong signal that Chinese investors are very interested in the food processing stage of production rather than owning farming operations and rural land for primary production"***
> *(KPMG and University of Sydney 2014, p. 7).*

> ***"Australian companies need Chinese partners with strong domestic links who can help reach these new customer markets quickly and profitably"***
> *(KPMG and University of Sydney 2013, p. 21).*

"Chinese investors are more interested in food processing and securing high quality, semi-processed food exports than in owning and managing large areas of land"

(KPMG and University of Sydney 2014, p. 13).

In addition to prospective investment in farmland and agribusiness, Chinese investors are interested in partnering with strong Australian businesses to develop commercially viable infrastructure projects,[46] from rural infrastructure through to domestic storage and transport to export facilities.

It is important that Australian suppliers of premium food and beverages recognise the desire of Chinese importers to have significant influence on the supply chain, from production, through processing and distribution. Reliability of supply is essential, rather than using China as an opportunistic overflow market.

Chinese investment in Australian food distribution infrastructure offers not only the prospect of commercial returns and greater reliability of supply, it can result in cost savings which are shared up the value chain and reflected in the delivered price of Australian produce.

> ***"Australia requires capital for new regional infrastructure and China has the capital and proven, deep experience to co-fund and co-deliver new road, rail and airport/shipping port assets which could transform our food production industry in existing and new regions throughout Australia"***
> *(KPMG and University of Sydney 2013, p. 22).*

On-line marketing

Though it is still at its early stages, on-line purchases by Chinese consumers of premium Australian food and beverages appear to have great potential. One approach already being used is to import product into the Shanghai Free Trade Zone and distribute orders to customers from there.

Developing northern Australian food production

Various proposals have been made for the large-scale development of northern Australia for food production. In 2012 the previous Australian Government released the report of a study commissioned by the Australia's Trade Minister and China's Commerce Minister. The report, Feeding the Future, has a strong focus on northern Australia, identifying the development of water and soil resources in northern Australia as having great potential.[47]

Australia's Minister for Trade and Investment, Andrew Robb, has been advocating for some time the development of arable land in northern Australia for the production of premium food for export. Robb points out that 60 per cent of Australia's rain falls in the north, but only about 2 per cent of this is captured and used, while the CSIRO has found that up to 17 million hectares across the north are potentially suitable for agriculture because of the region's arable soil. Robb argues that "capitalising on these opportunities will require a strong policy platform across key areas including governance, population, land use and access as well as improved core infrastructure and water assets. Government leadership and private-sector initiative and investment are essential."[48]

Shanghai Zhongfu's successful bid in 2012 for the right to develop the East Kimberley's Ord River Stage 2 expansion through a 50-year lease of farmland is an early indication of the potential for Australia-China cooperation in northern Australian agriculture.

The Australian Government is working with the Governments of Western Australia, the Northern Territory and Queensland on a Northern Australia White Paper scheduled for release in the first half of 2015.

The Importance of Personal Relationships

If Australia and China are to take full advantage of the opportunities available in food cooperation it is essential that personal relationships be developed and nurtured. Chinese businesses will want to get to know the ways of doing business in Australia and will seek partners they can trust and with whom they can form rewarding, long-term relationships.
Cooperation in agribusiness will require patience; there are no quick returns from a quick deal in the production and export of premium food and beverages. The Australian side will need to be patient too; Chinese investors are likely to want to test the waters by proceeding cautiously.

As interest in the idea of cooperating commercially in the production, processing and distribution of premium food and beverages continues to grow, more and more Chinese and Australian business interests will begin engaging with each other to explore commercial opportunities. As this occurs, it will be in the interests of both sides to conduct due diligence with a view to assessing the capacity of the parties to enter into deals and successfully implement them.

Australian businesses seeking to cooperate with Chinese counterparts should be mindful of Chinese government policy and priorities. Australian businesses can generate goodwill and official support where their interests align with government priorities. For example, Australian businesses assisting in the establishment of sheep stations in Xinjiang Province in northwest China can align commercial interests with Chinese government priorities for the economic development of the region.

> ***"Guanxi in Chinese means relationships, reciprocity or connections … Establishing good Guanxi is a better indicator of the future success of an agreement or joint venture"***
> *(KPMG 2012b, p. 21).*

Market Research into Chinese Tastes in Food

Food processed in Australia for Australian tastes will not necessarily be in demand in China. Vegemite, for example, is not universally liked, and there are many other examples of products successfully sold in Australia that might not enjoy success in China.

With this in mind, multinational companies such as Kraft are actively testing different variations of processed food products with Chinese consumers. While this is being done in China, Kraft executives and food technicians in Australia are able to view consumer responses live via video.

Large companies are able to afford this market design and testing but small and medium sized Australian companies cannot necessarily do so. They may need to form partnerships with multinational firms and work with Austrade in having their products tested and to be willing to modify them for Chinese consumer tastes.[49]

Australian Regulatory and Approval Processes

Australia does not have a particularly onerous system of regulating foreign investment in agriculture. The OECD has ranked Australia's regulation of agriculture the 17th most restrictive among 48 countries.[50]

Foreign Investment Review Board

Australia's Foreign Investment Review Board applies a national interest test in assessing foreign investment proposals whose dollar amount exceeds specified threshold amounts. The general threshold is $248 million (indexed annually) for investments by private companies and zero for investments by state-owned enterprises and sovereign wealth funds.[51]

The Australian Government has announced new thresholds for private investment in agriculture of $15 million for farmland and $53 million for agribusinesses.

Thresholds may be varied for countries that conclude trade and investment agreements with Australia. The US-Australia Free Trade Agreement provides for a higher threshold, currently $1 078 million (indexed annually). Australia has an investment agreement with New Zealand that provides for a similar threshold. The Australian Government has announced the completion of negotiations for free-trade agreements with Korea and Japan, which provide the threshold granted to the United States, except for agriculture, which is subject to the new, lower thresholds.

An Australian Government policy statement on foreign investment in agriculture released in January 2012 provides guidance on specific factors typically considered in relation to proposed acquisitions in the agricultural sector. They include the impact of the proposed investment on:

- The quality and availability of Australia's agricultural resources (including water);
- Land access and use;
- Agricultural production and productivity;
- Australia's capacity to remain a reliable supplier of agricultural products to both the Australian community and trading partners;
- Biodiversity; and
- Employment and prosperity in Australia's local and regional communities.[52]

In order to better inform the Australian public about the levels of foreign ownership of agricultural land, the Australian Government is establishing a national register of land ownership.

Since 2007 the Foreign Investment Review Board has assessed more than 350 applications for investment by Chinese companies in various industries and has approved all of them – six with conditions.

Australian Competition and Consumer Commission

The Australian Competition and Consumer Commission (ACCC) administers the Australian Consumer Act (2010). It assesses proposed mergers and takeovers against a test of whether or not the proposal is likely to substantially lessen competition. It applies the same test regardless of whether the proposal involves foreign or Australian investors.

In the past few years the ACCC has considered several major proposed mergers and acquisitions of agribusinesses and has approved almost all of them on the basis that they were unlikely to substantially lessen competition.[53]

In personal communication, the Chair of the ACCC, Rod Sims, has confirmed that the ACCC applies the same test to mergers and acquisitions regardless of whether they involve foreign or domestic investors. He pointed out that if a foreign company did not already have a major presence in an Australian industry its entry into Australia would be unlikely to substantially lessen competition.[54]

An Australia-China Trade Deal

Australia and China appear to be within reach of finalising a free trade agreement. Negotiations began in 2005 but a comprehensive deal liberalising trade and investment in all sectors of the economy does not appear feasible at this time. In 2012 the parties turned to negotiating what has been described as a mini-package – essentially an agricultural and investment deal.

Prime Minister Abbott and the Chinese leadership have expressed a determination to accelerate the negotiations. The Australian Government has publicly indicated its willingness to show some flexibility on Foreign Investment Review Board screening thresholds, including for Chinese state-owned enterprises that have an established track record in Australia.

Australia is at a competitive disadvantage against New Zealand in access to the Chinese market for agricultural goods and beverages. As a result of a free trade agreement concluded by New Zealand and China in 2008, New Zealand has enjoyed the elimination or phased reduction of tariffs on its food and beverage exports to China.

If Australia were to secure a deal comparable with that between New Zealand and China, the big beneficiaries would include the Australian dairy, beef, sheep meat, wine and seafood industries.

Investment Vehicles for discussion at Food Summit

It is suggested that the Food Summit discuss and evaluate various vehicles for facilitating investment and trade in premium food, wine and other beverages between Australia and China. Discussion might most conveniently be organised into the three stages in the premium food value chain: production, processing and distribution. Some topics and questions that arise from this background paper are set out below.

Food production

- What is the potential role of direct Chinese equity investment in Australian food production?
- Should any equity investment be majority, 50-50 or minority?
- What are the benefits and costs of aggregating smallholdings of land for acquisition?
- Can farms be purchased but farmers retained to continue the farming activities as sharecroppers?
- Can off-take agreements be negotiated with farmers and their cooperatives with Chinese investors standing ready to provide finance for farm consolidation and modernisation?

Food processing

- Have most of the opportunities for acquisition of large agribusinesses already been taken?
- What role is there for minority equity participation by Chinese investors in large Australian agribusinesses?
- Is Chinese investment in greenfield food processing, especially for dairy products, an attractive opportunity?
- Is there commercial potential in the case of high-quality beef for initial processing to occur is Australia with the finer cuts being done in an Australia-China joint venture located within the Shanghai Free Trade Zone?
- Would Chinese investors be interested in acquiring small Australian boutique food processing and winemaking businesses?

Food distribution

Are Chinese businesses interested in investing in Australian food distribution infrastructure, including taking equity positions in storage and transport infrastructure?

Next Steps

The Australia China Food Summit will discuss the various commercial opportunities and alternative investment vehicles for cooperation between Australian and Chinese businesses in the production, processing and distribution of premium-quality food and beverages.

The relative newness of Australia-Chinese cooperation in food and beverages makes it advisable for facilitators in Australia and China to be involved in identifying prospective parties and bringing them together. Those facilitators – economic advisory firms, legal firms and financiers – have a vital role to play in forging commercial relationships between Chinese and Australian-based businesses. They will also be needed to provide ongoing advice with a view to ensuring any deals made are successfully implemented to the satisfaction of the parties.

End Notes

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