

Mexico, Our *Partner* in Pecan Production?



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Industry's *Challenge*



- meet the increasing demand for pecans, particularly export demand from China, while continuing to provide adequate supplies for domestic consumption

Weak Economy's Impact?



- Oil price - Going up.
- Gross domestic product - annual rate of 2.8 % in 2011 4th quarter, from 1.8 % in the 3rd quarter
- Employment increasing slowly
- Unemployment declining, but bad
- Not seeking work – huge number of people
- New home purchases and prices
 - Worst year dating to 1963
 - S&P/Case-Shiller composite housing price index
 - ✦ price declines steepened year-over-year (down 3.7 %) to 2003 levels
 - National Association of Realtor survey said price fell 2.2 % in January

Industry Analysis



- Porter's 5 Forces Industry Analysis – different profit potential across industries
 - About profit opportunities
 - Key aspect of the firm's environment is the industry or industries in which it competes
 - Industry structure
 - ✦ Degree of control by large companies
 - ✦ Competitive rules of the game
 - ✦ Strategies potentially available

Entry – How easy for new producers to succeed?



- Economies of scale
- Capital requirement
- Access to Distribution Channels
- Government Policy
- Product differentiation
- Switching costs

Entry – How easy for new producers to succeed?



- **Potential Cost Disadvantages**
 - Technology available
 - Access to inputs
 - Best locations available, or taken
 - Subsidies to existing firms
 - Learning curve

Entry – How easy for new producers to succeed?



- Other factors that discourage entry
 - Retaliation
 - Entry deterring pricing
 - Protection (such as patents)
 - Experience
 - Technological change can make a firm's processes obsolete, enabling entry

Industry Analysis - Rivalry



- Intense rivalries between firms can depress profitability
 - Numerous, balanced firms
 - High stakes
 - ✦ Gains by one firm mean losses for another
 - ✦ Marginally profitable producers can't leave industry
 - Slow or no growth in product demand
 - When capacity increases, it happens in large units
 - Diverse competitors –don't understand each other's moves

Industry Analysis - Rivalry



- Intense rivalries (continued)
 - differing business objectives - owner/operators of small businesses accept low return for independence
 - cost of switching between suppliers is low
 - entry barriers are low
 - exit barriers are high (high fixed costs, specialized assets, labor agreements)

Industry Analysis - Substitutes



- Substitutes - don't expect to be relatively profitable
 - Same product, or do same tasks – can happen in very different ways
 - If no reason to choose one supplier over another, customers will tend to choose based on price
 - Important substitutes:
 - ✦ trends improve their price-performance tradeoff
 - ✦ are produced by industries earning high profits

Industry Analysis – Market Power of Buyers and Suppliers

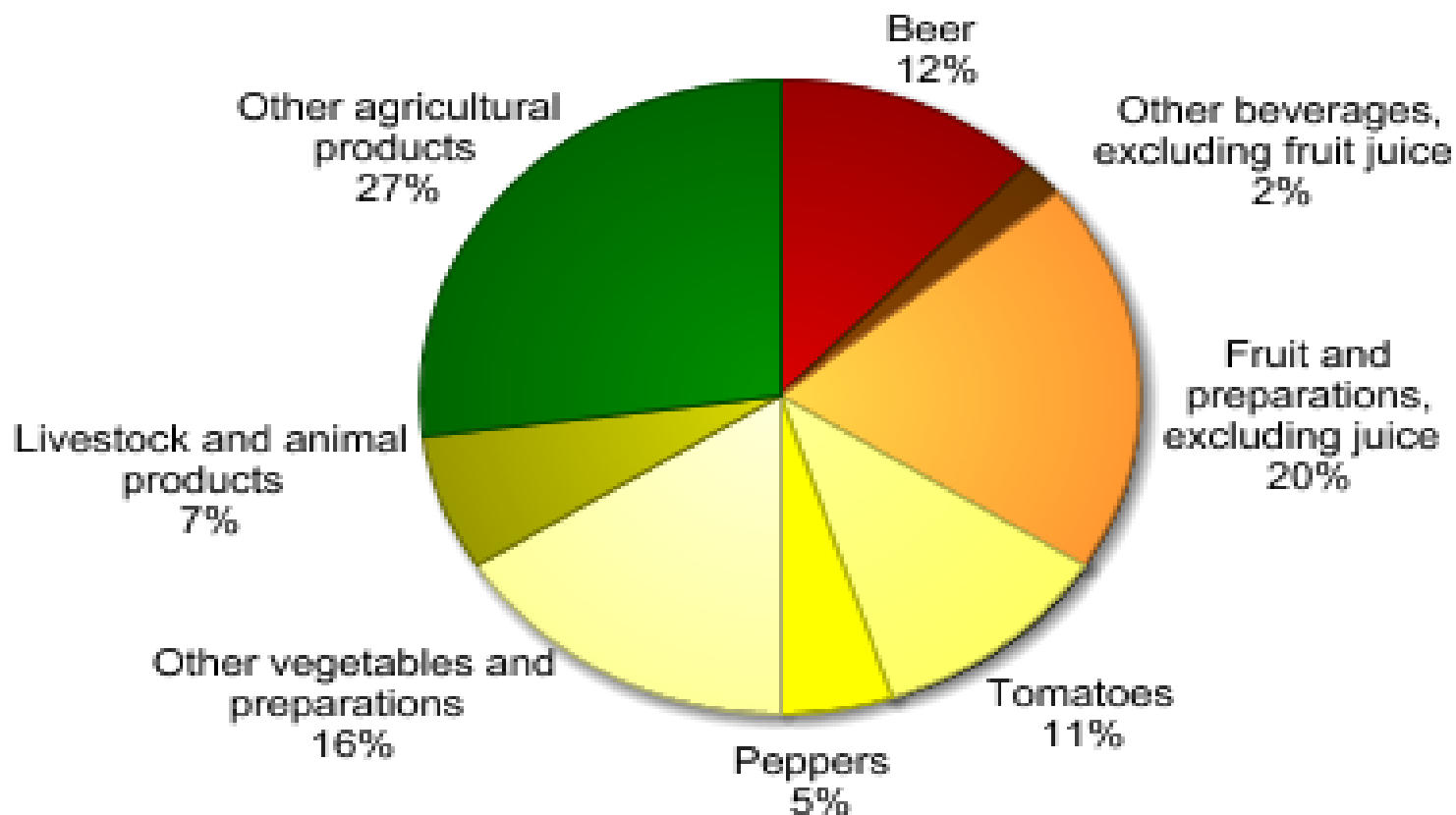


- Buyers with a position of strength compared to the seller may demand price/services breaks
- Price sensitivity - goods that often carry a smaller markup
 - Are standard
 - Comprise a significant portion of budget
 - Are less important to quality of the product at retail

Trade with Mexico



About two-thirds of U.S. agricultural imports from Mexico consisted of beer, fruit, or vegetables in 2010 1/



1/ Data are for calendar year 2010, when U.S. agricultural imports from Mexico equaled \$13.6 billion.

Source: USDA, Economic Research Service using data from USDA, Foreign Agricultural Service, Global Agricultural Trade System.

Mexico's Pecan Industry



- Expanding, according to GAIN report
- Production practices improving
- Mostly produced in good climatic conditions
 - Warm days, cool nights
 - Irrigated, water is adequate
- Product is average to high quality
- Estimated production
 - 2010-11 - 76,627 MT.
 - 2011-12 - 105,000 MT (lower than 2009-10)
 - Domestic market about 60,000,000 pounds
- Overall, 30% or so of North American production

Expansion in Mexico



- New planting/investment in orchards
- Share of orchards not yet bearing
 - 20% (GAIN report)
 - 30% (Jose Pena)
- Water issue
 - New orchards on farms with wells
 - Concern about water quantity available from wells

Mexican Exports (MT)

In-shell exports to		Shelled exports to	
2010-11			
U. S.	16,076	U. S.	35,914
Total	18,314	Total	35,932
2011-12			
U. S.	24,103	U. S.	10,154

Gain Report No. MX 1069, 9/15/2011 and Pecan Report

China Markets and U. S. Exports



Chinese Market



- In 2007
 - U.S. had a bumper pecan crop
 - Global shortage of walnuts developed
 - Price of pecans fell below the price of walnuts
- Source: WSJ
- Pecans: From 2007 to 2011, fastest growth among imported tree nuts
- Dramatic impact on U. S. supply
- Dramatic impact on U. S. price over past 3 to 4 years

Chinese Market



- Chinese prefer larger nuts (35 or lower count is preferred)
- Larger nuts mostly sourced from Southeast
- Chinese purchase range 60 to 120 million lbs since 2007

Chinese Market for Pecan



- Events and occasions are important
 - Lunar New Year festival
 - Gifts: Adorned gift packages
 - Gifts: friends, clients, other business associates
 - Gifts: May pair with fresh fruit gift baskets during the holiday seasons
- Nut quality, appearance, and packaging all impact retail sales
- U. S. nuts enjoy highest standing and recognition in the Hong Kong/China market
- Inelastic demand
 - Source: Financial Times

Chinese Market for Pecan



- Chinese perceive other benefits
- Comments from consumers
 - more nutritious than walnuts
 - very good for the brain
 - Beijing TV said eating pecans can help cardiovascular disease
 - very good for baby's brain development
- Source: WSJ article

Chinese Market for Pecan - Price



- Price volatility
 - 2010 - pecan wholesale prices in China were 320 percent higher than in 2009; 2011 - prices fell, but still 159 percent higher than the 2009 wholesale price

- Source: GAIN Report 10046

Chinese Market



- China's near-term demand
 - How much in storage?
 - January's Lunar New Year celebrations reduced stocks
- Other Nuts
 - Walnuts - Chinese production up 20% in 5 years, only 60% of trees bearing
 - Almonds – significant new plantings, poor production practices and low yield
- Significant government policy support for nut production in China

Exchange Rate with China



2012	1 US dollar = 6.296 Chinese yuan
2007	1 US dollar = about 7.8 Chinese yuan
Dollar is relatively weaker	

U. S. Market



US Domestic Processor Needs



- **Shellers**
 - getting the nuts they need before the Chinese buy them
 - coping with volatile prices to avoid profit-reducing squeezes
 - fruitcake prices are rising
- **Volatility of price**
 - types and varieties of pecans
 - growing seasons and the cost of production vary widely
 - wild or native variety harvest is 20% and 30%
- **Cold storage in good years reduces price volatility**

Now: Evaluate the Five Forces

- The question – what is the impact of each factor on industry profitability?

Entry – U. S./Mexico



- New pecan production
 - **Economies of scale**
 - ⊖ ~~Product differentiation~~
 - ⊖ ~~Switching costs~~
 - **Capital requirement**
 - ⊖ ~~Access to Distribution Channels~~
 - ⊖ ~~Government Policy~~

Entry – U. S./Mexico



- Cost Disadvantages for potential entrants
 - ⊖ ~~Technology available~~
 - ⊖ ~~Access to inputs~~
 - **Best locations – water issue in Mexico, perhaps US**
 - ⊖ ~~Subsidies~~
 - **Learning curve**

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 - ⊖ ~~Protection (patents)~~
 - **Experience**
 - ⊖ ~~Technological advance can make a firm's processes obsolete, enabling entry~~

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 - ~~Numerous, balanced~~
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 - ~~Slow growth in product demand~~
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- Intense rivalries (continued)
 - ~~firms have differing business objectives~~
 - ★ ~~owner/operators of small businesses accept low return~~
 - **entry barriers are low**
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Industry Analysis – Market Power of Buyers and Sellers



- **Buyers with a position of strength compared to the seller may demand price/services breaks**
- **Price sensitivity - goods that often carry a smaller markup**
 - **Are standard**
 - **Comprise a significant portion of budget**
 - ~~Are less important to quality of the product at retail—
baking application~~
 - ~~Pose threat of backward integration~~

Mexican Producers are **Partners** if...



- Expansion of acreage is moderate
- Bearing acreage increases gradually
- Mexican learning curve is modest, slow to improve production practices
- Demand continues to grow
- Production of substitute nuts in China is modest
- Reputation of U. S. nuts remains intact (lower quality Mexican nuts as reported in GAIN don't become a problem)
- Chinese population grows

Mexican Producers are **Competitors** if...



- Rapid expansion of bearing acreage in Mexico – what if supply increases 20% or 30% in 5 years (from current non-bearing tree inventory)?
- Mexican growers learn quickly – supply increases
- Demand slows in U. S. and China
 - Oil price – more for gas, less for fruitcakes and snacks
 - Changing Chinese household – 1 child policy, that child is protected, getting obese
 - Chinese population growth slows
- Chinese production of walnuts increases significantly
- Reputation of U. S. nuts declines
- Dollar strengthens



- Which of these scenarios is more likely?
 - Questions?