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natural capital know how

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Iwi and infinity quota ownership - what is it doing to quota wealth?

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The Treaty Settlement has come and gone, the allocation debate has been resolved and Iwi have now settled into the role of quota owner and therefore ACE utiliser or ACE lessor, safe in the knowledge that this asset / taonga is in their hands forever.

Unfortunately, while understandable, such a situation creates interesting dynamics. Quota value and therefore quota owner "wealth" is driven by balancing the relationship between annual free cash flows generated from the asset, in this case ACE revenue less costs, and the extrapolation of those free cash flows into capitalised values (balance sheet wealth). The assets' ability to generate ACE Fees and therefore free cash flow is a combination of factors i.e. management of the asset, utilisation of the asset, price the market is prepared to pay for the products of such assets and the costs to market.

As this balance is refined so then is the balance reflected in the return on investment of that asset and therefore its overall worth. For normal business, such wealth (capitalised balance sheet value) is then normally leveraged to buy even more assets which in turn generate further cash flow and therefore increased leveraging. The constant discipline being, that the return on investment should be greater than the cost of debt servicing.

However, where the asset owner has little or no interest in selling and/or is constrained by leverage value rules (as in the case of asset holding companies) the focus then shifts to maximising annual returns, in this case ACE revenues. In fishing, given production volumes are constrained by TACC's, increased returns on ACE can only be accommodated through supply chain efficiency, margin squeeze, increased market returns, or fishing irresponsibly.

Margin squeeze within the supply chain for the most part is generally shared by the harvesters, processors and logistics support. The fishing processor; looking to maintain or improve returns when "squeezed" can either try and extract more from the market, become more efficient, pass the additional costs of ACE on to harvesters or be forced to enter the market to obtain even more "marginal costed" ACE to maintain the production volume x margin = return = profit model.

Over recent times the squeeze has been passed down to, or at least shared with the fisher. Marginal fishing operators are then forced to either become more efficient, enter the market to buy more ACE (production volume x margin = return = profit) or consider ways/shortcuts to stay afloat. The latter is a direct incentive for bad behaviour. We are witnessing all of the above in many iwi held fisheries.

Fisher and processor focus shifts from one of commitment, to one of survival. The annual ACE wars deliver even more unrealistic ACE values, production and harvest volume uncertainty particularly for processors and harvesters and therefore there is little or no focus on long-term quota wealth enhancement.

For harvesters, it is particularly narrow or negative margins with 1 year lease horizons that do little to endear fishers to be interested in the long-term health and or sustainability of the resource. The result drives behavioural change and therefore increases the potential risk to the fishery, the industry, to brand reputation and to quota ownership (quota cuts, loss of access, additional compliance costs). All of which result in inevitable quota owner wealth reduction.

With Iwi being such big players in quota ownership this has significant implications for fisheries management and quota values going forward. The growth of Iwi quota ownership should be applauded but without clear understanding of the balance between annual free cash flows and wealth maximisation (in this case quota leveraging) the implications for what is described above must surely raise questions about the need for model changes.

Perhaps we need to more clearly consider models where success is measured by the following key factors a) return on investment that is aligned to risk and capital deployed across the supply chain b) the earnings capacity of the asset - i.e. the robustness of annual ACE revenues and c) wealth ...the ongoing value of quota d) and the health of the related marine environment its production depends upon. Being intertwined these require careful progression and steady balancing to achieve optimal results. In other words, Iwi need models where ACE revenues are the result of a transparent supply chain, with reasonable returns on investment able to be extracted across the supply chain that are commensurate with capital at risk and ACE values become the residual “rents” from the fishery and drive the wealth value of quota.

Such wealth can be used to raise capital for additional investment in the seafood value or supply chain or for other investments, commercial buildings, farms etc. In fact anywhere where the ROI can be shown to be greater than the cost of borrowing / debt servicing. **Rather than current overzealous risk averse strategies.**

To do this quota owners need to understand and agree that a collective and well managed model is a better outcome than the current competitive model. The CRA4 rock lobster fishery is a classic case in point. The lack of fine scale management coupled with skyrocketing market prices for rock lobster has resulted in;

- a myriad of increased fisher numbers and therefore:
 - increased/unrealistic demand for ACE i.e. new fishers desperate to establish themselves existing fishers trying to retain their operating volume needs.
- Increased pressure on the fishery i.e. more;
 - fishers
 - boats
 - pots
- Fish turned over more (unseen predation and damage) and potentially more susceptible to environmental change.
- Ghost fishing – lost pots and line.
- Serial depletion and effort transfer.
- Fishery decline.
- Quota cuts (in this case 33 Mt’s from 695mt to 662mt last year and likely to go further next year).

Many in the fishery, especially those with long term involvement and who witness it day by day called for much greater cuts i.e. TACC of 380 – 430mt. In the absence of powers of collective action attempts to shelve more quota proved fruitless.

1. Capital Value Impacts

A simple approach to quota value loss would be to multiply the level of the cut by the current market price i.e. 33mt X \$750,000 per mt equals \$24.75m loss in quota value.

This is not a realistic loss assessment approach. It ignores several fundamental questions

- Was the TACC artificially high in the first place?
- What have been the long term average catch rates for the last 15 years?
- Were current TACC's ever sustainable or was it simply greed?
- Is the current approach conducive to generating wealth?
- Is the current approach conducive to having fishers out on the water care about the fishery?
- Would a different approach be possible? One that identified the true status of overall loss?

Let us consider a different world. (PAU2) The Iwi quota owners in the fishery agree to sign multi year lease arrangements to pool their ACE each year for the next 10 years. They contract/appoint a manager who would have two major KPI's.

1. To show transparently that the quota owner is achieving the optimal ACE price each year without undermining 2 below.
2. To show quota owners that the value of their quota (wealth) is maintained or improved year on year.

2. Management Impacts

Such a Manager armed with the long-term ACE portfolio is then able to:

- Target the best dive team managers and their teams with contract certainty for the period (10 Years):
 - Remove the annual scramble for ACE.
 - Provide confidence for the dive team managers to invest better boats, better technology.
 - Build crew security.
 - Plan how their paua harvesting may fit within their wider annual business models.
 - Fish responsibly e.g. using new technology, not remove paua from rocks unless they're MLS.
- Fisher contracts would be aligned to:
 - Market pressure and market demand requirements.
 - Increased information requirements (to improve real time management options).
 - Flexible fishery management tools:
 - Variable size limits.
 - Sub-division.
 - Stat area by stat area limits (reduce serial depletion and effort shift).
 - Contributing to fishery Citizen Science initiatives to report observed change, taking samples i.e. sedimentation to be provided to management fora.

Participate in management and public SLTO fora about the state of the coasts, MPAs etc confident that the fishery is acting responsibly, has information and knows the areas and environmental conditions needed to sustain a healthy fishery.

Such a model would ensure people on the water have every incentive to:

- think about the value in maintaining the resource long term (healthy fishery, better catch rates, optimal efficiency, renewed contracts).
- align operations to basically provide patch management/care approaches that:
 - increase the likelihood of fishers taking corrective action knowing they will reap the benefits in later years, and,
 - Rationalise operations into fisher group zones which are then better stewarded.
- share information on critical changes in the fishery, implement immediate management strategies to correct changes (resting areas, shelving, size limit increases).
- invest in new technology and capital assets (to catch the fish, keep it in pristine condition or meet new market demands).

3. Critical Impacts

The most significant challenges to such an approach are 1) participants buying in to a long term multiyear commitment and 2) the requirement to move to a fully transparent supply chain pricing model.

Multi-year ACE commitment

In the absence of multi-year ACE commitments the model is subject to year on year ACE price pressures from new entrants or competing companies. Ace suppliers to this model, unless they can compare multi-year ACE revenue averages against the odd year of ACE price spikes can easily feel aggrieved and want to shift their ACE to chase the best price.

Fully transparent supply chain

The creation of a fully transparent supply chain allows those involved to a) understand market pricing and demand challenges and changes b) see how and where rents may be occurring c) identify efficiency opportunities d) understand key/core relationships and how each core component contributes e) see pricing and pricing processes transparently d) work together to improve pricing through better understanding and meeting market demand (provenance, quality, delivery, pricing).

Risk

Risk comes in many forms consumer preference, market price volatility, supply chain requirements, harvest risk, resource access, resource sustainability and resource allocation/utilisation (far from secure in the current political environment). The real question is what might quota values look like with such risks removed or substantively reduced?

Implementing such a regime may not be easy and only deals with one portion of risk. It will require time to show how well it could work and that is a risk. Unfortunately, there has been little or no analysis to show trends in the relationship between market price, ace price, supply chain participant profitability versus quota wealth values.

Diver collusion or monopolistic tendencies could also be a risk under such a model however, long term ACE contracts combined with transparent pricing and open book profitability models delivering a much clearer shared pain shared gain approach would ensure the fisher would also have too much at risk by a short-term price gouging approach.

Market/competitor opportunity to undermine the model is always a possibility however, experience would suggest where such models provide such transparent benefits with being involved, participant's tend to close ranks to protect such a framework and constantly seek to improve overall performance. End

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Opinion Piece