IMPLICIT CONTRACTS
AS A METHOD
OF
VERTICAL CO-ORDINATION
IN THE
NEW ZEALAND MEAT INDUSTRY

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ABSTRACT

A framework is developed using Williamson's seminal discussion of contractual arrangements and governance choice. The New Zealand Meat industry is the subject of this study in that contractual arrangements exist along-side more conventional trading relationships. The main body of the paper is devoted to; the review of other empirical studies of vertical co-ordination and; the collection and primary analysis of data. Primary results show the form and extent of vertical co-ordination in a small non-random sample. While the neo-classical contract to supply stock is used, many producers and processors operate and co-ordinate with a relational, implicit contract in which the producer deals almost exclusively with one company and develops a long term and 'important relationship' with an agent. Several regressions on measures of co-ordination, included in the appendices, while far from robust, show interesting patterns related to the transaction cost hypothesis.

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Chapter One: Introduction

Transaction cost economics has progressed considerably since Coase (1937) identified the distinction between the market and the firm: "the costs of using the price mechanism. It was the avoidance of the costs of carrying out the transactions through the market that could explain the existence of the firm" (1992, p.715). According to Williamson (1985 p.2) - "transaction cost analysis [now] supplants the usual preoccupation with technology and steady-state production (or distribution) with an examination of the comparative costs of planning, adapting and monitoring task completion under alternative governance structures".

The subject of this paper is the New Zealand meat industry. The study is, more accurately, focused on the present extent and form of vertical co-ordination within the meat industry. Recent developments in the relationship between the processor and meat producer have included the use of supply contracts. This is a likely response to the changing marketing effort of the industry which is aiming to differentiate meat products from commodity to specialist, value-added niche markets. However this requires that firms have a certainty of supply, a certainty of supply made more difficult by declining stock numbers and processing over-capacity.

This paper is thus organized as follows. A discussion of the transaction cost hypothesis is followed by a review of literature which empirically tests the transaction cost hypothesis. Secondly this paper presents the results of a survey of vertical co-ordination between a non-random sample of farms and meat processing companies. The surveyed farmers were asked to provide details of the past year's transactions. The transactions as organized by contract or agent are used as evidence of the co-ordination in the industry.

The results suggest that there is vertical co-ordination in various forms, namely the long-term trading relationship, or implicit contract and the formal contract. As there are many transaction-cost explanations of farmer and processor activity, this study while providing evidence of vertical co-ordination is limited by the size of the sample to a simple regression analysis of the determinants of the farmers' co-ordination activity.