INFOMETRICS

GlobalBro, Guaranteed Economic Waste

farming - 19 June 2001 – By Gareth Morgan

The herd has voted. The thunder of over 80% of hooves stampeding to support the unanimous preference of its elected dairy cooperative representatives, cannot be ignored –dairy farmers are solidly behind the GlobalCo concept.

What was so compelling to convince farmers that this is the vehicle that's best to take the industry to the next level? First and foremost has clearly been the promise that dairy farmers will remain 100% owners of the New Zealand dairy industry. No need to ask why. They only have to look over their fence and see strewn across the paddock the carnage of former New Zealand corporate great Fletcher Challenge and the many businesses Brierley has touched. It's enough for cooperative members to develop even further their fervent allergy for the corporate model. On the basis of that New Zealand history they have due cause. That globally it's corporates that dominate the business landscape apparently is of no relevance.

100% ownership may be a religious tenet within the dairy farmer brotherhood but looking forward one has to ask what it is they will really own 100% of. 100% of a $12bn industry is not as strong a return as 51% of a $30bn industry yet the former at present seems more likely.

GlobalCo has been criticised because it does not of itself deliver much of the extra equity the industry needs to achieve quantum lift internationally. Sure there will be some savings from cutting back on the number of limmos that leaders of each of Kiwi, NZDG and NZDB hitherto have required, but the savings from amalgamation are not huge in the scheme of the challenge the industry faces. One issue that has galvanised the need for this industry to restructure has been need for more equity capital.

Industry leaders responding to the criticism have indicated that one of the sources will be Joint Ventures. But these of course have already been exploited by the industry via the Dairy Board, so GlobalCo does not make them an additional route to get capital at all.

Next leaders have indicated retained profits will be a source. Of course they already are a source and as is well known an insufficient one – otherwise the need for a restructure wouldn't have existed. Unless the industry is intended to hold back more of the payout this claim is trivial. On that score farmers have been promised a rise in their payout - maybe the limmo savings will be so substantial as to afford both a higher payout and higher retained profits. Whatever, we know the industry has 'matured' insofar as funding sufficient expansion from retained earnings is concerned. It simply can't get its hands on enough capital quickly enough to play in the global merger and acquisition stage via this route.

The last of the leaders' claimed sources for additional capital is to raise debt. But again GlobalCo doesn't enable markedly greater borrowing capacity than the industry already has – and presumably under competent management has fully exploited – so this claim is also hollow.

In summary the capital constraint of the industry, one of the two main reasons for its needed rationalisation, has yet to be addressed.

The second major reason for rationalisation of this industry is one farmers have little interest in so accordingly hasn't featured at all in the cowshed meetings leading up to the vote. That issue is the misallocation of economic resources dairy farming entails. As a result much of the wealth generated within it is little more than a transfer from other sectors. This of course is an issue pertinent to economic policymakers rather than to those benefiting from the benevolence.

To the extent dairy farmers receive the dividends from their investment in the profitable downstream activities bundled within the milkfat price, then rationally they can only increase their revenue one way – by increasing the milkfat supplied. And as we all know they do – millions of additional Kgs of the stuff produced as farmers respond to the "super-charged" price for milk they receive. No question then we have massive investment on-farm as farmers clamber for more dividend. The price of raw milk might not change but so long as that dividend from downstream rises then so will the output of farms.

More logical would be for the dividends from the downstream activities to be returned directly to the farmer-investors in them, so that in the event they wish to increase their dividend income they simply invest further directly into those businesses. No need to milk more cows. This of course would help the flow of equity capital to those businesses while stem it to the far less profitable business on-farm.

But, courtesy of the protection afforded the quaint, co-operative agrarian model we cherish, that doesn’t occur. Rather the protection fosters major over-investment on-farm. And with farmer expectations lifted to the heavens as a result of the solidarity of the GlobalCo vote, stoked by industry leader promises of nirvana, expect a major increase in the misallocation of investment that is on-farm expansion.

The excesses of the Sheep Retention Scheme retreat into insignificance compared to the over-investment on-farm which continued protection of the dairy industry represents. So where are the regulators? Totally and utterly negligent, the Labour-Alliance government with support from National have given the green light for this industry to be above the provisions of the Commerce Commission who already have highlighted the damage wrought by an effective monopoly purchaser of farm milk. So desperate for economic good news stories have politicians become, so bloodied by the devastation wreaked within corporate New Zealand over the 1990’s, that any ‘good news’ business story will go with the government’s blessing.

And so for the dairy industry traditionalists it has proved now has been the perfect time to strike, to do the lobbying of once-were-taxi-driver politicians who can ride roughshod over conventional requirements for competition and economic efficiency, all in the name of 100% New Zealand ownership. The Clark/Anderton government champions the knowledge economy, in this industry its actions foster expansion of cow-milking and hold back the growth in the downstream high-margin, high-value industries. Not even the Greens have been able to rise to the consequences of mass utrophication of waterways which other New Zealanders have to pay for.

In Korea there's a famous quote from the head of Daewoo when he was asked whether the Korean government's economic reforms might be pursued to the point that Daewoo would go bust. His reply was that his company was now too big in the scheme of the Korean economy for that too ever be countenanced. He was wrong but the cost to Koreans of correcting the mistake of protecting Daewoo and other chaebol has and continues to be very high.

In New Zealand there's that same inevitability from an ever-encroaching expansion of dairy farming and the diversion of resources to it, irrespective of the returns from milking cows. Globalco is the signal for farmers to go forth and multiply.

You are invited to forward any comments, requests for elaboration to Gareth Morgan. If you have any design related comments about this page please email webmaster@infometrics.co.nz.