INFOMETRICS

Knackering NZ's Nokia

farming - 23 May 2001 – By Gareth Morgan

The downstream part of the dairy industry has the potential of becoming to New Zealand what Nokia has become to Finland - a company at the centre of a cluster providing a third of the country's annual GDP growth and 20% of exports - even though it employs only 3% of the workforce. GSM technology was the key to the transformation of Finland's largest forest product conglomerate into the world's premier telecommunications enterprise. It took less than 10 years.

Similarly, development of the technologies surrounding milk's proteins and enzymes offers New Zealand's dairy industry the opportunity to catapult from a conglomerate of dairy herds to a world leader in sophisticated manufacture of technologies in the medical, pharmaceutical, consumer foods and high-tech industrial materials sectors. It is incongruous then that this industry is so inward-looking, its leadership so insecure and unstable, and our government so derelict insofar as protecting New Zealand's economic interests, that this opportunity is passing the industry by.

That Waikato's dairy farmers are steadily moving to reject the GlobalCo proposition is perfectly rational. There can be no doubt that this construct is yet another jack-up by the protectionists who have dominated this industry, to entrench an organisational structure that favours their political authority. Any alternative that would sacrifice that, even if it offered farmer/owners a real opportunity to realise the full potential of the asset they own, is an anathema to this Dad's Army of dairy dons. The asset that farmers can't realise is not their farms of course but the investment they have in the downstream enterprises and intellectual property that this industry has got locked up and under-developed.

The dairy industry gets its profit margins from sales of a limited volume of low-processed or commodity products, from an expanding range of highlyprocessed consumer products, and from an emerging range of pharmaceutical applications. Where it definitely does not procure adequate margins is from the production of an ever-increasing volume of low-processed commodity product.

Against this backdrop then one would have thought any rational industry would be giving priority to the investment in those areas where the margins are the highest while avoiding expansion in those that are not. New Zealand's dairy industry is the opposite - more and more cows get milked, even if that's to the detriment of expansion of down-stream activities that have profit margins ten times those available on making raw milk. And the government is happy to pass legislation to ensure this economic corruption continues, happy to ignore the rational advice from policy advisers from all directions, happy to prefer instead the "wisdom" of one or two old industry warhorses-turned-Labour Party stooges who to my knowledge have never produced a peer-reviewed rationale as to why this industry should lock itself up in agrarian socialism.

To continue the Nokia analogy. That company's shareholding these days is international - 90% of its shares are owned outside of Finland. Unlike its fading competitor Ericsson for instance where the traditional family owners own only 30% of the capital but have 80% of the voting shares, Nokia has no privileged owners. This has enabled the company to acquire quickly the vast amounts of capital it has needed to maintain its first mover advantage in the markets it dominates. If Nokia's family owners had retained an inward-looking idiosyncrasy of preferring to remain a big fish in an ever-diminishing pond it could never have escaped the death-knell of being trapped in a low-margin, volume-based activity such as pulp. Only by not being frightened of taking in other people's money to expand its shareholding and capability to invest, has it arrived where it now is.

For the 'family' of New Zealand dairy farmer-owners the choice is identical. If the primary interest is to increase ones financial well-being the introverted model is self-defeating. GlobalCo is the epitome of such a construct, simply failing totally to enable the introduction of equity (rather than debt) capital needed into those parts of the business where the margins reward growth.

The tragedy is that the politics of the industry are so introverted that farmers are asked to believe that only by locking-out external capital can their well-being be assured. This xenophobia ignores the reality that it will be those dairy industries internationally that take in the capital and exploit the opportunities the technologies offer and exploit them fast, that will capture even-further the earnings this sector offers.

The criteria I've always used to assess whether any proposal to take the industry forward today has merits are;

- (a) Can equity capital flow more readily to the profitable activities in the industry as a result? Only then can the industry exploit its potential.
- (b) Will farm (all farm, not just dairy farm) prices cease to be driven by profits in the downstream dairy sector? Until this is the case we will continue to have a gross mis-allocation of the nation's investment resources toward ownership of land.
- (c) Can farmers retain control? Without this guaranteed, at least to the extent it is currently, there will and should not be any buy-in by farmers.

Unless the answer is yes to all three, any proposal promises to be a flop. If one looks at last year's MergeCo and this year's GlobalCo propositions they fail both (a) and (b). What does a proposal that meets these criteria look like then?

One that enabled the industry's farmer/owners to aggregate say via a co-op arrangement to form their own shareholding block would be a prerequisite. That co-op then would be the foundation shareholder in a new company, NZDAIRY Inc. From then on though NZDAIRY Inc. could offer shares to whoever it liked in order to raise capital for the expansion it desired. Single desk regulation of the industry would be totally unnecessary. Shareholder control by the farmers would be assured so long as their collective shareholder "BigCo-op", had in its own constitution a condition that it would never go below 51% ownership of NZDAIRY Inc. without 75%, 90%, 99% (whatever!)

approval of co-op members.

Insofar as dividing up the portion of the dividend the co-op earns from NZDAIRY Inc. is concerned, if farmer members want to keep doing it on the basis of kgs. of milkfat, let them. Same as if they want to divide it up according to the colour of farmers' eyes - it is simply irrelevant to anyone but those farmers involved. The important thing is that the industry is enabled to reach its potential and to shift from a volume-driven waste of investment resource to a value-driven reward of investment resource. From New Zealand's and farmers' perspectives this is vital.

And one mustn't underestimate the economy-wide implications of an industry that is enabled to exploit global best practice in its field. Back to Nokia - some traditional Finnish business companies have started to develop innovative products like smart clothing, intelligent tyres and real-estate control systems that are mostly based on wireless solutions developed by Nokia. These are the opportunities we pass by.

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.