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Dialogue: Fonterra's response smacks of paralysis

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Like it or not, NZ's economic prospects are now closely tied to the performance of one company, Fonterra – the mega dairy co-op formed last year under special legislation allowing it to by-pass normal checks by our monopolies watch-dog, the Commerce Commission.

If Fonterra doesn't succeed, we will all be worse off, not just dairy farmers.

Last week's resignation by commercial director, Mike Smith, highlights some critical problems in Fonterra.

Strip away the fluff and it is clear that Fonterra's success depends on just a handful of men: its CEO, Craig Norgate; a few senior managers, selected by Mr Norgate; and a few gritty farmer politicians, presently lead by John Roadley.

If you boil down many large businesses, you'll find their prospects also depend (in reality) on the judgement of just a few men and women. So what's different about Fonterra?

The first is terribly weak monitoring. Big companies need to be monitored by lots of different analysts and institutions with access to good information. Take Telecom for example: its business decisions are evaluated every week by thousands of highly experienced people all around the world. Many of those analysts also publish their views. They are certainly not always right, but problems are more likely to be spotted much sooner in a company that is monitored in this way than in one which is not.

Fonterra has virtually none of this external monitoring for shareholders.

The second major problem is that Fonterra's shareholders are largely powerless to respond promptly to weak performance. By contrast, shareholders in Telecom or Nestle (Fonterra's main rival) can sell their shares if they fail to perform.

All Fonterra's farmers can do is make political noises within the industry and campaign to change some of their directors once a year.

The result is that Fonterra's managers face *much* less commercial pressure from their shareholders than, for example, Telecom or Nestle.

Farmers' investment in Fonterra is, in effect, captured.

The third major problem in Fonterra is that its directors are likely to be controlled by their chief executive. A strong chief executive in Fonterra can easily control the flow of information to the directors and effectively limit their ability to disagree with him.

A fourth key weakness in Fonterra is the deep culture of non-business practices. For years now, farmers in central Waikato and Taranaki have been subsidising farmers in various other parts of NZ. Payouts have been distorted. Unprofitable activities have been hidden. Rules have been twisted. Why? In essence, to protect political power bases within the industry. Many of the dairy co-ops have a strong culture of 'Old Irish' politics. No doubt this is still at work in Fonterra.

So what does all this amount to? To-be-expected 'teething' problems, as claimed by Mr Roadley and the Prime Minister? (Curious that a Prime Minister, who does not sit at the board table, should seek to reassure private shareholders?)
No, Mike Smith's resignation should not be minimised as a minor event. His is the latest in a series of resignations which, put together, point strongly to some of Fonterra's underlying flaws.

Fonterra cannot afford to keep discarding the services of its best commercial minds. John Storey, Graham Fraser, Brian Allison and now Mike Smith – all pushed aside because an inner cabal of farmer-politicians and top managers prefer to sweep their concerns under the carpet.

Even current chairman, John Roadley, acknowledged last year that Fonterra had some key issues to address, but he promised this would happen "after the merger was in the bag".

As reported by Fonterra's advisers last year, these 'must do' issues include:

- A radical change in management culture;
- A new discipline in governance by directors;
- New internal performance monitoring systems;
- Compulsory 4% annual cost savings;
- Market based pricing between business units;
- Differential payouts based on true costs;
- A separate corporate structure for the value-added businesses with tradable shares; and
- A larger proportion of independent directors appointed for their business expertise.

The acid question now is, do Fonterra's directors have the courage to make these changes?

Given the four major flaws outlined above, chances are that the directors will wimp-out.

Their response so far? Commission yet another consultants' report – hardly an encouraging sign. Nor is holding workshops for directors on how to govern. It all smacks of amateurism, procrastination and paralysis.

Huge sums have already been spent on consultants. It is time for the directors to show if they can lead. The holes in Fonterra's structure are gapping. It will not work until they are properly filled.

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