Security Blanket or Straitjacket?

Farmers Patch Up a 19th Century Company for the 21st

By Rod Thomson
Chair, Canterbury Section
Dairy Farmers of New Zealand

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The usual fireworks were absent when Fonterra, New Zealand's giant dairy co-operative, held its AGM in Hamilton recently. Renowned for turning out en masse and vocally when weighty issues arise, a mere 200 farmers listened with barely a murmur to their chairman and chief executive.

Indeed, the New Zealand dairy industry is mostly in excellent shape. Although payout has retreated from the giddy heights of two seasons ago, anything over $4.00 per kg milksolids is profit on most farms, and the current season seems likely to exceed this by a useful margin.

Although the number of NZ dairy farms continues to fall, as smaller units are sold off for amalgamation or other land uses, these are fetching healthy prices. Sharemilking, for many years the path to farm ownership, is also declining, to the regret of many, but its place is being taken by equity partnerships in various forms.

On-farm, the dairy industry research and extension services continue to play a vital role in getting science and technology to the farmer. Though reorganized and with vastly greater resources, the McMeekan spirit of down-to-earth farm science is still alive and well in New Zealand.

What, then, in a dynamic and adaptable industry, is the major block to further progress?

The simple answer is farming politics. There are paths which dairy farmer leaders fear to tread, if they value their well-paid jobs. A revolving door exodus of board members and chairmen could resume again anytime, if sensitive topics come up.

The question at present is the capital structure of Fonterra. The co-operative is wholly owned by its 12 000 farmer suppliers and remains an effective milk monopoly. This cannot be justified commercially. The flimsy Qantas/Air NZ merger proposal, thrown out of court a few weeks back, would beat it hands down.

But dairy farmers like marketing monopolies. So when Fonterra was born out of the three-way merger between the two big dairy manufacturing companies, Kiwi and NZ Dairy Group, and the Dairy Board in 2001, the government allowed it to sidestep the usual Commerce Commission scrutiny.

This was understandable, for any government. The old structure was collapsing. Some progress was better than none. A Minister of Agriculture on the sidelines watching farmers scrap is one thing. A Minister volunteering as referee or player (and likely stretchered-off casualty!) is quite another.

And that decision, though expedient, may have been preferable to the extended Commerce Commission enquiry and the almost certain two-company solution which would have resulted. Farmer backlash could have stalled the deal politically, while the cash costs of an acrimonious Dairy Board breakup may have run into the hundreds of millions.

No definite answer can be given. What is certain is that a full-scale Commerce Commission enquiry would have exposed some of the economic nonsense which has been chanted, like a mantra, by industry leaders for decades.

Even now, many farmers believe they need a marketing monopoly to gang up on the rest of the world and demand higher dairy prices. Even now, many farmers believe that while excluding outside capital, Fonterra can match the growth rates of public companies like Nestle and Kraft. Even now, many farmers grumble at fronting up for share capital, while demanding their company invest more in consumer products.

This confusion has not gone unnoticed. Economic critics such as Gareth Morgan and Tony Baldwin have regularly taken the company to task. During the dairy conversion stampede in the late 1990s, Morgan famously described the extra milk as being 'roughly the value of seawater', while Baldwin says the current Fonterra board stance is 'intellectually dishonest'.

Most recently, Rebecca MacFie in *Unlimited* magazine put it well. She said 'deep structural flaws stand in the way of Fonterra ever being the force for "economic transformation" it was touted in 2001'. The facts support this.

Merger predictions of a $30bn (even $40bn!) company now look laughable: turnover is barely $12bn. The supposed vehicle for growth, Fonterra subsidiary NZ Milk, is actually going backwards. Its revenue declined 6% and its operating profit 28% last year. Commodities, largely milk powder, are still 80% of Fonterra sales.

Farmers have been sold a pup. The company cannot do what it said it would. Many of the old problems remain: bundling of returns, poor price signals, and potentially unstable capitalization. All these factors are holding the company back. They are severely limiting its potential, and costing farmers and New Zealand dearly.

Yet, ironically, this is what farmers want. Successive governments have delivered tham a security blanket: total industry control, no outside investment, monopoly marketing. The result is actually a straitjacket.

But what you've never had, you don't miss. Recall the healthy situation on-farm outlined earlier. Who, among the wealthy dairy farm retirees in Tauranga or Wanaka, is complaining? Sales to farmers of all descriptions: merchandise, tractors, cars, boats, are all thriving. Anyone telling these people they are on the wrong track has an uphill task.

The New Zealand dairy industry has a bright future, regardless of Fonterra and its obsolete capital structure. Trade barriers and overseas dairy subsidies are steadily coming down. Pasture-based production systems will always have cost advantages over those based on concentrates. NZ farmers are adaptable and knowledgeable.

Change at Fonterra is inevitable, though at least a decade will be required to see the big moves implemented. Once candour prevails over self-preservation, a few directors will speak out, and the process will begin. But those directors will be a suicide squad for a few years yet!

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