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Can Khosla fix New Zealand Milk?

Is Sanjay Khosla the man to reverse the fortunes of Fonterra's subsidiary New Zealand Milk?

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Is Sanjay Khosla the man to reverse the fortunes of Fonterra's under-performing consumer products subsidiary New Zealand Milk?

Given the problems Fonterra has had with New Zealand Milk, dairy farmers and directors alike will be hoping the Indian-born marketing guru's appointment to head the subsidiary will be divine intervention.

Fonterra undertook a global search to find a replacement for outgoing general manager David Pilkington, who was given notice more than eight months ago in a senior management shake-up.

It has been worth the time taken to find the right replacement because, says Fonterra chief executive Andrew Ferrier, "Mr Khosla has had an outstanding international career."

Khosla, who has been named a marketing superstar by industry bible Advertising Age, joins Fonterra from the lofty heights of multinational giant Unilever where he was overseeing a $5 billion turnover as senior vice president global beverages.

He is credited with transforming the Lipton tea business and forging a global joint venture with Pepsico.

Under his leadership the Lipton beverages business was one of the best performing in Unilever Foods, with Lipton Ice Tea achieving double-digit growth worldwide.

Ferrier says he is pleased to find someone with such a successful track record in running businesses and building global brands.

"He has not only successfully built global brands, sometimes from the ground up, but also achieved the dramatic gains in financial performance that come from creating high value, high-margin consumer goods."

Khosla is expected to have a significant influence in New Zealand Milk's future, says Ferrier, and the future and development of its local and international brand portfolio.

Aside from a brief press statement saying he was "really excited" about the opportunity, Khosla has not spoken publicly about joining the Fonterra team or his intentions for New Zealand Milk.

His appointment has still been greeted as a Godsend though.

In the Fonterra Shareholders Council annual report chairman John Monaghan expresses concern about the amount of time it has taken to find a replacement leader for the business.

But now the position has been filled, "We're very pleased with the calibre of the appointment," says Monaghan. "As farmers and councillors we value New Zealand Milk very highly and we obviously want to see it perform."

So is the council confident Khosla can get the subsidiary back on track?

"The company having made the appointment is progress in itself."

When Fonterra released its annual results in late July, outlining another poor showing by New Zealand Milk, chief executive Andrew Ferrier told Dairying Today shareholders could expect its contribution to value-add earnings to improve.

What sparked shareholders' concerns is that New Zealand Milk's net profit after tax for the 2003-04 year achieved only 33% of budget, resulting in earnings just covering costs of capital.

Ferrier explains the poor performance by saying New Zealand Milk had come through a tough year, absorbing considerable commodity price increases and fighting against an unfavourable exchange rate.

Either stating the blatantly obvious or trying to appease shareholders, he says: "We are budgeting for an improved operating performance this season and we are addressing the areas that have dragged down performance.

"New Zealand Milk is already benefiting from its move to Auckland, not only in terms of management focus but also in terms of its cost structures."

Is that going to be enough for Khosla to work his magic and turn the business' fortunes around?

Some commentators suggest not. Khosla, and indeed the Fonterra board, are wedged between a rock and a hard place.

While Ferrier argues the business still has "potential" because there are key markets where good returns are being demonstrated, others keeping an eye on the dairy giant suggest New Zealand Milk's promise will only be realised if it is split from the cooperative.

In short, critics suggest the new general manager will only have limited effect on Fonterra's consumer arm as long as the "flawed" company structure remains.

Dairy industry analyst Tony Baldwin has publicly stated that for a business like New Zealand Milk to meet growth targets in the value-add area it needs a normal company structure with "separate shares tradable and delinked from supply".

Gareth Morgan, another industry commentator, agrees.

He suggests the value-add business suffers because there is more focus on farmer payout as a measure of industry success rather than the dividend from Fonterra companies.

"Under the [current] arrangement it is difficult for the farmer to forego income as is necessary when Fonterra holds back earnings for investment in its downstream activities."

Those "downstream activities", says Morgan, include New Zealand Milk. "It means Sanjay may have to forgo profit maximising opportunities that require investment of capital that he hasn't been able to retain from profits because farmers insist on maximum payout."

The answer to this dilemma is to set New Zealand Milk up to operate like a listed company, where appropriate investment is greeted positively by its shareholders.

He suggests Fonterra's senior management is well aware of this but has failed to make the necessary changes because it is concerned about farmer backlash.

This time last year, former Shareholders Council chairman Tony O'Boyle commented to Dairying Today that directors put too much emphasis on long-term investment returns.

Such talk supports the critics' hypothesis and perhaps serves to highlight the fact that changing the company's leadership might not in itself solve New Zealand Milk's woes.

Whether Khosla will be able to turn New Zealand Milk around given this predicament remains to be seen.

Dairying Today pushed for an interview with Khosla to get his thoughts on what has become a thorny issue. But the private PR firm that acts as Fonterra's media minder told us that he would not be commenting publicly for several months "until he gets his feet on the ground".

One would assume Khosla was aware of the challenges presented by New Zealand Milk when he accepted the position. However, refusing to front up to the media about his intentions suggests he has a lot to learn about the company's unique corporate nature.

Over the past few years the Shareholders Council has expressed concern about the poor performance of New Zealand Milk. This year is no different; Khosla's new charge has again failed to perform to expectations. Fonterra shareholders are unhappy and should be within their rights to expect a statement of intent from the managing director, not a wall of silence.

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