TARANAKI DAILY NEWS

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Co-operative way to grow capital

By Graham Stuart of Fonterra

TONY BALDWIN (Farm View, October 21) seems locked in the time warp of debate that went on during the failed mega merger initiative more than five years ago. Free marketers philosophy then had zealous overtones that co-operatives are bad and free market competition is the only good.

That position blindly overlooks the fact that Fonterra and co-operatives around the world continue to perform very well for shareholders who continue to place their investments in a model that has successfully existed here since the late 19th century.

In the past 20 years Fonterra farmers have doubled their investments in farms, cows and Fonterra shares to $38 billion, providing not only good investment returns but also the confidence to reinvest. Fonterra distributes around $5 billion annually to farmers and accounts for 20% of export receipts and 7% of GDP.

Dairying under the co-operative model is undoubtedly one of New Zealand's biggest success stories. How we continue to drive dairying's growth is at the heart of the debate on capital structure. Our goal remains the expansion of profitable milk production -- currently growing at 3% per annum.

Mr Baldwin asserts that the dairy industry is founded on a set of "almost religious covenants". Apparently a champion of free markets, he suggests that we ride roughshod over shareholders' property rights, to sell the business they own to outside investors.

Fonterra's misplaced position is that there is no need to rush a review of capital structure. Why rush the change process? There are some tensions in our current structure but no impending threat and we can certainly fund any growth opportunity in the next three to five years from current equity sources.

Fonterra has demonstrated its ability to implement change radically and promptly. In the three years since we began the largest merger in New Zealand's corporate history we have unlocked more than $300 million of independently verified merger benefits during one of the largest commodity price swings in the industry's history.

Commercial reality dictates change will continue. But carrying out a capital structure review and change that is not forced or rushed should be welcomed. Fonterra cannot unlock higher margin businesses without raising significant new share capital. Since formation, Fonterra has improved margins by extracting costs and creating efficiencies without making significant demands on capital.

All over the world, value-adding businesses grow without having to frequently resort to capital markets for new equity. Fonterra shareholders have already demonstrated the ability to commit the equity required to fund our impressive growth and there is no reason to suggest that cannot continue for the foreseeable future.

These achievements are the result of doing the simple things well. Plans to continue to perform in this way are credible because, to date, we have achieved so emphatically.

Fonterra's position is that milk volumes will be effectively controlled, but it will still accept all milk produced. Fonterra must continue to accept all milk subject to certain conditions. It has never said it wants to "control" or limit volumes. Our stated goal is to encourage profitable milk production, maintaining New Zealand's status as the world's low-cost, high-quality milk producer.

Fair Value Share and open entry and exit are important because they mean Fonterra is an "open" co-operative while ensuring additional milk growth is profitable.

The milk cheque should be unbundled. An independent policy institute noted that open entry and exit gives Fonterra strong incentives to set the correct valuation of processing capital and the associated efficient price of milk. If share value is too high and the milk price too low, there is a risk to milk supply from an exit by suppliers when their supply is profitable.

Fonterra shareholders contribute soft capital. Shareholder expectations for sound, market-related returns mean the capital they subscribe is not "soft" money.

There are a few zealots like Tony Baldwin, who seem philosophically bent on sounding the death knell of co-operatives because of their so-called weak competitive position. But co-operatives around the world are prospering and growing, and retaining and growing their capital. They are evolving and changing to suit their own unique circumstances. So is Fonterra. *

Graham Stuart is Fonterra's group director of strategy and growth.

* Do you have an opinion or view on a rural issue -- local, national or international? Then Thursday Farmer's Farm View column is your opportunity to air those views and generate some healthy debate. Articles should be 600-800 words long and accompanied by a contact phone number and a brief description of the author. Either e-mail (farming@tnl.co.nz), fax (06 758-6849) or post to Terry Tacon, Farming Editor, PO Box 444, New Plymouth.

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