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Editorial: Dairy industry too important to be stifled

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The country is having cause to rue the previous Government's decision to leave dairy exporting under the control of a farmers' co-operative.

Fonterra, which receives 92 per cent of New Zealand's milk production, was formed on the fond hope that it would take the commodity to a higher level of value.

Not much has happened. The farmers have been taking the company's profits in payouts and leaving too little in the bank for investment in new trading opportunities.

If Fonterra is to pursue new and higher-valued markets it will need an additional source of capital, preferably one more stable than the farmers' shares that are redeemed whenever production drops.

Last year, the directors put a formal proposal to the 7000 farmer owners to form a company outside the co-operative with publicly listed shares.

It was rejected. Now the directors have developed an alternative capital restructuring proposal. The details have yet to be announced but the company has assured the farmers it will not include a public listing.

Chairman Sir Henry van der Heyden says farmers will retain 100 per cent of the company, which is a pity, for by his own admission "payout is a lot more important to them than value".

Their faith in investment to add value will not have been helped by the fact that just 31c/kg of last year's bumper $7.90/kg payout came from value-added sales.

And their ability to provide the company with extra capital this year has been hit by a 50 per cent drop in dairy prices from the recession in foreign markets. Many farmers are said to have gone into debt to meet existing obligations to Fonterra.

Yet if the company cannot find alternative sources of capital soon it is worried that more heavily subsidised production in Europe and the United States could flood commodity markets.

The need to lift Fonterra's products beyond bulk cheese blocks and milk powder has never been more urgent. Last year, the company cited opportunities in medical nutrition, cheese slices for McDonald's worldwide, pizza toppings in 30 countries and pharmaceutical grade protein, among others.

Eight years ago, when Fonterra was founded, these were the sort of sophisticated products envisaged. The medical and pharmaceutical uses chimed well with the Labour Government's "knowledge wave" of its early days. Now they are close to the heart of a new Prime Minister with ambitions to lift the country's economy to a higher level of value.

Nobody will be watching the farmers' reception to Fonterra's next capital-raising scheme more keenly than John Key. He has reportedly been acquainted with the details that will be announced to farmers next Friday.

The Government is also said to have been asked for legislative support for the scheme. If that amounts to statutory protection from competition for New Zealand's farm supplies, perhaps to encourage farmers to supply the additional capital, it would be a retrograde step.

Fonterra's worldwide operations long ago outgrew the scope of its domestic farmer base. The company buys and processes milk in many countries and trades far from home. It has been one of a few significant players in the small global market for milk. Now it bids to move in to more sophisticated products that are more capable of maintaining their price.

Yet farmers seem reluctant to let the company reduce their exposure to commodity price cycles. They are determined to keep total control of the company but their control is stifling it. The company earns more than a quarter of New Zealand export returns.

The industry is too important to be monopolised by a farmers' co-operative indefinitely. Independent entrants should be encouraged to pursue the opportunities Fonterra has found.

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