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Structure at odds with strategy

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Fonterra's vision is still to earn more from higher value market segments. By 2025, it wants total sales to come 21 per cent more from consumer and foodservices, 10 per cent more from overseas partnerships, 15 per cent less from ingredients and 6 per cent less from the global dairy auction market.

If you keep saying something and use more seductive words and pictures, perhaps you can persuade yourself that a wish can become a reality. However, 14 years on, Fonterra is further away from its core goal than when it was formed.

Rather than dabble with indifferent results in so many parts of the value chain, Fonterra should concentrate on the things it is good at and dispense with the rest. This may mean paring back to commodities and related ingredients. It certainly means Fonterra turning itself into a very efficient, low-overhead machine.

Fonterra should also only purchase and process volumes of raw milk that make economic sense. To this end, Fonterra should reduce its market share to below the statutory thresholds that require it to collect all raw milk wherever it is produced.

It should also put in place mechanisms to signal the value of raw milk on a regular basis during the season. The value of Fonterra's processing should also be signalled separately from the price of raw milk.

Critical is Fonterra recognising its weaknesses and ceasing to do things that don't have a strong prospect of meeting sensible risk-adjusted rates of return. Fonterra and farmer-suppliers should be driven by profitability, not volumes and market share, and this should be supported by better disclosure and performance monitoring.

If co-operative members want a financial stake in higher value dairy businesses, they can invest directly in successful international companies such as Nestle, Danone, Abbott Lab and Mead Johnson. Better than their current compulsory downstream investment through Fonterra, farmers could choose if and when to invest, the amount, and manage when they want to change their exposure.

Finally, Fonterra should organise itself so it doesn't rely on special legislation to exist and operate. As the Australian Competition Review Panel found last year, issues concerning the creation of "national champions" can and should be addressed under normal competition laws.

Fonterra chief executive Theo Spierings delivers bad news this year, when the co-op cut its dividend forecast as earnings fell. Picture / Bloomberg

Australians reject Fonterra model

It is interesting that Australians last year rejected the single integrated co-operative model. It was recommended by McKinsey & Co, key advisers and promoters in forming Fonterra.

The Australian Productivity Commission (ACP) completely dismissed the claim that a single dairy co-operative would give it market power to influence international prices — a myth that has dominated and constrained our own industry for so many decades.

Australian authorities also condemned the idea that success overseas requires unity and non-competition in the domestic market. As the Australian Competition and Consumer Commission stressed last year: "if you cannot beat your rivals at home how can you hope to do so overseas?" While the Australians have preserved effective competition at the farm gate, New Zealand's industry leadership for decades has focused on eliminating it. Fonterra claiming (as they do) that it's our "national champion" is equivalent to saying that we should have the All Blacks without the Super 15 and ITM rugby competitions.

The ACP also highlighted that there are potential risks if the industry's overall performance is linked with one company, and that Fonterra-like arrangements are not necessary to ensure that scale benefits at the plant level are realised.

And the ACP concluded "it is overly simplistic in the Commission's view to put New Zealand's relative increase in dairy exports primarily down to the formation of Fonterra, let alone to use this experience to drive policy decisions in Australia".

Conclusion

In reality, Fonterra was not a "breakthrough idea". It did not "catch the knowledge wave". Milk is not "white gold" or "better than an oil well".

As Bill English told Parliament in 2001, forming Fonterra was, underneath the flannel, the "product of a political deal between the Government and the dairy industry". It was a defensive compromise to break an impasse. The industry agreed to lose the Dairy Board's statutory "single exporter" powers on condition that the Government replaced it with special legislation enabling the formation of Fonterra.

In short, the statutory single buyer was swapped for a commercial near-monopoly with special rules.

It was a paradoxical deal: the industry believed it would continue a highly dominant dairy exporter; deregulation supporters hoped it would lead to contestability and significant innovation. And 14 years on, it looks like the industry was right.

Rare beast: A family business with staying power

I've always loved the idea of inter-generational family businesses — started by great-granddad (or even better, great-grandma) and built up over decades by descendants as passionate and hard-working as the founder.

Unfortunately, this model is something of a romantic notion and relatively few companies survive through the generations. According to the Family Business Institute, 30 per cent of family businesses worldwide survive into the second generation, 12 per cent make it into the third, and only 3 per cent last into the fourth and subsequent generations.

A lack of succession planning seems to be the most common obstacle, but there are others, relating to the nature of families.

Poor succession planning is not unique to family businesses. Imagine being a member of a royal family, waiting for the king or queen to surrender their throne and give the heir-apparent his or her turn. As an aside, things are looking up for royal heirs — in the last three years there have been four abdications, with Juan Carlos I of Spain, Albert II of Belgium, Queen Beatrix of the Netherlands and the Emir of Qatar all relinquishing their thrones to the next in line.

Succession planning in a family business has unique issues because you are dealing with family. Who wants to start a conversation with Dad about when he might like to give up control of the business so Junior can step in?

All Things Money

Carmel Fisher **Founder and Managing Director of Fisher Funds**

First-generation family business leaders . . . tend to have the hardest time letting go.

It is most difficult with first-generation family business leaders as they tend to have the hardest time letting go. This is partly because they are used to being in charge, having started a business from scratch and done everything that needed doing, from product development through to sales and finance. It is also hard because they haven't been through a successful succession before.

Family business leaders can also have a certain personality type that makes them hard to budge. They might resist giving up control because the business is their baby and they assume nobody can do it as well as them. They can also be reluctant to stop doing what they love, as they can't imagine what they'd do otherwise.

Rupert Murdoch and son Lachlan know all about mixing business and family. Picture / Bloomberg

One family business consultant takes an interesting approach. He starts by telling all family members the primary goal should be to help the BOSS be successful. All heads turn to the business leader, but the consultant quickly explains that the real boss is not one person, but the four constituencies that make up the word.

B stands for the Business and what it needs to be successful. The O stands for Others. In the context of succession planning, the Others are each member of the family and they all need to be committed to making the business a success.

The first S is for Self. This can be the hard part, as all family members need to articulate their own wants and needs. Apparently, an inability to speak directly to other family members about "selfish" issues is one of the biggest challenges in family businesses. The last S stands for stakeholders, including the whole family, employees, clients, suppliers and anyone connected with the business.

Having read all about the challenges of family businesses, I enjoyed hearing that Emma Hill is to take over as chair of Michael Hill International when her father retires in November. This is a first-generation family business with a passionate and determined founder who, I suspect, would not have given up control lightly. Mum is on the board too . . . no pressure, Emma!

The company's press release quoted Hill saying his daughter has the support of the board, the passion and the expertise to take the company to higher levels. Emma also commented on her 30 years in the business (from age 13) as a journey of "learning, perseverance and growth".

Every business is interesting but those involving families and generations overcoming their unique challenges to survive are, to my mind, in a league of their own.

■ *This column is presented in association with Fisher Funds.*