

Country-Wide NEW ZEALAND Farmers Weekly

Shift of power and cost cuts for Fonterra

by Country-Wide Reporter

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There are pluses and minuses to come out of Fonterra's latest up-heaval according to dairy industry analyst Tony Baldwin.

He says the two positives he can see are cost savings and a more streamlined decision making process.

On the downside Baldwin says Fonterra runs the risk of losing people from the industry with experience and knowledge and the board and senior managers could be diverted from identifying growth and revenue opportunities if all their energy is taken up by the business of NZMP.

"It's a good thing to do if they are not going to lose all the good people and get bogged down and miss other opportunities," says Baldwin.

Fonterra recently announced that it was going to re-absorb NZMP, its dairy ingredients arm and the world's largest dairy ingredients business.

NZMP's business includes the collection of milk from 13,000 suppliers, the manufacture and packaging of more than 1000 products and the operation of a global supply chain linking production plants in New Zealand and offshore to customers in more than 100 countries.

Fonterra chief executive Craig Norgate says the "change reflects a desire to create a single merger and acquisitions team for our whole organisation."

Meanwhile Baldwin believes there are three driving reasons behind the move. The likely reasons being power, commodity business and strategic direction.

Before the merger there were three legacy companies and all the decision making power was based in Wellington, the base of the original Dairy Board.

He says after the merger the power was moved to Auckland, but the power was still fragmented between the three legacy companies.

"That power has been taken and centralised."

Baldwin says the original McKinsey report recommended a small corporate center and a decentralised structure. But Wellington was still in the driving seat with NZMP.

"This is recentralised and a clear transfer of power. It says we are dismembering the Dairy Board."

According to Baldwin the cost savings of doing away with a stand alone NZMP aren't large at an estimate of \$10-\$15million.

It could also signal that the board is taking a detailed interest in the commodity side of business.

He suggests the delay in making the move, which came only weeks after Fonterra's first birthday, was so there wasn't much "blood on the ground" during the merger.

But Baldwin thinks it should have happened before now, to save expensive loss of opportunity. Those losses relate to the cost of rationalisation, establishing relationships with customers.

For the next couple of years Baldwin suggests Fonterra's focus will be on commodity business and it could be a good thing for farmers, especially if the payout becomes closer to the commodity milk price (CMP). But he doesn't think Fonterra absorbing NZMP will increase farmer wealth, like promised before the merger.

"I think this will be a popular move with farmers. NZMP wasn't providing the service they want. It appeals to immediate farmer concerns."

A danger Baldwin can see developing is loss of Fonterra's global view. The longer Craig Norgate fills Chris Moller's position as former NZMP managing director (now re-titled as chief operating officer) the further away from the merger promise they get.

Meanwhile Dairy Farmers New Zealand chairman Kevin Wooding has welcomed the move because it's a positive step towards "addressing duplication and overspending." He says there will also be an improvement in accountability.

He doesn't think it will change Fonterra's focus in the market place and the release of Project Galileo will shed light on the company's direction and focus.

Wooding says the overrun in spending of \$64million (an average of \$3500 a farmer) is unacceptable and he hopes next year Fonterra will spend within budget and more will make it's way into farmer pockets.

Chairman of the Shareholders council, Tony O'Boyle says from a council perspective the move of NZMP into Fonterra indicates that NZMP is at the heart of the business.

He doesn't think there will be a shift in Fonterra's global focus, but more a move towards what shareholders voted for. O'Boyle says it's more to do with efficiency building and making the most of milk.

O'Boyle says farmers will be sorry to see Chris Moller go, but it's all part of evolution and continuing to move forward.