NEW ZEALAND LISTENER

Fonterra: In all our interests

Should farmers vote to change their biggest drag-anchor, co-operative ownership of Fonterra?

By The Listener (Editorial) In Features

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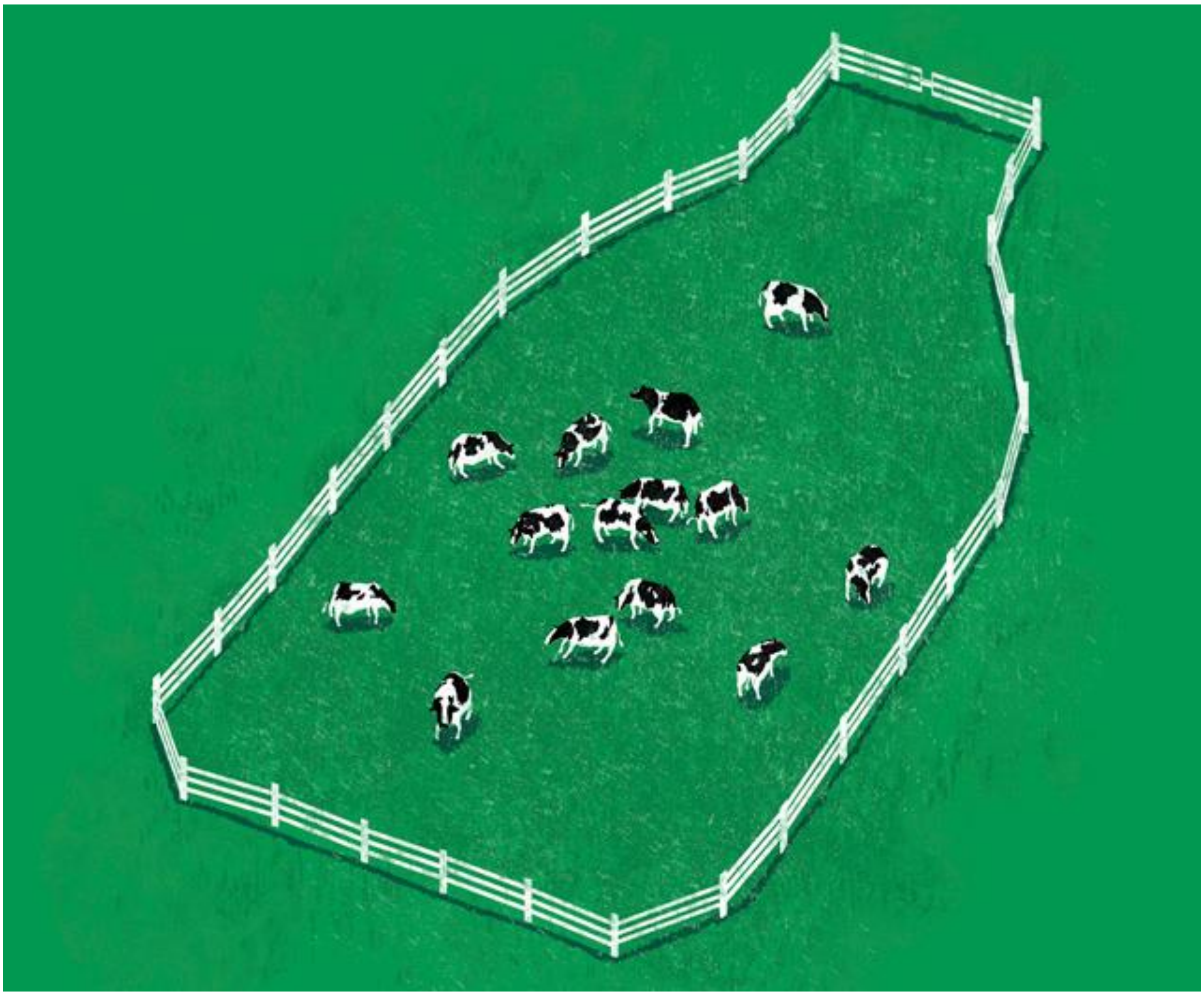

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As political wake-up calls go, Fonterra's has been a long time coming. Our biggest company is doing extremely well in challenging circumstances, but needs urgently to reassess its engagement with the public after the controversy over its treatment of suppliers and contractors. This caused genuine fear of hardship throughout rural New Zealand, and gave rise to broader criticism of the company's commercial stewardship – not all of which was fair.

As a farmers' co-operative, Fonterra is locked into a self-limiting regulatory and organisational structure that most in the industry now agree needs further reform. But the company must work a great deal harder to foster public and political goodwill if it's to continue to enjoy its privileged position, and gain the further deregulation it wants.

That goodwill curdled somewhat over its inept handling of the 2013 botulism scare. This year, its confusing and at times evasive response to queries over its new policy on suppliers' invoices showed it hadn't troubled to learn any PR lessons since the scare.

It has been caught using small, and often Fonterra-dependent, companies as a source of free capital – $70 million worth. Despite its attempted denials, the company did last year inform regular contractors it expected them to charge Fonterra 10% less for their services. It also informed about 1000 of its suppliers it intended to pay invoices 61 days following the end of the month within which the invoice is dated, meaning for some a three-month wait.

Only after a political furore, including thinly veiled threats from Government MPs, did the company relent. It claimed it had only intended the price cuts and invoice delays as a suggestion or point of negotiation with contractors. Given the respective sizes of those enjoined in negotiation, the clear implication of Fonterra's communiqués was: come to the party or we'll shop elsewhere. Fonterra has now modified these proposals, but they revealed a disturbing dissonance with the community to which it is so vital and with the nation's overall economic welfare.

New Zealanders understand that, facing prolonged doldrums in the global milk market, Fonterra must cut costs. Demand for dairy products may still be growing but with European production increasing as quotas come off, plus the slowdown in China and the ban in Russian markets, global dairy prices are still "bumping along the bottom". Yet dairy farmers don't work in isolation from other rural businesses. In a downturn like this, no one benefits from businesses going under, something even the banks – vowing to support most struggling farmers through cash or debt crises – have accepted.

Certainly, Fonterra is correct to point out the difficulties of doing right by its farmer owners in the current climate – and there is now increasing political support for cutting it some slack in terms of its statutory obligations. When Fonterra was created in 2001, a number of "trainer-wheel" measures were included in its governing legislation, chiefly the obligation to collect whatever milk was offered to it, and to supply milk to any business that requested it. These measures were intended to mitigate the company's anti-competitive dominance and ensure stability while farmers and processors got used to the dairy industry's new shape. There's growing consensus that the requirement to take all milk offered has been especially burdensome, forcing the company to build more and more processing capacity, without regard to market demand.

This mandatory focus on the commodity side of the industry also explains why the company has, in some critics' assessment, failed to put sufficient focus on developing value-added - products. Fonterra bosses appeared to acknowledge the criticism last month, signalling a new push into further processing.

Canny farmers may be able to offset income erosion with the pending new milk futures contract from NZX. However, farmers' biggest drag-anchor is surely their cumbersome co-operative ownership of Fonterra, and the limitations that imposes. Only they can vote to change that. Fonterra's biggest competitors, notably Nestlé, have been nimbler in the world food market, arguably because their farmer shareholders have ceded some power to managerial expertise. Our farmers soundly rejected a proposal in 2007 to float the company's successful brands business. It's time they reconsidered.

Fonterra may legally be their company, but economically it serves us all. We all want it to be successful – and to believe it has New Zealand's best interests at heart.

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