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John Wilson: Fonterra performance clearly shows we got it right

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John Wilson says it is important that Fonterra continues to evolve. Photo / Alan Gibson

NZ Herald
By John Wilson

The Business last week ran a feature by long-time dairy industry commentator Tony Baldwin. Today, Fonterra chairman John Wilson responds to his criticisms.

Statements made in the *Herald* last Friday completely dismiss the progress of Fonterra over the past 14 years and the contribution it has made to dairy farmers, local communities and the New Zealand economy.

The author of last week's article has opposed Fonterra's model from the start. While the comments made are neither new nor a surprise, they cannot go unchallenged. They are unfortunate for the dairy farmers and their families who work tirelessly every day to make New Zealand's dairy industry great and who are doing so now in the face of unprecedented low global milk prices that are creating challenges for their businesses and anxiety for their families.

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The dairy farmers who voted to form Fonterra would readily do so again. So would all those who have joined Fonterra in the past 14 years. They are perfectly clear that their co-operative is an extension of their farm, collecting and processing their milk as effectively as possible and getting it to market, while at the same time moving more of their milk into higher returning products.

Fourteen years ago, New Zealand dairy farmers were reliant on trading 95 per cent of milk production in the most deeply protected and highly subsidised industry in the world; in an average year our farmers were paid 30-40 per cent less than their US and EU counterparts and there was no price transparency. A fractured industry would never have the scale to survive such a deeply distorted world market.

As a co-operative, Fonterra's job is to provide a cost-effective and competitive supply chain to reach customers around the world, to achieve the world's best prices for farmers and to provide transparency, to allow farmers to make production and business decisions.

Has Fonterra achieved this? The answer is a resounding yes.

Since Fonterra's formation that gap between what our farmers are paid and what their global counterparts are paid has been closed. On average our farmers are paid the same if not on occasion more than their peers in these markets. Remarkable.

In determining the Farmgate Milk Price we give transparency between the value of milk produced on our farmers' farms for commodity manufacture and return on investment from value-add activities. Farmers are able to make decisions accordingly in capital allocation and marginal production decisions.

Today, after 14 years of existence, Fonterra has around 85 per cent market share of New Zealand milk, while increasing the volume of milk it processes by a huge 57 per cent over that time, 24 per cent in the past five years alone. This is despite new entrants having the opportunity to arrive from anywhere in the world, with little barrier to entry compared to most countries, and through legislation receive milk that is effectively subsidised by our Fonterra farmers.

It is true that our dairy farmers do not stand out as the lowest cost producers in the world today, but this is because New Zealand is a developed economy with higher labour costs than our low-cost peers, our farmers invest significantly in the environment and have high compliance costs.

We accept that and continue to strive to drive productivity within and beyond the farm gate to maintain global competitiveness.

The author of the comments in the *Herald* drew comparisons to Australia's fragmented dairy industry.

When Fonterra was formed the Australian and New Zealand dairy industries were roughly the same size. We are now double that size while the Australian industry has stagnated.

Having been in Australia last week, it is very clear that participants in the Australian dairy sector believe it needs to consolidate. The sector is dominated by short-term thinking. Real productivity through innovation throughout the value chain is lacking due to a lack of scale and capital. Driving through a dairy farming community in Australia shows a stark difference with New Zealand. They have not experienced the growth in wealth anything like their New Zealand counterparts.

The comments in last week's article are based on the notion, roundly rejected by farmers, that to succeed Fonterra really ought to think, act and behave just like a corporate, with a structure to match and a consumer business independently listed.

This ignores our unique strength coming from being a vertically integrated supply chain with scale, connecting high-quality milk from pasture-raised cows to consumers around the world.

The reality is that we have grown our ingredients' milk powder revenue from $7.9 billion in the 2002/03 financial year to $16 billion in 2013/14 and our consumer and foodservice revenue from $4.6 billion to $6.3 billion in the same period.

The growth in consumer and foodservice is more remarkable when you consider that the $4.6 billion also included specialist ingredient sales, which are now reported as part of ingredients.

The decision that our farmers are making to grow milk supply does require Fonterra to invest significantly in capacity capital, with more than $2.3 billion invested in the regions of New Zealand over the past three years alone, providing the jobs that come with that too.

In the past two years an unprecedented $230 million has been invested in consumer and food service processing capacity in New Zealand to supply export products to Asian markets, not to mention approximately $700 million invested in offshore consumer packing plants, such as in Indonesia, and the investment in Beingmate in China.

There are always areas we need to work on, such as some aspects of the Dairy Industry Restructuring Act which now need to be reworked.

It is important that Fonterra always continues to evolve - but our performance shows that we got it right with transparency, with structure and with scale.

We are shifting more volume into value than ever before.

The current 40c-50c earnings forecast represents a healthy improvement on past years and provides confidence that we are well placed to see upside as the market normalises.

More than ever before, it is critical that we stay on course to maintain our position and that will require discipline and highly capable management - both of which we have.

We will be able to take advantage of the turn because of the hard work that has been done over the past 14 years.

Where many other producer nations are now grappling with the need to consolidate processing and some are learning to live with lower subsidies, Fonterra's farmers should be congratulated for tackling these challenges more than a decade ago.