

A Co-operative - by the Suppliers for the Suppliers.

At the 5th Annual Lexis Nexis 2008 Rural Professional conference in Christchurch, Henry van der Heyden, Chairman, Fonterra spoke on “Fonterra – where is the co-operative heading”. Blue Read, Chairman, Fonterra Shareholders Council then spoke on “Keeping the co-operative relevant during times of change”. Both these presentations were a graphic reminder of why you should supply a co-operative.

Why?

A co-operative is based on voluntary membership owned largely by you the suppliers, for your benefit.

The fact that you (the supplier) own the co operative precludes any one else being able to poke their nose in, and take control.

A 75% vote is required to make major changes, which protects the co-operative.

A co-operative is about shareholders with common interests and common goals. Additionally it is interesting to note that the highest rated bank in the world, Rabo Bank, is basically a co-operative.

Co-operatives seem to service farmers well. (for this reason)

One of the advantages is that the co-operative also agrees to take all your milk at **any** time. This is a fundamental rule and is built into the constitution.

Anybody who has had to deal with milk being pumped out onto their land will understand this ruling.

Conversely, does a privately owned company have to take your milk on a bad day?

What happens if they have one processing plant and then they get a breakdown, where does your milk go?

A co-operative has to work to maximise a return to shareholders, and that is you, the suppliers. And yes, I agree that the co operative retains earnings and reinvests in other businesses, but as a shareholder you still actually own those other businesses as well.

On the other hand, does a privately owned company maximise your return, or do they just pay sufficient to maintain you as a supplier, so they can maximise their return on profit to their company? You have no share in the private company, and consequently no share in the profit.

In this volatile world, what happens if a company gets into financial trouble and falls over? Where will your milk go when this happens? What will the issues be and will you be able to pay your accounts, particularly the interest bill?

Are you a better lending risk supplying the co-operative than supplying other companies? I think so.

Ask yourself, in a down turn will a company reduce its return and pay out more to you? One would only have to look over the fence at the sheep and beef industry to see the privately owned meat works and the low returns to farmers.

Apparently, in the meat markets in Britain the buyers wait for the private sellers from New Zealand to bring the brilliant lamb products to the market. The buyers only have to wait until the sellers start under cutting each other to get high value lamb at rock bottom prices. It is very sad really. Could that happen in the Dairy Industry in New Zealand?

The Fonterra co-operative has some unenviable and distinct advantages. They are responsible for much of the traded milk product supply in the world, and there is no under cutting.

They are nearly a single seller, and that has worked splendidly in the past.

Do you think that all the traders, 'sprukers' and money people would love to get their 'sticky fingers' on the assets of the co-operative? You bet they would! If it were to be sold, they would likely strip the assets from the company, make a fortune and then sell the shell of the company back to who ever would still want it.

This would be just like many of the State Owned Enterprise's (S.O.E's) that were sold to private enterprise, in the 1980's. The assets were striped and then what was left of the company was dumped back onto the market at a later date. All the wealth went to private individuals and the State Owned Enterprises (S.O.E's) were invariably sold too cheaply in the first place.

The co-operative ownership prevents this happening without a substantial majority agreeing, which is most fortunate.

Yes, you can cash up the fair value shares, and go onto contract supply. The contract is what it says it is. It is for a period for two years, and there are strings attached - and rightly so.

You can bet your bottom dollar that the co-operative is going to move to show a better return on shares than they have in the past. It must become more desirable to supply with full fair value shares, but let us not forget that part of the value of the FVS is 'locked up' in the commodity production, collection, and sales part of the Coop. It is this part that gets the milk off the farm and manufactured in to a product that is less perishable, and more saleable, than fresh liquid milk. That significant part to the contribution of the value of the share seems to have been forgotten in the chase for Value Add returns and maybe, just maybe, Fonterra's "real" value hasn't been properly appreciated.

Fonterra and the co-operative do have an issue. Share redemption for Fonterra is a risk at the moment. What the final answer will be is still under development, but one thing is for certain, it is the co-operative structure that has served farmers well in the past and there is no conceivable reason why it shouldn't in the future..

In Summary:

The co-operative is a different animal than many perceive her to be.

It is an interesting ownership structure in which you all own shares.

And yes, they do some odd things, and yes, they annoy you. And yes, they do not have good relationships with their suppliers, but at the end of the day, you still own the co-operative.

To go and supply a company rather than from a co-operative has some considerable downside risks, as detailed above.

All farmers need to think about those risks before deciding to supply elsewhere.

Remember, a co-operative is by the suppliers for the suppliers.

This philosophy is not a reflection on the values of Companies in the market place as they do provide other options for some suppliers.

These are the opinions of Don Fraser of Fraser Farm Finance. Any decisions made should not be based on this article alone and appropriate professional assistance should be sought.

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