



KELLOGG

RURAL LEADERSHIP
PROGRAMME



An industrial analysis of dairy
processors in New Zealand

Kellogg Rural Leadership Programme

Course 39 2019

Stuart Davison

I wish to thank the Kellogg Programme Investing Partners for their continued support:



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Executive Summary

After 18 years of DIRA legislation, Fonterra has gone from being an almost monopolistic company within New Zealand's dairy processing industry, to being involved in a very competitive market place with the introduction of some major competitors in the shape of Open Country Dairy and Synlait to name a couple. This report shows how each company differentiates themselves from each other in an industry where the base product is exactly the same; milk. This differentiation of final products allows competition to be established in overseas markets for each of the companies. This competition within New Zealand for a stable or reducing milk pool, has created an increase in returns for farmer suppliers; without the threat of new entrants into its processing space, Fonterra would not be as strong as it currently is. Fonterra's strategies have been shaped around delivering the best return possible for its farmer suppliers, to ensure that they are not tempted to supply another processor, and to deal with the restrictions the DIRA has created around Fonterra.

This report gives insights into how each processor performs in comparison to one another, how each processors strategy of processing its products results in different revenue per kgMS, and how this revenue is distributed, either to farmer shareholders or to private shareholders. The report should also highlight the amount of competitors within New Zealand's dairy processors that are foreign owned.

Recommendations:

- 1- Fortify: Revitalized and continued support of Fonterra as a market leader; Fonterra is the market leader, not purely due to market share, but mostly by transparency allowing it to openly show everyone how it operates and sets its milk price and share price, by flying the "NZ Inc" flag and doing a lot of industry work on its own accord, while by default, taking other processors along for the ride. The Fonterra Co-Operative is the reason the dairy industry in New Zealand is so strong, this needs to be remembered and revered by all farmer suppliers.
- 2- Future proof: Farmer suppliers need to look beyond their own balance books to determine if a change in processor is actually beneficial in the long term. Does your new milk processor have any obligation to keep paying you a good farm gate milk price if Fonterra or DIRA are out of the picture; who is your new or potential processor working for, you or its shareholders?
- 3- Deregulate: DIRA legislation needs to be removed, and quickly. The initial aim of consumer protectionism is no longer required, as there are now enough processors within New Zealand for this to be controlled by market forces; which was part of the initial idea of DIRA. DIRA is also hindering Fonterra's ability to be able to make strategic decisions with its supplier base and all of its processing sites; not being able to accurately predict milk supply in the future accurately, hinders investment strategy and direction. Having the ability to control entry and exit of suppliers, along with the abolishment of the regulated milk supply to competitor's legislation, will allow more certainty around investments into processing capabilities; which means more product to process and add value to, and more money into New Zealand's economy and not into Foreign owned companies.
- 4- Compromise: Determine what amount of market share is optimum for each of New Zealand's dairy processors so that New Zealand's export margins are optimized for New Zealand's benefit. This should include some competition within New Zealand, such as Synlait, so that Fonterra has

some competition to constantly benchmark itself against, but not so much that buyers in foreign markets have the ability to bargain with exporters of New Zealand products.

Acknowledgements

I would like to acknowledge all the people that have made this project possible, by giving up their time to talk to me, and share their insights on their companies and the industry itself. I would also like to acknowledge all the help and insight from Patrick Aldwell for helping guide me through this project. I would also like to acknowledge the constant and unwavering support from my Wife Sophie; while we battle seasons, farming life and a full social calendar together, Sophie has gone the extra mile to ensure that I have the opportunity to make the most of the Kellogg Rural Leadership Course.

Also all the people and sponsors involved with the Rural Leadership Trust, it has been a life changing experience thus far.

Introduction

New Zealand has been a world leader in the global dairy industry for decades now, from on farm efficiencies to the ability to market products to the world, from our tiny island nation at the bottom of the Pacific. We have set our own path, competing with countries that have scale which far exceeds ours, using our difference, provenance story and our green image to persuade consumers to pay more for our premium products. New Zealand produces 30% of internationally traded dairy products, but only produces 3% of the world's dairy products; being the 8th largest dairy producer, this is quite the feat. Over the course of the history of dairy processing in New Zealand, there have been many changes; from many different and small processors all over New Zealand competing to sell the same product internationally, to the eventual merger of most of the processors in New Zealand to form a major processor, Fonterra. This change from many processors to a few has followed the change in technology and infrastructure within New Zealand. Due to milk's perishability, it is paramount that the milk is chilled and processed quickly to ensure that the milk is kept at its finest quality, so that the final product is of the utmost quality; this caused problems during the early years of the dairy industry in New Zealand. Many farms churned their own butter to be sold, or made their own cheese on farm to be sold. This evolved to having a dairy factory in the village, and farmers bringing their milk to the factory via milk can. As transport possibilities increased, and as refrigeration became more available, factories were able to be built in locations that provided better transport of the processed products, such as next to railway routes, or near sea ports. As milk tankers and on farm refrigeration became more widespread, the less extensive the factories needed to be, this meant that factories could merge with one another; which led to the merging of the cooperatives that owned the factories as well.

The industry has gone from one end of the spectrum to the other; in the 1920's there were about 600 different factories throughout New Zealand with 85% being Cooperatives; merging down to only four processors, Kiwi Cooperative Dairies, New Zealand Dairy Group, Westland and Tatua; but the industry is now seeing the expansion to more processors than just the three main players (Fonterra, Westland, Tatua) that were operating in 2001, after the merger of New Zealand Dairy Group and Kiwi Cooperative Dairies, to form Fonterra. As other dairy processors have entered the market, tensions have risen at a farmer supplier level; Fonterra gained massive support from its' farmer suppliers, with the way it revolutionized New Zealand's ability to market dairy products into overseas markets, solving the issue of many companies competing with each other in a foreign market. With Fonterra being an almost monopoly company, this changed the way New Zealand dairy farmers operated, and within the space of 14 years (2001-2015), farmers realized massive financial gains from the increase in farm gate milk price, the increase in the value of their land and the increase in the worth of their shares in Fonterra and their cows. This increase did not only occur because of the formation of Fonterra, in 2008 a free trade agreement with China was signed which saw China become our biggest importer of dairy products, for example. Part of the merger to form Fonterra was the removal of the dairy board from the industry; the dairy board was formed in 1923, and had a monopoly control of exporting all dairy products out of New Zealand. The Dairy Board used subsidiary companies to market products into other markets. This is called a single desk market, and was controlled by the government, which meant that the dairy board also set the milk price for all processors. Because the dairy board was merged into Fonterra, it was seen as important that Fonterra show how it sets its milk price, so that it was similar to how the dairy board set the Farm Gate Milk Price (FGMP).

With the financial gains that farmer suppliers achieved with the advent of Fonterra, backing of the company was strong, so when dairy processing competitors starting making inroads into the processing space, tensions rose amongst farmer suppliers. What farmers did not see occurring through the early years of Fonterra, was that due to a real lack of competition Fonterra may not have been operating as efficiently as it possibly could have been. This could have hindered the true potential of the company's value increase or milk being processed in to the highest value product; exemplified by the amount of whole milk powder which was produced during this time, which is a volatile commodity and not a high value consumer product.

Aims and Objectives

The aim of this report is to provide dairy farmers and others within the dairy industry with an insight into the industrial and competitive side of the milk processors that they supply; to show and to hopefully demonstrate that competition within the dairy processing industry is important and beneficial to all players, and to speculate on the future of competition in the dairy processing industry

Literature Review

To establish the background of the industrial side of dairy processors and how competition influences decisions, I needed to find out what actually causes the change in companies' strategies, and how this influences their approach to marketing, new entrants and threats to their business. A paper published in the Harvard Business Review, The Five Competitive Forces That Shape Strategy (Porter, 2008), was written to set out what influences decisions within businesses, and how those forces can be seen within business's. The five forces are: the threat of new entrants, bargaining power of buyers, threat of substitute products or services, bargaining power of suppliers and rivalry among existing competitors. The paper is very comprehensive in showing how these forces work in the real world, with current business examples, such examples are the direct competition between Boeing and Airbus for the production of aeroplanes. This comparison is then also given depth by outlining how these companies are "pushed" around by the bargaining power of the airlines who order the planes, and how the threat of new entrants or substitutes being established is minimal within this space. The paper has many of these comparisons throughout, and the use of these real world examples really make understanding how these influence any business easy to recognise.

Further to Porter's paper, the journal article "Guidelines for applying Porter's five forces framework: a set of industry analysis templates" (Dobbs, 2014) shows where common misconceptions arise in using the five forces as a tool for analysing business's. As the author states in this paper, often users of the five forces will try to analysis businesses using only one or two of the five forces, and not seeing the entire paradigm as a constantly changing equation. For example, if suppliers have greater bargaining power over one industry consumer, have you assumed it is only the one company that is affected by this supply problem, or are all competitors in this space effected equally? Therefore this means that this force doesn't change profitability or saleability of a product to just this business, all businesses will be affected. What needs to be established in this instance is whether or not the supplier is only bargaining with the company being analysed, or all of the companies it supplies. The templates at the end of this journal article are a basic outline of how these five forces can each be measured individually by breaking them down into the parts that make up the entire force. Using a sliding rule, and selecting how far along

each way you mark each parameter, the user of the template can quickly define how important each parameter is. This breakdown of each force is important to remember, for example, threats to a business are varied and many; but to ignore one and focus too heavily on another may skew the truth.

After defining the five competitive forces, the next definition that was needed, and was a reoccurring theme, was a company's ability or desire to differentiate its' products. This relates to the five forces directly, as the major theme of rivalry among existing competitors is prevalent in product differentiation. As this work is looking at only dairy processors, it is important to note that the majority of products produced are going to be similar final products. (Bertini, 2012), reported that consumers are willing to pay more for quality and are willing to be more discriminate of products when there are more similar products on offer. This means that for multiple processors producing similar products, it is seen to be beneficial to have competitors products on the shelf next to their own product; the issue for each company then is how they can differentiate their own product within this mix of similar products. (Bertini, 2012) states that a "crowded product space can be beneficial to firms striving to compete on quality", and through one of the experiments in the paper it is shown that consumers were willing to spend 40% more for a high quality product and 33% less for a lower quality product in a dense market place, compared to consumers in a sparse market place. This empirically shows that if a firm is willing to spend more money marketing their product as being of greater quality, and it is indeed of greater quality, then they are going to fetch or demand a higher price. Further to the definition of "greater quality", in the same paper, quality doesn't need to be in the form of the actual final product, but can be in the form of the marketing that sits behind the product too. In the case of dairy processors this can be seen in the form of environmental programmes, such as Synlait's Lead With Pride programme, which encourages farmer suppliers to engage in environmental actions which Synlait then uses as differentiation on its products at a shelf or at the intermediate/ingredients customer level.

Method

The method used in this report is a mix of a Literature Review, ground checking facts via a questionnaire to dairy processors, executives or directors and then thematic evaluation to be able to compare the different processors. Thematic Evaluation is a method of measuring qualitative data; data that is not numbers, but answers to questions or answers found through conversing with the interviewed person. From these answers (data), themes are found within the answers that can either be agreeing with the trend or disagreeing; this allocating of answers into themes allows myself to determine a difference between processors. The thematic analysis style that I have used is from the Auckland University's School of Psychology; which provides a good guideline for how to set out this type of data sorting, but encourages users to define their own methods to allow for individuals to set their own parameters for interpretation. The final evaluation of the thematic analysis will allow myself to differentiate the processors and show what each company has as their strengths, focusses and how they fit into the market place. There will be no need to rank any of the processors, as this is not the aim of the paper; what is to be determined is how each processor fits into this industry space.

Through industrial analysis of the major processors within the New Zealand dairy industry, via interviews or communication with the respective chairman/executive/representative of each processor, I aim to tease out what each different processor has as a benefit or strength and also to determine where each processor sits in the industry, and how they differentiate their products and themselves. To do this I will analyse what their different approaches are to marketing, mitigating threats and risks, how they

differentiate similar products from each other, how they decide on markets to pursue and how they perceive their own niche or mark on their intended markets.

Using Michael Porter’s Five Forces model to give the questionnaire some framework is also very important to this report. This has allowed the questions to be posed in a way that should pick up each processors strategies around the forces associated with Porter’s model; which gives insights to how each company sees itself within the marketplace. The five forces are explained in the diagram below, and outline how each forces is evaluated and how each force impacts on the overall industry dynamic. Because this analyses involves only dairy processors, and how they relate to farmer suppliers, the five forces is focused on the simplified value chain of farmer-processor-customer. Because of this, there has been no attention paid to suppliers of other services or products involved with the processing of milk into final products.



The questionnaire is located in the appendices, and was mostly used to open up questions on where each company had a different strategy.

Discussion

Introduction

For the reason that each processor is different, and have their own history and way of doing things, I have outlined how each company operates, where what and who they are, and some of their history. This discussion also allows for some of the answers to be brought into their story, using some of the answers from the interviews to provide a greater quality of background of these processors, a better insight. Through this insight, I have simplified the Five Force's model into a table below each processor, to exemplify each of the forces actions on each processor, to display which forces are relevant to each processor.

Fonterra

Fonterra is New Zealand's largest company, with 10,500 farmer shareholders, it is the envy of the world with its ability to be a farmer owned co-operative, and be so competitive at home and on the world stage. The name Fonterra is recognized throughout the dairy world, and is often complimented as a shining example of what a farmer owned co-op should be. Fonterra has processing sites throughout New Zealand, and also has sites in Australia, China and South America. Fonterra has partnered with other companies to achieve market reach, and support other processors in other countries, which also allows Fonterra to operate in those countries. Fonterra has deals to produce other companies' products under contract, which allows Fonterra to produce more product without any more marketing or risk on those products.

When Fonterra was formed from the merger of Kiwi Dairy and NZ Dairy Group, in 2001, there were concerns that this massive company would have a monopoly on the national dairy industry, as there were only two other smaller processors left, Westland and Tatua. The Government of the time, the Labour Party lead by Helen Clark, saw that there would be major benefits for New Zealand as a whole, but was concerned for the consumers within New Zealand being at the mercy of a monopolistic company controlling the domestic supply of dairy products, and exposing them to export dairy prices. As a way of allowing the merger to happen, and finding a way to protect domestic consumers, legislation called the Dairy Industry Restructuring Act (DIRA) was introduced. DIRA poses some challenges to Fonterra; some of these included: Fonterra are required to have open entry and exit for suppliers; Fonterra must pick up milk from any dairy farm, anywhere in New Zealand provided they are shareholders, and dairy farmers can leave Fonterra to supply a different processor, and Fonterra cannot penalise or disincentive the farmer for leaving. Fonterra must supply milk to Goodman Fielder at the farm gate milk price throughout the year to enable competition and to ensure there are domestic consumer products not exposed to world market prices, and it must also supply milk at the farm gate milk price to any company which wishes to start a dairy processing plant in New Zealand to the tune of 30million litres of milk per year.

18 years after the legislation was put in to place and the merger happened, DIRA is still in place, and it is now affecting Fonterra more than was originally anticipated. The open entry and exit clause has not allowed Fonterra to have any bargaining power over its suppliers at all, this allows farm suppliers to change from Fonterra to any other supplier, at the end of the season, without any penalty, and then that same supplier can come back to Fonterra at any time. This brings many problems to Fonterra,

fluctuating shares and share value, estimating seasonal production into the future becomes harder to predict, which has an impact on where the company should invest into stainless steel. With the legislation stating that Fonterra must pick up milk from any location, the company is finding that farmers who have brought farms close to processing sites are subsidising transport costs for farmers who have bought farms further away. This is a double edged problem too, as farms closer to the processing sites, and also the townships that surround these sites, are valued far higher than a farm located greater distances away. This tension could be appeased in the same way other processors tackle this problem, and charge farmers further away a greater cost of transport per litre of milk, but because of the stipulations of DIRA, this cannot happen. From what Fonterra is seeing, the consumer protection is not happening to the extent that was expected from this piece of legislation, which furthers the need for the legislation to be removed or realigned.

Fonterra is the leader of the New Zealand Dairy industry, and has a massive market share; but with this also comes problems. Due to DIRA, Fonterra has to set the farm gate milk price, and this has to be overseen by the Commerce Commission of New Zealand, this is so that there is transparency in how the price is set, and to ensure that there is no monopolisation affect. The problem this causes is that every other processor can see this information, and knows what the market leader is paying, this then makes it easy for competitors to set their own farm gate milk price, and pay a small amount more which is essentially to attract more suppliers. Because a majority of Fonterra's competitors are usually privately owned, opposed to being Co-Op's, the farm gate milk price does not encompass any dividend that a Fonterra farmer supplier would normally receive on top of the farm gate milk price. The true value of the milk is usually greater than what is paid to suppliers of privately owned processors. Other dairy processors do not have the same transparency when they set their own farm gate milk price, and Fonterra believes that this is almost misleading suppliers who are looking to change processors. Open Country Dairy (OCD) uses the wash-up system, with a four tranche pay setup; what this causes is an undetermined final farm gate milk price, and what Fonterra often finds is that suppliers that have changed to OCD don't actually know what their farm gate milk price is.

With the scale that Fonterra has in the New Zealand Dairy exporting space it is assumed that it would have a massive amount of sway within the global platform, and that it would be able to demand the price it expects for its products in any market place throughout the world; and it is often assumed that Fonterra wouldn't struggle to achieve market reach into any market it desires, but this is far from the truth. The global dairy market is often saturated with product, and countries that have the ability to ramp up and down export dairy volumes often lift export volumes when prices increase, which causes the price to quickly drop as sellers try to undercut each other to try and sell their product quickly, as dairy products are a perishable item. The Global Dairy Trade Auction (GDT) was brought about because of this problem, by Fonterra. Every two weeks Fonterra hosts an online auction, with product from Fonterra and any other registered processors, to sell in a transparent and open way. The GDT uses the United States Dollar (USD) to provide buyers with a comparable currency. This open and transparent way of selling dairy products allows what was once all closed door agreements, or long term contracts at fixed prices, to become constantly changing, which allows for great price discovery (which is a major part of the milk price manual, which is used to set the Farm Gate Milk price). This constant auctioning process allows for the volatile nature of a commodity, such a Whole Milk Powder, to be better followed. What this translates to for Fonterra is that if WMP is declining in price on the GDT, then a strategy can be put into place to produce more of a different product, such as Butter or Anhydrous Milk Fat (AMF).

What Fonterra is worried about with the transparency of the GDT is that other processors can see what Fonterra can sell a unit of WMP for, and then go to bidders on the auctions and undercut Fonterra and thus move their own product at the cost of Fonterra's product not being sold.

Given that Fonterra is seen as the market leader of dairy processors in New Zealand, it is often left to do all the flag flying for all New Zealand dairy processors worldwide. Past Fonterra chairman John Wilson often travelled with the then Prime Minister John Key, on trade envoys looking to agree to free trade agreements (FTAs). This was seen as Fonterra flying the "NZ inc" flag; what bothers Fonterra about this is that other privately or foreign owned companies also benefit from these FTA's, and the profits derived from the FTA's are then funneled out of New Zealand to the foreign owners. Fonterra is also very pragmatic at choosing the markets that it will sell product into, or carry out processing in. Recent examples are the geopolitical problems that are currently occurring in Venezuela; Fonterra has recently sold its share in a dairy processing company located in Venezuela as it deemed the country too volatile to operate in. Fonterra lost out in this transaction, Venezuela descended into military control faster than anyone expected, and no one expects political upsets such as this to occur as rapidly or as uncontrollable as what has occurred. What this translates to is Fonterra selling that company to the Venezuelan government for a greatly reduced price. What Fonterra is worried about in this space is that it spends its own time and money in making sure that New Zealand dairy has the best image around the world, and also at home. Fonterra invests heavily into supporting local communities through schemes such as "milk for schools", and into schemes to lift public perception of dairy in New Zealand, such as the recent #4am stories. These are not free nor cheap for the Co-Op, these costs are carried by the farmer shareholders, but are seen as essential to keep public perception positive for dairy farming in New Zealand and around the world. Other processors do not spend anything on these avenues, and simply ride on the back of what Fonterra is undertaking in this space.

Fonterra is already looking into future threats to its business as it moves into the future, recently investing into an alternative protein start-up company, Motif Ingredients, this has had an interesting response from some shareholders. Fonterra sees this sort of investment as a way to confirm its position as an ingredients supplier into the future, providing proteins to these companies that they have extracted from milk. The idea is that synthetics are coming, and that they will find their own position in the consumer foods market, what Fonterra wants is continuation of what Fonterra stands for, but bending and moving with the ever changing consumer market to stay in business is key. It is assumed that it is very possible that the liquid milk part of Fonterra's range of products will gradually disappear as consumers change to plant alternatives. But Fonterra still sees massive space to grow into more of the elite product market place, such as sports nutrition, which is an extremely specialized market. The sports nutrition, for example, requires the final product to be made up of proteins and fats that the human body needs for significant growth and healing required by elite athletes, these products are already being developed and researched and are showing great promise.

Currently Fonterra is still marketing its products around the world, and constantly trying to break into new and emerging market places. What makes this process easier for Fonterra, is having its Gold Standard NZMP labeled products, such as infant formula, WMP, SMP. This allows customers to recognise a trusted brand, which also creates loyalty amongst customers, and in developing middle class consumers, such as has been seen in China over the last decade, this trust is a major factor for ensuring return customers. Fonterra is also heavily involved in supplying larger customers with ingredients for different final products, such as WMP, anhydrous milk fat, lactose powder for pharmaceuticals and

whipping cream for baked goods. This sets Fonterra apart from its competitors, it has the scale and diversity of manufacturing sites to supply any customer with any product specified to their own requirements, and then supply that product in bulk. Fonterra also uses the fact that it is a Co-Op when marketing its products, as this sets it apart from the other corporates that it competes against, using things such as the fenced off waterways, by its shareholder farmers, as a way to differentiate and promote its products.

As the biggest dairy processor in New Zealand, Fonterra is ever worried about the constantly diminishing milk pool in New Zealand, but this is compounded by the entrants of new processors. The biggest change in New Zealand’s dairy sector came from creation of Fonterra, which removed the problem of many small scale processors exporting to the world, and competing with each other in overseas markets; allowing more processors to start in New Zealand is essentially stepping back to the old model. Currently under DIRA legislation, Fonterra cannot stop farmer suppliers leaving to supply another processor, and other processors can entice new suppliers by offering them a greater farm gate milk price. This has a compounding affect for the entire dairy industry; if Fonterra already had established processing capabilities for that supplier’s milk, and then lost that supplier to another processor, that volume of milk supplied by that supplier now has double the amount of processing stainless steel invested in New Zealand than needed. This also reduces the total processing efficiency of the dairy industry in New Zealand, which is hard to remedy; does Fonterra reduce its capacity or does it have less efficient factories with the ability to absorb old suppliers when they return?

Porters Forces	Examples
Threat of New Entrants	<ul style="list-style-type: none"> -Fonterra is the most vulnerable when it comes to new entrants into the dairy processing industry; DIRA allows Farmer suppliers to move to new processors with minimal repercussions. -New Entrants will choose locations that are beneficial to their own operations. This creates a great loss to Fonterra, in terms of transport, concentration of supply and maximum utilization of processing capacity. -As the biggest processor, and covering all aspects of dairy products, any new entrant will be competing with Fonterra
Bargaining power of Buyers	<ul style="list-style-type: none"> -Fonterra will always be at the mercy of its buyers, as with any company supplying perishable dairy products, but more so because Fonterra needs to sell large quantities of products due to its size compared to competitors. -Geopolitics and governments will always impact Fonterra’s ability to retain favorable customers
Bargaining power of Suppliers	<ul style="list-style-type: none"> -Fonterra suppliers have the ability to leave Fonterra to another processor, however this is not a bargaining chip, as Fonterra being a Co-Op cannot pay some suppliers more than others to keep them as suppliers. -Being a Co-Op, suppliers have voting power over board appointees etc.
Threat of Substitutes	<ul style="list-style-type: none"> -as with any dairy processors, novel food stuffs are on the horizon. Fonterra is taking steps to mitigate this risk by being a part of this, through the Motif Ingredients investment.
Competitive Rivalry	<ul style="list-style-type: none"> -Because Fonterra has such a large percentage of market share, rivalry is not as intense as if market share was more evenly distributed; however where this rivalry is further intensified is in the marketing of dairy products, due to the lack of ability to completely differentiate final products, and the nature of commodities on the world markets.

-Any new entrant increases Competitive Rivalry through the addition of extra processing capacity within New Zealand.
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Synlait

Synlait is a company that originated in Canterbury, New Zealand, established in 2000, which originally began as a collection of large scale farms, in 2007 the company diversified into Synlait Milk and Synlait Farms, with the milk side being in charge of the processing portion of the business, which left the Farms side to focus on farming. In 2007 work started on a processing plant on a 7hectare portion of the farm, and milk was processed for the first time in 2008. From that point to now, the expansion of Synlait Milk has seen the company expand from one processing site initially, to another site currently being developed in Pokeno, in North Waikato, a R&D site in Palmerston North and a blending and consumer packaging facility in Auckland. All this means that Synlait has the ability to process milk into a variety of products to suit customer requirements. Synlait processed 3.5% of New Zealand's milk, in 2017, up from 3.1 % in the 2016 year (TDB Advisory Group, 2018).

Because Synlait doesn't have the scale that Fonterra does, it cannot compete in the bulk product market like Fonterra does. To this point, Synlait's ability to provide smaller customers with exactly the specifications that they require for their own final product, in smaller quantities, is what sets it apart. This strategy is basically using differentiation of its products to help it stand out from the crowd, because at the end of the day all of New Zealand's dairy processors are producing very similar products. This strategy is also linked to the competition seen within overseas markets, Synlait sees long term contracts with ingredients customers as one way of confirming and keeping on going customers, but this leads to those customers being able to shop around other processors at the expiry of the contract, whereas Synlait would prefer to be in the position where it can offer any customer any option it wants in reference to milk powders; which allows a symbiosis of manufacturing and trade. This strategy also means that Synlait can fetch a higher price for its products; the product is different, exactly as was ordered and only in the quantity that is required. This is how Synlait is adding value to a commodity such as Whole Milk Powder, and delivering a better return for its shareholders.

To differentiate its products further, Synlait also has on farm programmes such as Lead with Pride, an environmental program that has a four tier ranking depending on how well each supplier is ranked on environmental protection. This, along with a premium for Palm Kernel Expeller free milk production, allows Synlait to market some of its products as "grass fed certified". Synlait also processes A2 milk, which allows for further differentiation of a basic dairy products, as some consumers see A2 as a better option when choosing dairy products. Synlait has a supply contract with the A2 Milk Company, supplying them with A2 milk powders. To a degree, this allows farmer suppliers to bargain with Synlait, if the supplier follows the steps on offer they receive a greater return, if the supplier can produce A2-A2 milk, then a greater farm gate milk price will be offered. Synlait sees these avenues as more of an incentive program than a bargaining chip for farmers; having the opinion that if all suppliers are treated fairly, they don't need to bargain. This notion of bargaining with the processor seems to be foreign to many New Zealand dairy farmers, as we are so used to being involved with a Co-Operative that should always be acting in the farmers' best interest, whereas processors such as Synlait are privately owned organizations, and therefore have the interests of its shareholders at heart. Possibly this bargaining

should be encouraged more, as it could lead to a better farm gate milk price for suppliers that have something better to offer to a company such as Synlait, such as a larger scale farm closer to the factory, which will reduce transport costs, for example.

This bargaining also extends to customers as well, Synlait sees customer relationships as being a massive part of the bargaining process. If each party in the trade is happy with the other, neither feels as if they are being treated unfairly, which stymies the need for bargaining from either side. This is important for Synlait as they are a Business to Business (B2B) company, and allows Synlait to reduce their exposure to risk with contracted B2B relationships, allowing for greater margins which it has realized over the last five years, reducing its debt to asset value from 45% to 11% over two years (TDB Advisory Group, 2018). This debt reduction has also occurred at the same time that it has increased its collection volume, from 3.1% to 3.5% of New Zealand’s milk pool (TDB Advisory Group, 2018).

Synlait is only a small fish in the world dairy products pool; but it still relies on global trade being favourable for positive trade. Synlait sees the GDT (Global Dairy Trade) as a bad strategy for selling dairy commodities; the ability for any prospective buyer to see what the latest GDT prices were makes selling a similar product for a higher price much more difficult.

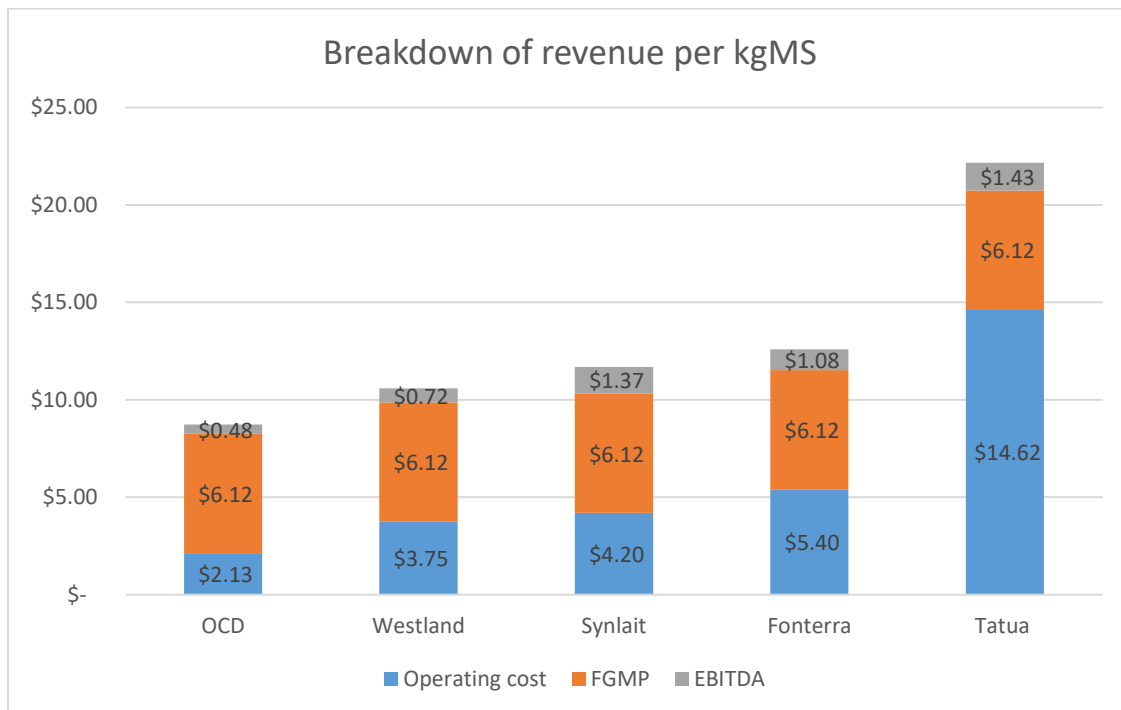


Figure 1 Breakdown of revenue per kgMS (TDB Advisory Group, 2018)

Synlait has also achieved one of the best returns of each kgMS out of all the processors. Synlait's EBITDA is 13.3% of its total revenue; compared to the best competitor, Fonterra at 9.4%, and the processor that makes the largest revenue of each kgMS, Tatua at 6.9%. This shows that even though Synlait isn't making the most expensive products, like Tatua is, its return on each kgMS is greater. This EBITDA is what leads to Synlait's ability to expand and grow, and supply a great return for its shareholders.

Synlait is the Third largest processor in New Zealand, and is executing its growth strategy well, with its expansion in the Waikato.

Porters Forces	Examples
Threat of New Entrants	-Synlait has a stronghold in Canterbury, being a new entrant itself, it doesn't have too many threats in the current climate, and is willing to pay more to suppliers to keep supply. -Biggest threat of new entrants exists in the marketing side of the business, differentiation of products can be matched by competitors.
Bargaining power of Buyers	-Buyers have large powers over Synlait, which Synlait uses to its advantage. Buyers are attracted to the ability to order products specified to their own requirements.
Bargaining power of Suppliers	-Farmer suppliers have the ability to return to Fonterra if they wish, there is a time period that they have to continue to supply Synlait until they can leave. But this gives suppliers power; which means they still get paid the same if not a little more than Fonterra suppliers.
Threat of Substitutes	-Similar to other dairy processors. -Any other processor could differentiate product lines to customers' specifications as well, it isn't a patented method.
Competitive Rivalry	-Synlait has a small market share, but Rivalry for milk supply is rife; because there is already enough production capacity in Canterbury, Synlait's introduction to the processing space has greatly increased rivalry. This also extends to Rivalry in the marketing space in foreign markets also.

Miraka

Miraka is a small dairy processor based in the Taupo region, supplied by only 100 farms. It is part owned by 9 local Maori Trusts and Incorporations, and part owned by Vinamilk, a Vietnamese dairy processor which brings experience and knowledge to the company. However, most importantly, Vinamilk allows Miraka greater access into Vietnam and other south east Asian countries to market their products. Miraka has a strong desire to protect the environment in which they operate, and this is a mainstay of the company's beliefs. Miraka is the first dairy processor in the world to use geothermal steam to run its processing operations, which is a completely renewable energy source. Miraka also has an environmental plan that it requires each supplier to abide by; planting of riparian margins, fencing off of all water ways and ensuring that each Miraka supplier leaves behind a better environment for future generations to come.

Since Miraka's establishment in 2011, with its processing plant in Mokai, Miraka's plan has been to start with a milk dryer and as time passes slowly develop into more value added products. So far this has included the addition of a UHT processing line and recently the addition of a packing line making consumer packs of nutritional milk powders. This has allowed Miraka to move away from competing with other processors in the commodity market, and allowed them to add value to the same base product, WMP, just offered directly to the consumer, as a final use product in 1kg bags. This reduction in the length of the value chain, has allowed Miraka to obtain a greater amount of the profit value of its products itself, without the need for middle customers to be involved. Although approximately 80% of its volumes are processed into WMP, WMP accounts for 60% of its revenue (TDB Advisory Group, 2018). This shows the increased margin that the newly introduced UHT line has achieved, which is currently

only working in a business-to-business fashion; currently the UHT line only processes 20% of the total 250million liters annually processed.

This strategy of ensuring that Miraka has a stable business producing a basic commodity over its establishing years has allowed Miraka to embolden itself financially before it starts to change its product lines and venture into other markets or products. This has been enhanced by the partnership it has with Vinamilk; having the markets to sell WMP into has made this strategy much easier to execute compared to a new entrant having to establish its own markets as well as securing supply. With the addition of the UHT line and the consumer packs, Miraka now has the ability to add more value to the milk it is supplied, which in turn allows a greater return to its shareholders; the local Iwi and Vinamilk.

Miraka has a vast number of countries that it markets product into; a large portion of these are developing nations, which require dairy products produced safely, or alternatively those countries do not have a substantial dairy industry themselves, large enough to support the requirements of the nation. Due to the fact that these countries are still developing, the risk of plant based alternatives encroaching on the market place is currently very slim, which has reduced the risk of substitutes taking some of the market share. But there are other risks to consider with these countries, mainly the geopolitical problems that often arise in these developing nations, such as a breakdown of the government, for instance the situation which developed in Venezuela, or the starting of conflicts as seen in Africa and the Middle East. The 1kg consumer packs that Miraka has started to produce have helped with this possible risk, as these are sold directly into China, and are easily sold this way, directly to the consumer.

Porters Forces	Examples
Threat of New Entrants	-Miraka has a stronghold in the Taupo region, being a new entrant itself, it doesn't have too many threats at the moment. Miraka is willing to pay more to suppliers to ensure supply. -Biggest threat of new entrants exists in the marketing side of the business, differentiation of products can be matched by competitors.
Bargaining power of Buyers	-Miraka have mitigated this issue by having Vinamilk as a partner/investor, which allows Miraka to use established trade avenues; which allows less buyer power, as there are already established relationships.
Bargaining power of Suppliers	-Milk suppliers have the ability to return to Fonterra if they wish, there is a time period that they have to continue to supply Miraka until they can leave. But this gives suppliers power; which means they still get paid the same from Miraka, if not more than Fonterra suppliers.
Threat of Substitutes	-Similar to other dairy processors. -Miraka isn't differentiating product to a great extent, so similar products are easily substituted for Miraka's products
Competitive Rivalry	-Miraka has a small market share, but Rivalry for milk supply is rife; because there is already enough production capacity in Taupo and the north island, Miraka's introduction to the processing space has greatly increased rivalry. This also extends to Rivalry in the marketing space in foreign markets.

Open Country Dairy

Open Country Dairy (OCD) was formed in 2002, after the 2001 DIRA legislation was passed alongside the creation of Fonterra. As a company majority owned by Talley's Group Limited (76%), OCD saw an opportunity to enter the dairy processing market within New Zealand, and put the Talley's' proven model of lean management and production into practice within the dairy processing sector. Now the second largest dairy processor in New Zealand, OCD has processing sites in most of the major dairy producing provinces of New Zealand; Taranaki, Southland and the Waikato, and has lured many suppliers from Fonterra with the promise of a greater milk price and the ability to supply milk without the need to own shares in the company. The attraction of the ability to sell Fonterra shares back to Fonterra and reap the capital value appealed to many farmer suppliers as a way to increase their own business portfolio; by either reducing their own debt or purchasing further investments. OCD is very protective of its business models and actions, and declined to be involved with this report, thus a lot of the OCD reporting has come from other industry commentators and financial reports. OCD focuses on bulk production of basic commodity products, such as WMP; producing its product as efficiently as possible and with minimal handling to reduce as many costs as possible. OCD's suppliers are currently not restricted on the levels of PKE they can feed at any time of lactation, whereas Fonterra and Synlait suppliers are restricted by a fat evaluation index of each load of milk or incentivized not to feed any. Other commentators have said that defining what OCD's farm gate milk price actually is, so that it can be compared to other processors, has been difficult. OCD uses a wash-up system, and pays the wash up every three months, using a four tranche pay system. This is often confusing to suppliers, as it is not as simple to compare total farm gate milk price at the end of the season, as it is with Fonterra. This is because each tranche of the payment depends on time of season; so that winter produced milk has a greater price than spring produced milk; these four payments then cannot be averaged over the season, as most suppliers still produce most of their milk production during spring and a majority of their milk at the lower spring milk price. There is also no advance payment system either, Fonterra pays an advance rate every month on an assumption of the rate they will be able to sell that milk at, whereas OCD pays the farm gate milk price for that tranche, and then sells the product. This means that the supplier doesn't make any more money if the world milk price increases over the length of the season, conversely they also don't lose any money either. In this way, OCD has hedged its bets and is hoping it can increase its own margins by not having to increase its payments to its suppliers if the market price increases. This way it also knows what it needs to sell its product for to make a profit, and can forward contract product to customers before the milk is processed.

OCD has not followed the recent trend of Milk Fats being worth more than Milk Proteins, as other suppliers have as they respond to market trends, but are still paying more for protein than fat. This is in part due to the way in which OCD processes milk, mostly into WMP and in large quantities. OCD has the lowest value product mix in the industry and achieves this by its ability to process large volumes at the lowest operational costs of all of its competitors (TDB Advisory Group, 2018).

Open Country Dairy's ability to spot an opening in an industry, after legislation, must be applauded. OCD used the DIRA legislation to get its processing sites up and running as it persuaded farmer suppliers to change to it; in a business sense, this was great opportunistic strategy, and now as the second largest

dairy processor in New Zealand, it sure paid off. Open Country continues to expand through suppliers leaving Fonterra and the allure of a better milk price.

Current strategy is aimed at following commodity prices with product mix, and aiming to increase cheese production with increased cheese capacity. Potential future investments may be aimed at higher value product developments. These developments will be funded through retained earnings, as OCD has successfully done over its lifetime, with a track record of reducing its debt to asset ratio very quickly, as seen in figure 2 below (TDB Advisory Group, 2018).

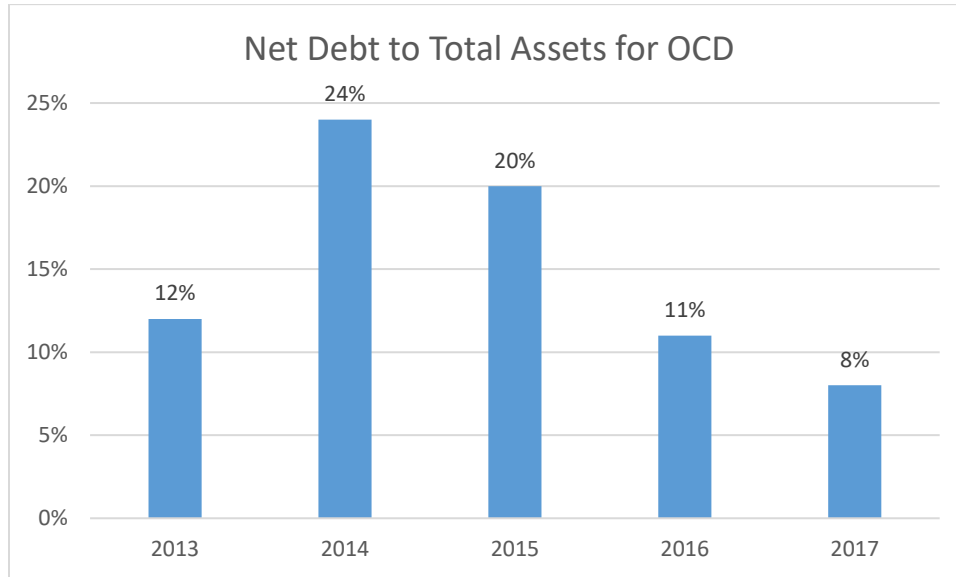


Figure 1: Net Debt to Total Assets for OCD

Porters Forces	Examples
Threat of New Entrants	-OCD has managed to secure supply off of Fonterra, which means it has little threat of new entrants as it is currently making its own space in the regions it has established itself in. Synlait is currently moving into the Waikato, which will put pressure on OCD, but OCD has a good supplier base at this point in time.
Bargaining power of Buyers	-OCD has a novel approach to bargaining with its buyers/customers. Due to its lean management mentality OCD can provide commodity products at lower prices than its competitors; which OCD uses to reduce the power of its buyers, by offering the lowest price.
Bargaining power of Suppliers	-Farmer suppliers have the ability to return to Fonterra or a competing processor, which gives farmer suppliers some power. This only exists with DIRA in place and Fonterra's strong position within New Zealand.
Threat of Substitutes	-OCD mitigates the threat of similar products by producing commodities. -Substitutes are seen as competitor's commodities also.

Competitive Rivalry	-Because OCD has established its processing capacity in locations throughout New Zealand that already have sufficient capacity, the rivalry has dramatically increased in these locations.
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Tatua

Tatua is a small Co-Operative based in the heart of the Waikato, being established in 1914, it has withstood the testament of time. With only 113 farmer suppliers all based around the factory, and only processing 1% of New Zealand’s milk (TDB Advisory Group, 2018), Tatua boasts one of the best shareholder returns of any of the dairy processors in New Zealand. Tatua has created and kept this status via some very good decisions over the years, deciding not to merge into Fonterra during 2001 was a major one, and limiting its supplier base is the other major decision. This limiting of supplier base has meant that the Co-Op doesn’t need to keep expanding and investing in or continually building new processing capabilities, which means it has been able to deliver a greater return to its suppliers.

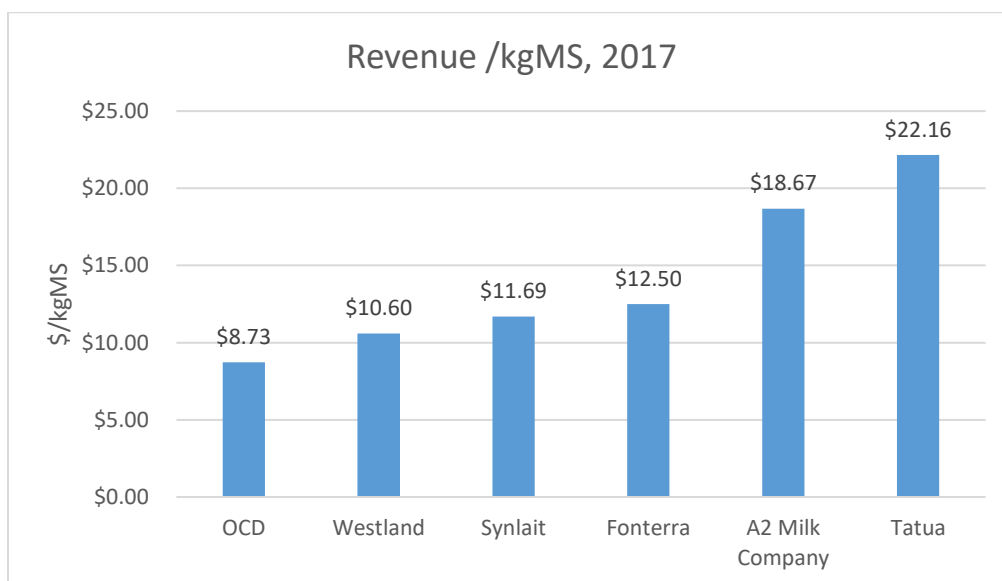


Figure 2: Revenue of different processors in the 2017 FY per kgMS

Prior to 2001, Tatua was also the site in which many new processes were developed and trialed for the then dairy board’s research, which means post 2001, the Tatua site was adorned with multiple different processing lines, capable of producing many different final products which ensures a greater use of all the milk supplied to it, but also the ability to produce more of a product that is in demand, than only producing WMP. Tatua also struck gold when they Patented Whipped Cream in a can, this revolutionized whipped cream and emboldened Tatua’s status as a pioneering company as well as a strong Co-Op. Tatua’s strategy of focusing on exporting specialized dairy products, such as the whipped cream from a can, has been paramount to its success. Tatua generates the most revenue per kilogram of milk solids than any of the other processors, seen in Figure 2, which in turn delivers the most for its farmer suppliers. This is also combined with the fact that the factory is centrally located to its suppliers, which means transport costs are lower. Suppliers are encouraged to supply flatter milk curves than a

traditional spring milk supply, to allow Tatua to keep its stainless steel utilized for more of the season, which allows for continuous supply of ingredients or food stuffs for its customers.

Tatua has also transformed the area around the factory, with the most expensive dairy land in New Zealand being located around Tatua, purely from the fact that the return farmers receive is greater than any other processor can supply, meaning a high demand for farms with a Tatua suppliers number hanging on the tanker track.

Porters Forces	Examples
Threat of New Entrants	-Tatua currently has a stronghold on its own area, and with its history of supplying a solid superior FGMP, Tatua should be able to hold its position geographically. -Tatua had a substantial gain when it developed its whipped cream in a can, but now that the patent has expired, it will see other processors start to compete in this space, this will put pressure on Tatua; which is why Tatua is launching new product lines.
Bargaining power of Buyers	-The power of buyers over Tatua is varied. Tatua only supplies small quantities of specific product. This means that buyers have demanded a product at a certain specification or they are only wanting a certain Tatua product. Which gives both parties similar power, but the buyer always has the ability to purchase similar product from a competitor.
Bargaining power of Suppliers	-Farmer suppliers have the same bargaining power as others; the ability to return to Fonterra under DIRA. -Farmer suppliers of Tatua are also shareholders, as Tatua is a Co-Operative, so there shouldn't be a need to bargain with Tatua.
Threat of Substitutes	-Tatua is one of the few processors in New Zealand that managed to patented a product, even though this patent has lapsed, it provided the biggest threat to its earnings as substitutes quickly appeared on the market when the patent expired.
Competitive Rivalry	-High, Tatua operates in the heart of the Waikato, the largest dairy region of New Zealand. With Fonterra, OCD and Synlait all processing within the Waikato, Tatua's suppliers could easily be absorbed into the other processors current processing capacity.

Westland Milk Products

Westland is also one of the last Co-Ops currently in New Zealand, processing 3.5% of New Zealand's milk volume, but having just agreed to a sale to the Chinese company Yili, it will no longer be owned by its farmer suppliers. Westland decided also not to join Fonterra during 2001, and has kept its foothold on the West Coast ever since.

Westland has always been compared to Fonterra, as both are Co-Ops, and both export a majority of their products. Where they differ, has been the payout the farmer suppliers receive for their milk, with Westland often \$1 behind per kilogram of Milk Solids; not to mention a share price that has not gained

any value for shareholders either. Westland has underperformed the rest of the industry; in the 2017 financial year, from the farm gate milk price to farmer shareholder/supplier, paying \$5.18 (including any dividend) versus the standardized FMGP of \$6.12 which doesn't include any dividend (TDB Advisory Group, 2018). This is due to its strategy shortfalls that have occurred over its recent history; Westland tried to differentiate its products, and create a diverse mix of final products, basically what other processors were also doing; where Westland failed was its market access for its new products. Westland invested in the processing ability to create these new products, before it had established customers for these products, this at the same time that it had to bear the cost of the increase production cost per kgMS for these differentiated products. This at the same time as carrying a high gearing of debt to total assets ratio, of 39% in the 2017 FY; to put that into perspective, both Fonterra and Synlait have had similar debt to asset ratios over the last five years, but have managed to reduce that ratio as quickly as possibly by earning increased margins off of the assets that were invested in. What compounds this issue is that Westland Co-op has a location protection in the form of the Southern Alps, which makes it inhibitive for other processors to collect milk and transport it over the main divide. This should be seen as an advantage for Westland's farmer suppliers, but it has been juxtaposed by the opposite, having no competition for its suppliers has meant that the farmer suppliers have become price takers.

Porters Forces	Examples
Threat of New Entrants	-Low, due to its geographic location. The southern alps provide an inhibitive barrier for other processors to collect from the west coast, without building processing capacity on the west coast.
Bargaining power of Buyers	-Too powerful, this is what caused Westland's demise. The ability of the buyer to acquire similar product from a competitor has allowed Westland to become underperforming.
Bargaining power of Suppliers	-Low, because there is no real competition for milk supply on the west coast, farmer suppliers are price takers. Coupled with the ownership structure being a Co-Op, Westland suppliers became price takers.
Threat of Substitutes	-Similar to other dairy processors.
Competitive Rivalry	-Low on the West Coast; Westland has the capacity to process all of the milk supplied, there are no competitors trying to take farmer suppliers. This should be a perfect environment to execute the "smaller processor difference".

Oceania Dairy (Yili)

Oceania Dairy is a small dairy processing company in south Canterbury, with a concentration of supplier farms surrounding its site. Oceania Dairy is owned by Yili Group, which is China's market leading dairy product producer and in 2018 was the world's third best-performing food brand. The processing plant in Glenavy can produce up to 47,000 tons of powder per year, handling more than 630 Million liters of milk per year. Recent expansion has seen other lines added to the facility, including Infant Formula blending, canning lines, UHT line, and an ability to produce and handle Anhydrous Milk Fat (AMF).

The Oceania Dairy site provides Yilli with control over the supply of its basic ingredients, for its food producing sites back in China. This means that it has effectively shortened the supply chain for its own products, and cut out the need to trade with another company to source its ingredients; which means

that for every kilogram of milk solids it processes and exports back to China, it makes a greater margin on, and removes the potential for New Zealand to earn those margins. If this amount of product was processed through a New Zealand Co-Op for example, that same milk solid would produce income for the farmer supplier, and then for the Co-Op, which would then spend that money in New Zealand again; compared with the profits being spent in China.

Porters Forces	Examples
Threat of New Entrants	-Being a processor with a set smaller scale, there shouldn't be much risk to the continued operation of Oceania Dairy in its current format. It can afford to pay its suppliers a greater FGMP than Fonterra, thus ensuring it will keep supply.
Bargaining power of Buyers	-Because Oceania is owned by Yili Group, a food producing company, its supply chain is directly back to China, with the assumption that the product can be easily sold.
Bargaining power of Suppliers	-Farmer suppliers currently have the ability to return to Fonterra, under current DIRA regulations; but this is mitigated by Oceania Dairy paying a greater FGMP than Fonterra
Threat of Substitutes	-Similar to other dairy processors. Potential substitutes could be in the shape of Yili preferring to move all production to its newly acquired Westland Milk Products site. This may cause Yili to deem Oceania Dairy not profitable enough due to its smaller scale.
Competitive Rivalry	-Being built in an area that was already serviced by Fonterra, the Rivalry of the area increased due to the demand of milk supply by both processors. It is not likely that another processor would encroach on this area due to the current rivalry.

Conclusions

New Zealand continues to set the worldwide standard of dairy production; through superior animal welfare, the finest milk quality and the lowest environmental impact per kgMS, to name a few, coupled together with a lack of scale in comparison to the rest of the world, New Zealand punches above its weight. With the formation of Fonterra in 2001, New Zealand saw the biggest change to the face of agriculture since the invention of chilled shipping or the dairy tanker. With a newly found ability to not be competing with themselves, New Zealand farmers started to reap the benefits of an almost monopolistic company controlling the value chain within the New Zealand dairy processing space. What did occur was a lack of competition within New Zealand post the 2001 merger, within dairy processors, which may have limited the amount of value that could have been generated during the early Fonterra and Westland years. With the introduction of other processors into the New Zealand market place, this need for Fonterra to perform better has been noticed; if Fonterra could not supply the best farm gate milk price to its farmer suppliers, it risked losing suppliers to other processors. As Fonterra's market share has fallen down to roughly the 80% mark, Fonterra is working hard to not lose too much more of

the ever shrinking milk pool. This contrasts perfectly with the Westland story, which has failed to perform, and delivered poor farm gate milk prices, which has led to its farmer shareholders agreeing to sell the co-op to Yili.

As other processors have come into the market place, they have had to define their own place within the dairy space within New Zealand. Examples such as Synlait have shown that a lack of scale is not always a limit of potential earnings, it is more importantly a great example of how differentiating products from competitors in the market place allows it to compete with giants such as Fonterra. Synlait's niche is being able to supply customers with what they want and need in the quantities they desire. Synlait's strategy of not competing with ingredients customers in their final product market place also allows Synlait to go along for the ride with its customers.

With the recent acquisition of Westland Milk Products, Yili is very rapidly taking up a decent portion of the milk pool within New Zealand. Yili's desire to shorten its own supply and value chain, and cement its ability to procure product, shows how important New Zealand's production of "clean green" milk is to China. Yili will not be limited by financial ability to purchase further assets, as the case may be with other processors; this needs to be seen as a risk to the New Zealand Dairy industry's ability to continue to operate under the control of New Zealanders, and in the best interests of New Zealand.

Miraka is leading the charge in being a sustainable dairy processor, and showing the bigger processors that consumer perceptions are always important; Miraka has shown how this strategy has allowed them to make good progression.

Overall, New Zealand's dairy processing industry is currently in a very competitive space with one major processor, and a raft of smaller processors. This increase in competition over the last 18 years, especially over the last ten years, has been of great benefit to farmer suppliers associated with each processor. Fonterra continues to set the farm gate milk price, and this means that competing processors need to offer a similar milk price, which has a massive benefit for all suppliers. A strong Fonterra means a strong dairy industry, as a Co-op it will always have the farmers best interests in mind, this compared with the corporate companies that would rather pay less for their milk to generate the greatest return. New Zealand as a whole, and of course farmers, should always look to other countries that have decided to sell their shares in the Co-Op they supply to free up capital. The best example of how a Co-op changes to a corporate and then forces its farmer suppliers to become price takers is the foodstuffs company Kerry Group, in Ireland, which started in the 1970's, and acquired most of the other dairy Co-op's in the south-southwestern regions of Ireland. The original Kerry Co-Op offered a good price to its shareholders for their shares, and this was taken up by a vast majority of its farmer shareholders. Because the company is now publicly listed, as Kerry Group, it has a prerogative to supply a return to its new shareholders, thus supplying a very low farm gate milk price to its farmer suppliers, which allowed Kerry to have a greater margin of return on its final products. Kerry Group operates a portion of the company as Kerry Co-op, which is meant to be for the farmer suppliers, but it has no negotiating power with Kerry Group. This has meant that Irish farmers supplying Kerry Group are price takers, and are often paid very low FGMP. Conversely Kerry Group has had very impressive growth over the last year itself, which shows how much of a margin it is making on each kgMS. Another example to take heed of is the Murray Goulburn Co-operative, which was Australia's biggest milk processor with 2500 farmer suppliers at its peak, which has now been brought out by Saputo Inc, a Canadian dairy giant. This change of ownership of the processor puts farmer suppliers in a difficult position, they are now price takers, there is no market leading Co-Op

setting a superior FGMP for the benefit of its own suppliers, such as in New Zealand. Dairy in Australia is currently going through massive changes, and many dairy farmers are struggling to stay in business, as operation costs are greater than the milk price received; a worthwhile example to remember when looking at changing processors.

Recommendations

List of actions:

- 1- Fortify: Revitalized and continued support of Fonterra as a market leader; Fonterra is the market leader, but not just due to market share, but mostly by transparency allowing it to show everyone how it operates and sets its milk price and share price, by flying the “NZ Inc” flag and doing a lot of industry work on its own accord, while taking other processors along for the ride. The Fonterra Co-Operative is the reason the dairy industry in New Zealand is so strong, this needs to be remembered and revered by all farmer suppliers.
- 2- Future proof: Farmer suppliers need to look beyond their own balance books to determine if a change in processor is actually beneficial long term. Does your new milk processor have any obligation to keep paying you a good farm gate milk price if Fonterra or DIRA are out of the picture; who is your new or potential processor working for; you or its shareholders?
- 3- Deregulate: DIRA legislation needs to be removed, and quickly. The initial reason of consumer protectionism is no longer required, as there are now enough processors within New Zealand for this to be controlled by market forces; which was part of the initial idea of DIRA. DIRA is also hindering Fonterra’s ability to be able to make strategic decisions with its supplier base and all of its processing sites; not being able to predict milk supply in the future accurately, hinders precise investment strategy and direction. Having the ability to control entry and exit of suppliers, along with the abolishment of the regulated milk supply to competitor’s legislation, will allow more certainty around investments into processing capabilities; which means more product to process and add value to, and more money into New Zealand’s economy and not into Foreign owned companies.
- 4- Compromise: Determine what amount of market share is optimum for each of New Zealand’s dairy processors so that New Zealand’s export margins are optimized for New Zealand’s benefit. This should include some competition within New Zealand, such as Synlait, so that Fonterra has some competition to constantly benchmark itself against, but not so much that buyers in foreign markets have the ability to bargain with exporters of New Zealand products.

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Appendices

Questions for Dairy Processors

- 1) What sets your company apart from Competitors:
 - a. Do you see DIRA as beneficial to the entire dairy industry as well as your own company?
 - b. Do you see Fonterra as an industry leader domestically?
 - c. And if so, influential enough to control Farm gate Milk Price in NZ currently and post DIRA?
 - d. How do you see competition impacting commodity prices that NZ processors receive in overseas markets?
 - e. How do you select the markets you approach to sell your products into?
 - f. Do you aim for different markets to other processors or directly compete with them?
 - g. How do you see the ability of the government to open international markets for your products?
 - h. Does the Government serve you equally as they do Fonterra? (for example: Do you think that markets are protected for your company and your products to the same extent that the government may for Fonterra, i.e. Foreign Affairs/ Trade/Agriculture ministers willing to help open and protect your ability to trade in certain countries/new markets) (and reverse for Fonterra/ or does the Govt. help/serve Fonterra at all)
 - i. How do you believe that competition of processors within New Zealand promotes a positive outcome for all players within the Dairy Industry?
- 2) Substitutes within your market place, Threats and Opportunities;
 - a. As substitutes arrive in the market place (i.e. almond milk, soy milk etc.), how do you lower the risk they create?
 - b. And if so, how do you see them impacting on your product range? (i.e. liquid milk, cheese)
 - c. What is the biggest substitute product on your radar at the moment?
 - d. And how do you plan on mitigating the risk it is creating?
- 3) Engaging your buyers for the best returns:
 - a. How does your company mitigate the buyer's ability to switch vendors?
 - b. What is the associated risk that this problem brings to your company? (I.e. lower returns to keep sales at predicted capacity?)
 - c. Do you see intermediate customers as more important (i.e. buyers of WMP and SMP customers) as better/lower risk than selling products such as cheese or liquid milk to final consumers? (i.e. higher risk due to shelf life)
- 4) Threat of new entrants and risk factors going forward:
 - a. Does the threat of new entrants pose any risk to your current strategy?
 - b. How does DIRA fit into your risk management plan/strategy for you?
 - c. Is loss of suppliers to new entrants a risk that you manage? And if so, How? (I.e. what are the benefits you offer current suppliers in this case?)
 - d. Do you think there are too many/ enough processors within NZ?
 - i. Why?

- e. What is the biggest threat/Risk to the future of your company? (short and long term) (I.e. Government, Tariffs, market access?)
- 5) Bargaining power of farmers:
- a. To supply your company what are the switching costs to a farmer supplier? (I.e. Coming from Fonterra I.e. vat, shares?)
 - b. To non-Co-Ops: do your farm suppliers have bargaining power over your company?
 - c. How does that influence your strategic decisions?
 - d. In terms of supplying dairy products globally, how much bargaining power does your company have over your buyers?
 - e. In terms of supplying dairy products globally, how much control does your company have over your buyers?
 - f. Does your company utilise your control or bargaining ability over your buyers to the maximum?
 - g. Do you rely on other market factors to optimise price?
 - h. Fonterra: Does Fonterra make the most of this? If so, how? (in-regards to the shareholders being suppliers also)