

# **Trading Among Farmers**

*WHO WANTS IT?*

**“Kellogg Rural Leadership Programme 2011”**

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# Executive Summary

My Research Question

## Trading Among Farmers - WHO WANTS IT?

My initial intention was to explore Trading Among Farmers (TAF) benefits, as an option for family succession. I believed TAF could be used as an alternative to, or combination of asset distribution, retirement cashflow, family succession vehicle etc...

During the 'education' process it became apparent that TAF's options and its flexibility would be wide and varied and therefore suitable for many farming business structures.

### What is TAF?

Trading Among Farmers is a capital structure consolidation which required Fonterra constitution amendments and legislative changes to the Dairy Industry Restructuring Act (DIRA).

Trading Among Farmers Key Objectives are:

- Remain strong, sustainable co-operative that protects farmers' interests
- Remove redemption risk
- More flexibility for shareholding farmers
- Permanent funding to drive highest sustainable returns for farmers
- 100% farmer control and ownership protected

As TAF neared the execution phase the project became one of reflecting on the process and what learning could be gained from the method used to introduce TAF, educate and engage with shareholders.

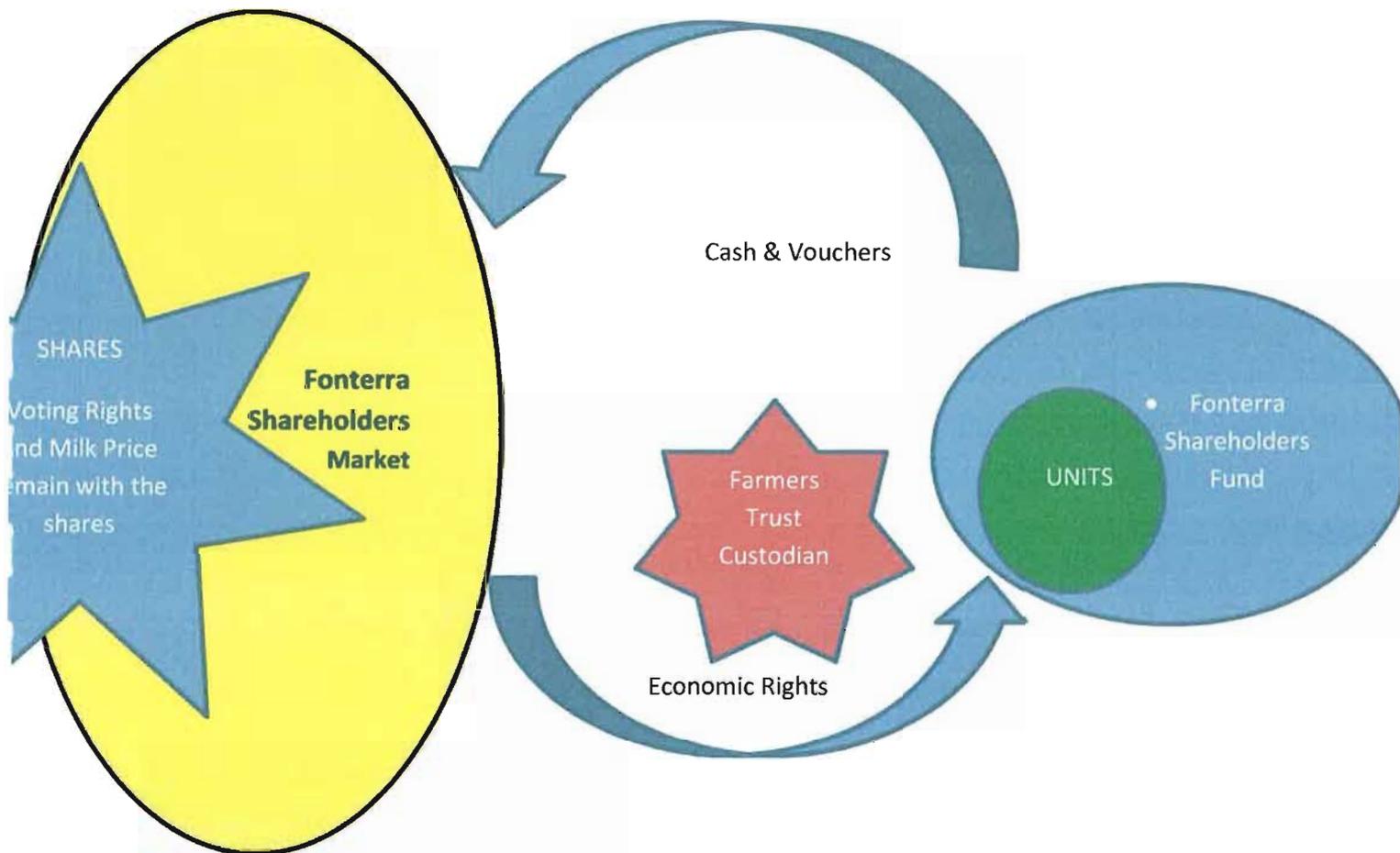
Interaction with Fonterra Leaders, Management and Shareholders during this process confirmed that the co-operative spirit was strong, passionate and willing to engage.

The apparent risks that come with change, and the reality that change is necessary, created a raft of personal behaviours. I have avoided highlighting personal comments and presented with an objective view.

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## Overview of Trading Among Farmers Design



### Fonterra Farmers

100% controlled and owned

Buying and selling from each other

### Fonterra Farmers & Public

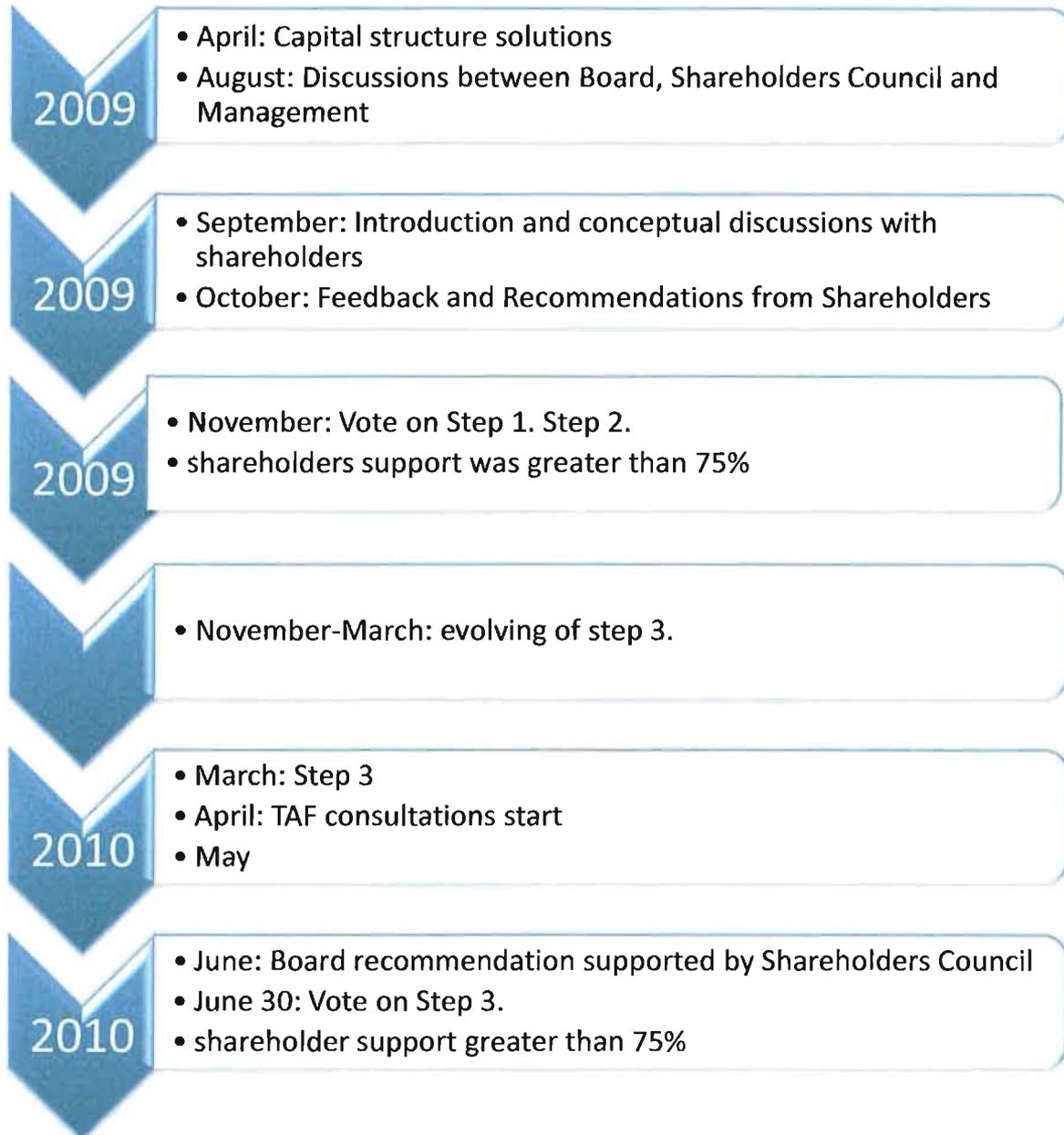
Trading on NZ Stock Exchange

- ❖ Economic rights – rights to distributions and changes in market value of the underlying Co-operative shares

Comment:

The measure of success will be determined by good governance. Shareholders have the most at stake and also the most influence on outcome. For the protection of their interests shareholders responsibility is to elect good governors for the best interests and success of their co-operative. Not by coincidence the success of the co-operative is aligned with the success of the shareholders.

## Timeline: TAF inception to execution



## Capital Structure Evolution

### Step 1.

Fonterra shareholders can hold Fonterra shares for up to 120% of milk production, and receive full dividend on shares not backed by milk production.

Transactions (buying or selling) of shares will take place at new season's price.

### Step 2.

Fonterra fair value share to represent a restricted market (not open to public).

Independently valued and a restricted market value (25% less approx.) applied.

### Step 3.

Allowing Fonterra farmers to buy or sell shares amongst themselves for the intention of establishing a market value rather than theoretical estimate.

For the benefit of Fonterra by providing permanent equity and give the Co-operative certainty of its capital.

Create opportunities for farmers to participate in the Co-operative which will allow better accessibility.

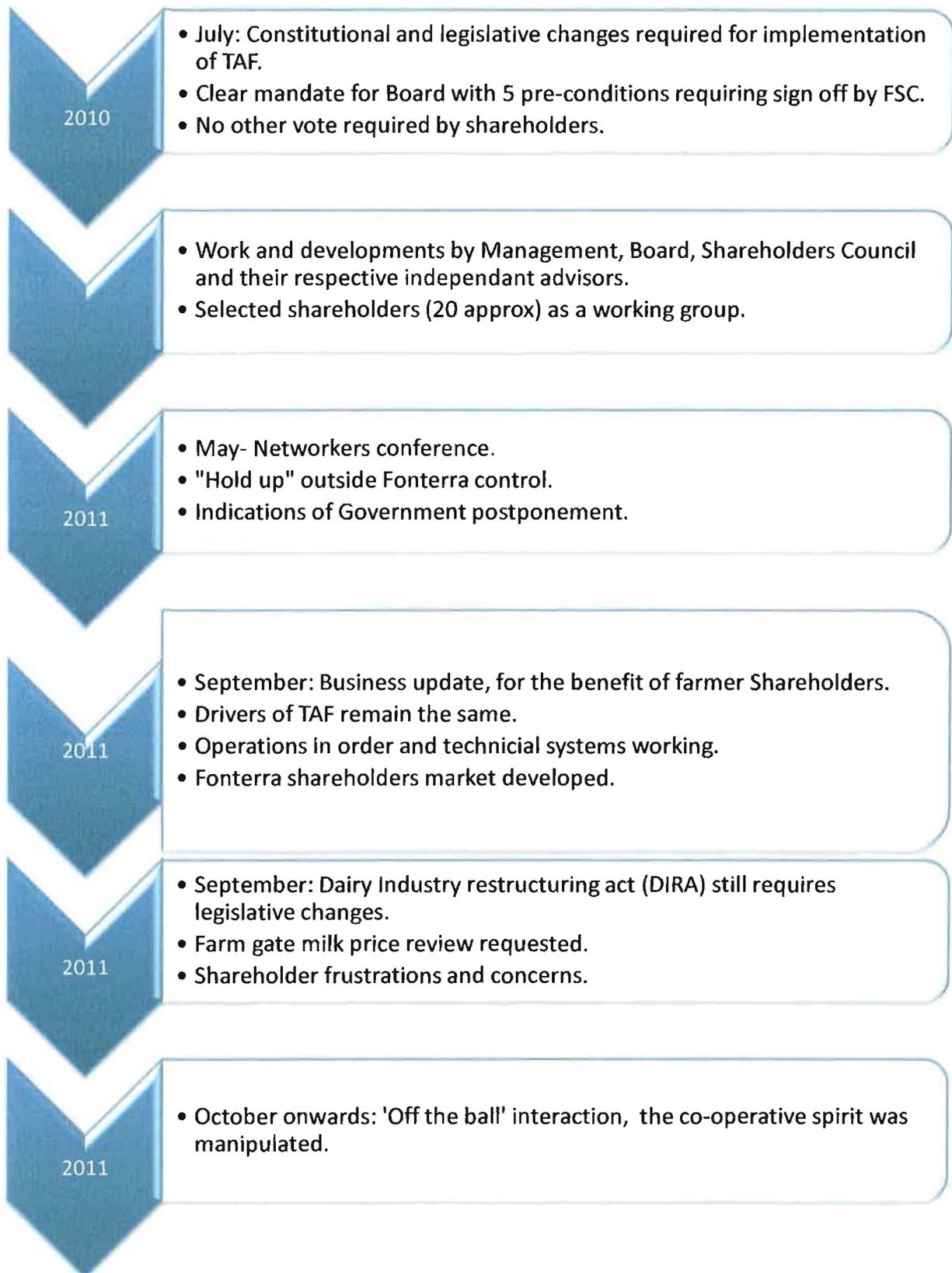
Not open to the public.

### Step 4.

For the advantage of Fonterra so it can be more competitive through strengthening its balance sheet and reducing debt, and by raising new equity from issuing dry shares.

\*Votes are for constitutional change and require shareholder support greater than

## Timeline: Evolving of TAF



## The Board's pre-conditions...

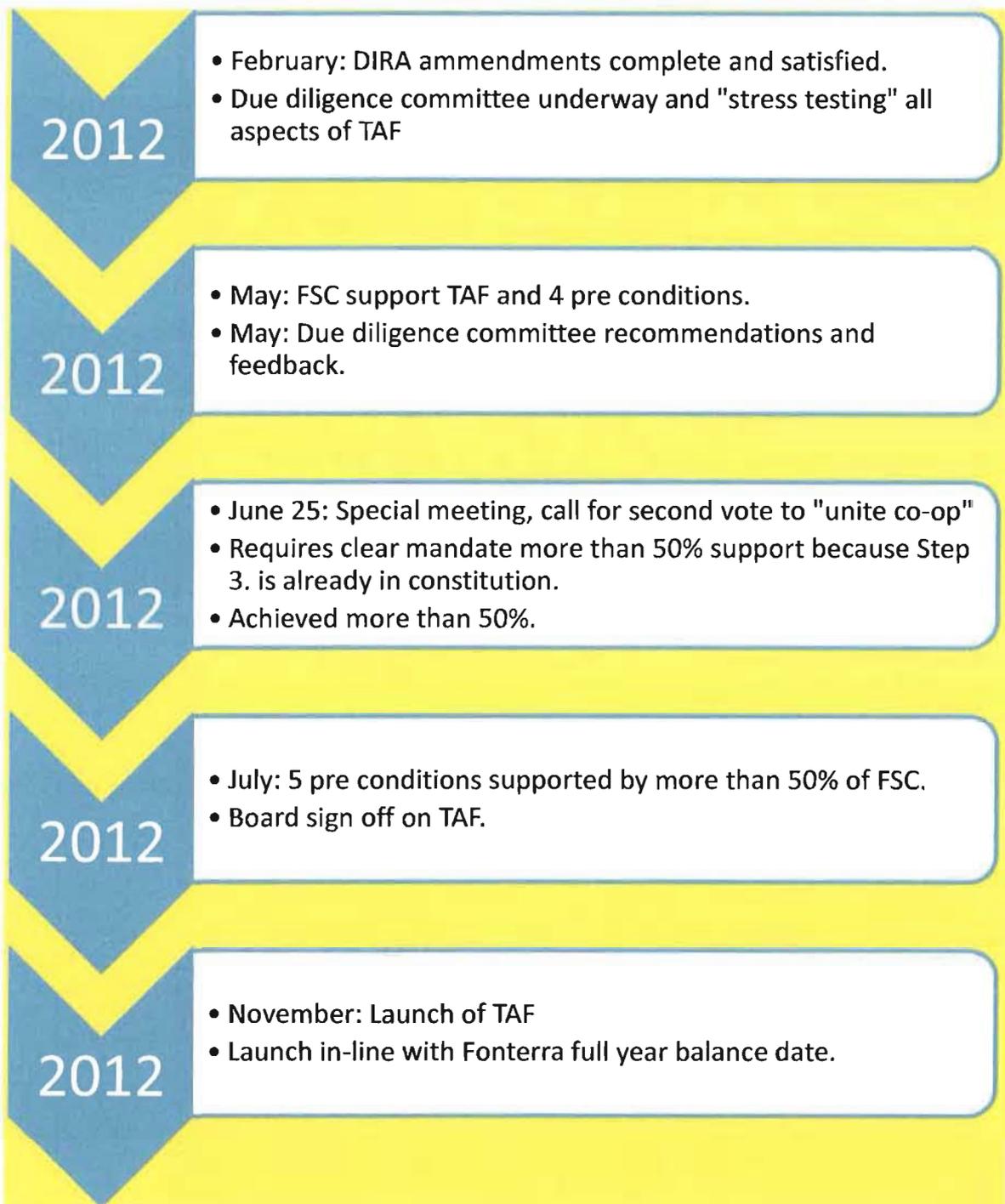
- The markets for shares and fund units have been properly set up, will work well together and be stable
- All necessary legislative changes (including to DIRA) have been passed
- All consents and approvals from regulatory and other bodies are in place
- The Shareholders Council is supportive (by majority of 50% or more)
- All farmer shareholders have had the opportunity to become familiar with how Trading Amongst Farmers will work

In addition the board has indicated it would need to be comfortable with the share price likely to be achieved when trading commences.

Comment on timeline and behaviours:

The purpose of including a physical time line was simply to capture events in their stages. The timeline is a good reference and presents a picture of duration. Being aware of the length of time a process can take to complete should determine a leaders approach to how they stay engaged with their stakeholders.

## Timeline: execution...



## Results

Who wants Trading Among Farmers?

2009	step 1. & 2. More than 75% shareholder support. (Constitutional vote requires greater than 75% , votes are based on shares backed by milk)
2010	step 3. More than 75% shareholder support.
2012	Mandate vote to support TAF 63% shareholder support. (Required greater than 50% shareholder support, votes based on shares backed by milk)
2012	Shareholders Council 97% support for 5pre conditions.
2012	Fonterra Board unanimous support for 5 pre-conditions and Launch of TAF

## Learnings from the process.

As I reflect over the last two years I can identify specific learnings that have influenced outcome and/or process, none more so than TIMING.

The duration of a process from conception to execution will have significant impact on process and there are some key areas to be aware of:

1. Leadership and Leaders performing their Roles.
2. Communication with all stakeholders.
3. Collective approach.
4. Media and communication

During this process I have had the opportunity to discuss and debate with Board members, Shareholders Councillors, shareholders and potential investors the events that played out.

I share these views through my eyes.

### **LEADERSHIP and Leaders performing their ROLES**

Fonterra Leadership structures are;

<b>The Board:</b>	A Governance Role.  9 elected Farmer directors (elected by shareholders) 4 elected Independent directors (elected by board and ratified by shareholders) Chairperson is a Farmer director.
<b>Shareholders Council:</b>	A representative role.  Elected by shareholders from within the 35 wards, a shareholder representative from each ward makes up the council. Chairperson is elected by council members and all members are Fonterra shareholders.
<b>Management:</b>	Staff employed by Fonterra.
<b>Networker:</b>	A communication role for shareholders.  Loosely used for feedback or delivery of Fonterra news or ideas. Identified by the regional Shareholder Councillors and/or Area Managers of Fonterra. No remuneration.

The growing necessity of our Networker members to engage with Fonterra staff, FSC, Board and the shareholder base for the purpose of CONTACT. The Networkers are armed with some information on Fonterra issues and by their very nature will deliver diverse and varying degrees of accuracy. I personally believe the Networker group should be the 'glue' sticky enough to keep a united co-operative but pliable enough so that shareholders concerns are comprehensively debated at all levels.

The power of this group is its volume, (shy of 10% of shareholders), but to be effective they need to know their purpose. Unlike Board and Shareholders Councillors the Networker job description can be less specific, short on detail, but in line with the co-operatives values.

**\*Co-operative Spirit \*Do what's Right \*Challenge Boundaries \*Make it Happen**

Programme initiatives such as the 'Know your Co-operative programmes' are great examples of shareholder education and engagement and need to be supported and encouraged for the greater Fonterra family.

**When Leadership Roles are crossed;**

**The Board**

Board member responsibility is to act in the best interest of the co-operative, but by nature of the process to elect directors (must have 9 farmer directors on a three year term), there are potential conflicts of interest for the farmer directors.

Through the forces of needing to be re-elected, directors must have support from the shareholder base and therefore could be influenced to represent a view versus acting in the best interests of the co-operative.

As our elected farmer directors are farmer shareholders first and foremost, their development as quality directors may take time to evolve, however there is very little information for our farmer shareholders to be made aware of the performance of their farmer directors.

There is a greater need for the understanding of the duties, skills, experience and diversity required from our directors, therefore the shareholders election process should be more objective.

Assessing potential candidates needs to be independent of immediate board to ensure the process is perceived to be both transparent and robust.

Where we can separate the identifying of the requirements from the interviewing of the candidates, a more credible process can evolve.

If the Board structure and make-up were to evolve, attention may be directed at the term of service, say from three to four years, or farmer director numbers versus independents. If we just look at the term of service the intention may be to create continuity and stability for a board.

Although I believe shareholders should remain in control of voting rights, shareholders have a responsibility to keep themselves informed and participate for the best outcomes.

### **Fonterra Shareholders Council (FSC)**

Shareholders Councillors have responsibility around reporting and monitoring with particular emphasis on representing shareholders views to board and management.

Messages from Shareholders Council back to shareholders should be the collective view of the Council, not personal view(s), and should be in line with the Co-operative's goals.

During the TAF process these roles were crossed at all levels with the added contribution from the shareholders, stakeholders (primarily government), and other dairy processing companies all fuelled by media speculation.

In support of my comments I refer to the behaviours of Shareholders Councillors and Councillors personal views in signing off the 5 pre-conditions. None more so than the Chairperson of Shareholders Council resigning because he could not support the Council's position.

This may have been a noble action, but I suspect the 'bigger the noise you can make the more attention you will receive, applies here.

The question that remained was, was this a representative view by the Chairperson (who had access to many resources and independent advice), or a Chairperson acting at a different level, be it governing or as a shareholder?

During the latter stages of the process the Shareholders Council had a message to deliver and a responsibility to deliver it. This was done succinctly and factually which mitigated the noise.

## **What did we observe?**

Objectively one could say this motivated a better education process and stimulated debate and the desire of shareholders to get themselves' informed. Through media, individuals representing alternative views from that of Fonterra's, were able to provoke, stimulate and confuse shareholders and the wider community. The reactions from shareholders were many and varied. If one took a simplistic, objective view the result was that shareholders engaged in the process.

The alteration of the initial process to give shareholders the opportunity of a second vote on TAF stimulated some different behaviour such as, interacting with media versus the channels within the Cooperative itself. The call from Fonterra to 'unite', all shareholders, was the Board's motivator for the second vote.

What occurred seemed to be a markedly more aggressive information push from Fonterra. 'Contact time', that is to say, meetings with shareholders by Board, Shareholders Council and Management or combinations of all (collective and united), was had.

***The learning here was that the loss of momentum gave opportunity to direct change and the fight back required more energy, resources, time and empathy.***

Did the shareholders benefit?

Personally I believe so.

The speculation which was followed by the informed responses being played out in the media created shareholder engagement. The risk here was that the facts and issues were not being discussed and misinformation was potentially to be more damaging.

To be constructive, I would challenge the leadership through the middle period of this process which led to more resources being employed to deliver an outcome that was in essence the same as what was initially tabled.

Reviewing the Fonterra Business update September 11th 2011:-

I question, and have questioned Fonterra's 'wait and see' approach. With the benefit of hindsight, we can now agree that not being able to execute the process within the stated timeframes, and the planned flow of events, did in fact jeopardise the outcome.

*Why was timing altered?*

The importance here is not the reason why, but that unforeseen events and circumstances can and will arise during some processes, and so what can we learn?

Government postponed the review of the Dairy Industry Regulation Act (DIRA) changes for TAF to be initiated due to priorities such as Christchurch earthquake, milk price review, general election etc...

But Fonterra, the business, must be robust enough and have relationships with communities, politicians, regulatory bodies etc... so that little effect is had or at least confidence remains. This confidence needs to be portrayed and supported by all stakeholders.

*How can this be achieved?*

A business of Fonterra's size and scale, and its importance to New Zealand's success relies upon having relationships with other stakeholders where decisions and interventions are prioritised in order to be timely, and that clear direction for all is achieved.

For Fonterra's part our leaders need to strategically network and reinforce the Cooperative's value to New Zealanders and to the Leaders of New Zealand so that they are informed about what the risks or gains are.

The roll-out of the 'Milk in Schools Programme' initiative is a good example where both community awareness and Fonterra profile benefit. Downstream central government observed and commented upon the positive support communities are receiving through Fonterra's sponsorship.

Early momentum that had shareholder support for TAF was lost through the middle period, September 2011, and shareholder engagement was not encouraged enough, although behind closed doors there were developments and consolidations.

The business of Fonterra is large and complex but shareholders expressed interest, demanded detail, requested and interpreted the structures and mechanics of TAF aggressively. On reflection this was not a constructive or well managed part of the TAF process.

*What could have helped?*

The use of Management without the presence of board I believe was under-utilised. Management, although they are employed to perform a role, deliver a message that is "pure".

The shareholders engage at a level that deals with issues, not the person or politics, so my observation of the shareholders interaction with management was that it was more positive, constructive and enquiring.

An example of when this did occur was when ward 32 had a small group meeting with "middle management" who were designing and preparing segments of the trading platform and how shareholders would trade shares. The interaction was not only factual in content but also in their experiences. Feedback after the meeting was positive and most importantly shareholders had expressed 'a connection' with the Fonterra team.

Leaders need to find a balance between judicial responsibility, shareholder contact and shareholder education, the latter put into the care of management.

The Chairpeople – in which areas was it important that they perform?

Keeping regular updates of developments, (not always having to deliver them), and creating opportunity for interested parties to understand implications of developments so as to prevent a void or vacuum effect.

If I refer to the reaction from the shareholders to the potential issues around the function of the custodian, early independent legal and commercial representation supported by Board, Council and Shareholders interface was essential to mitigate a red herring. We observed behaviour that could have jeopardised relationships and process. Leaders needed to preserve and respect relationships and be able to engage at all levels and with all parties, as did shareholders. The difficulty comes if neither party compromises. Given the common interest was Fonterra in this case, common ground was found but not without unnecessary cost.

Employing positive initiatives to smooth interaction such as investing in resources to identify skill sets required, and getting assistance to up-skill members would ensure members could have participated in the debate at a constructive level.

Board and Council should deliver a recommended view throughout the process with supporting evidence. Shareholders have elected members for the leadership of the co-operative and should be guided by them, but not blindly, to the intended outcome.

## **COMMUNICATION WITH ALL STAKEHOLDERS**

Communication is key. This is nothing new but the observation is that we need to be bringing all the stakeholders onto the same page.

Throughout the TAF process major events occurred that had implications for New Zealanders and New Zealand. These events interrupted legislative timing which deferred the ability to initiate TAF.

What was missing?

Turning a negative situation into a positive. What we knew was that our timing was deferred.

Here was the opportunity to keep shareholders engaged with the facts to date. The short and then the long term game and how it would play out. IMPORTANT - still the same OUTCOME.

Firstly, with reference to the mechanics of TAF, refresh why shareholders had so strongly supported the constitutional change, and the strength that it would bring to the co-op.

Reinforce the big picture because when all is good at home the “don’t fix what isn’t broke” mentality creeps in.

Follow with discussions, interaction and engagement with the information, or at least confidence that any issues arising have received full attention, supported by the independent ‘groups’ views (Board and Council). Perception is reality, and control of events narrows perception.

There was noise around the flow of information and the lack of it. Information can only be delivered at the speed it is obtained. That is not to say discussions on progress should not have been had. The point is to keep communicating.

## **COLLECTIVE APPROACH**

Fonterra Leadership is structured in multiple layers and discussions have been had on all levels with all interested parties to get best outcomes, efficiency and so on...

I have listened to these debates and contributed to them but I reflect on the TAF process and question our lack of commitment to our individual roles and responsibilities in order to achieve a collective outcome.

The challenges/tensions between Board and Shareholders Council, their respected independent advisors and creating the opportunity and forum to extract full value was essential to ensure the co-operative achieved the best outcome.

Interestingly we have independent advisors to advise their respective ‘employers’ but are we creating a forum for all interested parties to raise and share concerns, to discuss and dismiss potential issues?

Was the opportunity there for the independent advisors to present their findings, either individually or collectively, in order for them to benefit and understand each other’s position, and therefore provide any explanation if necessary?

How much of our public debate was avoidable if the ‘right’ people collectively were allowed to thrash out the issues and design mechanisms to mitigate risk and design a vehicle for best outcome?

(I refer to the 'custodian' debacle).

*The learning is to engage with the people of influence using independent view which has already been rigorously tested.*

## **MEDIA & COMMUNICATION**

Keeping up with future forms of communication and media options to enhance interaction are tools we will need to engage with. Using new technology to our advantage is a necessity because connecting with the shareholders, investors and ever expanding consumer base are priorities for promotion of brand, commercial practice, environmental awareness etc...

Regularly shareholders comment on the Chairperson's weekly note-form emails. This has been a positive form of communication that gives interaction with a large percentage of shareholders and has little demand on resources. This is a good example of efficiency created by technology and utilised by Fonterra.

Now with the launch of Trading Among Farmers and an ever inquisitive shareholder base, various forms of communication which are interactive and efficient need to be introduced. I believe this will be conducive to media.

**SUMMARY**

Value the importance of your role and understand how to perform your role.

Leaders must lead with integrity and purpose not political games for votes.

Communication with shareholders and stakeholders alike will be the future single most important interaction for Fonterra’s prosperity.

‘Good to Great’ will be commented upon and evaluated by many. The success will be built on a collective approach and united responsibility from us all. Fonterra needs New Zealand as much as New Zealand needs Fonterra.

**Positive Intent**



## CONCLUSION

Trading Among Farmers was in the development stage when I selected it for my Kellogg project. The potential long term commercial benefits and the share entry/exit flexibility I thought could be possible for our own and other shareholders farming businesses was the motivator for my project.

Timing of life and the growth of our farming business took priority over my Kellogg project. Nearly two years have passed since I commenced my project. During that time the process and initiation of TAF has been robustly debated, independently reviewed, voted into constitution, voted upon for a second time by shareholders to get a clear mandate to proceed with TAF, and the subsequent launch of TAF.

With the benefit of hindsight I have formed conclusions with assistance from, (hopefully not influenced by), the Fonterra "family". The process from initiation to execution of Trading Among Farmers has taught us lessons. Absent leadership, lack of factual and timely communication and poorly directed shareholder/stakeholder engagement can challenge process, and that challenge could affect outcome.

I recognise alternative views were expressed and were made with constructive intentions, but the piece of the puzzle that still remains unanswered for me is - Did the noise created by opposition to TAF stimulate more shareholder engagement, a wider community or investor interest, and a larger advertising campaign? And therefore was the audience more informed and was a better outcome achieved?

Albeit controversial, is any "noise" (national or international media forms, shareholder push back, internal leadership resignations etc...), good noise???

## Referencing:

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### Programme:

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NZ Institute of Directors Inc. Certificate in Company Direction 2009 - course material.

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