

'Short-term' plan panned

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COOPERATIVE share trading systems – such as the one included in Step Three of Fonterra's proposed restructure – are notable for their short lives, and tend to last one generation at most.

So says Onno van Bakkum, owner of the Dutch Co-op Champions research and advisory service, citing other international examples.

In the case of the Kerry Group (Ireland), after less than 25 years it is currently reviewing reducing a spin-out of shares to individual members, reducing the co-op's share from 23.7% down to possibly 9%, van Bakkum told *Rural News*.

He says the short lives of this and other companies is due to the difficulty of reconciling different drivers.

In Fonterra's case "the crucial difference between the two is the linkage of investments to milk supplies. There is a trade-off between the two: the one will go at the cost of the other. The proposed new system is a

step away from supplier interests".

Both the Fonterra Shareholders Council and Federated Farmers are backing Step Three.

"It seems clear to me they... overlook the longer term collective in-



Onno van Bakkum

terests of milk suppliers as decisions are made at different moments, in different settings, because of the partial de-linkage of investments from milk that's being proposed now.

"Farmers may each individually decide, very slowly, one after the other, or in large numbers following a major drought or disease, to apply to the shareholder fund. Non-supplier ownership would then become a reality without a conscious, collective vote."

He says this seems to be a typical issue once the dynamics of investor interests start playing a distinct role: it's sliding a downward slope, very difficult to stop and extremely costly to reverse.

"My fear of what might happen with Fonterra if farmers go ahead with the trading proposal, beyond 'the foreseeable future', is a cascade of small steps the effect of which would be the eventual loss of farmer ownership and control," van Bakkum says (see article below).

In the meantime, the company's orientation would move away from paying high milk prices to paying high dividends (to build up a good track record for future emissions), and investing in business activities focused on high returns (to capital, not necessarily milk), the beneficiaries of which would be occasional investors rather than milk supplying members.

Van Bakkum says all these would occur because it will be recognised that both shares

and investment units trade at a discount, and the company will be under severe pressure from the investor community to make further changes.

"If these cascading changes are a factual impossibility, I applaud the proposal drafters. If truly 'the fund would be designed so that the units would never be able to be converted to Fonterra shares': well done.

"But I'm not yet convinced. There is always the possibility that 75% of shareholders would

vote in favor of a second best solution. If these are not factually impossible, their combined effect is that collective ownership of member-suppliers will gradually erode.

"If trading is what farmers really want, I think they should accept this possibility from the outset."

Fonterra's proposed share trading will not solve the co-ops woes, according to an industry expert.



Slippery slide to loss of control

- The sharing up limit, already expanded from 120% to 200% under the proposal, would be increased even further;
- The 20% ceiling on aggregate dry shares would be raised;
- The 5% cap on individual dry share holdings would be lifted;
- The period of three years buying in and share sale would be extended;
- The percentage of shares

that could be linked to the shareholders fund would be raised;

• New share issues would be readily agreed by farmers, but funded increasingly through the shareholder fund, effectively strengthening non-supplier ownership of underlying shares;

• The ownership and trading rights of external investors in the fund's investment units would be broadened to reflect the reality of its underlying

share ownership;

• Somewhere down the road the milk price bonus for share-backed milk solids would come under question;

• The principle of distributing dividends on a milksolids basis would be compromised;

• A takeover bid would be launched for a minority holding in Fonterra;

• Instead some sort of restricted, public listing of shares would be sought, and restrictions would gradually be lifted.

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