Irish Nuffield
Scholarship Trust

Dairy Cooperatives

for the

21st Century

A report for Irelands Nuffield Scholarship Trust 2011

Sponsored by

Irish Cooperative Organisation Society (ICOS) and Golden Jubilee Trust

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Executive Summary

Dairy Co-ops for the 21st Century

This study endeavours to identify the fundamental points of difference that leads to a progressive, innovative, rationalised and successful dairy co-operative that delivers a sustainable milk price to farmer members which leads to real wealth creation in rural communities.

The methodology employed in formulating this report included extensive research in both printed and online documentation and intensive interviews with successful farmers, business people and board members and management of several Irish and international dairy co-operatives. In the course of this research the author travelled widely in Europe in 2011, concentrating on the co-operatives FrieslandCampina and FloraHolland in the Netherlands before heading to Argentina and Brazil in March 2012. The study tour of New Zealand and Australia in September - October 2012 was a steep learning curve in relation to how a co-operative can gain power in the international market place by farmers coming together and rationalising their industry and having a clear focus on maximizing the value of their milk.

The report seeks to outline the key differences between a co-operative way of doing business versus the more conventional investor driven organisations and identify what makes a co-operative successful.

The Irish dairy industry has failed to rationalise effectively and savings of 2 cents per litre can be identified by bringing the industry together from a processing and marketing perspective.

Irish co-operatives have evolved into multi-purpose organisations that process milk and also supply farm inputs as well as other businesses to provide value for members however this evolution has clouded the ownership of primary dairy co-ops with 70% of shareholding in the hands of dry or non active members and only 30% in the hands of active dairy farmers.

Irish dairy farmers and co-op members have disconnected from their co-ops over the the years of the milk quota regime. Quotas are being being abolished in 2015 and Irish farmers have an opportunity to expand production for the first time in 30 years – this is the time for us to re-engage with our co-operatives and create a business which can compete effectively in a global context, we need a Dairy Co-op for the 21st Century.

Report Recommendations

1. Culture Change

We need to create a single purpose milk processor, handling 80% of Irelands milk pool, this integrated co-op can concentrate on maximizing the value of members milk, to achieve this, we firstly have to revalue the milk processing assets of co-ops separately from other assets and establish a defined share class for each of these asset types. Apportion shares in the milk processor to dairy suppliers and apportion shares in agri-trading and all other assets to dry shareholders. All milk suppliers must have a shareholding reflective of milk supply.

2. Business Performance Payments

Milk pricing is the clearest interface between milk suppliers and management and thus needs to be transparent, it has to send clear signals to farmers on commodity returns from the global market and also pay a performance related dividend on shares (after retentions and additions to co-op reserves) that reflects the value add that management has achieved through innovation and efficiency. This performance dividend is distributed fairly if share holdings reflect milk supply. Transparent milk pricing and dividends related to profit keeps both membership and management focused on achieving the maximum performance from the business.

3. Share Redemption

Redemption of shares when a member ceases trading is necessary to keep shareholding in the hands of active dairy farmers. Redemption can be carried out at board discretion to reflect the risks to the businesses balance sheet i.e. the board may decide to leave a retired farmer redeem their shares over a set period of 5-10 years and a new milk supplier to buy shares over 2-4 years.

Establish a fair value for shares that reflects the appreciation or depreciation of the assets over the time period of a suppliers membership, this valuation will be carried out by an independent agency, a retiring member sells their shares to a new member thus reducing the risk to the company and if a member wishes to grow their milk supply new shares are issued to reflect volume. (Reason for allowing a fair value for shares is that it encourages a culture of maximising value from the business.)

4. Co-operative Education

Education programmes need to be established to reinvigorate and reconnect grass roots farmers with their co-ops, these programmes should encompass how the co-op business model works and how it differs from investor type businesses.

Education programmes for elected representatives must be more intensive and elected members should be voluntarily required to complete a set number of individual training courses over each term of service.

Points awarded on completion of education modules for elected representatives - with a minimum amount of points required for an individual to be eligible to contest a seat at council or board level of the representative structure.

The co-operatives in conjunction with Macra Na Feirme[1] should establish shadow boards that would be populated by enthusiastic young farmers, these shadow boards could interface with co-op boards to learn about their industry and also feed information up the line to senior board members, this would encourage involvement from a young age.

[1] Macra Na Feirme = Young Farmers Organisation

5. Constant Evolution

For a co-operative to be successful there is a need for constant evolution of structures within the organisation, constitutional rules that are more reflective of bygone times need to be adapted to a more modern society that reflects better communication and connectivity.

6. Encourage Excellence

For our industry to succeed we have to encourage excellence at all organisational levels from grass roots membership through representation structures on to board level who will focus on managements capability and delivery of optimum business performance.

Quotation from the author

"A co-operative is an organisation that is democratically controlled and governed by its members for the benefit of those members. Over the two years of carrying out my research, I have come to the conclusion that for a modern dairy co-op to be successful it is imperative that strict and comprehensive corporate and financial governance is applied at all levels of the business. Excellent governance and management will achieve solid and sustainable financial performance which will return value for members milk and also sustain the economic health of the dairy co-operative making it a –

"Dairy Co-op for the 21st Century"

David Murphy January 2013

"If you want to go quickly, go alone, if you want to go far, go together", (African proverb)

Background

What is a Cooperative and how does it differ from a conventional business

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

A cooperative is a vehicle for creating wealth and returning income to its members when conventional business structures can operate inefficiently for primary producers.

Milk for instance which is perishable by nature and has a relatively short lifespan if left in its natural state, places primary producers in a disadvantaged position when negotiating terms with perspective customers.

However if farmers can come together and process their own milk into higher value, less perishable products giving dairy farmers more leverage in the market place and by coming together enhancing marketing power and maximising returns to members.

Edgar Parnell of the Plunkett Foundation explains that cooperatives are essentially a people centred business;

[2] *"There are in reality only two types of business – that which is capital controlled and that which is people centred".*

The central theme of a people centred business or PCB according to Parnell:

"it exists to serve the needs of the people who are the users of the business, instead of placing investors in the driving seat".

The second type of business identified by Parnell is the Investor Driven Business. The basic purpose of an investor driven business is not about serving the needs of users but about meeting the needs of investors who own the business and meeting their needs for a good return on their investment, through dividends and capital growth.

[3] The key differences between an investor driven business and a person centred business is that an investor driven business aims to meet the needs of the investors who own the business – in particular their need for a satisfactory return on investment, this puts the investors in control. A PCB on the other hand, is organised to meet the needs of the people who use the business, their needs for particular benefits and services. The decisions about which particular benefits and services are to be provided by a PCB are made by the users of the business.

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[2] (Source Edgar Parnell 1990 People-Centred Business: PCBs – what they are, how they become successful and why they are important. Oxford: Plunkett Foundation for Cooperative Studies).

[3] (Source: The Competitive Advantages of Cooperatives. Robert Briscoe and Michael Ward. Pages 25-26)

"In short, the cooperative exists to make money for farmers; the investment-based agricultural company exists to make money from farmers"[4].

Dairy Co-ops in Ireland 1900 -2012

At the turn of the century there were 840 co-operatives in Ireland, small creameries were located in nearly every parish around the country, many small co-ops and private dairy companies competed fiercely for milk from farmers, this did not serve the industry well as it was difficult to achieve scale and efficiency in the business, with fierce competition many of these smaller companies started to fail, jeopardising the entire dairy industry, the government reacted by passing the Dairy Disposal Act of 1927 and set up the Dairy Disposal Company which facilitated the rationalisation of the creamery industry across the nation.

Today there are 27 dairy co-ops on the island of Ireland, 12 of which are processing milk in many different locations, however this trend of strategic mergers and rationalisation has all but come to an end with no major consolidation in the last 15 years. This is a position of weakness for the Irish dairy industry when we have to compete in a global market against large, highly integrated efficient milk processors from other countries.

"The small co-ops of today are the crossroad creameries of the 1960s and 70s",[5] (quotation Denis Brosnan)

Industry Overview

The Irish dairy industry is waking up from a long period of stagnation, milk production has not increased since the introduction of milk quotas in the early 1980's, and during the intervening period our milk processors concentrated on supplying products that qualified for intervention and EU market supports. This led to an over reliance on basic commodities such as butter, skim milk powder, whole milk powder and cheddar cheese etc. The dairy industry operated in a price protected bubble of EU subsidies and market protection mechanisms such as export refunds. This bubble has now been deflated as EU subsidies have been decoupled from product and paid directly to farmers and Ireland's dairy product prices have been exposed to true market forces.

"The shop we used to sell to, is now closed",[6] Quotation Padraig Walsh

The commodity type dairy products that Ireland became reliant upon are most exposed to the vagrancies of the market place and can experience extreme price volatility.

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[4] David Thirkell of the Plunkett Foundation "Ignorance abounds on the worth of farmer co-ops" Irish Farmers Journal November 7th 1998. The Competitive Advantages of Cooperatives. Robert Briscoe and Michael Ward. Page 43.
[5] Quotation Denis Brosnan, interview with Denis Brosnan conducted during ICOS - FBD Trust Co-operative Leadership for Young Farmers 1st December 2011

[6] (Quotation Padraig Walshe former leader IFA and Nuffield Scholar)

CAP Reform

The Mid Term Review, which was an extension of the Agenda 2000 reform of the European Common Agricultural Policy (CAP) resulted in the decision to abolish milk quotas by 2015. This is the first time in over 30 years that Irish farmers will be free to expand production, this policy change has unleashed great enthusiasm within the industry with many farmers planning expansion of their herds. It has also exposed the vulnerability of the sector to be in a position to cope with this expansion in milk supplies, investment in processing capacity is necessary to deal with this extra milk.

2020 FoodHarvest

The 2020 Foodharvest Report is a government overview and plan for agricultural and food sector of the Irish economy, the report states –

"On the basis of available data the Committee believes that a target of a 50 per cent increase in milk production by 2020 (using the average of the years 2007 to 2009 as a baseline) would be realistic and achievable, and that this will set the foundation for further expansion in subsequent years. This 2.75 billion litre increase would enhance the primary output value of the sector by about €700 million with further downstream benefits in the form of increased dairy product values, export earnings and employment. The report recommendations are designed to support the realisation of this potential growth and to provide a sustainable return for competitive producers and processors"[7].

The economic turmoil that Ireland has experienced since 2008 has seen a refocusing on export orientated businesses especially the significance of our food and drink sector, exports from this indigenous industry increased by 12% in 2011 to €8.85 bn.

The 2020 FoodHarvest Report also states:

Ireland's extensive, low-input grass-based production systems are the foundation of its green credentials, Through sustained investment, a collaborative interdisciplinary approach and focused marketing, Ireland can become synonymous with the production of environmentally sustainable and welfare friendly products. This should result in consumers in key markets recognising implicitly that, by buying Irish, they are choosing to value and respect the natural environment[8].

Conclusion

- Irelands dairy co-ops of today were born out of difficult circumstances in the nineteenth and early twentieth centuries when Irelands dairy farmers were loosing market share in the UK to their more innovative and competitive counter parts in Holland and Denmark,

[7] Source 2020 Food Harvest Report Page 41 Section 4.2
[8] 2020 Food Harvest Report

- The early Irish dairy industry organised itself around localised geographic areas with small creameries established at crossroads sites in many small parishes around the country.
- This led to fiercely traditional and localised loyalty of members to their local "creamery", this mindset has curtailed rationalisation of the industry ever since with traditionalists preferring "to go it alone" rather than explore merging with neighbouring co-ops to drive efficiencies, often times rationalisation did not occur until there was no other option.
- Ireland has an over exposure to basic commodities in the market place and commodity price cycles can be extremely volatile.
- The abolition of quotas in 2015 will bring great opportunity and also great challenges to the industry.
- The 2020 FoodHarvest Report has identified the benefits of growth to the economy of Irish dairy output,
- Government needs to facilitate this expansion in every way possible, including tax efficient investment allowances, encouragement of land mobility to allow more land to be harnessed for dairy production and also the encouragement of rationalization at processor level.

Chapter 1

Challenges Facing the Irish Dairy Industry

1.1 Our Competitors

The scale that our competitors have attained in the market place is an extreme challenge facing the Irish dairy sector. FrieslandCampina, are based in the Netherlands and have a turnover of €9.45bn, with 16000 suppliers, 20,500 employees and processing 8.4bn litres of milk (Consumer 56%, Cheese/Butter 27%).

Arla is based in Denmark and has a turnover of €6.6bn, it has 8500 members in Denmark and Sweden, Arla process 4bn litres in Denmark, 2.1bn litres in Sweden, 2bn litres in the UK, 2bn litres in Germany and 300m litres in Finland (46% Fresh, 25% Cheese, 13% Ingredients, 13% Butter/spreads)

Fonterra operating from New Zealand has a turnover of €9 bn, it processes 16.5 bn litres of milk, it has 10,700 suppliers with average milk solids per supplier of 111,000 kgs.

These are an example of the competitors we face in the global market they have focused on the consumer markets and have rationalized their processing over many years.

Fig 1. Five of the top ten global dairy companies are cooperatives (Source ICOS)

1.2 Product Type

Our dependence on commodity type products reduces returns that can be achieved in the market place, and we have to make up a lot of lost ground to compete for the more lucrative value added markets.

"*If Ireland moves towards commodity it won't serve us effectively, we need to concentrate on adding value*"[9], (quotation Denis Brosnan)

Part of the challenge facing the industry is to get dairy product higher up the value chain and into products such as food ingredients, i.e. getting higher concentrate protein powders such as Whey Protein Isolate (WPI) and Whey Protein Concentrate (WPC) to the market place.

Rabo Banks report on the international dairy industry "Global Dairy Outlook – Show Me The Money", expects to see strong growth for higher end whey products such as WPC 80s, 90s and WPIs (WPC 80 = 80% protein) mainly driven by demand for health drinks and high protein sports supplements, the report also highlights the rising demand for infant milk formula (IMF) driven by higher incomes and more female participation in the workforce in developing economies.

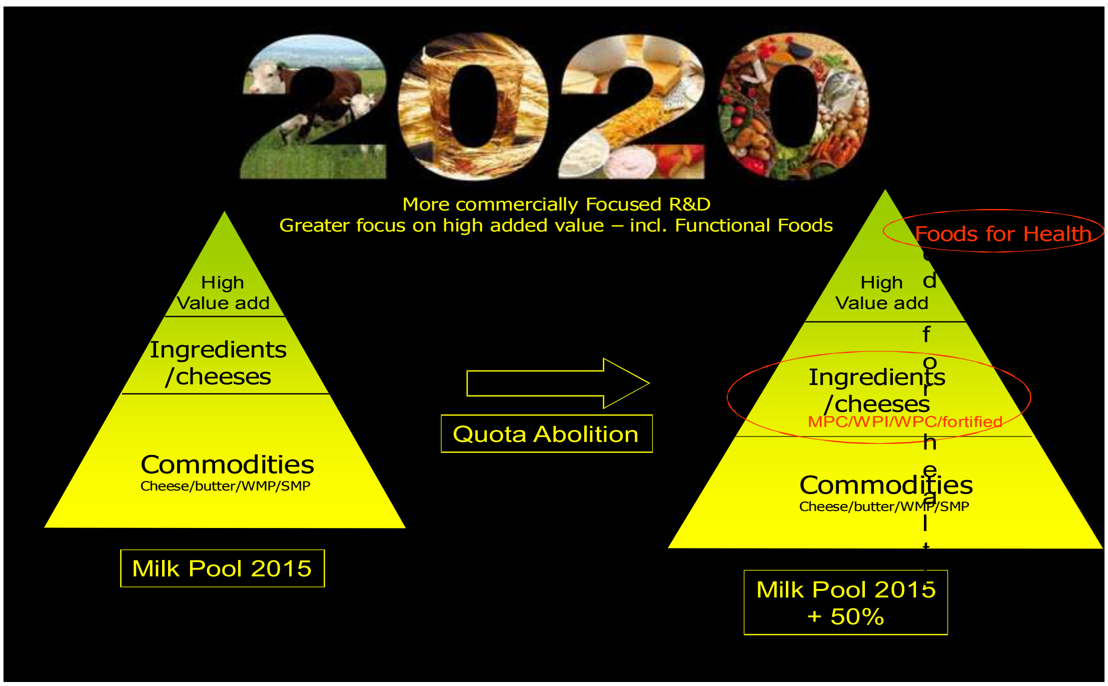

Fig 2. 2020 Foodharvest report highlighting the need to get dairy product higher up the value pyramid

Professor Paul Ross, Head of Biotechnology at Teagasc Moorepark Food Research Center puts it this way *"We need to get on the train of value added products or stay on the platform – research helps to identify future products, we have to innovate to succeed".*[10]

1.3 Processing Inefficiencies

The lack of cohesion and inefficiency in our milk processing sector adds cost to our industry. We are competing in an extremely aggressive market where scale is a major player in cost reduction.

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[9] Quotation Denis Brosnan, interview with Denis Brosnan conducted during ICOS - FBD Trust Co-operative Leadership for Young Farmers 1st December 2011

[10] Quotation from Professor Paul Ross from personnel interview conducted in Moorepark offices on 13/2/2012

Ireland has 4 companies processing 80% of our milk pool compared to Denmark which has one (Arla), Netherlands which has one (FrieslandCampina) and New Zealand which has one (Fonterra). This leads to duplication and inefficiencies in the Irish processing sector, the Promar report on the Irish dairy industry commissioned by the Department of Agriculture and ICOS in 2003 showed that raw milk processed per employee was 560 tons in Ireland compared to 881tons in Holland and 1120 tons per employee in New Zealand[11]. If you consider that Ireland has an extremely expensive labour cost this means that we require twice as many employees in Ireland to process the same amount of milk that our competitors in New Zealand are achieving, yet we have to compete on the open market with New Zealand.

> *In 2001, the operating margins achieved by Irish processors from their dairy processing business ranged from minus 0.3% to 6.7%, with an average of just 2.7%. These margins are lower than those of Arla and Friesland, which returned results of 3.2% and 3.8% respectively in 2001*[12]. (Source Promar Report)

1.4 Marketing our Dairy Product

The Irish Dairy Board was established in 1961 as a semi state body named An Bord Bainne, (later renamed the Irish Dairy Board (IDB) in 1973) to promote and sell Irish dairy product, the IDB acts as the international marketing arm for Irelands dairy produce, it has been very successful in establishing the Kerrygold brand and handles 60% of Irelands dairy exports, this equates to 2.8bn litres of whole milk equivalent.

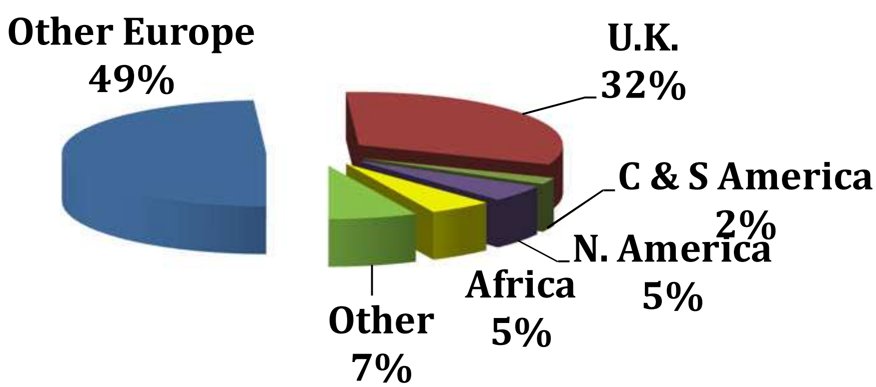

Fig 3. Pie chart shows geographic spread of IDBs customer base (Source Irish Dairy Board)

The IDB has an annual turnover of €1.8bn, it operates as a multinational company with 3,820 employees, the IDB is exclusively export orientated with sales in over fifty countries worldwide. The Irish Dairy Board is owned by the Irish dairy processing co-operatives and dairy companies and, through them, by Irish Dairy farmers. Fifteen directors who represent the country's co-ops, ICOS and the farm organizations, govern the Dairy Board.

[11] Promar Report Strategic Development Plan for the Irish Dairy Processing Sector page 31

[12] Promar Report Strategic Development Plan for the Irish Dairy Processing Sector page 43

The weakness of the Dairy Board is the fact that not all dairy product is marketed through it, this leads to competition between Irish manufacturers, a single sales force would strengthen our hand when dealing with retailers and customers.

"The export marketing of Irish dairy produce has evolved to a position at present where Ireland has a sales, marketing and distribution structure that involves significant duplication of effort between some of the larger processors and the IDB. The reality of the current position is that in many instances, Irish processors and the Dairy Board are directly competing in the same markets".[13] (Promar Report)

The fact that we only have one key brand – Kerrygold, is a sign of lack of investment in new brands and products this reflects on our disjointed marketing and product promotion.

The industry needs to have a sizable and coordinated budget for researching product development and the promotion and development of new products and brands, our competitors are constantly launching new consumer products this requires dedicated research and development and a large budget.

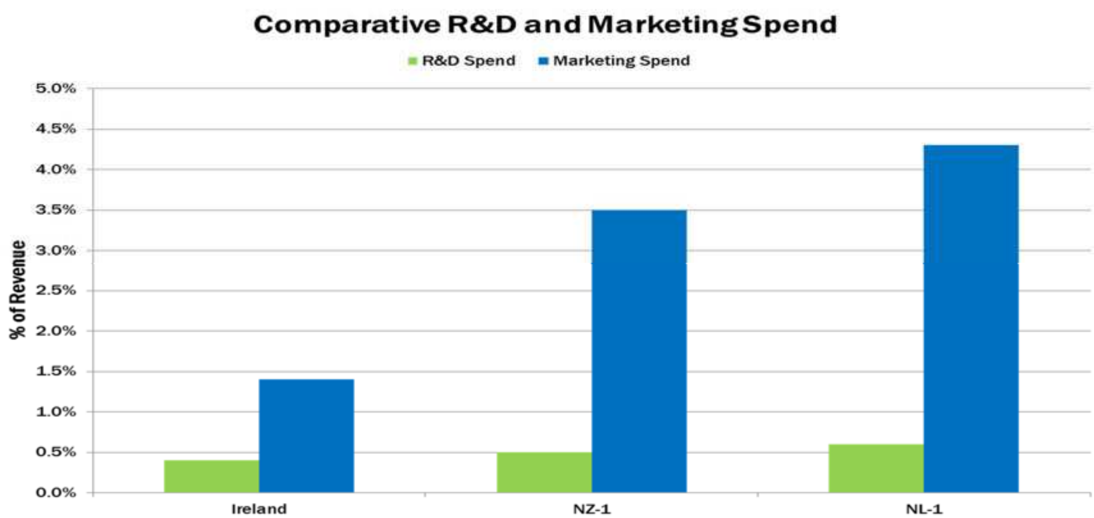

Fig 4. Peer Group R&D and marketing spend **Source ICOS**

1.5 Conclusion

For Ireland's dairy industry to compete effectively against its international counterparts we need:

- Extensive rationalisation in all sectors.
- We have to identify what markets and what products are most beneficial to fit with Ireland's seasonal milk supply and pursue them relentlessly.
- R&D on identifying and developing these products is vital to secure market share.
- A co-ordinated sales force is vital for maximising returns from the market – disjointed sellers are vulnerable and transfers power to perspective customers,

[13] Promar Report Strategic Development Plan for the Irish Dairy Processing Sector page 49

processors need to build customer relationships that are connected from the farm gate to the end user.

- We need to leverage our established Kerrygold brand and build on its brand recognition and high quality reputation.
- Milk processing in Ireland has not kept pace with our international competitors, we are less integrated, less efficient and less innovative. Research has shown we are retaining less profit especially in 2009 when dairy commodity values collapsed.

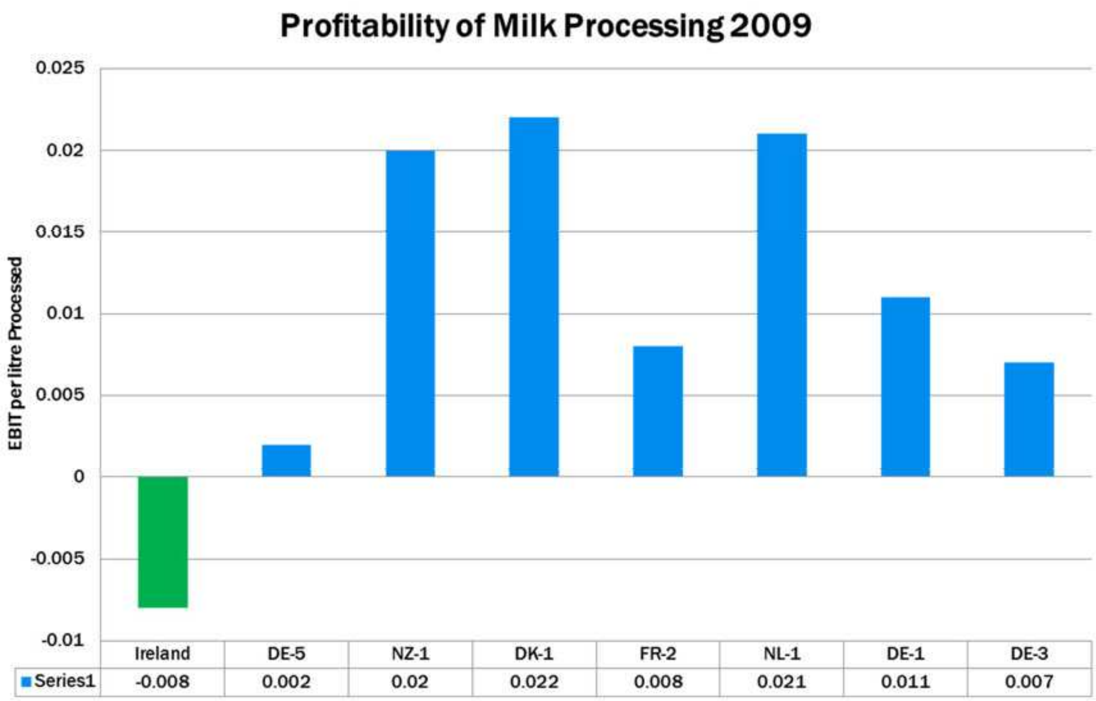

Fig 5. Peer Group Profit Retention 2009 **Source ICOS**

Chapter 2

2.1 Where to from here for the Irish Dairy Industry

The Irish dairy industry is on the cusp of a new period of sustained topline growth, where milk production is expected to grow by 50% from today's 5.3 billion litres to 7.9 billion litres by 2020.

"There was a golden era of milk production growth from 1973 – 1983, the next golden era will be post quota abolition in 2015"[14] (Quotation Denis Brosnan).

There is demand for more dairy product in the global market place as world population continues to grow and is predicted to reach 9 billion by 2050, this is going to put extreme pressure on the globes natural resources to produce enough food to sustain this population.

Demand for dairy product is expected to grow by 3% annually or 16 billion litres per year, this is equivalent to New Zealand's annual production.

Why do we need to retain control of our farm produce through the value chain? – A report commissioned for the Oxford Farming Conference of 2012 (Power in Agriculture) identifies that power in world agriculture is being concentrated in the hands of a few but very powerful Trans National Corporations, these corporations are investor driven business' as outlined earlier, they are totally focused on return for their investors and shareholders and their influence is far and wide in a global context:

- Four companies account for between 75% and 90% of the global grain trade
- 10 companies are responsible for over 40% of the global retail market
- Seven companies control virtually all fertiliser supply
- Five companies share 68% of the world's agrochemical market
- Three companies control almost 50% of the proprietary seeds market[15]

These Transnational Corporations can use their power and influence to set global price trends, operating as price makers for commodities such as globally traded dairy products. In the process of researching this report the author has concluded that for farmers to retain power over their produce they must have scale and efficiency in the market place and put themselves in a position to be price makers rather than price takers, it is with this thought in mind that the author believes that a cooperative model is best suited to retain power in the hands of primary producers.

2.2 Integration of the Irish Dairy Industry

There has been many reports outlining the need for industry integration over the years including the Promar Report commissioned in 2003 and in April 2009 ICOS unveiled a plan to rationalize the Irish dairy industry under the Milk Ireland initiative, highlighting the

[14] Quotation Denis Brosnan, interview with Denis Brosnan conducted during ICOS - FBD Trust Co-operative Leadership for Young Farmers 1st December 2011

[15] Power in Agriculture Report – Chapter 2 Economic Power page 3

benefits of co-ordinated processing, research and development and concentrating on marketing:

2.3 Milk Ireland - The Model

- Milk Ireland will have three main functions: production planning (processing), Irish Dairy Board (marketing) and product development.
- Before milk leaves a farm, Milk Ireland's centralised computer system will coordinate and allocate where the farmer's milk will be processed.
- Processing will be conducted based on three main criteria: product return, plant efficiency and location.
- The marketing arm will be central to the process, and it will be market-led.
- The co-op will be paid a 'commercial milk price' for the milk, based on the gross return from all the products produced, plus a processing fee for milk processed by their facilities.
- The milk price paid to the farmer will be made up of the commercial milk price, plus a return on investment fee, which will be a portion of the processing fee, plus a top-up from any other business the Co-op operates.
- The return on investment presents a good opportunity for efficient plants, as the Co-ops with the greatest level of investment and efficiency will produce a higher reward, and this will be reflected in the milk price.
- Plants which attract additional milk will increase efficiencies and attract higher income from processing thereby allowing the new pricing structure to pay even more.[16]

Integration of the Irish dairy industry needs to be at the forefront of every co-op members mind, every opportunity should be taken to remove cost from the system and achieve vertical integration at all levels of the dairy supply chain.

This mindset needs to be encouraged at grassroots level amongst co-op membership on the ground and support board members who drive change, obstacles to integration should not be tolerated and every effort needs to be made to remove impediments from slowing cooperative rationalisation.

Denis Brosnan former CEO of Kerry Group says: *"Co-op structures are not adequate as they have not changed in 30 years, we have to align our marketing arm, research arm and manufacturing arm, dairy co-ops and the Dairy Board need to populate their boards with expertise to maximise the benefits for the company, influential people need to get together and show that there is a better way".*[17]

[16] ICOS launch Milk Ireland initiative - 18-04-2009 Irish Farmers Journal

[17] Quotation Denis Brosnan, interview with Denis Brosnan conducted during ICOS - FBD Trust Co-operative Leadership for Young Farmers 1st December 2011

European Dairy Companies 2012

Rank	**Company**	**US$ bn**
1	Nestlé	$25.9
2	Danone	$19.5
3	Lactalis	$18.8
4	FrieslandCampina	$13.4
5	Arla Foods	$10.3
6	DMK	$6.4
7	Sodiaal	$6.1
8	Muller	$4.6
9	Bongrain	$4.6
10	***Glanbia***	***$3.4***
11	BEL	$3.1
12	***Irish Dairy Board***	***$2.6***
13	Dairy Crest	$2.6
14	Valio	$2.5
Total Value 2012		**$123.8**

Fig 6. The order of European Dairy Companies by turnover 2012

European Dairy Companies 1996

Rank	**Company**	**US$ bn**
1	**Nestle**	**$ 13.5**
2	**Danone**	**$ 5.7**
3	**Besnier**	**$ 4.7**
4	**Campina Melkunie**	**$ 3.8**
5	**Sodiaal**	**$ 3.3**
6	**MD Foods**	**$ 3.2**
7	**Friesland Dairy Foods**	**$ 2.6**
8	**CLE**	**$ 2.2**
9	**Coberco**	**$ 2.2**

10	**Parmalat**	**$ 2.1**
11	***Irish Dairy Board***	***$ 2.1***
12	**Bongrain**	**$ 2.0**
13	**BEL**	**$ 1.7**
14	**Arla**	**$ 1.7**
15	**Valio**	**$ 1.6**
16	***Waterford Foods***	***$ 1.4***
17	**Bols Wessanen**	**$ 1.3**
18	**Northern Foods**	**$ 1.2**
19	***Avonmore Foods***	***$ 1.1***
20	**Dairy Crest**	**$1.0**
Total Value 1996		**$ 57.4**

Fig 7. The order of European Dairy Companies by turnover 1996

2.4 Conclusion

Opportunity is at hand for dairying in Ireland with expected growth in demand for traded dairy products on the global stage, however the power of large multinational companies places us under competitive pressure, rationalisation of the industry is paramount to operate efficiently at this global level. Reports on achieving efficiency and best practice innovations already exist, we need to execute these proposals by encouraging effective people to be involved in their co-operatives and support those who drive the rationalisation programmes.

50% of the top-20 European dairy companies in 1996 are now part of a different entity in 2012, emergence of new larger co-ops and larger private companies, such as Muller & Lactalis is evidence of rationalization and vertical integration within the European dairy industry.

Chapter 3

3.1 Vision

"To effectively rationalise your dairy industry you need to paint a dream of where you want to be, Fonterra wanted to have size and scale on the global stage, that dream has to be more powerful of what went before, Fonterra concentrated on scale and market focus, an efficient supply chain with a focussed brand strategy, we quantified $300 million in savings could be achieved by rationalising our industry, we sold the dream to shareholders – farmers need to stick together, keep control and have strength in global markets and deliver something for New Zealand". [18] (Quotation Sir Henry van der Hayden)

Where does Ireland need to be in the global context of world dairy producers? This is the question that we as farmers need to ask ourselves, what is our vision, what is our destination, if we do not know our destination we will never get there.

Irish dairy farmers have to set out our destination of where we want to be in a specific time frame, this destination has to be established at ground level amongst the farmers and shareholders of our fragmented dairy co-op sector. This vision must be simple yet robust, delivering quantifiable benefits for dairy suppliers.

3.2 Vision Statement

A single Irish Dairy Cooperative to efficiently process and market 80% of Irish milk production by 2020, returning a sustainable milk price to producers.

It will do this by maximising efficiency at all levels of the dairy production chain. For farmers to 'buy in' to this model we need to quantify the value of an integrated dairy industry and the economic benefits for all stakeholders.

If Ireland is producing 7.5 billion litres of milk by 2020 and savings of 2 cents per litre can be achieved by:

(a) maximising production efficiency on farm,

(b) coordinating milk assembly nationally,

(c) operating our processing assets to optimum efficiency,

(d) coordinated research and development focusing on value add and health benefits of grass produced dairy products,

(e) a single sales force that can exert power and influence on the global market.

A single entity processing and marketing 80% of Irelands milk pool by 2020, this equates to 6.375 billion litres of milk (assuming the projected 50% growth in production is realised).

[18] Interview with Sir Henry van der Hayden in Fonterra Headquarters Auckland New Zealand October 2nd 2012

Effective rationalisation will result in savings of €0.02 cents/litre yielding a staggering €127,500,000.

Assuming the average dairy farmer in 2020 is supplying 454,000 litres per annum (100,000 gallons) this equates to 14,041 suppliers or an average saving per farmer of approximately €9,080 per annum.

Item	Reward	Opportunity
On Farm Efficiency	**1c / l**	Teagasc state there is a 10cent per litre production cost diff. between bottom 1/3 & top 1/3 of producers
Milk Assembly	**0.125c / l** **€6.9 MILLION** **UCC RESEARCH**	Ireland = 450 trucks, 5.5 bn litres, 17000 suppliers. V NZ = 450 trucks, 17bn litres, 14000 suppliers
Processing Efficiency **Total Costs**	**0.8 - 1c / l**	10% improvement would yield 0.8 – 1 cent per litre. E.g. Fonterra, post consolidation using statistical process control (SPC), and supplier standardisation
Product / Market Differentiation	**1 – 5???**	WMP = per kg milk thru dryer ➔ ~40c / l V Infant Formula = per kg milk thru dryer ➔ ~90c - €1 / l

Fig 8. Potential cost savings of effective rationalisation (Source ICOS)

"*Get your message across in cents per litre",* quotation from Eddie Glass[19]

3.3 Conclusion

We must establish a vision of where we want to be, this vision has to be simple and robust and understood by all stakeholders, it has to be quantified in cents per litre so the benefits can be clearly interpreted.

[19] Eddie Glass was the former president of the Federated Farmers in New Zealand and was instrumental in the formation of Fonterra

Chapter 4

4.1 Strategy

What is strategy – "*The determination of the long term goals and objectives of an enterprise and the adoption of courses of action and the allocation of resources necessary for carrying out these goals",*[20]

Strategic management has less to do with analytical skills than with adept cultural, political and people skills, a capacity to manage complexity and the tacit knowledge to create unique strategic assets and core competencies.[21]

The Irish dairy industry needs to harness our *unique strategic assets and core competencies.*

Kerry co-op and later Kerry Group Plc built their business on a simple equation for effecting growth:

Strategy x Capability x Capital = Sustained Profitable Growth [22]

Strategy is the road map that outlines the route for the enterprise to succeed, it has to be understood by all stakeholders and delivered by governors and management of the cooperative.

4.2 Fonterra Strategy

Fonterra's strategy focuses on four areas to meet the challenges and opportunities in the dairy industry.

1. *Ensure Fonterra remains one of the lowest cost, sustainable dairy co-operatives in the world.*
2. *Build trusting partnerships with customers by being a multi-origin supplier, allowing us to build more valuable relationships through supply chain integration and innovation.*
3. *In high growth markets, where it is not practical to use New Zealand milk, we will leverage our cow to consumer expertise to take leadership positions using locally produced milk.*
4. *Make Fonterra products the first choice of customers and consumers wherever we do business*[23]

4.3 FrieslandCampina Strategy

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[20] Alfred Chandler Strategy and Structure 1962
[21] Definitions of strategy and strategic management – Patrice Cooper Department of Management and Marketing UCC
[22] The Kerry Way by James J Kennelly : Strategy, Structure and Culture Page 423
[23] Source Fonterra Website

FrieslandCampina's strategy is - *to increase our added value and, at the same time, ensure all the milk produced by the member dairy farmers of our co-operative reaches its full value. To this end in our strategy route 2020 we want to achieve accelerated growth in selected markets and product categories*.[24]

Part of FrieslandCampina's strategy is to highlight environmental and sustainability issues facing their industry, excellent animal welfare is a critical part of this for positive consumer perception and subsequently the consumer choosing FrieslandCampina products over any others. FrieslandCampina are encouraging their members to allow cows to graze outdoors on grass, the co-op plans to achieve 80% outdoor grazing – the definition of outdoor grazing is to have cows on grass 120 days per year for 6 hours per day, this leads to a positive perception amongst consumers, (why are we not pushing this in Ireland?)

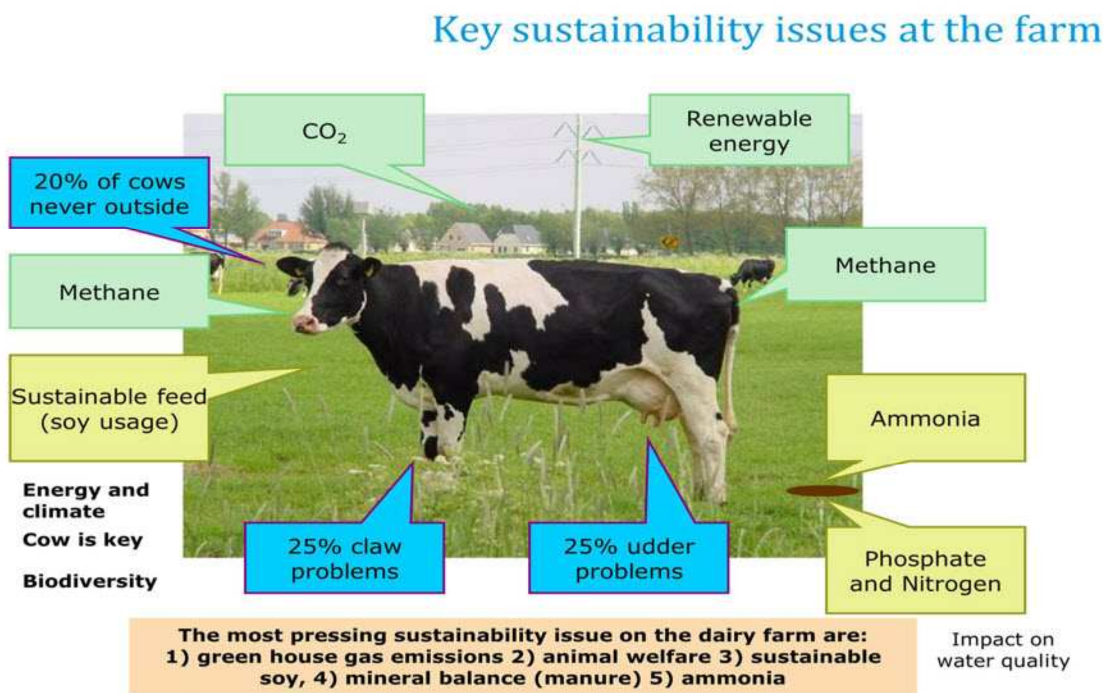

Fig 9. Sustainability issues in FrieslandCampina **Source FrieslandCampina**

According to Jan Willem Strasmaa Head Strategist of FrieslandCampina : "*Part of the strategy of FrieslandCampina is to create an open and transparent industry- telling a good story".*[25]

The importance of environmental sustainability and animal welfare are paramount for the Dutch co-operatives strategy, they are targeting 30% reduction of CO2 emissions in their dairy industry.

[24] Source FrieslandCampina Website

[25] Quotation Jan Willem Straatsma,Head Strategist and Manager Sustainable Farming FrieslandCampina. Interview conducted in FrieslandCampina Headquarters Amersfoort Netherlands 30-6-2011

Frans Keurentjes who is a member of FrieslandCampina Supervisory Board says: *"The sustainability program of FrieslandCampina is about improving the public perception of our product, you can never underestimate the importance of perception of your products by consumers".*[26]

4.4 Conclusion - Irelands Dairy Industry Strategy

- Take cost out of the system by rationalising the industry.
- Identify key products and markets that suit our seasonal milk supply and maximise their returns.
- Build lasting relationships with customers, offering client solutions for food ingredients.
- Focused research and development on new products driving value add and reducing our dependence on base commodities.
- Co-ordinated sales and marketing to maximise returns from the market.

Strategy is the road map that identifies the route to our destination, we cannot set a comprehensive strategy unless we know our destination or are clear on our vision, strategy without vision is a pointless exercise.

Sir Henry van der Hayden puts it this way: "*Governors and shareholders must buy into strategy and be accountable that management delivers it, strategy must encourage integration to maximise value for farmers and must be easily understood by all stakeholders, our strategy is to deliver sustainable co-operative performance, grow lasting customer partnerships and build trusted brands in chosen markets".*

[26] Quotation Frans Keurentjes. Interview conducted in Gronnigan Netherlands 3/7/2012

Chapter 5

Capability

5.1 Encouraging Capability

Governance of a co-operative is the responsibility of the board of directors but for a co-operative to be governed effectively directors need to have capability. If capable persons are allowed to rise to the top of an organisation the chances of success in guiding the business in a positive direction is more probable.

The board of any dairy co-operative is drawn from the membership through democratically held elections, the board is a direct reflection of the membership base.

Different co-ops around the world have different procedures for electing board members, Fonterra members for example vote directly for a national candidate and have a weighted voting system where every kg of milk solids backed by a co-op share is equal to one vote, the theory being that a national basis for selecting board members leads to attracting the best potential candidates thus removing the risk of regional interests having too much influence.

In Ireland the potential board of directors of Glanbia for instance are originally elected at local level as an area advisor to serve on a regional advisory committee, ordinary shareholders who are actively trading with the co-operative can vote at local elections on a one man one vote system. Generally regional advisory committees consist of 25 local representatives, from here an individual is elected by their peers on the advisory committee to serve at council level, after serving a minimum of one year at the council a candidate may put themselves forward again to their regional advisory committee for election to the board of directors.

Fig 10. Representation structure of Glanbia co-op

5.2 How do we encourage capability of our governors?

Whichever democratic system is chosen to select directors it is imperative that capable co-op members are selected, the fact that co-op directors are sourced from the membership, means that education of that membership on the benefits of co-operating in their milk processing business is of vital importance.

A well educated membership base will put forward excellent representatives who can then progress to board level and positively effect the direction of their company.

5.3 Membership Education

Why do we need to deliver co-operative education to the membership base? – since the establishment of the milk quota regime in 1983 the dairy industry in Ireland has effectively been placed in cold storage. With a stagnant milk pool and for many years a secure and stable market for our dairy commodities in EU intervention schemes, has led to a sense of disengagement of members from their co-ops, they were not engaged in initiatives to grow their co-op business or to encourage their boards and management to innovate and add value to their products.

The benefits of integration of processing and marketing assets has been lost in the fog of localised farm events such as growing the business inside the farm gate by buying more quota or investment in infrastructure that kept farmers compliant with strict EU environmental regulations.

This period of history is now coming to an end with the imminent conclusion of milk quotas in 2015, the advent of a growing milk pool will once again put focus on our co-operatives ability to collect, process and market our milk, it is time to reconnect our farmers to their co-operatives.

5.4 Education Delivery

The establishment of discussion groups at farm level in Ireland has seen many beneficial effects for individual farmers through peer group education and comparison and dissipation of best practise procedures which will maximise profitability.

This system of knowledge transfer needs to be tapped to educate farmer members on international best practice of different co-ops around the world, this will deliver a clear understanding to farmers of a well invested vertically integrated milk processor that can add value to shareholders milk and thus deliver a sustainable milk price.

Farm discussion groups need to devote at least 5-10% of their time to co-operative education; this is less than one monthly meeting or a proportion of several meetings through the year. Several discussion groups could come together to meet their local representatives and board members in conjunction with co-op management and discuss co-op strategy, efficiency programmes and mechanisms to add value to milk.

Responsibility for delivering this education lies with the individual co-operatives, ICOS and Teagasc; a simple educational template could be established and dispersed through specifically trained personnel. This material could also be circulated through the Irish

Farmers Journal and other agricultural press publications to the broader audience who may not participate in discussion groups.

5.5 Co-op Representative Education

It is the duty of a co-op director to operate for the best interest of all shareholders and his/her responsibilities are to the company first.

Members who have been elected onto the representative structures should be obliged to go through regular education programmes to enhance their ability to be affective.

These education programmes will have a points system of merit awarded on completion of particular courses and members who wish to put themselves forward for election to councils or to the board must be required to have sufficient points earned before consideration for a position.

The programme of education for the representation structures must include:

- Ownership structures
- Corporate governance
- Communication
- Leadership
- Strategic management
- New technologies in food
- Policy and regulation in relation to co-ops and the food industry
- Financial appraisal of the co-operative (how to recognise key performance indicators and an understanding of financial ratios – how to read and understand a set of accounts)
- International marketing and opportunities in the food industry

5.6 Conclusion

A co-operative is a democratic organisation that selects from its membership base the governors of the business. For effective governors to be elected it is critical that the members are well informed and educated about their industry and have an active connection and understanding of issues effecting their co-operative, members need to understand the bigger picture in relation to their business and not to focus on local issues or politics.

"You have to avoid the lethal cocktail of commerce and politics", quotation Liam Herlihy Chairman Glanbia Plc[27]

Sometimes hard decisions have to be made in the interest of the financial performance of the overall business, a well informed membership base will recognise the importance of making these hard decisions and a competent representative and board structure will concentrate on maximising the returns from the business.

[27] Interview with Liam Herlihy Chairman Glanbia Plc conducted on 8-6-2012

Capable directors will attract and select capable management who will drive the business to its maximum efficiencies and optimise opportunities.

Membership education is key to the initial selection of effective governors, members who put themselves forward as representatives should have mandatory educational standards to progress through the representative structure.

As a dairy farming member of a co-operative, it is vital to have a clear understanding of the organisation that is ultimately responsible for 90% of their farm income, education is key to this understanding.

Chapter 6

Co-operative Capital Structure

6.1 3rd Principle of Co-operatives – Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership[28].

6.2 Ireland Capital Structures v International Standards

If a co-operative is to be effective at processing milk it has to be sufficiently capitalised from the start.

Irish co-operatives over a number of years have neglected to maintain adequate capital on their balance sheets.

Irish Co-operatives typically have a shareholding per litre of milk supplied of 1-2 cent, their European counterparts generally have a shareholding of 3-16 cents per litre and co-ops in Australia and New Zealand can have up to 30 cents per litre of milk supplied.

However money spent on quota in Ireland over the last 20 years exceeds 15 cents per litre.[29]

<u>Ultimately a shareholding in the co-op as a reflection of milk supply is the most efficient way of maintaining capital</u>.

Irelands traditional multipurpose co-ops i.e. dairy processing plus agri trading has clouded ownership with members being either dry shareholders or milk supplying shareholders, this has been further complicated by inadequate redemption policies upon members retiring or ceasing to trade, this has led to large blocks of inactive shareholders on co-op share registers.

Raising capital for a co-operative is somewhat easier when there is sustained topline growth in milk supply, the fact that milk production in the EU has been capped by quota restrictions since 1983 has dramatically curtailed this supply of capital within Irish co-ops, this quota regime is finally coming to an end in 2015.

New Zealand's milk supply has consistently grown by 2-3% per annum and also the share capital of Fonterra as a direct reflection of this growth.

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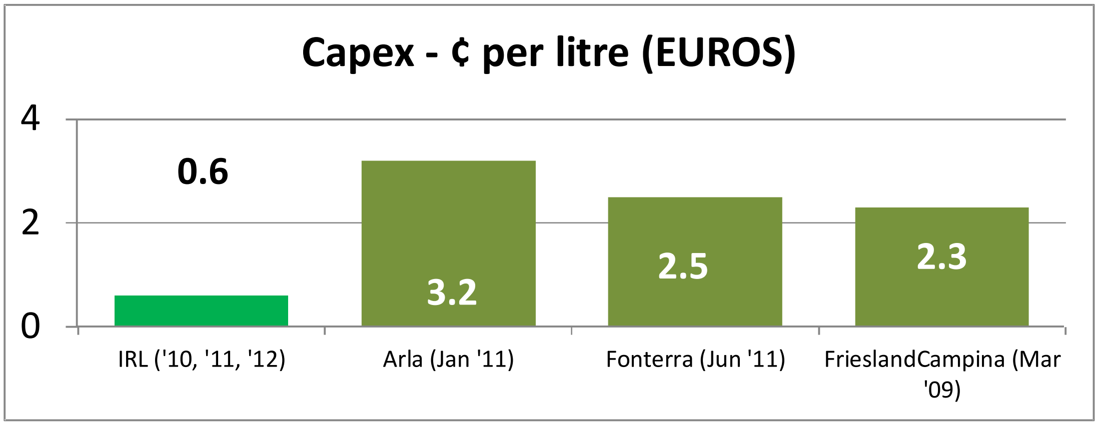
[28] (Source http://www.ica.coop/coop/principles.html)See appendix for co-op principles

[29] Source – Typical Shareholdings per litre of milk – from power point presentation delivered by Tom O Callaghan at ICOS Co-Op Leadership Training course 23/11/2011

"Capital structure must have – (a) mechanism to provide capital for growth and (b) an option for farmers to get capital out (redemption) without putting co-op balance sheet at risk". Quotation Sir Henry van der Hayden.

Dairy farmers have to understand that their co-operative needs to be adequately funded to be effective, a business that is starved of cash cannot succeed, it will be short of cash for reinvestment and research and development to drive innovation.



Source ICOS

Fig 11. Capex per litre. Table clearly shows that capital expenditure in Irish milk processors has been considerably lower than our international competitors.

The availability of capital is fundamental for the success of any business and co-operatives are no different, lack of capital investment will seriously undermine the ability of a co-op to operate effectively by not having funds available for investment in R&D, marketing and processing innovation and efficiencies.
Other forms of capital are bank borrowings, dividend yielding bonds issued to members and non members, and revolving loan structures.

6.3 Conclusion

- Ireland's co-op sector is under-capitalised.
- Members' capital tied up within the co-operative needs to directly reflect the volume of milk that an individual member trades with the co-operative.
- Ownership of the co-op needs to be held in the hands of active dairy suppliers, single purpose co-operatives, i.e. milk processing only, are more effective at pursuing efficiencies, as all members are focused on a maximum return on their milk.
- Clear redemption policies have to be adhered to when membership ceases in order to keep the organisation focused on active members needs.
- Valuation of shares at redemption needs to be clearly defined, some examples are Fonterra's fair value share (the value of the assets are reflected in the share value, thus portraying any appreciation or depreciation in value) or the more traditional € in € out which is more common in Ireland.[30]

[30] Note – € in € out reflects that the initial investment has not appreciated over time but the share ownership gives the shareholder dividend and voting rights for more information on capital structures in leading dairy co-operatives see appendix.

- We in Ireland could benefit from a fair value system of valuing co-op shares as it would focus membership mindset on growing value in their co-op, this would encourage efficiency amongst management to maximise returns from the business.

Chapter 7

Signals that Enhance Efficiency

7.1 Milk Price

There is a strong focus within Irish dairy farming on the price that is paid for milk, with considerable attention being paid to the annual milk price audit and monthly league tables. While the importance of the milk price is understandable, given the pressures on farm incomes, it can however inhibit longer term strategic planning for the industry as a whole. The dairy industry is critically dependent on its ability to produce products that are in demand and that are competitive on international markets. This requires continuous and significant investment aimed at improving the quality, attractiveness and value-added content of its products. It also requires an unrelenting focus on improving efficiency and productivity at every level of the production chain, from pasture to the product purchaser.[31] (Source Promar Report)

Irish dairy farmers are consumed by milk price and is often only compared to what our neighbouring co-operative is paying and "why are we not paying the same or not more". Setting milk price takes up considerable time at board level where milk price is set at monthly intervals and reflects on what the markets are returning in that particular month. This results in vulnerability for co-ops as the conversion of milk into cheese or powders is a longer timeframe process and many of these products may not be purchased until several months after the milk originally left the farm. This leads to high pressure on working capital at peak milk production and often the returns for dairy products may have changed considerably by the time the particular product finds a home, this is particularly true of cheese which by its nature needs time to mature.

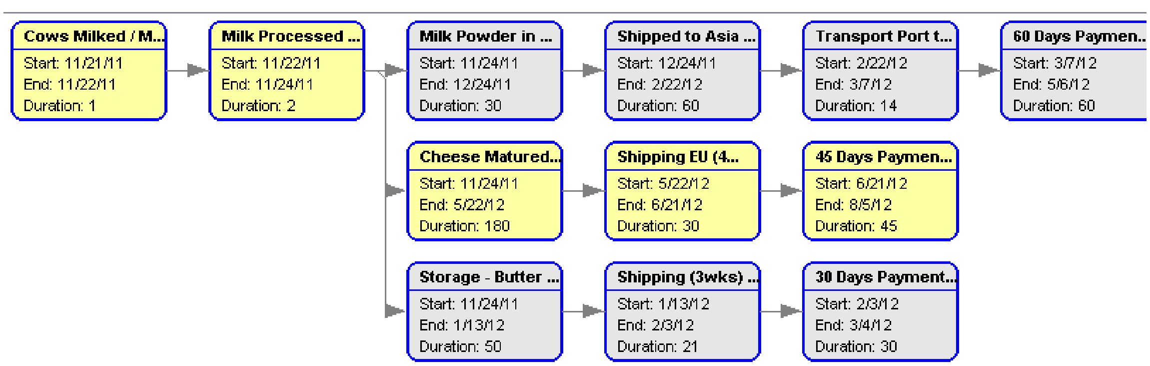


Fig 12. Processing Timescale - The chart outlines the timescale involved in different processes (Source ICOS)

7.2 International Milk Pricing Policy

Many of our international competitors have transparent pricing regimes in place for valuing milk, these are generally reviewed every three months and adjustments are made according to international trading conditions and returns from the markets. This can take considerable

[31] Promar Report Strategic Development Plan for the Irish Dairy Processing Sector Page 18

pressure off the co-ops working capital thus reducing the risk to the business. Supplementary payments can be made in the form of a 13th payment or a retro payment when the dust has settled on actual market returns.

Company	Fonterra		Warrnambool		Murray Goulburn	
Country	New Zealand		Australia		Australia	
Year	2010/11		2009/10		2010/11	
Total Paid / Year Target Price	$7.50		$2.45 Fat, $5.95 Protein		$5.50	
	$	% Target exc. Retro	$	% Target / Accruing	$	% Target Accruing
June (season start)	$ 4.30	57%	$2.06 F, $5.15P	86%		
July	$ 4.30	57%	$2.06 F, $5.15P	86%	$ 4.75	86%
August	$ 4.30	57%	$2.06 F, $5.15P	86%	$ 4.75	86%
September	$ 4.30	57%	$2.06 F, $5.15P	86%	$ 4.75	86%
October	$ 4.60	61%	$2.06 F, $5.15P	86%	$ 4.92	89%
November	$ 4.60	61%	$2.16 F, $5.35P	89%	$ 4.92	89%
December	$ 4.85	65%	$2.16 F, $5.35P	89%	$ 4.92	89%
January	$ 4.85	65%	$2.31 F, $5.65P	95%	$ 4.92	89%
February	$ 5.65	75%	$2.31 F, $5.65P	95%	$ 5.25	95%
March	$ 5.80	77%	$2.31 F, $5.65P	95%	$ 5.42	99%
April	$ 6.00	80%	$2.41 F, $5.85P	98%		
May (season end)	$ 6.20	83%	$2.41 F, $5.85P	98%		
June			$2.41 F, $5.85P	98%		
July retro payment	$ 6.40		$2.45 F, $5.95P	100%		
August retro payment	$ 6.75					
September retro payment	$ 7.15					
October retro payment	$ 7.50					

Fig 13. International dairy pricing mechanisms (Source ICOS)

7.3 Fonterra Milk Price

The Fonterra milk pricing policy is particularly interesting in that it fulfils two criteria (1) a market return on base commodities, this is established by the prices paid on Fonterra’s Global Dairy Trading Platform (GDT), costs of processing are established by deducting reasonable costs, such as what it would cost to ship raw milk to Fonterra’s factories, produce these same commodities in an efficient way, freight them to market and make an appropriate return on investment. These costs are subtracted from the GDT commodity prices and what is left over is what is paid to farmers as their farm gate milk price. (2) The value add piece – any value that is added to Fonterra’s milk by moving products up the value pyramid is paid to farmers in the form of dividends on shares.

Fonterra’s returns from value-add and consumer products reflect the result of significant investments in manufacturing capability and market development, which have been funded from capital invested over time by Fonterra’s shareholders. Returns on these investments are distributed as dividends on Fonterra’s shares. If value-add returns were instead distributed through a higher Milk Price, these returns would end up being paid on the basis of milk supplied rather than shares purchased, even though it is the share investment that generates the value add returns.[32] (Source Fonterra’s Milk Price – The Facts)

If we look at the Fonterra mechanism for valuing milk and ask what signals does it send to its farmer members, firstly it pays a farm gate milk price that directly reflects commodity markets by doing this it is reflective of a very competitive international trade and farmers clearly understand the market signals, this encourages efficiency at farm level, secondly it encourages

[32] Fonterra website milk pricing Questions and Answers

farmer members to finance their co-op through share ownership where this capital can be employed to add value to their produce and also this share ownership entitles members to benefit from dividends that reflect the performance of the business.

7.4 FrieslandCampina Milk Price

Friesland Campina's monthly milk price is guaranteed, based on the average of a basket of Europe's other top co-ops – for 2012 suppliers will achieve an average of approx 33 c/litre.

Friesland target is a 3% working profit on the performance of the business; this is equal to 2.5c/litre. The profit is divided in a number of ways. Half is retained for reinvestment in Friesland Campina in which the farmer is issued with new bonds for the same value. The remaining half is split again some being paid as a thirteenth payment on milk supplied and the reminder as a top up interest payment on previous bonds held.

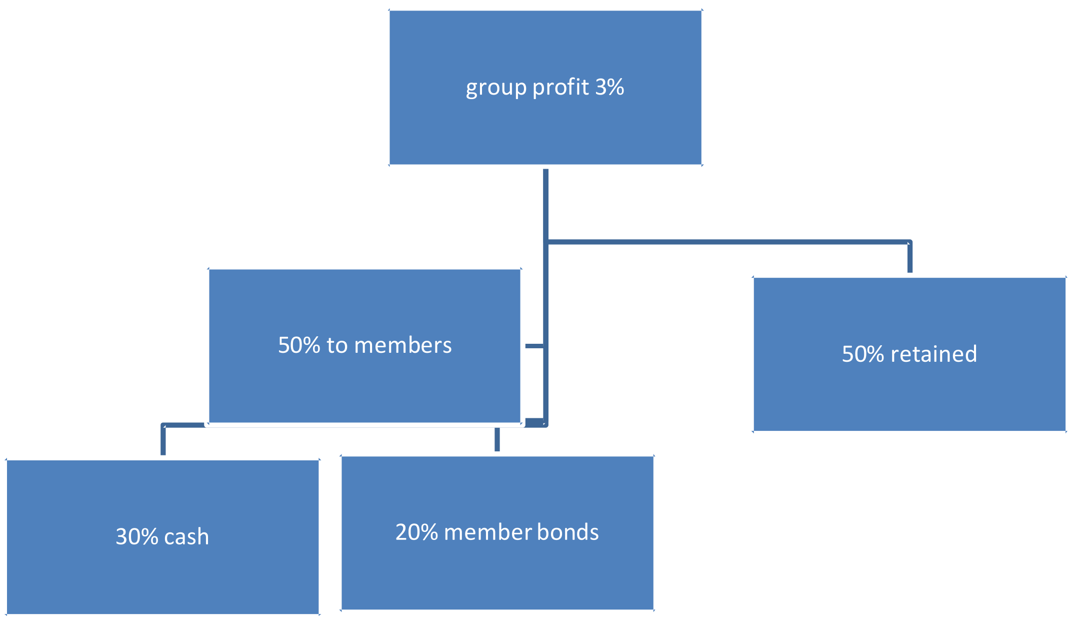


Fig 14. Allocation of Profit FrieslandCampina

The big advantage with this model is that it will grow the value of the business into the future for the next generation while paying members fairly for supply and loyalty along the way. The goodwill of the business continues.

This concentration by members on co-op performance will encourage efficiency and rationalisation at all levels of the the business it makes members "Challenging Stakeholders".

7.5 The Challenging Stakeholder

"*The flaw in co-operatives is that they sometimes lack a* ***challenging stakeholder*** *such as the case in a Plc (public listed company) for a co-op to be successful it requires a challenging stakeholder that sets a clear criteria affecting (a)profit policy (b)cash policy and (c)equity* *policy - farmer members need to be this challenging stakeholder".*[33] (Quotation Mr. Jim Bergin CEO Glanbia Ingredients Ireland)

What is the difference between Irish co-operatives and our international competitors, what has curtailed integration and rationalisation in our industry that has left our processors in a fragmented form lacking serious clout in the international market place. What was the mindset of Dutch, Danish and New Zealand dairy farmers that drove rationalisation in their industries.

In the course of researching this Nuffield Scholarship the author believes that it comes down to culture and the way Irish dairy farmers and co-op members view their co-operatives, there has been a disconnect between farmer suppliers and co-op management, this was fermented during the quota years when milk supply was capped and co-ops could only grow by diversifying away from core business, milk supplying members lost their feeling of ownership, we became disconnected from our milk as soon as it left our farms and furthermore co-op shareholdings became diluted by dry shareholders and inactive members.

Over the past 20 years the most successful food companies in Ireland have probably been Kerry Group Plc and Glanbia Plc, both companies were born out of co-ops that turned to outside investors for much needed capital to drive the business, this outside investor is the ***challenging stakeholder*** that was needed to create excellent corporate discipline that channelled the energies of the company to maintaining profit margins through constant innovation and ruthless reduction of costs, this led to high performance companies that return solid share capital appreciation and consistent dividends on equity. If a Plc fails to deliver on any of these criteria it will be punished by its stakeholders – share values will fall and management will soon be replaced by more competent executives – their careers and salaries are performance related.

Liam Herlihy Chairman of Glanbia Plc puts it this way *"You measure the success of a business in profit, a Plc is interested in profit only, a co-operative must focus on profit but must also focus on members needs, a co-op must have a sustainable profit margin to maintain banking covenants and build reserves that allow for sudden change such as currency fluctuation etc.. You need to clearly define individual business units and plan for specific profit on each unit, board meetings will analyse profit performance on a monthly basis and also compare to the same month last year, the board sets strategy and drives management to achieve results".*[34]

This pursuit of profit builds a culture within an organisation, a culture that is constantly looking to maximise profit and ruthlessly reduce costs, this is achieved through good corporate discipline and good corporate governance, a culture within the business of constant measurement and assessment.

Farmers in The Netherlands, Denmark and New Zealand understand this culture they have been and continue to be that "challenging stakeholder", farmers in these countries realise the benefits of bringing their co-ops together to achieve efficiencies through integration and the combined power of focused innovation and marketing.

[33] Interview conducted 20-11-2012 with Jim Bergin CEO Glanbia Ingredients Ireland
[34] Interview with Liam Herlihy Chairman Glanbia Plc conducted on 8-6-2012

7.3 Conclusion

Clear signals to members from the co-operative on where the profit is attained is essential, as milk price is the number one focus for members it is vital that the milk pricing mechanism displays where and how value add is achieved.

Performance related bonus payment for milk will incentivise members to encourage management to pursue efficiency within the organisation; it will clearly define the effectiveness of the board to set a successful strategy and encourage excellent corporate governance to drive management to achieve strategic objectives.

Farmer shareholders, elected representatives and board members of a co-operative need to establish a culture of excellence in corporate governance, a culture that delivers clear signals to management in relation to performance and to members in relation to sustainable profits on which the success of the business depends.

Performance related payments that are assigned to shareholding is the most transparent way for benefits to be shared amongst members therefore share ownership that directly reflects milk supply is critical.

It is of fundamental importance that the ownership of milk processing assets are concentrated in the hands of active dairy farmers and that investment is rewarded accordingly.

In the view of the author we in Ireland have to introduce mechanisms that separate the shareholdings within co-ops.

We have to separate dry and non active shareholders from milk supplying shareholders and award dividends in proportion to the performance of particular business units i.e. dry shareholder benefit from the returns from the agri-trading division plus any other activities the co-op carries out and dairy suppliers derive dividends from the milk processing sector of the business.

Chapter 8

Findings

8.1 The Seeds of Today

Ireland's dairy co-ops of today were born out of difficult circumstances in the nineteenth and early twentieth centuries when Ireland's dairy farmers were loosing market share in the UK to their more innovative and competitive counter parts in Holland and Denmark.

The early Irish dairy industry organised itself around localised geographic areas with small creameries established in many parishes around the country. This led to fiercely traditional and localised loyalty of members to their local "creamery", this mindset has curtailed rationalisation of the industry ever since, with traditionalists preferring "to go it alone" rather than explore merging with neighbouring co-ops to drive efficiencies. If effective rationalisation is to take place dairy farmers need to move away from short term localised thinking and gain a more national and international perspective on our industry.

8.2 Rationalisation and Integration

The Irish dairy industry has failed to rationalise effectively and has been left behind by its international competitors. This is leading to inefficiency in our processing sector with assets not being utilised to their maximum potential and duplication of processes across the industry. Research has shown that our primary competitors have one entity processing 80% of their respective countries milk pools, in Ireland we have 4 organisations processing 80% of our milk pool.

The dairy industry in Ireland has failed to integrate its research and development and marketing divisions, R&D is capital intensive and requires a consolidated approach to identify successful products.

Dairy marketing in Ireland is disjointed with the Irish Dairy Board handling 60% of product and the other 40% being offloaded by individual milk processors, this leads to competition and duplication in the market place.

8.3 Dependency on Basic Commodities

Through the stagnation of the milk quota period, Irelands dairy processors grew dependant on EU market supports that led to a concentration on basic commodities such as butter, skim milk powder, whole milk powder and cheddar cheese, we failed to innovate and build a product portfolio that was more aligned with consumer needs, we are now left with an over exposure to commodities and the volatility in the market that comes with global commodity trading.

8.4 Multipurpose Co-operatives

The dairy co-ops in Ireland today are generally multipurpose trading entities i.e. they engage in several different businesses such as milk processing, agri-trading, grain and feed milling etc, this format was born out of tradition and evolved further during the milk quota years as co-ops could not grow their milk pools. International best practice would suggest that a single purpose co-op is more successful as it can concentrate on core competencies with membership and management clearly focused on running the business to maximise the return on milk.

8.5 Shareholding

The fact that Irish dairy co-ops are generally multipurpose organisations has clouded ownership over the years with share registers carrying several different categories of owners, these include:

- Dry shareholders who trade with the co-op but do not supply milk, these shareholdings generally have voting rights and bare a dividend yield.
- Milk suppliers who depend on the co-op to process their milk and often times also trade for farm inputs, these shares also have voting rights and a dividend yield.
- Retired or non active farmers on share registers that have retained their shares but no longer trade with the organisation, these shares do not carry voting rights but do carry a dividend yield. This non active shareholder came about by co-ops not strictly implementing redemption of shares when farmers ceased trading.

The development of share ownership in this direction has led to a position where today there is roughly 70% of shares held by dry and non active shareholders and the remainder being held by milk suppliers.

8.6 Share ownership as a reflection of milk supplied

In researching this paper the author has come to the conclusion that the most successful dairy co-ops with a global marketing presence are generally single purpose milk processors that concentrate on maximising the value of members milk.

These organisations operate by sending clear and correct market signals to their milk suppliers through transparent milk pricing mechanisms that firstly reflect commodity prices and secondly reflect a “value-add” component that is paid separately to milk price.

The value add component is generally paid as a performance related payment to shareholders that reflects the profitability of the organisation, it is returned to members as a dividend on their shares and if a shareholding is reflective of milk supplied it represents a return for both milk supplied and share capital invested.

8.7 Irish Co-ops are undercapitalised

Irish Co-operatives typically have a shareholding per litre of milk supplied of 1-2 cent, their European counterparts generally have a shareholding of 3-16 cents per litre and co-ops in Australia and New Zealand can have up to 30 cents per litre of milk supplied.

This lack of capital in Irish co-ops has curtailed our ability to invest in R&D and technology that can add value to product and enhance efficiency.

8.8 Vision, Strategy and Corporate Governance

Irish co-ops have evolved into service providers processing milk and supplying farm inputs, for rationalisation to take place and for the Irish dairy industry to take its *"rightful place amongst world dairy companies"*,[35] we need to establish a clear vision of where and what we want to be.

We have to establish a clear strategy of how we are going to get there and we need to develop a culture of excellent corporate governance and corporate discipline to ensure that our core businesses operate to the best international standards maximising the returns for members milk.

[35] Quotation from Mr. Sean Malloy, Head Strategist with Glanbia Ingredients Ireland

Chapter 9

Recommendations

9.1 Culture Change

Irish co-operative milk processors have to be separated from the traditional multi purpose type organisations that have evolved in this country and become single purpose entities that concentrate on adding value to milk. At least 80% of the processing assets need to be transferred into a single organisation that will control the vast majority of the Irish milk pool and ownership of this new entity has to be concentrated in the hands of dairy farmers, this will be difficult to achieve as currently 70% of the ownership of co-op assets is held by non milk supplying shareholders, to achieve this outcome this report recommends the following:

- Revalue the milk processing assets of co-ops separately from other assets and establish a defined share class for each of these asset types. (This will require open and transparent valuation and will be carried out by independent agencies).
- Apportion shares in the milk processor to dairy suppliers and apportion shares in agri-trading and all other assets to dry shareholders.
- As dairy processing in Ireland requires significant investment to deal with a growing milk pool and assuming that dry shareholders do not wish to invest in this sector will act as a catalyst for this share transfer.
- Any differential in valuations needs to be addressed by cash transfers.
- All milk suppliers must have a shareholding reflective of milk supply e.g. 1 share per 100 litres of milk.
- Milk suppliers need to understand that their shares are a delivery right to have their milk processed and marketed, but also a share acts as a dividend right and enables the co-op member to share in the profits of the organisation.

Responsibility for implementing this recommendation lies with individual dairy co-ops, ICOS and the farm organisations IFA and ICMSA[36], these organisations need to create a culture where milk processing is established as a singular asset.

9.2 Business Performance Payments

Milk pricing is the clearest interface between milk suppliers and management and thus needs to be transparent:

- It has to send clear signals to farmers on commodity returns from the global market and also pay a performance related dividend on shares (after retentions and additions to co-op reserves) that reflects the value add that management has achieved through innovation and efficiency.
- This performance dividend is distributed fairly if share holdings reflect milk supply.

[36] IFA = Irish Farmers Association and ICMSA = Irish Creamery Milk Suppliers Association

- Transparent milk pricing and dividends related to profit keeps both membership and management focused on achieving the maximum performance from the business.
- Management should be incentivised to achieve high performance from the business with bonuses reflecting the profit of the organisation.

Responsibility for implementing this recommendation lies with individual dairy co-ops, ICOS, farm organisations IFA and ICMSA and also Teagasc where the transition to transparent milk pricing could be communicated to farmers through discussion groups.

9.3 Share Redemption

Redemption of shares when a member ceases trading is necessary to keep shareholding in the hands of active dairy farmers.

- Redemption can be carried out at board discretion to reflect the risks to the businesses balance sheet i.e. the board may decide to leave a retired farmer redeem their shares over a set period of 5-10 years and a new milk supplier to buy shares over 2-4 years.
- Establish a fair value for shares that reflects the appreciation or depreciation of the assets over the time period of a supplier's membership, this valuation will be carried out by an independent agency; a retiring member sells their shares to a new member thus reducing the risk to the company.
- Reason for allowing a fair value for shares is that it encourages a culture amongst members and management of maximising value from the business.
- If a member wishes to grow their milk supply new shares are issued to reflect volume.

Responsibility for implementing this recommendation lies with individual dairy co-ops and ICOS.

9.4 Co-operative Education

Education programmes need to be established to reinvigorate and reconnect grass roots farmers with their co-ops.

- These programmes should encompass how the co-op business model works and how it differs from investor type businesses.
- Education programmes for elected representatives must be more intensive and elected members should be voluntarily required to complete a set number of individual training courses over each term of service.
- Points awarded on completion of education modules for elected representatives with a minimum amount of points required for an individual to be eligible to contest a seat at council or board level of the representative structure.
- The co-operatives in conjunction with Macra Na Feirme[37] should establish shadow boards that would be populated by enthusiastic young farmers. These shadow boards could interface with co-op boards to learn about their industry and also feed information up the line to senior board members. This would encourage involvement from a young age.

[37] Macra Na Feirme = Young Farmers Organisation

Responsibility for implementing this recommendation lies with individual dairy co-ops ICOS, Macra Na Feirme, Teagasc and the national agricultural media such as the Farmers Journal and Farming Independent. The programmes aimed at grassroots members can be delivered through the discussion group format in conjunction with Teagasc. Representation education could take place in central locations where larger groups from neighbouring co-ops could come together thus building relationships between perspective future board members.

9.5 Constant Evolution

For a co-operative to be successful there is a need for constant evolution of structures within the organisation, constitutional rules that are more reflective of bygone times need to be adapted to a more modern society that reflects better communication and connectivity.

- Constitutional rule changes that require membership approval (SGMs) should be carried out at regional vote centres thus reducing members need to travel to a central location.
- Local representation links should be broken at Regional Advisory Committee Level for perspective candidates to progress to Council level and on to potential board seats, candidates should seek the approval of their peers on regional advisory committees through democratic procedures, eligibility for election would depend on completion of necessary educational modules and effectiveness on advisory committees. This would allow capable people rise through the organisation faster.
- Sub committees gathered from council members need to be established to investigate international co-operative evolution and advise on the implementation of international best practice their findings should be made available to all members of the co-operative.

Responsibility for implementing this recommendation lies with individual dairy co-ops and ICOS.

9.6 Encourage Excellence

For our industry to succeed we have to encourage excellence at all organisational levels from grass roots membership through representation structures on to board level who will focus on managements capability and delivery of optimum business performance.

- This excellence can be delivered through constant education and the evolution of our co-operatives to adapt to a way of doing business that can survive and thrive in the 21st Century.
- Transparent easily understood signals reflecting market realities and business performance will encourage a culture that questions how and why things are done in a certain manner and can we improve upon them, it will create a culture of constantly wanting to improve performance and looking for opportunities to create value.

Responsibility for delivering excellence lies with the membership of the co-operative.

“If you want to go quickly, go alone, if you want to go far, go together”, (African proverb)

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27 (Source http://www.ica.coop/coop/principles.html)See appendix for co-op principles
28 Source – Typical Shareholdings per litre of milk – from power point presentation delivered by Tom O Callaghan at ICOS Co-Op Leadership Training course 23/11/2011

30 Promar Report Strategic Development Plan for the Irish Dairy Processing Sector Page 18

31 Fonterra website milk pricing Questions and Answers

32 Interview conducted 20-11-2012 with Jim Bergin CEO Glanbia Ingredients Ireland
33 Interview with Liam Herlihy Chairman Glanbia Plc conducted on 8-6-2012

Appendix

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1.1 Co-operative Origins

In 1844, toward the end of the Industrial Revolution a group of 28 weavers in the industrial town of Rochdale, England, established a small cooperatively owned store that sold a few necessities and later entire shelves of weavers supplies, food and agricultural products. Spurred on by having being relieved of their jobs by their local manufacturing company and after an unsuccessful strike, the 28 weavers pooled 140 British pounds and began purchasing oatmeal, sugar, butter and flour. They codified their experience in the "Rochdale Principles of Cooperation" that have been amended over time and are now the "Principles of the International Cooperative Alliance (ICA)"[38].

1.2 Co-operative Principles

The co-operative principles are guidelines by which co-operatives put their values into practice.

1st Principle: Voluntary and Open Membership

[38] (Source The Cooperative Movement – Globalization from Below, by Richard C.Williams. History and Theory of the Cooperative Movement – page 10)

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2nd Principle: Democratic Member Control

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner.

3rd Principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4th Principle: Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter to agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5th Principle: Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation.

6th Principle: Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures.

7th Principle: Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.[39]

1.3 History of Irelands Cooperative Movement

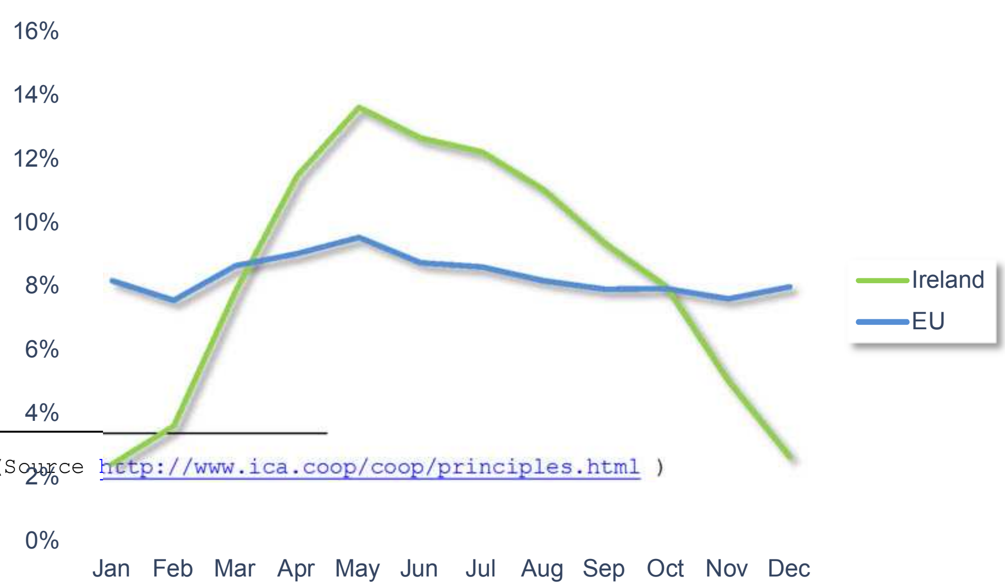
The founding father of the Irish cooperative movement was Sir Horace Plunkett, born in 1854 in County Meath, he was the third son of the 16th Lord Dunsany. Following his education at Eton and Oxford, Plunkett moved to the USA in 1879 and spent ten years ranching in Wyoming. Sir Horace was a member of the Anglo-Irish aristocracy, a member of the British Parliament, he became interested in the cooperative movement and was influenced by the utopian and cooperative ideals of Robert Owen an industrialist who had experimented with industrial cooperatives in England. Sir Horace realised that the competition from more efficient dairy producers from Denmark and Holland had greatly diminished the return that Irish farmers were getting from the sale of butter mainly into the British market.

Sir Horace Plunkett realised that the Irish dairy sector had to modernise to compete with its European counterparts so he travelled the country spreading the revolutionary message of the benefits of cooperation at farmers meetings etc, to a mainly conservative audience and against the traditionalist and often hostile private milk merchants, shopkeepers and traders.

Sir Horace wanted Irish farmers to band together and process their milk in a modern efficient manner and market their produce collectively thus removing the middle man who often took large margins for themselves.

Adopting the Danish Co-operative Model, the Irish Agricultural Organisation Society Ltd. (later renamed Irish Co-operative Organisation Society Limited (ICOS)), was formed by Sir. Horace Plunkett and his friends in 1894. The Irish Co-operative Organisation Society (ICOS) is a co-operative umbrella organisation that serves and promotes commercial co-operative businesses and enterprise, across multiple sections of the Irish economy.

1.4 Seasonality and how it effects efficiency



[39] (Source http://www.ica.coop/coop/principles.html)

Irelands milk production curve versus EU average (Source ICOS)

Milk plants in Ireland are often operating below maximum efficiency due to the seasonality of our milk supply curve, this adds extensive costs due to plants operating during the shoulder periods of the milk season when there is excess capacity in the system.

However Ireland's competitive advantage is based on the fact that it can produce milk cost effectively from grass, to do this, Irelands milk production profile follows the grass growing season, the majority of Irish dairy cows calve in the period between late January and early April, this leads to a production supply curve which is considerably different to our competitors. The Irish production peak occurs between the months of April to June, this means that our processing plants are operating at maximum capacity for this period only and throughput drops off as the year progresses, this leads to inefficiency in plant utilization and also reduces our ability to produce product for the more lucrative fresh retail market which requires all year round milk production – our competitors in Europe achieve all year round production by calving cows throughout the year leading to a flat milk production profile. However our comparative advantage of producing milk off of grass should not be underestimated, it supplies a relatively cheaper source of raw material and a very high quality product which has natural advantages for marketing and our ability to supply a sustainable product.

1.5 Kerry Group Strategy

The Discipline of Formal Strategic Planning: Clarity and Purpose

It is not unusual for many business enterprises to pay lip service to the idea of serious strategic planning. Targets may be arbitrarily set by upper management, with lower levels of the organization consigned to retrofitting action plans to attain "the number". In others it is an informal process, limited to the very few, who, "by the seat of their pants" develop a general direction of where they think the organisation is going. At Kerry Group however the process of strategic planning is formal, rigorous, participatory and dead serious. One should particularly emphasise that it is in fact an ongoing process, not a discrete, spasmodic activity that rears its head once a year, is grudgingly addressed and promptly put in the drawer until the following year. It is a central organising principle of the Kerry enterprise, a lynchpin in its growth and development and a prime mechanism in its execution of programs, its integration of acquisitions and its overall conduct in business.[40]

Kerry Group, initially Kerry Co-operative started processing milk in Listowel County Kerry in 1972 and from those humble beginnings has built a multinational food ingredients business, with total revenues 2011 of €5.3bn and an EBITA of €601m, Kerry Group which is listed on both the Irish and London Stock Exchanges has a market capitalisation of €6bn, it has created enormous wealth for shareholders in Kerry and further afield. Due to restrictions on capital and also milk supply Kerry Co-op decided to go the PLC route in 1986 and took in outside investors in exchange for a share in the company, it is a high growth strategy that

[40] Extract from The Kerry Way, page 420, The Kerry Way – The History of Kerry Group 1972-2000, by James J. Kennelly

sometimes pushed the resources of Kerry Group to the limit but in the long term has served shareholders well.

Companies that have risen to global leadership over the past 20 years invariably began with ambitions out of proportion to their resources and capabilities. This concept, fundamentally different from that which underpins Western management thought, is "strategic intent". These organisations begin with a goal that exceeds their present grasp and existing resources. Then they rally the organisation to close the gap by setting challenges that focus employees efforts in the near to medium term. Year after year, they emphasise competitive innovation: building a portfolio of competitive advantages, searching markets for "loose bricks" that rivals have left under-defended, changing the terms of competitive engagement to avoid playing by the leaders rules. The result is a global leadership position and an approach to competition that has reduced larger, stronger western rivals to an endless game of catch-up ball.[41]

1.6 Fonterra Strategy

An integral part of Fonterra's strategy is to concentrate on constantly taking costs out of the system to maintain Fonterra's position a "*lowest cost sustainable co-operative in the world*" management can achieve this by integrating process's such as "lean manufacturing"[42] and constantly reviewing procedures within the processing division of the business, however this strategy has to initially be outlined by the governors of the co-op and strictly implemented by management.

1.7 Arla Strategy

Whey protein

"We aim to double sales of powdered whey protein and become global market leader by 2015. "*

Why focus on whey protein?
Extracting protein from whey – the product left over from cheese production – is good business. ... added value protein products from Arla Foods Ingredients are included in ice cream, yogurt, infant formula, dietary supplements and many other food products across the world.

How will the targets be achieved?
The key is to improve access to whey because without the raw material we will fail to exploit the huge potential in the markets. One of Arla Foods Ingredients' tasks is to focus on the United States, the world's largest whey protein market, and the aim is to establish local production before 2015. Arla Foods Ingredients, however, wants to access more whey in

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[41] The Kerry Way page 421-422, The History of Kerry Group 1972-2000 James J. Kennelly – particular passage extracted from Gary Hamel and C.K. Prahalad (1989) "Strategic Intent" Harvard Business Review, May/June 1989 page 63

[42] **Lean manufacturing** From Wikipedia, the free encyclopedia

Lean manufacturing, **lean enterprise**, or **lean production**, often simply, "**Lean**," is a production practice that considers the expenditure of resources for any goal other than the creation of value for the end customer to be wasteful, and thus a target for elimination. Working from the perspective of the customer who consumes a product or service, "value" is defined as any action or process that a customer would be willing to pay for.

Europe and more partnerships are expected along the lines of those already in existence in Norway and France.

Arla's strategy is clear and focused on extracting maximum value from whey, this strategy is pushing Arla away from basic commodities and adding value through supplying highly concentrated whey proteins to the fast expanding processed foods sector, whey products are highly valued by food formulators for a wide range of functional benefits including the improvement of texture and flavour of foods, they also contribute to the nutritional values, contributing high quality proteins that are easily digestible and also a good source of calcium, vitamins and minerals.

1.8 Examples of Co-op Capital Structures

FrieslandCampina

Number of members 14,391

- Milk supply to increase by 20% after 2015
- F/C committed to buy all members milk
- All suppliers must be members
- Shareholding is held in the form of bonds (interest rate about 4%)
- Each year, 20% of profit is allocated to members in proportion to their milk supply, in the form of bonds
- New entrants pay an non refundable "entrance fee" of 4c/litre
- Expanding members do not have to pay for more equity/bonds
- Membership stops when milk supply ceases
- Retired members can sell or keep the bonds they have built up
- The price of the bonds is the nominal value (plus interest)
- Other members can buy the bonds, and Rabobank buys if no other buyer
- Suppliers who transfer to another Co-Op must sell their bonds
- Suppliers who transfer to another Co-Op receive a departing payment from FrieslandCampina of 5c/litre, a condition imposed by the EU to assist competition.

Each year the members' equity (fixed member bonds) is increased from the distribution of profits at the year end. Members receive 20% of the profit, which is allocated pro-rata to milk supply, and get this in the form of fixed member bonds. This distribution of profits is in addition to the 30% of profits which is paid out to dairy farmers as a performance bonus on milk. At the end of 2011 the total equity was €2,264m, of which €1,003m is member bonds, €591m retained earnings and €370m issued capital. [43]

Fonterra
Number of members - 10,500

[43] International Co-Op Members Capital Funding pages 2-3 courtesy of Jim Woulfe CEO Dairygold

- All milk suppliers must be members and shareholders, and as soon as they cease to supply, their membership ceases.
- Each farmer has a very large capital stake in Fonterra, on average currently valued at over €200,000.
- This capital cost was up to 50% higher in the past, but share values have fallen.
- New entrants have to pay for capital up-front (currently at about 20c/litre) on their annual supply. This is usually built into the land price when a dairy farm changes hands.
- Expanding suppliers also have to buy additional shares at the going share price
- Shares are valued each year depending on the performance of Fonterra.
- There is a dividend on shares, which reflects the Value Add (performance)

Shareholding is in direct proportion to milk supply, at the rate of 1 share per kg Milk Solids i.e. 11.8 litres @ 4.73% fat and 3.75% protein, the NZ average (or 14 litres @ 3.6% fat and 3.3% protein - Irish milk). This is called the Share Standard.
New and expanding suppliers are required to purchase the additional shares to bring them up to the Share Standard of their planned production in the season ahead.
Suppliers who cease supplying Fonterra (through retirement or transfer to another processor) must dispose of their shareholding,
Trading Among Farmers (TAF) is a new system whereby farmers who need to buy or sell shares will do so through the Fonterra Share Trading system. This has the advantage of removing the "Redemption Risk" for Fonterra, in that it will then not be obliged to buy back shares if supply falls. This issue has been the subject of intense debate for the past number of years.[44]

Dairy Farmers of America
Number of members: 16,000 voting members on 9,300 farms

- All milk suppliers are required to become shareholders.
- There is a target share capital base of 4 US cents/litre.
- This capital target can be build up by deduction from the milk cheque over a 10-15 year period.
- When farmers retire, membership ceases immediately, but their shares are redeemed in stages over 10 years, subject to Board approval.

Currently the targeted base capital level for members of DFA is $1.75 per hundredweight (or 3.2 euro cents/litre). To arrive at the base capital rate, DFA uses a member's base capital account balance and divides that by their average milk production for the two prior years. Capital accounts with DFA are redeemed at the sole discretion of the Board of Directors. Currently, DFA's capital plan states 10 years from the last active year on the accounts is when the account is anticipated to be paid in full. Membership ceases when the member stops supplying milk.
Milk output in the US is expected to increase by 2.4% in 2012.[45]

[44] International Co-Op Members Capital Funding pages 6-7 courtesy of Jim Woulfe CEO Dairygold
[45] International Co-Op Members Capital Funding pages 10-11 courtesy of Jim Woulfe CEO Dairygold

1.9 FrieslandCampina Structures

Milk price
The milk price FrieslandCampina pays its member dairy farmers annually, consists of the guaranteed price, the annual performance payment and registered reserves (issue of fixed member bonds).
Explanation of milk price system

Issue of fixed member bonds (registered reserves)
The amount of the registered reserves depends on the result of FrieslandCampina and the retained earnings policy. With effect from the 2011 financial year, FrieslandCampina sets aside 20% of the result in the form of fixed member bonds. This amount is paid out annually following the adoption of the annual financial statements pro rata to the value of the milk supplied.

Corporate governance

Basic principles
Royal FrieslandCampina N.V. (the 'Company') voluntarily applies the principles of the Dutch Corporate Governance Code (the 'Code'). The manner in which these principles are applied is described below. The principles of the Code that the Company does not apply, and the reasons why, are also described. Zuivelcoöperatie FrieslandCampina U.A. (the 'Cooperative') is exempted from applying the statutory two-tier rules ("structuurregime"). The Company is a statutory two-tier company. A covenant has been agreed with the Central Works Council (the 'CWC') under which the members of the Company's Supervisory Board (the 'Supervisory Board') are appointed using a co-option system by the Supervisory Board.

Shareholders structure
All the shares in the Company's capital are held by the Cooperative, the members of which are involved in dairy farming or the acquisition, processing or sale of milk. The Cooperative's geographical area of operations is divided into 21 districts, each of which has a District Council. The Cooperative's members appoint the Boards of the 21 districts. Together the 210 members of the District Councils form the Members' Council of the Cooperative. The Members' Council appoints the nine members of the Cooperative Board on the recommendation of the Cooperative Council. The Cooperative is the sole shareholder of the Company. The Cooperative Board exercises the Cooperative's shareholders' rights and in this capacity functions as the General meeting of Shareholders of the Company. There are a number of decisions regarding which, on the grounds of the Company's Articles of Association, the Company's Executive Board (the 'Executive Board') must obtain the approval of the General Meeting of Shareholders. For a number of the decisions for which the Cooperative Board votes on behalf of the Cooperative, the Cooperative Board must obtain the approval of the Members' Council before casting its vote. Such approval from the Members' Council is also applicable for a number of other major decisions of the Company's General Meeting of Shareholders.

Board structure
The Company has a so-called two-tier structure with a management board (the Executive Board) and a Supervisory Board. The Executive Board comprises six members:

- a Chief Executive Officer (CEO)
- a Chief Financial Officer (CFO)
- four Chief Operating Officers (COOs)

Each COO is responsible for one of the business groups. The Executive Board's composition and division of tasks is explained here.

The Supervisory Board comprises thirteen members: the nine members of the Co-operative Board plus four 'external' members. The Supervisory Board's composition can be found here.

Supervisory Board Committees

The Supervisory Board has formed two committees: the Audit Committee, which comprises four Supervisory Board members, and the Remuneration & Appointment Committee, which comprises three Supervisory Board members. The composition of the Supervisory Board's committees can be found here.

Report of the Supervisory Board

The topics covered in the Report of the Supervisory Board include the activities of the Supervisory Board and its committees during the year under review. This report can be downloaded via this link.

Shareholders structure

All the shares in the Company's capital are held by the Cooperative, the members of which are involved in dairy farming or the acquisition, processing or sale of milk. The Cooperative's geographical area of operations is divided into 21 districts, each of which has a District Council. The Cooperative's members appoint the Boards of the 21 districts. Together the 210 members of the District Councils form the Members' Council of the Cooperative. The Members' Council appoints the nine members of the Cooperative Board on the recommendation of the Cooperative Council. The Cooperative is the sole shareholder of the Company. The Cooperative Board exercises the Cooperative's shareholders' rights and in this capacity functions as the General meeting of Shareholders of the Company. There are a number of decisions regarding which, on the grounds of the Company's Articles of Association, the Company's Executive Board (the 'Executive Board') must obtain the approval of the General Meeting of Shareholders. For a number of the decisions for which the Cooperative Board votes on behalf of the Cooperative, the Cooperative Board must obtain the approval of the Members' Council before casting its vote. Such approval from the Members' Council is also applicable for a number of other major decisions of the Company's General Meeting of Shareholders.

(Source)
http://www.frieslandcampina.com/english/financial/milkprice.aspx?activetab=2#tabs

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List of Interviewees

Pat MacLoughlin ICOS 30-5-2011

Tom O Callaghan ICOS 30-5-2011 (Several interviews over the research period)

Bram Prins (Netherlands) 30-6-2011

Jan Willem Straatsma (FrieslandCampina) 30-6-2011

Frans Keurentjes (FrieslandCampina) 3-7-2011

Michael Treacy (IFA Brussels) 5-7-2011

Conor Mulvihill ICOS (Brussels) 5-7-2011

Katy Loe Copa Cogeca (Brussels) 7-7-2011

Sir Henry van der Hayden (Fonterra New Zealand) 5-9-2011 / 2-10-2012

Liam Herlihy (Glanbia – several interviews over research period)

Kevin Twomey (Discussion Groups of Ireland) several interviews over research period.

TJ Flanagan ICOS 23-11-2011 (several interviews over research period)

Denis Brosnan Kerry Group (Retired) 1-12-2011

John O Brien (Barryroe Co-op) 1-2-2012

Dan MacSweeney CEO Carberry 1-2-2012

Derry Connolly Chairman Carberry 1-2-2012

Professor Paul Ross (Moorepark Research Centre) 13-2-2012

Andy MacFarlane 6-3-2012

Jack Kennedy (Irish Farmers Journal) 5-4-2012

Padraig Walshe 6-6-2012

Sean Malloy Glanbia (several interviews over research period)

Eddie Glass New Zealand 26-9-2012

Willie Leferink New Zealand 27-9-2012

Desiree Reid New Zealand 27-9-2012

John Roadley New Zealand 29-9-2012

Trina Dunning LIC New Zealand 1-10-2012

Lynn Medich Rockwell Software New Zealand 1-10-2012

Joanne Bills Dairy Australia 8-10-2012

Robert Poole Murray Goulburn Australia 8-10-2012

Brendon Smart Nuffield Australia 15-10-2012

Jim Geltch Nuffield Australia 16-10-2012

Terry Hehir Organic Dairy Farmers of Australia 18-10-2012

Mike Hedditch Sun Rice Australia 19-10-2012

Jim Bergin Glanbia 20-11-2012

Dr Michael Keane UCC 11-12-2012

Dr Pat Enright UCC 11-12-2012

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