Co-operatives require a Farmers' Fixit

In the wake of the Brexit vote, the New York Times succinctly observed:

"The lasting damage may be to old ways of thinking"

Old ways of thinking are causing untold damage to the fortunes of farmers, let alone NZ's.

Addressing NZ's prospects for potential growth the IMF in February warned that while NZ has world class institutions and a strong policy framework, our income levels remain low relative to OECD peers.

Shockingly so; based on structural policy settings, NZ's per capita income should be 20% above the OECD average, not 20% below.

Houston, we have a problem.

Faced with these problems in the past at the macro level NZ undertook fundamental structural reform to transform our prospects.

Now we have a business level problem.

The primary sector is the core of our economy and drives 70% of our export wealth.

So in the search for solutions to our sub-par performance it pays to start with the biggest players – our agri-businesses.

The business structure that dominates the primary sector is the co-operative.

Much akin to the State-Owned Enterprise model, business performance of the co-ops is subservient to the dictates of the ownership, capital is constrained and the governance regime suffers from politics at the expense of professionalism.

Both models sell NZ short.

In an effort to have some of the bigger remaining SOE's lift their game the mixed-ownership model was deployed to immediate and evident success.

Now it is the turn of co-ops.

It is not the government that must ride to the rescue, it is the farmer owners.

There is widespread recognition of what success looks like – agricultural enterprises driving up the value chain capturing higher returns for farmers through what I term 'premium plays'.

The trouble is that the structural features of co-ops work against such an outcome.

The incentives are all wrong.

The Board must pay primary homage to the owners with price to suppliers trumping all other business drivers.

Available capital for backing a high value play is constrained in two ways.

The first call on free cash flow is to bulk up the price paid to suppliers, and in turn suppliers, while shunning external capital, are reluctant to fund new endeavours.

All this is compounded by a governance regime where director tenure and dominance is a function of farmer politics.

It is a self-defeating dynamic.

The very things that will drive more value for farmers are smarter governance, access to more capital and commitment to business strategies that shape lucrative markets and deploy the superb provenance of the land in the highest margin categories.

The calls to action are growing louder.

The Secretary of the Treasury in official-speak observes - "co-operatives are typically less transparent in performance reporting; owners are more motivated by growing the value of their own business than providing for the growth of the co-operative; usual market disciplines faced by conventionally structured entities tend to be less visible and effective for co-operatives; and governance is also often less transparent and more challenging"

Ouch.

The Chairman of the Productivity Commission, himself a past CEO of MPI, echoes the charge of governance, capital and ownership constraints with the co-operative model.

And last month Stephen Jennings, with strong NZ reform and global business credentials, called for a "comprehensive review of the ownership and governance arrangements for the processing and marketing arms of our primary industries. In too many instances, including the dairy industry, the incentives for world-class performance and innovation simply aren't strong enough".

It is time for farmers to address the case for co-operative Fixit.

So, what's it going to take?

Statistics showing superior performance in different business models might carry the day, but I doubt it, so deeply ingrained is the co-op culture.

External shocks, of which there are plenty, might force a re-think, but force - fed reform is hard to swallow, let alone stick.

Banks, pressing for remedies to business failure, can effect change but this is seen as a bitter pill.

I have worked for and with farmers all my public and private career and for my money the remedy must come from within.

Farmers must champion the co-op reform cause.

I can't help reaching for a Harvard Business review article at the turn of the century by Gary Hamel entitled "Waking Up IBM – How a Gang of Unlikely Rebels Transformed Big Blue"

The introduction reads "Six years ago (1994) IBM was a has-been. Today it is an e-business powerhouse. It didn't turn around by imposing change from the top. It let ideas, initiatives, and enthusiasm bubble up from below. Maybe your company should do the same."

Hamel advocates seven steps for organising a corporate insurrection.

I readily confess to change agent DNA, and with an evident appetite for Hamel's approach let me take those seven steps and apply them to co-op transformation.

Step one – establish a point of view.

It must be credible – co-ops are underperforming; it must be coherent – make the logical case for governance, capital and ownership change; it must be compelling – emotionally farmers can better tell their story to win premium customers, an approach denied by the 'one for all, all for one' modus operandi of the co-op; it must be commercial – a clear link to an improved bottom line by moving beyond the co-op.

Step two – write a manifesto.

To be a successful pioneer (and there are some notable examples already in agri-business) the imagination of farmers must be captured by the vision of a high margin, high value future for their precious agricultural provenance.

Step three – create a coalition.

I along with 350 other agri-business operators and officials took part in the Te Hono Bootcamp at Mystery Creek earlier this year. This movement was spawned by the succession of Stanford Bootcamps, a collaboration involving all the key agri-business players from Minister to the major agricultural companies.

In the Bootcamp movement we have a ready-made coalition.

Step four – pick your targets.

The movement has to get the blessing of the 'suits'.

Independent directors of co-ops, ambitious CEO's facing constraints, farming leaders who in the past have championed game changing reform all combine to constitute credible crusaders who can best win over the reform resisters.

Step five – Co-opt and neutralise.

Using the design thinking approach deployed by the d-school at Stanford – empathise, define, ideate, prototype and test together, solutions can be owned by all parties. Win/win has to be the modus operandi.

Step six- find a translator.

Build a bridge to the people with co-op power – deploy people with demonstrable business credentials who are steeped in agri-business and who bring acumen and compelling advocacy to the table.

Step seven – Win small, win early, win often

Ideas have to be shown to work.

The mixed ownership model has worked for SOE's.

Half-hearted governance reform has not worked for Fonterra.

The good news is that the co-ops have started to wake up with many now embarking on reform to varying degrees.

Three strategies are in evident play; clean the house, hybrid and the whole hog.

Clean the house seems to be the preferred strategy for the biggest co-operative player - Fonterra. The trouble is they are caught in a vicious cycle of chasing their milk price tail, building stainless steel for commodity processing and starved of the capital necessary to take them up the value chain. More worryingly there seems to be a disconnect between their strategic intent (what they say,) their strategic action (what they do) and their culture famously described by the Independent Inquiry as feeding into an adverse "Fortress Fonterra" perception.

The hybrid approach adopted by Silver Fern Farms, albeit forced by initially by their bankers but voted through by shareholders, involves a plan where the co-op is maintained for 'rations' through its 50% shareholding, but not for business 'duty' which is undertaken by a more classically constructed JV company and Board.

LIC has embarked on a variation of the hybrid theme with the core supplier services to be held in the co-op, but the innovative ag tech play to be spun off into a vehicle open to external capital and expertise.

The whole hog approach is that pursued by two companies of which I am a director – Synlait Milk Ltd a listed company, and the NZ Merino Company Limited, a private entity with shares held by growers and management. Both elected to leave their respective co-ops and both, not by coincidence, are premium plays that innovate in product, supplier and customer strategies.

All the while the clock is ticking.

Tempting as it is to settle for the comfort of an incremental approach, how we lift performance now and win in the future matters most.

Clean the house won't cut it any more.

It is time for what the Founders of Google term "moonshot thinking" if we are to gain and maintain control of our destiny.

Why not try for more A2 successes- a differentiated high value play accessing growth capital from the public markets.

Why not take the Tatua model of chosen suppliers dedicated to a high value food service niche, demutualise and replicate through the dairy provinces with their own distinctive provenance?

Why not spin out and commercialise a radical innovation play from the Fonterra mothership?

And yes there is one role for the government – to sort the regulatory regime for milk that is weighted in favour of the protected dominant at the expense of the start-up.

The major hurdle to embracing a new business model capable of unleashing new market and margin dynamic is the reflex farmer reaction to reject anything that can be represented as a loss of control.

The control myth needs to be de-bunked.

As the predicament of Silver Fern Farms shows the ultimate loss of control stems from the failure of business performance.

Control of an enterprise with compromised governance, control but starved of capital, and most damagingly control that shuts down the drive for innovation is counter-productive control.

'Control' that matters comes from advancing a business model that can shape markets, that can create and capture high margin, and that can allow producers to tell their story directly in the authentic fashion that modern consumers demand and value.

It's time for farmers to embrace new ways of thinking.

New fuel is needed in the tank of our agri-businesses, better returns call for better business models, and in doing a favour to farmer's pockets the nation will be done a favour as well.

"Every kilo, always a premium" – there's a Fixit cause worth fighting for.

Ruth Richardson

August 2016