'Short-term' plan panned

PHIL WHYTE

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

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

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

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

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

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

"It seems clear to me they… overlook the longer term collective interests of milk suppliers as decisions are made at different moments, in different settings, because of the partial de-linkage of investments from milk that's being proposed now.

Onno van Bekkum

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

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

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

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

Van Bekkum says all these would occur because it will be recognised that both shares and investment units trade at a discount, and the company will be under severe pressure from the investor community to make further changes.

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

"But I'm not yet convinced. There is always the possibility that 75% of shareholders would vote in favor of a second best solution. If these are not factually impossible, their combined effect is that collective ownership of member-suppliers will gradually erode.

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

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

Slippery slide to loss of control

- The sharing up limit, already expanded from 120% to 200% under the proposal, would be increased even further;
- The 20% ceiling on aggregate dry shares would be raised;
- The 5% cap on individual dry share holdings would be lifted;
- The period of three years buying in and share sale would be extended;
- The percentage of shares that could be linked to the shareholders fund would be raised;
- New share issues would be readily agreed by farmers, but funded increasingly through the shareholder fund, effectively strengthening non-supplier ownership of underlying shares;
- The ownership and trading rights of external investors in the fund's investment units would be broadened to reflect the reality of its underlying share ownership;
- Somewhere down the road the milk price bonus for share-backed milk solids would come under question;
- The principle of distributing dividends on a milksolids basis would be compromised;
- A takeover bid would be launched for a minority holding in Fonterra;
- Instead some sort of restricted, public listing of shares would be sought, and restrictions would gradually be lifted.

'Trading among farmers' confusing

ONNO VAN BEKKUM

AS AN overseas observer of the debate about Fonterra's restructure I would like to acknowledge at the outset that my perspective may be biased, and in sharing my views with *Dairy News'* readers I don't wish to suggest farmers vote either for or against the proposal.

However, I do wish to share some of my understanding of what's at stake.

Firstly, I find the term "Trading among farmers" to be confusing. The way I look at it, "farmer investors" and "farmer suppliers" are not the same.

"The solidarity of farmer investors is far weaker than that of farmer suppliers. My concern is that the number of milk-backed shares would soon be outnumbered by a pool of dry shares, plus shares backed by the shareholder fund."

For example, the statement "Additional capital raised from dry share issues would be directed to growing future farmer shareholder returns" appears to refer to farmer investors and not to farmer suppliers.

The suggestion is that since the beneficiaries of the proposal are proclaimed to be "farmers", milk suppliers will benefit.

But they should realise that instead we are talking about an exclusive group of investors: dairy farmers (though not as farmers), ex dairy farmers, possibly plus institutions and the public, but I'll come back to that.

The solidarity of farmer investors is far weaker than that of farmer suppliers. My concern is that the number of milk-backed shares would soon be outnumbered by a pool of dry shares, plus shares backed by the shareholder fund.

That will increase pressure for further reform, moving the co-operative further away from farmer-suppliers.

Digging a little deeper, the proposal purports to ensure "Fonterra remains 100% farmer controlled and owned", as "investment units" would have only economic, ie dividend and share value, rights, not voting rights. I believe this would be short-lived.

The market doesn't like hybrid structures and will discount these investment units, putting the company and farmers under pressure. The moment farmers start to enforce decisions that run counter to investor interests this "ownership" battle will surface.

The board could easily dismiss the clamour of dairy equity following share price reductions in recent years as it had no connection to dairy equity. It would not be so easy with the new structure. Furthermore, reference is made to "friendly investors" such as "sharemilkers, dry farmers and offshore suppliers" but also includes "institutions and the public".

Friendly investors sounds nice but I doubt they really exist. I do, however, think co-investment by offshore suppliers is a great idea. Solidarity between farmers shouldn't stop at national borders.

The proposal aims to "strengthen the balance sheet of Fonterra" but in itself it doesn't generate new capital. It simply transfers balance sheet weakness from the co-operative to someone else. This would "make every farmer's investment in Fonterra more secure", says the co-operative, but farmers should realise they will be paying that bill themselves.

As for the "ability to make better use of retentions" to strengthen the balance sheet, this is common among companies and cooperatives, but I fail to see why it requires "trading among farmers".

Similarly, I don't see how trading among farmers will grow shareholder returns.

There are benefits from being relieved of the obligation to redeem billions of dollars of shares but if "opportunities with potential returns exceeding 20%" really exist surely farmers and their financiers would back those anyway.

Growing shareholder returns has nothing to do with the proposed trading system, unless what

Onno van Bekkum

is meant is that returns will be creamed off from the milk price. That isn't wealth creation; it's wealth redistribution.

Fonterra says "the current system penalises loyal shareholders who effectively fund the return of share capital to farmers leaving the co-operative". I have my doubts about this statement too.

It is true generations acquire ownership from the previous ones so farmers leaving the cooperative redeem their initial and incremental investments, plus hopefully some value increase.

The new system doesn't necessarily change this though. It simply facilitates non-supplier buy-in.

To summarise, I question the validity and even relevance of a number of the arguments supporting the trading proposal. Some of the ideas, such as having a shareholder fund to provide flexibility, participation of offshore suppliers, and a dividend reinvestment programme are good, but they don't necessarily require trading among farmers.

There are many risks to farmer-supplier ownership by introducing share trading and I'm not convinced that this is the way the cooperative should be moving forward.

The question is, of course, is there an alternative? It seems that during the past five years all eyes have been focused on share trading, first with the public listing option, and now with the more restricted (investor) "farmer" trading option, with public trading of investment units.

How much attention has been given to other options? "There is no co-operative anywhere in the world that is the same as Fonterra".

True, but that doesn't mean there isn't anything out there to be learnt from and that could effectively be recombined into a new model solving Fonterra's redemption problem and capital growth challenge. I would think there are alternatives.

- *Onno van Bekkum is cooperative expert and owner of "CO-OP Champions" research & advisory, based in the Netherlands. Contact: vanbekkum@coopchampions.com*

TAF warning

AN OVERSEAS cooperative expert warns Fonterra's proposed share trading scheme will eventually erode farmer ownership.

Netherlands-based Onno van Bekkum does not support the co-op passing on redemption risk to farmer shareholders under its Trading Among Farmers (TAF) plan.

In his submission to MAF, van Bekkum points out the loss of farmer control in Irish dairy Kerry Group.

He believes farmer ownership of Fonterra will be watered down under TAF.

It will be watered down gradually, he says.

"Just as it did in Kerry Group in Ireland, for example," he says.

"Not overnight, but gradually, driven by internal and external forces that make it very logical it will continue to water down, once you pass the watershed point.

"And while that generation of Irish dairy farmers earned a great deal, as dairy farmers they are now stuck with a fragmented dairy business that doesn't really serve their milk producer interests."

Van Bekkum says he fears the same would happen to Fonterra.

"The question is: do you want a New Zealand owned cooperative champion sustainably driving cash back to rural communities or do you prefer to set up Fonterra as a target for overseas investors, milking New Zealand farmers and therefore the economy?"

TAF allows Fonterra farmers to trade shares among themselves freeing up the co-op from redemption risk.

A Fonterra Shareholders Fund will trade dry shares and investors will be able to buy units and earn dividend payments on these dry shares. However, voting rights associated with dry shares remain with Fonterra farmers.

But Van Bekkum says there are flaws in the discussion about redemption risk.

Redemption risk is being passed from the cooperative to farmers and won't disappear, he says.

"It is still there. But now it hangs around the neck of farmers instead of the cooperative.

"Their only escape, eventually, is selling to external investors.

"Which is what the fund allows them to do.

"And which will happen, sooner or later."

Van Bekkum says formally Fonterra will be owned by farmers and non-farmers, but it will be so-called farmer controlled.

"But I see that only as a temporary arrangement.

Published in General News

Tagged under Fonterra

Front foot it!

ANDREW SWALLOW

'LICENSE TO operate: regulatory barrier or market opportunity?'

That was the title four guest speakers spoke to at Agmardt's annual agribusiness breakfast, preceding the practical day of the Young Farmer Contest.

Fish and Game chief executive Bryce Johnson said five years ago the topic would have been "heresy" in such a setting but now it's time has come.


Bryce Johnson

"What agriculture needs to do is take the lead.... The trick is to stay ahead of the game. You've got to collaborate with the policy makers."

Revamping the Clean Streams Accord is "a huge opportunity" and as Land and Water Forum (LAWF) progress has shown, all New Zealanders want more or less the same outcomes.

Environmental NGOs (which F&G is not), rather than being the enemy, are "really part of your strategic opportunity".

Johnson's presentation followed Lincoln University vice chancellor Andy West's, who gave a "big picture" personal view that world agriculture – New Zealand included – needs to intensify production, not just to feed the predicted 10 billion population of 2050, but to protect the environment.

"What we're doing right now is sending an awful lot of species extinct. We've got to intensify our use of land. The question is: does New Zealand want to be a part of that?"

Intensification, for example through partially housed dairy systems, offers a win-win to increase production and reduce environmental impact, he said, declaring he has an interest in the Herd Home company.

"We could double our [dairy] production just by feeding our cows properly." That would be worth $7 billion at the farmgate, $13 billion ex factory. In sheep the potential is probably even greater, he added.

However, compromises and strategic decisions at a national level need to be made.

"How many water bodies should be pristine?... What we've got at the moment is an arms race going on between different communities about who can set the highest standards quickest."

Federated Farmers Dairy chair Willy Leferink acknowledged agriculture "has some issues to address, particularly when it comes to nutrient loading."

"The problem is the science is struggling to keep up with all the people who write policy."

Inappropriate policy risks forcing unnecessary development costs on the industry, he warned.

He also had a dig at urban pollution, but noted in voting terms, New Zealand's 30,000 farmers "don't mean a thing" compared to the 2.9 million majority.

"But at least this Government listens to us."

TAF sceptics seek second opinion

ANDREW SWALLOW


Leonie Guiney

A GROUP of Fonterra shareholders has commissioned a report on hybrid cooperative models because they're concerned they're not getting the full story from their own board and management.

"We have been forced to do this because, to date, we've not been allowed access to the official due diligence that we as farmers have all paid for," group spokeswoman Leonie Guiney told *Rural News* last week.

At their own expense Guiney and others commissioned Dutch co-operatives analyst Onno van Bekkum to look at the success or otherwise of cooperatives elsewhere in the world that have pursued models that involve non-farmer equity in cooperatives.

"Part of the problem is there's nothing to compare TAF with. But it is imperative some expert analysis from a cooperative viewpoint is made available to farmers in the next few weeks as we consider what is a critical vote for the future of our cooperative."

She's concerned Fonterra's dossier of information, due to be mailed to shareholders late last week, including voting papers, will simply be too much for some to digest, and they'll take the "trust the board" approach and just tick the boxes.

"We must continue to test the concept against our cooperative principles and remember why we've not prioritised share value as our primary goal in the past. People must understand what they're voting on."

She also believes the vote threshold should be 75%. "No board that prioritised the co-op would consider anything less to be a mandate."

She notes chief executive Theo Spierings recently said co-op unity is more important than TAF. "The only way to ensure that unity is for any resolution to require 75%."

Guiney is dismayed by what she believes is selective circulation of media commentary on TAF by Fonterra. For example, a recent Radio Live interview featuring Rod Oram repeating Fonterra chairman Henry van der Heyden's line that there's a vocal minority who don't understand the TAF model was emailed to the entire supply base by Fonterra regional managers, yet interviews with Simon Couper about his reasons for standing down from the Shareholders Council were not.

"Couper was our elected representative who has seen the detail behind this and he's stood down on principle because he doesn't believe 100% ownership and control can be maintained. Yet they think Rod Oram's comments are more important."

As for the "vocal minority" allegation, signatories to a petition calling for a second vote on TAF alone represented $630m worth of Fonterra shares – about 7% of supply, she points out.

"The ones who signed are only the tip of the iceberg. Vocal minority? I don't think so!"

Fonterra told *Rural News* it is not being selective in what it circulates. The Oram interview was sent by an area manager following farmer feedback expressing interest in independent reviews and comments on TAF. It is doing everything it can to ensure all the information is available to shareholders in time to be read, discussed and questioned, the co-op says.

The pack posted to farmers contains a 23-page report which is the same as the board received except for a few minor edits and exclusion of the appendices for commercially sensitive reasons.

In addition to next week's 51 meetings, in the run-up to the June 25 special meeting and vote, farmers may call directors, shareholders' councillors, networkers, area managers and members of the TAF project team. Questions posted on Fencepost will all answered and legally verified.

About van Bekkum

ONNO VAN Bekkum describes himself as a cooperative strategist. He is MSc in agricultural economics from Wageningen University and PhD in economics from Nyenrode Business University, Holland. He has worked as a consultant for cooperatives including Rabobank, FrieslandCampina, Fonterra, Tine, and Dairy Farmers of Britain, among others.

• See *www.coopchampions.com*

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CRUNCH TIME

"I've just seen many cooperatives going down the drain when investor interests start prevailing over producer interests."

– Dutch co-op expert Onno van Bekkum

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Future farmers show off skills.
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Study finds in-shed technology popular.
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Share valuation the real issue – Dutch expert

ANDREW SWALLOW

FONTERRA HAS a serious problem but, contrary to the board's claims, it is not redemption, says a Netherlands-based cooperatives expert.

"Share valuation is really the heart of the problem," says Onno van Bekkum, chief executive of Coop Champions and a lecturer on cooperative businesses at Nyenrode Business University.

Van Bekkum has produced a report for a group of Fonterra shareholders concerned at TAF's implications for the cooperative's future, and supplied an exclusive preview article to *Dairy News.*

"There has been a lot of good thinking gone into this [TAF] proposal. But I fear with this impressive level of technical detail farmers might lose sight over the bigger picture," he warns.

He doubts share trading will contribute to a stable cooperative, and says he can't think of any example where such a system has worked to the satisfaction of farmers.

"I've just seen many cooperatives going down the drain when investor interests start prevailing over producer interests. That's what TAF does: it deliberately creates a separate cluster of investor interests – both internal and external. You don't want that in a cooperative. You want to keep a clear focus on producer interests."

While he has concerns at what is effectively a scheme that will encourage some to cash in their shares, it would be understandable if it was a means to raise capital, he adds.

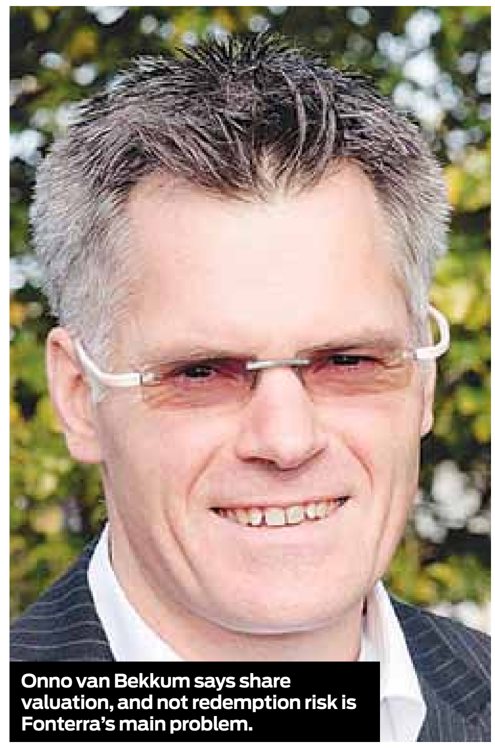
"Then at least you would build up something."

As it is, the trading of dividend-bearing units linked to shares will simply drain up to 20% of dividends from the cooperative.

"If you decide to trade, why not start trading internally?"

He also doubts Fonterra will be able to limit the fund size, as it suggests.

"I don't think farmers would vote in favour of TAF thinking they won't be using the fund. There will always be moments when people are in need of cash."


Onno van Bekkum says share valuation, and not redemption risk is Fonterra's main problem.

He notes the blueprint itself mentions "avoiding a flood of shares into the fund after launch".

"I fear it might not be long until the constitutional limit of 20% may be reached, with or without shocks created by droughts, diseases, financial crises, etc. And then what?"

The board has several options, as proposed in the risk management policy.

"Firstly, buying back units, which means you're basically back on a track similar to redeeming shares. So how much do you gain from TAF?

"Secondly, introducing dividend reinvestment. Great, but you don't need TAF for that!

"Thirdly, reducing the transfer limit, which requires members to buy back a portion of their shares: I'm not sure if that would really work in practice.

"Fourthly, issuing shares, to farmers presumably. Does that mean raising the limit on dry shares? Doesn't that mean we're further down the sliding slope then?

"Fifthly, altering the constitution to allow more than 20% in the fund. Is that what a 'preferred option' – to be recommended at a 'special meeting' for shareholders – could also be about? That, again, is risky."

Van Bekkum says he would solve Fonterra's valuation problem without introducing dry shares.

"The restricted share value was a step in the right direction."

End-of-season transaction, a rolling three season-average production/share requirement, and three years to buy in/out all make sense, as does dividend reinvestment.

The fact that reducing share value to the restricted figure of $4.52/share from its $6.79 peak passed without uproar from farmers is a positive sign that shareholders, in general, are not overly focused on share value, he says.

"As the leadership has begun to see, the basis of any strong capital base is retained earnings. I think these are sufficient ingredients for a robust capital structure. I would be inclined to think you might not really need TAF."

As for redemption risk, TAF effectively passes it to farmers.

"I think it's not fair simply to pass that burden on to farmers' shoulders. It's not particularly cooperative. It's amazing that farmers just accept that without discussion."

COMPLEX DOCUMENTS

THE COMPLEXITY of the documentation supplied by Fonterra on TAF is noted by van Bekkum.

"Your New Zealand farmers must be highly educated people to read this language of lawyers and accountants."

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Report questions TAF's need

ANDREW SWALLOW

A DUTCH cooperatives expert is questioning whether Fonterra's farmers need TAF.

In a report commissioned by a group of shareholders concerned at the lack of independent analysis of the proposal, Onno van Bekkum slams many of the arguments for TAF put forward by the board.

While the 24-page report is a little long-winded and at times confusing, the concluding pages are damning.

TAF is complex, both in concept and in language; it attempts to integrate conflicting principles of cooperative and stockmarket models, and shifts the board mindset towards satisfying investor demands with strategic focus on return on investment, rather than milk processed, he argues.

"[It] looks at milk as a 'cost' factor rather than as a source of wealth creation [and] erodes the linkage between milk supply and investment."

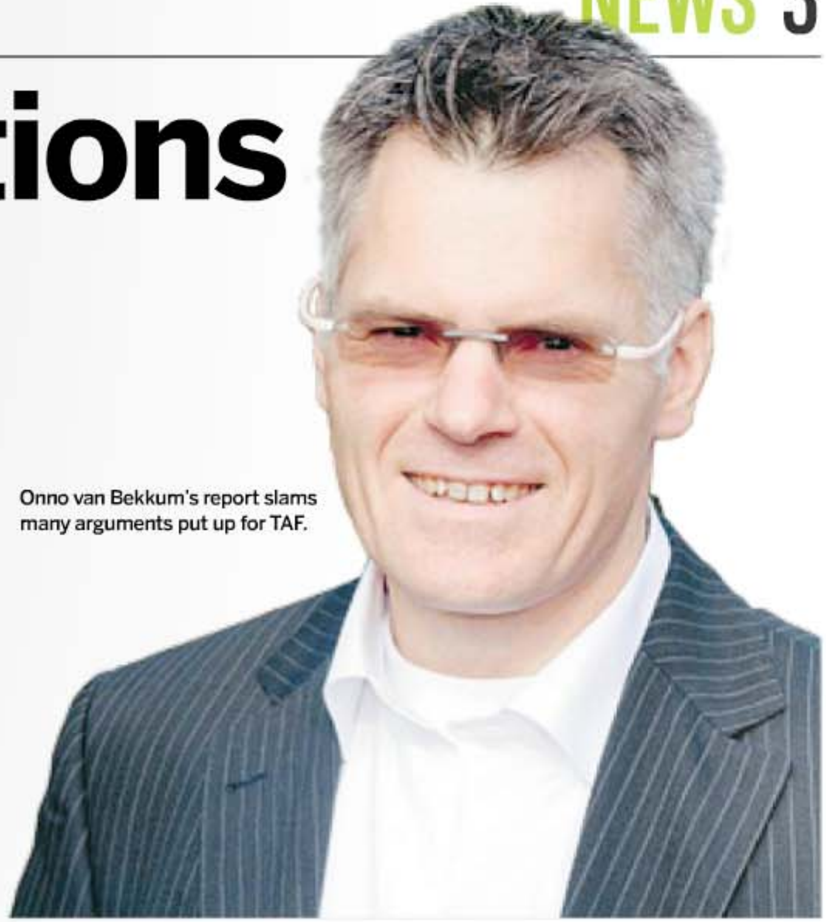
Some shareholders' focus will shift to that of investors, creating tensions between groups within the cooperative with different investment profiles.

The likely increase in share price will tax milk growth, inhibit entry to the cooperative, and incentivise exit.

Those trading shares into the fund but retaining supply rights could find they are "locked in" as prices rise such that they cannot afford to buy their way out.

Dividends paid to outside unit investors would be money lost to the dairy chain and for all the protection mechanisms Fonterra has proposed, van Bekkum doubts it could contain investor interest.

He drives a bus though the cooperative's selling points for TAF as outlined in the 'What you need to know' booklet, saying that rather than being an 'easier to use' method of buying or redeeming shares, it may well demand more from farmers.



Onno van Bekkum's report slams many arguments put up for TAF.

Farmers are already 'in the driver's seat' and the three-year opt in/out periods do not require TAF to implement.

Claims that share value will be set by the price farmer shareholders trade at also don't wash. "No it won't. The share price will effectively be set by the public market."

As for TAF leading to 'a stronger cooperative', it may lead to a business with a stronger capital base but that is not necessarily the same as a stronger cooperative.

"But if TAF creates a stable capital base by solving the redemption problem, then this must be accepted as a valid argument.

More TAF stories page 4

Waikato Times
www.waikatotimes.co.nz

Warnings of curdled co-operative

ANDREA FOX Last updated 08:16 19/06/2012

With less than a week until Fonterra farmers vote on the watershed Trading Among Farmers (TAF) capital restructure, the war of words continues with a new report commissioned opponents claiming TAF "privatises" the co-operative.

But former Dairy Board and New Zealand Dairy Group chairman John Storey believes some shareholders are focusing on TAF's "problems rather than the advantages".

At a recent TAF meeting between directors and farmers in his home farming district of Te Awamutu, Storey said there had been "a lot of concentration on little details, and not a lot of questions around the big picture" of the upcoming vote.

"It's a no-brainer. There's no damage to the co-operative ... [unit] investors not happy will sell their units. This puts the hea on management to perform."

As the clock ticks down to Monday's special shareholders vote meeting in Hamilton, Fonterra chairman Sir Henry van der Heyden has re-stated that TAF is not about raising capital, which will still come from farmer-suppliers, he said.

"Cash invested in buying units in the Fonterra Shareholders Fund will go to farmers selling the economic rights to their shares – not to Fonterra," van der Heyden said.

But Netherlands co-operative expert Dr Onno van Bekkum, in a report commissioned by the "Our Co-op" group of shareholders opposed to TAF, said the proposal "strikes an axe in the co-operative roots of Fonterra".

"From the privatisation of the Dairy Board, Fonterra inherited a deficient share structure. But instead of replacing that with genuinely co-operative share, TAF actually privatises the co-operative itself," he said.

"TAF would transfer the total outstanding redemption claim, currently valued at $6 billion, to the body of members.

"This is not `co-operative'. By denying members access to the equity built up collectively in Fonterra for many years, TAF cuts out the heart from the co-operative."

Van Bekkum said TAF would convert Fonterra "into what we call a farmer-owned business".

"Less than that even: up to 20 per cent financial ownership of the shares will be with external investors. A co-operative encouraging its members to sell shares so external investors may have their bit of the cake – that is unprecedented and a co-operative."

Van der Heyden has issued a statement rejecting talk at the recent round of farmer meetings on TAF that its purpose is to raise capital.

TAF's purpose was to remove "redemption risk" from the balance sheet of New Zealand's biggest company, he said.

Under TAF units, linked to the performance of the Fonterra share price, will be offered to sharemarket investors. They will NZX-listed and dividend-carrying, but holders will not be able to vote them.

This opportunity for outside investment, and its possible impact on milk price vs dividend and Fonterra's share price, has spooked many farmers who fear it sets the co-operative on the path to a full sharemarket listing.

Van der Heyden said the company was currently obliged to cash up or redeem the shares of suppliers who wanted to exit reduce milk supply.

Removing this risk by enabling TAF would also create permanent capital, he said. "But it's not new capital and certainly nc new capital is coming from outside investors."

That van der Heyden is still having to push this message at the 11th hour suggests the trading among farmers concept, ev after two drawn-out years of development and discussion, is not as well understood as it could be.

Van Bekkum said TAF shifts Fonterra's primary focus to generating dividends – "and that's how farmers will view their new `investment"'.

"Under TAF, farmers' perspective will be decreasingly `co-operative'. In this proposed future they will vote individually, as investors.

"TAF allows farmers to `share up' 100 per cent or sell down 33 per cent of their `wet' shares, creating a 3:1 distribution rar in individual ownership.

"This disruption of the share-to-milk linkage fuels free-riding behaviour and leads to member solidarity breakdown."

Van Bekkum also claimed this "flexibility" also created disincentives for farmers, in their primary role as milk suppliers, to invest in Fonterra.

Waikato Times
www.waikatotimes.co.nz

Timely talk tackles TAF for farmers

ALI TOCKER Last updated 08:01 26/06/2012

Annual conference covers today's challenges for Fed Farmers' members, writes Ali Tocker.

Farmers will hear from a global expert on co-operatives, critical of Fonterra's Trading Among Farme proposals, at Federated Farmers' national conference in Auckland this week.

The farmer group's president, Bruce Wills, said the talk by Dr Onno van Bekkum was timely, given yesterday's farmer-shareholder votes on the dairy co-operative's TAF proposals.

Van Bekkum, of The Netherlands, has worked as a consultant for a range of co-operatives includin Fonterra, Rabobank and Dairy Farmers of Britain.

A New Zealand anti-TAF lobby group led by Leonie Guiney, the Fonterra Farmers Protecting Our C op group, commissioned Van Bekkum to do a due diligence on TAF from a co-operative perspectiv

In his report, he said the TAF proposal "strikes an axe in the co-operative roots of Fonterra".

"By denying members access to the equity built up collectively in Fonterra for many years, TAF cut out the heart from the co-operative ... A co-operative encouraging its members to sell shares so external investors may have their bit of the cake – that is unprecedented and anti-co-operative," he wrote.

Van Bekkum is the chief executive of a "one-man" organisation launched in January 2010 to promo an "interactive learning environment for co-operative leaders".

Van Bekkum has a PhD in economics, and his areas of interest in co-operatives include ownership and capitalisation, business strategy and leadership.

The Federated Farmers conference runs from Wednesday to Friday this week at the Crowne Plaza

Wills said highlights on the agenda would include briefings from Finance Minister Bill English, Prima Industries Minister David Carter and Opposition Leader David Shearer.

Wills will share his experiences from meeting with global agricultural leaders at the World Farmers Organisation general assembly in Rome, and Federated Farmers chief executive Conor English wil share relevant information for New Zealand farming from the Rio+20 Earth Summit.

Other topics will include animal welfare and the animal welfare compliance framework, and farm environmental management. Updates will be given on the Land and Water Forum and the success to the Dairying and Clean Streams Accord, as well as a "green outlook" for primary industries. Transpower's line strategy and agricultural aviation will also be discussed.

In a new feature, interactive couch sessions will be held on three hot topics – foreign ownership, the environment and local government. Experts and commentators taking part will include Tony Bouchi from Save Our Farms, KPMG business advisory partner Tim White, Waikato University agribusines professor Dr Jacqueline Rowarth, AgKnowledge director Dr Doug Edmeades and local government representatives.

Winners in the Federated Farmers National Awards will be announced on Thursday, including agri business person and agri personality of the year.

"Central to this great evening is the Vodafone cream of the crop awards, where we assemble almos all of agriculture's major award winners for the past 12 months. It is a huge undertaking but central us celebrating agriculture's continued success," Wills said.

Federated Farmers' board elections will take place on Friday.

Change needs new mindset

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Trading among farmers (TAF) will drive the mindset of Fonterra's governors, managers and farmers away from cooperative principles towards being a farmer-owned business – a distinctly different structure from what it is today, according to cooperative specialist Onno van Bekkum.

Netherlands-based van Bekkum, one of the keynote speakers at the International Cooperatives Conference, is also the author of a report for the Fonterra Farmers Protecting Our Co-op group.

While he agrees that the fair value share system, whereby farmers take their full value in the cooperative with them when they leave, is a "millstone around Fonterra's neck" he doesn't believe TAF is the way to solve it.

The structure brings to the fore conflicting organisational principles integrating into a single system both the cooperative and stock market models. The increased status of the investment model would push return on investment to top of mind in management and governance thinking, he said.

While it now looks like TAF will proceed, being able to recognise these behaviours and control or make calls against them would be important to the continuing protection of the co-op, he said.

Onno van Bekkum – doesn't believe TAF is the solution.

'The market behaviour of external investors will influence the pace at which New Zealand dairy farmers can grow their farms and supplies to Fonterra …'

No structure is ever set in concrete and Fonterra's chair Sir Henry van der Heyden has said if TAF doesn't deliver as expected the cooperative can unwind it within two years. So looking out for signs of the problems foreshadowed in van Bekkum's report will be important over the next two years.

In his report van Bekkum warns that TAF could encourage a shift in management focus too far in favour of driving profits. "Beware of executive incentive payments being linked to the share price," he said.

Language and attitudes could change so that milk is seen as cost factor rather than a source of farmers' and the country's wealth creation.

He also suggested looking out for increasing tensions between cooperative members who will have a greater diversity in investment profiles. Some will have a maximum of dry shares, others will only have wet shares, some will have fund units and there will be many who will have a mix of each.

Governors will be working for masters with a much greater range of needs than ever before.

Van Bekkum believes the structure will induce a higher share price that will ultimately incentivise members to sell the economic rights of their shares and dis-incentivise milk growth and new entrants to the cooperative.

The market behaviour of external investors will influence the pace at which New Zealand dairy farmers can grow their farms and supplies to Fonterra. He points out that people aren't born cooperative, and opportunists who don't have the long term, inter-generational view of being a cooperative member aren't protected against in TAF.

Instead the structure encourages free-riding behaviours that Fonterra has labelled flexibility, he warned.

Van Bekkum had never seen a cooperative that actively encouraged its members to sell their shares as they were being encouraged to do with the Fonterra shareholders fund (FSF).

Up to $500m worth of shares would be linked to the fund which was half the amount the board was worried about protecting against with redemption risk. Van Bekkum warned farmers to be wary if the regulations and restrictions designed to protect them within TAF begin to be blamed for stagnation of the fund as the next step could be to convince them the restrictions need to be relaxed.

"That would be the slippery slope then towards loss of ownership."

The fact one third of Fonterra's milk solids voted against the proposal would have Fonterra's governors' eyes wide open and trust now had to be put in them to also be on the lookout for unwanted outcomes of TAF.

Tension drives success

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Two Fonterra directors, Nicola Shadbolt and John Wilson, acknowledged the importance of a healthy tension and robust debate within the co-op when addressing the conference on the role of cooperatives and mutuals in economy and society in Wellington in June.

Shadbolt said Fonterra shareholders had an intense desire to discuss ownership and control, "and that's what keeps cooperatives alive".

Wilson likened cooperative membership to being part of a big family, "with all the foibles of a typical reality TV show family". He had just been engaged in the rounds of farmer meetings before the vote on trading among farmers (TAF). He described these as a "a magnificent engagement and discussion of the key issues within our cooperative".


Nicola Shadbolt – long term view of world.


John Wilson – like a reality TV show.

'We must listen to what our shareholders say and make sure our farmers have every chance to understand the issues before us at any time.'

From the outside, he said, it might seem Fonterra decision-making was glacial. But this was not a weakness.

"It is the strength of our co-op that we have to bring our shareholders with us," Wilson said. "We must listen to what our shareholders say and make sure our farmers have every chance to understand the issues before us at any time.

"That's what we call healthy tension."

It led to real consensus and to ensuring the company could move forward cooperatively. Diversity must be celebrated, not squelched.

"Passion" was a key element of cooperative membership, too, Wilson said. He and his brother are the third generation of a dairy-farming family.

"And we have benefited greatly over the years by being both suppliers and owners of our cooperative," he said.

It hadn't been easy and there had been major challenges. But "a co-op model for us as dairy farmers is the only possible solution … it just makes sense at every level".

Shadbolt said Fonterra had a long-term view of the world. It was structured to discourage short-term opportunism, and it was a social construct. It was rare in any business for managers to be told they must pay the most they possibly can for inputs and make a profit.

"It creates a wonderful tension and drives a fantastic efficiency," she said. "So we have the long term, we have efficiency drivers and we have this sort of egalitarian construct within that business model."

Shadbolt said one of her students at Massey University had examined the differences between cooperative and corporate businesses. The big point of difference was mutuality – "the co-op is about the collective good, the mutual benefit".

Social cohesion and balancing the interests of different factions had its challenges, she said.

This – and loyalty – were "a critical difference".

Referring to the TAF debate, Shadbolt said farmers had a keen desire to discuss ownership and control, "and that's what keeps cooperatives alive – it keeps them very vibrant".

How else could they re-invent the cooperative, without a debate about what the reinvention should look like?