



BUSI553 – International Business Week

Assignment: **Dairy Sector Report**



Prepared for:

MBA 31, 2007

Facilitator: Glen Munn, Don Walker

Date: 23.11.2007

Prepared by Mainland Consulting Group:

Ben Brabent

Jorit Nühs

Martin Schwarte

George Thomson

Word Count: 12,100

Executive Summary

The success of the New Zealand dairy industry means a strong New Zealand economy and the dairy industry is, essentially, Fonterra. There are many global factors effecting Fonterra and its management of these will determine its success going forward. Three critical issues for Fonterra relate to the foundations of dairy establishment, the roots of competitive advantage, and prospects for growth and dominance.

- **Foundations**

The dairy industry in New Zealand has evolved to its' current position from the unique combination of climate and location. The key issues of climate are its temperate nature, abundance of water and land use and topography. Location has driven the development by necessity of scale operations and the resulting skills in technologies and marketing. Current environmental concerns for Fonterra include water availability, carbon emissions and the emergence of 'food miles'.

Over all Fonterra appears to be doing a good job in maintaining its' foundation but further work is required.

- **Competitiveness**

The New Zealand dairy industries ability to remain competitive over time is in large part due to the innovative and persistent nature of its major source of human capital: farmers. This is has been due to large numbers of young people and those from outside the industry joining dairying through its ease of entry and good career prospects. These are driven currently by the Modern Apprenticeship scheme, and the tradition of 'share milking'.

Fonterra does not seem to understand its responsibility in this area and must act soon to mitigate the potentially threatening trend of farms becoming unattainable for new farmers and the consequent lack of attraction to ambitious new entrants.

- **Growth and Dominance**

Fonterra's future growth and dominance requires an appropriate capital and business structure. Currently strongly vertically integrated the growing trend of globalisation sees Fonterra battling numerous competitors on numerous market fronts. The company has the potential to be the world leader in dairy but requires more cash than it currently has to take advantage of current opportunities. Any future plans must address the issue of redemption risk and the inherent antagonism between farmer suppliers' priorities and those of portfolio investors.

Fonterra are a company focussed on growth and the outlook for their recent proposal is positive but only if the two major risks are addressed to the satisfaction of farmers.

Fonterra is a company focussed on growth with a good understanding of its foundations and where it has come from. Its prospects for the future are excellent if it can overcome the hurdles identified. The overriding threats to Fonterra's future are:

- **Managing the process of capital structure change**

This may only be overcome through extensive consultation with farmers and an understanding of their needs combined with educating them on Fonterra's needs.

- Securing the next generation of ambitious, educated, energetic young farmers
This will only be achieved by providing clear and attractive career paths and the ability for young farmers to have a stake in profits. Ideally this would be through a well functioning share milking structure but global trends may force new approaches and Fonterra must understand how taking responsibility for this is securing the long term sustainable competitive advantage of the co-operative.

Contents

EXECUTIVE SUMMARY	2
CONTENTS.....	5
1. INTRODUCTION.....	6
2. CLIMATE AND LOCATION	7
2.1 CLIMATE.....	7
2.1.1 <i>Critical Factors: Temperate climate</i>	8
2.1.2 <i>Critical factors: Water availability</i>	8
2.1.3 <i>Critical factors: Land use & topography</i>	9
2.2 LOCATION.....	10
2.2.1 <i>Economies of scale: Co-operatives</i>	10
2.2.1.1 <i>Advantages of Scale: Technology</i>	11
2.2.1.2 <i>Advantage of Scale: Marketing</i>	12
2.3 CURRENT TRENDS: ENVIRONMENTAL CONCERNS	13
2.3.1 <i>Climate: Water scarcity</i>	13
2.3.2 <i>Climate: Bio-fuels</i>	14
2.3.3 <i>Climate: Emissions and climate change</i>	15
2.3.4 <i>Location: Emissions and carbon</i>	15
2.3.5 <i>Location: Proximity to China</i>	16
2.4 OVERVIEW	16
3. HUMAN CAPITAL AND INNOVATION	17
3.1 HUMAN CAPITAL	18
3.2 HUMAN CAPITAL DEVELOPMENT IN DAIRY	19
3.1 CAREER ENTRY: MODERN APPRENTICESHIPS	19
3.1.1 <i>Recruitment</i>	20
3.1.2 <i>Early Training</i>	21
3.1.2 <i>Employment</i>	21
3.2 BUILDING WEALTH: SHARE MILKING	21
3.3 HUMAN CAPITAL: SWOT	24
3.3.1 <i>Strengths</i>	24
3.3.2 <i>Weaknesses</i>	25
3.3.3 <i>Opportunities</i>	25
3.3.4 <i>Threats</i>	25
3.4 CURRENT TRENDS: LAND PRICE INFLATION	27
3.5 OVERVIEW	28
4. CAPITAL AND BUSINESS STRUCTURE	29
4.1 THE CO-OPERATIVE	29
4.1.1 <i>Fonterra</i>	29
4.1.2 <i>Current Situation</i>	31
4.2 VERTICAL INTEGRATION	33
4.3 CURRENT TRENDS: GLOBALISATION	34
4.4 PROPOSED CHANGES: SWOT	36
4.4.1 <i>Strengths</i>	36
4.4.2 <i>Weaknesses</i>	37
4.4.3 <i>Opportunities</i>	37
4.4.4 <i>Threats</i>	38
4.4.5 <i>Summary</i>	40
4.5 OVERVIEW	41
5. CONCLUSION	41
6. REFERENCES	43