

Trojan horse for investors?

Alan Robb

In the past few months Fonterra farmers have been seeing TAF (Trading Among Farmers) for what it is: a Trojan horse. Though superficially attractive on the outside, it contains those very things which will destroy their life.

The overwhelming vote last year in favour of TAF appeared to open the door to non-voting investment in the co-operative by outsiders. The case from the board of Fonterra was that institutions and small investors would welcome the opportunity to put money into an established business with world-wide markets. Control would remain with farmer suppliers.

This is no longer appears so. Institutional investors have made it plain that if they put money into a business they want some control.

In May 2011 Fonterra's chief financial officer, Jonathan Mason, had secret meetings with institutional investors in Auckland and Wellington 'tweaking the terms' of the rights which outside investors would buy.

Undoubtedly this 'tweaking' has involved making the conditions more attractive to the institutions – and probably less attractive to Fonterra's suppliers.

In June Mason spoke at a seminar for 600 clients of Craigs Investment Partners. His address can be found at <http://www.craigsip.com/about-us/news/articles-cw/fonterra-highlights.html>

Farmers who have followed the debate on TAF should be asking themselves "How does TAF and the presence of non-suppliers benefit me?"

The answer is that it will not.

Membership of a dairy co-operative benefits the farmers by ensuring that they get the best possible return for milk supplied. This involves minimizing costs, not the least of which is the cost of capital. Investors seek the maximum return on capital. This involves minimizing payments for inputs, such as milk. The interests of suppliers and investors are diametrically opposed.

Members of dairy co-operatives seek stability and certainty. By working co-operatively they have traditionally reduced risk and sought to capture a greater percentage of the value added to their product.

Fonterra's decision, when it was formed, to depart from the customary share-capital basis of 'a dollar in and a dollar out' introduced an additional level of risk with its so-called 'fair value shares'.

Until now its shares have fluctuated annually. Farmers faced the risk (and reality) that they could get back less than they contributed after a year if excess shares had to be surrendered because of reduced milk supply.

TAF will result in greater fluctuations in share values. The market makers will want share values to fluctuate. They stand to make more money in a fluctuating market than in a stable one. Greater fluctuations in share prices would mean greater risk for farmers.

Share price would undoubtedly dominate milk prices. The prime concern of Fonterra must be to get the best possible price for farmers' milk and protect its markets.

TAF appears to have consumed considerable amounts of executive and board time but remains as impractical and unattractive as Fonterra's peak notes.

Peak notes were dumped after farmer protest in 2004, despite the board's support for them.

The rising swell of voices against the TAF proposal suggests that farmers are becoming well aware of the downside of allowing non-members to have even an indirect interest in Fonterra shares.

The Trojan horse should not be allowed inside the gate.

Alan Robb is an adjunct professor in the cooperatives programme at Saint Mary's University, Canada, and independent financial analyst and commentator based in New Zealand.