RECOMMENDATIONS ON THE RELATIONSHIP BETWEEN ACTIVE SHAREHOLDERS AND CO-OPS IN THE CONTEXT OF THE POST 2015 DAIRY EXPANSION

Introduction

After 30 years of the EU milk quota regime, the Irish dairy industry is actively preparing for the post 2015 era, when quotas will no longer restrict its potential to expand in response to growing global food demand. Strong population growth, especially in developing countries and Asia, and the rising strength of increasingly affluent middle classes with western consumption aspirations are creating real and well documented opportunities for higher exports from countries with strong milk production potential such as Ireland.

Over the last two years, the National Dairy Committee has consulted extensively on the issues concerning the planning required by farmers, milk purchasing and processing co-operatives and the Irish Dairy Board, to deliver on the post 2015 expansion of the dairy sector.

Between two series of regional meetings involving IFA members and co-op board members in 2010 and 2011, the Committee ran a very well received event on 9th February 2011 titled “Dairy 2020 – making profitable expansion happen”. This event provided the first outing of the Dairy Expansion Activation Group recommendations, an outline of the Irish Dairy Board marketing plans, and the opportunity for comprehensive discussions with all the main industry players.

Drawing from this work, the National Dairy Committee has in recent months undertaken the drafting of recommended principles to underpin post 2015 developments, to provide as much visibility and predictability as possible for expanding milk producers, while strengthening the ownership and control of dairy co-ops by active farmers, to form the bedrock of future industry expansion.

While the recommendations in this document have been drafted by the National Dairy Committee, IFA is well aware that most co-operatives have members that are not dairy farmers, but have full rights within the co-operative structure as active shareholders, either because they sell grain or other produce to the co-op, or trade with the co-op. It is crucial that co-ops would provide all active shareholders with the same opportunities to up their shareholding as they do dairy farmers.

The challenges ahead

While this is an exciting time of opportunities for Irish dairy farmers, many challenges have yet to be overcome to achieve the optimum outcome and deliver profitable expansion and strong milk prices for farmers:

- In the context of the industry's expansion plans, farmers will need to **prioritise scarce available resource for on-farm investment**. IFA estimates that the cost of on-farm investment could be up to €1.5 b to deliver the Food Harvest 2020 50% expansion target.
- There is a significant level of collaboration already among co-ops, **but a great deal more is required to optimise use of resources**. The processing industry and the Irish Dairy Board must urgently come forward with plans to deliver on the processing and marketing aspects of expansion which give **priority for investment decisions to joint projects and greater collaboration**.
- Even allowing for the strong Plc element of Kerry, and to a lesser extent Glanbia, the majority of the Irish dairy industry is owned by farmers through co-op structures. However, **active farmers have over time become under-represented** among the industry's co-op shareholders. Indeed, dairy farmers only own 30% of co-ops' shares, and the typical shareholding of milk suppliers in Ireland is equivalent to around 1c/l. The connection between milk supplies and shareholding has therefore been weakened.
- Despite this, dairy farmers have retained a strong level of influence through their representation on boards and committees. However, not all co-ops have reflected this in **rule changes preserving a stronger say for active dairy farmers** where major decisions which impact them most require shareholder votes.
- The **volatility of global dairy product prices** will have a strong impact on dairy farmers' incomes and their ability to plan, finance and deliver expansion.
- With specific regards to **specialist liquid milk production**, the moves towards post 2015 on-farm cost-efficient expansion will not of themselves improve the year-round availability of milk from freshly calved cows. It is therefore crucial that existing specialist producer panels and their contractual arrangements be sustained.
- Last but not least, the end of quotas in 2015 will remove the clarity which has existed up till now in terms of volume **signals between producers and processors**.

The National Dairy Committee believes that, in dealing with all of these challenges, a reinforced connection between active dairy farmers, their milk supplies and the shareholding in the co-op will be critical.

In the context of retaining the controlling influence in co-ops for years to come, the National Dairy Committee believes active dairy farmers will have to consider increasing their shareholding.

The Committee's recommendations are therefore as follows:

Duties of all co-ops to shareholder suppliers regarding milk volumes, processing and marketing capacity

- Co-operatives – whether processing or non-processing, have the responsibility to **ascertain the collective potential** for expansion post 2015 of their milk supply base, and to **provide the processing capacity** for this additional milk. From a cost effectiveness point of view, this should be done preferably jointly with other (processing) co-operatives and for the **marketing capacity** in co-operation with the Irish Dairy Board.
- They must also endeavour to fairly and proportionately **distribute the expansion potential among their suppliers** in consultation with them and with due regard to fairness and the actual individual expansion capacity of suppliers.
- This process must happen in all co-ops immediately, as it is essential to **give farmers clear signals** on volume expansion opportunities post 2015 as soon as possible. There must be clarity as to the **volumes** of milk co-ops plan to purchase from each supplier.

- Specialist liquid milk producer panels, who will needed to secure continued supplies of fresh quality milk year-round at a substantially higher cost, must be nurtured, and **liquid milk production contracts** must be protected.

Funding of the processing industry

- Once existing capacity has been fully optimised, including through maximum co-operation and joint processing agreements, processing capacity expansion and additional working capital will be required. Dairy co-ops must come forward promptly with **a plan on how this expansion is to be funded, prioritising joint investments, and to outline their shareholding policy** (see below).
- This plan must utilise **existing co-op resources,** and attract **bank finance and other investment funds** on the basis of expected **return on investment.**
- Any request for additional funding from farmers as part of the industry's funding plan must be **voluntary**, and represent a **tax efficient and profitable investment** for these farmers.
- Farmers, meanwhile, will have to find up to €1.5b to invest on farm to fulfil their part of the expansion plans, and any **processing capacity funding plan must not undermine on-farm investment**.
- **The National Dairy Committee proposes the setting up of an industry working group to examine ways of utilising funds sourced from farmers on a voluntary basis through investment or revolving-type schemes as part of the funding plan for the industry in the most tax efficient possible fashion.**

Shareholding and control by active shareholders

- All dairy co-operatives, including those which purchase, but do not process milk, should arrange that all **active milk supplier shareholders and other active shareholders are given access to increased shareholding** within the said co-op, and are strongly encouraged to take it up over a reasonable period of time.
- **Active shareholders**, either grain producers, suppliers of other produce to the co-op or farmers who otherwise trade with the co-op **must be given the same opportunities** to up their shareholding as dairy farmers.
- Co-ops should move to deal with non-active shareholders so that, over time, the co-op is **owned in its entirety by active shareholders**.
- Co-ops should review their rules to ensure that, without disenfranchising other shareholders, **active milk supplier shareholders have a greater say** in matters that are of direct relevance to the dairy activity of the co-op.
- Over time, and with due regard to the rights of non-milk supplying shareholders within each co-op, active dairy farmers should be **given opportunities and encouragement to increase their shareholding level to a point to be assessed by each co-op board, and linked to supply levels**. Farmers should be allowed to build up their shareholding to that agreed level over reasonable periods of time, in order to **avoid undermining the necessary on-farm investment**.
- To provide for **an exit, as well as an entry, mechanism**, **shares should be saleable within the co-op.** In this way, a dairy farmer retiring from milk production can realise a value for his shares and they can then become available for other active milk suppliers and other shareholders to acquire.
- To ensure the necessary renewal of its supply base, each co-op should agree a method to allow **new entrants to milk production to become shareholders and progressively increase their**

shareholding to the same supply-linked level as existing suppliers - depending on expansion opportunities within the co-op.

Proposal for an industry working group on voluntary financing by farmers

It is absolutely critical that the best and most efficient use be made of scarce resources in the industry. In this spirit, the National Dairy Committee proposes the setting up of an industry working group to examine ways of utilising funds that may need to be sourced from farmers as part of the funding plan for the industry in the best and most tax efficient fashion possible.

IFA will seek to advance this proposal with industry early in the New Year.

Conclusion

Over the last 30 years, milk quotas have had their place: together with well funded market supports and import tariffs, they guaranteed stable and relatively high milk prices. However, they also prevented important evolution in the sector, and have now truly outlived their usefulness in the absence of adequate levels of EU funded market supports. While we believe carefully planned expansion is the way forward, we must avoid artificial restrictions which could hamper farmers' competitiveness and their ability to avail of real global market opportunities.

The dairy sector has rightly been identified for its expansion potential. While much has been made of the investment required in additional processing, R&D and marketing, farmers will have to spend a multiple of that investment on farm to deliver the extra milk. Any financing plan by industry must take this into account, allow farmers to prioritise their resources on-farm, and any additional contribution required from farmers should be in the context of a tax efficient, profitable investment.

The (mainly) co-operative structure of the sector is undoubtedly a strength from a farmer viewpoint provided active farmers, whether milk suppliers or other active shareholders, are in control. It is therefore fundamental that all co-ops would change their rules over time to ensure that they are fully owned by active farmer shareholders, with an agreed supply-related, incrementally reached level of shareholding applicable to all milk suppliers.

While respecting the rights of all active shareholders, co-ops must move urgently to amend their rules in order to ensure that active dairy farmers have the predominant influence and say in decisions which are directly relevant to the dairy activity, especially those governing the plans to deliver on our expansion ambitions.

Finally, co-ops must urgently publish their plans for this process. Critical within this will be the quantification by the co-op of the volume expansion opportunities identified on the market place, and the fair and proportionate distribution of those opportunities for increased production to reflect farmers' respective capacity.

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