

Large Herds Conference

**Marketing New Zealand's
Dairy Output:**

What Changes Are Needed and Why?

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MARKETING NEW ZEALAND'S DAIRY OUTPUT: WHAT CHANGES ARE NEEDED AND WHY?

1. INTRODUCTION

The 1990s promises to be a decade of exciting and beneficial change in the New Zealand economy. The continuing implementation of a programme of structural reform is laying the foundations for a significant and sustained reversal of our inferior economic performance.

Undoubtedly the dairy industry will want to participate fully in this revitalisation process. In fact, the significance of the industry to the New Zealand economy means it must be involved. Dairy farmers are already experiencing some of the benefits. Lower costs through a more competitive ports industry, reduced protection and more efficient state-owned enterprises are examples.

Enhancing competition, reducing real tax burdens, removing price distortions and restoring the roles of incentives and choice in business and private decision making are key factors in getting New Zealand back on a path of economic growth and rising living standards. This is very much the setting for my remarks today. Competition, clear price signals and choice are just as important and potentially beneficial to dairy farmers and their industry as they are to the economy as a whole.

I have been asked to present a personal viewpoint on the marketing structure that would best suit the dairy industry in the future. Although I grew up on a dairy farm and helped promote the industry's interests in Europe for several years, I would claim no particular dairy industry expertise. The task is therefore an ambitious one. Alternatively, this could be an advantage if you are interested in the questioning and ideas of an outsider, who has a constructive purpose in mind.

My participation undoubtedly also reflects the fact that the New Zealand Business Roundtable has commissioned a major study into the agricultural marketing systems and structures best suited to New Zealand's circumstances and aspirations. I will be drawing on the research and preliminary conclusions of that study which is in the process of being finalised.

The Business Roundtable is an organisation of chief executives of major New Zealand business firms. Its purpose is to contribute to the development of policies which reflect overall national interests.

The importance of agriculture, including the dairy industry, in the New Zealand economy is a major reason why we have an interest in how well our marketing systems perform. Also, a number of Business Roundtable members head companies which are involved in agribusiness. Other considerations underlying our interest include the fact that many of New Zealand's existing agricultural marketing structures and systems have been in place for a long time, and that they involve varying degrees of statutory control and restriction on participation and competition. Part of our research programme has involved reviewing regulatory controls on major industries in the economy.

The substantial overhaul of longstanding regulatory arrangements, and the removal of restrictions on choice and competition, are proving very beneficial elsewhere in the economy. It is in the interests of us all to examine and discuss whether this might not also be the case in agricultural marketing.

Today, I want to question and challenge some features of the existing marketing systems and structures in the New Zealand dairy industry, and suggest some changes which I consider would benefit dairy farmers, the industry and the economy as a whole. Perhaps even more important, I want to encourage you, as dairy farmers, to do the same.

I will not be advocating the wholesale dismantling of existing marketing structures in the dairy industry. The Dairy Board, in particular, could well be one of the industry's most valuable marketing assets. The difficulty which analysts, and I suspect many dairy farmers, have is that under the current marketing regime an unequivocal judgment on the Board's performance is impossible to make.

I agree with the Porter study's conclusions regarding the importance of competition to innovation and improved commercial performance, but do not agree with the contention that this necessarily requires large numbers of industry participants within New Zealand. The key consideration is to make sure there are no unnecessary impediments to entrepreneurs being able to test ideas, pursue opportunities and take risks. This may or may not result in a large number of players in New Zealand.

I will return later to these important considerations. What I intend to do next is to outline briefly the history and role of the dairy industry's existing marketing arrangements.

2. THE EVOLUTION AND ROLE OF MARKETING STRUCTURES IN THE DAIRY INDUSTRY

The distinction between marketing systems and structures on the one hand, and the actual marketing functions and activities on the other, is very important. In essence, the marketing systems and structures - the concern of this address - are critically important in determining:

- how well the marketing functions and activities are performed;
- how effectively this performance can be assessed; and
- how dairy farmers receive and respond to returns from their various investments in the industry on and off the farm.

Dairy farmers have expertise in the efficient production of milk and generally do not have expertise, or want to be involved, in detailed oversight of the processing, packaging and marketing of the products made from their milk. However, they do want to be satisfied that these manufacturing and marketing functions are carried out in their best commercial interests.

Dairy farmers therefore require two things from the marketing system. Those requirements are that it:

- maximises the returns received for milk; and
- provides a basis for dairy farmers being sure that this is occurring.

To use the traditional jargon of the industry, maximum producer returns with adequate accountability. The desire of dairy farmers to be sure these two requirements are met underlies, in large part, the origins and apparent continuing support for the industry's existing marketing arrangements.

These marketing arrangements involve milk processing being undertaken exclusively by producer cooperative manufacturing companies, and a producer board being the sole exporter of New Zealand's dairy products. The Dairy Board and the manufacturing cooperatives work very closely together although individual cooperatives are generally not in direct contact with their markets or customers.

Dairy farmers 'own' the marketing system because 'their' cooperatives effectively 'own' the New Zealand Dairy Board. However, dairy farmers do not have an explicitly tradeable asset reflecting their equity in cooperatives or the Board.

The existing marketing arrangements and structures are also partly a product of the industry's history. In particular, they evolved in part from the involvement of the government in marketing associated with historical links between Britain and New Zealand, and 'special' arrangements put in place during the two World Wars. In preparing this paper I recalled - with a slight shudder - that in my days on a dairy farm the predecessor of the Dairy Board was a government bureaucracy.

Dairy farmers have lived with, and some would say prospered under, this marketing system and structure for some time. There appears to be a cooperative culture in the dairy industry which holds that dairy farmers must own and control the processing and marketing sectors of the industry. This culture has supported, and in turn derives from, the history of government involvement, intervention and control which, in a self-fulfilling way, has led to the perception that dairy farmers must 'cooperate or perish'.

Dairy farmer judgments about what marketing systems and structures are needed have also been influenced, particularly more recently, by the characteristics of the international market for dairy products. While New Zealand is a major player in world dairy trade, both international trade and New Zealand are relatively minor elements of the world dairy industry.

These characteristics, together with the widespread use of production subsidies and market entry restrictions, make the world dairy market volatile, and particularly hard work for an efficient and unassisted producer and exporter. The dairy industry appears to have the view that only the current export marketing arrangements will maximise producer returns in such a politicised and distorted international market place. Interestingly, the dairy industry really has had no entrepreneurial experience with alternative systems and structures for processing and marketing its output.

At the very least, existing perceptions and views need to be regularly examined to assess their relationship to reality, and their contemporary relevance. This is all the more necessary when it is considered how different the industry's cooperative and statutory structures are from the conventional corporate model in respect of openness to competition, performance indicators, accountability systems, and ownership and control.

I hasten to add that being different does not necessarily mean a change needs to be made. Assessment of performance compared with the likely performance of alternatives, or of a system which provided greater choice, should be the basis for such a conclusion.

In my view the dairy industry's marketing systems and structures can be changed in a way which would improve their performance, and hence returns received by dairy farmers. Furthermore, I believe this can be achieved without needing to expose dairy farmers to unnecessary commercial risks or threaten existing marketing organisations if they perform satisfactorily.

As the means of explaining my views, and the main reasons why I consider changes to existing marketing systems and structures are needed, I intend to discuss the following three broad topics:

- the reasons why the current organisational structures in manufacturing and marketing make it very difficult for dairy farmers to assess commercial performance and know whether their returns are being maximised;
- the basis on which dairy farmers make investment and production decisions and the implications for the structure and growth of the dairy industry; and
- the extent to which market characteristics require that the industry's marketing structures exercise 'control' over export marketing and restrict participation.

While market circumstances are a major reason advanced in support of current arrangements, what I consider to be much more important are issues relating to how dairy farmer returns from processing and marketing are determined and delivered, and how these affect the monitoring of the system's performance and farmer investment and production decisions. I believe that all the issues relating to overseas market circumstances either have their consequences exaggerated significantly or can be managed or accommodated by means which are much less restrictive on commercial opportunities and choice than the current arrangements.

3. HOW CAN DAIRY FARMERS TELL IF THE CURRENT ARRANGEMENTS MAXIMISE THEIR RETURNS?

Dairy farmers receive a net return per kilogram of milk supplied to their manufacturing cooperative. Diverse factors influence the net return, including:

- market returns obtained by the Dairy Board for the products manufactured from the milk and pooled across certain markets and products;
- returns from the Board's non-New Zealand dairy product trade and from non-dairy commercial activities;
- all marketing costs, including freight, insurance, finance, administration and promotion, which are also subject to pooling;
- returns to individual manufacturing cooperatives from sales on the domestic market;
- all processing and manufacturing costs past the farm gate; and
- cooperative and Board investment funding through either retention of earnings or borrowing costs.

The payout received for milk fat and protein is the major commercial indicator dairy farmers have for determining whether their entire production, processing and marketing system is maximising their income, and the returns they are receiving on their investment in the dairy industry on and off the farm. The manner in which this return is determined and delivered to dairy farmers reflects the particular organisational features of the industry's marketing structure, namely a statutory 'single seller' on the export market and cooperative manufacturing companies owned by their milk suppliers. Along this chain between milk delivery and consumer, people who are eventually accountable to dairy farmers endeavour to maximise market receipts and minimise associated manufacturing and marketing costs. In doing both, their objective is to maximise the milkfat payout to the dairy farmer.

The diversity of commercial information embodied in this single dairy farmer return severely reduces its usefulness as an indicator of the efficiency and profitability of the industry's manufacturing and marketing activities. For example, the average dairy farmer has around \$150,000 invested off-farm in processing and marketing. The dairy farmer has no way of knowing how well each item of off-farm investment is performing, absolutely and relative to the farm investment.

There are simply no comparative commercial performance indicators. Neither the Board nor the cooperatives report profits or remit separately identifiable dividends. The off-farm equity held by a dairy farmer is only negotiable if the farm is transacted - i.e. it becomes capitalised into the land value and probably discounted because of the restricted and indirect way in which it can be commercially negotiated. If you wish to be a dairy farmer you have no choice but to make this off-farm investment. There is no explicit share price because there is no direct market for the off-farm equity.

There are really only three bases on which dairy farmers can reach any conclusions about the economic performance of 'their' manufacturing and marketing system and each of them has major deficiencies.

First, they can compare their incomes with those of farmers in other rural industries. This is of limited value unless scale of farming operations and extent of off-farm investment in other industries can be taken into account.

Generally, dairy farmers appear to be 'satisfied' when their incomes compare favourably with those of farmers in other industries. Rising dairy farmer anxiety levels, and discussion about performance and accountability, are usually associated with periods when incomes fall absolutely or relative to other industries. This behaviour means that those responsible for the industry's performance past the farm gate have a strong incentive to keep incomes at 'comparable' levels, but this may not mean at their highest levels.

Dairy farmer incomes do not appear to have differed significantly from those of beef/sheep farmers. The dairy industry has not been growing vigorously. The production base has been static and growth in physical output has been due entirely to a rise in output per cow, which happens to be the factor dairy farmers have most direct control over.

This evidence does not suggest that the existing marketing system has been an engine room for growth or above average farm incomes. However, it could be that without

this system the dairy industry would be considerably smaller and incomes lower. That hypothesis is very difficult to prove or refute.

The second basis on which a dairy farmer can assess commercial performance is by comparing returns received from the cooperative being supplied with returns from other cooperatives. This comparison throws some light on the relative efficiency of manufacturing between cooperatives but indicates nothing about marketing efficiency or returns to off-farm investments. Differing levels of retentions for investment between cooperatives would also confound this indicator.

Finally, the dairy farmer can rely on what is said by elected representatives and senior management in the Board and cooperatives. However, the commercially useful information provided to dairy farmers appears to be very limited and not of a comparative nature, and so has to be taken very much 'on trust'.

Furthermore, most of the information provided to dairy farmers relates to variables such as gross returns, changes in turnover and developments in market share. These are really indicators of activity rather than performance.

The clear conclusion from this analysis is that a 'cost' to dairy farmers of the current marketing structures is a lack of satisfactory performance indicators. This is a major deficiency given the size and diversity of the investment each dairy farmer has in the industry. No amount of accountability in the form of consultation and questioning by dairy farmers will satisfactorily substitute for performance indicators such as profitability, dividends (returns on capital), share prices and ultimately survival. This is all the more so when there is an absence of markets for the capital and management involved in the marketing system and structures.

Various forms of review and audit are proposed to overcome this lack of performance information and market-based disciplines and sanctions. The fact that they are proposed, and seen to be necessary by dairy farmers, indicates that the deficiency is recognised.

However, reviews and audits of the types proposed are unlikely to assist dairy farmers greatly in their assessments of performance. This has been evidenced in the case of state-owned enterprises where it is now being appreciated that markets in capital and management, and associated performance indicators such as share prices and dividends, are essential to performance monitoring and ensuring efficient use of the resources involved.

There are structural options available to the dairy industry which would provide dairy farmers with conventional performance indicators and improved markets for their various investments in the industry without necessarily sacrificing the desire to hold equity in manufacturing and marketing activities. I will return to these options later.

4. WHAT INFLUENCES DAIRY FARMER INVESTMENT AND PRODUCTION DECISIONS?

As in all business endeavours, investment and production decisions made by dairy farmers are influenced by returns. The dairy farmer's net return will be the basis for deciding whether to stay in dairying and what level of output, or output growth, to

aim for. In aggregate, these individual responses will determine the size and growth of the New Zealand dairy industry.

Dairy farmers currently base these important decisions on a composite and residual net return for milk that contains a diversity of information on returns and costs. The nature of this return is such that its appropriateness as a guide to on-farm investment and production decisions would have to be questioned.

The reasons why the current return on milk may be an inappropriate basis for deciding what to do on the farm are fairly clear-cut. The return which a dairy farmer receives, and which determines whether to run an extra cow, is not the net return that will be received for the extra production from that cow. It is an average return, pooled across various markets, reduced by off-farm costs which have also been pooled, and including revenue obtained from activities which have nothing to do with what markets are paying for New Zealand dairy products.

Furthermore, the dairy farmer's return includes a return to off-farm investments in the manufacturing cooperative, the Dairy Board, and the Board's off-shore portfolio of businesses. Overall, it is a very confusing and misleading commercial signal on which to base milk production decisions.

The following two examples illustrate the point.

New Zealand retains favoured access to the United Kingdom butter market. This has been estimated to be worth some \$200 million per year to dairy farmers compared with returns if the same butter had to be sold on the international market. In fact, the benefits could be greater if, as a result of placing this additional quantity of butter on the international market, prices in this market were driven down.

This United Kingdom premium is combined with returns from other markets when paying the dairy farmer an averaged net return. As a consequence it raises milkfat returns, and hence production, by more than is economically justified given returns in markets where this extra production will have to be sold.

What this means is that after having successfully secured this premium the industry dissipates at least part of the benefit by increasing production when this is not what the market is indicating should happen. This problem, and the loss of income it entails for dairy farmers, can only be avoided if the premium from the United Kingdom market is returned to the 'shareholder' in a manner not likely to induce a production increase.

The second example illustrating how the return to the dairy farmer is likely to result in the wrong milk production decisions concerns the increasingly diverse range of commercial activities performed by the Dairy Board.

In 1989/90, 32 per cent of Dairy Board revenue was derived from either non-New Zealand dairy products (23 per cent) or non-dairy products (9 per cent). The Board publishes only limited information on exactly how this revenue is generated although the wholly-owned Sovenz Group would appear to be a significant contributor to non-dairy revenue. It is involved in a variety of activities including trading in motor vehicles and tractors, meat, peat moss, potash, vodka, and the construction of processing facilities for dairy, meat and fish.

Simply put, the profits from these diverse, non-New Zealand and non-dairy product activities should not be returned to farmers as a return on the milk they produce. To do so is to invite and encourage significant commercial and economic distortions in the production and manufacturing sectors of the industry.

If such distortions are not occurring there are two possible explanations, and both should encourage critical scrutiny by dairy farmers.

The first is that these non-core activities are not profitable and therefore not contributing any distortion to the milk price. The second is that they are profitable but for some reason the profits are not reaching dairy farmers in the return on milk.

These potential investment distortions caused by the method used to deliver returns to dairy farmers represent another 'cost' associated with the existing marketing systems and structures. The obvious question is what changes can be made to marketing structures to remove these costs. However, before moving to that question I want to consider whether there are benefits from the current arrangements which might exceed these costs. In particular, are these 'costs' worth accepting because of the improved returns dairy farmers might receive from an 'orderly and disciplined' approach to international marketing?

5. MARKET CHARACTERISTICS AND THEIR IMPLICATIONS FOR CONTROLS OVER EXPORT MARKETING

New Zealand produces 1.5 per cent of the world's milk but accounts for around one quarter of world trade in dairy products. Because very little of world production enters trade, the market is volatile and unpredictable. This is to be expected since small changes in production can have significant effects on quantities which enter trade.

Production subsidies and restrictions on market entry are also widespread in the international dairy market. In particular, the international market for dairy products is very much influenced by developments in the European Community, the United States and the Soviet Union. Between them, these three groups participate in more than three quarters of world trade in dairy products. Japan is also an important market with a protected domestic industry.

There is no doubt that participating in such a politicised and subsidised world market is hard work. But New Zealand has no option but to persevere and do the best we can. This, of course, is complemented by political activities and negotiations aimed at reducing surplus international production, intervention and subsidies.

The important question for the New Zealand dairy industry concerns whether the current marketing arrangements, particularly the 'single seller' on the export market, are required to maximise returns because of these market circumstances. It is also necessary to consider whether, in fact, there would be greater innovation, market development and penetration, and improved returns, if others were allowed to participate in exporting.

These questions focus on the ability of the New Zealand dairy industry to act effectively as a monopolist on the export market. It is possible that the New Zealand

dairy industry could be a successful monopolist in situations where institutional arrangements in the importing country favour New Zealand if it presents itself as if it were a single entity, or where New Zealand has some natural supply advantages it can exploit.

A clear instance where the New Zealand dairy industry has a readily available monopoly is the United Kingdom market quota. As noted earlier, this may be worth an additional \$200 million per year to New Zealand. Whether the dairy industry alone or the community generally should be the recipient of this 'economic rent' is an issue but one which I do not intend to debate here.

The point I want to highlight is that obtaining this additional revenue does require that the New Zealand dairy industry operates in the United Kingdom market in a coordinated way. If multiple New Zealand exporters competed in this market then the premium would be lost to United Kingdom importers.

Such a situation in international trade is not unique, however. For example, the Japanese motor vehicle industry has faced quantitative export restrictions (so-called 'Voluntary Restraint Arrangements') in the United States market but appears to have captured the associated economic rents without forming an industry 'board' or operating as a single seller. Moreover, I know of no other significant market for New Zealand dairy products with the same characteristics and hence the same uncomplicated opportunity for successful monopoly behaviour.

Similarly, I see no evidence to suggest New Zealand has a product which is unique in a way that might enable us to extract monopoly advantages or premiums. On the contrary, the world seems to be awash with the same or similar dairy industry products to those New Zealand is exporting.

Professor Wayne Cartwright has estimated that price premiums of up to 5 per cent over spot and tender prices are available for dairy commodity suppliers that can guarantee delivery, volumes and quality. This is not a particularly big margin, nor is it free for the taking. It could only be achieved at some cost with a monopoly exporter marketing structure. Moreover, there are other ways of organising reliable supply.

It is clearly not possible in a paper such as this to explore all the arguments and considerations relevant to the pros and cons of the dairy industry's current 'single seller' export marketing structure. However, even if a detailed analysis were undertaken, I have some difficulty in seeing how an unequivocal empirically-based conclusion one way or the other could be sustained. If only one marketing system and structure were used, and all the alternatives were precluded absolutely, from where does one derive unequivocal counterfactual evidence?

The report of the Porter Project appears to have popularised the All Black analogy to illustrate the advantages to New Zealand of commercial choice and competition. The All Blacks are successful, it is argued, because they are the product of an intensely competitive system. I consider the analogy very apt.

However, I have heard dairy industry representatives argue that the All Blacks illustrate perfectly the merit of the industry's current 'single seller' marketing arrangements. They agree that domestic competition is what makes the All Blacks

great, but point out that New Zealand does not send numerous teams overseas and require them to compete with each other on New Zealand's behalf.

To me, the use of the analogy in this way really misses the point. The dairy industry is not facing a single overseas market for its output. The market for dairy products is extremely diverse and changing all the time. In these circumstances, leaving all the marketing to just one organisation makes as much sense as expecting the All Blacks to represent New Zealand in every sport we choose to compete in overseas. Would the Japanese motor vehicle industry see things that way?

6. SOME SUGGESTED CHANGES TO CURRENT MARKETING STRUCTURES

It is my view as a policy analyst that dairy farmers would benefit from more competition in the export marketing of their output and organisational structures which embodied more conventional commercial performance indicators. This is likely to enhance the diversity of skills and ideas brought to bear on the export marketing task. It would also provide dairy farmers with a better basis for monitoring the performance of the marketing system and greater individual choice over the extent to which they wished to participate in commercial activities past the farm gate.

I consider it most unlikely that removing the Board's export monopoly would threaten the organisation's survival or success. The Board is a large, experienced international marketer. Its attributes and market experience provide it with distinctive advantages in competing with any new entrants. If, for some reason, this was not the outcome when it faced competition, then the industry is better off discovering that now rather than at some time in the future.

The fact that many dairy farmers are anxious about changing existing arrangements and introducing more competition is understandable. Current marketing structures have been in place for a long time. However, what I find puzzling is why the industry does not avail itself of readily available options which would allow dairy farmers effectively to test views such as mine without immediately putting at risk the major features and claimed benefits of the existing marketing arrangements.

Because differing views about what marketing systems and structures are best suited to the New Zealand dairy industry seem unlikely to be resolved by debate, it is very important that some of the alternatives being advocated are tested in the market place. My concluding remarks outline the way in which I believe this can be done.

Currently, there are two policy issues under debate in New Zealand which provide the opportunity for important changes to the dairy industry's marketing structure to be introduced and their consequences assessed.

One is the Dairy Board Amendment Bill which was introduced into the Parliament before the last election and is currently being considered by a Select Committee. The other is the Companies Bill, which is also under consideration by a Select Committee and is of particular relevance to the dairy industry because of the implications it carries for the cooperative form of business structure.

The Dairy Board Amendment Bill proposes relatively minor but potentially very important changes to the industry's marketing arrangements. In particular, it would relax, but not remove totally, the control exercised by the Dairy Board over exports.

The Bill proposes the introduction of very modest (and Board-controlled) competition on the export market. The Explanatory Note tells us that the Bill:

"...allows exporters to apply to the Board for permission to export dairy produce, and requires the Board to give its permission if satisfied that the produce is intended for markets in States that do not impose quantitative restrictions on imports, and that the export of the produce will not harm overall returns to the New Zealand dairy industry.

"The Board will not be able to use its powers of compulsory acquisition in respect of dairy produce for which an exporter has applied for permission to export, unless permission has been refused".

The changes proposed in the Bill would provide opportunities for existing manufacturing cooperatives, or possible new entrants, to undertake export marketing outside the Board's control and direct influence. If the Board refused an applicant permission to export, it would have to explain, in terms of industry benefits, why permission was refused.

It is my understanding that the Dairy Board is not fully supportive of these changes being introduced. I find it difficult to understand why the Board would wish to adopt this position – unless it viewed the Bill as a Trojan horse. Dairy farmers should be particularly suspicious of any attempts to base the approval process on internal, non-transparent criteria.

While the changes might fall considerably short of what I think is necessary in terms of introducing more choice and competition, at least they are likely to demonstrate the ability of commercial participants to seek out and develop new markets, products and methods of marketing. If such attempts fail, dairy farmers would be no worse off; if they succeed, then this must result in greater demand for milk output.

Perhaps of most importance, the commercial activities likely to emerge would provide dairy farmers with valuable experience and evidence of marketing alternatives and their consequences. And this would be achieved without putting at risk the major features of the existing marketing arrangements.

If I were an innovative dairy farmer with an interest in testing alternative marketing systems I would be advocating strongly the passage of the Dairy Board Amendment Bill.

The second current policy issue is the Companies Bill and the commercial structure and forms of accountability of relevance to the dairy industry which it raises. The Dairy Board, on behalf of the manufacturing cooperatives, has made a submission to the Select Committee advocating provisions in the final legislation which will ensure cooperatives can continue to be structured and operate as they have in the past.

In my view, if a group of individuals wish to form themselves into a business which operates on traditional cooperative lines then corporate law should allow this to happen. However, what I find of interest is the very strong advocacy from the

industry for the exclusive use of this form of business structure in the dairy manufacturing sector. As I discussed earlier, it is the cooperative business structure, with its particular and unique method of delivering returns to member shareholders, which makes it very difficult for dairy farmers to monitor commercial performance and which contributes to investment and production decisions which may sometimes be inappropriate.

As is the case with marketing structures, there are organisational alternatives available which would allow dairy farmers to retain control of their manufacturing cooperative if that were considered beneficial, while allowing returns from differing investments to be separated, conventional asset markets to function, and normal performance indicators to exist.

There are various corporate models which allow equity to be raised, shares to be traded and dividends paid without putting the organisation at risk of takeover by 'outsiders'. Essentially these models involve the issue of different categories of shares with restrictions on trading and ownership sufficient to ensure that any particular group or class of shareholder can maintain effective control and ownership. Such restrictions may have an efficiency cost, and should not be applied without good reason, but they are a straightforward way of maintaining a closely-held ownership stake in a firm.

This is a model which allows individuals who want to pursue a cooperative business philosophy to enjoy the best of both worlds. I am surprised to find this corporate model not being used widely in the dairy industry.

Removing the Dairy Board's total control over export marketing would encourage the adoption of alternative commercial structures in the manufacturing sector. While dairy farmers might want, initially at least, to consider structures which allow them to maintain control and be 'takeover-proof', I would commend consideration of the potential benefits from non-producer shareholding. 'Outside' investors can be valuable sources of capital. There is no reason to believe their objectives would not be the same as farmer shareholders - the maximisation of long term returns from their investment. They might even bring new ideas and suggestions for improving profitability.

7 CONCLUSION

Let me finish by summarising my key points and conclusions.

The New Zealand dairy industry has a set of marketing arrangements and structures which have been in place for a long time. They involve significant restrictions on choice, entry and competition. This appears to reflect a strong cooperative culture in the industry and a belief that a 'New Zealand Incorporated' approach to export marketing and exclusively cooperative manufacturing companies are in the best interests of dairy farmers.

Two very significant deficiencies in these arrangements derive from the manner in which the 'single seller' Dairy Board and manufacturing cooperatives deliver returns to the dairy farmer. The dairy farmer's return for milk is a composite of returns and costs from a variety of activities and investments. This places severe limitations on the ability of dairy farmers to monitor effectively commercial performance and returns on investment and to be able to negotiate their equity. This return is also potentially a very misleading indicator for on-farm investment and milk production decisions.

Apart from the United Kingdom market, which is likely to continue to diminish in importance, the traditional reasons put forward in support of a 'single seller' exporter do not stand up well to close scrutiny. This essentially reflects the fact that the New Zealand dairy industry is very limited in its ability to be an effective monopolist in the international dairy market. It is in competition with many other suppliers and many other substitute food products.

However, rather than continue to pursue a barren debate about whether or not the existing systems and structures should be changed, the dairy industry should take advantage of available opportunities to test the consequences of greater choice, more competition and corporate structures which allow commercial activities to be subject to conventional performance measures and market sanctions, side by side with existing arrangements. The suggestions I have made fall short of the extent of choice and competition I consider the industry needs. However, they represent some very low-risk steps in the right direction.