

Cover Story

## Time to Re-engage with our Co-operatives

Glanbia supplier, David Murphy, from Tallow Co. Waterford has just completed a Nuffield Scholarship with a project entitled, "Dairy Cooperatives for the 21<sup>st</sup> Century", and he makes some strong recommendations for the Irish dairy sector, based on almost 2 years of travel, meetings, interviews and investigations in Europe, the Americas, and Australasia.



farmers, business people and board members and management of Irish and international dairy co-operatives. In the course of this research the author travelled widely in Europe in 2011, concentrating on the co-operatives FrieslandCampina and FloraHolland in the Netherlands

The study endeavours to identify the fundamental points of difference that lead to a progressive, innovative, rationalised and successful dairy co-operative that delivers a sustainable milk price to farmer members which leads to real wealth creation in rural communities.

before heading to Argentina and Brazil in March 2012. The study tour of New Zealand and Australia in September - October 2012 was a steep learning curve in relation to how a co-operative can gain power in the international market place by farmers coming together and rationalising their industry and having a clear focus on maximizing the value of their milk.

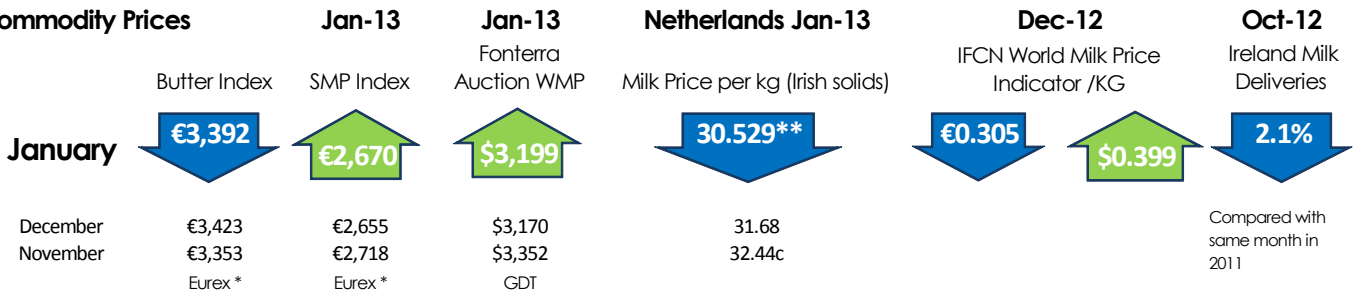
The methodology employed in formulating the report included extensive research in both printed and online documentation and intensive interviews with successful

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Market Insight

## Dairy Markets

### Commodity Prices



\*: Eurex Futures Dairy Market Indices

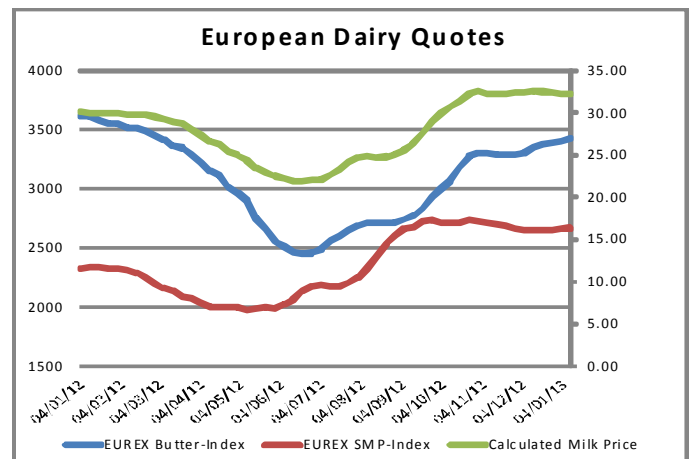
\*\* No seasonality bonus in January

Market News

The Christmas period brought continued relative stability to dairy markets, with some weakness in Butter quotes (at €3392 down almost €50 from their mid-December peak) and some strengthening in SMP quotes (at €2670 up about €15 per tonne, but still around €60 shy of their late October levels). Current calculated milk prices, on the basis of these quotes remain at about 32.3 cents per litre. Friesland Campina's January Guaranteed price, at Irish solids levels comes to 30.53c per kg or 31.43 cents per litre. Meanwhile the Fonterra farmer milk price prediction, at Irish solids, remains at 26-27c per litre.

Meanwhile, the USDA reports a December 2012 milk price of \$21.10 per cwt (equivalent to just over €0.34c per litre at Irish solids). This is down from \$22 in November, but still close to an all-time high, and is contributing to strong US milk production despite the persistent drought. US production in November grew by just 1% on the previous year, an improvement on the supply decrease for September and October, but well down on the 3-4%

growth of early 2012. The resultant full figure for 2012 will be an increase of 1.8%. US production for 2013 is expected to be on par with 2012, despite extensive culling, and due to strong yield increases.



## Milk and Dairy Products in the EU: A Review of 2012

From an Euro 27 perspective 2011 ended with an average EU annual raw milk price of 34c per litre. At the beginning of 2012, the EU average milk price decreased from 34.4c per litre in January to 30.9c in June.

Ireland suffered as much as many EU states, but our co-operative structures have been continually cited as the key reason for saving us from the devastation caused to milk suppliers in the likes of the UK, where dairy suppliers were picked off individually as they lacked co-operative backing.

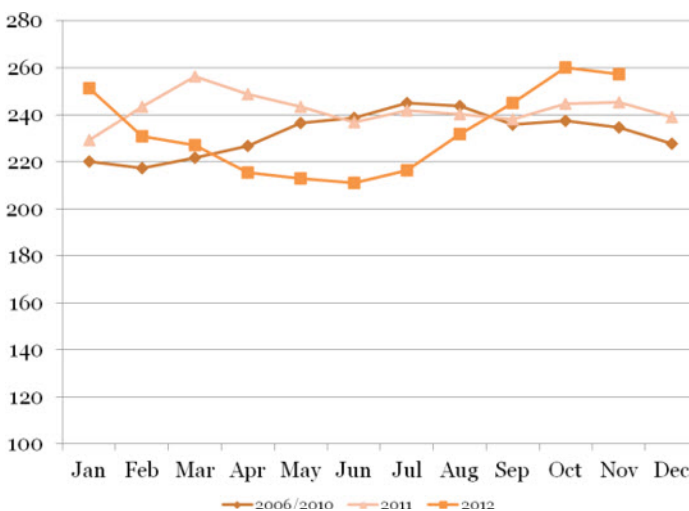
Milk prices began to slightly improve in the third quarter of 2012.

Margins fell for milk producers by 17% due to an 8% decrease in farm gate prices (source: Commission report on soft-landing of dairy quotas, 2012).

In the Dairy commodity arena prices have suffered a similar decrease: in May 2012, the butter price was 257 €/100 kg only marginally above the intervention price of 221.75 €/100 kg. Skimmed milk powder price was 200 €/100 kg (intervention price: 169.80 €/100 kg), but this started to recover in August. At that time, around 130,000 tonnes of butter were accepted under private storage, a sizable chunk of it from us in Ireland.

Private storage aid proved itself to be a vital tool in protecting Irish Co-ops from the very worst of the dairy slump in Q1 and Q2 of 2012.

From January to September 2012, cows' milk collected in the overall EU increased by around 1.2% compared



to the same period in 2011. We in Ireland have seen a decrease along with dairy farmers in the UK Belgium, Italy and Bulgaria.

EU output of butter, SMP and cheese production increased by 3%, 6.1%, 1.9% respectively during the same period. Only WMP production decreased in 2011 as well as in 2012.

From a quota viewpoint we and five other Member States exceeded their 2011/2012 quota level, namely: Austria, the Netherlands, Germany, Cyprus and Luxembourg. The Netherlands also exceeded both their quota for deliveries and direct sales.

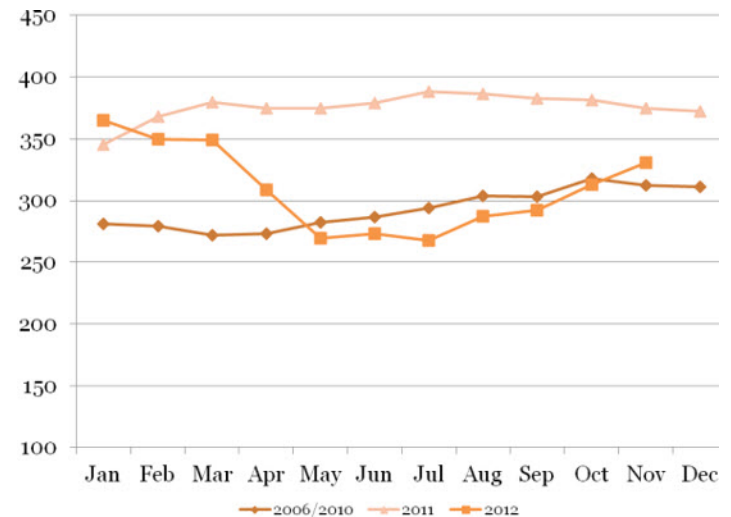
Currently the EU as a whole is 4.7% below EU total quota volume.

In other Key Dairy markets- US milk production increased by 2.8%, New Zealand by 11.4% (up to July) and Australia by 4.7%.

EU Cheese exports to third countries increased by around 14% and SMP and butter exports increased by around 10%. There seem to be good opportunities for European SMP on the Chinese and North African markets, and our co-ops are exploiting this as non- EU markets increase in importance for us.

World demand looks positive and medium term prospects seem favourable according to the OECD-FAO Agricultural Outlook 2012-2021. In developing countries, it is believed that consumption of dairy products will increase by 30% up to 2021. At the same time, China and India in particular are expected to increase their own milk production capacity.

Price trend charts:



Average European price for SMP (€ per 100kg) Average European price for Butter (€ per 100kg)

## Ireland Takes the Presidency of the EU: Time Table & Dairy Implications



Uachtaránacht na hÉireann ar  
Chomhairle an Aontais Eorpaigh  
Irish Presidency of the Council  
of the European Union  
eu2013.ie

Ireland took over  
control of the  
EU's  
rotating  
Presidency from

Cyprus on Jan 1 at a critical juncture in talks on the future of the Common Agricultural Policy with the hope of striking a deal among Farm Ministers at the Agriculture Council on June 25 & 26 in Luxembourg.

With direct payments of €1.75 Billion a year coming from the CAP into the Irish rural and agricultural economy the importance of these negotiations are not to be lost on anyone, especially our co-operatives.

The timing of the final deal depends largely on when EU leaders manage to hammer out a deal on the long-term budget. No date has yet been confirmed by European Council President Herman Van Rompuy's team for the talks, but an EU summit is scheduled for Feb 7-8 on the matter.

An agreement on the future CAP also depends on progress made in trilogue talks between MEPs and Council negotiators, which are set to kick off formally once the Parliament adopts its position in plenary (likely in mid-March, 11-14). Time for haggling between the institutions will be short, but if no agreement is reached in June, looming elections in Germany in the autumn will complicate talks, while a new Commission college will take up office in 2014.

### 'Soft Landing' of Dairy on track according to Commission – ICOS Begg to Differ

The soft-landing ahead of the abolition of dairy quotas on April 1, 2015 is "on track", as milk output falls short of the quota ceiling in the vast majority of Member States & quota prices are already at zero or close to zero, according to the 2nd report on the dairy sector published by the Commission before the Christmas break.

The report states that the milk quota price is on a downward trend - "very low or equal to zero in the majority of Member States".

While ICOS figures have shown a reduction in quota price in Ireland ICOS has long argued that the 'soft landing' has been a false promise, with millions of euro spent and still being spent on quota purchase in the run up to quota abolition. We will continue to attempt to work with our allies to look for means to avoid superlevy fines like the €17 million our industry

Our Minister Simon Coveney is set to lay out his work programme - largely dedicated to CAP reform - to Farm Ministers at the first Council of the year on Jan 28. Farm Council meetings are also scheduled for Feb 25/26, Mar 18/19, April 22/23, May 13/14 & June 25/26. The Informal Council gathering will take place around Dublin on May 26-28.

Key issues for our Dairy co-operatives include the reform of the EU rules on the organisation of the dairy markets called in EU jargon the single CMO, which will dictate rules on intervention, PSAs, supply management and export refunds to name but a few.

Of almost equal importance are the negotiations on direct payments to dairy farmers, as these often act as the key protector of farm incomes during times of market crises, taking price hike demand pressure off the co-operatives that are not warranted by the market.

ICOS continues to be at the vanguard of these negotiations both in Brussels and in Dublin.

Our Presidency is also set to be a busy time for reforming rules for animal & plant health, with Farm Ministers scheduled to discuss Commission proposals for revising animal & plant health legislation as well as marketing, controls & production of seeds in March. Bilateral Trade deals between the EU and 3<sup>rd</sup> countries will also have significant implications for Irish Dairy co-operatives as we strive to grow market share in these developing markets.

had to pay this year at a time when the EU as a whole was well under quota.

As regard future dairy prospects, the report is more positive predicting favourable medium & long-term prospects for the sector, in line with population growth. EU production of fresh dairy products is expected to increase by almost 8% from 2009-2022, with cheese by almost 10%. Meanwhile, EU SMP is projected to increase by about 28% over the outlook period, with the EU seeing its market share rise to 31% of global exports in 2022. Authors of the report predict that EU market share will gradually decrease for most dairy products, "as a result of a higher rate of increase in exports from other countries", but it should still account for about 31% of global exports in 2022.

The report seeks to outline the key differences between a co-operative way of doing business versus the more conventional investor driven organisations and identify what makes a co-operative successful.

David asserts that the Irish dairy industry has failed to rationalise effectively and benefits of 2 cents per litre can be achieved by bringing the industry together to on a consolidated processing, marketing, innovation and R&D platform.

Irish co-operatives have evolved into multi-purpose organisations that process milk and also supply farm inputs as well as other businesses to provide value for members however this evolution has clouded the ownership of co-ops with 70% of shareholding in the hands of dry or non-active members and only 30% in the hands of active dairy farmers.

Irish dairy farmers and co-op members have disconnected from their co-ops over the years of the milk quota regime. Quotas are being abolished in 2015 and Irish farmers have an opportunity to expand production for the first time in 30 years – this is the time for us to re-engage with our co-operatives and create a business which can compete effectively in a global context, we need a Dairy Co-op for the 21<sup>st</sup> Century.

## Report Recommendations

### 1. Culture Change

We need to create a single purpose milk processor, handling 80% of Ireland's milk pool, this integrated co-op can concentrate on maximizing the value of members milk, to achieve this, we firstly have to revalue the milk processing assets of co-ops separately from other assets and establish a defined share class for each of these asset types. Apportion shares in the milk processor to dairy suppliers and apportion shares in agri-trading and all other assets to dry shareholders. All milk suppliers must have a shareholding reflective of milk supply.

### 2. Business Performance Payments

Milk pricing is the clearest interface between milk suppliers and management and thus needs to be transparent, it has to send clear signals to farmers on commodity returns from the global market and also pay a performance related dividend on shares (after retentions and additions to co-op reserves) that reflects the value add that management has achieved through innovation and efficiency. This performance dividend is distributed fairly if share holdings reflect milk supply. Transparent milk pricing and dividends

related to profit keeps both membership and management focused on achieving the maximum performance from the business.

### 3. Share Redemption

Redemption of shares when a member ceases trading is necessary to keep shareholding in the hands of active dairy farmers. Redemption can be carried out at board discretion to reflect the risks to the businesses balance sheet i.e. the board may decide to leave a retired farmer redeem their shares over a set period of 5-10 years and a new milk supplier to buy shares over 2-4 years.

Establish a fair value for shares that reflects the appreciation or depreciation of the assets over the time period of a suppliers membership, a retiring member sells their shares to a new member thus reducing the risk to the company and if a member wishes to grow their milk supply new shares are issued to reflect volume.

### 4. Co-operative Education

Education programmes need to be established to reinvigorate and reconnect grass roots farmers with their co-ops, these programmes should encompass how the co-op business model works and how it differs from investor type businesses.

Education programmes for elected representatives must be more intensive and elected members should be voluntarily required to complete a set number of individual training courses over each term of service.

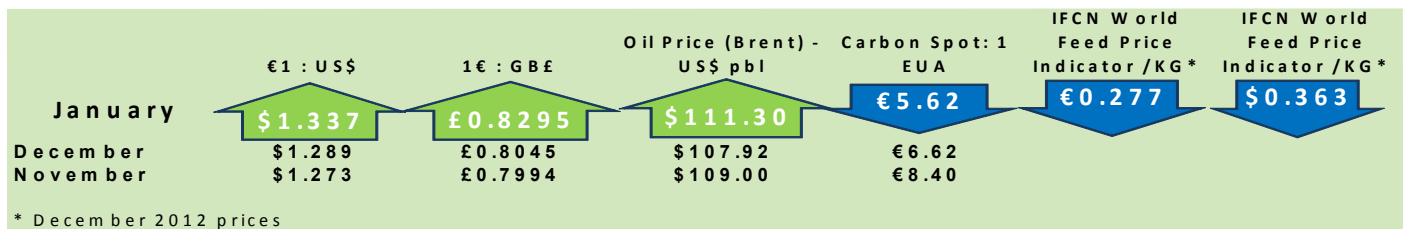
Points awarded on completion of education modules for elected representatives - with a minimum amount of points required for an individual to be eligible to contest a seat at council or board level of the representative structure.

### 5. Constant Evolution

For a co-operative to be successful there is a need for constant evolution of structures within the organisation, Rules that are more reflective of bygone times need to be adapted to a more modern Society that reflects better communication and connectivity.

### 6. Encourage Excellence

For our industry to succeed we have to encourage excellence at all organisational levels from grass roots membership through representation structures on to board level who will focus on managements capability and delivery of optimum business performance.



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