Optimising farmgate returns from the market

A paper for the Australian Dairy Conference 2012

February 2012

freshagenda

Summary

What this study has covered

- Freshlogic is pleased to have the opportunity to provide input to the 10th Australian Dairy Conference ("ADC") . Our paper and presentation will draw on our existing knowledge and some refreshed research into these factors.
- The scope to optimise returns can flow from a milk producer's ability to **understand the choices** that are and will be available and the **ability to influence an outcome** in the value of milk supplied to the market.
- The paper can't simply present a summary of what is on offer today – we have seen gradual yet significant change, increasing complexity and diversity at farmgate in the dairy industry in the 10 years that ADC has been a key event. The future developments that will drive the dairy market must shape those longer-term considerations.
- This paper looks into the scope for further change and how producers can embrace those future developments.
- Our approach has taken a wide definition of "influence". Choices must be affected by the **risks** producers are prepared to take and how they may be able to manage them in future, how **informed and aware** of options they wish to make themselves, the level of **volatility** they can tolerate, the **markets** they wish to be exposed to, and the production **systems, skills and know-how** they can harness.

Key findings

- Rapid change is affecting the dairy world, altering the nature of opportunity and competition for a burgeoning market as the globe struggles to feed itself. Despite these, it is clear that world market prices will drive the value of milk, and that farmer-owned structures in the supply chain that compete in export markets are most critical in setting that value across all uses.
- If the base value of milk is optimised, by definition, all milk producers will have the opportunity to obtain better returns from the marketplace.
- However how individual suppliers take advantage of price signals, and whether they make the correct choice of which market that a milk supplier is part of are critical determinants that affect the performance of any dairy enterprise.
- Change to the structure of co-operatives is occurring gradually in all major dairy regions, and the pressure for change in the Australasian industry context is as strong as in other markets. Change is challenging the dairy co-operative the world over, yet changes in the Australian industry (other than companies exiting that model) has been slow by comparison.
- A comparison of the performance of dairy companies in this region shows a significant additional value that has been extracted from domestic and export markets by companies which have pursued more collaborative and performance-based models.
- Changing structure by itself won't deliver a lift in company performance or the average industry milk value. Stronger business performance comes down to management skill and the business culture that is fostered.
- The structure of a farmer-owned company is not the business of all milk producers – although all will have a stake in such an outcome. Producers who are owners of dairy co-operatives have the opportunity to create or support change in the way their companies are governed and structured, provided the rationale for change is compelling.

The scope of this report

The report content

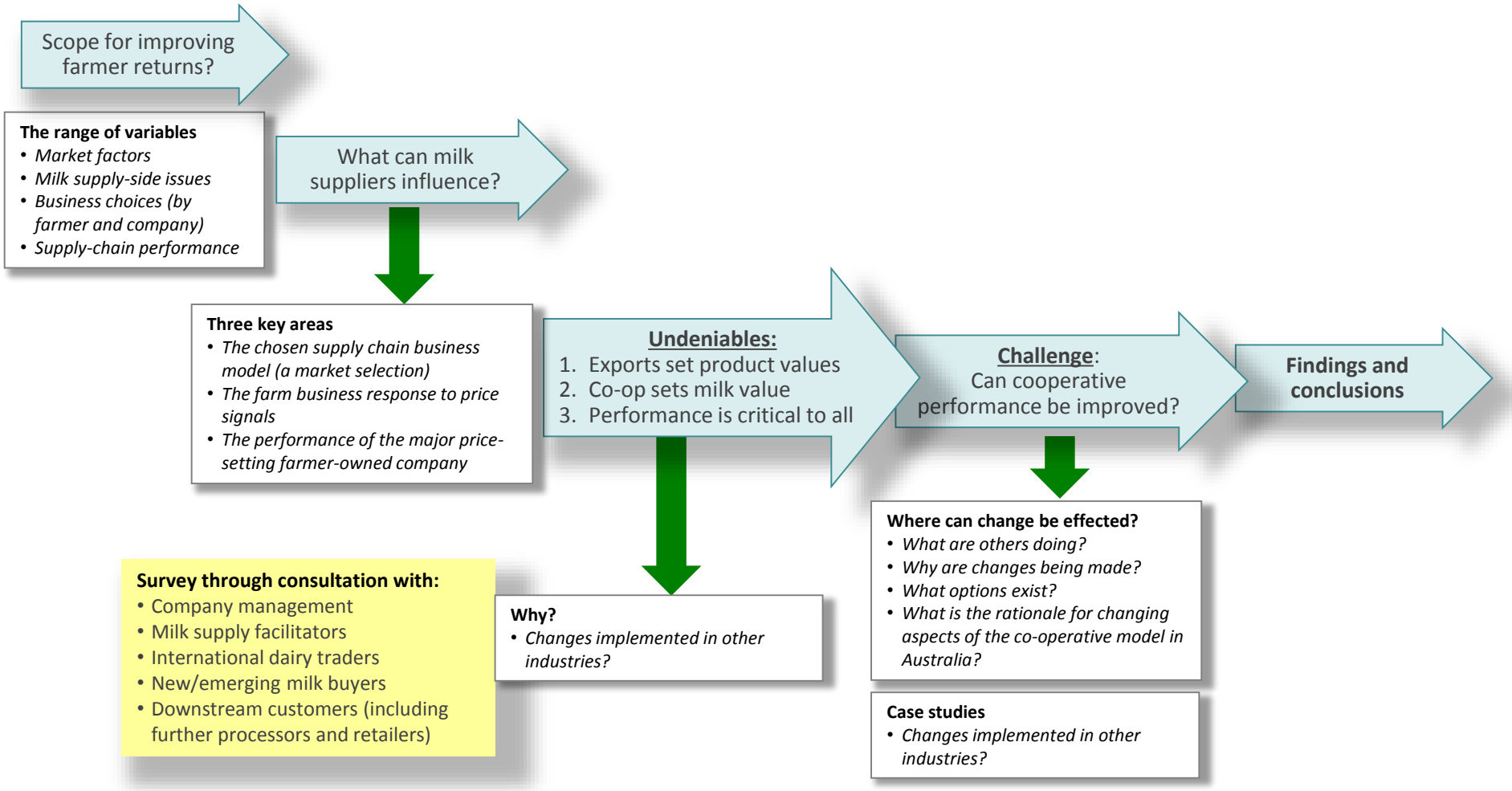
The document provides the following analysis:

- **What will influence the dairy value chain** and global and domestic dairy markets in the future
- **What milk producers can influence** and **how;**
- **Alternate pricing options and "business models"** that are available to Australian milk producers and the pressures being applied to those in future;
- **Case studies of approaches** taken in the world to change the traditional farmer-owned dairy company;
- **How dairy companies have performed** in recent years;
- Changes that are possible and that have been applied to dairy companies;
- **Reminding the reader that optimising returns to the dairy business requires a holistic view** – taking account of what it takes to "line up your own dairy enterprise supply chain" to take best advantage of what the market might offer

Topic	Content	Pages
Rationale for this approach	A schematic of where and why provider influence is relevant.	4
Observations	A summary of some important principles on which this study draws	5
Future change in the value chain	A schematic of the major changes affecting the dairy value chain	6
Influences of returns	A schematic of what key factors affect farmgate returns – and which of these can milk suppliers actually influence	7
Influence by milk producers	This provides direction for the structure of the document, and the relationship between the factors of influence.	8
How milk is priced	Approaches to milk pricing	9 and 10
Value chains in the milk market	Value chain models accessible by producers and the pressures being applied to those in future	11 and 12
	Relevant case studies to illustrate potential new approaches and strengths and weaknesses of models in use	13 to 16
Returns	A comparison of medium term returns from the milk market and financial position of farmer-owned companies	17
Change to farmer-owned companies	The nature of changes possible and cases applied in the global dairy market	18 to 21
The holistic challenge	What it takes to turn a top-line revenue return into profit	22

Rationale for the focus of this paper

The approach to the research and development of the delivery materials will be based on the key steps and considerations in the process outlined below.



Some key observations

Farmer perspectives

- **Focus on uncontrollables** - *There is a propensity of dairy farmers to look outside their sphere of control to seek magic bullets for better returns. Optimising milk price is a common area of focus.*
- **Support for a big co-op is vital, but isn't for me** - *A common comment is made that "co-ops are vital and should be supported, but I'd rather chase the extra bucks with other processors who offer a deal to suit my business".*

Basic principles

- **Structure as a solution** – *Appropriate governance and capital structure only provide the settings and impetus for better management. Management skill does not depend on these, but success has far better prospects with them in place.*

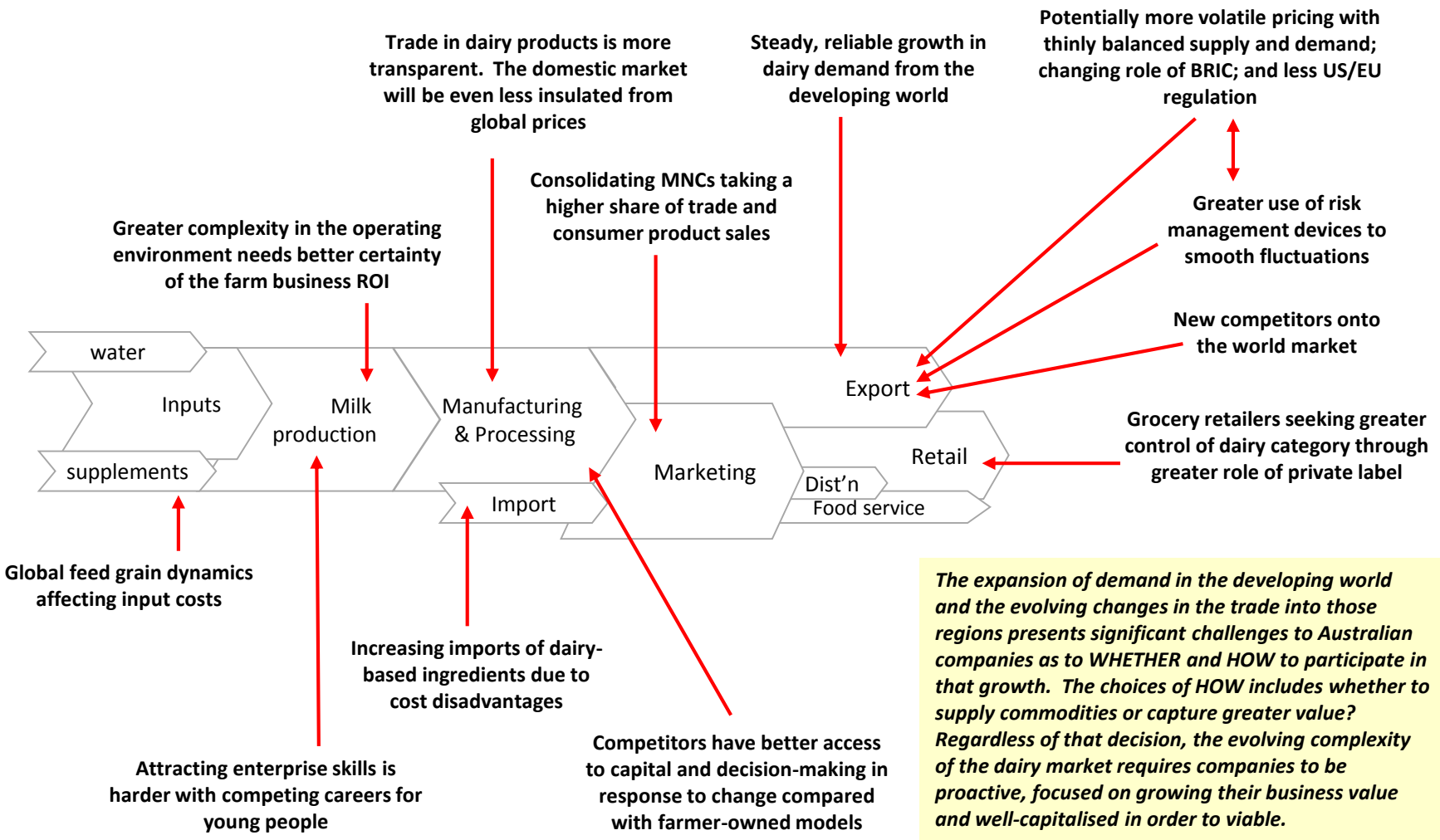
  Better performance won't come from a change in structure. Structure can influence how a business is governed and managed, but by itself won't cause improvement.
- **Equity** - *Equality in treatment (pricing, market access, transport costs) isn't equitable.*
- **Responsibility** - *It is easy to blame management for any underperformance, but ultimately the owners of the business (supplier members) have to take responsibility*
- **Leverage** *is not created by bargaining together, but is only created either by creating a shortage in milk supply; or improved commercial performance (and capacity to return to suppliers and owners) of the major farmer-owned milk buyer*
- **Price setting** - *Major farmer-owned company sets a firm price as long as it is strong. If it weakens, all prices will fall to the long-run marginal cost of producing milk locally, or the value of the next best option. A private or publicly listed milk buyer will* ***only pay what they have to*** *in order to secure milk and obtain a competitive advantage for their business to the benefit of their shareholders.*

The challenge from change

- **Denying the importance of governance** - *Co-ops that ignore commercial governance imperatives will be forced to continually remodel their business, exit or perish*
- **Fear of change** *from tradition is the biggest barrier to better performance*
- **Retention** - *In the face of competition, retention of milk suppliers is addressed primarily by blanketing the ground with field staff rather than allowing performance to speak for itself*
- **Evolution** - *Co-ops the world over are evolving – Australia's only change has been that there are fewer of them.*

The changing dairy world

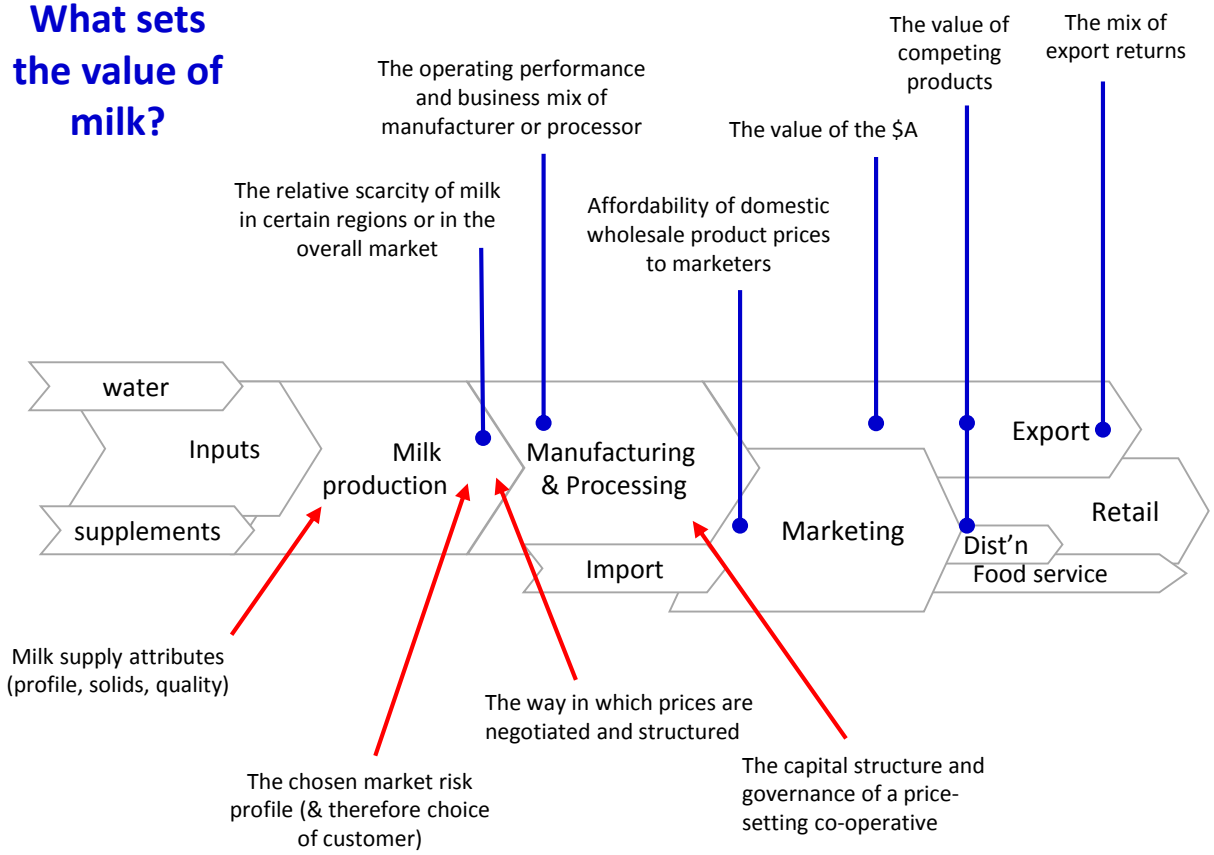
The factors identified on the previous page are made further complex by a number of emerging pressure points on the dairy value chain.



The expansion of demand in the developing world and the evolving changes in the trade into those regions presents significant challenges to Australian companies as to WHETHER and HOW to participate in that growth. The choices of HOW includes whether to supply commodities or capture greater value? Regardless of that decision, the evolving complexity of the dairy market requires companies to be proactive, focused on growing their business value and well-capitalised in order to viable.

The factors influencing farmgate returns

What sets the value of milk?

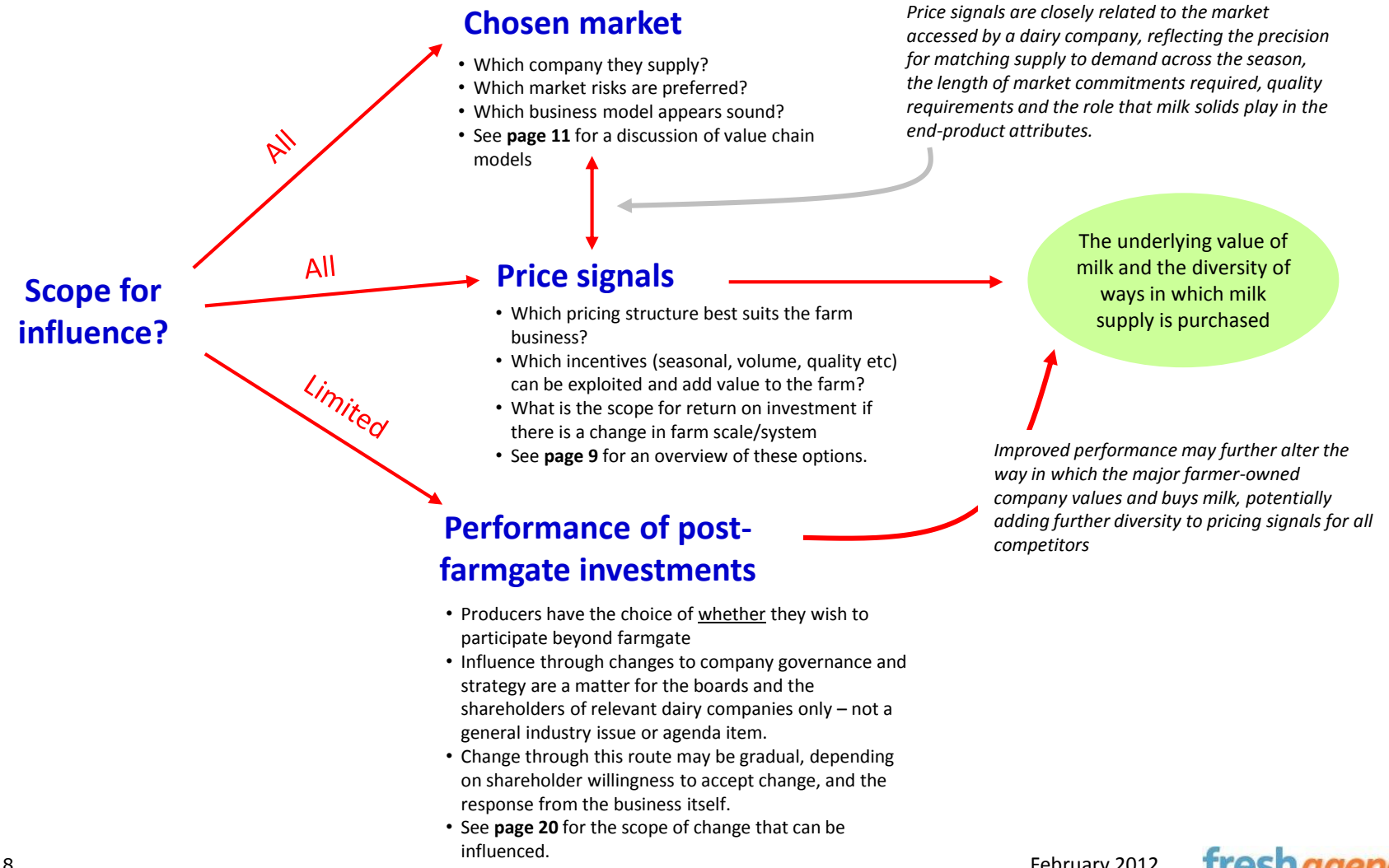


What can a dairy farmer influence?

Capacity to influence returns

- Returns from the dairy markets to the southern Australian milk pool are set by a range of external factors, few of which can be influenced directly by milk producers.
- The nature of milk supply arrangements (outlined later in this document on pages 9 and 10) ensures little direct "look-through" is available through milk supply terms.
- The effective choices available to milk suppliers – and their interrelationship – are explained on the following page.

What can milk producers influence?



The approaches in milk pricing

An industry consolidating yet offering greater diversity

Ultimately, the market options for raw milk boil down to **what is on offer** and **what a producer can access**. Dairy markets are, over time, increasing in their complexity, adding to the scope for product niches in fresh products, ingredients, cheese etc.

The range of milk supply arrangements and contractual options available to Australian dairy farmers are gradually improving in their diversity, reflecting the intensity of competition for milk at the farmgate in a low-growth production environment.

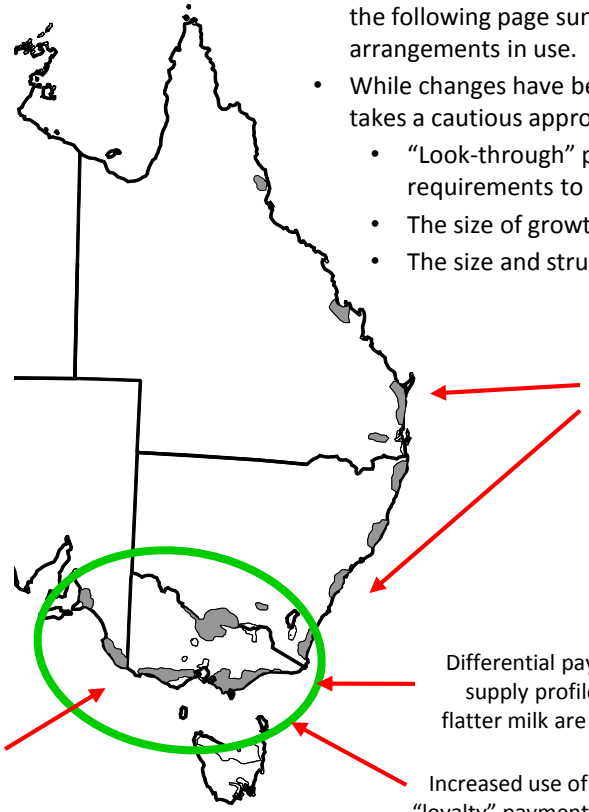
While the number of major dairy companies has consolidated in recent years, a number of smaller companies have emerged as competitive milk buyers, improving the choice for many in the large export-focused regions. While the volume of milk has remained largely the same, a greater portion of volume is demanded by domestic buyers, intensifying competition between manufacturers for available supply to meet the sustained export demand.

While competition may drive keener pricing for milk, it is merely building more cost into the total supply chain, through lower overall plant utilisation and higher logistics costs.

The practice of "notional" milk supply arrangements has been extended taking some buyers into regions far from their actual factories. Meanwhile the consolidation of fresh milk markets has narrowed effective choices for suppliers in northern coastal regions and Western Australia.

Innovations in milk price structures and signals:

- Innovations in recent years have been limited to a number of factors shown on the industry production map on this page.
- Conservatism by the major milk buyers that offer generic milk payment structures has traditionally contributed to limitations in innovation. The table on the following page summarises the features of supply arrangements in use.
- While changes have been made, the pricing at present takes a cautious approach to:
  - "Look-through" pricing to match plant requirements to milk supply profiles
  - The size of growth or volume incentives
  - The size and structure of seasonality incentives



Two-tiered pricing by fresh milk companies to manage cost of supply of demand volumes.

Differential payment options based on supply profiles – the incentives for flatter milk are now more highly valued

Increased use of conditional "loyalty" payments to minimise supplier mobility within seasons

Increasing incidence of discrete or "special deals" offered to larger, more attractive suppliers, or groups/aggregations working together

The approaches in milk pricing

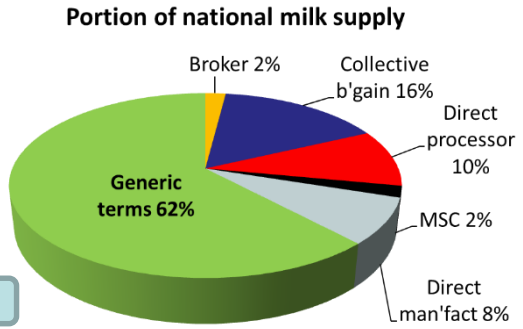
This page provides a high-level summary of the nature of options available in the farmgate market in 2011 from major milk buyers. Other smaller company offers exist in all regions of the industry. The purpose of this illustration is to show the nature of structures and the extent of diversity in options.

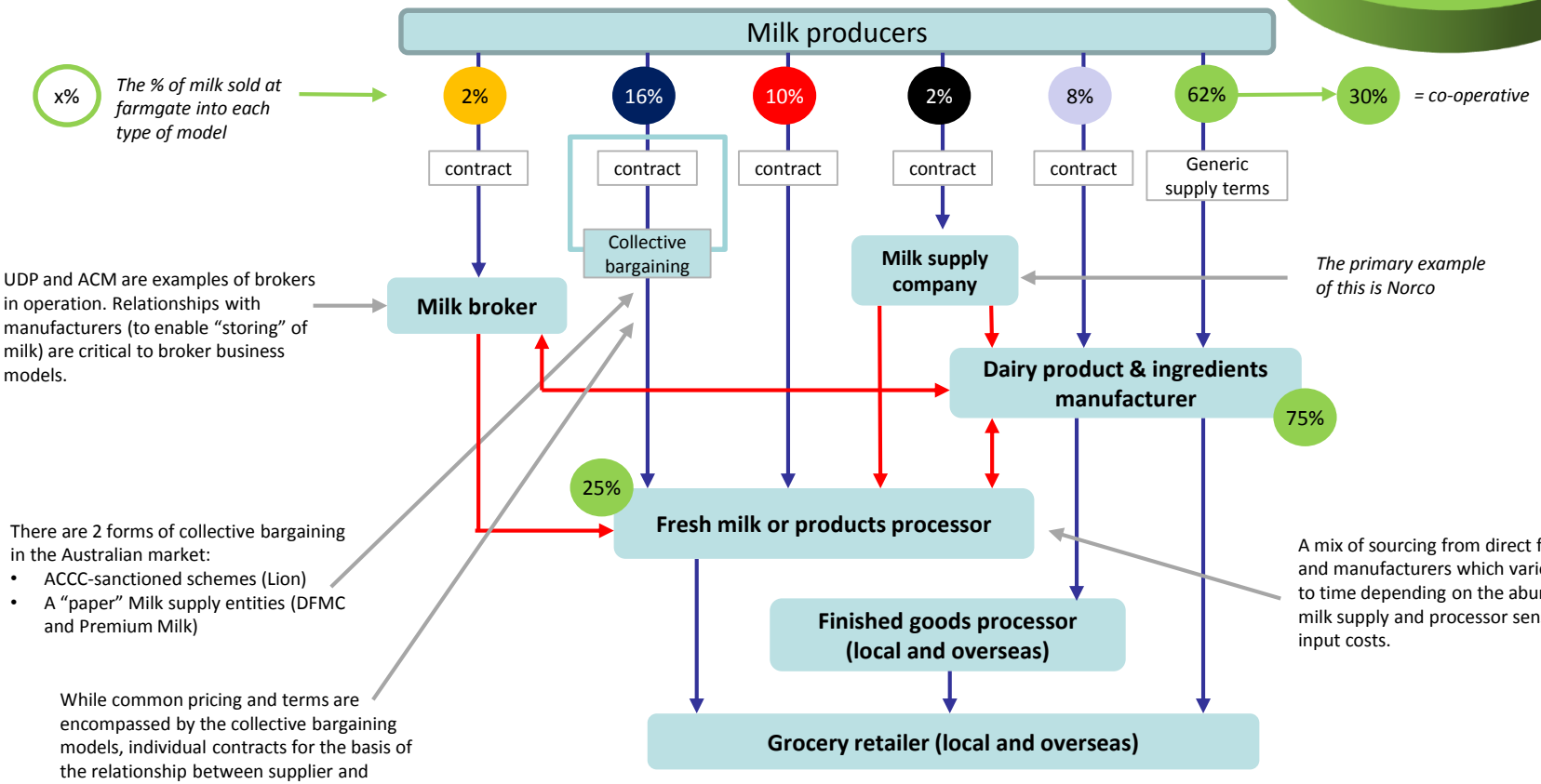
	Full-year price	Duration of contract	System options	Step-up payments	Two-tiered pricing	Volume and/or Cartage	Prod'y/volume incentive	Compulsory shares	Growth/new milk	Seasonal incentives	Quality Bonus	Loyalty premium	Production profile variations	Regional variations	Market-related pricing for selected	Other comments
Fresh processors																
Lion	Y	1-3yrs			Y	C	Y				Y			Y		• Tier 1 pricing based on affordable fresh milk requirement, with Tier 2 prices linked to southern manufacturer prices. • Average price depends on individual access to Tier 1.
DFMC	Y	2-3yrs			Y	C	Y				Y			Y		
Parmalat Northern	Y	3yrs	2		Y	C					Y			Y	Y	• Tiered pricing still applies to PDA supply group
Parmalat Vic	Y	1yr				C	Y				Y			Y		
Manufacturers																
Murray Goulburn		GSY	3	Y		VC	Y	Y	Y	Y	Y	Y	Y			• Payments based on season-to-season payment "pools" with step-ups following lead or expectation of payment by MG • Payment structures for base and incentives largely unchanged in the past decade • Greater diversity in offering by MG based on supply profiles has stimulated more flexibility from others
Fonterra	Y*	GSY	3	Y		VC	Y		Y	Y	Y		Y	Y	Y	
WCB	Y*	GSY	2	Y		VC	Y		Y	Y	Y		Y	Y	Y	
Bega Cheese	Y	GSY		Y		VC	Y			Y	Y	Y		Y		
Tatura		GSY	2	Y		VC	Y					Y				
Burra Foods		GSY		Y		VC	Y									
Milk brokers																
UDP	Y	1 yr		Y		V	Y			Y	Y			Y		

Y = yes; GSY = generic single year structure; V = Volume based; C = cartage
* = for some milk supply arrangements on offer

Value chain models

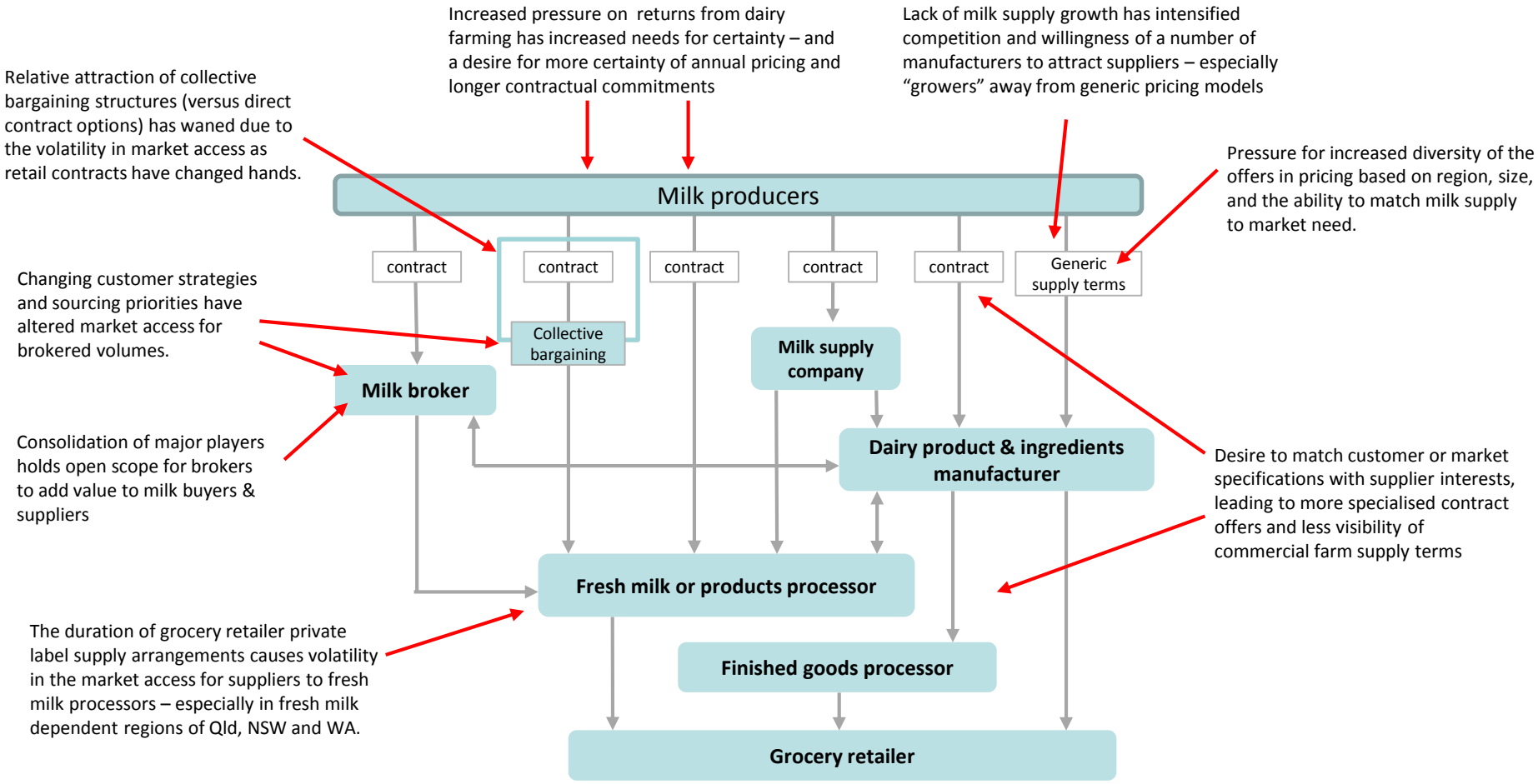
There are various business or supply chain models that apply to the sourcing and supply of milk to dairy companies. Producers should ideally be aware of the nature and purpose of the models they engage in, their strengths and weaknesses, the opportunities they provide and threats they are exposed to in a volatile, competitive world.





Pressure points on value chain models

There are various pressures on the supply chain models outlined on the previous page.



There are a number of relevant case studies in the structure of the value chain between milk supplier and the retail market which are relevant to the Australian industry now and in the future. These are outlined on the following pages

Value chain case studies

The milk supply company concept is not foreign to the Australian industry, featuring a farmer-owned company owning its own processing plants and on-selling milk to processors customers. Producers in Australia have romanced this concept as a way of creating greater leverage, but caution is required. The UK experience is an unhappy one.

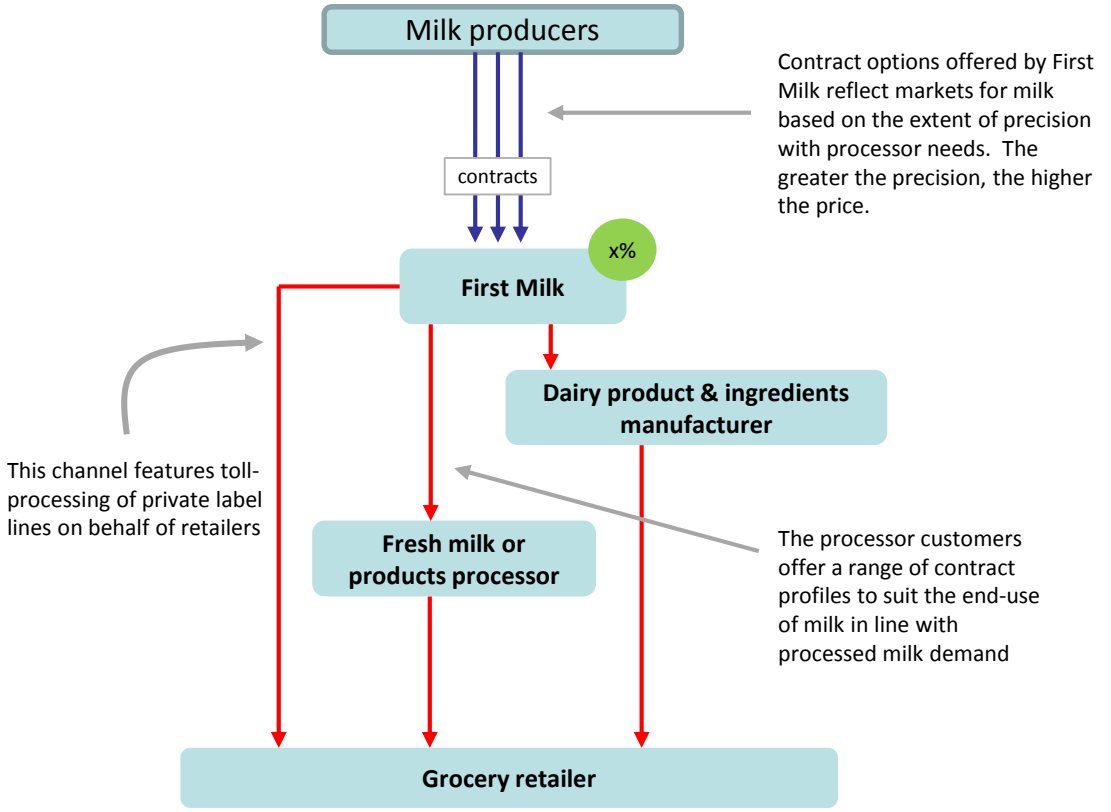
Innovations relevant to Australian producers:

- The company has attracted members in 2010 and 2011 based on performance
- FM has progressively selected business ventures that would contribute to greater returns on milk
- The company offers a range of milk contract options allowing the producer to select that which best suits the farm business, while being competitive with fresh milk processors
- FM operates with a high ratio of suppliers to field staff and leaves representational issues to farmer committees

Challenges faced by this model?

- Co-operation is a relatively new concept in the UK industry
- A high % of milk is directly sourced by processors
- The volatility of retail private label packaging contracts exposes the company to changes in market access
- Whether the scale of its processing facilities and brand portfolios can ensure it remains competitive.

First Milk was created as a milk trading and logistics company in the UK industry, and has gradually evolved into a business model that mixes ingredient production, own-product manufacturing and milk brokering. In 2011, it collected about 13% of the UK's milk.



Value chain case studies

Dominant national co-operatives didn't characterise the US dairy industry until the 1990s – DFA was formed in 1996.

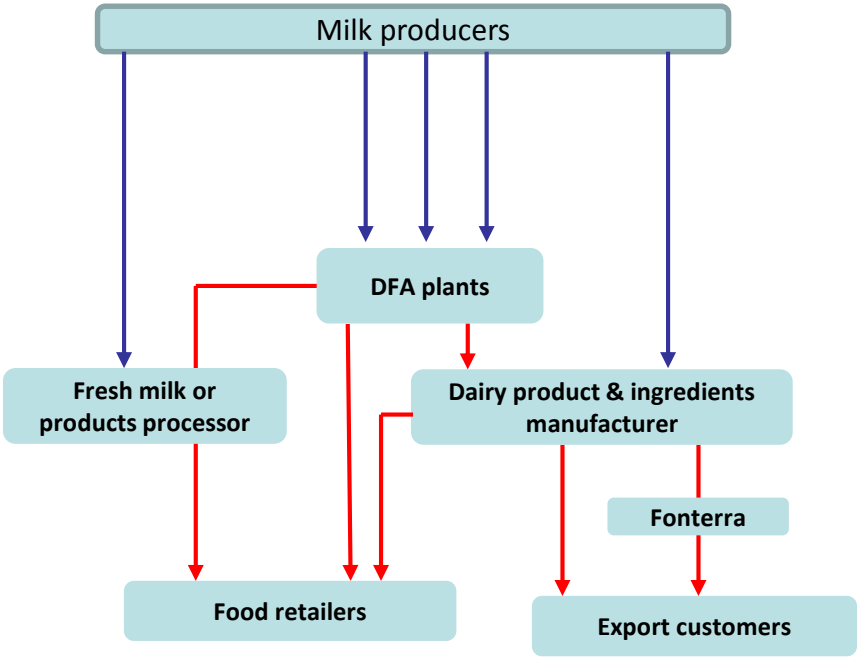
Dairy Farmers of America (DFA) was an attempt to create farmer strength and underpin the survival of regional co-operatives by aggregation, yet created an even larger model of mediocrity. DFA has evolved since creation in 1996 into a large processor/handler. It collected about 19% of US milk in 2011.

Aspects relevant to Australian producers:

- The company aggregated for strength, but found its model was challenged by making competitive returns from investments in plants
- Rather than process all DFA suppliers milk into product, the company saw merit in developing alliances with other brand manufacturers and processors
- It has become a hybrid model, acting as a giant milk handler in certain regions
- Provides members with certainty of market access for their milk (through DFA)

Challenges faced by this model?

- DFA has frequently run into competition law issues due to its dominance of regions, accused of either giving producers limited choice or collusion on prices to buyers
- The managed market in the US industry allows farmer-owned businesses to set prices through regulation.
- If and when the market is deregulated and individual prices are determined without regulated price orders, this price-setting co-operative's ability to deliver will be sorely tested. DFA lobbies hard against deregulation of the price support regimes in the US industry.



Value chain case studies

The Australian industry has various examples of industry collaboration, but none as strong as the way in which Bega works with a number of partners and customers in extracting the best value for shareholders.

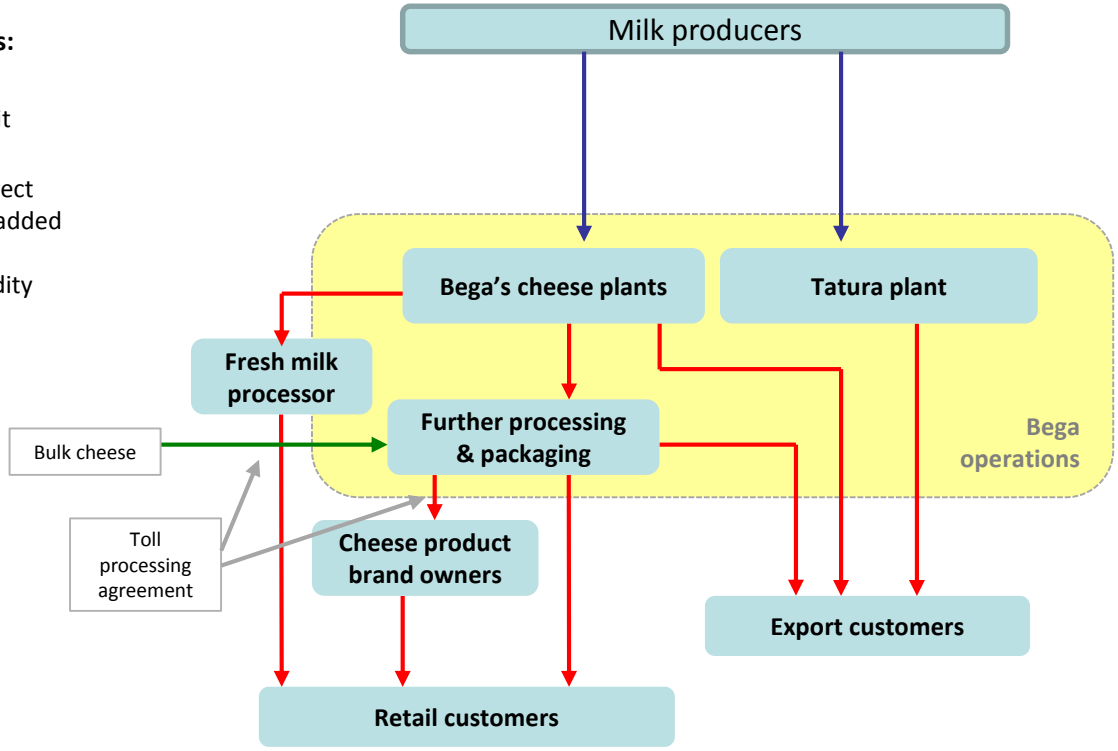
Bega Cheese has developed into a diversified manufacturer from co-operative beginnings with significant locational disadvantages. Recent expansion through merger with Tatura and purchase of Kraft's facilities have increased the diversity of the operation across ingredients and finished products as well as customer exposures.

Innovations relevant to other Australian producers:

- Bega has long been a co-operating co-operative
- Bega has acquired milk and product supply where it could profitably add to the business
- The downstream business activities beyond the direct processing of Bega supplier milk into cheese have added wealth to the owners of the business and added a premium to their milk returns above their commodity milk price.

Challenges faced by this model?

- Participating in the next phase of industry consolidation
- Balancing the importance of critical partner and customer relationships while growing business value



Value chain case studies

Grocery retailers have enormous influence over the health of the processed food value chain. Efforts to expand that influence in the share of food spending by taking greater command over food categories has included greater use of private label lines. This has weakened the unit value and increased the commoditisation of packaged milk. Improved returns from milk and other products may come from more use of directly-sourced raw materials – several precedents of which exist in other fresh food categories.

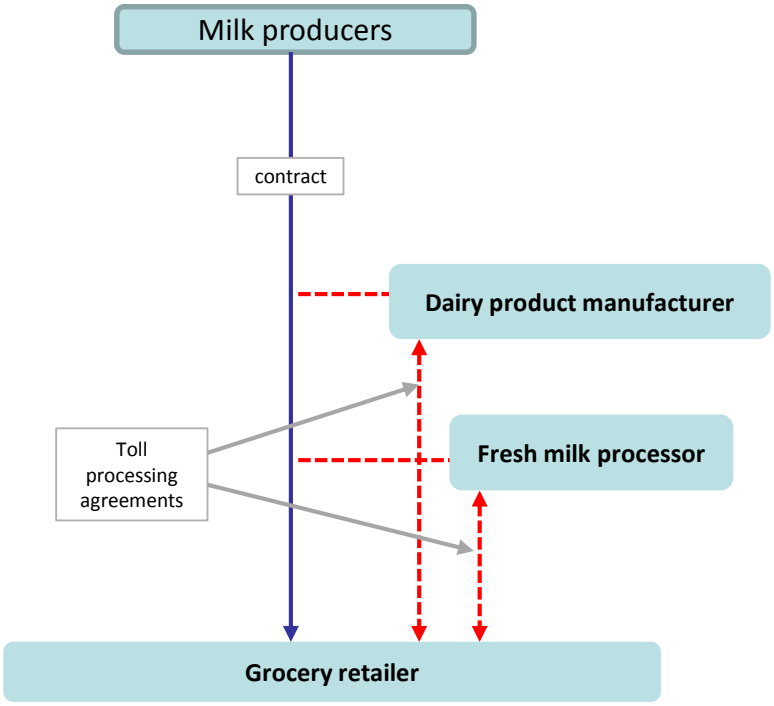
Direct retailer contracts have evolved in the UK market as a means for milk producers to deal direct with retailers. While small in overall volume, much is made by retailers of the directly-sourced product, for which their milk suppliers are generally paid the highest available farmgate prices.

Innovations relevant to Australian producers:

- The direct relationship between a milk producer and retailer hasn't been seen in the Australian market.
- With the inevitable pressure on retailers to grow the value of their private label proposition through differentiation, some use of this device is conceivable.
- Milk supply agreements provide for precise supply profile requirements and strict quality, welfare and sustainability requirements to meet the promise made by the retailer on the label. Retailers in the UK set the benchmark for strict adherance to those standards, which are followed by other processors supplying those same retailers with other private label and branded lines.

Challenges faced by this model?

- Toll processing is an essential feature of the model, and even though the direct-supply agreement is with the milk producer, the processor takes the risk of market movements in volumes.



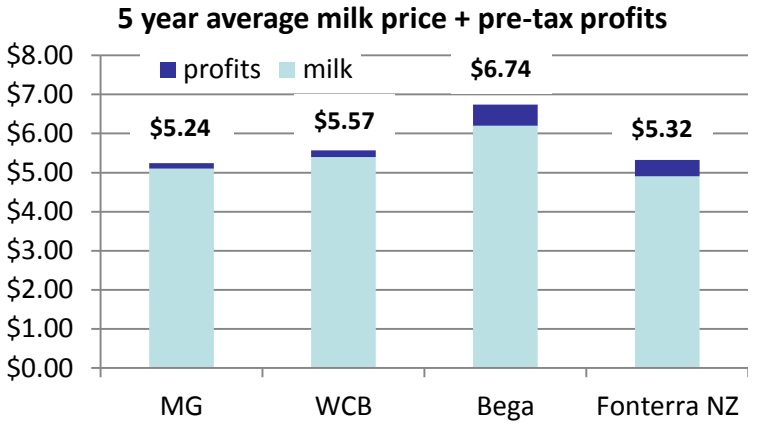
How do the results compare?

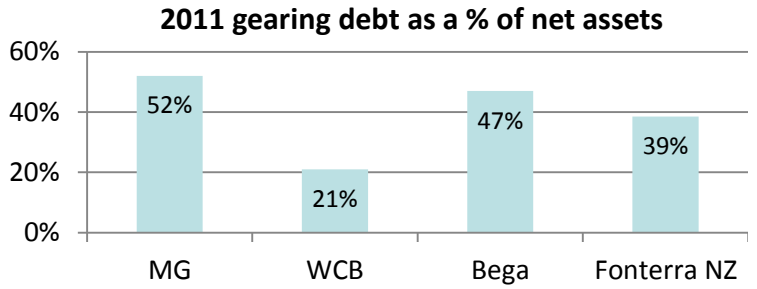
The performance of farmer-owned businesses

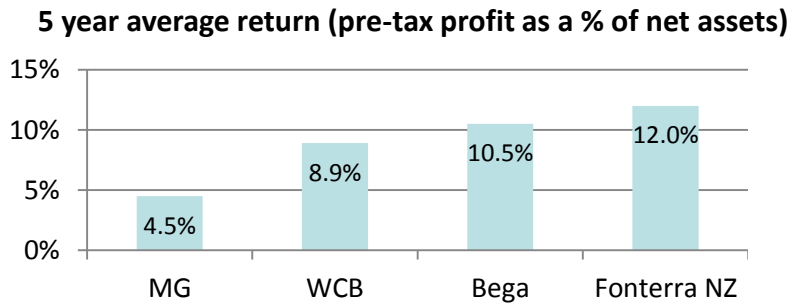
- The charts on the right show the results of analysis of 5 years trading results to June 2011 of the major farmer-owned entities in the Australasian dairy industry.
- The first chart shows the combined milk price payout and pre-tax profits of each business, as a measure of the value extracted from milk, less costs of conversion, marketing and distribution.
- Fonterra is included in this analysis as a total group – Australian business profitability is not disclosed, nor are profits distributed to Australian suppliers. Milk prices are typically closely aligned season to season across between MG and Fonterra Milk Australia.
- Results over this 5 year period were affected by the impacts of the GFC, whereby MG and WCB incurred losses.
- Regardless of those impacts, the analysis shows that over this period, the largest manufactures in the Australian industry operates with the slimmest operating margin, highest financial gearing and achieves the lowest return on investments of those assessed. The size and geographic spread of its business is a contributing factor in this comparison, compared to the higher utilisation of assets of WCB and Bega, but the value-adding activities of Fonterra and Bega have added more significantly to business profits.

Notes:

- This comparison has been based on published financial statements as to milk volumes, company profitability and the cost of milk. This has been supplemented with analysis using Freshlogic's milk price comparison tool over the past 5 years.
- The Fonterra results are in average 5-year $A equivalents. Financial numbers (expressed in $NZ in source materials) have been converted to $A based on the average exchanges over the period.
- Bega payments reflect direct supply to Bega Cheese only, excluding Tatura Milk. Bega's earnings however reflect a contribution from that business.







The global impetus for changes to co-ops

There is strong impetus for change in the structure and business of farmer-owned dairy companies in major production regions, as identified in the table below. While these may be country-specific, the fact that other co-ops are re-modeling will ultimately contribute to competitive pressure in the marketplace, and also contribute to the impetus for further change to Australasian companies.

	Pressure points	Major responses from farmer-owned dairy sector	Other factors
New Zealand	○ Emerging competitors in processing, providing lower barriers to enter supply arrangements ○ Significant redemption risk due to land values and aging farmers ○ Desire for permanence in the capital base ○ Facilitating growth in milk supply including the propensity to attract young enterprise builders into dairy	○ Facilitating trading in shares for validity of share value ○ Clarity in operating performance ○ Use of external investment capital	Due to Fonterra's dominance, regulatory pressure exists to guard against lack of choice
UK	○ Complex milk payment structures in terms of the diversity of options and the scope for differentiation. ○ Managing profitable milk use in liquid and processing markets ○ Highly competitive farmgate environment ○ Strengthening business culture on farms after a long period of operating without regulation ○ A short history of co-operation, created after deregulation	○ Seeking greater added-value to milk through business models ○ A greater focus on performance, not milk price and supplier priorities ○ Member contributions of equity capital	Majority of milk stays in domestic market, and the UK is a net importer. Co-ops collect less than 30% of milk.
US	○ Strong history of traditional co-operative presence ○ Diverse production regions which cause great variation in farm scale, business culture and respect for co-op traditions	○ A number of joint venture arrangements between DFA and customers ○ Business diversification by Land'o'Lakes	US competition law favours collusion by co-ops
Northern Europe	○ Major redemption risk from rapid exposure for EU farmers to commercial change ○ Complex representational structures to deal with supplier issues and board elections. ○ Gradual deregulation of the EU dairy sector, exposing producers to greater volatility	○ Cross-border mergers to improve exposure to low-cost milk fields ○ Tradability of share capital ○ Use of external investment capital to fund brand development and international expansion	
Latin America	○ Rapid growth in volume and sophistication of demand ○ Expanding MNC processors building new supply chains ○ Strong competitive pressure on small scale co-ops	○ Slowly merging and creating alliances with global brand owners	
Australia	○ Vigorous competition for milk supply. ○ Strengthening farm business culture, hunger for certainty of ROI ○ Greater internationalisation by competing dairy groups	○ Consolidation and development of diversifying alliances by Bega ○ Listing of shares by Bega and WCB ○ Exit by ACF	56% of southern mainland milk field collected by non-co-operatives

Evolving farmer-owned companies

Members

Overall orientation
- *Evolvement from member and milk orientation towards market, investment and corporate orientation*

Shares

Capital structure innovation
- *Fair value shares, acquired on entry/growth*
- *Tradable shares*
- *External minority investments in shares*
- *Listed subsidiary entities*
- *Clarity in reporting price versus company profit*

Board
Company

Governance
- *Adding external skilled professionals*
- *Farmer directors selected based purely on skill*
- *Separating representation structures from board management*

Strategy

Business strategies
- *Greater internationalisation to expand markets and reduce supply risks*
- *Increased diversification (geographic, product and thru-chain involvement) in the interests of continuity of business rather than the member transaction*

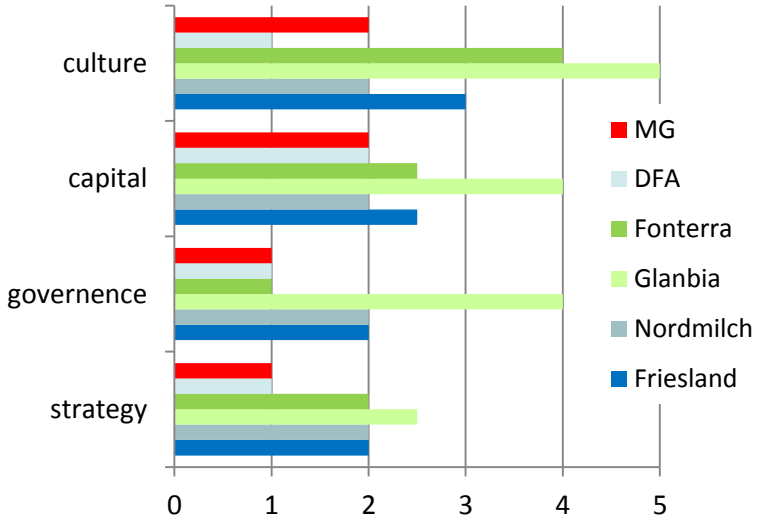
Business model

Models
- *Collaboration for value and business continuity*
- *Upstream and downstream alliances and Joint Ventures*

How do companies compare?

A highly relevant 2009 study of co-operatives in dairy and related industries compared the development in the models used by co-operatives on several grounds. The chart below shows the results of that comparison, taking account of the use of devices including those identified on the left of this page.

It is worth noting that these scores were applied in 2009 on the 2008 progress, such that further changes in the structure and accountability of Fonterra would improve its "governance" score, and Nordmilch has merged into DMK, which has adopted a more commercial and expansive business model.



Scores are from 1 to 5 where 5 is most commercial and considered by the study to provide the greatest opportunity for better performance in the interests of the shareholders

*Co-operative Champions or Investor Targets? The Challenges of Internationalisation and External Capital

What can change in a farmer-owned structure?

The cases illustrated on the prior pages show there is considerable scope for change to farmer-owned dairy company models. This pages summarises the 6 areas where change may be effected; the rationale and some key examples.

Aspect	*What would change entail?*	*Why?*	*Examples*
Board composition	• Increasing the proportion of independent professional directors on boards	• Inject more commercial skills into board decision making • Decisions aligned to what is better for the business rather than for the suppliers	• Fonterra and others - a number of external professional directors on Boards
	• Ensuring that the basis of farmer involvement on boards is based on skills and not representation • Invoke other means to provide representational input		• Fonterra and others - Farmers are selected on the basis of their skill not region/interest
Permanence of equity	• Allowing trading in shares (subject to ownership controls and supplier qualification) to ensure shares attain their own value	• Ensures suppliers' equity has permanence and meaning on the balance sheet • Increasing capital to the business	• Fonterra Trading amongst Farmers • WCB and Bega listing • UK co-op models
Increased sources of capital	• Allow greater contribution to capital by suppliers • Invite other forms of equity capital where feasible without loss of control	• Provide a better financial base for the business	• First Milk and Milk Link – injection of capital by producers
Business model	• Evaluating optimal use of milk in the business to achieve a better return on volumes and use of capital	• There may be scope to achieve a better overall return and use of capital by involvement in JVs rather than processing all milk	• DFA (US) has large number of alliances with downstream processors and manufacturers. • Internationalisation of EU co-ops • Hybrid supply/processing approaches used by UK co-ops • Introduction of capital to subsidiaries (Glanbia, Sodiaal)
Milk pricing flexibility	• Departing from tradition and reducing the need for equity in milk pricing	• Create a better reflection of commercial value of milk and impacts of costs in pricing • Provide a better basis for reward for investment on farm	• UK co-ops forced to match the devices used by others – industry as a whole has improved its matching of supply to demand requirements
Issues management	• Reducing the investment in field resources to address issues and non-commercial concerns • Allow better performance to address retention	• Reduces the costs of operation • Allow producers to evolve to a more commercial (not "hand-holding") culture • Encourage greater user-pays adoption of technical advice in production issues	• Approaches used by UK and EU co-ops to focus on commercial issues, not representation • Fonterra Shareholders Council deals with policy issues affecting governance • Supplier forums used by EU co-ops

Comparing governance structures

This page summarises the various approaches taken in several local and international cases of governance, through board composition, board selection criteria, and the role of representation in the relationship between suppliers and the company. It shows varying degrees to which commercial skills have been present in boardrooms, and the basis for the selection of farmer directors.

	Structural model	Board members	% of milk collected by co-ops	Farmer directors	Independent professionals	Executive management	Basis for farmer board member selection	Other governance and representational devices	% of board made up of farmers
Murray Goulburn	Farmer-owned limited company	12	44	10	1	1	Regional	None	83
WCB	Listed company	9		5	3	1	Skill	Supplier Advisory Forum	55
Bega Cheese	Listed company	8		6	2		Skill	None	75
Fonterra NZ	Co-operative	13	89	8	5		Skill	Shareholders Council with 35 members representing regions (NZ). Bonlac Supply Co Board and a separate Fonterra Milk Supplier Forum (Australia)	61
First Milk (UK)	Farmer-owned limited company	11	30	6	3	2	Skill	Supplier Forum	55
Milk Link (UK)	Farmer-owned limited company	9		5	2	2	Skill	Supplier Forum	55
Arla Foods (Sweden)	Co-operative	23	90+	19	4#		Regional representation	Regional Boards and District committees	83
FrieslandCampina (Netherlands)	Subsidiary of Co-operative	13	80+	9	4#		Skill	Members (210 members) and District Councils (21)	69
DFA	Co-operative	51	80+ (1)	51			Regional/district	Regional Boards and District committees	100
Land'o'lakes	Co-operative	27		24	3*		Regional/district	Regional Boards and District committees	100*

* These are advisory board members with no voting rights as directors

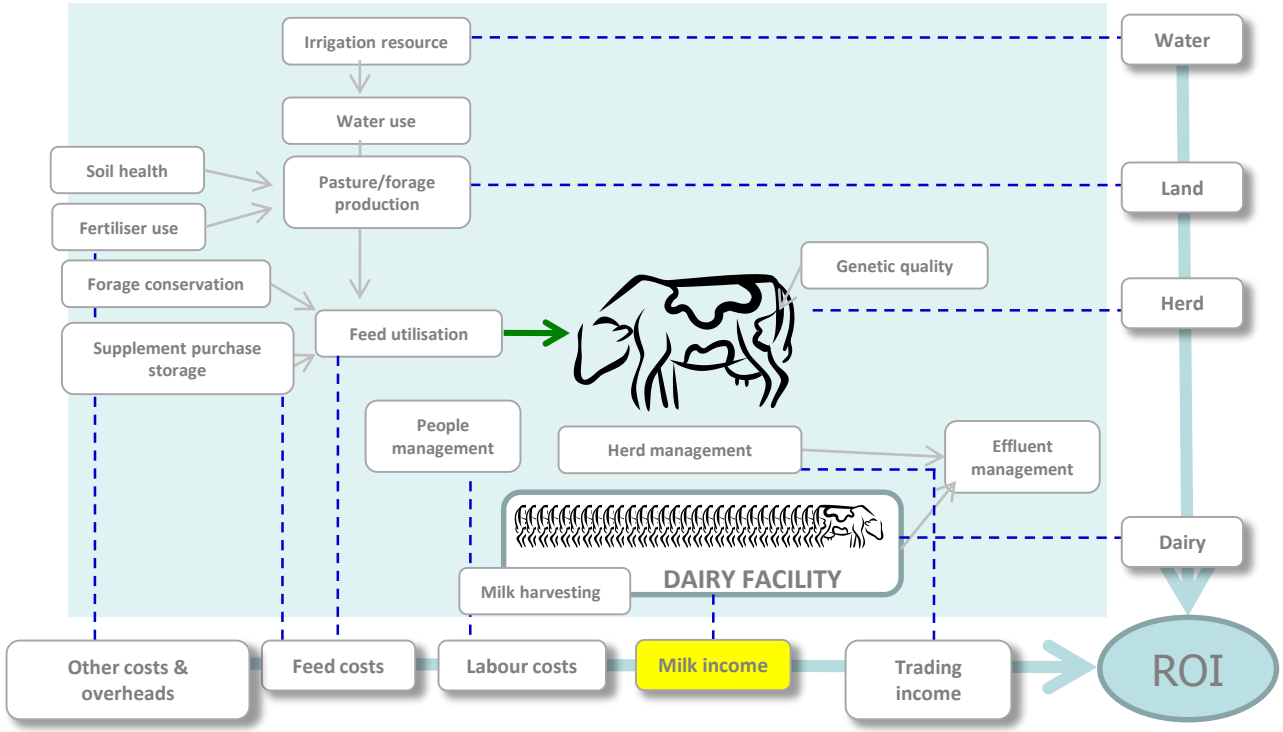
the inclusion of non-farmer directors follows European practices of having a number of professional directors on a "supervisory board". Companies are obliged to have these posts.

(1) The dominance of co-operatives in the US industry varies considerably region-to-region, but were no less than 76% in any one region in 2008.

Optimising returns

Optimising "enterprise returns"

- Optimising returns from the marketplace isn't simply about achieving as high a top line for the dairy enterprise as possible. A choice of a certain market for a producer's milk may incur higher operating costs and risks that could erode returns over time. Conversely, a choice of production system that protects the downside risks regarding costs, may close the door to market opportunities which beckon and are readily attainable.
- Optimising returns is about lining up a holistic production approach to match the chosen downstream value chain.
- A holistic approach to "alignment of business with market" is the ideal way in which a milk producer can ensure the business best aligns with the available market channels or models outlined earlier
- Decision-makers should develop their own criteria for selection of the most suitable market options based on:
  - the **risks** producers are prepared to take and how they may be managed in future
  - **volatility** that can be tolerated in revenue and variable costs
  - the production **systems, skills and know-how** that can be harnessed.



Business and presenter background

Freshlogic

- Freshlogic is an industry and market intelligence firm based in Hawthorn in Melbourne, servicing the food and agribusiness sectors. Freshlogic works with a range of agribusiness industries and enterprises to develop market-focused industry and enterprise strategies.
- Freshlogic uses insight and technology to collect and convert data on the full range of market and supply chain variables into usable information to guide better commercial decisions for input suppliers, producers, manufacturers distributors and retailers working in complex perishable product supply chains.
- Freshlogic has been involved in the analysis of supply chain conditions and the determinants of the value of foods – including dairy products – in the Australian food market for many years, and has a deep understanding of the dairy industry and its markets.

Steve Spencer

Steve is a leading dairy consultant and analyst. He has worked across the Australian food industry in dairy, citrus, livestock, and poultry industries; as well as in policy areas of innovation, trade, and competition, Steve has significant experience in industry and enterprise analysis, planning and supply chains.

Steve works for a variety of clients in the dairy industry including milk producers, capital providers, processors and manufacturers, retailers and international traders. His project work includes assignments into global and Australian market dynamics, supply chain structures, farmgate supply outlooks and the sustainability of milk production in various farm production systems.

He has deep knowledge of the structure of milk pricing arrangements and the factors affecting change in the style and structure of offerings by dairy companies in Australian and overseas industries.

Steve led a major study of the future environment in the Australian dairy industry known as Advancing Dairy Australia, and subsequently developed Dairy Situation & Outlook (2004) as a platform for consistent industry information which has been produced (from 2005 to 2011) within Dairy Australia.

Freshlogic also undertakes analysis of the Australian consumer – what food they buy, how choices are affected by sentiment and what trends affect prospects for retail sales in different segments of the market.

Steve has undertaken large studies of how prices are set and influenced in food chains within the Australian food industry and is the author of two published works on the structure of food chains in Australia which analyse the drivers of prices and returns:

- Price Determination in the Australian Food Industry (2003)
- FOODmap – a comparative analysis of food distribution channels (2007 – being revised and extended in 2011).