A review of fonterra group's strategy and business model

Business, Strategy

Fonterra was formed in the October 2001 merger of the New Zealand Dairy Group (NZDG), Kiwi Cooperative Dairies, and the New Zealand Dairy Board (NZDB). It has become the world’s leading exporter of dairy products, responsible for over a third of international dairy trade. The Group is co-operatively owned by over 10, 500 dairy farmers whose products make their way to customers in approximately 140 countries. Fonterra aims for global dairyleadershipand its purpose is to sell their farmer shareholders’ milk (Fonterra Co-operative Group, 2011).

Analysis of the Dairy Industry using Porter’s Five Forces Porter's first force describes the threat of potential entrants. Barriers to entry and economies of scale are significant for new entrants. However, New Zealand’s deregulated market structure and relatively low cost might attract entrants as a base of export oriented supply and processing. The threat of new entrant is medium (Vallyon, 2003). Porter's second force is bargaining power of buyers.

The New Zealand dairy industry exports 95% of the country’s dairy production. Continued consolidation offoodmanufacturing and retailers has the effect of reducing overall numbers of buyers in the industry and increasing their purchasing power (Vallyon, 2003). Faced with the fact that buyers face few switching costs, it is fair to say that buyers have high bargaining power in the industry. Porter's next force is bargaining power of suppliers. The dairy industry is a seller’s market with global demand exceeding supply.

This opens up opportunities for other uprising overseas markets to the industry with suppliers from India, China and Brazil. Fonterra supplies are secured through the co-operatives structure and a significant threat exists if Fonterra fail to make competitive milk payouts to its farmer shareholders (Vallyon, 2003). It is clear that Fonterra suppliers have some bargaining power in the industry. Porter's fourth industry force is the threat of substitute products. Dairy milk is a unique natural product without any artificial substitutes.

However there is development of alternatives including soya milks and non-dairy milks such as goat, buffalo and sheep. Danone, Unilever and Coca-cola have also made significant acquisitions or partnerships with organic milk producers. Although a dairy product, organic milk can be considered as a parallel value chain as it requires different knowledge and techniques at each stage of the process (Vallyon, 2003). In this sense, the force is low to medium. Porter’s final force is the intensity of competitive rivalry.

As a global leading dairy exporter, Fonterra faces increasing threats as global competitors become aware of its size and influence in the industry. Continued consolidation of industry could see competing dairy resources being merged into larger, more efficient competitors. In the evolution of trade liberalisation, competitors may respond through increasing global growth strategies (Vallyon, 2003). Hence this force is high. Fonterra’s Strategies Fonterra’s business model is a farmer-owned co-operative, widely spread around the vertically integrated New Zealand Dairy Industry.

At Fonterra, the goal is to build a business that pays the farmer shareholders the maximum sustainable price for their milk and that maximises profits from the capital invested in the Co-operative (Fonterra Co-operative Group, 2010). To achieve this, Fonterra has three key strategies in becoming the company that is the source of natural dairy nutrition to the world. Firstly they intend to deliver sustainable co-operative performance. With its scale and reach of operations, Fonterra creates enormous logistics complexities.

However, when it comes to processing, recent projects like Drier 4 at Edendale (ED4) in Southland are said to be the most efficient milk powder unit in the world. Likewise, in order to optimise the supply chain at home so to deliver product to their customers as efficiently as possible, Fonterra expanded a key cool and dry store logistics hub that has taken more than 50, 000 truck movements off local roads and has largely eliminated the need for contracted storage around the Waikato (Fonterra Co-operative Group, 2010). This is working alongside with the enhanced use of rails to move products around the country.

Then elsewhere, the Group has also taken its development online with the launch of globalDairyTrade (gDT), an internet-based auction platform through which sellers offer to sell commodity dairy products (Q&As: globalDairyTrade Information Portal, 2011). In 2010 gDT has sold 359, 000 metric tonnes on the platform (Fonterra Co-operative Group, 2010). Fonterra’s second strategic goal is to build trusted brands in chosen markets. Fonterra has a strategy to strengthen their positions in key regional markets where ownership of the supply chain gives a degree of competitive advantage (Fonterra Co-operative Group, 2010).

The focus has been on high growth markets within Asia/Africa/Middle East (Asia/AME) and Latin America, and the existing strong market franchises in ANZ. Anlene provides a great insight to Fonterra's brand strategy at work. Created in Asia in 1991 to support bonehealth, Anlene is now the clear number one high-calcium milk brand across Asia. Priced at 30-50% above regular milks, Anlene is a trusted premium brand in the Asia market, which has an expanding middle class that is caring more about healthy nutrition for the wholefamily(Fonterra Co-operative Group, 2010).

Additionally, Fonterra has continually restructured their investment portfolio to ensure they can capitalise on the most promising market opportunities. To support its expansion in Africa and the Middle East, they have purchased the remaining 51 per cent stake in Saudi New Zealand Milk Products (SNZMP), a dairy manufacturing facility in Saudi Arabia, has secured manufacturing capacity to support growth plans in the Middle East. Currently packing Anchor and Anlene milk powders and producing processed cheese, SNZMP supplies 20 countries in the region (Fonterra Co-operative Group, 2010).

The third strategy Fonterra have adopted is to grow lasting customer partnership with the world's leading food and nutritional companies. The company looks to improve their ability to source and add value to dairy supply so to strengthen their position as the supplier of choice from around the world. In order to achieve it, they have focused on developing customer partnerships in premium ingredients and in foodservice solutions. Premium ingredients are products that are more advanced than standard dairy ingredients. Examples are nutritional bases for infant formula and growing-up milk powders (Fonterra Co-operative Group, 2010).

Fonterra is already the preferred supplier of all five of the world's largest infant formula companies with stronger demand from their customers to partner them. Key customers have strong growth ambitions and they are looking to Fonterra as a preferred source of high-quality paediatric nutrition products. A premium ingredients category with exciting prospects is pharmaceutical lactose, with Fonterra a world leader in lactose excipients through their joint venture with RoyalFrieslandCampina which develops, produces and markets high quality lactose used in the pharmaceutical, nutrition and food industries (Fonterra Co-operative Group, 2010).