AgriHQ Pulse: Ian Proudfoot's latest opinion piece

Murray Gouldburn's predicaments highlight the challenges of really adding value to products

Until last Wednesday, Murray Goulburn was a leading participant in the rejuvenation of the Australian dairy sector. They had developed and executed a value add strategy, achieved a successful listing of investment units on the stock exchange, delivered profits and sustained a milk price above a point that all economic fundamentals suggested was achievable.

Last Wednesday the success story started to crumble. The co-operative went into a trading halt before announcing an 85 cent per kilogram cut in their forecast milk price for the current season and a reduction of over 30% in the forecast profit for the current year. The company has seen almost a 50% reduction in its unit price on the stock exchange, the departure of both its CEO and CFO and two Directors.

Not surprisingly the board is facing intense scrutiny over what has gone wrong and how such significant shifts in milk price and profitability had not been detected earlier. Questions are being raised over the accuracy of the disclosures made in the prospectus and whether the Directors had met continuous disclosure regulations. There has been talk of class actions being launched against the co-operative.

It is interesting trying to unpick what has happened given the limited information that is currently available in the market. Murray Goulburn's former CEO had been very clear in his view that his co-operative had clearly adopted a different strategy to Fonterra. He suggested they were adding value to more of its milk and this was enabling the co-op to maintain a significant premium over the commodity milk price, however questions are being raised over whether the value added strategy was delivering all that it had been expected from it.

Last year's KPMG Agribusiness Agenda explored the theme of adding value to primary products and reached a conclusion that it was very easy to talk about adding value to production but much harder to actually achieve. Most organisations adopting value add strategies fail to meet their return expectations because they do not have the culture to deliver what they hoped to achieve. Our work suggests that too often companies underestimate the investment required to successfully grow value; it is not just about building a processing plant but significant time and money needs to be invested into a range of intangible value drivers. Components including developing people, brand and consumer experiences and solution focused innovation, all contributing to overall success. Without the intangible investments it is more likely that a company will add cost in excess of the additional revenue that is created.

Murray Goulburn had embarked on a number of value add strategies utilising the A$500 million it raised in its float last year. These include the development of nutritional powders predominately targeted at the Chinese markets, dairy beverages and cheese products. Prior to its IPO, the co-operative had also invested heavily into liquid milk processing as part of its value add strategy, building two plants that were producing white milk for sale in domestic supermarkets. This is an investment that critics are challenging, as the plants had been developed in response to the co-operative entering into a low margin, high volume contract to supply one of the major Australian supermarket chains with house brand milk.

This contract illustrates the challenge of adding value after capital, input and processing costs have been taken into account. It also illustrates that in our fast changing world a contract that is conceived as value add can quickly become commoditised if it is not built on a basis of unique intellectual property.

The coming weeks will undoubtedly provide further analysis on the specific issues that have arisen at Murray Goulburn. If there are immediate lessons for other companies in the industry, to my mind, they are not to overlook the cost, complexity and time that is involved in adding value to a product and to recognise that value add is not static but continuously evolving.

This can is exemplified in the fishing industry. The way to maximise the value of a fish is to take it out of the water alive and do nothing to it other than add a story about sustainably harvested, natural seafood as it is delivered to a white table cloth restaurant. The reality is that doing nothing too a fish is significantly more complex and expensive than processing and freezing the fish after it is caught. However when the fresh product is backed by the right investment into its intangible attributes, the ability to transform its value is great and this can deliver premiums that justify the time and cost involved. The key to sustaining these premiums is to ensure the product offering and underlying story is continuously evolving to meet the changing needs of the ultimate consumer.

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