

Managing milk price changes

The positive outlook for dairying is a real plus for the New Zealand economy and all involved in the Dairy industry. It offers new opportunities to achieve long overdue returns for capital, management and staff. It also brings new challenges about how best to achieve sustainability and a “win/win” result.

One area that may require new thinking is balancing the impact significantly higher milk price on staffing – especially percentage based share milking agreements. There are number of these arrangements currently being reviewed. Some businesses may struggle with their potential cost if they continue to adopt agreement terms designed for historical milk prices nearer \$4.00 / kg MS. At the same time they will need to recognise the need to offer competitive arrangements to retain and reward top people.

The increase in milk prices must benefit all parties - especially variable order milkers who have received only modest returns at lower milk prices in recent years. It is equally important, however, that any new a formula is sufficiently flexible to manage potential milk price volatility and promote sustainability.

What is needed here is clear strategic thinking. Agreements must be developed around sound business understanding and accurate estimates of costs. Business owners will need to manage their staffing costs while also coping with significant changes in other operating expenses as fuel, fertiliser and interest.

I'm heavily involved in such reviews at present. Most involve agreements formulated around previously lower milk prices. Until now the percentage share agreed has reflected the need to manage the milker's risk at these lower returns.

Continuing a relatively high milkers share after a 60% increase in milk price has real potential to distort results and make staffing costs unsustainable. It risks making the use of sharemilking less attractive and could force a return to employing salaried staff. This could result in lost career opportunity and limit the availability of a key step on the career path for Dairy staff.

Setting the share too low risks inferior returns to milkers if prices or production drop.

My approach is to first promote transparency when reviewing such arrangements. First priority must be to achieve an accurate estimate of the milker's costs so there is reliable agreement on what is likely to cost the milker to provide the staff and other inputs they will be responsible for. The combination of direct costs and milker's reward expectations combined with a margin for risk can then be used to calculate an appropriate percentage share.

One option is to set the milker's share of milk income higher at lower milk prices and reduce this gradually as the milk price rise beyond an agreed trigger point. This buffers the effect of unexpected changes in milk price to keep costs realistic. Another is to adopt a lower percentage and have the owner guarantee a minimum milk price. This reduces the milker's risk at lower milk prices while enabling their returns to remain competitive at higher prices without being unsustainable.

The recent changes in industry fortunes confirm there is no "magical" percentage that works for all situations. Each is different and the outcome must be consistent with minimum legal requirements as well as the spirit of mutual benefit that has made sharemilking so successful in the past.

Open communication, goodwill and top advice are key ingredients to help harvest the benefits that lie ahead.

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