Department of
Primary Industries and Regional Development

GOVERNMENT OF WESTERN AUSTRALIA

Partnering for Customer Value case study:

Mountain Milk Co-operative

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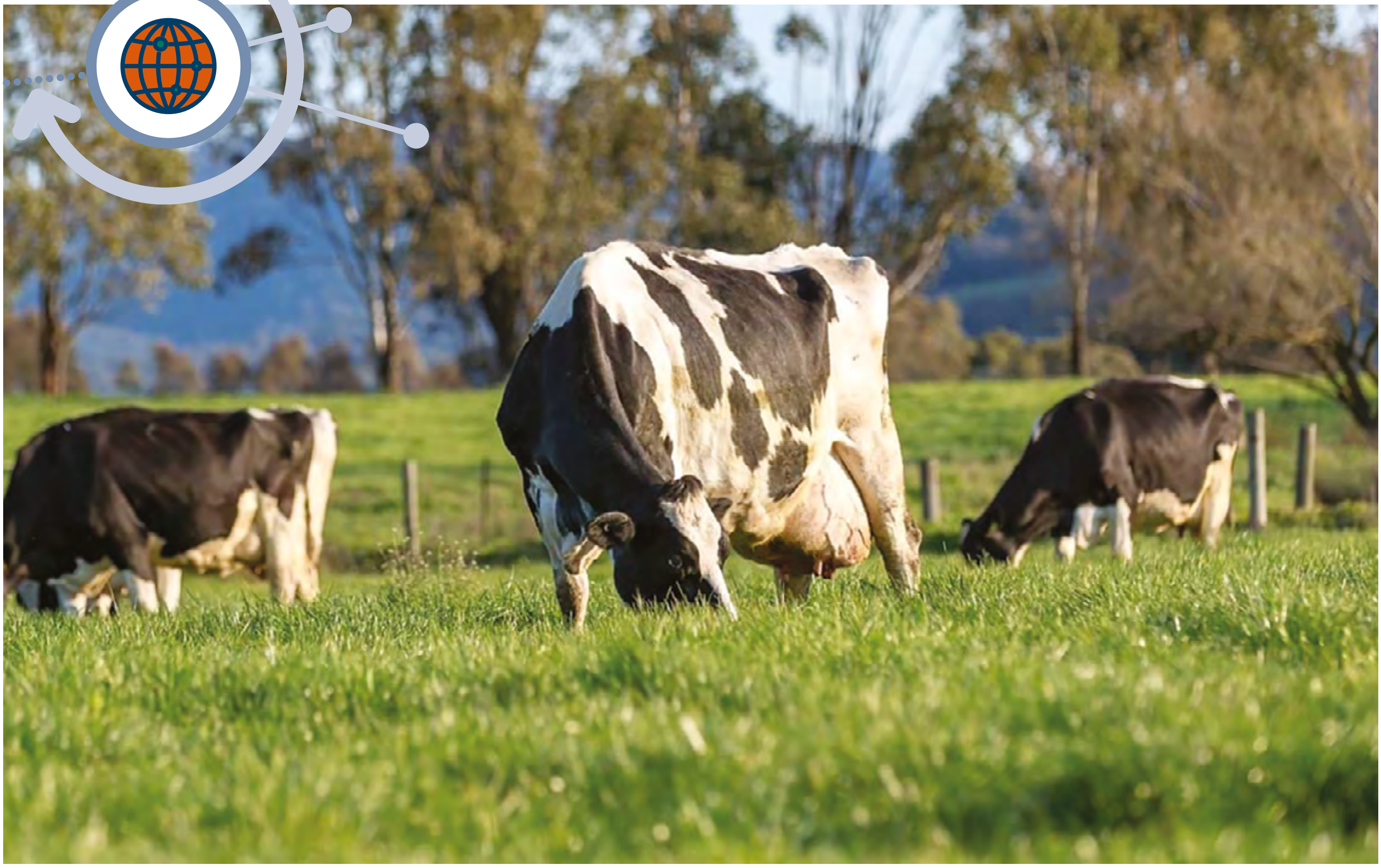
Business
Mountain Milk Co-operative

Location
Kiewa Valley, Victoria

Product
Milk



The collaboration

Mountain Milk Co-operative is a collaboration between five farming families, all located within a short distance of each other in the lush Kiewa Valley of Northern Victoria.

The group was first drawn together by concerns about how the big processors were treating their dairy farmers. They felt geographically 'cornered' with only two options for processors to sell to and neither were delivering milk prices that allowed growth, let alone regular maintenance on farm. A number of the farmers had been dedicated Murray Goulburn Co-operative members for many years and felt that the processor was no longer acting like a co-operative. They believed that a fundamental tenant of a co-operative should be to include members in the decision making.

The rumoured closure of the local Murray Goulburn milk processing plant in Kiewa, which a number of them supplied, also got them thinking about the option of vertically integrating and doing their own processing.

Despite the fact that these were highly efficient milk producers, the farmers shared a frustration about the lack of control over their own destinies in a market dynamic where the processors held most of the market power. The group believed that by working together, they would have more chance of riding out this difficult time in the dairy industry. An informal discussion soon evolved into a formal collaboration and despite the escalating industry challenges, this alliance has enabled them to improve their profitability and long term sustainability through increasing the value of their milk and at the same time lowering their costs. Increasing the value of their milk was possible by improving their understanding of their value proposition in the eyes of the customer.

The Mountain Milk Co-operative case study profiles the earliest stages of value chain configuration and the need for investment in strategic planning and independent advice from objective and experienced professionals with specific industry knowledge. A further learning from this case study is the critical importance of taking a considered, step-by-step approach to collaboration rather than impatient, bold steps that could expose all participants to risks. Taking the time to understand their point of difference and the value proposition that they could offer the market was important. Collaborative farming models have a high rate of failure in Australia but this group avoided any misunderstandings at the outset by working through the details so that all members of this collaboration had a shared understanding of their strategic direction.

The Mountain Milk Co-operative case study illustrates how the considered and strategic manner in which these farmers approached the collaborative challenge resulted in improved financial outcomes for all members and enabled them to participate in a higher value segment of Australia's flourishing dairy exports.

Mountain Milk Co-operative Directors.

A risky investment in vertical integration that was proposed in the early days of the collaboration was avoided by seeking expert opinion and recognising where their strengths (and weaknesses) were in the value chain. This case study strongly demonstrates the power of collaboration to ensure the future sustainability of a group of family farms and their regional community.

TABLE 1. Summary of key elements of the Mountain Milk Co-operative collaboration

The collaboration	Mountain Milk Co-operative is an alliance between five farming families in the Kiewa Valley of Northern Victoria who collectively produce 22 million litres of premium grade milk and export via a long term strategic alliance with a processor.
Catalyst for collaboration	The challenges in the dairy industry in recent years are well documented. The group were concerned about their future given the uncertainty around the dairy industry in general and their local situation in particular. A number of members supplied the Murray Goulburn plant at Kiewa, which was facing closure. The impetus escalated when the Murray Goulburn crisis reached tipping point and the shareholders voted to sell to Canadian dairy processor Saputo.
Entity structure	After considerable research, a co-operative structure was chosen as the appropriate entity for this collaboration because it suited the philosophy of the group and was simpler and less costly to administer. The group is distinctly a ‘selling co-operative’ rather than a ‘processing co-operative’ at this point. Traditionally, dairy processing was born out of co-operatives in Australia, which later evolved into large corporate structures.
Governance	A five member board plus a non-voting CEO governs the alliance. All board positions are a three year term and the chair is elected annually.
Business model	The basis of the business model is that the members undertake to commit all of their milk to a supply agreement. In the first instance, the group has entered into a strategic alliance with food processor Freedom Foods Group based around a rolling, longer term contract. Farmers are paid monthly, but at a set rate throughout the year making the transaction much simpler to manage for both supplier and processor (other processors pay a fluctuating seasonal rate based on a complex formula with multiple incentive variations). Because Mountain Milk Co-operative farms are within 10 km of each other, the processor has low cost milk collection and communication is streamlined through one point of contact. Unlike most milk pooling collaborations which chase the highest price for the season, this longer term, flat priced strategic alliance gives the group security and enables them to gain a premium for their superior quality milk. For the processor, this longer term commitment assures the supply to fulfil export contracts. This is important in a time of excess processing capacity and declining milk supply. The longer term business plan is to expand the collaboration by bringing in new supplier members and either entering into a range of strategic supply arrangements with processors or potentially processing and marketing fresh milk in their own right.

Markets & channels

The business-to-business alliance with Freedom Foods Group is to supply the processor a premium milk for their UHT product range which is sold in both export and domestic markets. Freedom branded UHT milk delivers higher value returns than commodity powdered milk, the bulk of Victoria's milk exports, because of its brand.

The intention is to mitigate the risk of over reliance on this one customer by developing another supply chain for fresh milk sold under the Mountain Milk Co-operative brand, which is owned by the co-operative. This milk could be contract packed by another processor. While the brand would be built in the domestic market, in the longer term, fresh milk exports are being considered, based on the superior quality of milk from the Kiewa Valley and the strong provenance story.

Supply chain model

The current supply chain aggregates all milk produced by the collaboration to supply the processor under a flat pricing model based around a rolling contract secured for a longer term than is usual in the industry. The strategic plan is to gradually expand the supply base and become more vertically integrated using contract processors.

Financial model

Members make an initial $5,000 investment to buy shares in the co-operative entity. A levy is collected on all milk sold in order to fund a professional executive and to finance the continuing development of the collaboration and the planning for the second channel to market.

Under the arrangements with the processor, milk payment is made directly to the supplier member, obviating the need for the co-operative to run an accounting function. This reduces cost, simplifies the business model and avoids the need for a corporate business entity structure and back office support staff.

Members cannot sell any of their milk outside of the group without prior approval from the board.

Performance

The Mountain Milk Co-operative farming families are now more profitable, and the reliable cash flow negotiated under the flat, annual rate payment terms has made it easier to plan for business growth and investment.

Risks

The feature of the Mountain Milk Co-operative business model is that it is very low risk. This low risk model has been achieved with a very small capital contribution from the members. The co-operative has none of this financial capital at risk and has minimal overheads, which are adequately covered by the ongoing milk levy. The agricultural risk remains, which would be the case under any model. The processor, Freedom Foods Group, carries all of the market risk.

The only real risk for Mountain Milk Co-operative at present is that it has only one customer, which is of some concern given the extreme volatility in the dairy industry. However, because Freedom Foods Group is a diversified food business with dairy being only a small part of its business, the risk is minimal. The Mountain Milk Co-operative farmers are fully aware of the need to have more than one customer and propose to mitigate the risk by building their pool of milk through recruiting new members so that they can diversify the customer base.

The agricultural context

The Kiewa Valley in North Eastern Victoria is an idyllic location for dairy farming with year round pasture thanks to high and reliable rainfall, as well as access to secure river water for supplementary irrigation. Unlike the fully irrigated dairy farms of the Goulburn Valley, the profitability of 'dry land' or 'grazing' dairy farming in the Kiewa Valley has been more consistent over the years, because farmers are not as exposed to the fluctuating costs of irrigation, where ever increasing water delivery and pumping costs are diluting profitability. Many of the dairy farms in the Goulburn Valley, which was once the backbone of Australia's dairy industry, have ceased to operate because of the combination of high water costs, low water allocations and low milk prices.

Land is tightly held in the Kiewa Valley so most of the dairy farms remain smaller, family owned operations and have not reached the scale of the corporate dairies in other regions of Australia.

At an average herd size across the group of over 400 head, these dairies are larger than the national average herd size, but remain family farms with hands-on owner managers. In order to reach the scale and negotiating power of the larger corporate dairies, the Kiewa Valley farming families knew they needed to collaborate and bargain collectively to improve their market power both on the selling and buying side.

The Kiewa Valley comprises a set of micro climate environments, including river flats, rolling hills and mountain slopes. Some farms have access to opportunistic or permanent irrigation. The different production conditions across the valley means that there is great variation in the farm management styles in terms of calving times, herd management and feeding systems. This is important because it means that the milk supply from the Kiewa Valley has a less extreme spring flush of milk that is characteristic of most dryland dairying areas in Australia.

The spring flush has the effect of deflating milk prices at that time of year. Farms in the region can manage calving in both autumn and/or spring, enabled by the climate and year round feed availability, which means the Valley's milk production curve is to some extent, flatter over the year. This flatter supply is highly attractive to processors for managing factory throughput. This feature was one element of the value proposition that the Mountain Milk Co-operative farmers were able to leverage to add value for their customer.

The rationale and approach

Uncertainty of the future was the catalyst for action

The genesis of the Mountain Milk Co-operative was around 2015 when Australia's largest co-operative, Murray Goulburn, began operating as a corporate rather than a co-operative. In the midst of a major expansion plan, the processor announced the closure of its Kiewa processing plant because it did not fit with its long term strategy. The Kiewa plant processed and sold daily pasteurised milk under the Kiewa Country Milk brand, manufactured a highly profitable cream cheese range and had a joint venture with Danone to make yoghurt. When the plant closure was first mooted, this group of farmers began having conversations around the feasibility of purchasing all or part of the Kiewa plant, with a particular interest in buying the fresh milk business because of its loyal brand support in the surrounding region. Murray Goulburn then announced that the plant would not be sold, it would be closed and left dormant to prevent a competitor from entering the market. This move did get the Mountain Milk Co-operative members motivated to consider other options.

The situation for Murray Goulburn quickly deteriorated during 2017 when it announced the severity of its financial position to the market. The business had made a fundamental miscalculation in its domestic contracts, e.g. the $1 milk contract with Coles, as well as over estimating the future of the global dairy market. Murray Goulburn had been forecasting massive growth and encouraging its suppliers to invest millions to expand production. Many dairy farmers went into debt to finance the expected growth being promoted by Murray Goulburn.

As a last ditch effort to save the giant co-operative, Murray Goulburn introduced the 'claw back' scheme, whereby its suppliers were forced to

> "It has been a considerable commitment by (the board who are) busy people running complex operations — but it has been essential to ensure our foundation is strong."
>
> **Patten Bridge, Chief Executive Officer, Mountain Milk Co-operative**

"We would have liked to have started with more members, but we are confident that the group will grow over time once we have proven the benefits of this to others in the valley"

Farmer Member

pay back part of the milk payments they had received earlier in the season. This put many dairy farms across Victoria in a perilous financial situation, resulting in bankruptcies and devastating financial and social consequences for communities in dairying areas.

The eventual demise and sale of Murray Goulburn to Canadian processor Saputo in 2018 had consequences for the entire industry and this event, coupled with global market conditions at the time, sent milk prices from all processors into freefall, from which they have not fully recovered. The key ramification across the industry has been a loss of trust and confidence in the processors, resulting in farmers deciding to leave the industry. These exiting farmers have created supply shortages which have been magnified by the latest drought. The significant demise in milk production has in turn put segments of the processing sector under considerable risk due to the reduced throughput in their factories.

Having had the foresight to see the troubled times ahead for the industry, the Mountain Milk Co-operative had already begun discussions about collaborating a year before the Murray Goulburn collapse and the group were able to work through how they could best ride this difficult period together and protect their local community from the fall out. The group had accessed a 'Farming Together' federal government grant to finance professional, independent consultancy services to develop the collaborative model.

The development process

The Mountain Milk Co-operative consists of highly skilled dairy farmers who have industry leadership experience and well developed industry connections. The group fittingly engaged a consultant of comparable skill and experience. Mr Patten Bridge was engaged to work with the group and facilitate the development of a collaboration. Patten is a highly experienced dairy industry professional with deep networks and excellent administrative and communication skills. He lives in the region and shares the group's values and strong sense of community. Patten is now the Chief Executive Officer of Mountain Milk Co-operative, engaged on a consultancy basis. With Patten's skillful guidance, the group considered a range of options for collaboration, both for reducing the cost of production and for building the value of their milk. They began with the cost reduction challenge.

Together the group researched other collaborative farming models and found that there was limited evidence of successful collaborative activity in the dairy industry. While broad acre models of collaboration involved sharing machinery and aggregating land to achieve increased scale and a better return on investment in high tech machinery, this did not generate the same economies of scale across different dairy farms. The limiting factor in grazing dairy enterprises is that there is a maximum distance that cows can walk for milking and there are major capital expenses on each farm such as improved pastures, cows and milking technology. A centralised, large scale dairy would not be feasible here. The individual farms had already invested heavily to develop management systems to suit their farm circumstances and location.

The Mountain Milk Co-operative realised that they would need to break new ground in devising a collaborative business model for the grazing dairy industry whereby business independence could be maintained, but value could be added through collaboration. The following steps were taken by the founding members to start exploring these opportunities:

1. The members openly shared their financial data with a view to identifying major cost items and opportunities for savings. Each member benchmarked their costs against the top 25% of the dairy industry using the national DairyBase system.
2. A workshop was held to determine opportunities for cost control within the collaboration, agreed priority areas and focus the next steps.
3. A broad strategy document was drafted reflecting what was agreed.
4. A community workshop was held with other local dairy farmers in the region to share the learnings they had acquired to date on the benefits of collaboration.

The community workshop was held to gauge interest from the other dairy farmers as to whether they would like to join the collaboration. The group knew that a higher volume of milk would further strengthen their negotiating power. While supportive of the group's efforts, the concerns that the other farmers expressed about joining the group included:

- Nervousness about the general instability of the industry
- Concerns about leaving their current processor Saputo, who had purchased the Kiewa plant from Murray Goulburn
- Apprehension about the added complexity that a collaborative model might bring to their business.

Now with a committed group of five businesses, the Mountain Milk Co-operative set about defining and documenting their vision.

In their early discussions about adding value to their milk, the group were seriously considering purchasing a processing and distribution facility as a means of removing their total reliance on the major dairy processors. At this time, there did appear to be an absence of alternatives for adding value to their milk. The group sought out expert opinion and advice from a wide range of professionals to inform their deliberations and quickly came to the conclusion that, at this early stage, developing a processing business would be too challenging in both a financial sense as well a managerial sense as no one in the group had any expertise in running such a facility. The risks were simply too high. However, the idea of investing in processing and marketing is still an option on the table for the longer term.

The agreed operating parameters

After taking this time to review the situation, it was decided that the drastic state of the dairy industry required a response that both reduced milk production costs as well as increased milk value. The following objectives were stated:

1. To increase the returns from the milk produced by members
2. To reduce the cost of production
3. To improve the efficiency and sustainability of member businesses.

> "Don't get me wrong, it hasn't all been easy. We have had some pretty tense moments and heavy discussions to get to where we are today."
>
> **Farmer Member**

Improving the work/life balance of members was seen as a further desired consequence of the above objectives.

A purpose statement was also articulated for the organisation as follows:

- Optimise profitability by reducing the cost of production and strengthening the market position
- Build member confidence in the future of the industry and their businesses
- Increase market influence, reduce risk and provide security for all members
- Strengthen the relationship with local communities and stimulate awareness of the important role dairy plays in building vibrant futures.

Guiding principles were also established:

1. Don't try to take on too much, too soon
2. Don't expect everyone will want to be involved.

It was agreed that a measure of flexibility was needed within the operating parameters so, while the structures of the group were disciplined in relation to milk price contracts and milk standards, the agreement was to be flexible in relation to other collaborative activity such as collaborative purchasing and shared farming activity. The rationale was that dairy farming is a multi-faceted business requiring expertise in cropping, irrigation, technology, animal husbandry as well as business management and therefore, imposing demands on individual farms across all of these disciplines may be too restrictive.

It was also agreed that activities needed to be documented and measured so that members could assess the return on investment for their time and effort as well as funds contributed. This information would become important for attracting new members in the future and 'proving' the collaborative concept in relation to grazing dairy operations. Any new members would need to be vetted by the group and there are high expectations of adherence to the quality and animal health and welfare standards that form part of their charter.

The group also has a documented conflict resolution process and should any future conflict be irreconcilable, then there is an agreed exit process.

The financial structure

As part of the process the group researched at length and sought advice on what was the most appropriate structure for the entity. They decided that in this early stage the co-operative structure worked best for the group at its current size. The co-operative structure also suited the philosophy of the group. They wanted transparency, honesty and trust with a focus on member value. Some had been dedicated members of the Murray Goulburn Co-operative for years and there was a family history of belonging to the smaller predecessor co-operatives that came before it, so they valued the principle of collective decision making. Furthermore, a co-operative was seen to be simpler and less costly to manage. After many years of dedicated supply, it was a difficult decision and a very brave move for the original members to break away from the established processors and go out on their own. After all, for many years they had left everything to the processor and simply produced milk. They recognised that going out on their own would create many new challenges.

To support this decision, three of the farmer members undertook further studies, completing a postgraduate course in cooperative governance through the University of Newcastle, which ensured a solid understanding of the financial structures and legalities of co-operatives.

The authors note that a co-operative structure could be compromising in the future when the group has assets such as brands and marketing goodwill and in time, they may need to consider transitioning into a company structure. The members felt that consumers and the community would relate better to a co-operative as part of their branding story.

Strategic planning

In 2018, the five founding member dairies developed the first five-year strategic plan for Mountain Milk Co-operative. The original intention of investing in a processing facility was off the table for the time being. The foundations of their strategy lay in consolidating a relationship with progressive food processor Freedom Foods Group to produce the premium milk for UHT exports, while simultaneously developing a second complementary channel to market for their superior fresh milk using a toll packing processor. The fresh milk channel would be underpinned by a provenance brand linked to the Kiewa Valley.

Freedom Foods Group with their philosophy of ‘making foods better’ was a good cultural fit with this progressive collaboration who also aimed to do just that.

Recognising that vertical integration into processing and marketing would be a high risk strategy for a newly formed collaboration without specific skills in this area, the alternative option of a strategic alliance with Freedom Foods Group reduced risk because it created business value on both sides. The strength in the alliance for Mountain Milk Co-operative was in their ‘hard to replicate’ advantage of a unique provenance as well as the commitment to third party audit schedule around farm practices, such as animal health and welfare which was the first schedule to be adopted. These points of difference coupled with a somewhat flatter supply curve, high quality milk and a commitment to volume supply, presented a compelling offer. For Freedom Foods Group the value was in the assured throughput to run their processing plant efficiently and the confidence in supply needed to pursue business development in export markets. The focus on animal health and welfare was also a strong fit with the Freedom Foods brand.

The goals stated in Mountain Milk Co-operative’s strategy are to grow the collaboration’s output towards an ambitious milk production target by 2023 and to build the membership beyond the current farming families.

The central mission of the collaboration was to secure the long-term viability and sustainability of member businesses. Specifically, the group decided to focus on:

1. Increasing milk prices
2. Improving pricing stability
3. Reducing input costs; the detailed examination of the data shared by the members identified feed and labour costs as being the largest common costs centres and as such, these became areas of focus in the short term
4. Improving labour efficiencies across all farms; shared labour pool, career pathways for apprentices, shared HR and OH&S information, shared mechanic, vets, etc.

> “In a sense we were waking up. We realised we could potentially create greater value by innovating and showcasing good farming practices and the benefits of working together.”
>
> **Farmer Member**

“Getting the labour sharing model right is going to be the next big challenge. It will make a massive difference to quality of life as well as controlling one of our biggest costs.”

Independent consultant

“People have been so generous with their time in helping us. I think everyone is really supportive of the idea of farmers taking control of their own destiny.”

Farmer Member

5. Supporting collaborative activity on farm, e.g. shared calf rearing.
6. Shared risk management, e.g. insurance, grain hedging, etc.

Focus areas

The group explored the full spectrum of potential cost savings outlined in the strategic plan. This included adding new business arms to the collaboration, for example, setting up a separate entity for machinery sharing for the cropping component of their business or forming a jointly owned contracting business to carry out pasture work across all properties and others in the region. The major cost items of feed costs and labour were highest priorities.

Feed costs

Feed costs are the highest input cost for all members averaging 36% of operating expenditure across the group. The seasonality and variability of feed cost makes it a difficult cost to manage for an individual farmer. The group set about reviewing existing relationships with suppliers and exploring opportunities for bulk buying. Trade within the group was also considered. 2019 has produced some of the highest prices ever seen for feed, making this initiative very timely.

Labour costs

At 18% of operating costs, labour was an obvious focus point. Labour is problematic across the entire agricultural sector and recruiting and keeping skilled people with a strong work ethic is a particular challenge in more remote communities such as the Kiewa Valley. Dairy farms need an ongoing stream of contract workers and relief workers to cover holidays and other leave. These workers could be recruited centrally and shared across the group according to work flows. An internship approach to apprentice training would enable all farms to work with the shared apprentice until the best fit full time employer is selected when the apprentice graduates. Investing in the region’s youth and the next generation of dairy farmers is important to the group. In the future the group could even consolidate payroll, HR services and OH&S documentation. Even professional and skilled staff such as vets or mechanics could be hired to work for the entire group.

The group has not yet been able to capture a definitive measure on how much they have saved via collective purchasing. Their CEO notes that they have probably saved between 5% on some purchases and 8% on others but because of their small size and agile operational style, they do not yet have a mechanism for measuring these collective cost savings. Quite often, they just save the delivery fee by putting in orders for two farmers on the one delivery, but these small incremental savings are all continuing to add up as they build their collaborative model.

The Mountain Milk Co-operative brand story

A central part of the long term strategy for Mountain Milk Co-operative is the need to develop a brand based around provenance. The Kiewa Valley has a great provenance story, located in Victoria’s picturesque High Country, with lush pastures in a pristine environment. The family farmer story also strikes a chord with consumers who increasingly want to know where their food comes from. Animal health and the environment are also considered an important part of the Mountain Milk Co-operative brand story and the businesses within the group consider this a high priority. The group's animal welfare code of practice includes the humane management of bobby calves, which is a high profile issue with consumers at present.

The development of a brand is also important because, as articulated in their strategic plan, the group recognises the risks in the current business of being aligned to only one supplier and has a proposal to enter into a consumer facing branded product range, potentially in fresh milk. This may be achieved without excessive risk by using a toll packer to process and pack the milk. The group understand that this would add considerable complexity to the collaboration in that the team lacks sales and marketing skills at present.

As the Mountain Milk Co-operative brand strategy evolves, the producers will need to establish more formal quality specifications to underpin the brand. At the moment, the quality specifications are mandated by Freedom Foods as part of their supply agreement. In the future, the fact that this small group of dairy farmers are likeminded and all share the same values in terms of animal health, hygiene and best practice milking, will not be enough. With new members joining and their own brand to protect, there will need to be clearly articulated manuals around a code of conduct to ensure quality expectations that align with their premium brand positioning in the market. However, this process may be simplified by drawing on the existing dairy industry documentation to provide a common, agreed standard.

This 'step out' strategy to develop a second supply chain for branded milk would require the group to expand significantly as outlined in the growth target in the strategic plan. The group were fortunate enough to get help from JWT, one of Australia's largest advertising agencies on a pro bono basis. The agency enthusiastically embraced the project, bringing its team to the region for a planning workshop to take the farmers through the brand development journey.

Quality of life and sense of community

The Mountain Milk Co-operative documentation makes mention of 'quality of life' for members throughout. After a tumultuous period in the industry, members are aware of the importance of supporting each other to protect their physical and mental wellbeing and they see the collaboration as a means to achieve this additional value add for members. One initiative proposed is to provide men's health checks on farm for members and potentially others in the local dairy community.

It is evident to an observer that the formation of the group has already fostered a sense of solidarity and a stronger bond between the members that provides them support in their business decision making. A central part of the co-operative's values is a deep sense of community. As noted, a community focus group was held as part of the strategic planning process.

Communications

Because the collaboration is a small group, members use WhatsApp messaging service to communicate on a daily basis. An example of how this is used is if one farmer is ordering a delivery of fertiliser, he can quickly check with the others via WhatsApp to see if they also require any, so that a full load can be ordered, saving delivery costs.

"To us, the added benefit in this is that we are supporting each other, both in business decisions and life generally. We want to take that element of it to the next step and invest in a men's health program."

Farmer Member

"The WhatsApp tool has been so powerful for instant communication and the guys are using it really effectively. They are in touch on a daily basis and share their data and production information instantly."

Independent Administrator

The mechanics of the value chain

The dairy industry has an extremely complex pricing model where dairy farmers are paid a seasonal milk price that reduces during the spring period when milk production is at its peak and increases during winter when cows are naturally producing less. On top of the seasonal variations, producers are paid different rates based on a number of variables around supply volume and milk quality, namely solids and bacterial loads. The quality of milk from dairy to dairy can vary considerably due to the professionalism of the farmer, herd genetics, weather and grazing conditions. The standard practice is that some of the incentive payments are paid at the end of the financial year as a lump sum rather than in the monthly milk cheque, meaning producers were always uncertain about the final price they would get.

The milk pricing model of the traditional dairy co-operative structure meant that the dairy farmers carried a large part of the market risk. The season opening price is indicative only. Producers get an upfront payment and a series of progress payments on a pooled basis reflecting market conditions. Furthermore, the pricing formula is subject to seasonal incentives and disincentives to allow processors to manage the seasonality of milk supply, notably the spring flush and the winter shortage.

The result of this pricing complexity is that essentially, no two dairy farms are earning the same rate for their milk and the earnings to the farmers fluctuate wildly throughout the year making cash flow management a challenge. From the processor point of view, management of this seasonal formula requires sophisticated accounting and bookkeeping systems and additional staff resources.

From the dairy farm point of view, the complexity makes it difficult to forecast cash flow and tensions between the processors and dairy farmers are fueled every time the seasonal price or pricing formula is renegotiated.

The Mountain Milk Co-operative farms are all located in a close geographic area with very similar pasture conditions and the dairies in the group are all of a very high professional standard in terms of skill and commitment to milk quality and herd health. Furthermore, the milk from Kiewa Valley naturally has somewhat less seasonal peaks and troughs in production compared to other regions due to the milder seasonal differences and the micro climates enabling the ability to calve in autumn and spring. This is a notable competitive advantage for the group as they could supply to better even out the processing throughput. The region's more reliable water supply also means less risk to the processor, compared to other dairying regions in Victoria.

The ability of the group to supply a large volume of milk on a somewhat flatter, year round basis was one of the competitive advantages that became key to negotiating the net pricing model with Freedom Foods that pays them the same milk rate per kilo of solids in every calendar month of the year. It is a net price without the complicated long term incentives. This contract was a win-win for the producers and the processor. The rolling agreement with a longer term than normal timeframe gave Freedom Foods certainty of supply in a short market, simplification of accounting and the ability to cost their UHT product with a fixed input cost so that long term export contracts could be

committed to. For the dairy farmers, the fixed price enabled them to forecast cash flow based on the litres of milk produced each month and the certainty of placing their milk during a period of industry volatility. The contract has a rollover clause for a second long term period with a provision for revised pricing. Unlike this agreement, most dairy contracts are negotiated seasonally which takes time and is a distraction to the business of both the supplier and processor.

From the perspective of these dairy farmers, the central issue with traditional processor payment systems was that they provided no link whatsoever with real market returns. Obviously, the main goal of the processors is profit maximisation, but this left the farmers with a model whereby they were chasing an incentive that was effectively counterproductive to profitable farming.

Overall, the Mountain Milk Co-operative has achieved better prices than paid by their previous processors and importantly, more stable pricing. They were able to achieve this outcome by understanding the concept of the 'customer value proposition' in their negotiations.

Understanding the customer value proposition

During 2017 Mountain Milk Co-operative's alliance partner, Freedom Foods acquired and invested in a UHT processing plant in Shepparton, Victoria, a convenient distance from the Kiewa Valley, in order to produce premium UHT milk for the domestic and export markets. Although UHT milk is a commodity category, there is still a significant amount of brand loyalty and relevance for UHT milk in emerging markets where consumers are used to powdered or condensed milk.

Freedom Foods is a reliable trading partner for Mountain Milk Co-operative and importantly its dairy operations are at a size where the Kiewa Valley supply is important to them, so there is strong mutual dependency in the contract.

About Freedom Foods Group

Freedom Foods Group Limited is a listed Australian food processing company specialising in healthy and 'allergen free' foods including cereals, snacks, dairy and nut milks and canned seafood. Its portfolio of over 150 products includes brands such as Freedom Foods, So Natural, Australia's Own, Milk Lab, Vitalife and others. It also has a business called Freedom Foods Group Nutritionals which is manufacturing dairy based protein ingredients and premixes for use in products such as infant formula.

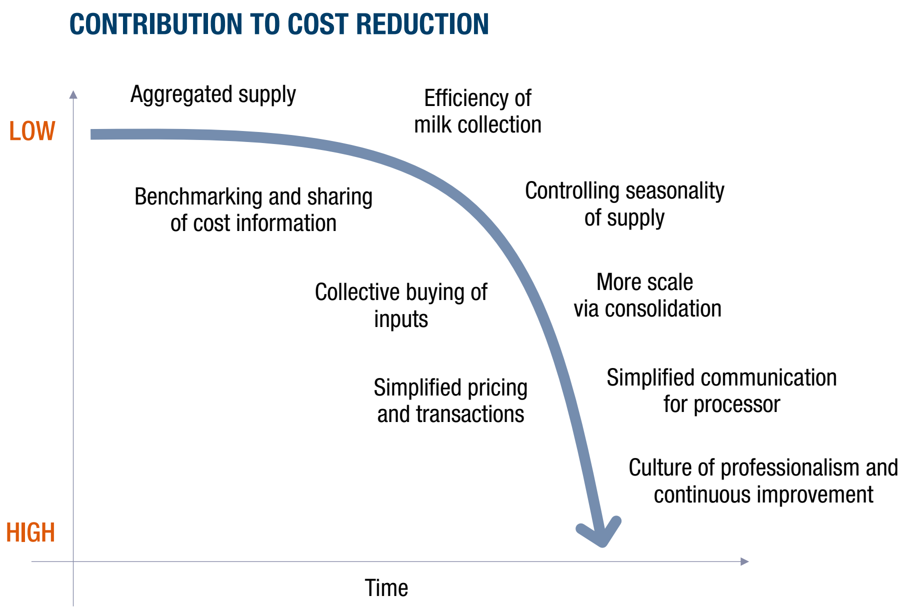
Freedom Foods Group is a relatively young and progressive business in the Australian food industry and has experienced rapid growth since its inception in the 1990s. It now has six processing sites around Australia, is acquiring more brands and is also reporting continual growth in its Asian export business. The dairy categories are a driver of the export business growth and notwithstanding the impacts of drought, Freedom Foods has recently accelerated investment to increase their dairy processing capacity at Shepparton in Victoria, nominating aggressive sales growth targets. There are now around 40 dairy farms supplying Freedom Foods' milk requirements.

The Mountain Milk Co-operative customer value proposition for Freedom Foods includes:

- The security that third party auditing provides
- Assured supply for the longer term, extended contract period
- Somewhat flatter supply assists in optimising plant operations
- Secure supply by virtue of the reliable climate. This means less reliance on high cost irrigation water or uncertain water security, making these farms more viable. Many dairy farms are closing down in other production areas
- This confidence in supply enabled the pursuit of new business in export markets
- Easier to manage flat monthly payments contractually and administratively
- All milk collection points are within 10 km of each other, reducing pickup costs
- There is a single point of contact for communication via the group's administrator
- Uniform milk of a superior quality; lower bacterial load due to clean production systems and animal health which is better for drinking milk compared to powdered milk.
- Dealing with a group of professional suppliers committed to ethical and sustainable farming practices
- Strong provenance story of milk from Victoria's pristine high country region, which could be leveraged in the Freedom Foods brand, particularly in export markets
- The focus on animal health and welfare provides a good fit with the Freedom Foods brand values
- Mutual respect within the trading relationship.

Essentially, Mountain Milk Co-operative recognised that it could increase the value of the milk it sells to Freedom Foods by understanding more about the business of Freedom Foods.

This is an example of what academics term *'servitisation'* or *'whole product'*, where suppliers create better value for their customers through a shift from simply trading a commodity to selling a package of improved products and services that are tailored to the customer's needs. Through partnering, Mountain Milk Co-operative is able to deliver more customer value to Freedom Foods Group, while also reducing its costs (Figure 1).



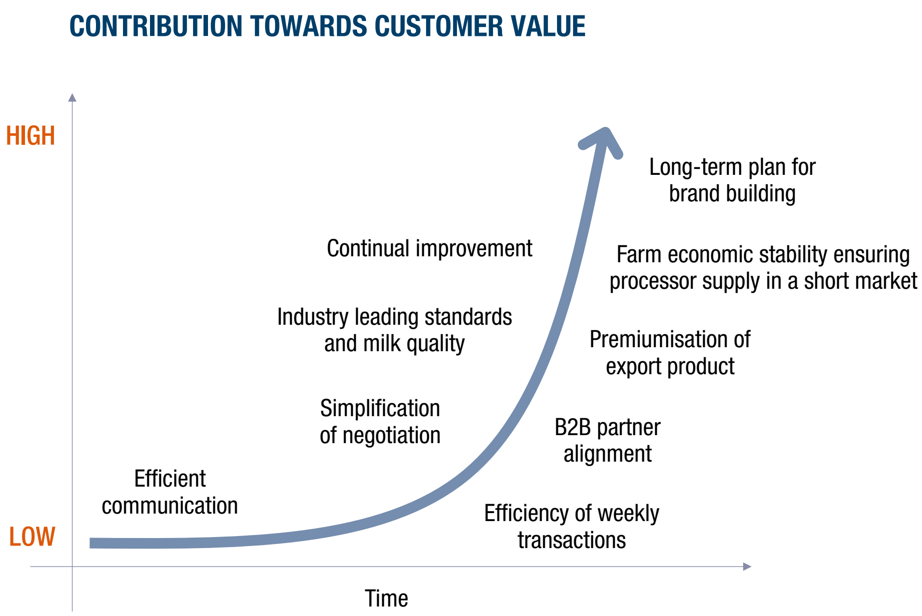


FIGURE 1. Mountain Milk Co-operative benefits

The case study learnings

> "I know a lot of it has just been ideas to date, but this whole exercise has delivered more benefits than we ever expected"
>
> **Farmer Member**

Benefits of this collaboration

- ✓ A group of small producers was able to gain the benefits of scale afforded to a larger producer by aggregating supply and negotiating a supply contract as a group.
- ✓ The group was able to achieve an increased price relative to their previous contracts by better understanding their customer's need and improving the value proposition to them.
- ✓ Cash flow has been improved with a simplified, flat, net pricing model that enables better business planning.
- ✓ Cost reductions have been achieved and there is scope for more.
- ✓ The premium quality and provenance of the Kiewa Valley milk was able to be realised for export. This milk was previously blended across the big processors, much of which went to low value milk powder exports. The new contract enables members to participate in a higher value export market for UHT milk.
- ✓ The processor is able to negotiate longer term export contracts with confidence and be more competitive in the global milk market due to the longer than usual rolling contract with a fixed pricing model.
- ✓ The members have structured their collaboration to retain individual business independence, but still reap the benefits of collaboration achieving a good balance of discipline and flexibility.
- ✓ The members have a strong peer support network which gives them great peace of mind and a network of likeminded operators to discuss their business decisions with.
- ✓ The community benefits from having a stable and sustainable local dairy industry during a time of industry flux.
- ✓ Another unforeseen benefit of the Mountain Milk Co-operative is that the group is a good size for becoming a test case for new programs and initiatives in the dairy industry. Because there is a central contact point for the group, it has become easier for industry bodies like Dairy Australia or regional authorities to engage with the group, unlike in other regions.
- ✓ Although the Mountain Milk Co-operative is still working through the practicalities of delivering on many of the collaboration ideas flagged in their planning stage, all agree that the journey to date has delivered much more than any of them expected and all have learnt much as individuals in the process. Members acknowledge that there have been tense moments and issues of disagreement, but the group has worked through these successfully with the assistance of the independent consultant and with strong community support for the concept.

“(The board) represents a strong and shared determination to secure a future for dairy in the region and not just for their own farms. They are an impressive and visionary bunch who are not afraid to show leadership in their communities!”

Patten Bridge, CEO
Mountain Milk Co-operative

The critical importance of independent and specialist facilitation

The Mountain Milk Co-operative was fortunate to secure a very experienced consultant (now engaged as CEO), with career experience and trusted networks in the dairy industry. The consultant selected fortuitously has a good understanding of the Kiewa Valley and the on-farm aspects of grazing dairying.

In this example of Mountain Milk Co-operative, employing a less skilled consultant or a facilitator, without the specific industry knowledge and networks could have easily led the group in the wrong direction.

The benefits of investing in a skilled, independent administrator, consultant or manager apply to any collaboration:

- ✓ Professional skills that may be lacking within a group of farmers
- ✓ Networks across the industry and with other professional advisors from disciplines such as marketing, processing or finance
- ✓ Experience across the whole supply chain as well as an understanding of ‘on farm’ issues
- ✓ Objectivity and impartiality in facilitating meetings and the meeting skills to guide the discussions
- ✓ Business, organisational and administrative skills
- ✓ Governance disciplines
- ✓ Documentation and record keeping
- ✓ Professional representation for engaging with processors and industry bodies, which also saves time for farmers
- ✓ A central communication point within the group and for external communication.

Critical success factors

The critical success factors for Mountain Milk Co-operative could be applied to any collaboration:

1. A group of likeminded partners who share an aspiration for producing a high quality product and continuous improvement in all aspects of their businesses
2. A paid, professional, independent consultant (in this case performing the role of CEO) with vast experience in the industry sector and with the networks to bring in specialist advice when needed.
3. A well-researched and detailed planning process that was fully documented before the partners enacted the collaboration and formed a co-operative.
4. A strategic approach to choosing the supply chains and supply chain partners where the collaboration can best leverage their competitive advantage (i.e. a consistently premium milk suited to higher value UHT for export).

Key learnings

1. The importance of engaging a skilled, independent administrator or consultant who can methodically guide the group through the foundation process.
2. The initial investment in time and professional advice to get the collaborative model right and clearly articulate it in a set of values, quality standards, priorities and a five year strategic plan has paid off for this farsighted group.
3. Focusing on a tight list of priority actions and not taking on too much too quickly helped this group avoid hastily taking on unmanageable risk.
4. The commitment of the members to researching, studying, planning and developing this collaboration, despite their busy lives running their individual businesses, has been a notable contributor to their success.

Partnering for Customer Value

The Agribusiness Food and Trade (AFT) directorate of the Department of Primary Industries and Regional Development (DPIRD) works to enable growth in the value, competitiveness and diversification of the WA agrifood sector through facilitation of value adding, investment and export for the benefit of the community.

As part of this work, Partnering for Customer Value is providing research and business intelligence on practices that lead to international competitiveness and improved export capacity. A portfolio of cross-sector case studies shows real world examples of how businesses can build strategic relationships by delivering true value to their customers.

For more information

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