

Written evidence submitted by Dairy Crest

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EFRA Committee: Dairy Prices

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ABOUT DAIRY CREST

Dairy Crest – an Overview

- The dairy sector is one of the largest food market categories in the UK worth £10bn¹.
- Dairy Crest is the leading British owned dairy company. We are the only UK listed dairy business and the only major milk processor predominantly in British ownership.
- Dairy Crest is one of the UK's largest purchasers of fresh milk, buying circa 1.8 billion litres every year. We source 80% of our milk directly from 1,100 dairy farmers across England and Wales.

Dairy Crest Direct - a collaborative approach

- All of our direct supplying farmers are members of Dairy Crest Direct (DCD). This is an independent farmer representative body which was established in May 2004 and independently funded through farmers' subscriptions. This organisation structure allows us to work together on improving our supply chain.
- This was evident in April 2013, when we were the first raw milk buyer to launch, jointly with DCD, a simple, robust and transparent milk pricing formula.
- Elected regional representatives operate within a Farmer Forum - to determine the direction and aims of the business. The Forum in turn elects a Board that is responsible for running the organisation.
- Earlier this year, DCD (supported by Dairy Crest) was successful in securing a Defra/RDPE grant to invest in future development projects, including evolving into a formal Producer Organisation (PO), advancing Dairy Futures opportunities and the development of a milk production forecasting tool.

The state of dairy farming in UK

- Parts of the UK have amongst the best natural conditions in the world for dairy farming with lush grass and an advantageous climate.

¹ Kantar 52 w/e 18 March 2012

- We also have an excellent tradition of animal husbandry and some exceptional dairy farmers - the skills which have been passed down the generations, showcased in our excellent dairy products, including top quality cheese and milk.
- The dairy sector makes up a significant section of the British rural economy with dairy forming 17 per cent of the agricultural output of the UK as a whole. Dairy farming provides the foundation for large parts of the rural economy indirectly as well through drivers, local supplier, vets and other dependent industries.
- However, the shape of the dairy sector in this country is changing, with the number of dairy farmers in the sector dropping. In fact, in the past ten years, the number of dairy farmers in England and Wales has fallen by 43%. (Source: Defra, DARD, SEERAD.)
- This is in part due to volatility. After a period of record milk prices throughout 2013, and into the beginning of this year, there have now been a number of reductions in farmgate milk prices across Europe, including in the UK. These price reductions reflect the dramatic falls in global dairy markets over the past few months due in part to global over-production and a slowing down in the rate of consumption in countries such as China.
- Global Dairy Trade auction prices are 50% down from their peak at the start of 2014; UK cream prices have fallen back 20% and cheese stocks are at record high levels. Half of the butterfat supplied by our farmers is processed into butter, whilst the other half is sold on the commodity cream market. These external market conditions therefore have a very direct impact on the farmgate price of milk.
- These falls have been further exacerbated by the recent Russian trade ban on dairy products. Since the ban was announced - at the beginning of August – we understand that about 250,000 tonnes of EU cheese destined for Russia have no point of onward sale – that is the equivalent of 2.5 billion litres of milk, around 20% of the UK's annual milk production. Therefore European commodity cheese processors have stopped making cheese and instead process that milk into skimmed milk powder and butter. This has quickly led to surpluses of stock on these commodity markets and consequently further dramatic falls in value.

Creating a more sustainable dairy sector

Dairy Crest believes that there are a number of different measures that can - and must - be taken to secure the future of the dairy sector:

- Firstly, every effort must be made to ensure the British dairy sector can compete on a global level. We need to make sure that it is a vibrant market place where companies can grow and invest. For that we need farmers and processors to be as lean and efficient as possible and therefore able to secure sufficient margins to allow them to invest and innovate.
- Secondly, we need to see this investment used to manufacture British dairy brands, such as Cathedral City, Clover, FRijj and Country Life. Businesses should be encouraged and helped to innovate around new product development (NPD) and expand where possible. For example, at Dairy Crest we are very proud of our Cathedral City cheese. We continually innovate – in the past year we have introduced new flavours, sizes and formats. When we do have successful brands we share the benefits with farmers who supply the milk – no ifs, no buts!
- Thirdly, the industry must continue to invest in new and innovative added value product streams for export. Dairy Crest is for instance, currently investing £65million at our creamery in Davidstow to manufacture products for the fast-growing infant formula market. These products are adding further value to raw milk so will help us to cushion the whole supply chain from the volatility of global commodity markets.

Proposed sale of Dairy Crest Dairies operations to Müller UK & Ireland Group

- Further to our stated strategy and the measures outlined above, including the need for scale to improve investment in the sector, in November 2014 we announced the proposed sale of our Dairies business to Müller UK & Ireland Group. The sale is still conditional on the approval of Dairy Crest shareholders and the relevant competition authorities. The combination of our Dairies operations with those of Müller Wiseman Dairies (the fresh milk, cream and butter business owned by Müller) will build on the progress we have already made in improving efficiency.
- We believe it will help to create a more sustainable UK dairy sector by delivering economies of scale and cost efficiencies that will underpin investment in the industry. This in turn should help the UK to compete more successfully in global markets, which is essential for British dairy farmers.
- After completion our focus will be on our profitable, predominantly branded, cheese and spreads operations. As outlined above, we will grow revenue and profits by continuing to develop whey-based products.

Questions from the Inquiry

1. How effective have Government measures to support the dairy industry been in securing the long-term viability of dairy farming in England?

Dairy Crest believes that the Government has been broadly supportive of the dairy sector over the past five years in a number of areas where we would hope to see continued support:

- **Export for growth strategy:** Dairy Crest has aligned our business strategy with the Government's plans for export-led recovery. We sit on the Dairy Export Forum which has proved very useful. On top of this, we have been on a number of trade missions with UKTI and been involved with the "Britain is Great" campaign.
- **Bovine TB:** Bovine TB is devastating to the farming sector and has proved extremely expensive to the taxpayer. Apart from the financial aspects of the disease, the emotional strain it places on farmers affected is severe and is not sufficiently recognised, let alone the moral issues regarding the destruction of thousands of healthy cattle each year. Dairy Crest has been pleased to see a strategy put in place by the Government.
- **Voluntary Code of Practice (VCOP):** We welcomed the introduction of VCOP, as opposed to statutory legislation, and although we still have concerns with the way it has been implemented (see Q3) we believe the steps taken by Defra in 2012 were helpful in securing a more stable footing for the sector.

Looking ahead:

- **Country of Origin Labelling:** Current labelling practices are poorly understood by consumers and are sometimes even misleading. A British flag reassures consumers of the provenance and world-leading standards. It is synonymous with quality and it's a mark people trust. As it stands, cheese made in Ireland, with Irish milk from Irish cows, can be labelled as British if it is merely cut and packed in the UK. This is misleading for consumers and penalises Britain's dairy farmers who put their hard work, skill and time into producing and supplying top-quality milk. We want a labelling system which consumers can trust so they can make informed choices – and support British dairy farmers.
- **Health Benefits:** We would like to see further promotion of the health benefits of milk. Research from the Universities of Reading, Cardiff and Bristol released last July has claimed that drinking milk could cut people's chances of dying from heart disease and strokes, reducing the risk of chronic illness by up to a fifth.

2. What impact has the [EU milk package](#) under the Common Agricultural Policy had on dairy farming and what outcomes should the Government aim to secure from the EU?

- The EU Dairy Package has proved to be a helpful catalyst for change/review of farmer-processor relationships.
- We welcome the Commission's proposals, which will make it considerably easier for dairy farmers to cooperate over prices and so increase their bargaining power, without fear of investigation from competition authorities.
- It is now up to the Government and devolved administrations to ensure that any legislation passed helps to serve the UK dairy industry.
- As mentioned previously, DCD is in the process of investigating becoming a formally constituted PO, a move which Dairy Crest has wholeheartedly supported.

3. How successful have voluntary approaches such as the Dairy Industry Code of Best Practice for Contractual Relations been in securing the long-term future of dairy farming?

- Dairy Crest is firmly committed to delivering against our promises in relation to the Dairy Industry Code of Best Practice on Contractual Relationships (VCOP). Since it was signed in 2012, we have changed our way of working and are fully compliant with VCOP:
 1. Dairy Crest was the first raw milk buyer to take up VCOP working principles in summer 2012. This was in May before it was signed off by Defra and other milk buyers.
 2. In April 2013, we were then the first raw milk buyer to bring out a transparent formula option for our farmers on a non-aligned standard liquid contract, as recommended by VCOP.
 3. Two of the key elements relate to notice period for a price change and the ability for a farmer on a discretionary priced contract to resign with 3 months' notice if they do not agree to a price change. We have worked with our farmers to reflect these principles.

4. In summary, we have taken VCOP fully into our business and have worked hard to make it work for the whole supply chain.

What this has meant for the British dairy sector

- VCOP has delivered innovation within the industry in regard to contract options available to farmers.
- As demonstrated by our announcement last year, this has also delivered formula pricing for non-aligned farmers – a key aim for VCOP when it was signed. Dairy Crest believes the option for formula pricing should be a long term aim for the dairy sector to ensure transparency of milk price.
- Since VCOP was introduced, there has been an improvement in the bargaining power of farmers which, combined with good market conditions last year and better weather, helped lead to a slowdown in the cessation rate of farmers and a new found optimism in the sector.
- There has also been improved engagement from farmers when deciding their contract options. In particular, we have noticed closer scrutiny from our suppliers of the contracts and models they are signed up to – a good thing for the sector as a whole as this ensures a fully engaged supply chain.

Areas of concern

- The main issue which has affected VCOP and its ability to function optimally has been the nature of its terms surrounding notice periods for farmers on discretionary priced contracts. Those terms currently operate differently for businesses which have different ownership structures. There is not a level playing field between co-operatives/transitionary co-operatives and other businesses such as private businesses or PLCs. In practice, a farmer who is contracted to a co-operative must give 12 months' notice to leave his contract, whilst a farmer on a discretionary priced contract at a dairy business other than a formal co-operative can leave on 3 months' notice. Instead of giving farmers more choice, VCOP currently skews the market to the advantage of the co-operatives, transitionary co-ops and non-Dairy UK members.
- Because of this difference in terms, a number of raw milk buyers, in particular mid-tier size companies, are not currently complying with the 3 months' notice

period clause. This is because the co-ops/transitionary co-ops have a competitive advantage when it comes to procuring milk and a number of raw milk buyers feel that compliance with VCOP would directly affect the security of their milk supply.

- This built in disparity across the sector puts the future of VCOP in doubt. For it to work long term and avoid the threat of legislation, we need to see it work across the sector. For this to happen, it must be more attractive for all raw milk buyers and encourage a level playing field to help competition and milk supply. We do not believe that legislation would be a good thing for the British dairy sector and hope that VCOP can be amended following the review process to help avoid this.
- However, it must be noted that VCOP – even if the whole industry was fully compliant with it – will not make any difference to current farmgate milk price dynamics, which have been driven by global markets.

4. How effective is the regime established under the [Groceries Code Adjudicator Act 2013](#) in ensuring fair and stable prices for milk producers?

- The remit of the Groceries Code Adjudicator 2013 was clearly defined when it was set up to cover the relationship with retailers and their direct suppliers. Therefore it has not had any bearing on milk prices.

5. What should the processing organisations, farmers themselves and their farming representatives do to improve the prospects for dairy farmers in a volatile market?

Adding value through growing brands

- As previously mentioned, the best way to mitigate global commodity risks is for the sector to focus on adding value to the supply chain.

Cathedral City – a virtuous circle

- This is best evidenced with farmers in the South West, who supply our cheese business. We buy milk from 265 farms in Cornwall and 135 in Devon, with an average herd size of around 170 cows. This is one of the largest and most dense milk fields in the UK.

- In Davidstow, we have created a 'virtuous circle' - milk from a traditional dairying milk field in the world is turned into high quality cheeses in a well invested, world-class creamery, sold as leading brands, allowing it to pay a premium for the milk, which encourages further investment by the farmers in their farms and so in the milk field.
- On average, Davidstow farmers have received a premium of 1.3 pence per litre (around 5 per cent) for their milk over the last five years. Over 2013/14, we were able to offer farmers on a Davidstow contract 10 months of stability and it remains one of the leading priced milk contracts in the UK.

Creating an efficient and lean supply chain

- Dairy Crest believes that, as evidenced with our recent announcement to sell our Dairies operations to Müller UK & Ireland Group, the British dairy sector needs to create businesses of scale. We believe the proposed sale will strengthen the wider UK dairy sector bringing much needed security for Britain's dairy farmers. Investment will be more attractive, enabling the British dairy industry to compete more successfully in global markets.

Forward looking Investment

- Going forward, we have announced a £65 million investment to make demineralised whey powder and galacto-oligosaccharide (GOS) at our creamery in Davidstow, Cornwall. Both products will be aimed at the infant nutrition market and will add further value to our milk stream.

Making dairy commercial

- Dairy companies and retailers must communicate more effectively with the public so they know why it matters to buy British and to buy British dairy products. We have to help them to make the right decisions when they go into the supermarket and promote the naturally healthy range of products we make as a sector.

Working collaboratively throughout the supply chain

- We believe processors need to recognise the range of dairy farm types and business models in the diverse models of contracts offered and ensure the 'one size fits all' approach to our dairy farmers is avoided.
- We have continued to offer some more volume of our unique milk price formula to non-aligned liquid farmers on a quarterly basis so they can choose the contract and payment system which suits their individual businesses best.
- We continue to develop the unique, complimentary farm advisory service, White Gold, to offer further support to farmers and help them run their businesses as efficiently and sustainably as possible. Our regionally based farm liaison team participate in additional training and awareness events to ensure that farmers are kept up to date with the latest dairy knowledge and legislation.
- We are working with our existing retailer milk pools to increase efficiency and explore new market opportunities that deliver farmer value. Examples include the M&S 'Better for you' milk initiative and further cow welfare monitoring initiatives for the Waitrose Dairy Farmers Milk Scheme.
- We will continue to maintain the highest standards. The milk produced by our direct suppliers is 'farm assured', ensuring that we use only top quality milk produced to stringent standards governing food safety, animal welfare and protection of the environment. Our direct supplying farms must comply fully with the requirements of the Assured Dairy Farm (ADF) national dairy farm assurance scheme.
- We are a long-term supporter of initiatives to encourage and support the next generation of dairy farmers and are proud to sponsor Dairy Crest/NFU South West Scholarship Fund.
- Dairy Crest also gives financial backing to The Prince's Countryside Fund which aims to rejuvenate the rural economy and also supports the farming help charities who care for farmers in any sort of distress. We are a key partner with others in the dairy sector in The Prince's Dairy Initiative which is working with traditional family farmers to help them reduce their costs and remain in dairy farming.
- The dairy sector is proactive on combating climate change. Dairy Crest has contributed to and complied with the Dairy Roadmap that has set ambitious targets for the amount of recycled plastic used in bottles, energy and CO2

emissions. We have also been working with our farmers to help them achieve these targets.

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