

Report of the Environment, Planning and Countryside Committee's consideration of evidence taken on the Strategic Action Plan for the Welsh Dairy Industry

Introduction

1. The Welsh Assembly Government published for consultation its Strategic Action Plan for the Welsh Dairy Industry on 29 January. The consultation closes on 30 March. The plan sets out three key aims:
 - To improve levels of understanding of market trends and consumer behaviour;
 - To foster innovation and improve the supply chain;
 - To improve the business performance of producers and processors in response to changing market conditions and consumer demands.

2. The Environment, Planning and Countryside Committee took evidence on the plan at its meetings on 7 February and 1 March. The organisations represented at the evidence sessions were:
 - J Sainsbury plc
 - NFU Cymru
 - FUW – Undeb Amaethwyr Cymru

The Committee regrets that Tesco felt unable to respond to our invitation to give evidence on 7 February, also that a full work programme meant that within the time available this term it was not possible to invite others, such as co-operatives and processors. The organisations that attended Committee also submitted written evidence in advance of the meetings. This can be found at Annex 1. The transcripts of oral evidence are at Annex 2.

3. The report that follows summarises the main issues discussed and is the Committee's response to the Welsh Assembly Government's consultation. We realise that the Minister does not have responsibility for the many commercial issues and pressures affecting the dairy industry. We therefore make a limited number of recommendations where we believe that the strategic plan may be improved, so that the Minister is able to truly represent Welsh interests and explore innovative proposals.

Responses to the strategic action plan

4. The witnesses shared with us their opinion of the plan. Sainsbury's believed that the Minister had correctly identified the components for a sustainable, efficient, profitable and innovative dairy industry. However, it would have liked to have seen greater importance attached to the wishes of the consumer in taking forward the strategy. The unions were

both critical of the plan. The FUW's view is that the plan lacks clearly defined goals, making it difficult to monitor and evaluate. It also believes that greater clarity is required with regard to the source of funding for the plan. NFU Cymru were also critical stating in oral evidence that it saw no commitment from the Welsh Assembly Government to tackle the macro issues – retail/buyer behaviour; competitive framework that would allow for consolidation; reducing the regulatory burden - affecting the profitability of the industry. Like the FUW, it too would wish to see financial projections for achieving objectives.

Current state of the dairy industry in Wales

5. In its written evidence, Sainsbury's noted the key challenges facing farming today: the reduction in the number of farms; a lack of overall investment; and the problems of succession planning. Even though we were alarmed by press reports that by 2011 the UK might be in the position of importing milk, we were nevertheless encouraged to hear from Sainsbury's that they consider that there is scope for the Welsh dairy industry to grow.
6. We were however told a great deal about the worrying state of the dairy industry in Wales. In its written evidence, NFU Cymru referred to "the dire and deteriorating circumstances of the Welsh industry", which is exacerbated by the consequences of bovine tuberculosis for milk producing herds. The strategy notes that the number of dairy farmers, which has already fallen by around 1,000 in recent years, is likely to decrease by another 5.6 per cent or a further 1,000 in the next three to four years. Production has not yet fallen, because the scale of business is significantly greater than previously. However, we appreciate that the industry would be particularly vulnerable were larger businesses to leave. There would be a danger that the infrastructure would collapse leaving parts of Wales without a dairy industry. Since dairy farming is often the most popular route for young farmers entering the industry, the impact of the decline on the future of farming cannot be overstated.
7. We believe that the future of the dairy industry cannot and should not be considered in isolation. We record our concerns regarding the environmental impact of farmers leaving the industry or of them needing to keep 1,000-cow superherds to be viable as milk producers. We would be concerned about the consequences of storing large amounts of slurry on farms and we would oppose the use of satellite grass-growing areas, where farmers sometimes transport silage to herds that are not sent out to pasture near the dairy from many miles away. It is also difficult to overstate the effect of further depopulation on the sustainability of the rural economy.

Farm-gate prices

8. Members wished to explore the determinants of prices paid to farmers for milk production, which are among the lowest in the European Union, and sought transparency because of the disparity between farm-gate prices and those paid by consumers in retail outlets. In its written evidence, the FUW drew our attention to the fact that while there has been a decline in the price paid to the farmer for milk there have been significant increases in production costs. We are of course aware of recent pressures on costs caused by increases in energy prices in particular. NFU Cymru told us that producers now receive 27 per cent of the retail price of liquid milk and stressed that producers need profitability and confidence to invest in their businesses.
9. Sainsbury's informed the Committee that it monitors the prices of some 14,000 products weekly to compare its prices with those of its competitors. If the price of milk were to move, then it would amend its price to remain competitive. It emphasised that prices had fallen since deregulation, but maintained that it bought its milk from processors delivering a higher level of return than the average market.
10. It appeared to us therefore that there are several factors influencing milk prices. First, the role of the processors in the supply chain and their necessary percentage of milk costs, which unfortunately was an issue we were unable to examine in detail. Secondly, milk distribution, and we were urged to consider whether it might be better to take some milk through depots rather than directly into stores. Finally, there is the issue of farm-level efficiency and whether a price range around 17 pence per litre is appropriate.

Supply Chain

Stability of supply

11. Securing stability of supply was clearly a major concern for retailers. Sainsbury's told us that it had entered into contract in many of the dairy areas for conventional and organic milk to ensure a sustainable supply. It explained that it was now seeking more constructive relationships with farmers, as well as processors, so that the producers could be involved in their vision for dairy retailing.

Farmer/processor/retailer

12. We were interested to learn of the farm-level agreements that Sainsbury's have secured to ensure supply of organic milk and welcome its farm promise initiative to support farmers converting to organic standards. The farmer receives a contribution towards the additional costs associated with converting from conventional to organic milk production at the rate of 11 pence per litre.

13. The Committee welcomes Sainsbury's initiative with regard to the dairy development groups created in October 2006, and believes that it will help to get the supply chain working together. We learned that these groups will have quarterly forums and will seek to promote a closer working relationship between the retailer, processor and farmer.
14. We understand from NFU Cymru that current contracts between producers and processors are binding for 18-months, but are not binding on price. This clearly severely disadvantages the producer.
15. One of the NFU's main concerns was that the Welsh Assembly Government should provide a competition framework that would permit the consolidation of milk processing activities. Further that the milk processing sector, especially the farmer-owned businesses, should be allowed to rationalise to improve its competitiveness.

Milk co-operatives

16. There are currently three co-operatives in Wales which have 60 per cent of the milk produced. We were concerned to hear that the development of their processing capacity is still quite slow and has not kept pace with consumer demand. The FUW told us that they thought that the cooperatives would eventually merge and that that would benefit the industry. It argued that the Office of Fair Trading's approach to competition policy in respect of mergers in the dairy industry should be addressed to meet the challenges of an increasingly global market. NFU Cymru would like to see farmer-owned organisations in a stronger bargaining position with large retailers.

Competitiveness

17. Given the recent publicity surrounding the Competition Commission's announcement on anti-competitive practices in retailing and processing, we were interested to hear the witnesses' views of what message they would wish the Minister to convey to the UK Government and the Commission. NFU Cymru suggested that the Minister might wish to influence the Office of Fair Trading to consider the production side of the dairy industry as well as consumer issues. We agree that this may help to support the industry. **We recommend that the Minister discuss with the Office of Fair Trading how it might extend its dealings with the dairy industry to consider the difficulties of milk producers.**

Need for investment

18. It was made clear to us that the industry needs further investment to add value to the dairy sector. Again, we are particularly concerned that Irish producers will be advantaged by the Irish dairy processing aid package, which aims to promote capital investment in the processing

and marketing of dairy products. **We recommend that the Minister reconsider his funding support for the dairy industry, and ensure that, following this consultation, the final strategic action plan, contains financial projections for achieving the plan's key objectives.**

The Irish Dairy Industry – Bord Bia

19. NFU Cymru's suggested that the Welsh Assembly Government should consider combining the management group of the dairy development centre with the Assembly's dairy strategy group and the Welsh Milk Development Council committee, to emulate the configuration and operation of Bord Bia in Ireland, which had added 10 per cent to the value of Irish exports last year. **Given that promotion and management of the dairy industry is hugely fragmented in Wales, we were very interested in this innovative proposal, and recommend that the Minister investigates the establishment of a new group to promote and manage the dairy industry in Wales along the lines of Bord Bia.**
20. NFU Cymru also advocated that the Welsh Assembly Government should undertake work to determine whether a body similar to Bord Bia in Wales could embrace other sectors such as Hybu Cig Cymru. **We recommend that the Minister investigate the feasibility of configuring a future merged dairy management body with similar bodies in other sectors of the industry.**

Retailing dairy products

Consumer demand

21. Sainsbury's told us that its dairy business was one of its most vibrant and innovative product areas, with growth in products such as yoghurts, active health products, functional and spreadable fats and the cheese market. It also vividly outlined consumer demand for dairy products, with more than ever before demanding quality and taste:

"Efficient and high-quality production facilities, the demand of product integrity, consistent quality, being able to show due diligence in production, particularly with own-label products, represent a high demand that is now driven in the marketplace by the consumer."

However, Sainsbury's cautioned against over-investment in organic milk since it accounts for only 5 per cent of organic sales.

Sourcing UK products

22. While we were pleased to hear of the growth in dairy business for `retailers, we were nevertheless concerned to learn that much of the

growth is not being delivered through a UK source of supply. For example, we were told that most yoghurts are sourced in Europe despite incontrovertible evidence of consumer preference. Also that sourcing added value products with suitable packaging or in bottled format, such as flavoured fresh milk, was proving difficult.

23. Nevertheless, Sainsbury's told us of its attempts to source UK products and we were encouraged to read that it stocks 81 Welsh supplier branded lines from 23 Welsh suppliers.

Written evidence provided for 7 February and 1 March meetings

Dairy Strategy Consultation – J Sainsbury plc submission

Introduction

1. Sainsbury's welcomes the opportunity to give evidence to the EPC Committee and to comment on the draft Dairy Strategy published last month by the Minister for Environment, Planning and Countryside.

Background on Sainsbury's

General

2. Sainsbury's has around 747 stores (including 275 convenience), 150,000 employees, 40 distribution depots and around 26,000 food and drink products (about half own-brand). Each week over 16m customers shop with us. We are the third largest supermarket in the UK after Tesco and Asda.

3. Sainsbury's has been committed to supporting British farmers for over 130 years. We believe that many of our customers prefer British produce provided that the quality and price are right. We sell over £6bn of British food. Of the food that can be grown in the UK, we source 90% British.

4. All of Sainsbury's own-brand milk, cream, eggs and butter are from British farms, including our organic products.

5. All of our poultry, primal pork and sausages are British; 96% of our primal beef is British or Irish; 70% of our primal lamb is British with the remaining 30% coming from New Zealand when lamb is out of season here. All of our organic meat, fish and poultry are British. We sell more British apples than any other supermarket chain.

In Wales

6. Sainsbury's has nine stores in Wales, which includes eight petrol forecourts, seven in-store restaurants and four pharmacies. Seven of our nine stores are in South Wales (Cardiff: Roath, Thornhill and Queen's Street; Newport; Cwmbran; Bridgend and Swansea) and two in North Wales (Wrexham and Rhyl). We serve approximately 285,000 customers each week in Wales and employ over 2,550 people.

7. We have a number of specific Welsh-led sourcing and marketing policies, which includes selected lines of Welsh products well-marketed in store, a commitment to increase Welsh sourcing and marketing, support to Welsh beef farmers through the *Farm Connections* IT project, as well as continuing to hold in-store promotions such as St David's Day celebrations and cooking events to promote Welsh food. We also source a number of products that are sold across the UK from suppliers in Wales.

8. We currently stock 81 Welsh supplier branded lines from 23 Welsh suppliers. Given our relatively small number of stores in Wales, the overall

number of our Welsh-branded lines is still high relative to our competitors. For example, IGD figures state that Tesco has 57 stores, with our independent research finding that they have 26 Welsh suppliers (against our 23) and 110 branded lines (against our 81). We estimate that we source over £100m of own-brand products a year from our top 6 Welsh suppliers.

9. In addition we source a number of products made in Wales that are not specifically branded as Welsh. For example: our largest supplier of hams and cooked meats to our store deli counters is from a supplier in Flintshire; a significant number of our own-brand ready meal lines are made in Wrexham; all our own-brand Chinese ready meals are made in Swansea; and we source some of our own-brand apples from a supplier in Wye.

10. A significant proportion of our total lamb and beef lines across the UK have been reared and processed in Wales. We also have a proportion of non-Welsh lamb and beef lines that are processed on the English-Welsh border, helping to provide Welsh jobs and support the Welsh economy. We have a number of chicken lines that have been reared and processed in Wales.

11. Annex A has examples of some of our Welsh-sourced product lines as well as other information about the way we promote and support Welsh suppliers.

Sainsbury's Dairy Policy

12. Although we recognise the influence of the supermarkets on the dairy industry, the four largest grocery retailers account for less than 25% of volume sales of raw milk processed in the UK.¹

13. As noted above, all of Sainsbury's own-brand milk, cream, eggs and butter are British.

14. Sainsbury's policy is to work with the processing sector and, through them, with the farming community, to improve the efficiency of the industry. Over the last 18 months we have made a number of changes to how we source liquid milk.

15. In January 2005 we awarded a new contract to Wiseman and Dairycrest for a period of 18 months. The contract was awarded on a 50%/50% basis and its length was designed to provide stability to the sector. In addition and despite this agreement, following requests from the processors two price increases were awarded (the first in March 2005 and the second in January 2006). Both processors pay in the upper quartile of milk prices to their farmers.

16. During the summer of 2006 negotiations to renew the liquid milk contract resulted in a further 18-month contract being awarded to the same processors

¹ Competition Commission Emerging Thinking working paper on buyer power

commencing August 2006. This has given a total period of 3 years of stability for our suppliers and their contracted farmers.

17. Following the NFU vision document for milk published in October 2005 Sainsbury' has been working closely with our processors and farmer partnership groups (DairyCrest Direct and Wiseman milk partners) to provide a more structured way of working within the sector and, in particular, to work more closely with the farmers who supply us.

18. As a result of this we announced in October 2006 the creation of Sainsbury's Dairy Development Groups. The groups will meet regularly and have quarterly forums to ensure we foster the spirit of cooperation. These groups are designed to provide a closer working relationship between retailer processor and farmers. There will be around 450 farmers in the group and the focus will be on improving farmer efficiencies. These farmers will benefit from a longer term and more direct relationship with Sainsbury's, providing greater confidence for their future. So far we have recruited about half of the farmers that we need for these Dairy Development Groups. We are currently recruiting additional farmers to be members of this group and will be looking to include Welsh farmers. By working with the industry in this way we believe that we can be seen to be supporting the British Dairy industry during a period of significant change.

19. Another significant development for us has been the launch of *Farm Promise* milk. This is milk from farmers going through conversion to organic standards and 11p for every litre (including 5p from the customer) goes back to the farmer to contribute to the additional costs associated with converting from conventional to organic milk production. Sainsbury's is committed to supporting *Farm Promise* farmers for two years and 3 months whilst they are in conversion and then we give them a year's contract. Since the launch of the scheme we have given £100,000 back to farmers.

20. Sainsbury's source a significant number of Dairy products from Wales. Where there is a specific local product, it will be sold in our Welsh stores only but many are sold nationally in our stores across the UK. Annex B lists our Welsh-sourced Dairy products.

Sainsbury's Views on The Draft Dairy Strategy

21. Sainsbury recognise the importance of the Dairy Industry to Wales and the other areas of the British Isles that are the "milk fields" of the UK. We also recognise the current problems within the British farming industry as a whole: the reduction in the number of farms, a lack of overall investment and the problems of succession planning. We are in regular discussion about these problems with our farmer groups in all sectors and the farming unions. The NFU's *Vision for Dairy* highlighted the problems too.

22. The impact of 60 years of the MMB scheme and subsequent deregulation and CAP reform are proving very painful for Dairy farmers. In addition, the changing strategies of the major Dairy companies and more recently the Milk

co-ops has led to transfers of processing capacity and slow long market development and product innovation.

23. We believe that a number of factors impact on the British – and Welsh – Dairy industry now and in the future:

- the world market will determine the commodity prices
- innovation, premiumisation and provenance (local/regional) will be key trends for consumers
- consumers will demand quality and taste
- efficient and high quality production capability will be required.
- there will be increasing demands for environmental improvements and high levels of animal welfare
- there will be a need to identify and understand consumer needs.

24. There are clear examples of the UK Dairy Industry and its retailers responding to these trends, for example premiumisation through brands like Sainsbury's *Taste the Difference*, which has recently been growing at 19% in Dairy. During the last 12 months, under the Sainsbury's brand we have launched over 200 new Dairy products. Innovation is vibrant within many sectors such as Organics, active drinks, functional products and regional cheese. The Dairy industry has shown good growth in recent years and we believe that there are further opportunities to grow the category over the coming years by providing customers with a wider range of new, exciting products.

25. A number of suppliers that can meet the needs of Sainsbury's and our customers have been introduced to us via our *Supply Something New* scheme. This is an innovative scheme under which senior colleagues form Sainsbury's take to the road every 2 months in a search round the UK for new, innovative suppliers (large and small). We already have a network of over 3,500 small, local suppliers and are looking to increase them. The characteristics of suppliers - large and small - that are delivering success under *Supply Something New* are that they have:

- a clear business plan and a focus and passion for the business
- efficient and good quality production facilities
- knowledge of retailers needs and awareness of supply requirements
- a Corporate Responsibility agenda
- an understanding of their ultimate consumers
- (above all) a great product.

26. The Dairy strategy published by the Minister for EPC has correctly identified the components for a sustainable, efficient, profitable and innovative Welsh Dairy industry. The key factor that will drive this, however, must be the wishes of the consumer and we would like to see greater importance attached to this in taking forward the strategy.

5 February 2007

Annex A : Sainsbury's Products Sourced In Wales²

Chilled:

Pork & leek sausages from Edwards of Conwy (butchery counter and pre-packed)
Welsh lamb (butchery counter) – own label
Welsh liver (butchery counter) – own label
Welsh rump steak, sirloin steak, fillet steak (butchery counter) – own label
Welsh Saddle (butchery counter) – own label
Taste the Difference loin chop (butchery counter) – own label
Taste the Difference fore shanks with cabernet sauvignon, mushroom and bacon sauce (pre-packed) – own label
Taste the Difference Welsh Hill Lamb leg (pre-packed) – own label
Taste the Difference Rump Steaks with Double Gloucester Cheddar Cheese (pre-packed) – own label
Lamb Shanks (pre-packed) – own label
Half leg of lamb (pre-packed) – own label
Welsh lamb loin chops and cutlets (both pre-packed) – own label
Cawl Mangu, faggots and peas ready meals from The Welsh Pantry company.
Traditional faggots from Peters

Fresh:

Various types of sliced fresh bread from Braces
Chocolate waffles from Tregroes
Welsh Cakes from Tan Y Castell
Apples – own label
Organic carrots – Patrick Holden
Potatoes - own label

Grocery:

Pure Butter Celtic Shortbread from Daffodil Cottage
Welsh fudge from Daffodil Cottage
Still and sparkling water from Brecon Carreg
Sparkling water from Ty Nant
Welsh Brew Tea from Murroughs Welsh Brew

Beers, Wines and Spirits:

Lager and bitter from Brains
Double Dragon bitter from Felin Foel Brewery
Penderyn Malt Whisky from the Welsh Whisky company
Cariad Dry White Wine from Llanerch Vineyard

We currently use Welsh Dragon stickers on selected lines. On Welsh-branded lines and some of our own-brand products such as cheese and meat the packaging will indicate that it is a Welsh product, often with a short story about it on the front or back of the packaging. For example, on our Taste the Difference pre-packed Welsh Hill lamb half leg fillet, we clearly display the

² This is not a fully comprehensive list

Welsh flag on the front, and on the side have a photo of our supplier, farmer David Williams from Powys, plus the Hybu Cig Cymru (HCC)/Meat Promotion Wales insignia, showing that the lamb is 'Farm Assured' and has PGI status. 'Farm Assured' means that farms belong to the FAWL scheme, and are inspected for compliance with a set of farm standards to ensure that stock that enters the food chain are reared with due consideration for welfare and husbandry. PGI status signifies that Welsh Lamb and Welsh Beef has been born, raised and slaughtered in Wales.

At Christmas we take the opportunity in our Welsh stores to promote Welsh products, for example, Snowdonia Cheese was on offer.

Each year we have a presence at the Welsh Show. We showcase a range of Welsh products with the latest in-store marketing, have our senior buyers present to meet prospective suppliers and customers and have cooking demonstrations to offer tips and advice on preparing the best Welsh dishes. At last year's Show we showcased our Welsh Goats cheese with our supplier Abergavenny Foods.

A number of our Welsh sourced products, especially are own-brand ones, are sold not just in our Welsh stores but across the UK, helping to give wider coverage and promotion to Welsh products across our store estate.

We will also continue to market Welsh beef and lamb at the eight meat counters we have in our Welsh stores and clearly market these products as Welsh-sourced, with point of sale designs, including Welsh Dragon stickers.

In January 2007 Hybu Cig Cymru (HCC)/Meat Promotion Wales, agreed to act as a partner with us in supporting the new 'Farm Connections' IT computer, software and training scheme for key beef producers. This move will ensure that 200 Welsh beef farmers will now be provided with computers and software paid for by us, as well as receiving training which teaches the farmers about the basics on computer use, software training and the use of internet and email. This will help Welsh farmers to better manage their businesses and understand our policies on sourcing. It is part of a wider *Farm Connections* programme, which was announced at the start of January, which saw Sainsbury's partner the Red Meat Industry Forum (RMIF), meat processor Anglo Beef Processors (ABP) and the Regional Development Agencies (RDAs) for the West Midlands and the South West.

Annex B – Sainsbury's Dairy Suppliers

Dragon Welsh Mild Cheddar, Mature Cheddar, Old Shire Special Reserve and Monterrey Jack from South Caernarfon Creameries (deli counter)

Black Bomber Waxed Truckle cheese (pre-packed) from Snowdonia company

Medium Welsh Cheddar and Mature Cheddar (pre-packed) from Cadog

Mature Welsh cheddar (deli counter) – own label

Welsh Goats cheese (pre-packed) – own label

Calon Vintage cheddar (pre-packed) – own label

Mature Welsh Cheddar (pre-packed) from Colliers

Caerphilly, and Welsh goats with and without chives – own label

Welsh-sourced milk (whole, semi-skimmed and skimmed) – own label and branded – 15 lines including 4 from Rachel's Organics

Various types of yoghurts from Rachel's – 9 lines

Fruit yogurts from Llaeth Y llan – 3 lines

Various types of ice cream from Thayers

Various cheese-based party foods from Abergavenny Fine Foods.



NFU Cymru Evidence to the EPC Committee on the WAG's Strategic Action Plan for the Welsh Dairy Industry

Introduction:

(1) NFU Cymru represents some 15,000 members in Wales and represents the majority of Welsh milk producers.

(2) NFU Cymru welcomes the EPC Committee's decision to examine the Welsh Assembly Government's strategic action plan for the Welsh dairy industry and the opportunity provided to comment both in writing and orally to the Committee's deliberations on this issue.

Backdrop:

(3) There has been copious analysis of the state of the dairy industry in both Wales and the rest of Great Britain and the strategic action plan reflects this. NFU Cymru does not take issue with this nor do we intend to refer or dwell on such analysis since it does little other than substantiate the dire and deteriorating circumstances in the Welsh industry, but provides little by way of future direction and resolution of the difficulties. Rather, NFU Cymru believes it more constructive to focus on the way forward.

The Welsh Assembly Government's role:

(4) The Minister in his foreword to the consultation acknowledges that the dairy industry in Wales "continues to face a number of challenges". NFU Cymru accepts and recognises that many of the problems the industry faces are commercial in nature and therefore the solutions must be such, but we do believe that the Welsh Assembly Government should maintain a keen and close watch on the sector, should

scrutinise the activities of the supply chain, should seek to influence issues at Westminster and Brussels levels and should intervene where appropriate. NFU Cymru believes the Welsh Assembly Government has a responsibility to create the regulatory conditions in which the industry in Wales can be profitable.

(5) Whilst the Welsh Assembly Government are providing business management and technical advice via Farming Connect and are encouraging branded product innovation, NFU Cymru feels it should also be alive to and involved in:

- 1) Addressing abuses of retail/buyer behaviour in conjunction with UK regulators.
- 2) Providing a competition framework that allows consolidation of milk processing business to allow them to compete in an increasingly unsupported and global market.
- 3) Ensuring that regulatory requirements implemented on dairy farms are based on objective criteria, and proportionate, cost-effective and are constant with those prevailing in other countries.
- 4) Maintaining a common framework for the CAP, in terms of support for the dairy sector and the funding of pillar 2 schemes designed to support the Welsh Assembly's sustainability objective.
- 5) Eradicating bTB.

Vision pursuit

(6) The plan is in pursuit of a vision which sees "the development of a sustainable, profitable, efficient and innovative Welsh dairy sector which benefits the people of Wales".

NFU Cymru shares this aspiration but to achieve this vision certain key conditions have to prevail:

- 1) The dairy business has to be profitable. At present many dairy businesses are unprofitable and reinvestment which is critical to meet both increased regulatory demands and to deliver future competitiveness is being compromised. Profit comes from a combination of cost cutting and improving technical performance - for which there is currently assistance through

Farming Connect, the activities of the Dairy Development Centre (DDC) and the Milk Development Council (MDC) - and achieving fair returns from the market place. In this latter respect all the evidence is that dairy producers are not receiving a fair share of the retail price. In 1995 the milk producer's share of the retail price was 59% this has fallen to 35% today. Over the same period the supermarkets share has risen from 3% to 30%.

- 2) There has to be stability and predictability. Without market and milk price stability producers will not have the confidence to invest for the future.
- 3) Increasingly, to spread fixed costs over a greater turnover producers require scale of enterprise through higher yields / cow numbers whilst balanced against the potential pitfalls such as reliance on employed labour or higher costs of the production system. Economies of scales are essential for other than those involved in niche markets which the strategic plan accepts will be small relatively.
- 4) Welsh milk producers need to be competitive. There is evidence that, Wales's producers have natural production advantages, alluded to in the strategy document, but this has to be matched by competitiveness in the milk processing sector and we are not satisfied that this is being sufficiently addressed.
- 5) There has to be collaboration particularly in the large scale processing sector between farmers, between farms and processors and crucially between farmers and retailers with all parties finding a long-term perspective. At present NFU Cymru feels that the majority of retailers have not understood the fragility of the domestic dairy industry and the longer-term implications for domestic consumers, nor have they made steps to take responsibility for milk and dairy supply chains in Wales.
- 6) Greater transparency of market signals, consumer trends and business operations is required to foster trust and confidence throughout the supply chain.
- 7) Finally, there needs to be a long-term focus rather than decisions based on short-term opportunism when it comes to milk pricing.

Obstacles to the strategic vision:

(7) NFU Cymru shares the view of the strategic action plan that the industry will operate on two scales and that there is no single panacea for the industry. Diversity must be embraced but there are obstacles which if not insurmountable, are likely to prove challenging. The main ones are:

- 1) Cash. NFU Cymru is concerned about the producing industry's ability to invest. We are concerned too at the need for processors to invest in new, more efficient capacity, more local branding and to develop new value added products.
- 2) Policy. This manifests itself at both an EU and domestic level. At an EU level the prospect of further dairy reform and the abolition of milk quota and at a domestic level approaches to sustainability, nutrition, competition policy etc.
- 3) Regulation and the burden of additional cost this generally inflicts on the farming and food sectors.
- 4) Further exposure to international and competition as a consequence of World Trade Organisation (WTO) agreement.
- 5) Rising input costs.
- 6) Rising incidence of bTB.

The forgoing obstacles have given rise to low morale and anxiety in the industry with short-term signals having the potential to have catastrophic consequences for the long-term position of the Welsh dairy industry. This is reflected in a dearth of new, young blood entering the dairy sector and a reliance on migrant workers.

How do we achieve success:

(8) This response to the strategic action plan for the Welsh dairy industry identifies the role NFU Cymru believes the Welsh Assembly Government has in determining the future of the milk industry in Wales, and the conditions which NFU Cymru believes must prevail if the vision set by the dairy strategy group is to be realised. We have outlined in previous sections those issues which we believe are currently preventing or inhibiting this success. Our concern is that in the context of what we would consider 'macro' issues – retail / buyer behaviour, competitive framework that allows for consolidation, reducing the regulatory burden etc. we see little or no

commitment on the part of the Welsh Assembly Government to addressing these issues in the specifics of the strategy but rather a concentration on 'micro' issues which whilst important will not be the main determinants of whether the Welsh dairy industry thrives or fails.

(9) The action plan identifies three key strategic aims but it is not always clear at what part of the supply chain these are specifically aimed. We would prefer to see a more succinct and targeted approach at specific parts of the supply chain with a synthesised list of objectives.

Market trends and consumer behaviour

(10) One of the strategic objectives identified is to improve the understanding of market trends and consumer behaviour. Whilst this may be of benefit to those exploring niche outlets we do not feel that this is a key issue for the majority of producers but rather is an issue for processors seeking to identify market opportunities. We do however entirely concur with the need to move away from regular and damaging tendering exercises which take millions of pounds of value out of the industry and agree the need to actively encourage the development of better contracts. A draft NFU standard milk supply contract with associated documents is currently being worked up by our legal department. The issue of raw milk supply contracts needs to be addressed urgently so that processors can not use producer's money to buy shelf-space with the impunity that they do at present. Much of the action identified in this section has already been initiated and represents ongoing activity.

(11) Of paramount importance is the need to develop the Welsh dairy product brand and to encourage consumers to express domestic preference. It is unfair that dairy farmers in Wales are forced to comply with strict farm assurance standards only for retailers and food service companies to import products produced to inferior standards for example, cheese which is in direct competition with 80% of the output of the Welsh dairy industry!

(12) NFU Cymru believes that there may be lessons to be learned from looking at "Bord Bia" in Eire where there is an integrated approach to production and marketing

across the Irish food spectrum. NFU Cymru would advocate a strategy to evaluate whether the interests of farmers and growers in Wales would be better served by establishing a similar Welsh umbrella that is a commercially driven company under which HCC, DD, and other Welsh sector bodies would operate with some shared services but where levy income would be deployed in favour of the sector from which it was raised. NFU Cymru feels that this would help to re-establish the profile, identity and commercial acumen which we feel has recently been lost.

Innovation and supply chain linkages

(13) The second of the three key strategic aims identified in the plans is to foster innovation and improve supply chain linkages.

(14) NFU Cymru fully supports the proposed strengthening of both the delivery and remit of the Dairy Development Centre. In fact NFU Cymru believes there may be merit in exploring whether in Wales DDC should become the main dairy focus with levies currently raised by the MDC in Wales being redeployed in favour of the DDC with DDC purchasing from the MDC those services deemed of relevance to the Welsh dairy sector. There is currently uncertainty as to whether the Levy Board UK will ring fence sectoral levies i.e. milk levies will be devoted to the dairy sector or whether there will be a geographical spread amongst the sectoral Board Chairmen. NFU Cymru needs assurance that Welsh Dairy interests will be fairly and equitably served, NFU Cymru is firmly of the view that there has to be a closer integration of the activities of the DDC, the MDC and the Assembly's Dairy Strategy Group and we draw this idea to the Committee's attention for further consideration in the context of the more integrated Welsh approach alluded to in paragraph 12.

(15) Much of this section focuses on improving on farm efficiency but there is insufficient recognition of the need to improve efficiency in the processing sector. NFU Cymru believes that Welsh producers are amongst the most efficient in Europe, but to outclass competitors the processing sector upon which Wales depends must be equally efficient.

(16) Whilst we see that there is a strategic role for the Assembly in ensuring that R&D projects that have possible solutions to technical difficulties faced by the Welsh

dairy industry should be progressed, we are not convinced that links with academia will be the main route for the development of high value products. We see a role for academia in developing products with a long-term R&D requirement and highlighting possibilities for product development not on the present processing agenda. However, high value products will largely be the main outcome of commercial innovation which will be led by dairy companies and not by academic or central bodies.

Business Performance

(17) The third key objective of the strategic plan is to improve the business performance of producers and processors in response to changing market conditions and consumer demands much of the work here identified is again ongoing and represents little new.

(18) In this section the need to attract inward investment projects is alluded to. NFU Cymru would like to see more detail on this and how it is intended to secure major processing capacity and to ensure that companies are not just intent on obtaining short-term financial inducements only to move on as soon as the assistance runs out.

(19) NFU Cymru is aware of the recent major investment package introduced in Eire and is concerned that this will impact adversely on Wales given the proximity of Eire and the fact that it is export orientated. Wales would benefit from a similar commitment and investment package.

(20) We support a programme of research into the most economically and environmentally important areas of milk production systems. NFU Cymru envisages a situation that with the growing diversity of land-use in terms of energy crops and the increasing demand for food that there is potential for increasing conflict between efficient milk production and environmental sustainability. As the strategic plan acknowledges a viable and technically efficient industry is a pre-requisite for a sustainable environment. Farmers are fully supportive of a voluntary approach to reducing adverse impacts on the environment so as to avoid further statutory controls but the uptake of agri-environment measures such as Tir Gofal and Tir Cynnal will only occur if these schemes are tailored to meet the specific needs of dairy farmers

and are compatible with encouraging efficient dairy businesses. Dairy farmers will need assistance in complying with the Water Framework Directive and this needs to be borne in mind when axis II measures are being revised under the Welsh RDP. In terms of climate change and the Assembly's sustainability agenda grass based milk production systems have the potential to assist in terms both of reducing food miles and in acting as a carbon sink. NFU Cymru is content with the dairy strategy group leading a partnership of stakeholders to draw up an environmental plan for dairy farming in Wales, indeed NFU Cymru was instrumental in seeking such an integrated approach in Wales and would wish to actively participate in this work.

What is success?

(21) The strategic plan indicates that Welsh Assembly Government officials will agree a framework for reporting and measuring progress. NFU Cymru believes this is imperative if there is to be an evaluation of the success or otherwise of the strategy, and so that the plan may be suitably revised if it is not delivering to targets.

Budget

(22) No budget lines are attached to the delivery of the dairy strategic plans. It would be helpful if the financial projections were laid down. This is particularly important given that there will inevitably have to be a prioritisation of activity within the key strategic plans.

Engagement

(23) NFU Cymru welcomes the commitment to develop an ongoing dialogue with partner organisations. With the exception of an exchange with Promar Consultants last spring, NFU Cymru, despite being representative the majority of dairy farmers in Wales, has at no time been consulted either informally or formally in the drafting of the strategic plan.

Key Conclusions and Recommendations:

- WAG cannot involve itself in commercial issues but should intervene and influence 'macro' issues on the milk scene, it should for example seek to influence and address abuses of retail behaviour.

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- WAG should seek to influence the DTI and provide a competition framework that permits consolidation of milk processing activity.
 - WAG should ensure that regulatory requirements are based on objective criteria, are proportionate, cost effective, and consistently applied.
 - Producers are not receiving a fair share of the retail price.
 - Producers need profitability and confidence to invest for the future.
 - The milk processing sector must be allowed to rationalise and improve its competitiveness.
 - There is a need to move away from regular and damaging tendering exercises and encourage the development of better producer contracts.
 - There is a need to re-establish the momentum and further develop the profile and identity of Welsh food brands including milk and dairy products.
 - There should be an examination of Bord Bia in Eire to establish whether there are lessons to be learned for the development of the Welsh food sector including milk.
 - A study should be undertaken to assess whether there is scope for DDC, HCC and other sector bodies in Wales to operate more efficiently under an umbrella organisation such as Bord Bia.
 - The activities of the DDC should be further developed and an evaluation should be undertaken to establish whether the interests of milk producers in Wales would be better served by milk levies in Wales being deployed, in favour of DDC with MDC services of relevance to Wales contracted from MDC. This should involve a root and branch review of the levy spend on the Welsh dairy sector.
 - More detail should be provided on how the WAG intends to attract long-term inward investment projects to add value to the dairy sector.
 - Axis II measures under the Welsh RDP must be tailored to meet and encourage environmentally sustainable dairy businesses but that are permitted to operate efficiently.
 - Where possible a voluntary approach which avoids further statutory controls on the dairy sector should be pursued to reduce adverse impacts on the environment.

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- We agree that the dairy strategy group should lead a partnership of stakeholders to draw up an environmental plan for dairy farming in Wales. This should however work closely with the Axis II working group.

NFU Cymru looks forward to providing oral evidence to the EPC Committee and to clarifying and elaborating upon the content of this submission.

Mary James
Deputy Director/ Head of Policy
NFU Cymru

Farmers Union Wales Submission for the Dairy Strategy Consultation

Welsh Dairy Industry

The Farmers' Union of Wales welcomes the opportunity to contribute to Committee's consideration of the future of dairying in Wales. By nature of its terrain, climate and farm structure, Wales is predominantly a livestock producing area and the scope for viable alternative enterprises is limited. The dairy sector, therefore, has a more important role in the context of Welsh farming than is the case for the UK as a whole where there are other practises such as farm cropping which can be more extensively practised.

Agriculture supports more than 10% of full time equivalent employees in many parts of rural Wales when the multiplier effect is taken into account with dairy farms contributing significantly to this figure. Whilst no specific figures are available for Wales, at a UK level, approximately two-thirds of the output of the agricultural sector - £11 billion by value - goes into processing. This accounts for 34% of total inputs by value, and the food processing sector is now the largest manufacturing sector in the UK, accounting for 7.9% of gross value added (£77.3 billion) and 3.8 million jobs, or just under 15% of the total workforce. The economic health of the primary production sectors is therefore indirectly of much greater economic significance than its direct size would suggest.

The most notable fact about the dairy industry is that while the price of milk on the supermarket shelf has risen 8.8p/litre in the past decade, the price paid to the farmer has fallen by 6p/litre. This decline in the price of milk paid to the farmer has coincided with significant increases in production costs.

The recently published draft strategic dairy action plan for the Welsh dairy industry recognises that Wales has a number of competitive advantages which contribute to the efficient production of milk and the development of new dairy products. The strategy notes these as being the Welsh landscape and climate, a committed, predominantly family-based business approach as well as an image of healthy food production, all of which add up to a brand potential second to none. The strategy document also identifies climate change, protecting and enhancing the environment, waste management and the EU water framework directive are challenges with which the dairy industry will have to contend.

Discussion at the Union's central Milk and Dairy Produce Committee meeting identified a number of concerns with regard to the draft action plan. Committee is of the view that the plan lacks clearly defined goals thereby making it very difficult to measure at the end of the plan period whether the combined action points have been successful. There is also insufficient detail with regard to the source of funding for the action plan and the Union's Milk Committee are of the view that greater clarity is required with regard to the money which the Welsh Assembly Government is proposing to allocate to the programme of activity.

Comparisons were made with the previous dairy strategic action published in March 1999 which set out four broad strategic goals. These included improving the marketing of the Welsh dairy sector, maximising the performance of milk processors, maximising the performance of milk producers and improving the information base of the industry both in terms of Welsh statistics and meeting the needs of individual businesses. This document also identified clear market opportunities for the Welsh dairy sector which could be exploited within the Welsh, UK and International Market.

In the past, milk processing has largely been under separate ownership and control from milk production other than in long established co-operatives such as South Caernarfon Creameries. However, over the past five years there have been significant developments in terms of the development of integrated farm co-operatives, predominantly First Milk and Dairy Farmers of Britain who together process 60% of the milk produced in Wales.

The FUW has consistently argued that the competition rules should allow further integration of milk processing businesses. There is a need to address the OFT's approach to competition policy in respect of mergers in the dairy sector in order to meet the challenges from an increasingly global market.

There is some evidence that the alignment of milk processors with retail customers and specialisation of milk processing may bring about a greater divergence between the returns afforded by premium markets and those of the commodity market. This is an issue which should be a major consideration for the Welsh dairy strategy. The MDC dairy supply chain document clearly identified the fact that branded sales in liquid and cheese are rising for the first time in thirty years. This document also suggested that the growth in fresh products was largely being met by foreign companies.

When comparing milk prices with those which exist on mainland Europe, it is clear that the UK receives the lowest farm gate price in the EU15 and has done so for the past 10 years. Furthermore, countries which are predominantly dependent on commodity products have seen their prices fall compared to those which have successfully taken advantage of the value added market.

Milk quotas were introduced as part of the European Union's dairy regime in April 1984. Two basic policy options were available to the Commission - either to reduce support for the dairy industry or to curtail the extent to which the industry could produce. The Farmers' Union of Wales, in the UK context, was an almost lone voice in advocating the introduction of supply control, ie milk quotas, rather than support price cuts, as a means of controlling milk production. The Union's concern was that the extent of price cuts required to cut production would be such as to cripple the smaller family dairy enterprise such as typifies the dairy industry in Wales and the Union's central Milk Committee has recently concluded that the retention of quotas continues to be in the best interests of Welsh milk producers.

Under the CAP reform agreement, price support has been cut by the equivalent of 22% over four years. This is only being partially compensated for by the introduction of direct payments, equivalent to 60% of the price cut. The value of future direct payments will be diluted by compulsory and voluntary modulation, financial discipline, and funding of the National Reserve. The likely impacts of the 2003 reform are summarised in tables produced by David Colman and David Harvey in their document “The Future of UK Dairy Farming”.

Projected intervention milk price equivalent (pence per litre)

Year	Butter Price Cut	Skimmed Milk Powder Price Cut	IMPE £0.70 =	IMPE £0.75 =	IMPE £0.62 =
2004	7%	5%	17.87	19.33	15.52
2005	7%	5%	16.59	17.96	14.39
2006	7%	5%	15.30	16.59	13.25
2007 onward	4%	-	14.92	16.18	12.92

It is apparent from this table that the future exchange rate between the euro and the pound will be quite critical.

The FUW has consistently argued that the 2003 reform of the common agricultural policy, which effectively removed the link between food production and support, should form the parameters within which any future WTO agreement was secured. The 2003 agreement will undoubtedly have a major impact on Welsh dairy farmers, not least because of the fact that 80% of the Welsh land area is categorised as ‘less favoured area’. Given that the 2003 CAP reform agreement pre-empted future trade agreements, the Union is firmly of the view that no conclusion is preferable to an unsatisfactory conclusion to the ‘Doha round’.

Increasing food miles are aggravating global pollution. A reduction in ‘food travelled miles’ in turn reduces emissions and the impact of associated carbon dioxide releases on climate change. Currently, food transportation accounts for around 30% of lorries on the UK’s roads and creates 3.5 million tonnes of CO² every year. Food labelling legislation is therefore needed to give the consumer better knowledge of product origin, and to expose the hypocrisy of cross-border animal welfare standards.

The Competition Commission report published in the year 2000 identified twenty-seven practices which, when carried out by any of the major supermarkets, adversely affected the competitiveness of supplies and operated against the public interest.

The Farmers’ Union of Wales considers that there are two key areas which need addressing in order to safeguard the interests of Welsh milk producers. Firstly, the

climate of fear amongst suppliers means that the dispute resolution process must be made truly independent of the supermarkets so that individual suppliers cannot be identified. Secondly, the wording of the code must be strengthened. The current vagueness of the wording means that it would be very hard to prove a breach of the code, even if the supplier were to have the confidence to bring a complaint forward.

These changes must then be put on a statutory basis. If supermarkets are merely asked to give undertakings to a new code - as they have done with the existing code - they will have the opportunity to weaken it. We believe that the code could be put on a statutory basis, without the need for primary legislation, using the powers given to the Competition Commission by sections 138 and 161 of the Enterprise Act.

AMO/MS/CM/11
21 February 2007



**Cynulliad Cenedlaethol Cymru
Y Pwyllgor Amgylchedd, Cynllunio a Chefn Gwlad**

**The National Assembly for Wales
The Environment, Planning and Countryside
Committee**

**Dydd Mercher, 7 Chwefror 2007
Wednesday, 7 February 2007**

Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir cyfieithiad Saesneg o gyfraniadau yn y Gymraeg.

These proceedings are reported in the language in which they were spoken in the committee. In addition, an English translation of Welsh speeches is included.

Aelodau Cynulliad yn bresennol
Assembly Members in attendance

Lorraine Barrett	Llafur Labour
Mick Bates	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Jocelyn Davies	Plaid Cymru The Party of Wales
Glyn Davies	Cadeirydd Chair
Tamsin Dunwoody	Llafur (Dirprwy Weinidog) Labour (Deputy Minister)
Elin Jones	Plaid Cymru The Party of Wales
Brynle Williams	Ceidwadwyr Cymru Welsh Conservatives

Eraill yn bresennol
Others in attendance

Michael Hodgson,	Rheolwr Categori Llaeth a Chaws, J Sainsbury plc Category Manager Dairy and Cheese, J Sainsbury plc
Simon Twigger,	Cyfarwyddwr Uned Busnes Llaeth, J Sainsbury plc Dairy Business Unit Director, J Sainsbury plc
Erica Zimmer,	Pennaeth Materion Corfforaethol, J Sainsbury plc Head of Corporate Affairs, J Sainsbury plc

Gwasanaeth y Pwyllgor
Committee Service

Dr Kathryn Jenkins	Clerc Clerk
Dan Collier	Dirprwy Glerc Deputy Clerk

Ymgynghoriad ar y Strategaeth Laeth
Dairy Strategy Consultation

[1] **Glyn Davies:** Welcome back from the break, and I give a special welcome to our witnesses from Sainsbury's. I will just say by way of a preamble that we have had a draft dairy strategy from the Government here, which is going out to consultation, and the committee thought that it might want to respond to that draft, although clearly there will be further discussions when the consultation period is over and all the

responses are in. In order to help us with that, we thought that it would be useful to talk to representatives of the dairy industry, and the unions in particular, and the major supermarkets. Two supermarkets, Sainsbury's and Tesco, agreed to come to us, and Tesco withdrew quite late on, which disappointed me, but I am grateful to the three of you for coming here. We are not proposing to have anything like a formal discussion; it is a general discussion around the issue, focusing on the draft strategy, which will help us make a response to the administration here, and will help us in discussions when the final strategy is agreed. That is the general thrust of where we are.

[2] **Lorraine Barrett:** Sorry to interrupt you. Why did Tesco withdraw? Is it that it did not want to send representatives, or was it just difficult for Tesco to send someone?

[3] **Glyn Davies:** I think that the reason that Tesco felt that it could not send representatives was that it wanted longer to prepare. The draft strategy was published a bit later than we were anticipating. That was also the reason that the two unions were unable to come, and we postponed that until 1 March. I think that Tesco would have come on the same date, but the timetable was so tight for that meeting that I only found half an hour for the unions, and I did not think that there was any point in trying to squeeze the agenda further.

[4] I will hand over to our witnesses.

[5] **Mr Twigger:** Thank you for inviting us. We have gone through the dairy strategy and you have had a document from us in response. Hopefully you will not find us unprepared, if others thought that they needed more time for preparation.

[6] As a company, we believe that it is important to support the development of the British dairy sector, as well as the Welsh sector that we are focusing on today. This is particularly the case on an end-to-end supply chain basis. I have prepared a few notes by way of introduction that do not repeat the document that you received from us and hopefully amplify what we think are the key points. Thank you for your introduction, and your suggestion that this then becomes an open session for you to learn from us in terms of anything of value that we can add to the discussion.

[7] So I will just quickly run through some opening words. I think that it is probably best to introduce ourselves first of all, and explain what we do. On my left is Erica Zimmer, who is the head of external affairs, and her primary role within the business is to ensure easy access for Government departments, and also non-Governmental organisations, that may want to engage in dialogue with us. That does not mean that Erica goes out on her own; as you see today, she pulls in the various people in the business who can support her in her work. Michael and I come from the trading area of the business. To make clear how we are structured, we are split into business units, and those focus on the products that we sell and are specifically designated to certain product markets. The reason that Michael and I are here today is that we are both involved with the dairy sector, as I will explain. The business unit is not just a buying function; it looks after the supply chain, product development, the technical quality of our own-label products, and the strategic direction. So the business unit encompasses a whole area. My role is that I am the business unit director for the dairy, bakery and convenience foods that we sell within the business.

Michael Hodgson is what we call our category manager for dairy, so Michael has a team that looks after everything that we buy to do with dairy and covers those areas that I have just talked about. So, that is not only about what we buy and what we put on our shelves, it is also about monitoring the markets and how they are developing, and taking responsibility for quality, the supply chain and the sustainability of our supplies. That is all part of Michael's responsibility in dairy. Therefore I hope that you feel that you have two people today who can tell you what is going on in Sainsbury's dairy business, and what we see as the key market trends.

[8] One key aspect that will, hopefully, come out of what we talk about today is that the vital part of Michael's job, and my job as the business unit director, is to understand consumer trends, to ensure that Sainsbury's is in line with those trends, and to develop the products quickly, if it is an own-label product, and, if it is a branded product, to get those products into our business—ahead of our competitors, hopefully. If we can get ahead of our competitors, and meet customer needs faster, then that is great for us as a business. However, the consumer, and how we focus on the consumer, is a key aspect of our business, and the transition that you have seen in Sainsbury's over the last two to three years.

[9] In the submission, we give you details as to stores, numbers of people, and so on. One interesting thing that Michael keeps telling me, and of which we are proud in our business, is that the business started as a purveyor of butter, eggs and cheese in 1869, and we still look back on that. There is a book—what is its title?

[10] **Mr Hodgson:** It is *The Best Butter in the World: A History of Sainsbury's*.

[11] **Mr Twigger:** The 'best butter in the world' is what Sainsbury's had as its belief and principle. Therefore, our heritage in the dairy sector, of over 130 years, is important to us. We continue to source as much of our products as we can from Britain and we are proud to say that 90 per cent of what we can buy in the UK is labelled as British today in our stores. We attempt to label everything clearly, as you will see when you go around our stores.

[12] Our relationship with Wales and its suppliers, and therefore the Welsh economy, has been difficult to calculate, because we have quite a few processing units and packers along the borders in Shropshire, Cheshire and Gloucestershire—one of our major packing plants for liquid milk is just on the other side of the border in Severnside. However, we have many products outside the dairy sector for which we have main suppliers in Wales, particularly ready meals at about 30 per cent of our supply. Our top six own-label suppliers in Wales have about £100 million-worth of turnover with us; we estimate total turnover to be in excess of £200 million.

[13] I will reiterate some of the comments that we made in our written statement. We are concerned about British agriculture, where it is today, and the sustainability of several of the sectors. We fully appreciate the tremendous change that is happening in many of the market sectors—dairy and others—and we engage, as we are doing today, with the interested parties in this arena, such the unions, which you are meeting shortly, and government and non-governmental bodies. In the paper that we have submitted we have given you a few examples of some of the initiatives that we have started to kick off in the various sectors.

[14] In the dairy area, to be a little more specific, despite the negativity—and I use that word carefully—around the dairy industry, and the amount of change that is going on, we find at Sainsbury's that dairy is one of our most vibrant areas. That will, hopefully, come across today, and we will explain why. We have considerable growth—and in my area, particularly, that growth has been above the departmental average—in areas such as yoghurts, active health products, functional and spreadable fats, and, significantly, in parts of the cheese market. Our problem in the UK is that a large proportion of this growth is not being delivered through a UK source of supply. We can talk about that in more detail. However, the growth shows that the UK consumer is not switched off from dairy products, so the scares around fat in dairy products and those sorts of things are not coming through in the behaviours that we are seeing.

[15] Therefore, the market is there for UK and Welsh dairy sales to expand, if we can only get on to that positive pulse of products that meet customers' needs. For example, if you consider where the majority of yoghurts are sourced from today, and how the UK yoghurt industry has changed over 20 years, much of that product now comes from Europe, in particular, and you cannot source here some of the packed formats that you might want to buy in stores. That applies to kids' products, which you can buy in tubes and squeezies and all those sorts of things now. It is particularly in relation to some of the packaging formats. We can explore that further together.

[16] We have a policy in the dairy department to source from the UK whenever it is reasonable to do so, and we have talked about some of the packaging formats in relation to that. In our written submission, we state that our own-brand milk, butter, cream and eggs are all British—and they are. Our own-label cheese that can be sourced from Britain—cheese such as parmesan and so on is more difficult—is clearly labelled and all our generic cheddar, including our 'basics' line of products, is British. In January, we launched all our low-fat yoghurts again—we have just launched our 'fabulously fruity' range. That is one of the larger parts of the non-labelled yoghurt market, and that is still all sourced from the UK, which has not been the trend in recent years.

12.00 p.m.

[17] An important point that will, hopefully, come out of this morning's discussion is that stability of supply is vital to a supermarket. A supermarket without product on a shelf, that is, poor availability, whether as a result of not being able to get the products or poor distribution and distribution problems, suffers. It is vital to have product on the shelf. Therefore, in recent years, we have entered into contracts in many of the dairy areas for conventional and organic milk to ensure that we have a sustainable supply. Where we buy those products from, and from whom, is important. In the recent past, a principle that we have been working to is to build greater relationships through the supply chain, thereby involving the farmer as well as the processor, which has been historically the main focus of our attention, in our forward vision and in what we are trying to do.

[18] We mention, in our paper, the recent developments in dairy, particularly around our dairy development groups, but that extends into other things that you are

seeing around beef and eggs and such areas, where we are getting closer to farmer groups, particularly to farmers who have a supply relationship with us through particular processors. The key point there is that it is about a supply chain working together; it is not a case of us by-passing the processors or the processors by-passing the farmer. We need all parties in the room if we are to get the types of discussions and developments necessary to have a sustainable supply in the British Isles of some of the core agricultural materials that a retailer needs to sell.

[19] Where we have had specific issues, such as with the supply of organic milk, which I think may be an interesting area to discuss this morning, we have, with our processors, entered into farm-level agreements. We mention farm-promise milk in our document, and how that has developed. We are proud to say that our first farmer has now come off the farm promise scheme, is fully converted to organic and is now supplying us with organic milk. We are now recruiting more people on to the scheme to help us have a sustainable supply for the future.

[20] On the draft strategy paper—you might think that I have taken a long time to get here, but, hopefully, the other points are relevant—we think that it reflected fairly the challenges that resulted from deregulation of the industry and the subsequent reform of the common agricultural policy. It discusses those in quite a summarised way, but I think that is a fair summary of the effects now being experienced.

[21] On the establishment of the milk co-operatives, which have been very important to the Welsh dairy industry, the development of their processing capacity is still quite slow, while the market is moving on in terms of customer demand. In many ways the UK dairy industry is playing catch-up, following the years of subsidy and regulation around Milk Marketing Board schemes. Added value is still relatively low, as you can see when you walk down a dairy aisle in the stores and look at the innovative products that are now coming on to the shelves. Many of those products, as I have said, are not currently available from the UK market. There is difficulty even with what we would call quite simple added value, for example, flavoured fresh milk, which is a fairly simple product. Flavoured milk has not been available in fresh form, but has been UHT milk and so on. We have struggled and we now have a supply point for that, and it has been very successful in terms of the sales that we have achieved. To compare that with the price of a pint of milk, we are charging £1.09 a litre for that, and it is very successful. Being able to get that in a bottled format has been a struggle, but it is a fairly simple development given that it is, you might say, just adding flavour to fresh milk.

[22] So, added value is still quite low. We are very conscious that 4 billion litres of milk is still destined for low-value and low-price markets. We also believe—and you can correct us on this if we are wrong—that around 80 per cent of Welsh milk is destined for cheese production. So, there is a debate there as to why the Welsh dairy industry is heavily involved with one segment, when in fact cheddar is only—what is the figure, Michael?

[23] **Mr Hodgson:** It is only 14 per cent of our total dairy business.

[24] **Mr Twigger:** So, there is an issue of what Wales's milk is destined to produce, in contrast to what the wider elements of the dairy industry are seeing as

growth areas.

[25] We mention in our written evidence what we see as the key factors—hopefully, you have read that—around world pricing, the trends towards innovation, premiumisation and, to a great extent, provenance, which I think is interesting for the Welsh dairy industry, and consumer demand for regional and local products. More than ever before, consumers are demanding quality and taste from us. The importance of great-tasting products is something that you cannot get away from, because they create real customer satisfaction, and get them to come back and buy time after time.

[26] Efficient and high-quality production facilities, the demands of product integrity, consistent quality, being able to show due diligence in production, particularly with own-label products, represent a high demand that is now driven into the marketplace by the consumer. Environmental improvements, animal welfare and high standards, you will all be aware, are growing needs, and are demanded from us as retailers.

[27] The last point, on which we have touched already, is the high level of customer insight and understanding necessary to break into new markets successfully. There are many products, and we also launch lots that do not succeed. The ones that succeed are normally the simple ones that really meet a customer need, and having an insight of that is vital.

[28] Finally, in our document we have also tried to show you what we see as a successful supplier. Those notes have not come from just the dairy sector; they are from all sectors that we deal with. There are some real characteristics and real signs from when people come through the door and talk to us about what they do and how they are and what they believe in—that comes through strongly, as does how they make their products successful. We can give you examples of that. Probably, the most relevant one that we would drop on the table is one that you will be familiar with—Rachel's Dairy. We believe that that company identified a need quite early; we linked up with it in the early 1990s and in 2000 first put its milk on our shelves, and today, still, we are that product's largest retailer. In our business, that product is the best-selling brand in organic milk. First-mover advantage, to drop a bit of terminology in, is always important in getting large market shares, and there are many examples in our business where we have picked up people early in their development, helped work with that particular supplier, and been successful. Our trade with Rachel's exceeds £5 million, and the organic milk and yoghurt products that we sell today are still successful.

[29] A summary of our thoughts in some of these areas would be that there are probably three things that we think are important. One of those is to improve the understanding of market trends and consumer behaviour. That would be the core of what we think is important. Interestingly, in the draft strategy, they are not No. 1 or No. 2 on the points made—the marketing and identification of products is actually point 16 or 17.

[30] The second point would be innovation and fostering of the supply chain to develop products that actually move through and do the right things through the supply chain. Newness for the customer is important. When you look at markets that

have developed from almost nothing in a very limited time, be it in the little probiotic drinks, none of which are made in the UK, or such things as smoothies for Innocent or other things, it shows that you can move markets quite quickly if you have the right ideas.

[31] The third point is that we are going to have to compete in a worldwide market and, therefore, the business performance of processors and producers, and making ourselves competitive and reflecting ourselves in the changing market conditions, which do not stand still, is going to be important. So, just targeting ourselves at where we are today will not get us to success, because the market is moving on all the time.

[32] Hopefully, we have given you some additional thoughts. We believe that there is scope in the UK and, particularly, the Welsh dairy industry to grow. The climate is great here, dairy production is relatively simple compared with what other constraints there may be, and there are lots of moves within your major processors at the moment in terms of two new chief executives in the co-operatives—we have met; I know those people. If we can now establish a broader involvement in dairy products in the UK, and within the Wales environment more locally, we believe that that will be a major success point in growing the volume and the market. Hopefully, that has been helpful and gives you an introduction.

12.10 p.m.

[33] **Glyn Davies:** Thank you. I think that one of the reasons why more Welsh milk goes into cheese is because we are quite a long way from the markets. We export quite a lot of what is produced in Wales and, given the transport costs, it is much more sensible to do so once the water has been taken out of the milk and it is in the form of cheese. That is probably one of the main reasons why more Welsh milk goes into cheese; I think that it is about 80 per cent, whereas it is a bit less than 30 per cent UK-wide.

[34] **Tamsin Dunwoody:** Thank you for your presentation and paper. I completely agree about marketing the analysis of need and identifying the gaps that we, as producers, could be aiming for. My concern is the added value that we can apply to Welsh milk. You have touched on one of the key issues, which is the transportation of milk in bulk from our extreme rural areas into any processing or retail outlet. You have main storage facilities where people come in and the milk is redistributed; I have an issue with the environmental impact of that, but that is your working process. So, the transportation issue is crucial to us and to the farmers who are further out in rural areas.

[35] I am interested in the balance of moving the product that we are creating from milk, which is currently predominantly cheese, into the yoghurt sector, in which there seems to be extremely high potential for growth for us as a producing nation. You mentioned one or two of these nasty little plastic tubes that my kids love as a product—I say guiltily—but this is innovation and working forward. I like the idea of the group that you have been getting together, but I am slightly concerned that you do not have enough farmers involved at the moment, though you are seeking more farmers to be part of the group. How would you recommend that we, as a country, should move forward on that added-value product, because it requires access to large

producer units, transportation, contracts and significant capital investment, all of which is associated with creating a clear market that we could fill? So, I am asking you to solve all of our problems. [*Laughter.*]

[36] **Mr Hodgson:** Let us take the example of strawberry pro-biotic drinking yoghurt, which is one of the lines that I think you were alluding to. It has been hugely successful and it is a big growth area for us. We have had to buy that product from Switzerland, where there are big processing plants with a great deal of efficiency, and a lot of understanding of the customer and the market. They have invested heavily in that part of their business, and, as a consequence, they are obviously able to enter new markets and extend beyond. If you look at the British dairy industry, there are very few products that we export, and many of our brands—such as Cathedral City, for example—are not really known outside the British mainland. This centres around having a clear understanding of the customer and having efficient and modern production facilities.

[37] **Mr Twigger:** I will just add to that by saying that, if you take the example that Michael gave about Switzerland, there are many more miles between Switzerland and here than there are between Swansea and other places in the United Kingdom and most of the retail conurbations where people might buy a product. Most yoghurt has a shelf life of 21 days plus, so there is a little danger that the transport issue will become true in some ways—milk is expensive to transport but product is not necessarily as expensive to transport. Through modern technology and cleanliness of production, there is a much longer shelf life on product; for example, I currently buy all my Chinese ready meals from Swansea, and they are distributed nationally, with seven to eight days life of manufacture. So, there is something here that says that the issue of distance has to be considered, because, if you are transporting a lot of water—as is the case with milk—then that is a problem. However, there are many products that are transported over longer distances that have a shorter shelf-life.

[38] Things do not have to start large. I will give you an example from the breakfast that we ate this morning. We stayed at the Holiday Inn Express just over the road, if you want to go and talk to them, where Scottish yoghurt was on sale. We then started to debate whether we sell a regional Welsh yoghurt, apart from Rachel's. We do, but in a very limited way. However, Rowan Glen is in our Scottish stores and has started to migrate to some of the stores near Scotland. You do not have to start big; you can start by rolling out from areas that are close by and build markets and innovation. So, they would be the two supplementary points to Michael's comments.

[39] **Elin Jones:** Thank you for your paper and your presentation; it has been quite informative. Supermarkets get a lot of bad press—and I am sure that you see some of it—regarding the price paid to milk producers. I do not want to put you on the spot, but, from looking at what has been written on milk pricing, there is a great deal of mystery about where the problem lies. Do you have any views on why the prices paid to milk producers—generally, not just in terms of your milk producers—are so low? What do you see as the major determinants of milk prices for producers?

[40] Moving on to the organic sector, which you identified as an area of growth, it has always been suggested that there is a ceiling for organic growth and it has been questioned whether it can go much further. I do not subscribe to that. How do you see

the future of the organic milk and milk products industry? You seem to suggest that it is something in which you are investing and that you see it as a growth area. Can you expand on that?

[41] **Mr Twigger:** I will take the first question and Michael can talk in detail about organics and what we are doing in that area. It might be useful to share with you, quickly, how we price products; I will not take up a lot of time on it. We measure 14,000 individual products every week and compare our prices with our competitors' prices. The buyers then respond to that. So, every week, 14,000 products are checked. We then compare our prices and we will stay competitive. So, on a product like liquid milk, which is the most emotive issue around dairy, we will monitor the price and if it moves, we will move. We will come on to an instance where we did that. That is how the pricing works.

[42] On the supply side, we would look at a number of elements. One of those is quality, because one of the key things that we have been doing at Sainsbury's is building quality back into our products; the customer demands quality, and we can, in that way, differentiate ourselves on what we are selling, particularly in fresh foods. Another element is service; as I have said before, not to have milk on our shelves because the supplier that we have gone with does not present the product is not a good situation to be in. The supplier needs to be able to supply us with a range of products in the right pack formats and in the ways that we want to do it. We are beginning to see more innovation in how milk is packaged and how things might develop. There is a lot of work to do with regard to the environmental issues surrounding the disposal of the milk bottles—rather than recycling, there is the possibility of a return to the returnable glass system that we used to have in this country. We also demand efficiency; we want people who are efficient at what they do. So, we have the demand side where we will look purely at what is happening in the marketplace and, secondly, the supply side. We are looking for those things.

12.20 p.m.

[43] What has happened on milk pricing particularly is that, if you look at some of the charts that have been produced and look at what has happened in the last year or so, last March, there was a massive drop in the retail pricing, so there was a bit of a competitive issue there. Within 24 to 48 hours, we had dropped our price to that level, but we did not sell one litre more milk at that point. So, we are working in a very inelastic sector. We run a few promotions, normally to introduce new products or to encourage customers to try things like St Ivel Advance and so on. When we promote things like Cravendale, we do not see any more litres being sold—sales just swap around. So, we have very different market dynamics compared to some other markets, in which promotion is very elastic, and you are able to drive volume.

[44] On milk prices, prices have fallen since the deregulation of the industry. We still buy our milk from processors who we believe offer a higher level of return than the average market—we detailed in our paper who we buy from. Those prices are at the upper quartile of prices that are returned to farmers at present.

[45] **Glyn Davies:** This is a key issue that worries a lot of people in Wales. I accept that it is not straightforward, because the strategy itself means a huge restructuring of

the industry. It talks about the numbers of producers falling by another 1,000 in the next three or four years, which is pretty dramatic. I do not know what will drive that, but what we read is that a lot of that is price related to competitiveness. However, that is a pretty major issue. Alongside that, the amount of milk produced has not fallen at all, despite 1,000 farmers going out of milk production just over recent years. So, this is not straightforward, but there is a lot of mystery in what one reads about this; some you take in and some you do not.

[46] The price of milk has risen substantially over a period of time, but the price paid to the farming industry has not. People always ask where that difference has gone and why they do not receive the same proportion of the final price as they received many years ago. That is one of the real issues here. We read about it and we understand that a lot of the dairy industry is not profitable, and is producing below cost. We would not mind you commenting on how we might want to address that.

[47] **Mr Twigger:** Shall I comment on that first?

[48] **Glyn Davies:** I do not expect you to say that you will pay another 6p a litre or anything like that. [*Laughter.*]

[49] **Mr Twigger:** Should I take Elin's second question?

[50] **Glyn Davies:** I would rather deal with Elin's first point. However, this is the key point, and we will go to the organic issue afterwards. I suspect that Brynle wants to come in on this as well, so we may as well deal with this and then go on to the organic point. You only have two minutes, at most, Brynle.

[51] **Brynle Williams:** One thing that concerns me at the moment is the farm-gate price. I am aware that Sainsbury's—fair play—has kicked back to a certain degree to the farmer. However, I am still trying to understand how, with production costs running at 16p or 17p a litre, their money is being lost. What concerns me is the long-term effect on the industry. The retail industry is squeezing and squeezing. We know what the farmer is getting, and we know what the housewife is paying, but we cannot get that bit in the middle, that transparency. What frightens me is the future of the dairy industry. You have made plain your concerns about the environment, animal welfare, production, and so on, and yet the commercial industry—not just Sainsbury's—is forcing agriculture into factory-farming methods of high stocking density, which will cause a lot of environmental problems.

[52] Where is that missing slice of money? When can we expect to see an increase, and where do you predict an increase on the market share coming back to the producer, because, ultimately, without producers there will be no Sainsbury's? Also, where do you see the industry going in the next 10 years? I would like to see a commitment from your industry to safeguarding our industry in the next 10 years, because, as you know, major long-term investments are taking place on some dairy farms, but many farms will not invest, and I think that we will lose 1,000 producers in Wales in the next two years.

[53] **Mr Twigger:** I think that this subject is probably one of the most emotive ones around the dairy industry. The first point to make is that we do not buy raw milk,

obviously; we buy packed product, whether it be cheese, yoghurts or liquid milk. There is a third party that we would encourage you to get to this table, which is the processing industry, so that you can piece the three areas together. From that point of view, we are now attempting to create, through the supply chain, a wider debate. Hence, we are forming dairy groups, and we are inviting farmers to join them. The first producer meetings will probably be towards the end of this month or in early March. One of the reasons why we believe it is important to have producer groups is to try to improve everyone's knowledge of what the actual cost of production is on a farm. Brynle, you mentioned the figure of 17p; we heard noises that it is 14p or 15p, and we hear noises that it is 22p. On the price of milk, that is a huge variance.

[54] Equally, we need to understand the processing and some of the other things that go on with regard to the ways that we then distribute milk, and some of the history behind that. We still take milk directly into stores. I know that you have raised issues in relation to depots, but we need to ask whether we would be better to take some milk through depots: what are the economics of the full supply chain? One of the purposes of the groups, which I think we included in our submission, is to allow everyone to sit down and establish what we can work on together as the key issues for understanding where the cost streams are. We see work that suggests that, within the supply chain—I am not talking about farm level, but from the farm gate onwards—there is 2p to 3p per litre that is wasted. The question is: if that could be liberated, and if even a proportion of it—and I am not suggesting that it should or should not be shared—went back to the farm-gate price, that would make a colossal difference to where we are today.

[55] At the same time, we need to understand exactly where the efficiency at farm level sits—whether it is 16p, 17p, 18p or whatever. There is so much noise around milk pricing and how the supply chain works that we really have to get down to brass tacks. The element that I would overlay that with is the fact that we are working in a market, and the market price dictates how much we pay. We believe that we pay in the higher levels for milk. This is an abnormal market; there is published pricing. I do not know of any other market with the equivalent of Milkprices.com or whatever other website you use to print off a list of prices. You can look up the commodity price of cocoa beans, but there is nothing quite like the milk market.

[56] **Brynle Williams:** May I stop you there—

[57] **Glyn Davies:** No, Brynle, we do not have time. There will be no further questions. We shall have an answer to the organic question after this, and that will be it.

[58] **Mr Hodgson:** I would like to add one comment, going back to your point about support for the dairy industry over the longer term. That is very important to us, and that is exactly why we have established those groups. It is a very significant step for us. It provides us with the opportunity, which we have never had before, of working through the chain—farmer, processor and retailer—to really understand how the industry comes together. That is our commitment to the industry, which we will be supporting as an ongoing feature.

[59] **Glyn Davies:** Can you touch on Elin's point about the capacity for organic

milk?

[60] **Mr Hodgson:** Yes. Organic milk is in rapid growth. At the moment, it represents about 11 per cent of our milk sales, but that is growing. We have faced some challenges in that sector because it has been difficult sometimes to secure sufficient supplies of organic milk. One great thing that we have been in a position to do is to ensure that all our liquid milk is British. We have never sold fresh liquid milk that has not been British. Assisting farmers in moving towards an organic position is something that we have wanted to do. That was the thinking behind the creation of Farm Promise milk. You will find the product in our stores; 5p from the sale of every bottle goes back to the farmer; in fact, in total, 11p goes back to the farmer to assist with the costs of conversion. As Simon said earlier, we are very proud that we have now a farmer who is fully converted and has reached organic status.

12.30 p.m.

[61] We consider that there is yet more growth within this, as consumers recognise some of the benefits that it brings, such as omega-3 and the other health connotations that people might take from it. So, we want to work closely with the industry to get it in balance. At the same time, it is about getting it right, so that it is in balance and that we do not get into a situation of over-supply, as was the case three or four years ago. It is about making sure that we are working together throughout the chain to ensure efficiency and balance.

[62] **Mr Twigger:** If I could make one last comment on organic products, liquid milk is the largest part of what we sell in dairy, but of our total dairy sales, organic sales are growing but still only make up 5 per cent of organic sales, and we are 25 per cent of the market. So, while it is a solution for the Welsh dairy industry to think about, to be involved with and to be part of the growth, there is obviously a much larger market to be thinking about, namely the conventional one. If you look at one of the most successful businesses in this area, which is probably Yeo Valley, it has a substantial conventional business as well as an organic one, although it started from a very successful growth in organic. It has been able to develop its technology and its innovation in yoghurt and other soft dairy products, and other products that may come about, and it has been able to use that expertise to be able to grow a substantial conventional business as well.

[63] **Glyn Davies:** We have reached the appointed hour for the closure of the committee. This discussion could have carried on; I have a dozen questions in my mind, but we have to close. Thank you for coming along. Your presentation at the beginning was informative and helpful. Thank you, and with that, I declare the meeting closed.



**Cynulliad Cenedlaethol Cymru
Pwyllgor yr Amgylchedd, Cynllunio a Chefn Gwlad**

**The National Assembly for Wales
The Environment, Planning and Countryside
Committee**

**Dydd Iau, 1 Mawrth 2007
Thursday, 1 March 2007**

Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir cyfieithiad Saesneg o gyfraniadau yn y Gymraeg.

These proceedings are reported in the language in which they were spoken in the committee. In addition, an English translation of Welsh speeches is included.

Aelodau Cynulliad yn bresennol
Assembly Members in attendance

Lorraine Barrett	Llafur Labour
Mick Bates	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats
Jocelyn Davies	Plaid Cymru The Party of Wales
Glyn Davies	Ceidwadwyr Cymru (Cadeirydd y Pwyllgor) Welsh Conservatives (Committee Chair)
Tamsin Dunwoody	Llafur (Dirprwy Weinidog) Labour (Deputy Minister)
Elin Jones	Plaid Cymru The Party of Wales
Brynle Williams	Ceidwadwyr Cymru Welsh Conservatives

Eraill yn bresennol
Others in attendance

Dai Davies	Llywydd, Undeb Cenedlaethol yr Amaethwyr Cymru President, National Farmers' Union Wales
Eifion Hughes	Cadeirydd, Pwyllgor Llaeth a Chynnyrch Llaeth, Undeb Amaethwyr Cymru Chair, Milk and Dairy Produce Committee, Farmers' Union of Wales
Mary James	Pennaeth Polisi/Is-gyfarwyddwr, Undeb Cenedlaethol yr Amaethwyr Cymru Head of Policy/Deputy Director, National Farmers' Union Wales
Arwyn Owen	Cyfarwyddwr Polisi Amaethyddol, Undeb Amaethwyr Cymru Director of Agricultural Policy, Farmers' Union of Wales

Gwasanaeth y Pwyllgor
Committee Service

Dr Kathryn Jenkins	Clerc Clerk
Dan Collier	Dirprwy Glerc Deputy Clerk

*Cynhaliwyd y cyfarfod yn yr Ardd Fotaneg Genedlaethol, Llanarthne.
The meeting was held in the National Botanic Garden of Wales, Llanarthne.*

Ymgynghoriad ar y Strategaeth Laeth Dairy Strategy Consultation

[1] **Glyn Davies:** I invite the guests who are helping us with the draft dairy strategy to come to the table. I welcome our guests to committee. To explain where we are, the Government has published its draft strategy for consultation, and we as a committee may well make a contribution to it. We will probably have a paper on this at our final meeting in a fortnight's time, which we will use as a contribution to the consultation. We invited Sainsbury's to our last meeting to help us. Representatives from Tesco were coming too, but they withdrew at the last minute.

[2] Our guests today have also kindly agreed to come in to help us. I ask them to summarise the main points in the written evidence that they have given us, as that would be useful. We can then have a question-and-answer session. They are helping us to form a response to the consultation document. Who wants to go first?

[3] **Mr Davies:** On behalf of the National Farmers' Union Cymru, I thank you for this invitation, and I thank you, Chair, for rearranging your programme to accommodate us. As an organisation we felt that this was a very important document for the dairy industry in Wales, and a rushed response would have been unworthy of it.

[4] To introduce myself, I am Dai Davies, the president of NFU Cymru, and I am a dairy farmer from Carmarthenshire. On my left is Mary James, the head of policy at NFU Cymru and the deputy director. NFU Cymru represents about 15,000 members, and more than half of the dairy producers in Wales.

[5] We welcome the committee's decision to examine the Welsh Assembly Government's strategic action plan for the Welsh dairy industry, and we thank you for giving us the opportunity to come here today and give a written as well as an oral report. However, Chair, I am somewhat disappointed that, apart from the brief meeting that we had at the Assembly with Promar Consultants, this is the first time that we have had the opportunity to get engaged with this strategic plan. As you said, in the limited time that we have, there is no point in my coming here and going back over the dire and deteriorating circumstances of the dairy industry in Wales. NFU Cymru accepts that many of the problems facing the industry are commercial, and that many of the answers must be so. However, sadly we see no commitment from the Welsh Assembly Government in the strategy to tackle the macro issues affecting the profitability of the industry; the Government seems to be concentrating on the micro issues which, though important, will not determine whether the Welsh dairy industry thrives or fails.

[6] The main issues that need to be addressed by the Welsh Assembly Government in the eyes of NFU Cymru are as follows. The Government must provide a competition framework that permits the consolidation of milk processing activities, and the milk processing sector must be allowed to rationalise to improve its competitiveness, especially in the farmer-owned businesses. The Welsh Assembly

Government must also address abuses of retail power and behaviour. Using processors' money to buy shelf space is totally unacceptable. Producers are not receiving a fair share of the retail price; if you look at the situation in 1995, producers got 59 per cent of the retail price of liquid milk, but today they only get 27 per cent. Today we see that the share of the supermarkets has gone up by 27 per cent since 1995, but that the producers' share has decreased by 30 per cent. Draw your own conclusions from that.

12.00 p.m.

[7] Producers need profitability and confidence to invest in the future. As far as we are concerned, regulations must be based on objective criteria, proportionate and cost-effective. There is a danger of regulating the dairy farmer out of business. We feel strongly that the axis 2 measures of the RDP should be tailored to encourage and develop an environmentally sustainable dairy industry. Where possible, a voluntary code of practice should be applied as we already see in the arable sector. Better contracts need to be established between producers and processors; 18-month contracts that are binding on time, but not binding on price would not be acceptable in any other industry.

[8] A more holistic and pragmatic approach needs to be followed to eradicate tuberculosis, but, as time is limited, I will not expand on that issue.

[9] This brings me on to the need of the Welsh Assembly Government to think outside the conventional box. Could lessons be learned from Bord Bia in the Republic of Ireland? Could we develop a Welsh food sector board here in Wales? Would the interests of dairy farmers be better served by combining the management group of the dairy development centre with the Assembly's dairy strategy group and the Welsh Milk Development Council committee, with the milk levies collected in Wales managed by this new board or organisation? I would go even further and suggest that a study should be undertaken to see if a body, such as Bord Bia, should be embraced in the activities not only of the milk sector, but also of Hybu Cig Cymru and other sector bodies in Wales.

[10] The momentum and further development of the profile and identity of Welsh food brands, including milk and dairy, must be re-established. I am somewhat concerned about the agri-food directorate's situation. Should the directorate be incorporated into an umbrella organisation, such as Bord Bia, if the Welsh Assembly Government wished to go in that direction?

[11] I am somewhat disappointed with the strategy document. It is light on how the Welsh Assembly Government intends to attract inward investment projects to Wales to add value to the dairy sector in Wales. As an industry, we are concerned about the potential effect that the Irish dairy processing aid package could have on the Welsh dairy industry. In July 2006, €100 million was offered by the Irish Government to promote capital investment in the processing and marketing of dairy products. As most of us know, the Republic of Ireland is a major cheese producer, so it is in direct competition with the Welsh dairy industry.

[12] Many difficulties are now faced by farmers and processors alike, and we are

fully aware of the difficulties in Dansco at the moment; it has had plenty of publicity. The recent announcement by Lactalis McLelland Ltd in Felinfach, and Dairygold all stress the urgent need to get our act together. If we are to save the dairy industry in Wales, we must all work together to provide one strategy; little empires here and there are no use whatsoever. Let us all work together and pull together for the future. I hope that whatever comes out of this strategy is not put on the shelf and allowed to collect dust.

[13] **Glyn Davies:** Thank you, Dai. That was quite a challenging presentation, which is exactly what we wanted. Eifion, you are next.

[14] **Mr Hughes:** I thank you for the opportunity to speak, along with Arwyn, our director of policy. I agree with virtually everything that Dai said. I am a little disappointed that the report does not go quite far enough. I am also very pleased in my own mind that the agri-food money will not be touched. I would like that to be increased dramatically.

[15] I will take a different outlook from Dai's. You have talked about the whole industry—and we know that there are difficulties in the cheese sector and that 80 per cent of our milk goes into cheese, which brings labelling into it, especially with regard to imported cheese.

[16] Therefore, let us talk about the dairy farmer and feet-on-ground milking. We will take Anglesey as an example. Some 10 years ago, there were 170 milk producers on the island; now, there are 50. I know that we are producing 'virtually' the same amount of milk, but if you apply that to the whole of Wales, it means that a dairy farmer is leaving the industry virtually every 36 hours. Think of the knock-on effect that that has on the countryside.

[17] All that we really want is a fair share of the price. Our price, as we said before, has gone down 10p a litre over the past 10 years. The housewife pays more than 6p a litre more. The money is in the industry, but the way in which it is shared out is dramatically wrong. Somebody somewhere, perhaps an ombudsman, has to look at the whole industry, so that we can have a vibrant dairy industry and stop the greed of other people. With those short words, I will finish. Thank you again for your time.

[18] **Glyn Davies:** I was interested in your consolidation of the bodies involved and the creation of some sort of Bord Bia, like there is in Ireland. I admit that I do not know much about that, but I want to know more about it. That is an innovative proposal. Has there been much discussion of that? Is it a fairly new proposal, or have you done a fair bit of work on it?

[19] **Mr Davies:** I am sure that Mary will come in at some point, but I will just say that you have to remember that we have not had this document for long. As I said at the beginning, we were glad to have it and we have delved fairly deeply into it, because we wanted to give you a rational and thought-out response. That has been one of the ideas that have come to the fore. At the end of the day, it is your decision and we can only present things as we see them to you. It is up to you whether you want to go in that direction.

[20] **Glyn Davies:** In a sense, we all share the frustration. An election will be intervening and there will be a big change in the way in which the Government of Wales operates after May. It would have been far more satisfactory had we been able to start looking at the dairy strategy six months ago. However, despite the fact that we have only two meetings left after the draft strategy was made public, we thought that it was worthwhile to try to make a contribution, from the committee members' point of view. Having listened to that, I would like to go to Ireland and talk through these ideas to see whether I want to say that we should recommend this in a committee report. It is difficult to do that without having taken proper evidence. I share a frustration with you, that is all.

[21] **Ms James:** We have looked with some envy at the performance of Bord Bia. The value of Irish exports is over £8 billion, and, last year, particularly as a consequence of the activities of Bord Bia, another 10 per cent was added to the value of those exports. It provides an integrated approach to market development, promotion and differentiating Irish products. As Dai said, it is in direct competition with us and it seems that, with the performance that it has exhibited over the past 12 months, there are certainly lessons for us to learn in Wales from its activity.

[22] **Glyn Davies:** We have talked about the number of farmers who have been leaving the industry, and one of the most frightening things that I saw in the draft report was that it seemed to be based on the assumption that another 1,000 farmers will be leaving in a fairly short time.

[23] **Mr Hughes:** The decline in the industry will rapidly increase unless something dramatic is done about it. Far more than three farmers will be leaving.

[24] **Glyn Davies:** This may seem like a provocative, challenging statement, and I do not intend it to be, but we are seeing, and have seen, a dramatic reduction in the number of dairy farmers, and yet the industry has not contracted in the sense of milk production. The anticipation in the dairy strategy is that it could decrease by another 1,000, but the amount of milk produced will remain static.

[25] **Mr Hughes:** That is true, but the majority of dairy farms that were going to get bigger have got bigger. There is no scope for them to get much bigger, as they are running at full capacity. The amount of other dairy farms that would like to get bigger, but cannot afford it means that they are in exactly the same situation. You will see a dramatic decline in milk production, or in the milk field. It is bound to happen, because the money is not there to invest—those who could invest have got bigger, and they are running at virtually their full capacity.

12.10 p.m.

[26] **Ms James:** The other aspect to that is that, because the industry's' structure has changed dramatically in recent years, you will see a much more major impact on the milk supply levels when individuals go out of the business. A small producer going out of production does not have a massive impact on the totality. However, we have got to the situation now where the scale of business is significantly greater than it was hitherto, with the result that it places a vulnerability not only on the entire industry's infrastructure, but also on the supply of milk to the consumer.

[27] **Glyn Davies:** We have read warnings, have we not—was it the Waitrose guy who said that, in five years' time, we could be in the position of importing? We have read the warnings that we have seen.

[28] **Brynle Williams:** What concerns me is these 1,000 people, which both our contributors have mentioned. I think that we will see a significant shift. Those 1,000 people will make one devil of a difference—to the countryside alone. If we purport to be environmentally friendly, we cannot afford to lose these producers. However, what concerns me more than that is that the producers who remain could end up with 1,000-cow superherds, given all the environmental problems that they bring with them. On depopulation, both of your unions are looking at the overall picture, but perhaps we, as politicians, are not seeing the overall picture. I am not saying this to cause a stir, but the Irish Government is far more committed to agriculture than our Government is. I am not being provocative; I am just saying it as I see it as a farmer.

[29] **Glyn Davies:** It depends on who is listening to you, Brynle. There was not a question there really, but do you want to come in on that, Arwyn?

[30] **Mr Owen:** The strategy document mentions the fact that the numbers of dairy farmers will decline by 5.6 per cent a year, which is a total of 1,000. When we read that, we were concerned; that is, we would hope that that trend would not continue if the strategy is a success. We read that as being an almost inevitable decline in the number of milk producers, whereas, in reality, we would like to see the strategy setting out a programme that would reverse that trend.

[31] **Mr Davies:** If that is the case, it would be an enormous strain on the dairy industry in Wales, because you have a dairy infrastructure, and you must have the facilities to collect milk daily. If we are going to reduce the number of farms from 2,200 to around 1,200, it makes you wonder whether that infrastructure will be in place. It will probably be there in parts of Clwyd and Pembrokeshire, and perhaps west Carmarthenshire. However, I am afraid that, if we drop to that, the rest of Wales will be no-go areas for the dairy industry. Sadly, the dairy industry, historically, has been a way for young farmers to come into the industry; you buy your cattle today, and, in a month to six weeks' time, you expect to get a milk cheque. That is not the case with beef or sheep.

[32] The other issue that you mentioned, Mr chairman, was that you see bigger herds growing to compensate for the smaller ones. The major expansion that we have seen has probably plateaued, and we see some of the larger ones that have overinvested deciding to give it all up. In the cereal sector, we have seen farms grow and grow to thousands of acres. In the dairy sector, you cannot fly your cows into pasture; you have to have the pasture accessible to your dairy set up. Therefore, the land must be within walking distance, as it were, from the dairy, and that limits the size that you can have. The only other thing that you can do, which I am not in favour of—and I am sure that any environmentalists here are not in favour of it either—is have satellite grass-growing areas somewhere else, where you tractor and trailer your silage in from miles away. That does not help the industry.

[33] On pushing these larger and larger herds, which the retailers seem to

encourage us to do, there is a huge question mark over the environment in that regard. On the one hand, we have heard this morning how the Assembly feels about protecting the environment in Wales; on the other, having large, 1,000-unit dairy cows means storing huge amounts of slurry in one area, and there must be a question mark over that, and over the consequences for the environment if, God save us, something were to go wrong.

[34] **Glyn Davies:** I was only commenting on the way that I read the strategy, which was exactly the same as Arwyn did. I did not read it as wanting to encourage this trend; it surprised me that it was an acceptance of this trend and an acceptance of the numbers. It may be that an attempt has been made to draw up the strategy from a realistic base, and there is an extrapolation of current trends, but I was surprised by the acceptance. I have not heard any politician say that he or she is in favour of it as a trend. I would be very surprised if anybody here were to say that.

[35] **Elin Jones:** I have a question about the macro level and, to an extent, what is outside of the direct control of the Assembly and the Assembly Government, in what statements the Assembly Government can make and what pressure it can exert at a UK level on anti-competitive prices, which the recent Competition Commission announcement referred to, although it asked for greater evidence of the exact nature of the anti-competitive practices in the processing and retailing. I have a bit of a downer on the processors at the moment, given events in Ceredigion.

[36] What message from Wales would you want to see an Assembly Government Minister say loud and clear to the Competition Commission, to tell it what we want to see happening with regard to the dairy industry and the issues that you refer to in the NFU paper about consolidation of milk processing activity? I do not quite understand what that actually means as a full message to the Competition Commission.

[37] Bord Bia is a very interesting idea that I had not really thought about beyond the fact that Welsh beef and lamb have such a strong identity and subsequently a strong advertisement and marketing influence, none of which Welsh dairy has, of course; it is hugely fragmented. I am interested in what you are suggesting in the NFU paper along the lines of the Bord Bia. What also interests me, going back to Sainsbury's presentation to committee, and what Eifion said as well, is the reference to the fact that we are very much dominated by the cheese-producing market here in Wales, and that a body is needed to look at the development of new products and growth-market products such as yoghurt and smoothie drinks, which are currently being imported to the UK as there are not enough suppliers in Wales or the UK to meet demand. I am interested in how a Bord Bia of sorts or an Assembly Government sponsored organisation could be far more proactive in the market, because I think of the factories that are, or are soon to be, lying empty in Felinfach that could be used for something. Who takes the initiative to actually do that? It cannot be left to individual farmers, because it is such a huge ordeal, but somebody needs to take the initiative in those kinds of situations, and I think that, although the potential exists, it is a matter of how you orchestrate it, and that seems to be missing at the moment.

[38] **Lorraine Barrett:** Touching on Elin's remarks, can our speakers mention co-operatives, perhaps? Elin asked how individuals can pull it together, and perhaps something could be said about co-operatives.

[39] **Glyn Davies:** There is a bit of a history there, is there not? Does anybody want to respond to Elin's and Lorraine's points?

[40] **Ms James:** I will pick up on Elin's first point. It was interesting that, last week, some of your colleagues in the all-party parliamentary group for the dairy sector, who have been looking at the dairy industry, commented that they felt that the Office of Fair Trading should be looking after the production side of the industry rather than just looking exclusively at the prospects for consumers. That may be an area that perhaps, in terms of the OFT, greater credence could be given to.

[41] In terms of Bord Bia, you mentioned the integrated strategy that we now have to promote and market red meat, which we would like to emulate in the dairy sector. That is why we feel that there is scope for the dairy development centre in Wales, Milk Development Council activity in Wales, the agri-food strategy in Wales, and us as an industry participating in it, so that we bring all these groups together. At the moment, you have the potential for things to fall between the activity of those groups, and I suspect even a degree of replication as well, because there is not that integrated approach at present. So, we are seeking to emulate the best practice that we have already seen with Hybu Cig Cymru in the dairy sector.

12.20 p.m.

[42] You inquired about new product development, and, again, we see this as a combination of activity. That is on the part of academia, in terms of identifying potential products that processors are not currently working on, but, ultimately, the processors and commercial businesses will take forward the scope identified in the market. We concur with your view: Wales is producing 11 per cent of milk produced in the UK, and yet we are exporting only 4 per cent of it. If we could emulate the activity of Bord Bia, which has grown its export market over 10 per cent in the last 12 months, we would see that figure of 4 per cent rise significantly.

[43] **Glyn Davies:** I want to finish in five minutes' time. I know that it seems unsatisfactory, but we wanted to squeeze this in, because the timetabling makes it difficult for everyone to come to the final meeting. I have already apologised for the fact that we will finish 10 minutes late, so I do not want to apologise again. So, we will finish at 12.25 p.m. irrespective of whether it is in the middle of someone's speech. Mick wants to come in to make a point, and only those who have not spoken before can come in. I will ask Members to speak first, and we will then have responses.

[44] **Mick Bates:** Thank you very much for your presentations. They were very different, but extremely useful from our point of view with regard to developing a dairy strategy. First, you covered dairy product development, and it is important for added value to have product development, but I did not quite pick up on the co-operative issue. To what extent is it possible to recreate things such as the Milk Marketing Board, because it now seems to represent an era of stability? When deregulation occurred, a lot of people saw an advantage in getting an extra 0.5p or whatever, and there was a fragmentation of the industry in terms of infrastructure. Is there anywhere to travel to take that as an aim? In view of the Chairman's comments,

I will just ask that.

[45] **Glyn Davies:** Let us deal with that point, because if it gets to 12.25 p.m., I want to stop. Mick, it is an important question that you ask about the whole co-operative principle. You can come back on this, Mick, but we will stick with this point now.

[46] **Mr Hughes:** There are already three co-operatives, which are First Milk, First Link and Dairy Farmers of Britain. As it says in your report, Dairy Farmers of Britain and First Milk have 60 per cent of the milk produced in Wales, which is not enough. However, if the three co-operatives merged or worked closer together, which eventually I think they will, we will be in a stronger position. Again, a lot of this is down to the old farmer attitude of, 'I am all right, Jack', 10 years ago, when deregulation came, and when some farmers were greedy and went for the 1p or 2p, which has now cost the industry 10p.

[47] **Mr Davies:** When Milk Marque broke up, 66 per cent of the milk in Wales was being sold through one co-operative. As far as the UK was concerned, 46 per cent of its milk went through Milk Marque. However, since that time, we have seen our major retailers, such as Tesco, exceeding 34 per cent of the market. With only 46 per cent of the milk going through the Milk Marque, it was felt that we should break it up, and, because it was broken up, we have lost power. We need to bring these farmer-owned organisations back together, so that we can be in a better bargaining position with the large retailers.

[48] I will just pick up on one thing that Elin said. We view Hybu Cig Cymru as being a major success. It has been supported by the Welsh Assembly Government, and we are very grateful for that. The milk sector, on the other hand, has had very little support from the Welsh Assembly Government up until now. I can understand why, in that you did not have a peg to hang your hat on, as it were. Our hope is that we could bring this together, because there is common ground between HCC and the milk sector, as they are both livestock based. So there is common ground there, and it would be good if we could form something under one umbrella, and bring them both together. Therefore, any help from the Welsh Assembly could be targeted in one direction. It would be my hope to achieve something like that.

[49] **Glyn Davies:** It is almost 12.25 p.m..

[50] **Mick Bates:** There are two important points to make. We have talked a great deal about liquid milk. In the dairy sector at one time, the barren and the calf were also a significant part of the income. Please comment on any way in which the current situation could be improved. The other issue is energy costs. How much have those risen in the dairy industry, and what, if anything, can be done to help to reduce those costs?

[51] **Mr Davies:** The cost of production has gone up by 1.8p per litre in the past 18 months or so. A great deal of that is because of energy costs and so on. With regard to other countries in Europe, looking at Germany for instance, the amount of public money injected into the production of energy on farms is phenomenal. We have seen very little of that here. Perhaps, under the RDP, there will be a possibility of setting

up plans or strategies for farms becoming tools for producing energy. The potential exists; they create methane. Why allow that methane to go into the air when it could be turned into energy, benefiting the whole population?

[52] **Glyn Davies:** I remember seeing this profile on television of Brynle Williams. I think that Brynle himself became the great national inventor of energy from methane. May it come yet. [*Laughter.*] On that happy note, we conclude our meeting. Thank you for coming to help us.