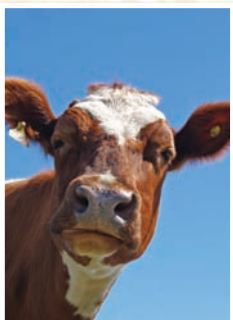


Compete to Grow



*A vision and strategy for
the British dairy industry*



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The trading environment for British dairy farming has been extremely challenging for almost two decades. Market conditions and the regulatory and policy landscape have all taken their toll on the confidence of British dairy farmers.

Today however, the future presents a number of opportunities to British dairy farmers who are prepared to look to the future and invest. Population growth and consumption trends suggest the global and domestic dairy market will grow.

Growth at farm gate can only happen in conjunction with increased processing capacity. While much has been said about investment in liquid milk processing, growth will also require more state-of-the-art processing capacity for other dairy products.

With this vision and strategy I want to unite dairy farmers and processors in increasing our domestic production and processing. Farmers and processors need confidence in each other's will and ability to invest and produce what the market wants and needs and seize these opportunities.

We believe that to trade globally, you need to compete globally; that's the basis for *Compete to Grow* our vision and strategy for a growing British dairy industry.

These are my key messages:

- The next 5-10 years presents a major growth opportunity for British dairy farmers, if we don't take advantage of it, other countries will.
- British processors must seize opportunities for domestic and global market growth.
- To grow, farmers and the whole supply chain will need to be competitive.
- For farmers to be competitive, they will need to invest. The supply chain must recognise the scale of investment that farmers will need to make.
- For farmers to invest they need trust in the supply chain.
- The foundation for that trust must be equitable contracts, which comply with the Dairy Industry Code of Best Practice for Contractual Relations and fairly reward farmers for their investment and quality output.
- There must be a greater share of supply chain margins for farmers' investment and profitability, in reward for quality output.

Farmers want a fair chance in a fair market. Achieving this is what the NFU is all about and will be the focus of the NFU dairy board in delivering on this strategy.

Finally I'd like to thank Rob Harrison, Jeremy Burdett, James Miller and Michael Oakes, who formed the strategy working group and Rob Newbery the author of this document.



Mansel Raymond
Chairman of the
NFU dairy board





Rob Harrison

Vice chairman of the NFU dairy board and project lead for the NFU Compete to Grow dairy industry strategy

My focus for the British dairy industry is the future, not the past. I've invested to make my business more efficient; to ensure my cows are more content and to ensure the milk I produce is what the consumer wants. In return I expect a fair financial return from the market place in order to secure a sustainable future for my family and my farm.

The future seems rich with opportunity, demand is growing, markets are expanding and all the time new technologies present themselves. I believe that our industry has all the promise and potential it needs to be a world leader in terms of efficiency, product quality and added value.

Yes there are challenges and hurdles; for instance bTB, poor producer margins and regulatory red tape; but hurdles are meant to be overcome.

I've committed to a positive future in my business; I hope British dairying can collectively commit to the future by deploying this strategy. Long-term equitable trading relationships between farmers and processors, built on trust, transparency and a mutual commitment to invest in our businesses to improve efficiency and meet the demands of the market place.

I recognise that how I farm needs to live up to the expectations of the modern consumer and I need to demonstrate that, through the Red Tractor. Likewise, I expect my milk buyer to recognise the value of my efforts and deliver a milk price that allows me to make the on-going investment necessary in my business to meet these aspirations.

This strategy identifies roles and responsibilities for me as a farmer, the rest of the supply chain, the government, trade associations and our levy board. Central to this strategy is the need to work together and keep our eye on the prize.

The British dairy industry is at a cross roads. Farmers, individually and collectively, milk buyers and ancillary businesses and interested organisations, have the opportunity to steer British dairying down a path that allows efficient, well-run businesses to sustainably prosper and for our sector to emerge as a global leader.

This document brings together government and industry strategic projects, market information and supply chain analysis, to demonstrate the position of strength that the British dairy industry holds.

Against a backdrop of a £1.5bn dairy trade deficit, an exciting opportunity exists to find ways of growing our industry by reducing that deficit.

The NFU believes that to take advantage of this position, the whole supply chain needs strategic co-ordination to develop and maintain a competitive edge, based on efficiency, innovation and added value.

The need for such a strategy was identified by the dairy coalition of organisations, in its 10-point plan, published in September 2012. What's more the NFU has surveyed farmers, trade associations and other interested stakeholders, on the importance of producing this strategy at this time. ninety-eight per cent of respondents agreed it is vital that the industry has an ambitious strategy, which is communicated to farmers, processors, the supply chain, investors and consumers.

Supported by DairyCo, the NFU has committed to set this process in motion, working with the dairy coalition, with DairyUK and consulting with farmers, processors and a range of other stakeholders and companies.

This strategy has used this vision and guiding principles of the Dairy2020 initiative. Dairy2020 used the 'futures' approach to establish the actions and behaviours the dairy industry should adopt to ensure a sustainable future.

Whatever the direction our dairy industry takes, it should be a vibrant UK dairy industry that enables people, environment and business to thrive (see Annex, page 23).



Summary of recommendations

The global market and demand for dairy products is growing and the global dairy industry will grow accordingly. Post 2015, quota restrictions that are currently preventing some countries from expanding, should no longer exist. Globally and within Europe, dairy industries are positioning themselves for growth.

The British dairy industry is in pole position to become a national and international success story. On the foundation of major investment in processing infrastructure, a move to more equitable contractual relationships and the currently-untapped potential of an already efficient, but potentially highly efficient dairy farm base, this industry has all the ingredients for success.

Based on predictions and analysis of domestic growth in demand for dairy products in the UK and by maintaining/achieving 100% self-sufficiency (balanced trade), between four and five billion litres of extra milk at farm gate would be required by 2020.

According to analysis of DairyCo's MilkBench +, if the bottom 25% of producers in terms of efficiency were to achieve the technical performance of the average, increased output would be 7% or 0.8 billion litres (Britain).

The NFU believe that if farmers are paid a market price that allows for an on-going sustainable investment in capital infrastructure of 3.5ppl and there is a commitment to equitable contracts that comply with the code for contracts - the combination of efficiency gains, farm expansion and new entrants could allow output growth to equal the demand growth required to achieve national self-sufficiency (trade balance).

The risk of failure to grow as fast as, or faster than, our competitors would be diminished economies of scale, and ultimately becoming uncompetitive and accelerated contraction.

Together

1. Competing globally means being globally competitive; all stages of the supply chain have a responsibility to continually improve efficiency and effectiveness and where possible benchmark their performance against others.
2. Building a position of global competitiveness will require the supply-chain to work together to add value to British dairy products. Together farmers, processors and retailers must build long terms (and where possible short chain) relationships, based on equitable trading terms and value creation.
3. All parties should work together (within the confines of competition law) to develop a co-ordinated strategy and pre-competitive messages to promote British Dairy (domestically and internationally).
4. All parties should work to promote and develop the Red Tractor Assurance Dairy Scheme (RTA Dairy), to improve understanding and recognition. The scheme must be relevant to the needs and concerns of the modern consumer and appropriate for the modern dairy industry.
5. We must continue to measure and communicate our performance in terms of environmental sustainability and recognise its contribution to economic gains, through the Dairy Roadmap target reporting.
6. We must 'champion champions'; delivery on this strategy will require a common understanding of the potential of the British the dairy industry. From farm to shelf, we must recognise and applaud success.
7. Work to ensure a CAP that delivers a level playing field in Europe, including resistance of supply management or other legislative/policy mechanisms that inhibit the competitiveness of British dairying, post quotas in 2015 or otherwise.
8. To ensure a broadly sustainable and responsible future for the dairy industry we must test this strategy against, and work to deploy the vision and guiding principles of the 'Dairy2020 initiative'.
9. Continue efforts toward the eradication of bTB.

Farmers

10. British dairy farmers can increase output, through improving technical efficiency and expansion.
11. It is vital that British dairy farmers can and do continue to develop competitive and efficient businesses and farming systems. Dairy farmers should benchmark technical key performance indicators in their business and remain responsive to change.
12. DairyCo's Milkbench+ report shows us that farmers large and small have the potential to be efficient, but efficiency doesn't stand still and improvement must be continual to stay ahead of the competition.
13. Farmers must be responsive to the needs of the modern consumer and communicate this by championing and complying with the Red Tractor assurance system.
14. As supply chain consolidation continues, the importance of farmer collaboration to improve their bargaining position is greater than ever. Farmers should consider collaboration for instance through joining a co-operative, marketing their milk via a producer organisation or forming or joining a democratically accountable producer representative group for dialogue with their milk buyer.
15. Farmers need to choose their milk buyers with a broader evaluation than just price at a given time. Consideration for trust in a buyer's strategy, sustainability and compatibility (market orientation) with their farm business are vital.
16. Farmers should consider risk management strategies. For instance futures/derivatives as they become available, to manage market volatility. In the short term by utilising tools to manage trade credit risks, like credit checks on milk buyers.
17. Farmers should consider effective succession planning to retain capital and productive infrastructure in their business and hence the industry.

Milk buyers

18. Milk Buyers operating in Britain should offer supply contracts that comply with the Dairy Industry Code of Best Practice for Contractual Relations.
19. Through sustainable milk prices, milk buyers need to recognise the absolute importance of farm level infrastructural investment, to maintain efficiency and competitiveness.
20. The NFU believes that British dairy processors should include one or both of the following in their corporate strategy:
 - growing the share of the British market through import displacement, accessing export markets.
 - Fighting purely for share of a diminishing proportion of the domestic market, rather than growing that market, is unsustainable.
21. Strategies to achieve growth should include; investment in efficient processing capacity, world-class product innovation, branding that achieves value creation, the establishment of value adding, long term, short chain relationships.
22. Milk buyers should support and engage in dialogue with producers collaborative/representative groups.

Retailers and food service companies

23. Must take responsibility for sustainable raw milk procurement policies as described for milk buyers.
24. Buyers should seek to establish long term short chain relationships with British dairy farmers.
25. Should support the development of brands, product innovation and efficiency to improve the competitiveness of British dairying.



NFU

- 26. Communicate and oversee the uptake of and monitor this strategy.
- 27. On behalf of our members, engage with consumers and the public on issues such as the Red Tractor, dairy farming production systems and other issues of relevance or concern to the modern consumer.
- 28. The NFU must continue to lobby politically and commercially to create an environment in which dairy farmers can trade efficiently and fairly.
- 29. Provide technical, political and co-ordination support to groups of farmers who which to collaborate to improve their bargaining position in the supply chain or add value to raw milk.
- 30. The NFU should undertake to examine successful global production and supply of milk and milk products.
- 31. Work with farmers and milk buyers to ensure the complete and effective uptake and development of the Dairy Industry Code of Best Practice for Contractual Relations.

DairyCo

- 32. DairyCo should continue to develop and improve its provision of services to Dairy farmers, targeted to individual needs, to meet the technical challenges of this strategy. For instance MilkBench+ should be developed to accommodate a greater number of dairy farmer participants.
- 33. A common understanding of the 'key performance indicators' to technical and business efficiency should be promoted and developed by DairyCo, to support the uptake of knowledge transfer activities and benchmarking.
- 34. Continue where appropriate, to support farmers with technical tools, skills development and advice to deliver on technical KPIs.
- 35. DairyCo/AHDB has an important role to play in communicating to consumers the value and meaning of the Red Tractor.
- 36. Continue to provide technical support and relevant market information to farmers and farmer collaborative groups, in their discussions and negotiations with milk buyers.
- 37. As part of a whole chain promotional strategy, DairyCo should continue to promote and manage the image of dairy farming, to maintain the reputation and standing of the industry in the eye of the public, which will support confidence in milk and dairy products.

DairyUK/Dairy Council

- 38. Through DairyUK and the Dairy Council, the processing sector has an important responsibility to promote the image of dairy and dairy products to consumers and society.
- 39. Work with processor members to develop and roll-out of the Dairy Industry Code of Best Practice for Contractual Relations.
- 40. The Dairy Council has a vital role to play in communicating the health benefits and dispelling negative myths about dairy products.
- 41. Dairy UK now has an opportunity to develop precompetitive strategies for the promotion of British cheese and more generally export growth and import displacement by British dairy products. These strategies must be based on value creation and equitable supply chain relationships.
- 42. As part of a whole chain promotional strategy, DairyUK/Dairy Council should cohesively continue to promote and manage the image of processed dairy products, to maintain the reputation and standing of the industry in the eye of the public.
- 43. As part of a whole chain promotional strategy, DairyUK/Dairy Council should continue to promote the quality and nutritional value of processed dairy products.

Defra

- 44. Defra and ministers should bring together the relevant key stakeholders and decision makers within the industry to bring this strategy to life.
- 45. Red tape remains an impediment to growth and investment, it is important that Defra move forward with implementation of the Macdonald review recommendations
- 46. Defra must continue to press for equitable contractual relationships for all dairy farmers, through support of Dairy Industry Code of Best Practice for Contractual Relations and the establishment/ strengthening of producer collaboration.
- 47. Defra has a vital role to play in championing the dairy sector within government and in its communications with the press, public and other stakeholders.
- 48. The industry needs Defra's continued support, for a co-ordinated British dairy and food strategy and messaging to increase exports and displace import, in order to reduce the dairy trade deficit.
- 49. Defra must fight for a CAP settlement that creates a fair and level playing field in Europe.
- 50. Defra must deliver on its bTB eradication strategy.

“ The British dairy industry has a number of opportunities, but the key to all of them is trust and collaboration in the supply chain and production and processing to the highest standards of efficiency, innovation and quality. ”

The case for growth - demand

It is widely accepted that the global population will grow to reach 9 billion people by 2050. There is clearly a challenge ahead for agriculture to feed these extra mouths, against the challenges of climate change and tightening natural resource constraints.

The following chapter sets out the projected trends in demand growth and the opportunities for growth this represents for the British dairy industry.

Domestic demand

Global food demand growth will also be reflected in domestic demand growth, the combination of increased demand for dairy products domestically, with the potential to displace imports with home produced dairy products presents a significant opportunity for British dairying.

The following charts plot the current and projected domestic consumption, production and self sufficiency of key dairy product categories in the UK. Liquid milk is assumed 100% self-sufficiency today, so no account of production relative to consumption is made. For each category, a calculation of farm-gate output requirements has been made if the industry were achieving 100% self-sufficiency. This assumes a neutral trade balance, where exports equal imports, rather than as a consequence of market protection/isolation.

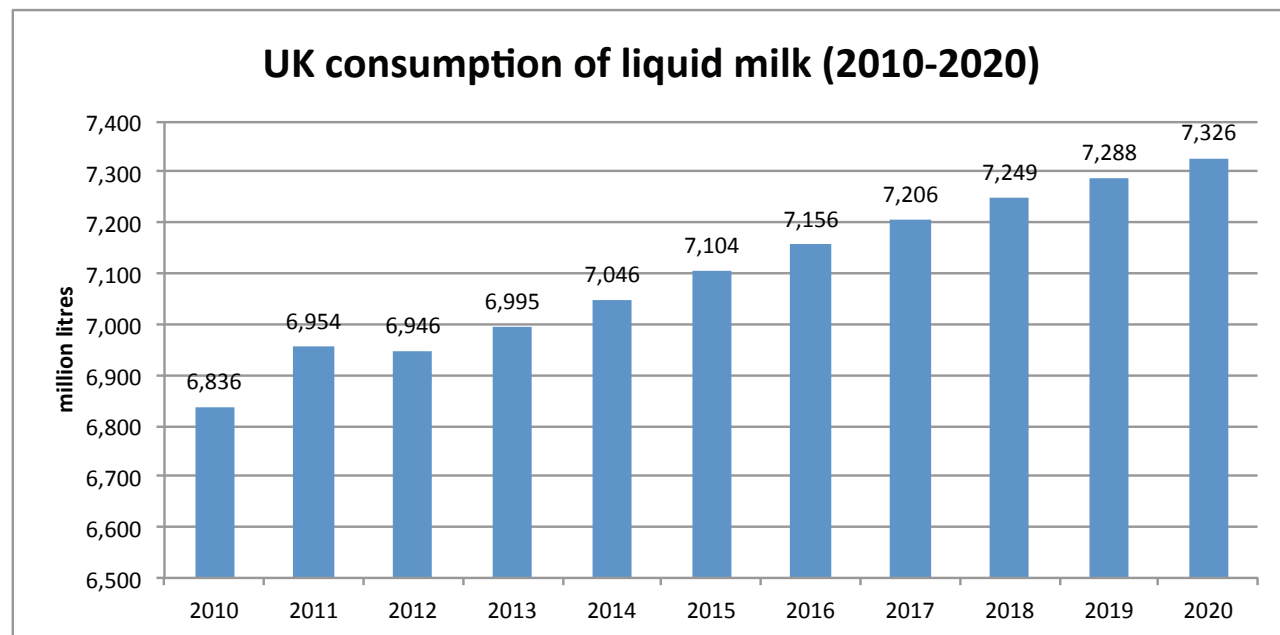


Chart 1 – domestic consumption of liquid Milk (source Defra and DairyCo)

The milk, cream and flavoured milk market is expected to grow, in value terms, by 9% from 2010-15 to a total of £4.3bn in 2015. In volume terms, the market is forecast to grow by 4.6% over 2010-15, to a total of 5.4bn litres in 2015.

Performance will continue to be driven by the fortunes of the fresh liquid milk, the largest market segment. Volume sales of fresh liquid milk are expected to grow by 3.9% from 2010-15, to a total of 5.1bn litres while value sales are expected to grow by 6.5% over the same period to a total of £3.7bn in 2015. Volume growth for cream is expected to grow by 10.8% between 2010 and 2015 to a total of 103m litres in 2015. Value growth is forecast at 24.3% over the same period, to a total of £373 million in 2015.

Volume growth forecasts for flavoured milk also look favourable (22% increase between 2010 and 2015), although starting from much lower base than fresh liquid milk. By 2015, the volume market is expected to reach 140m litres in 2015. In value terms, the market is expected to grow by 33.5%, totalling £235m in 2015.

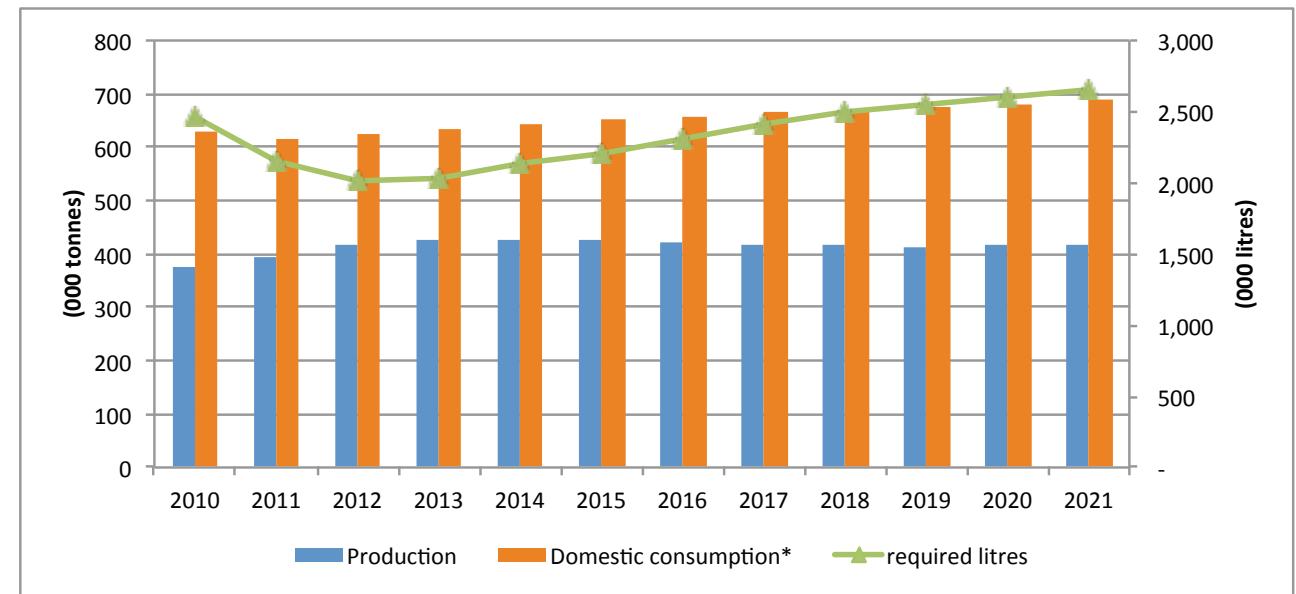


Chart 2 – domestic production and consumption and self sufficiency of cheese, 2010-2021, millions of tonnes (source Defra and DairyCo)



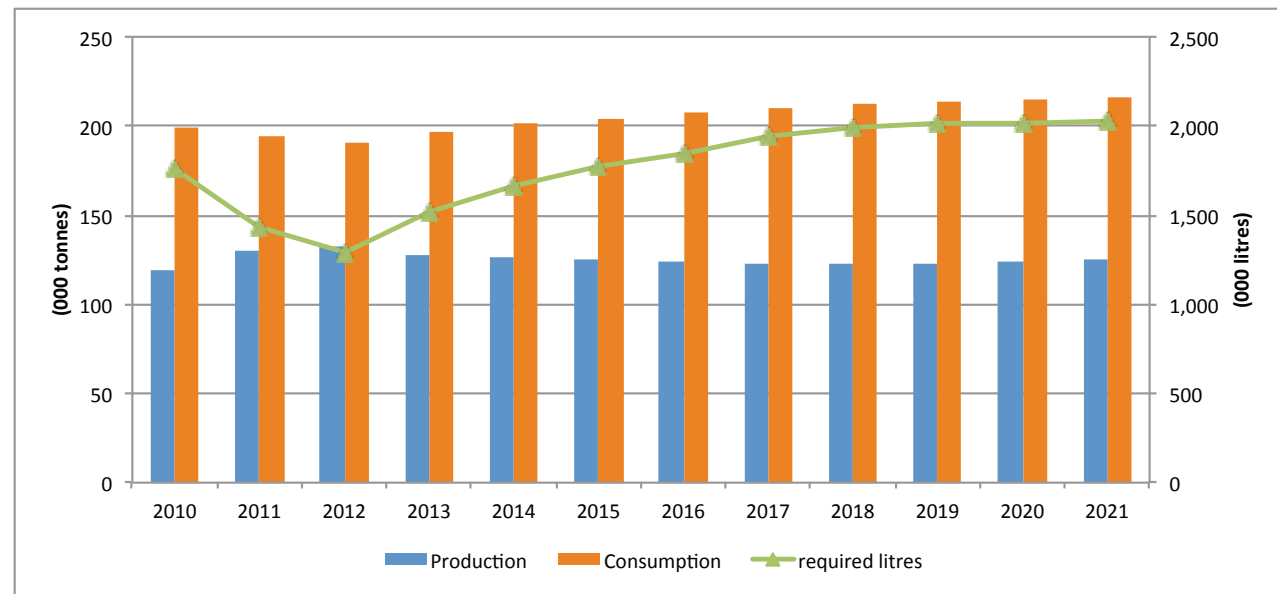
Cheese has a wide demographic appeal with over 95% of adults regularly consuming cheese. The cheese market is expected to grow, in value terms, by 29% over 2011-16, to a total of £3.07bn in 2016. This will partly be fuelled by price inflation and volume growth of 19% over 2011-16, to a total of 415,000 tonnes in 2016.

Certain demographic changes to the UK population will present opportunities for cheese manufacturers and the cheese supply chain. The rise in the high usage 25-34 age group will boost future consumer demand.

The cheese category has been heavily promoted (discounting, volume deals etc) in the UK over the past five years. While promotion is likely to form part of a strategy to increase consumption and displace imports, it is arguably unsustainable and cheese prices will inevitably increase in the future. In order to prevent a curb in future demand, cheese manufacturers must concentrate on product quality, efficiency and new product development and innovation to ensure the evolving demographic patterns are catered for with the right product mix. For instance products packaged and branded to capitalise on the projected growth in the number of 5-9 year olds and their lunchbox occasions.

It should also be recognised that significant opportunities still exist to build value into cheese supply chains by effectively processing and marketing whey. While businesses have already done a great deal to develop this market place, it remains an untapped opportunity.

Total self-sufficiency (balanced trade) in cheese in the UK would result in a liquid milk equivalent requirement of 2.2bn litres by 2015 or 2.6bn litres by 2020 of milk at farm gate.



The butter spreads and edible oils market, as a whole, is expected to grow in value by 28% over 2011-16, to a total of £2bn in 2016. Opportunities for import displacement as a result of recent strategic investments by some major dairy companies and the diversion of British cream into popular branded products are also significant.

Total self-sufficiency in butter in the UK would result in a liquid milk equivalent requirement of 1.7bn litres by 2015 and 2bn litres by 2020 of milk at farm gate.

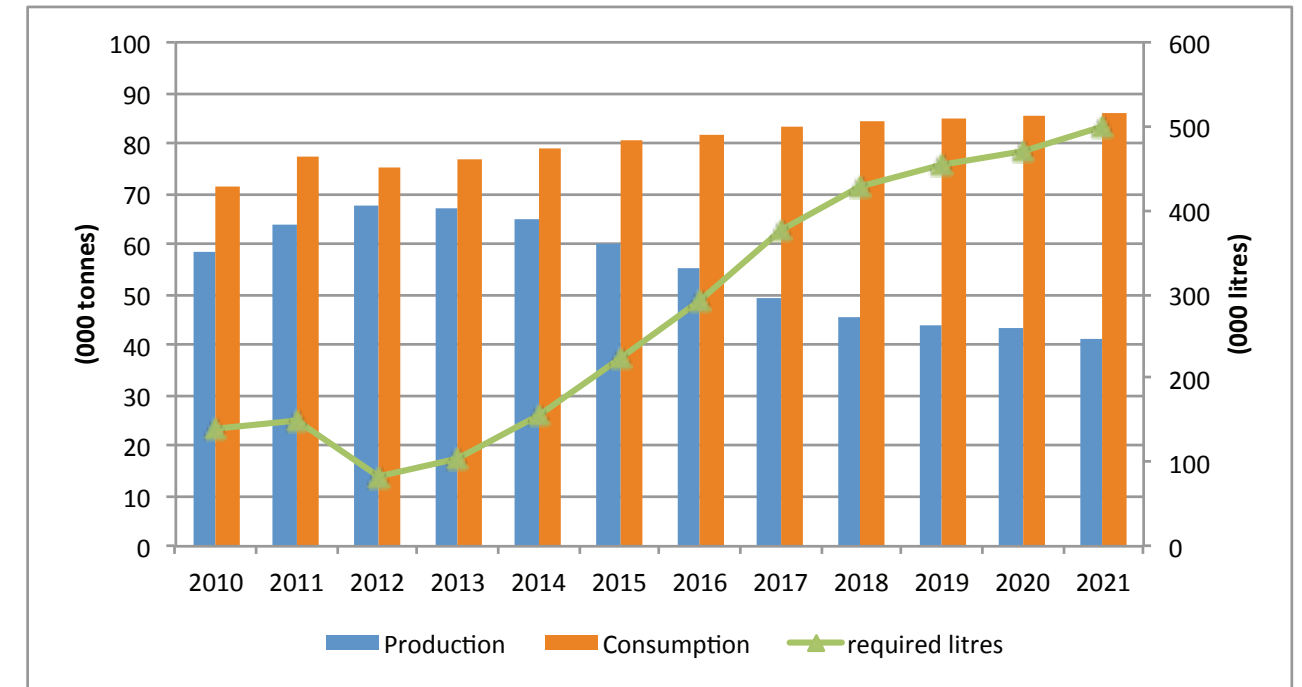


Chart 4 - UK consumption, production and self sufficiency of skimmed milk powder, 2010-2021, millions of tonnes (source Defra and DairyCo)



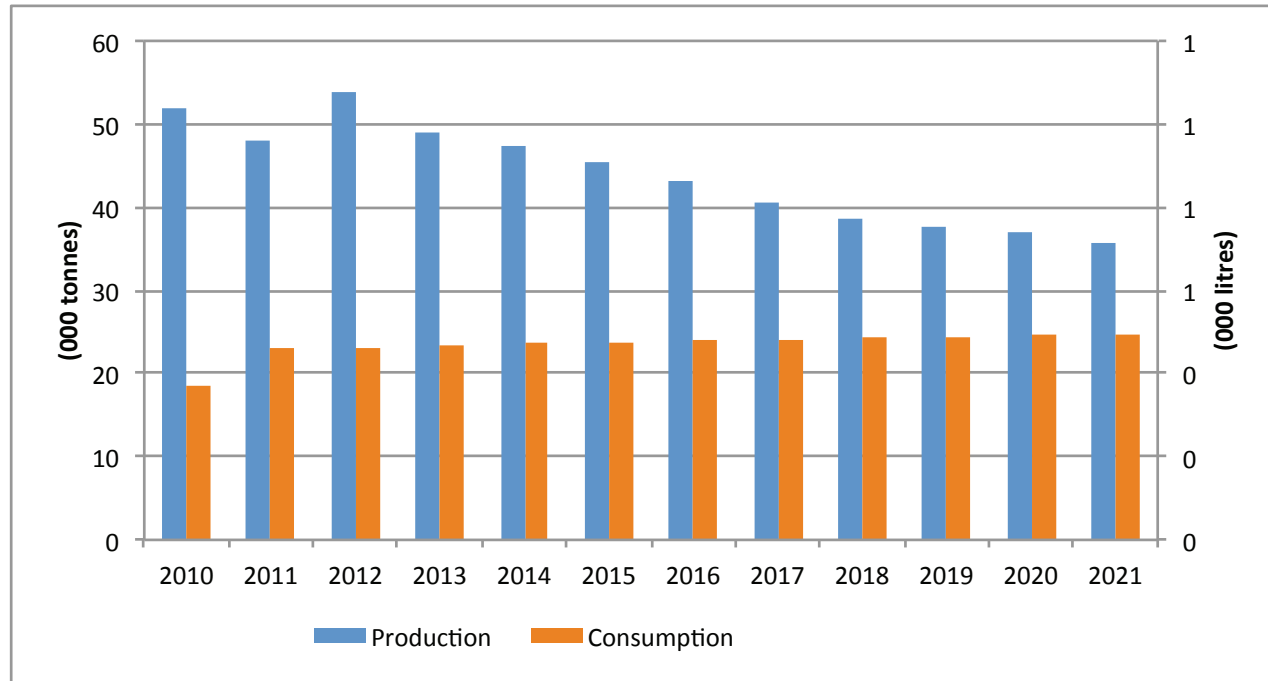


Chart 5 - UK consumption, production and self sufficiency of whole milk powder, 2010-2021, millions of tonnes (source Defra and DairyCo)

Projections show increased consumption of milk powders until 2020, yet decreasing production and consequently self-sufficiency. Market volatility will inhibit significant extra investment in milk powder production, however milk drying will remain an important tool in a volatile market, allowing UK processors, specifically farmer owned processors, manufacture exportable surpluses to maintain tension in the domestic market.

100% self-sufficiency in milk powders in the UK would result in a liquid milk equivalent requirement of 0.25bn litres by 2015 and 0.5bn litres by 2020 of milk at farm gate.

Yogurts/desserts



Much has been said recently about the 'dessert deficit' and the opportunities that exist for UK processor to displace imports of yoghurts and develop domestic brands or new products. Approximately 40% of yogurts consumed in the UK is made with French or European milk. The total UK yoghurt consumption is in the region of 740k tonnes, of this 444k tonnes if produced in the UK and 296k tonnes imported.

As significant opportunity exists for British milk processors to reduce this deficit, through the development of strong brands and more importantly innovative robust products, that have both domestic and export potential.

Global demand

The government's Foresight report, The Future of Food and Farming predicted a substantial increased demand for food globally between now and 2050. This growth in demand and the pressure on food supply chains presents an opportunity for food producers. The Foresight report said...



The global food system will experience an unprecedented confluence of pressures over the next 40 years. On the demand side, global population size will increase from nearly 7bn today to 8bn by 2030, and probably to over nine billion by 2050; many people are likely to be wealthier, creating demand for a more varied, high-quality diet requiring additional resources to produce. On the production side, competition for land, water and energy will intensify, while the effects of climate change will become increasingly apparent. The need to reduce greenhouse gas emissions and adapt to a changing climate will become imperative. Over this period globalisation will continue, exposing the food system to novel economic and political pressures.



With global populations set to rise from 7bn today, to 8bn by 2030 and 9bn by 2050, opportunities for food producers to respond to this growing market place are considerable.

In the FAO outlook report, World Agriculture toward 2015/2030, the FAO has analysed global dairy trends as far as 2030. Their analysis says that as incomes rise, people generally prefer to spend a higher share of their food budget on animal protein, so meat and dairy consumption tends to grow faster than that of food crops. As a result, the past three decades have seen buoyant growth in the consumption of livestock products, especially in newly industrialising countries.

In developing countries, demand for milk and dairy products is expected to rise from 20m tonnes a year in 1997-99 to 39m tonnes a year in 2030. Milk and dairy consumption in developing countries has risen from 28kg per person per year in 1964-66 to 45kg in 1997-99, and could rise to 66kg per person per year by 2030. In contrast, milk and dairy consumption in developed countries is expected to rise from 212kg per person per year 1997-99, to 221kg per person per year by 2030.

Defra's own in-house OECD Aglink model provides global commodity analysis up to 2020. The model includes consumption trends for butter, cheese and skimmed milk powder.

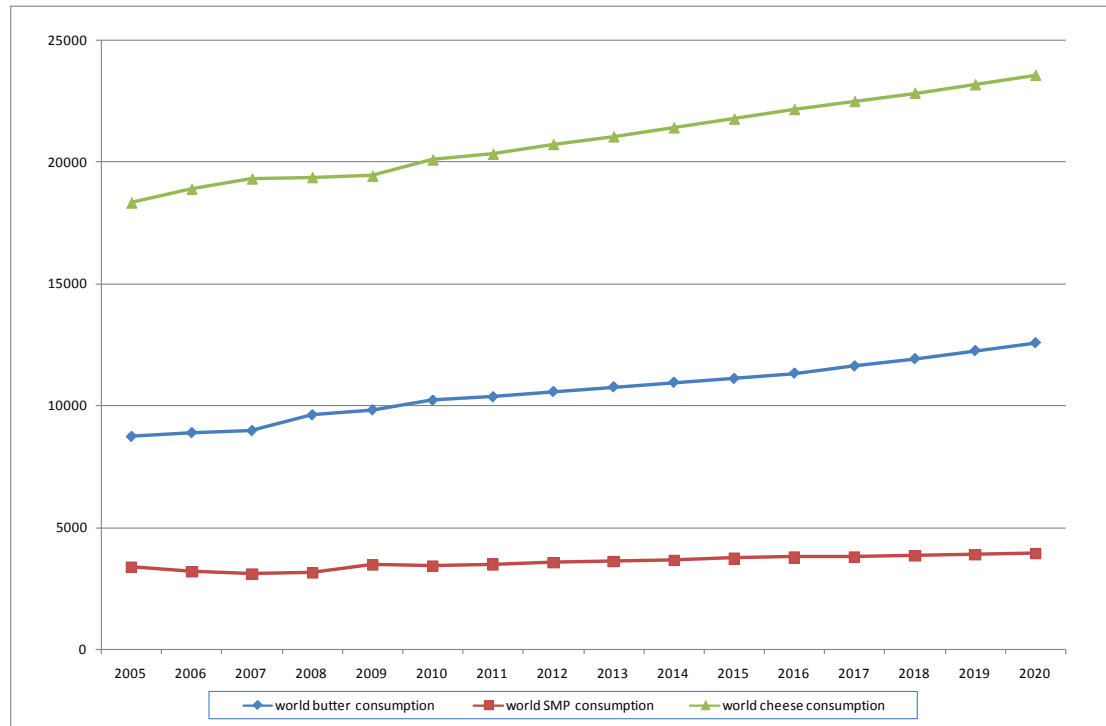


Chart 6 - Aglink, world consumption in butter and cheese, and skimmed milk powder (source Defra and DairyCo).

Key conclusions

DairyCo's Export Opportunities for the UK Dairy Industry report October 2012, suggested that while significant opportunities for exporting British dairy products exist, accessing developing markets is a slow process and key dairy exporters such as New Zealand already have a head start on the UK. DairyCo recommends a balance strategy to displace imports, access nearer export markets and where possible accessing developing markets further afield.

Clearly global dairy industry will respond to this projected increase in demand for dairy products. Even if the British dairy industry chooses to not respond to demand growth and continues to focus on the proportion of the domestic market it will not be unaffected by the growth in demand globally. National dairy industries that do respond to the growth in demand, by growing their output, will enjoy improved efficiencies of scale in investment, innovation and efficiency. As the global benchmark moves forward, it will become harder and harder for the British industry to defend even a static position.

The British dairy industry can and must be part of the global response to demand growth. However for the British dairy industry to trade and compete globally, it must become and remain globally competitive. To be competitive, the whole supply chain needs to invest in continual improvements to efficiency and productivity.

To maintain and grow its domestic and export market share, the British dairy sector must have a clear and compelling point of difference. The Red Tractor mark of product and process assurance is well-established, robust and respected in the domestic market place but the industry needs to develop its international offer / image. The British dairy industry must work collectively to ensure the standards remain relevant, by giving the consumer and businesses in the supply chain the assurances that they need. Today's consumer seeks assurances about food safety, animal welfare and environmental responsibility.

In the domestic market the Red Tractor came under attack when the retailer J Sainsbury's took the decision to remove the logo from packs of food in 2012. While bitterly disappointing for farmers, who invest in the standards behind the logo, the decision not to use the logo is a reminder of the need to engage with consumers on the need, importance and value of what the logo stands for. A specific recommendation is for the supply chain to agree a strategy to promote the meaning and value of farm assurance to the consumer.

The recent phenomenon of infant formula milk being bought in British retailers to send to consumers in China, at great effort and expense, highlights the lack of faith in supply chain assurance and standards in developing markets. This presents a clear and exciting opportunity for British dairy products. The British dairy processing sector, could work together in a co-ordinated and precompetitive manner to promote the British dairy industry in exports markets, by promoting the assurance standards adhered to by the British dairy industry.

For the Red Tractor to be a robust platform upon which to promote the British dairy industry, it must remain relevant. Farmer, processors and retailers must continue to work constructively to adapt the standards to meet the concerns of the modern consumer. In the UK, business to business and business to consumer assurance is a part of life, consumers assume schemes like the Corgi registration of gas engineers, will be complied with, likewise they assume farmers and food processors are complying with modern relevant industry standards. The scheme must streamline, by stripping out redundant requirements, to reflect modern dairy farming practice, while at the same time it must adapt to provide evidence based assurances to the modern consumer, for instance in relation to animal welfare.



The capacity to increase output

The Green Food Project seeks to answer the question; can the domestic food industry increase its output while reducing its impact on the environment? In July 2012 Defra published the dairy sub-group report of the Green Food project. This report included analysis of the DairyCo Milkbench+ benchmarking data. This analysis highlighted a range in efficiency (as measured by net margin p/l) of farms within the three categories, cows at grass, composite and high-output cows. MilkBench+ data suggests that neither system of production nor scale (within certain parameters) were a barrier to efficiency and profitability. However, the range in efficiency does present a significant opportunity of the British dairy industry to increase output. Where farmers can invest to utilise best and latest management practices, significant improvement to productivity is possible.

DairyCo's MilkBench+ data suggests that bringing the efficiency of the bottom quarter up to the average would result in a 7% increase in milk production, furthermore by bringing the efficiency of all the sample farms to that of the top quarter of performers would result in a 35% increase in milk production. Specific technical recommendations for archiving this included, optimising the utilisation of grass and forage; herd health, genetics and fertility management; optimized diet and cow environment. The NFU believes that for farmers to unlock these technical improvements, sufficient money to invest at farm level and continued and enhanced industry investment in R&D and knowledge transfer are essential.

As well as efficiency potential, increased output could be achieved as a result of direct investment in productive capital and infrastructure (cows, land etc) and by increasing inputs for yield, provided that market signals support such investment by farmers.



Creating the environment in which farmers can excel

As previously set out in this document, there is great potential for increased output from the British dairy sector. By giving the right people the opportunities to efficiently utilise inputs and resources, it is possible for British dairy farming to produce more, while impacting less. Benchmarking should inform businesses and individuals where their strengths and weaknesses lie and be used for targeted investment, utilisation of outside expertise or restructure.

Through our survey and consultation of farmers, a common theme was the inability to invest in efficient, productive infrastructure. Following over a decade of low milk prices that failed to fully cover typical costs of production, many farmers have been unable to make necessary investment in the infrastructure of their farms. This failure to invest depreciation is clearly unsustainable, particularly in the context of this strategy that highlights the need for farmers to maximise their productive potential.

According to Kite Consulting's analysis of customer farm business data, there is a clear correlation between investment in capital infrastructure and efficiency gains. To stand still a farm business needs to invest a minimum of 2ppl, to factor sustainable growth or business development, this rises to 3ppl, whereas when a business can on average invest 4ppl, improvements in efficiency and output can be observed. When farmers find it impossible to make the minimum levels of investment, then this expenditure is merely put off, until major investment is forced upon the business or the business ceases trading. It is vital that the whole supply chain recognises the need for continual and sufficient investment at farm level, in order that production can be maintained, increased and made more efficient. We suggest that investment at farm level of at least 3.5ppl should be allowed for.

The analysis of Milkbench+ carried as part of the Green Food dairy sub-group report, identified a series of fundamental performance indicators, that if managed correctly, resulted typically in higher levels of efficiency and output. A clear and common understanding within the industry of the technical, key performance indicators for dairy farming efficiency should be established and clearly communicated. Consultants, service providers, technicians and nutritional/herd health input providers should focus on delivery against these common KPIs. Too often farmers are overloaded with technical and scientific advice and product information, from different sources, which is often not coordinated or complimentary.

The skills and ability of dairy farmers, is clearly an important element when considering technical efficiency. Skills development and recognition were identified as important tools to unlocking improvements to the efficiency of the sector. This applies equally to all stages of the supply chain and is a guiding principle number 4 of Dairy2020. Farmers should make full use of DairyPro the skills recognition database, provided by DairyCo, for staff and their own skills and training recognition. Continual professional development and an investment in skills should be central to dairy farmers' business strategies.

Another important aspect when considering skills is a business, legislative/fiscal and capital landscape that allows for succession. Failure to create the right business and employment opportunities for the most skilful and driven dairy farmers and farm workers, would risk

losing the people who are most able to achieve profitable growth. Succession mechanisms are potentially important to business growth, new entrants and the retention of capital infrastructure in the industry in the event of retirement or diversification from milk production. Dairy farming can be broken down into three core business activities; breeding, heifer rearing and dry cow management to bring quality cows to the point of production; feeding, the production of high quality, nutritious feeds and forages; and milking, the process of combining the former elements by managing a milking herd's health, welfare and harvesting milk. Dairying across multiple farms, by splitting down the farming system, can enable phased expansion and contraction, can be tax effective and opens up options to individuals. The key to such arrangements is getting the right people doing the right job.

There are many forms of succession planning, which allow capital to be maintained as valuable productive infrastructure. Succession can be within families and partnerships or with third parties, but all rely on trust, communication and planning. For instance, near retirement dairy farmers with no family or other succession plans, provide a huge opportunity to new entrants or expanding producers. There can be great benefits for both parties, such as tax relief, continued legacy and the transfer of skills and knowledge.

Effective succession planning opens up new opportunities to both those looking to expand or establish a business, as well as for those looking to scale back or exit the industry. It will be important for sustaining the scale and investment already in the industry and for encouraging new entrants and investment for the future.

British processor strategies

The NFU consulted with a number of the UK's processors via an interview process, in broader discussions and assimilated information from public statements.

Almost without exception, processors we consulted believed that the growing global market place presented an opportunity for their business and for the wider British dairy industry. It was also acknowledged by all processors that the growth of the global dairy industry represented a threat to the British industry if it failed to respond.

All processors we met highlighted that the foundation for growth in output at farm level had to be profitability. What's more they identified the range in efficiency at farm level as a priority target area for policy makers and for the farmers themselves.

A number of processors stated that value creation in the supply chain, came as a result of longer term and trusting relationships. Many acknowledged that supply chain trust had been damaged over the past 10 years, but that the Dairy Industry Code of Best Practice for Contractual Relations, was a good foundation upon which to build more trusting relationships between farmers and processors.

When asked about their respective approach to growing their respective share of the domestic or export markets, so as to effect a reduction of the trade deficit, responses fell into two camps. The first camp were the processors whose focus was clearly still service of UK retailers and major food service companies. Among these businesses, for some, competition

with other UK processors was their first consideration, but all acknowledged the need to compete against existing or future imports. For these businesses, strategy centred on brand development. They felt that establishing UK consumer loyalty for specific speciality, British and/or branded products were important tools in displacing imports.

A distinguishing factor between farmer-owned co-operative businesses and privately owned dairy companies was their view of the role of commodity markets. For farmer-owned co-operatives, whose KPI will always be the performance of the combined milk price and members dividend, commodity markets remain an important tool to manage volatility and through exportable surpluses, to maintain tension in the market. Among privately-owned dairy companies, while there was clear recognition of the need to pay a sustainable milk price, their preference was to add value, for instance through brands, maintain a return on capital invested and where possible to pay a competitive milk price.

All milk processors highlighted the importance of the farmer and the farm in adding value to dairy products and building brands. The most influence on environmental and welfare sustainability and the management of milk quality and constituents were achieved on the farm; this was noted as an important factor in continued process efficiency.

Processors noted the important role of the Red Tractor in maintaining loyalty for British dairy products domestically, but also the future importance of the scheme in displacing imports of dairy products. Again the role of the farmer in making the Red Tractor a robust marketing tool was noted by most, however the need for a co-ordinated whole chain strategy to communicate the scheme to the consumer was widely acknowledged.

Overall summary conclusions

It is clear that the confluence of global population growth, improved affluence in developing parts of the world and climate change will all put pressure on food supply chains. This pressure is an opportunity for food producers. The dairy industries of some countries have responded to this challenge already, with ambitious strategies for growth and export promotion. The Irish farming industry, through a whole supply chain initiative and with the support of its government, have predicted that the Irish dairy industry will increase output by 50% by 2030. They plan to achieve this through improvements to efficiency, allocating more resources to dairy production and as a consequence of a cohesive strategy. While the absolute outcome of these predictions is unknown, the process setting out what possible, if all in the supply chain do their part, is positive.

Looking at demand growth predictions by Defra and DairyCo domestically achieving 100% self sufficiency as a result of import displacement and increased export, the UK market could utilise increases in farm level production of between 4 and 5bn litres of milk by 2020.

From a supply perspective, analysis of on farm performance data, DairyCo's Milkbench+, suggests that an extra 3.9bn litres of milk could be produced by British farmers with sufficient investment and subsequent improvements to efficiency. With the right market signals and a milk price consistently capable of returning an investors margin to dairy farming businesses, the NFU believe that British farmers would have the confidence to allocate new resources and



where necessary scale up production to achieve this significant growth potential.

Clearly farmers will not invest at farm level if the milk processing sector is not engaged in a similar investment programme for expansion. At the time of publishing this report significant developments are underway in the British processing sector. Without mentioning specific companies, positive activities include...

- Investment is globally competitive liquid milk processing infrastructure.
- Investment in new butter manufacturing capacity.
- Investment in infrastructural improvements to cheese supply chains/cutting/ maturation facilities.
- Investment in promotion and development of already strong performing brands, capable of adding and retaining value.
- Establishing product flows (via specific milk supply contract for farmers) of dairy commodities onto export markets.
- Developing positions in new and emerging market segments, with high value added potential for dairy, such as sports nutrition and low fat dairy.

In addition to this non exhaustive list of strategic activities, milk buyers are now competing aggressively with each other for supplies of milk, to reflect the scarcity value that increased demand is creating.

The combination of processor consolidation and business expansion mean that farmers are doing business with increasingly large and in some cases globalised dairy processing businesses. It is therefore vital that farmers' interface with the market, provides the best possible bargaining position. This strategy therefore recommends that British dairy farmers should consider collaboration for their interface with the market place. This might be via membership of a processor co-operative, via a marketing or negotiating producer organisation or via a producer representative body within a milk buyer/processor. In the coming months and years, as the industry evolves, important contractual discussions are set to take place, as the market evolves post quota restrictions. It is important that farmers have the most professional representation in these discussions. For instance, we predict that some milk supply contracts will be used as mechanisms to manage volume supplies of milk into processors, post quotas in 2015. This is even more likely if the UK industry starts to increase output in the coming years. Farmers should be in a position to collectively engage appropriate professional representation for discussions with their respective milk buyer.

Lessons that can be learned from the summer of 2012, #SOSdairy and also the horsemeat scandal that affected the beef industry; is the value of long-term, short-chain relationships. Via such arrangements, equitable distributions of margin can be managed, supply chain standards can be maintained and the trust of the consumer upheld. The dairy industry has an opportunity to develop such arrangements in the future as a means of encouraging growth and development of the sector.

The British dairy industry has a number of opportunities, but the key to all of them is trust and collaboration in the supply chain and production and processing to the highest standards of efficiency, innovation and quality.

Dairy 2020 Vision

Vision: A vibrant UK dairy industry, that enables people, environment and business to thrive.

Dairy 2020 Guiding Principles

1. Looking outward

Proactively engaging with all key stakeholders as a leading member of the global food industry. Regularly monitoring and evaluating the performance of the UK dairy sector within a national and global context.

2. Innovating and investing

Actively investing in technology, science and business models which deliver superior nutrition, improved environmental outcomes and long-term economic value. Fostering a dynamic, entrepreneurial culture for competitiveness on a global and local scale.

3. Working together

Co-operating actively and transparently across the supply chain to build trust and add value.

4. Building skills and attracting talent

Working to ensure staff wellbeing and a culture of continuous learning and development.

5. Engaging consumers

Communicating transparently, listening actively, and systematically involving consumers in key debates, particularly on nutrition.

6. Minimising environmental impact

Achieving commercial success while striving to minimise negative environmental impact.

7. Stewarding nature

Working to protect and enhance ecosystems, improving elements such as biodiversity, water, soil fertility and nutrient availability.

8. Improving animal welfare

Improving standards and safeguarding the health and welfare of the dairy cow.

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