POLICY BRIEF

September 2018

Milk price volatility and dairy contracts in Somerset

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Somerset has a strong tradition of agriculture, especially in dairy and livestock farming. The total number of agricultural holdings in Somerset in 2007 exceeded 9000 units, of which about 30% were small farms with less than 50 hectares, and more than 50% were very small farms below 5 hectares. Dairy farms are quite numerous in the area, accounting for about 12% of Somerset's farms. In short, herd size numbers in the county have increased but essentially the county retains a profile of mostly family run dairy farms. Somerset is also home to a number of large processors and high-quality dairy industries, including Dairy Crest, Müller Wiseman Dairies, Wykes, Barber's, and Yeo Valley Organic, making it a good location to study dairy contracts and relations.

This brief has been developed from research conducted as part of the H2020-funded project, Sufisa. Its main focus has been to access the perspectives of the dairy farmers themselves, together with a range of stakeholders, including dairy processors and farmer cooperatives, that have a direct interest in the dairy sector in Somerset. To that end, a series of interviews, focus groups and workshops were conducted between March 2016 and May 2018. Further details are available from http://www.ccri.ac.uk/ and http://www.sufisa.eu/.

This research is based on work done in Somerset, but is likely to resonate in other agricultural areas of the UK. It comes at a crucial time for the sector, given the ongoing Brexit negotiations and the ongoing role of the *Dairy Industry Voluntary Code of Best Practice on Contractual Relationships*, which was introduced in 2012 to improve equity of contractual relationships. The following key messages are intended to draw attention to the issues that have arisen from the research and which have potential policy implications for the dairy sector.

Key messages

- Milk price volatility was a key characteristic of the dairy industry. Price volatility was intensifying, resulting in more dramatic highs and lows in farm-gate milk prices. As a dairy farmer, low milk price relative to the cost of production is a key concern. Issues of global oversupply and undersupply were thought to be the key causes of volatility. As a result, there is a pressing need for those in the industry to be more sensitive to the market, in order to maintain a stable price.

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SUFISA

This policy brief is the result of research conducted as part of the EC-funded SUFISA project (Sustainable finance for sustainable agriculture and fisheries), H2020 Grant Agreement 635577. Responsibility for the information and views set out in this report lies entirely with the authors.

- The research identified a number of different supply chain arrangements and strategies for selling milk in an effort to help manage market volatility. They are summarised as follows:

    1. Collective organisational sales
        (i) Co-operatives (e.g. Arla, OMSCo, First Milk)
        (ii) DPO (Dairy Crest Direct)
    2. Individual sales
        (i) Supermarket aligned contracts (10% of sales)
        (ii) Direct to processor/milk buyer (e.g. Muller non-aligned, Crediton Dairies, Barber's, Wykes)
        (iii) Informal arrangements (direct to the consumer)

- Within these different arrangements we identified a range of contractual stipulations and pricing mechanisms. These included 'cost of production plus' (notably supermarket-aligned contracts), 'A and B pricing' and 'formulaic or basket pricing'. The last two examples are the main pricing mechanisms used in the sector and the main difference between them is the quantities that can be supplied. There is significant debate in the industry as to which contracts are best, with some arguing that those allowing unlimited quantities are a key cause of oversupply. A and B pricing (where a core price is offered for a pre-agreed quantity and a market realisation price is offered for any additional volumes) as seen by some industry stakeholders as a key mechanism for managing supply in increasingly volatile market conditions, but this was not a view always shared by surveyed farmer organisations.

- Dairy Producer Organisations (DPOs) are a mechanism that have the potential to increase farmer bargaining power and ability to negotiate milk prices. There is currently only one DPO in the UK. The *actual* power of a DPO to drive price negotiations with the processor was felt to be limited. There were also concerns about the difficulty of the process associated with legally becoming a DPO, with groups in some cases operating in less formalised pools instead of applying for DPO status.

- The research also highlighted concerns about succession and recruitment into the industry. The opportunity for young people without familial connections to the industry to enter the industry remains limited. There is a need for innovative start up initiatives – such as share farming schemes – to make the industry more accessible to new entrants.

- Brexit represented a divisive topic. Although the research captured a variety of views on Brexit, it has in the interim caused *great uncertainty* amongst the industry. This research has demonstrated the need for nuanced post-Brexit policy decision-making that takes into account the potentially differentiated impacts of a changing policy context on dairy farmers and their different supply chain arrangements.

Brexit has caused *significant* uncertainty throughout the industry

Key concerns include:
(1) Trade and a trade deal
(2) Availability of labour
(3) Availability of subsidies and competitiveness

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