

# A Executive Summary

The UK dairy industry is moving from a politically controlled industry with substantial levels of market support, to one that operates in a much freer market with much less market support. Present contracts provided by milk buyers often lead to farmers not meeting market needs, and producing the wrong type of milk, in the wrong place and at the wrong time. This reduces profits for everyone, particularly farmers. If these poor market signals continue in a freer market the UK may find itself losing ground to competitors.

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- Contracts which do not pay farmers on the basis of what the customer wants/needs or on the basis that the customer buys the milk. Often contracts reflect the pooling of overall milk sales rather than specific market needs
- Prices which are set by looking at unimportant or varying market indicators (lack of transparency)
- Contracts which incentivise level supply by more or less than the value of that level supply to customers
- Farmers who compound these problems by not maximising the price they get from contracts
- Milk Prices which can be changed at short notice or retrospectively without the option of the farmer ceasing to supply that customer

Many of the problems of poor market signals could be solved by renegotiating raw milk contracts and this report suggests that contracts should become more differentiated, focusing on the needs of different markets and customers.

MDC is not trying to establish how contracts should be agreed as that is a matter for commercial negotiations between milk producers and buyers. However, MDC suggests the following principles should be considered by milk buyers and farmers, and whether implementation of them in their own contracts might result in a more efficient and profitable outlook for both farmers and processors.

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- Clear Pricing - Contracts should set prices for known periods with options to quit the contract at any price change or have a transparent system for setting prices
- Known Volumes - Monthly milk volumes should be contracted in cases where volumes are critically important
- Accuracy - All contracts should be accurate and pay the true value for what a buyer wants
- Differentiation - Contracts should be different for milk going to different customers, factories/products, etc.
- Appropriate - Inappropriate contracts should not be offered to farmers
- Partnership<sup>1</sup> - There should be partnership between farmers and milk buyers and joint negotiations with the eventual customer wherever possible
- Realism - Negotiations of contracts should be done on a rational, realistic basis by both sides using accurate and relevant information to set base prices.
- Reward - Risk and reward must be allocated appropriately within a contract

<sup>1</sup> Wherever this report refers to partnership it does not mean partnership in the legal sense but in the sense of a constructive relationship of many different forms and types focused on mutual benefit.

There are several difficulties with these principles, notably around flexibility of milk supplies, shared transport and contracted volumes. Contracts using these principles could in some cases restrict flexibility and could increase cost. However, increased costs are not important if that cost increases value and a higher price can be charged for the milk, increasing profit levels. It is up to commercial players to investigate each case and decide whether any additional cost is outweighed by any additional value created.

It is likely that in the future contracts will be far more important than quota, and that many of the least desirable features from a farmer's point of view (such as contractual milk volume) could be imposed anyway. This means that it is vital that milk buyers and farmers discuss raw milk contracts in the context of partnership based on mutual profitability and efficiency. Contracts should be clear, accurate and straight forward, in order that they provide the correct market signals and help the industry to be competitive in a freer market.