



Fewer processors could mean more profit for farmers?

A groundbreaking economic model that will improve understanding of the relationships in the liquid milk supply chain is launched today. Produced by economists at the University of Oxford, the project has been co-funded by the Milk Development Council (MDC) and the Department for Environment and Rural Affairs (Defra).

“The model explains how competitive forces influence buyer-seller relationships within the supply chain and clarifies where the bargaining power lies in price negotiations,” says Huw Thomas, head of market information at the MDC. “The insights it provides are powerful and in some cases they challenge the established wisdom in the dairy sector.”

It provides evidence that reducing the number of processors in the liquid milk market would result in an increased share of the profits being returned to processors to be shared between themselves and farmers. It also reveals such a change would not impact on retail prices, a point particularly pertinent for any proposed future mergers.

The model confirms that during the period examined, the supermarkets held the majority of the bargaining power in the supply chain. It explains that of the 15p margin on each litre of milk, only 5ppl was available for negotiation between processors and supermarkets. The economists found that supermarkets were able to secure 3.2ppl or about 64% of this 5ppl margin, nearly 90% of the total supply chain margin.

The model finds processors are the stronger partner in the negotiations that follow with the farmer-owned co-operatives or directly with farmers' groups. Their bargaining-power rests in their ability to source milk from either co-operatives or directly from farmers.

The model shows that farmers are in the weakest position, only able to secure 0.5ppl or about 3% of the total supply chain margin from liquid milk (as the industry was structured up to 2006).

The Oxford economists found that there is generally no evidence of uncompetitive behaviour by supermarkets and the supermarkets' ability to charge a margin of 33% on liquid milk can be explained by consumer shopping behaviour.

Mr Thomas added: "The findings demonstrate that the way the dairy market has worked in the past has meant dairy farmers had little bargaining power. Although the industry is moving forward significantly in many areas, such as the development of genuinely dedicated supply chains, this new economic model provides understanding that will help continue the development of a more efficient market place that should benefit all in the supply chain, particularly dairy farmers."

Mr Thomas concludes: "In my view the biggest contribution to making the supply chain more efficient would be the further development of milk supply contracts. The MDC and the NFU have for some years highlighted the shortcomings in milk contracts offered by processors to farmers. In particular, greater alignment of notice and price fixing periods would be beneficial."

The full report can be found <http://www.mdcdatum.org.uk>

Ends

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Notes for Editors:

The Milk Development Council (MDC) was set up in 1994 (after the disbanding of the milk boards) to pick up essential services for dairy farmers that would not otherwise be provided. These services include the genetic evaluation of dairy breeding stock, research and development into better ways of producing milk, and the stimulation and development of the market for milk.

The MDC is funded entirely by milk producers, via a statutory levy on all milk sold off-farm, at the rate of 0.06p per litre. This provides an annual income of around £7m.

The MDC's current focus is on improving the profitability of dairy farming by focusing on three specific areas:

- Innovation and consumer education to stimulate demand and create more value in the dairy 'category'
- Better supply chain relationships that ensure farmers as well as processors and retailers can enjoy a sustainable share of the profits
- Competitive milk production to help farmers realise better margins in the short term and increase their ability to compete in European markets in the long term.

The MDC co-funds the industry's nutritional and issues management resource – The Dairy Council – with the processors' trade body Dairy UK.