

# **Scottish Dairy Review: “Ambition 2025”**

## **Report & Recommendations**

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By 2025, Scotland will be a nation producing over 1.6 billion litres of milk a year. A 50% increase over 10-12 years will have resulted from a new, ambitious, market-driven growth agenda being grasped and driven on by both farmers and dairy companies, supported by their industry bodies, government and its agencies in Scotland.

Crucially, this growth will be the product of partnership, a pursuit of added value and a direct consequence of the development of markets.

The country will boast a foundation of profitable farm businesses, who have undertaken a step change in technical efficiency and a change in the culture of using professional advice. These farmers will be supplying their partners; confident, profitable, entrepreneurial dairy companies who have invested in growth and are committed to adding value in Scotland.

The nation’s reputation for quality dairy production and manufacturing will have been cemented and will have earned new customers at home and, particularly, overseas. A foundation of liquid milk supply to UK customers will be supplemented by increased import substitution of dairy products. However the game-changer will have been the development of new export markets which are now the destination for the majority of non-liquid, added value dairy products manufactured in Scotland.

This is “Ambition 2025”.

James Withers  
Chairman, Scottish Dairy Review  
August 2013

## **Introduction**

In November 2012, Richard Lochhead MSP, Cabinet Secretary for Rural Affairs and Environment, commissioned the Scottish Dairy Review (full remit and background here - <http://www.scotland.gov.uk/News/Releases/2012/11/dairy21112012>).

Over the last nine months, a wide consultation has been held with industry organisations and dairy companies, supplemented by an open consultation.

In addition, in-depth research was also conducted into markets for, structures in, and attitudes towards, the sector. This document outlines the main findings and key recommendations, with supporting research available as a supplement.

Thanks are due to many people who have supported this review. The list includes the organisations that led strands of research, the industry bodies that committed their time and energy to look constructively at complex issues and the many individuals connected to the industry that shared their personal insights and experience.

This report aspires to being a “call to arms” for the dairy sector in Scotland. There is no single answer in forging a sustainable future but this report identifies some key areas for focus.

It now requires a united approach from farmers and processors, industry bodies and government to drive on from here.

**A combination of factors presents the dairy industry in Scotland with the opportunity of a generation. The critical players in and around the industry must now come together in partnership to grasp it.**

## **Dairy farming in Scotland in 2013**

At the outset of this report, I was clear that I had no desire to analyse in great depth what had gone before. Whilst recognising many of the challenges that players through the dairy supply chain in Scotland have faced, the focus of the report was to identify ambition and opportunity.

Scotland is as well placed as any nation to forge a successful, profitable and sustainable dairy industry. All of the core ingredients of a successful industry are to be found within our shores.

Our most efficient farm businesses are Europe's most efficient. They have demonstrated both resilience and a willingness to invest. The diversity of both farm businesses and dairy companies is an attribute of the sector in this country.

Our climate is well-suited to grazing systems and dairy production and our natural, clean environment is an extraordinary asset. In addition, Scotland has a growing reputation for food and drink both at home and internationally and the whole industry is experiencing significant growth. Our 'provenance' story is an invaluable tool, perhaps the most important we have. Our story can be as strong and compelling as anywhere else in the world, but it must be told.

Global demand for premium, healthy products with strong provenance credentials is surging, particularly in dairy. This opportunity is recognised - and forms the foundation of - an established food and drink industry strategy, co-ordinated by Scotland Food & Drink and supported by the Scottish Government and all key food and drink stakeholders.

As an island nation, with strong demand for fresh, liquid milk, we have a ready market on our doorstep. However, the greatest future growth opportunities relate to non-liquid dairy products. The opportunities are at home through import substitution and overseas in terms of export development. There are significant opportunities to develop premium, added value products in a world that increasingly demands them.

All of this positions Scotland as a highly attractive inward investment proposition.

Whilst this report does not aspire to be a history lesson, it is important to understand why Scotland has not developed these new markets to date, whilst many of our international competitors have.

The strength of the liquid market in the UK remains an attribute and a secure market, albeit proportionately less important for Scotland than other parts of the UK. However, having such a significant market 'on our doorstep' has stifled innovation in a wider range of added value products.

There has been a lack of leadership in the sector in terms of economic growth and there is no unifying vision for the sector. In some ways, given the significant changes that have occurred in the dairy industry in recent years, this is not surprising. A significant feature has been the increase in international ownership of operations in Scotland, with companies such as Arla, Lactalis and Muller securing a significant foothold in Scotland's dairy scene. This has significant implications for the future of Scotland's dairy industry, with key strategic decisions by these companies which affect Scottish operations unlikely to be taken in this country. However, international ownership brings with it significant strengths.

Two of Scotland's strongest food and drink export sectors – Scotch whisky and salmon – have significant international ownership. However, a strong brand - built around premium, quality and provenance – has attracted strong support from parent companies willing to invest in commercial opportunities in this country. This model of ownership offers these opportunities for Scotland's dairy sector too if industry and government move quickly and collectively as partners to grasp them. A culture of support should surround all dairy companies with a stated commitment to invest in Scotland.

Levels of trust and collaboration between supply chain players are still not strong enough, albeit steps have been taken to strengthen this over the last 18 months. Indeed, a sign of this was the very welcome recognition from all parties in the review of the potential value in greater collaboration.

Whilst in many ways understandable, there is a disproportionate focus of debate on farmgate milk prices. This has distracted from the real drivers of on-farm profitability, exacerbated an atmosphere of negativity and clouded the important debate on long term market-building.

The Voluntary Code of Practice – in particular formula pricing - offers real opportunities for higher levels of transparency and the hope that pressure and focus on farmgate pricing will moderate. Improved communication and transparency is critical throughout the chain and this will contribute to improving arguably the most important factor at farm level; confidence.

All interviewees in the research phase of this review recognised the potential for value improvements in the operation of the chain through a more collaborative approach. However, no-one can leave the responsibility of finding extra value to others in the chain; everyone has a role.

These challenges are real, but surmountable. We are blessed in this country with a level of support for the food and drink industry that would be the envy of many of our competitors. This covers areas such as research and development, product innovation, skills, resource efficiency, market and consumer insight and other key capability building areas. Implicit within this report is the need for the dairy sector to capitalise on these existing support structures that already operate in the food and drink landscape in Scotland.

Real opportunity lies ahead for Scotland's dairy sector. This view is not the product of blind ambition, it is informed by research and the models that have been very successfully developed across other food and drink sectors in Scotland and by our competitors abroad. The challenges are real too. However, they should now act as the catalyst for action in the key areas outlined in this report, as Scotland and its dairy sector moves to grasp Ambition 2025.

## **Key recommendations**

### **A. Vision & leadership**

#### **Background**

To make Ambition 2025 a reality, Scotland's dairy sector requires a single unifying growth ambition. It also requires new, collective and collaborative leadership. This review seeks to provide a foundation for that, but merely fires a starting gun on a series of next steps. Leadership will be critical, so too a long term perspective from all key players in the industry.

#### **Recommendation 1**

- A new streamlined structure is required to drive forward the dairy ambition and corral efforts. A Scottish Dairy Growth Board should be established. It should be chaired by an experienced business leader and comprise the key players in the industry. The modest administrative costs of the Board and Chairman's remuneration should be funded by Scottish Government, with secretariat support provided by an independent, industry-focussed organisation. The Board will oversee the development of "Ambition 2025" and its associated action plan. Each element of the action plan should have both an industry and public sector 'champion' to spearhead its delivery. This framework should aim for a launch in early 2014. All other delivery recommendations should be steered by and report to the Scottish Dairy Growth Board.

#### **Recommendation 2**

- Involvement of organisations and individuals on the Scottish Dairy Growth Board is conditional on stated commitment from all members – public and private sector - to work positively in partnership to deliver a long term vision and growth agenda for the sector. In addition, they must commit to a new dialogue and language, "talking up" both the prospects and opportunities for the sector.

#### **Recommendation 3**

- Once the partnership in the Board has agreed the further detail of Ambition 2025 and its associated action plan, future applications by dairy companies under capital grant schemes administered by Scottish Government and its agencies should be assessed against their contribution to the unified strategy.

## **B. Development of markets**

### **Background**

Global demand for dairy products is rising, against the wider context of growing global demand for premium food with strong provenance and health credentials. This increased demand is being driven by emerging markets, in particular in the BRICs and surrounding regions. Currently, the Scottish dairy industry, like the rest of the UK dairy industry, is far too over-reliant on the domestic market (around 92% of Scottish dairy products are sold in the UK). This leaves the sector massively over-exposed to a few large customers. Exploiting these emerging export opportunities is an economic imperative, to strengthen the returns for the sector and better manage its risk.

The export focus must be on added value premium products; Scotland cannot and must not seek to compete in large volume markets. It is also worth noting the significant and growing market worldwide for health-enhancing foods. The health benefits of milk consumption are proven, but there is still huge scope for innovation in dairy to develop new products for this multi-billion pound market.

In addition, there is significant scope for import substitution, given the ongoing demand from UK consumers for domestically produced, high quality products.

### **Recommendation 4**

- As part of the new food and drink export strategy being developed by Scotland Food & Drink, Scottish Development International (SDI) and partners, a specific dairy workstream should be developed. Informed by and reporting to the Scottish Dairy Growth Board, it should comprise a list of key priority export markets (in particular looking to opportunities and trade activity in emerging markets). This prioritisation should then translate into new staff resource on the ground in key markets, with proven supplementary activity such as trade missions taking both producers and companies to see and evaluate the specific market opportunities.

### **Recommendation 5**

- Once the list of priority markets is developed, an increased programme of engagement with dairy companies operating in Scotland should be developed to heighten awareness of opportunities and to develop adequate support structures. This will require a focus from SDI, Scotland Food & Drink and its partners to seek commercial commitment to the new export agenda.

### **Recommendation 6**

- A dedicated Export Growth Fund should be established, to support staff investment within companies in the form of dedicated export managers. The fund would be conditional on companies agreeing to match fund any investment in this type of resource. Ideally, applications to such a fund would come from collaborative investment between dairy companies in Scotland.



However, in the short term, it is most likely to be dairy companies as a consortium with other complimentary food and drink manufacturers.

### **Recommendation 7**

- Scotland's growing reputation overseas as a "Land of Food & Drink" must be harnessed. Informed by the prioritisation of export markets, marketing expertise should be sought to brand the dairy story and offering from Scotland, in line with the wider "Scotland, Land of Food & Drink" branding. This marketing plan should also develop the case for joint investment across major dairy companies in a future "umbrella" brand for Scottish dairy in export markets. This could be a crucial step in the development and safeguarding of peripheral milk fields and processing facilities in particular; they face specific costs but arguably have the strongest brand and provenance potential. Under such a brand, the awareness of dairy products from Scotland would increase, from which individual companies could exploit their specific commercial opportunities. There are good examples of where this umbrella branding approach has worked in dairy sectors in competitor countries. It should also draw on lessons from other food and drink sectors in Scotland who have successfully branded their products overseas, such as Scotch Whisky, Scottish salmon and Scotch Beef and Scotch Lamb. This requires Board decisions to be taken by the major companies operating in Scotland to invest in the 'Scottish' proposition.

### **Recommendation 8**

- Recognising the interests of UK consumers in products of 'local' provenance, the Scottish Government, through its Retailers Forum, should seek a voluntary commitment from the all major UK retailers to label the country of origin on cheese products initially, with an assessment of the potential to roll this out across other dairy products.

## **C. Structures/collaboration**

The culture of co-operation and collaboration in Scotland and the UK has been criticised for many years. In fact there are incredibly strong co-operative structures that exist within the Scottish food and drink industry with around £1 in £4 of food turnover now under co-operative structures. There is no doubt though, that the UK has been behind the curve in developing internationally competitive co-operatives, for many reasons that have been debated before.

Beyond supporting the development of individual co-operatives, the value of co-operation and collaboration in all its forms must be recognised. Collaboration must become the cornerstone of the future development of the Scottish dairy industry and embedded in its culture.

There has been much debate about the development of Producer Organisations (POs) in the dairy sector. A wholesale, single step move towards developing one or

more dairy POs in Scotland is unrealistic and the jury is out on its likely effectiveness. However, developing greater collaborative structures, amongst farmers, amongst processors and between those two links in the chain is essential. It should be stressed that the benefit of greater farmer collaboration will be felt as much by milk processors as by farmers themselves. And, at farm level, the benefits are less to do with milk price negotiation, but much more to do with transparency, understanding of pressures through the chain, performance improvements and joint business planning.

### **Recommendation 9**

- All producer groups should be formalised, with an agreed constitution and structure over the next 3 years. Funding should be made available for an “honest broker” organisation to deliver a programme of engagement with all dairy companies and their producers to highlight the broad, multi-chain benefits of properly constituted producer groups and to co-ordinate their development. Some producer groups may view this as a stepping stone towards the establishment of a formal, legal PO. This would be an option, but is not a given.

### **Recommendation 10**

- Properly constituted producer groups should have access to a grant scheme to fund the cost of a co-ordinator for the first 2-3 years to ensure they are properly functioning and well-developed. Historically, the Scottish Government’s Marketing Development Scheme made provision for this type of funding. The new Scotland Rural Development Programme 2014-2020 should make a similar provision.

### **Recommendation 11**

- The formation of properly constituted producer groups should drive the adoption of transparent pricing formula in milk supply contracts. There is not a ‘one-size-fits-all’ formula, however the parameters should be agreed between milk supplier and milk buyer, through the producer group.

### **Recommendation 12**

- Under the new Scottish Rural Development Programme, one of the criteria for assessing application from dairy companies for capital grant funding should be their support for the establishment and operation of a formal producer groups.

## **D. Farm advice & technical efficiency**

Milk prices paid to Scottish dairy farmers have lagged behind their EU counterparts for many years. This, alongside a lack of transparency on margins being made elsewhere in the supply chain, created a culture of mistrust and, at worse, a feeling

of victimisation at the farmgate. However, the focus on farmgate milk prices – whilst understandable and not without merit - has clouded debate on the real drivers of profitability on farm.

Profitability does not rest on the milk price alone, indeed, over the last 10-15 years it has arguably been one of the least relevant factors. There are profitable dairy farms in Scotland and unprofitable dairy farms. The difference between the two is not simply a product of milk price paid by the buyer, nor location of farm, herd size or even milk yield. It is in the overall technical efficiency in operations.

Whilst accepting that comparing one farm's cost of production against another is crude and overly simplistic, there are clear messages emerging from existing data which cannot be ignored. According to the latest DairyCo report, across the UK, the best performing 25% of the industry have a cost of production of 24 pence per litre (ppl) on average. The worst performing have an average cost of production of 35ppl. For a modest-sized dairy farm, producing a million litres of milk, this is the difference between a net loss of £54,000 or a net profit of £66,000. Therein lies the opportunity to transform the profitability of many farms.

We need a cultural change in the acceptance of professional, external advice on farm and a much more effective and co-ordinated structure for delivery. This can lead to a transformation in technical efficiency, whether in terms of broad business planning, peer-to-peer learning, benchmarking, risk management or the detail of critical issues such as feeding regimes, dairy cow fertility and tackling animal health problems such as Johne's.

### **Recommendation 13**

- Proposals should be drawn up to establish an independent “Scottish Dairy Bureau”. This process should be guided by and report to the new Scottish Dairy Growth Board. It will act as the one-stop-shop for authoritative information, advice and training. Its independence and governance is crucial. It will not be a public sector agency, but an industry-led initiative. It will not be run by those that have a vested, commercial interest in the provision of advice or training, but by those that can proactively and reactively work with farmers in directing them to the best source of advice to improve business planning and technical efficiency. This should include encouraging farmer-to-farmer advice and structures, which has proven benefits. Whilst a detailed business case should be developed, the funding for this should be a partnership between industry – potentially through levy collected by DairyCo - and Scottish Government. It will require collaboration between key advisory bodies and anyone currently providing advice on farm (e.g. SRUC – including Scottish Dairy Academy -, feed companies, Lantra, DairyCo, vets etc).

#### **Recommendation 14**

- The Scottish Dairy Bureau should analyse the current provision of information, advice and training and identify any gaps in support.

#### **Recommendation 15**

- Funding by the Scottish Government for organisations to provide farm advisory services to dairy farm businesses should be prioritised to organisations working in partnership with the Bureau.

#### **Recommendation 16**

- Under the future capital grant funding programmes for dairy farm businesses within the new Scotland Rural Development Programme, a clear and explicit element of the assessment process for new applications should be the use of professional, external business planning tools & advice.

### **E. Wider industry support structures**

In the last few years, as a direct consequence of the development of a National Food & Drink Policy and the establishment of Scotland Food & Drink as an industry leadership body, the support structure for the food and drink industry as a whole has strengthened immensely. Recommendation 13 addresses the need for better targeted and accessible support for primary production, however there are many more initiatives in existence. Some of these have a remit at farm level, but many are focussed on supporting manufacturing companies. These projects represent millions of pounds of investment and cover the main capability building priorities of Scottish companies, including skills, collaboration, innovation and market development and consumer intelligence. Whilst the development of this support for the food and drink sector has been invaluable and - in some cases - world-leading, greater effort is required to communicate the support available to the dairy sector.

#### **Recommendation 17**

- Scotland Food & Drink should engage with its industry partners – DairyUK & NFU Scotland in particular – and its own company members to better articulate the support available and signpost businesses to the best available advice

## **F. Wider Government policy**

### **Common Agricultural Policy**

There is a great deal of debate ongoing around Common Agricultural Policy reform. The future prospects of the dairy sector will rely much less on CAP reform negotiations, which are in many ways never-ending and cyclical, and much more on the other elements covered in this report. In many ways, the success of the dairy sector's development could be measured by a reducing significance to farmers of pillar one direct payments under the CAP.

Whilst the Single Farm Payment is a smaller proportion of business turnover for the average dairy farm than it is for other farm businesses, CAP support remains of significant importance to dairy farmers. Ironically, despite the debate over inactive "farmers" claiming support, it is the businesses most intensively active in food production that stand to see some of the greatest reductions in support as the Single Farm Payment System moves away from the historic basis.

Given the potential of the dairy sector to be an "exemplar" for the industry over future years, policy stability is important, as much for producer confidence as anything else.

#### **Recommendation 18**

- The Scottish Government should continue to press the UK Government on its negotiating position on the CAP to ensure it reflects the importance of the dairy sector to Scottish agriculture and local economies. Critically, at the point of implementation of the new regime, the Scottish Government should explore all opportunities to mitigate the reductions on active farmers. For the dairy sector, this can provide breathing space until Ambition 2025 can be realised and market-led profitability can be secured.

### **Health policy**

Currently under development is a new voluntary framework to address Scotland's woeful record of diet-related illnesses across the population. Of concern is a growing rhetoric and emphasis – both in Scotland and the UK – on simplistic labels for "good" foods and "bad" foods; with dairy products often finding themselves in the latter category.

#### **Recommendation 19**

- A change in language and approach is needed on a number of fronts in relation to dairy consumption and diet. An example should be set by the Scottish Government and Food Standards Agency when taking forward any future proposals to improve Scotland's dietary record.
  - The health benefits of milk consumption should be emphasised.

- The economic opportunity to supply the healthy food market – supported by a range of initiatives under Scotland Food & Drink – should be emphasised; the health agenda should represent an opportunity for dairy companies rather than being perceived as a threat.
- The message of dietary balance must be stressed and it must be recognised that the increasingly simplistic debate of “good” food versus “bad” food is misleading and unhelpful.
- The broader ‘healthy living’ agenda must reflect the equal importance of physical exercise alongside dietary choices.

**Ends**



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