

**Agricultural Co-op Development Initiative (Ag-CDI) conference  
26-28 Nov 2008**



Firstly many thanks for your kind invitation to speak at this prestigious conference. I feel somewhat flattered as England and the UK, as I will explain later, is not at the forefront of co-operative development but we have come to recognise the opportunities and benefits cooperation and collaboration can offer the agricultural and food industry, and it has over recent years come more into the picture. What I hope I can offer your conference is the UK experience in playing catch up and to put this in the context of the global challenge, both immediate and longer term.

(slide 2) But firstly what is EFFF and why has it developed?

**English Farming and Food Partnerships (EFFF)  
– Our history**

- Short! Started in 2004
- Mission – to help develop co-operation and collaboration between farmers, and between farmers and their supply chains to improve the performance of all those in the chain
- Why?
  - *England and UK far behind our main competitors in co-operation*
  - *Revenue and profitability of farming historically low – little capture of downstream value*

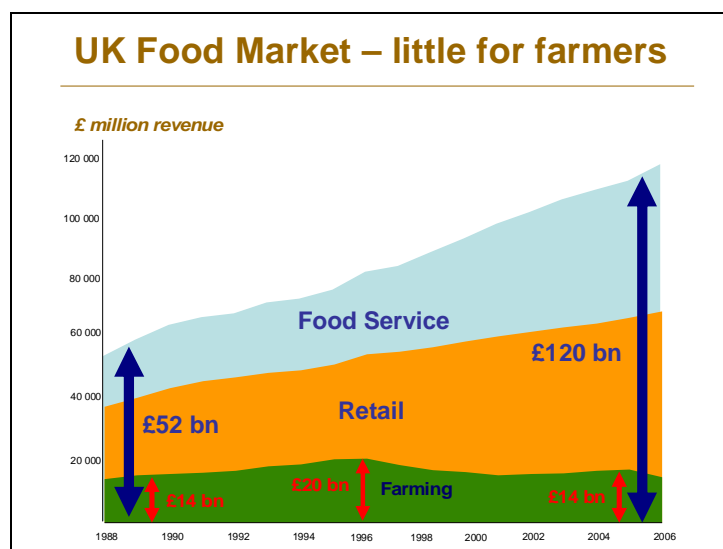
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The UK has had a series of well publicised agricultural crisis over the last 10-15 years primarily around livestock health; salmonella in poultry, BSE in cattle and

foot and mouth in ruminant livestock. Coupled with this has been increasing scepticism of modern farming practices by consumers and a desire to know what goes into their food. The farming industry from an economic perspective has been moving from a period of production support and price protection under the Common Agricultural Policy from the 70's to the 90's to one which now has to be far more market orientated. The result of this has been a protracted period of low profitability as the industry struggles to adjust to the new order. In practice farmers were disconnected from the food businesses they were there to supply and more worrying the end consumer.

A Government study into the farming industry was undertaken in 2002. One of the central recommendations was that farmers needed to co-operate together, both in production but also importantly with the supply chain. The report recommended an independent organisation was set up with the express remit of helping develop co-operation and collaboration between farmers and between farmers and their supply chains and as a result EFPF started in 2004..

England and the UK are far behind other EU and North American countries for lots of historic reasons, probably central to this being the highly regulatory marketing boards which ran from the 1930's to 1990's and covered most products. These were initially created to provide price protection for farmers but also ensure security of supply in a troubled pre and post Second World War period. These boards did this well initially but created no motivation for farmers to try and secure value down chain as this graph shows (slide 3).



The UK food market has grown steadily in retail expenditure for food consumed in the home and even more rapidly for food service; being food consumed away from the home in restaurants, fast food outlets as well as in hospitals, schools and so on. But the value returned to farmers has remained broadly static barring some rise in the mid 90s due to supply imbalance.

Having painted this picture of a country that is behind many others in its co-operative activity I must point out we do have some excellent, innovative and growing co-ops. Overall England has around 300 agricultural co-ops with combined annual revenue of around £5 billion.

**Revenue of England's top 10 Co-ops  
small but growing.....**

£m				
Rank	Name	2004	2006	Sector
1	DFoB	436	510	Dairy
2	Milk Link	392	574	Dairy
3	First Milk	447	505	Dairy
4	Grainfarmers	205	393	Grain/Oilseeds
5	G's Marketing	173	195	Horticulture
6	Centaur	134	154	Grain
7	Countrywide	122	151	Supply
8	Mole Valley	115	145	Supply
9	KG	94	120	Horticulture
10	Worldwide Fruit	114	103	Grain/Oils
Top 10 Total		2232	2949	
Top 30 Total		3065	3943	

£ = approx 2 \$ Canadian      +30%

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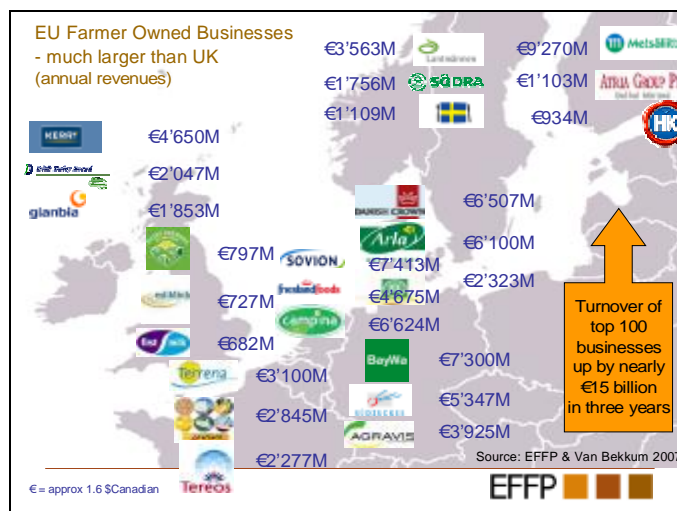
(Slide 4) This shows our top 10 co-ops, we often refer to them as farmer controlled or farmer owned businesses so forgive me if I slip into that terminology. In the top three we have our milk co-ops which were formed as recently as 2000 from the break up of the single co-op Milk Marque which itself evolved from the demise of the old Milk Marketing Board. They have a clear vision of achieving farmer ownership of processing and have invested heavily over the last 5 years into cheese production and other added value liquid milk products.

Centaur and Grainfarmers have formally merged literally last week which will make for a formidable farmer owned grain marketing business with around 25% grain in the UK marketed through the new business 'Openfield'.

Countrywide and Mole Valley are two substantial input supply businesses; which have diversified into rural retail, targeting the rural consumer and those urban consumers who want anything rural!

The horticultural businesses have all focused on supplying the major supermarkets with vegetables, soft fruit and top fruit. KG, now known as Berry World and Worldwide Fruit have developed strong linkages and acquisitions in Europe, America and Australasia to enable them to category manage year round supplies for their supermarket customers.

So some very innovative businesses that have grown significantly over the last few years. Indeed the top 30 which accounts for around 60% of total agricultural co-operative revenue have increased revenue by 30% between 2004 and 2006 and this trend has continued into 2007.



(Slide 5) – The scale of co-operative activity in Europe though paints a different picture, of businesses of substantial scale, now multi national and highly integrated into the supply chains in which they operate. Even Ireland has achieved the development of farmer owned businesses in their dairy sector many fold the size of those in the UK. Irish Dairy Board - manufacturers of Kerrygold butter has returned £140m to farmers over the last 20 years from adding value to members' milk.

The large French farmer owned businesses tend to be all-purpose with supply, storage and marketing activities such as In Vivo; though there are some specialist food businesses such as Tereos, processing sugar.

Very large German co-ops are found in input supply but also sugar processing.

The Netherlands and Denmark have very highly developed downstream food businesses in the meat and milk sector with well recognised European brands such as Lurpak butter. Many of these businesses operate in England and are supplied by English farmers but of course they are not members or owners of the business. Sovion has just acquired one of our largest meat processors, Grampian Foods. English farmers wait to see how they will be dealt with as a result.

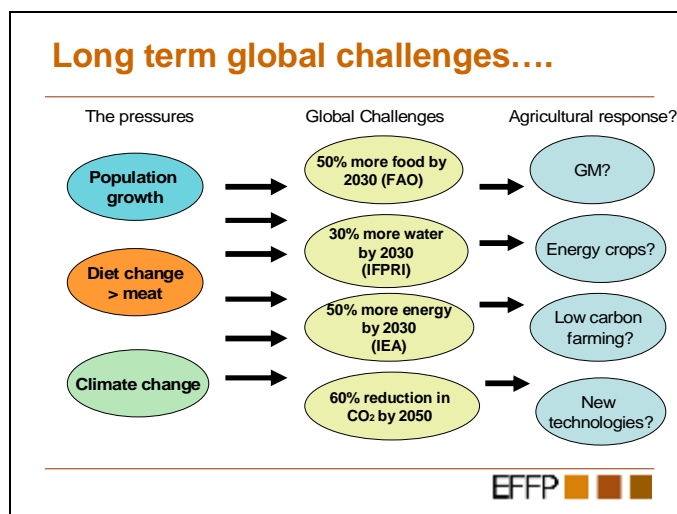
You may note with these larger businesses I will use the terminology – Farmer Owned rather than co-operative, the reason being some, not all, have converted their structure; usually when they reach a point where they require substantial capital for investment beyond that which can be provided by members or lending banks within a co-operative business structure. Whilst not impossible as has been proven by co-ops such as Campina and the English co-ops, some have however taken the conversion route, changing to a conventional shareholder

company and attracting external investors, as indeed Kerry did way back in the late 80's.

The upside is greater available capital, the downside is the end of the link between usage (or supply to the co-op) and return. The relationship between the former co-op and its supplying farmers inevitably changes over time as priority is focused on shareholder return. Initially a high proportion of shareholders is represented by farmers but over time will become unaligned. A subject we could, I am sure, debate for many hours as a number of advocates of the pure co-operative structure frequently do! Maybe I will hear more at this conference.

Furthermore scale is not a guarantee of performance; speaking to some EU farmers recently they are sceptical about some of their co-ops; believing they are too big, have too high market share and are inefficient and complacent. You just can't win!

I have probably spoken for too long about the UK and European co-operative structure but I want to discuss some of the challenges we face with the ongoing development of our co-operative businesses a little later so it is important to set the scene.



(Slide 6) We have a massive long term global challenge. A population forecast to climb to 9bn by the middle of the century coupled with increase in wealth in areas of the World such as Asia with a resulting demand for higher value meat diets. Piled on top of this daunting challenge is the subject never out of the news - climate change.

Distinguished organisations estimate that over a very short period of 20 years we will need 50% more food, 30% more fresh water and 50% more energy. We can argue about the absolute percentages but either way they are of exceptionally high order even at the lower end of estimates.

Were this not challenge enough there is a very large level of consensus that to achieve a modicum of control over future climatic conditions we have to achieve a reduction in Green House Gas emissions of the order of 60% within the next 40 years, which will mean some extremely stretching targets in the interim period. Again the absolute figure is not the issue to debate at this conference but it sets a framework in which the industry has to operate.

And of the responses here are some of the key ones – GM causes hostile debate and this is a highly controversial subject in the UK. The benefits would appear irrefutable, relative to a low level of risk and would seem the key to both yield and water usage.

Energy crops in Europe, unlike America are considered as a strategic response to climate change and not primarily as energy security. In fact construction of bio-diesel and bio-ethanol plants in the UK has virtually ground to a halt, faced with high and volatile feedstock prices, high capital cost and uncertain oil prices, now combined with a banking crisis. The biggest issue though is whether this form of energy production is compatible with the challenges of food production over the coming decades and in reality makes a true contribution to a reduction in GHGs.


Changes in farming practices combined with new technologies in crop protection and the like will be key factors with solutions that will contribute both to the yield challenge but also to climate change, providing research and development is adequately funded across the world.

**2006-8 has seen the start of a change.....**

- Poor cereal harvests
- Increasing demand – Far East
- Bio-fuels

⇒ *Supply shortages, high prices & volatility*

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(Slide 7) – We have had more than a mere taster of some of the things to come during the last two seasons. Poor cereal harvest aggravating already low stocks coupled with a boom in commodities, partly real demand from Far Eastern prosperity, partly speculation, and a relatively small influence of bio-fuel production created the boom in agricultural commodities we saw over the last year, but now reversed. But one thing we are increasingly seeing in very high volatility and in the UK we are having to get used to it.

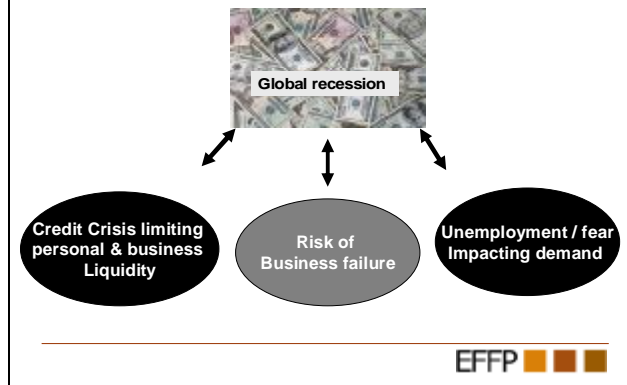
### 2006-8 has seen the start of a change.....

- Poor cereal harvests
  - Increasing demand – Far East
  - Bio-fuels
- ⇒ *Supply shortages, high prices & volatility*
- A new era – end of plentiful supplies?
  - Changing attitudes of food companies?  
- *Greater concern re. security of supply*

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(Slide 8) – So are we entering a new era of much tighter supplies? Furthermore are the attitudes of food companies and processors changing towards farmers and the desire to establish longer term relationships rather than the traditional short term trading view? We do see this happening and believe it will change the relationship with farmers for the better providing the farming industry can and is prepared play its part.

### The immediate business environment....



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(Slide 9) – But the immediate business environment is of course desperate!  
*I apologise that these are US Dollars but we hold them responsible for starting it!*

We have a credit crisis, limiting personal and business liquidity, rising unemployment and fear which impacts on demand as we each believe we are going to be next, and we are witnessing business failures; hardly the climate to be thinking positively about new opportunities and new ways of working.....

### The immediate business environment....

- Global economic crisis may be deep and /or lengthy
- Recovery may not start to occur before 2010-11
- But 'long term' drivers – *increasing food demand & climate change* will remain

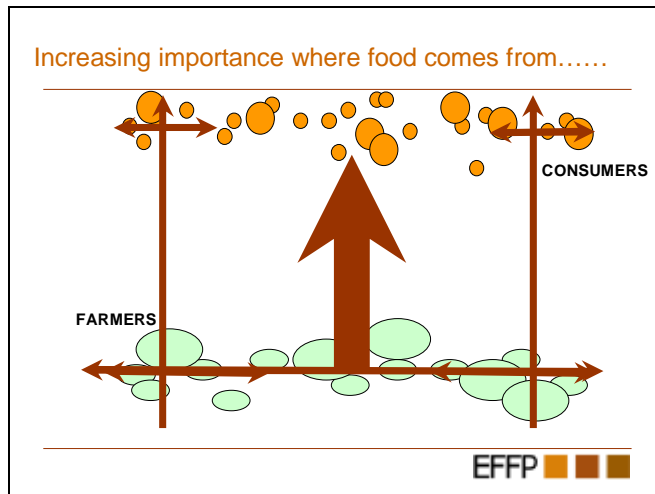
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(Slide 10) – We may face a long tough period – this is our thinking in the UK, you may be more optimistic; the US usually turns around before the rest of the World but however this crisis unfolds I am sure the majority agree the 'long term drivers' won't change and those will offer opportunities for agricultural businesses.

### **Co-operation and collaboration - a route to new opportunities?**

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(Slide 11) – So does co-operation and collaboration provide a route to new opportunities? Co-operation sounds more formal, a co-operative is a business structure where members set criteria and abide by rules, collaboration is perhaps more about trust between businesses that remain separate leading to benefits for both. Both have a role and in some cases both are required. A collaborative supply arrangement with a processor giving commitment to supply x thousand tonnes over period y within a pricing framework of z, might need a farmer co-operative to ensure that producers can fulfil that commitment to supply.



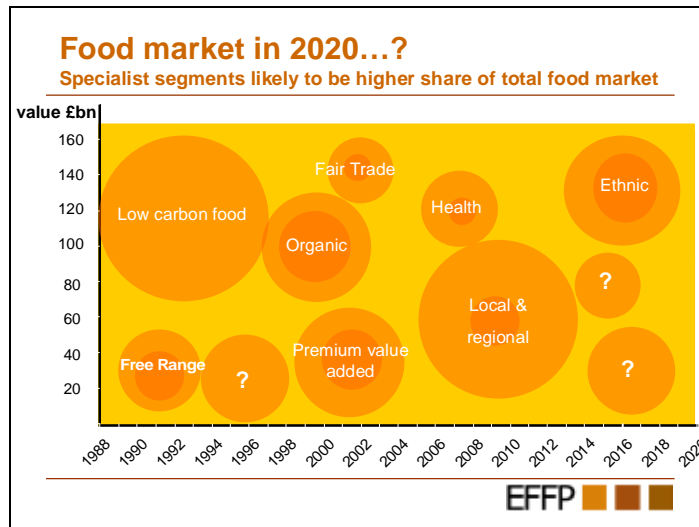
(Slide 12) - The old trusted formula for UK farmers was to produce a load of 'raw material' and somehow it finds its way to a mass of consumers; as products bearing no resemblance to what left the farm, in fact most farmers historically haven't had much interest beyond the farm gate. That is changing and the opportunities are increasingly whereby farmers are producing a specific product for a specific group of consumers, owning or collaborating in the processes that go between.

### Consumer trends

- Range of developing market segments offer opportunities with consumer interest in:
  - Health & nutrition
  - Provenance & local
  - Convenience & indulgence

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(Slide 13) - Let's look at some examples – there is a range of developing market segments – this young lady is washing her hair in milk though we are not necessary advocating that though there is a sublime message!  
 - Local milk for our largest retailer sold at a premium and farmers paid a premium and fruit in a drink to get kids to consume more.



(Slide 14) – Just imagining what our food market will look like in 2020 – it is becoming increasingly segmented now – those segments will grow and there will be new ones, some we can't yet imagine while we sit here, low carbon might be one of them though!



(Slide 15) – Lets look at more examples. Milklink, one of the three major milk co-ops is a good example having developed a range of premium cheeses and milk based drinks. Interestingly Tickler, an extra mature distinctive flavoured Cheddar cheese is being launched into the US market this very week.



(Slide 16) - Mey Selections from the North of Scotland is an interesting brand, backed by Prince Charles, a great supporter of rural matters. A supply company was formed with 270 of the region's farmers as members and achieved revenues of £4.6m in its first year of trading in 2007. Needless to say the name helps but the brand is projecting both quality and provenance based on traditional systems around smaller family farms and has particularly appeal in London restaurants and shops as well as the immediate locality. They are even projecting some relatively young farmers (for Scotland!).




(Slide 17) – Camgrain is a fascinating example. When EFP started we thought that achieving dedicated supply chains and added value for what on the face of it is a commodity based cereal sector would be the most difficult. In fact we were wrong and in many ways collaboration between arable producers is easier than with beef and sheep farmers. They are more commercial and are prepared to adapt and change their businesses to meet market conditions. Earlier this year Camgrain, a co-operative grain store, the largest in the UK with around 200,000 tonnes of state of the art storage and primary processing reached agreement with the UK's second largest retailer Sainsbury's to provide milling wheat for flour into its 360 in store bakeries. The attraction of the product is vendor assurance

and traceability, however there is also the issue of security of supply and the desire for Sainsbury's to build stronger links back to supplying farmers which it can do through a co-operative such as this.

All these have much more information on their websites if you Google them.

**But many challenges.....**

- Farmer commitment to invest time and capital beyond the farm gate
- Business structure - balancing returns based on usage and ownership
- Management and resource to make it all happen (especially for low volume niche & local products)
- Logistics – cost effective route to market
- Raising capital (for multi - million \$ downstream projects)

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(Slide 18) – These are great success stories but there are of course considerable challenges for co-operative businesses which are trying to break into the supply chain and get directly or at least closer to the consumer to capture more of the final product value. Each of these points could form the basis of a talk in their own right so I can only touch on the key issues.

Small initiatives and start ups face difficulty with a conflict of workload priorities between the farm and the new venture beyond the farm gate. We see time and time again small groups of hard pressed farmers with a potentially good product such as quality beef from a local area for which there would almost certainly be some premium for direct marketing, but they simply cannot put the time resource into getting the venture underway. Coupled with this is the hesitation in investing off farm – again conflicting priorities, when I need a new barn or tractor, do I do that or invest in a marketing campaign or off farm processing?

Business structure is a major subject in itself in which I do not profess to be an expert. Put simply if the business aims to reward owners on their commitment to supply then the structure has to reflect this; most likely as a member based co-op. If it is to reward provision of investment capital then an investor based shareholder company maybe more appropriate. Key is to give thought to the structure at the outset and at intervals thereafter, as the interests of the owners can quickly move out of line with the original intended objectives. This can be particularly evident for co-operative businesses that become dependant on non member trade; do non members get the same price as members? If so how are members rewarded? Perhaps by dividends but what if the price pressures placed on the business, possibly by the need to compete for non member business is

such that no significant dividend is payable? A conundrum indeed which has faced many supply co-ops and livestock marketing co-ops, causing some to convert.

Management and resource to make it all happen – the needs of small start up ventures in management, administration, regulation, marketing, office costs, packaging, transport and logistics can be completely disproportionate to revenue in the early years. It can be a killer before the business is even underway. One way round it maybe to get close to a larger established business that could undertake some of these tasks at a cost equating more closely to those of a more mature business, in other words achieving the economies of scale without the scale. We have examples of where this has happened in the UK. We at EFP also believe there could be a case for a Central Service Provider or hub that could be established to undertake these services for a whole range of co-operative ventures, particularly on a region basis, (our regions would seem very small and local compared to those over here!) This is something we are investigating, however it would require some public funding to develop, which would be challenging in itself.

Raising capital is an area we believe there are key constraints. The UK milk co-ops for instance have had to rely on bank debt for their downstream investment, repaying long term assets with short term debt, putting great pressure on returns to producer members, who have been faced with guaranteeing the co-op loans, paying a levy and accepting lower prices to cover capital repayment and interest. We believe there is a need and a case for a specialist investment fund for agri-food businesses, structured over a longer period than may conventionally be the case. To achieve this investors have to be interested in and see the sector as an opportunity. This is an area EFP is looking into but it is early days!

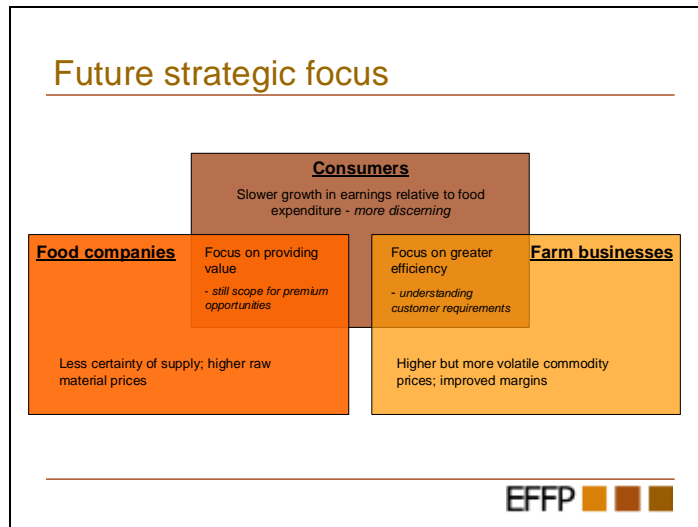
(Slide 19)

## Conclusions

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- Tough period for many businesses through global economic crisis.
- Key drivers remain - longer term supply : demand balance shift leading to better prices but volatility the norm.
- Food companies will need collaborative supply chains and stronger long term relationships with farmers.
- Farmers must meet the needs of their customers – build trust.

(Slide 20)



In summary the focus as we see it will change over time accelerated in part by recent events – in the UK food is not likely to continue to get cheaper in relation to earnings as it has done over the last two decades, the consumer will be more discerning for lots of reasons, partly based on price but also in relation to all the other personal interests and preferences they may have. A great opportunity to meet those aspirations!

Food companies will of course focus on value to be price competitive for the benefit of this ever more discerning consumer; but there will be scope for many premium and specialist segments. Consistent supply of raw materials will be more of an issue than it has been over recent decades. But a great opportunity!

Farmers will focus on efficiency but must understand what their customers really require; but if they do this and can counteract or cope with increased volatility they should secure improved margins. A great opportunity!

### Final thoughts.....

- A World of opportunities for the right products and the right businesses
- **Co-operation can be the key to open the door**



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David Neal-Smith Nov 2008