

# **Fairtrade begins at home**

## Supermarkets and the effect on British farming livelihoods

A report by the Church of England's  
Ethical Investment Advisory Group

**November 2007**









# Contents

Table of Contents.....	3
Executive Summary.....	4
Foreword by the Bishop of Exeter, the Rt Revd Michael Langrish.....	6
Introduction.....	8
Setting the scene.....	8
Industry Overview.....	10
The UK Market.....	10
Competition Commission.....	11
Supermarkets Code of Practice: is it working?.....	12
Labelling and Branding.....	14
Made in Britain?.....	14
Product assurance.....	15
Promotions in Store.....	16
Promotions at the expense of the farmer.....	16
Produce: Commodity vs niche.....	18
Payments and Contracts.....	20
Buyers.....	20
Contracts.....	21
Payment terms.....	22
Facilitation payments.....	23
Pernicious practices.....	23
Working Practices.....	26
The UK Dairy Industry in Crisis.....	28
The Dairy industry in crisis.....	28
Milk Prices.....	30
Implications of a diminishing UK agriculture industry.....	35
Summary.....	36
Who We Are, Acknowledgements and Thanks.....	37
The Ethical Investment Advisory Group.....	37
Acknowledgements & Thanks.....	38

# Executive Summary

This project, carried out by the Socially Responsible Investment Unit at CCLA Investment Management Ltd on behalf of the Church of England's Ethical Investment Advisory Group (EIAG), was conducted during the first half of 2007 via a series of one-to-one and group meetings with farmers around England.

The request made to the EIAG to look into the relationship between the major food retailers and farmers came in direct response to concerns from members of the Church of England's General Synod regarding the doubtful viability of many farming livelihoods given the squeeze on farm gate prices. This review represents a contribution to the ongoing debate around the future of a vibrant, sustainable agricultural sector to which the Church is committed. As part of this review we have found:

- continuing price pressure on many parts of farming that are putting livelihoods at risk
- there are many complex reasons for the malaise in British farming, but the pursuit of cheap food, coupled with the skewed buying power of the food majors is undoubtedly contributing to the difficulties of the sector
- the review identifies a number of invisible and pernicious practices that the consumer is largely unaware of, and which have been accepted by farmers as a *fait accompli* as part of the price of doing business
- these practices include labelling that obscures the country of origin of the primary ingredients of some products labelled as British but often only processed or packaged here; flexible contract terms that

seldom work to the advantage of the farmer; flexible payment terms that, subject to arbitrary change, have often put farmers to increased cost and financial loss; facilitation payments; deductions and a range of financial inducements paid to the retailer or processor at the farmer's expense. There is little evidence that retailers share the benefits of promotions with farmers, and much evidence that farmers, in the main, bear the costs

- this report looks particularly at the dairy industry where retailer price competitiveness for a staple product has led to a significant reduction in the number of dairy herds, placing many of those remaining at the margins of economic viability, although more recently there are some positive signs of change

- we conclude that farmers do not seek special treatment, but a genuinely free market that is not skewed towards a few retailers with enormous buying power. There is visible inequality and dysfunction within the supply chain, which in our view requires attention.

Farmers are asking for no more than a *fair price for a fair product* which requires a connection to be made by the British consumer that fair trade begins at home with British produce, reared and farmed by British producers.

# Foreword by the Bishop of Exeter, the Rt Revd Michael Langrish

As bishops of a church which is a major investor in the retail food industry and which is also the landlord to many tenant farmers, we have a duty to consider the relationship between these two areas of business. In particular we have to ask whether this relationship is fair and whether it operates within what we consider to be the principles of Fair Trade. Are human beings treated with dignity and respect, or is there some exploitation of one group of people for the unfair gain of another?

This report makes it quite clear that the business practices of the major food retailers have placed considerable stress on the farming community through the use of methods which we believe to be unfair and of which consumers seem to be unaware. Farmers seem to be unwilling to complain or to expose these practices for fear that their produce may be

boycotted by the major retailers. It is clear that the Supermarkets Code of Practice is not working although some major retailers are better than others, and those who operate predominantly in the premium and niche markets appear to be far more concerned about paying fair prices as well as caring for the well-being of their suppliers.

It is also clear to us that the labelling of food products (whether by the supermarkets or food producers) can be seriously misleading to the consumer who, although obtaining cheap food and paying a lower proportion of their income than in the past, may also be paying the price in terms of quality and accuracy of information concerning the contents. The low inflation which the British population has enjoyed for a number of years appears to have been generated, at least in part, at the expense



of the livelihood and well-being of the farming community. We are moving towards a situation where we will be unable to be self-sufficient in basic foodstuffs, such as milk, and have to rely on imports which are produced on a cost basis which is not viable in the country.

The landscape and life of Britain are intimately related to the use which we make of the land. Although this has constantly changed over the centuries, we may soon find ourselves living in an age when herds and flocks are no longer seen, and in which virtually the whole population is totally disconnected from any contact with the production of the food which it eats. The link with the land, which is a powerful theme in theology, scripture and folk-lore, may well be lost and with it an essential part of our national heritage and identity.

We live in an age when we are increasingly concerned with Fair-trade for producers in the developing world and with carbon-footprints and their impact on the environment. We also need to ensure that we place our own house in order and trade fairly with those at home as well as taking seriously the wider impact which these issues can have on the environment in which we will have to live.

+ Richard Oxon:

The Palace  
Exeter EX1 1HY  
June 2007

# Introduction



Our work began in 2003 following a request at the General Synod

The work initially focused on discussions with the major UK supermarkets

## Setting the scene

In 2003, at the Church of England's General Synod in York, the Ethical Investment Advisory Group was asked if it would commence engagement with the major food retailers over the hardships being experienced within the rural farming community following a notable squeeze on farmgate prices. The request emerged in recognition that the Church of England is unusual in not only being an investor in the food retail sector, but also a significant land owner in its own right, with tenant farmers that supply supermarkets with produce either directly or through middlemen.

The work initially focused on discussions with the major UK supermarkets to understand how the supply chain worked, how they dealt with suppliers, and how produce is effectively brought to market. These conversations allowed us to examine, not only

issues to do with the supply of fresh produce on a daily basis, but also wider environmental concerns, sustainable practices, labour issues, labelling, alcohol marketing, obesity and consumer health issues. For the Church, this is all part of what it means to be an informed, responsible shareholder. During this time, the EIAG built up a picture of the major issues facing the food retailers, allowing us to enter into informed dialogue with them.

In late 2006, we attended a meeting at the Arthur Rank Centre, a collaborative initiative supported by the National Churches, the Royal Agricultural Society of England and the Rank Foundation, serving the rural community and its churches, at Stoneleigh Park, Warwickshire. At the meeting, we presented to an ecumenical group of around 50 Rural Officers and Agricultural Chaplains on the work of the EIAG and the engagement process the SRI Unit has had



with supermarkets. In response, attendees at the meeting were able to put the case to us that the answers provided by the supermarkets were not necessarily the full picture. They were able to provide examples of cases of difficulty facing UK farming and agriculture in many rural parts of the country.

A desire emerged from that meeting to help facilitate dialogue with farmers to help the EIAG complete its picture of what was actually happening in these key relationships between our major supermarkets and the produce suppliers. This report is the outcome of work inspired by that meeting at the Arthur Rank Centre; it was felt that in order to obtain a realistic first hand view of both good and bad supermarket buying practices with farmers, meetings with those at the end of the supply chain was of fundamental necessity if the work of engaging with the food retail sector was to be of continuing value.

During the first half of 2007, the SRI Unit undertook to visit as many farmers as possible, sometimes on their own farms, and in other instances in larger groups organised by Rural Officers and

Agricultural Chaplains. The work has taken us to Devon, Somerset, Cheshire, North Yorkshire, Kent, Sussex and Hampshire to meet around 50 farmers. Meetings took place with dairy farmers, cheese producers (cow and goat), potato farmers, livestock farmers (beef, lamb and pork) and vegetable and herb growers from both owned and tenanted farmers.

There were a number of instances of farmers declining to meet with us, citing a fear of damaging their future relationships with the supermarkets they, in many instances *exclusively*, serve; this was disappointing but is in itself eloquent testimony of some dysfunction in the market.

This report is dedicated to the many people we met in celebration of the devotion and commitment they bring to perpetuating a vibrant British farming sector and keeping the countryside of Britain the way it is known and loved by many. In nearly every instance, those we talked to said they wanted no more than a *“fair price for a fair product”*, hence the title of our report: **Fair Trade Begins At Home**, a sentiment we fully endorse.

We met with roughly 50 farmers around the country

Farmers want no more than a fair price for a fair product



# Industry Overview

Supermarkets are a retail and economic success story

## The UK Market

The UK supermarkets are an unparalleled economic and retail success story; they are convenient, encourage quality, range and value, and are among the most efficient users of capital in the market. Their dominance and success derives increasingly from supplying nearly everything a consumer could want in one place.

The cumulative effect of the consumer exercising choice in this way has led to social change on an unparalleled scale, in our towns, in the landscape and in our shopping habits. Some commentators have thus referred to them literally as *“marvellous examples of the law*

*of unintended consequences”*. The negative social effects of this retail revolution have been cited as including the fragmentation of communities and ancillary services, for instance the closure of local shops and businesses, the erosion of the traditional high street, increased traffic congestion, pollution and price pressure on farmers, growers and suppliers. The supermarkets are a success story beyond expectation; most of us use them, whilst at the same time perceiving that this may come at a cost.

The UK food retail market is among the most fiercely competitive in the world, and is

Market share	1970	1994	2005/06
Supermarket A	1.5%	9.9%	16.7%
Supermarket B	n/a	13.6%	11.2%
Supermarket C	6.1%	20.0%	15.9%
Supermarket D	7.2%	18.3%	31.3%

dominated by four major players with a 75% share of the food retail market and sales exceeding £62bn. The major players primarily compete either on price or on quality. Those in the middle have experienced market squeeze. Part of the reason for this is the “disconnect” of cheap food. The UK spends less disposable income on food (9.7% in 1999) than the EU average (12.9% in 1999). In 1963, around 24% of UK household expenditure was on food and drink. In 2004, this had fallen to around 9%. Governments have silently encouraged cheap food as a key determinant of low price inflation, but this has come with wider negative social and economic consequences for rural industry. Cheap food is only possible because of intensive farming, rigorous cost controls at the farm-gate and the economies of scale enjoyed by the behemoths of the industry. The most successful supermarkets show that consumers are still motivated primarily by price and healthier, safer food comes at a price premium; this appears to be culturally accepted by consumers. This emphasis on value and price is the main reason for many of the concerns arising from *the* dominant power of the food retailing giants.

The EIAG’s engagement and dialogue with the sector has covered many issues, most especially sourcing non-food items from the developing economies of the world, which has rightly exercised popular attention in the treatment of workers in the factories of South East Asia, China,

Bangladesh and elsewhere. Less well known is the story of how our every day produce, our fruit and vegetables, and our meat, finds its way to the supermarket shelves and the complex set of circumstances that get it there. When one thinks of fair trade, the mind automatically thinks of a fair deal for the low income farmer in the developing world: the coffee and cocoa grower, the banana growers of the Windward Isles, but seldom the British farmer. In the following chapters, and based on our conversations with farmers themselves, we want to lift the lid on what we call the “invisible” practices inherent within the supply chain, of which the consumer is largely ignorant, and which cumulatively, over time, has put many at the edge of economic viability, resulting in many farmers leaving the industry altogether. This is evident most clearly in the milk industry, discussed in depth later in this report.

It is not too rash to make the case that Fair Trade should be for all, and that it should begin at home in the sense of ensuring supplier relationships are founded on the principle of a fair price for a fair product. Without this practice, British farming faces an uncertain future of inevitable decline with adverse social consequences for society as a whole and the consumer in particular. It will also change the face of the landscape forever.

## Competition Commission

The Competition Commission is now engaged on its third exhaustive review of the food retail sector. In the past, it has

Major food retailers compete on either price or on quality

The EIAG’s engagement with the sector covered many issues including sourcing non-food items from the developing world

It is not too rash to make the case that Fair Trade should be for all and that it should begin at home



The Commission found some evidence that some pricing practices distorted competition and gave rise to a complex monopoly

It was hard to find first hand evidence of abuse because of an unwillingness by suppliers to come forward

identified practices which, based on an imbalance in buying power led to what the Commission called “a second complex monopoly” that could adversely affect the competitiveness of some of their suppliers. The Commission, found for instance that reduction in farm-gate costs had been passed on to consumers, although they noted that buyer power meant that the burden of cost would in most instances fall disproportionately on small suppliers such as farmers. Although problems were identified, none were put down to anti-competitive abuse, hence there has been a consequent lack of action.

Regarding pricing practices, the Commission found some evidence that certain practices distorted competition and gave rise to a complex monopoly, whilst others were deemed to be against the public interest. The Commission put a list of 52 alleged practices to the main parties and asked them to say which of them they had engaged in during the previous five years. It was found that a majority of these practices had been carried out. They included requiring or requesting non-cost related discounts, sometimes retrospectively; imposing charges and making changes to contractual arrangements without adequate notice. Many of these types of practice were mentioned to us in the conversations we have had with farmers, and are discussed more fully in the chapter on payments and contracts. All through this process the Commission found it extremely difficult to find first hand evidence of abuse because

of an unwillingness by suppliers to come forward, which it called a “*climate of apprehension*”; this has been *the* perennial problem associated with the market. Our work has teased out many of these practices which remain common and pernicious. The reluctance of some farmers to talk to us suggests little has changed since the Commission reported in 2000.

The review led to charges that the supermarkets were engaged in a range of practices that were deemed to be undesirable, the most compelling being the transfer of risk from the “main party to the supplier” in contractual and payment terms. Some of these practices remain, from our discussions, prevalent, and wide ranging and include the requirement to make pre-payments, requiring financial contribution to mount promotions, requirement to give “over-riders” (in anticipation discounts), seeking retrospective discounts, debiting of invoices without prior agreement, payments to cover wastage, and opportune de-listing of suppliers. Much of this is covered later in this report.

### **Supermarkets Code of Practice: is it working?**

The Supermarkets Code of Practice was introduced by the Commission in an attempt to self-regulate the worst abuses identified during the review. The Code was limited to parties with more than 8% of the food retail market, effectively catching all of the major players, but avoiding the convenience and niche sectors. The final Code does allow supermarkets to seek financial contributions towards

promotions, so long as these are deemed to be “reasonable”; how this was adequately to be defined was not stated, and we were unable to find any farmer who had explored this. Since the Code’s inception, it has faced mounting criticism. The discretion to define “reasonable” is one perceived weakness; another is the reliance on declarations of abusive behaviour from those who stand to lose most from being identified by the retailers, making it effectively toothless.

Supermarkets have maintained their commitment to the Code, and stress that relations with suppliers are good; we certainly found specific evidence of good practice based on relations that were professional and supportive.

The degree to which the Code has influenced or changed behaviour is, however, a moot point. The conversations we had with farmers all stressed the Code was

not working and had not rooted out the worst market abuses; many admitted they would not make recourse to it, others that they had no confidence of redress given there were only limited options as far as getting produce to market is concerned. Those with undiversified businesses were far less likely to raise any concerning issues than those who had several avenues to market. The Code sets out best practice in several areas, and these are worth setting out again:

- Terms of business to be available in writing
- No undue delay in payment
- No retrospective reduction in price without notice
- Contribution to marketing costs
- Lump sum payments as condition for “listing” a supplier

The conversations we had with farmers all stressed the Code was not working and had not rooted out the worst abuses



# Labelling and Branding

There are some misleading labelling systems being used by supermarkets

Many products contain underlying ingredients imported from other countries undermining the Britishness of a product

## Made in Britain?

Our conversations brought to light some misleading labelling systems being used by supermarkets. There is strong evidence to suggest that consumers wish to support local and British agriculture, and this is clearly recognised by the supermarket industry through their promotion of “British” foods and produce. The desire to support British farming and a growing sense that buying local is best is evident in the growing number of farmers’ markets springing up across the country. As an example of this, dairy farmers have created niche products through packaging milk in a way that reflects the region from which it comes and then sold at a premium, such as Jersey milk, or locally branded milk.

However, it appears that many consumers are unaware that, despite the appearance of being British (through the use of a Union Jack or naming), many products contain underlying ingredients imported from other countries around the world thereby

undermining the Britishness of a product whose integrity suggests it is wholly UK produced. This is not always made clear in the labelling of products. Many farmers we met recognised the consumer’s desire to support British farming, just as canny marketing departments of food retailers have done, and are concerned that good intentions by shoppers are not actually being felt on the ground.

This means that many products marketed or given a British feel are in fact supporting non-British farmers supplying raw ingredients for items such as cheese, yogurts and sausages. It was made clear to us for instance, that many supermarket cheeses labelled as British may contain non-UK farmed dairy ingredients. Others affirmed the loop-hole of labelling regulations allowing a product to be called British if it was packed or processed here.

This of course came to light most recently at Bernard Matthews



where turkey proclaimed as British was being reared overseas prior to processing in the UK.

### Product assurance

Farm assurance is a key part of the industry. In order to meet consumer demands for farm assured produce, many farmers have chosen to sign up to various environmental and assurance schemes that are currently in place, which demand environmentally responsible standards of farming. This has often been at the behest of the supermarkets knowing their customers want products that are thus assured. In order to receive the right label and assurance for their products, as well as the ability to attract better contracts from the supermarkets, significant capital sums are invested in the business. For commodity products, the farmers and

suppliers are often expected to foot the bill; whether any premium in the price is received to cover this additional expenditure differs from supermarket to supermarket.

This assurance not only often comes at a financial cost, but also changes the whole nature of farming; every supplier we spoke to addressed the increased levels of paper work, undertaken at the expense of working the land. Farming had for some become an office job, as opposed to a physical and manual one. Many schemes though, particularly the environmental ones, are welcomed by farmers who wish to be recognised for following high environmental standards. The request was that this dedication should be reflected fairly in buying and sourcing practices, and there was evidence that this was not always the case.

Farmers have chosen to sign up to various environmental and assurance schemes to meet consumer demands



# Promotions in Store

## Promotions at the expense of the farmer

Promotions, two for one offers, special buys, and featured products are an enticing way of attracting customer interest and influencing their purchasing decisions. It is well understood that publishers, for instance, pay leading book retailers to have their promoted authors heavily featured in the eponymous three-for-two offers that now dominate front of store.

Consumers would be forgiven for thinking that different rules apply to fresh and seasonal produce, but this would appear not to be the case.

In our conversations with farmers and producers, the economic implications of supermarket special offers were often raised. Supermarkets plan ahead, and need to ensure a ready supply of goods that are placed on special promotion. Suppliers will be

expected to meet the anticipated increase in volume necessitating, in many instances, increased costs from their own pockets. One producer of fresh vegetables told us that historically the packer-processors determined the nature of promotions and special offers, planned in conjunction with a number of suppliers. These were now driven exclusively by the retailers, but are funded entirely by the farmer.

For example a typical deal of this kind suggested to us entailed a halving of the farm-gate price as a result of the farmer funding a decision by a retailer to promote fresh vegetables at special offer. The resulting price received by the farmer (£7 instead of £14 per tonne) put the cost of production well above any viable economic return. Another producer explained that non-participation in such promotions raised the risk of

prejudicing the future relationship with the retailer, increasing the burden of pressure to take part irrespective of the economic cost and the threat to livelihood.

Promotions were historically based on supply, such as surplus of produce during the peak of a season but it seems that they are now decided by the stores on an apparently random basis. The larger chains often lead the way with price promotions on specific items such as three-for-two offers, and the increased pressure from other chains following suit exacerbates the problem.

One lamb farmer provided an example of how his premium product “spring lamb” requires extra time, effort and costs in rearing lamb indoors early in the year in order to obtain a premium spring lamb price. When it came to delivery to the supermarket, after the lamb was reared, the farmer informed us that the retailer had decided it was not spring lamb season “yet” (despite historically this always being the case), it would be a later date that particular year. The farmer claimed this resulted in his incurring extra costs without the premium price expected and the ability for the supermarket to source its lamb from standard sources to sell at a premium price. The producer had

no choice but to accept a payment less than expected, resulting in an overall loss.

A supplier of specialist dairy products tested the theory that few, including supermarket staff, understand how promotions work by inquiring of a supermarket worker if it was the supermarket that bore the cost of a product on special promotion. The supplier was assured by the member of staff that the retailer bears the entire cost of a promotion, even though the supplier knew this not to be the case. This lack of knowledge by both consumers and staff that special promotions are at the expense of the farmer, rather than supermarkets bearing the cost of giving customers a good deal, adds to the pressure on suppliers in the food retail industry.

Promotions represent another grey and largely invisible practice in which the retailers are able to exercise their phenomenal economies of scale at the expense of farmers and producers who as a result often supply at below cost. *A Fair Price for a Fair Product* would seem to invite both parties to benefit from the increased volumes generated by a special promotion. This is seldom the case, and unless the supplier is well insulated through diversification, may well incur a serious loss of income as a result.

Promotions used to be based on supply linked to surplus but are now at the demand from retailers

Promotions represent a grey and largely invisible practice in which retailers are able to exercise their economies of scale



# Produce: Commodity vs niche

Niche products create higher value with their higher margins as there are few players

Over 10 years, there were 30 producers growing in one locality, there are now just four

A very clear distinction can be made between the “niche” and the “commodity” product. It is apparent that niche products produce higher value with their higher margins, and as there are fewer players, the supply chain is more valued by the supermarket. This was evident in many of our meetings with farmers.

Those producing commodity products (vegetables, milk, fruit and so forth) appear to be at the mercy of the supermarkets and middlemen to a much greater extent than the niche producers (e.g. speciality cheeses and milks). Supermarket buying practices appeared far less “ethical” amongst commodity producers in terms of contracts, payments and continuity. Niche players have fared better, with speciality cheese producers providing exemplary examples of treatment from supermarkets through regular payments, help with promotions and mutually beneficial marketing campaigns.

Clearly then not all practices are bad. Supermarkets have provided opportunities for enterprising farmers by offering a perfect arena in which to sell as well as promote their products.

There have been examples of companies providing financing in order to improve systems and processes, particularly with niche players; with one farmer clearly crediting the supermarkets for enabling him to get his business off the ground, which he believed would not have happened without supermarket support.

This beneficial business arrangement makes diversifying into niche areas for the farmer attractive. However, it then leaves a question over how these niche players may be treated in the future if their products become so available they effectively make the transition from niche to commodity.

There was clear evidence that the farming industry has consolidated considerably over the past decade. A whole section dedicated to the milk industry follows, however this consolidation is not unique to dairy farmers. Over 10 years, one potato farmer spoke of 30 producers growing in his locality. There are now just four. He spoke of a rationalisation of the supply base by one of the main retailers, which once completed was able to “turn the screw” on suppliers.





# Payments and Contracts

Different supermarket chains carry out different buying practices which have a bearing on the farming industry

As we have already mentioned, many farmers recognise that without supermarkets they would have been unable to introduce new products, achieve growth and expand their operations. However, this appears to have come at a price. We believe that this price is manifested through the exponential pressure applied by the supermarkets in day-to-day business operations.

## Buyers

There was evidence that different supermarket chains carried out different buying practices, which is having a significant bearing on the overall impact on the farming industry. There were some supermarkets that kept their buyers in the same locality over long periods of time. This allowed buyers to build relationships with the suppliers, and forge understandings which provide mutual benefit to both farmer and supermarket. This works well, such as when some promotions funded by the farmers have only been sustainable in the knowledge

that the supermarket remains committed to continue its supply with the farmer and help out during more difficult times. This builds quality products, continuous supply and mutual loyalty.

Other supermarkets work differently, moving their buyers continuously from region to region or from product to product, in an effort to drive strict target related buying through the exertion of pressure on suppliers. Relationships are prevented from being formed and target-driven practices are then mobilised throughout the supply chain.

There are many cases of farmers who, having agreed with a buyer to increase output and costs in exchange for beneficial orders or continued support, find the supermarket's part of the bargain is not met. This occurs because a new buyer with no prior knowledge of this "deal" is brought through a rotation scheme. This drives suspicion and a lack of loyalty from the supplier towards



the supermarket. Our research has shown that few farmers are provided with written contracts. This appears to create a situation in which a new buyer can find greater latitude to deny any promise or assurance given by a predecessor. Many farmers told us that the lack of written contracts, and accordingly certainty, did much to undermine the overall supplier/buyer relationship and left farmers in a vulnerable position.

One cheese producer, for example, told us of a supermarket's cheese-of-the-month promotion. The cheese took 12 months to produce which took planning and investment. The cheese-of-the-month promotion was withdrawn overnight when the buyer changed, creating an enormous surplus at the producer's expense, and consequently having a financial impact.

Clearly one success of the supermarkets has been the ability to manage costs by increasing their own margins at the expense of others. Although commercially this makes sense, it is questionable ethically and is carried out at the cost of good corporate responsibility; potentially having a negative reputational consequence for supermarkets.

## Contracts

Our discussions showed little evidence of the use of any official written contracts between supermarkets and farmers. When one producer with whom we spoke requested an official contract from a supermarket, the

response received was "when our customers give us a written contract, we will give you one". Although this appears fair to some extent, it is worth drawing the comparison with the directors and staff of food retailers who do have contracts with which they can hold the food retailer to account. For example, an executive director of a supermarket normally holds a 12-month rolling contract assuring that whatever the future, they will be remunerated well should contracts be terminated. Our discussions suggested that farmers on the other hand are often given very short notice by the supermarkets, in some cases just a few hours, when their services are no longer required or orders need to be changed. Termination payments do not feature as they do for executives. Despite verbal contracts being legally binding, no farmer felt that he or she had recourse to complain when failure to meet the contract occurred. The reason for this was the implicit threat of losing any future business with that supermarket.

Understandably farmers consider themselves to be in a particularly difficult position when they are reliant on a specific supermarket. Given the general absence of written contracts in some of these situations, it seems that a farmer's reliance on a single retailer is the preferred option for the supermarkets, in that it suits them to keep the farmer in that position.

However, interestingly, another farmer spoke of his desire to avoid written contracts as in his opinion

One success of the supermarkets has been the ability to manage costs by increasing their own margins at the expense of others

Some farmers have had to wait significantly longer for payment than the 30 days recommended by the UK government in which suppliers ought to be paid

One farmer was left £100,000 short of working capital overnight when payment terms were changed

they do not work in the farmer's favour. In his view, if the price of a product goes up, the supermarket adheres to the contract to avoid paying the extra cost but if it goes down, they will happily ensure that purchasing power is used to take advantage of this drop in price.

### Payment terms

Payment terms are far from standard across the industry ranging greatly in length. We met some farmers who spoke of exceptionally good payment terms from both the supermarkets and middlemen. We met others who had to wait much longer than 30 days for payment, this being the length of time by which the UK government recommends suppliers are paid (DTI Prompt Payment Code).

There was a clear distinction between those whose payment terms had been met regularly, whatever they were, enabling a reliable stream of capital into the business, and those who experienced very haphazard payment terms with invoices being settled quickly in one month and very slowly in another. We met several farmers who named one supermarket in particular that lengthened payment terms without notice. This left many in a very difficult position financially as a result of arbitrary, indiscriminate changes to terms.

One farmer claimed to be left £100,000 short of working capital overnight when a supermarket significantly lengthened the payment terms in its supply chain. We had in fact spoken to the supermarket concerned when they introduced new payment terms and we were provided with reassurance that they were working with suppliers to ensure that the impact was not negative. Unfortunately, each producer we spoke to supplying this particular company had suffered financially as a consequence. This offered us no evidence of a procedure being implemented to ensure producers did not suffer during this time. The phrase "non-negotiable" was used by one to describe how a change in terms was imposed.

One fresh vegetable producer supplies two supermarkets via a middle man. He receives two prices for the same product, one below cost of production and the other at a profit (what he considered to be a fair price). This effectively means that one supermarket is subsidising the other by ensuring the farmer did not go out of business. The supermarket paying the higher price was also concerned that the farmer was being paid in a regular fashion through the middleman and checked down the supply chain to make sure that this was happening, a responsible

business practice that was otherwise not widely evident.

### Facilitation payments

An analogy was made of the food chain to an hourglass, thousands of consumers wanting to purchase their products sourced from thousands of farmers but through a bottleneck of only a handful of retailers. This places huge power in the hands of the retailers with both consumers and farmers reliant on them to create a market place.

As with many businesses, farmers and food producers may be subjected to (entirely legal) facilitation payments in order to “win” or maintain business relationships with the supermarkets. It was suggested that these are requested of the middleman by the supermarket, but which are then passed onto the farmer.

Examples of facilitation payments include regular deductions from invoices, promotions at the expense of the farmer, taking on additional costs and other ranges of financial inducements paid to the retailer at the farmer’s expense.

### Pernicious practices

In addition to these types of payments, producers are facing additional costs through the deduction from invoices for products that do not meet supermarket specific requirements.

Most farmers believe this to be perfectly acceptable on the whole. However, it appears that at times deductions are made from invoices for products on this basis where

the farmer knew the product to be acceptable. These so called “unacceptable” or defective products appear not to be returned to the farmer. What happens to much of the produce that is not paid for, remains an enigma. For example, a slight difference in fat content of a product elicits discounts in the price paid to the farmer, even though the product all reaches the supermarket shelf at the same price (a product that exceeds fat content requirements does not incite a premium).

We were given examples of a number of practices which, although not illegal in themselves, were apparently being conducted to such an extent that we have termed them pernicious; resulting in a significant shift in margins in favour of the middlemen and the supermarkets but at the expense of farmers. One farmer commented that a supermarket has the ability merely to withdraw from some markets for as short as one week which would then have a profound negative impact on that market.

Another farmer spoke of a 0.05% deduction for defects from all invoices. To him, this was

Farmers and food producers are subjected to facilitation payments in order to maintain business relationships

There are a number of evident practices that are not illegal but conducted to an extreme that we have termed pernicious

This constant skimming amasses to sizeable amounts and significant margin gains for the middlemen and supermarkets



acceptable as he understood his produce would not always be 100% perfect. However we experienced evidence of what we considered extreme cases, which may amount to pernicious practice. A dairy farmer said one supermarket knocked a regular amount off his weekly invoices for no legitimate reason. He never chased the company for the money as he had no extra time to do so and employing extra staff would cost him more than he would be able to recoup, so he just accepted it. Another spoke of discounts for extra work being needed to finish his product off, when he knew this work was not needed. A significant amount, but not enough to warrant chasing the middleman, so once again just accepted. Over time, these deductions amount to a considerable "loss" to the farming industry. This type of "skimming" practice also appears in the receiving of products. One

arable farmer spoke of middlemen who routinely "rejected" 5% of all his produce, although there was no evidence that this was not entering the food chain as none was returned to the farmer. Another practice was last minute changes to the orders. One meat farmer spoke of how his lorry was loaded up with livestock leaving for the abattoir and the supermarket telephoned as the lorry was leaving to cut the order significantly. He spoke of the supermarket taking delivery of the full original order, but only paying for what was "required" and this resulted in the livestock being sold at less than the cost of rearing it. Examples of this type of practice were raised at each meeting we had and just accepted as part of business by the farmer. However this constant skimming amasses to sizeable amounts and significant margin gains for middlemen and supermarkets.



A photograph of a red tractor with a front loader, driving through a green field. The tractor is moving from left to right, leaving a dark, tilled path behind it. The field is lush green, and the background is slightly blurred.

# Working Practices

The farmers with whom we met may or may not be typical of farming as a whole. Many smallholders have gone out of business faced with rising costs and diminishing returns. However all those we met were keen business people, having driven technological and cost efficiencies to improve margins, but still often living just above or at the edge of economic viability.

There were examples of good industry efficiencies and working practices amongst farmers. For example, one potato farmer was able to strike a deal with a lettuce farmer to pool resources. They found that their busy periods differed so were able to share tractors, as well as labour.

Each farmer we spoke to was asked about the national minimum wage and rates they pay their staff. There was not a single farmer paying at the national minimum wage, all paid well above this and

some significantly above. This makes an interesting comparison with the food retailing industry where paying staff at or around the minimum wage is commonly accepted. One farmer kindly opened his books to show us the overall package paid to his workers amounted to around £30k per annum, per worker when housing and council tax are included.

The farmers generally demonstrated good working practices in relation to their employees, evident through staff loyalty and a sense of community. However, in order to remain decent employers, much is sacrificed by most farmers. One meat producer spoke of being in the industry for over a decade during which time he had only had one week off to take his wife away.

Whilst many were very happy to make the sacrifices, there are clearly times when those who are still in the business consider





abandoning farming owing to the extremely long hours for little financial reward or a secure future. Every farmer spoke of seven day weeks, and around 12 hour days.

One of the reasons farmers have to pay their staff well is a lack of labourers from which to source. We heard many good stories of labour practices, offering those from poorer countries regular employment. One fresh produce farmer employed the same two people who had been coming back for six years, and had in fact brought family back to work too. Some farmers paid for airfares as it was easier and more reliable to employ those from overseas who they knew well.

What became evident when speaking to farmers, were the incredible hours that were worked in order to run operations efficiently. One dairy farmer paid over £7 per hour to his workers who started their day at 2am, had three hours off during the day and then worked to

4pm. Being a dairy farm, cows need to be milked twice a day, seven days a week. For some, this may amount to an 80 hour week.

Another dairy farmer had no extra cash to employ another worker. An extra 2p per litre would have allowed him to do so. He relied on his son, who worked with him and who had not had more than one week off in three years. He estimated his working week to be around 100 hours, without a day off, to break even. The two pence per litre would for him mean an extra £25,000 p.a., enough to employ a herdsman.

Sad stories abound with one fresh vegetable producer speaking of having employed the same ladies in the summer for 20 years, but unable to do so any longer as he was retiring early, as over the past few years he had been operating at a loss, eating into his retirement savings. This is leaving his staff without any further work.

Farmers regularly work 80 hour weeks, having little time off

# The UK Dairy Industry in Crisis

Whatever metric is used to look at the industry, decline is the inevitable conclusion

The UK is now less than 90% self-sufficient in milk production

**The Dairy industry in crisis**  
The UK dairy industry is in crisis. Whatever metric is used to look at the industry, decline is the inevitable conclusion.

There are many complex reasons for this, and not all to do with falling farm-gate prices, but inevitably simple economics means that if the cost of production exceeds the price retailers are prepared to pay, dairy herds will go out of production, as they have been at an accelerating rate. One farmer was recalled as saying “auctioneers are busier than ever before”.

Milk is a staple product; one of the few alongside bread that consumers buy because they

require it. To that extent, we believe the consumer, whilst having the choice to shop around for cheaper milk, in reality would rarely do so, and would be relatively insensitive to a rise in price of a few pence per litre. Considering milk is now cheaper than bottled mineral water, this is understandable.

The Milk Development Council informed us that the UK is broadly self-sufficient in liquid milk, but less so for manufactured and dried milk based products. According to the National Farmers Union there has been a 53% decrease in the number of dairy herds since 1995, with seven farms going out of production on average every week. The Milk Development

## British Dairy Farmers 1995-2005

	Scotland	North	Midlands	South East	South West
1996	2,135	4,233	5,722	1,675	5,919
2005	1,523	2,840	3,904	965	4,210

Source: Milk Development Council

Council suggests up to 16% of those remaining will exit the industry in the next two years.

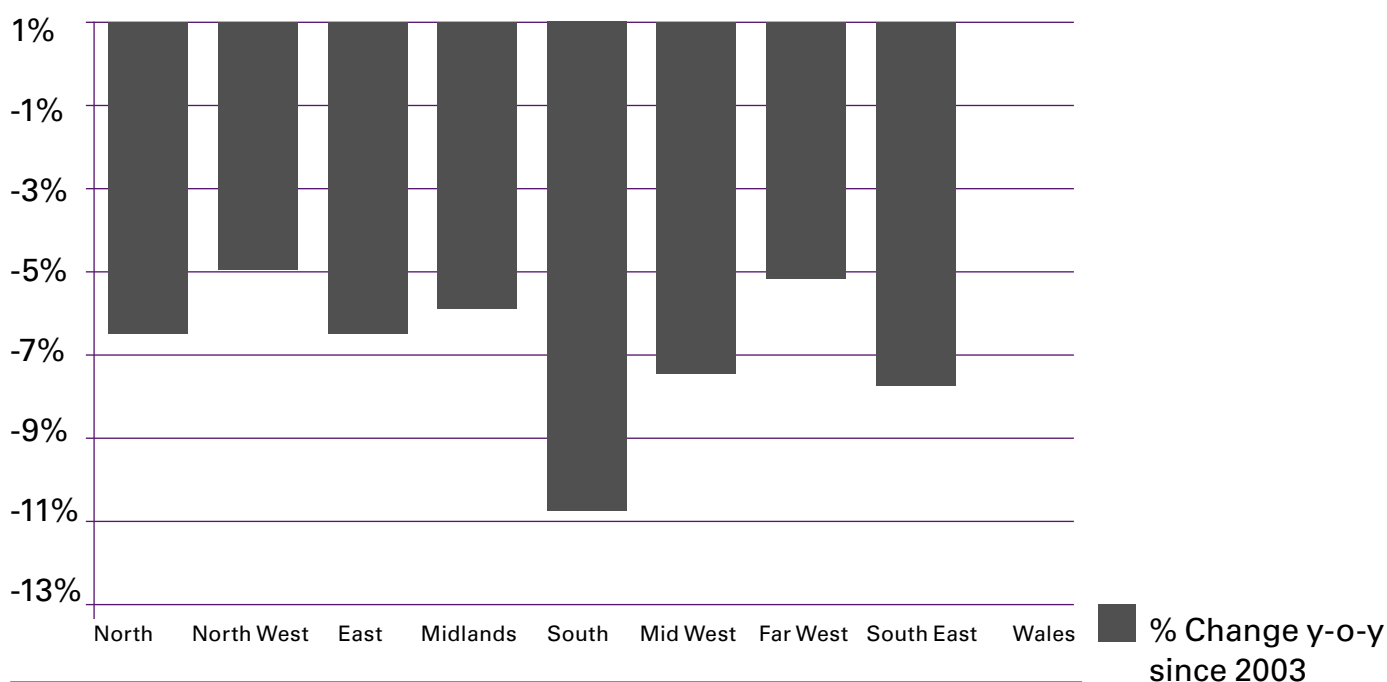
In every region of the UK the story of attrition within the dairy industry is the same; in the two largest milk producing regions, the Midlands and South West, there has been a decline of 31.7% and 28.8% respectively. The number of dairy cows has been put at something in the region of 1.78 million in 2005 – a decline of 31% over a decade. The following graph shows the year-on-year change since 2003 in the number of dairy producers, with no region showing a positive or neutral figure.

This decline was evident in our own conversations; in Cheshire we met with dairy farmers now practically alone in milk production in an area that once

sustained many family herds. Admittedly, the less efficient producer would always face cost pressures, but it was put to us that many efficient and highly cost effective farms had ceased production owing to the farm gate price being, in many instances, below the cost of production.

The current price of milk, and other farm produce, in no way reflects the enormous cost increases faced by farmers over the past decade or so. Production costs have risen through wage inflation, the cost of red diesel, energy prices, water costs, vet bills, animal feed and rental inflation. It should also be borne in mind that it costs a farmer £1,000 per annum to rear each calf for the two years before lactation. This creates inbuilt insustainability within the industry which may then fold should pressures continue.

### Change in number of dairy farmers year on year since 2003 via region



Source: Milk Development Council



The current milk price in no way reflects the enormous cost increases faced by farmers over the past decade

Producers have suffered loss of margin share over the past decade

Milk Prices

Before the Milk Marketing Board was abolished in 1994, guaranteeing a fixed price to farmers for their product, and serving to smooth out price variables in an imperfect market, farmers routinely received 24.5p per litre or 58% of the retail price, with the processor (dairy) taking 16.4p per litre (39.9%), and the retailer just 1.3p or 3% of the retail price. Although fixed by the intervention of a “market regulator” this guaranteed fairness in the supply chain for a staple product. What has clearly happened over the intervening years is an increase in the retailer’s margin at the expense of the farmer producer. Processor’s have largely driven efficiencies within their own businesses, and have preserved their margin as a constant over time.

This table clearly demonstrates the loss of margin producers have suffered over the past decade, which has seen their share fall

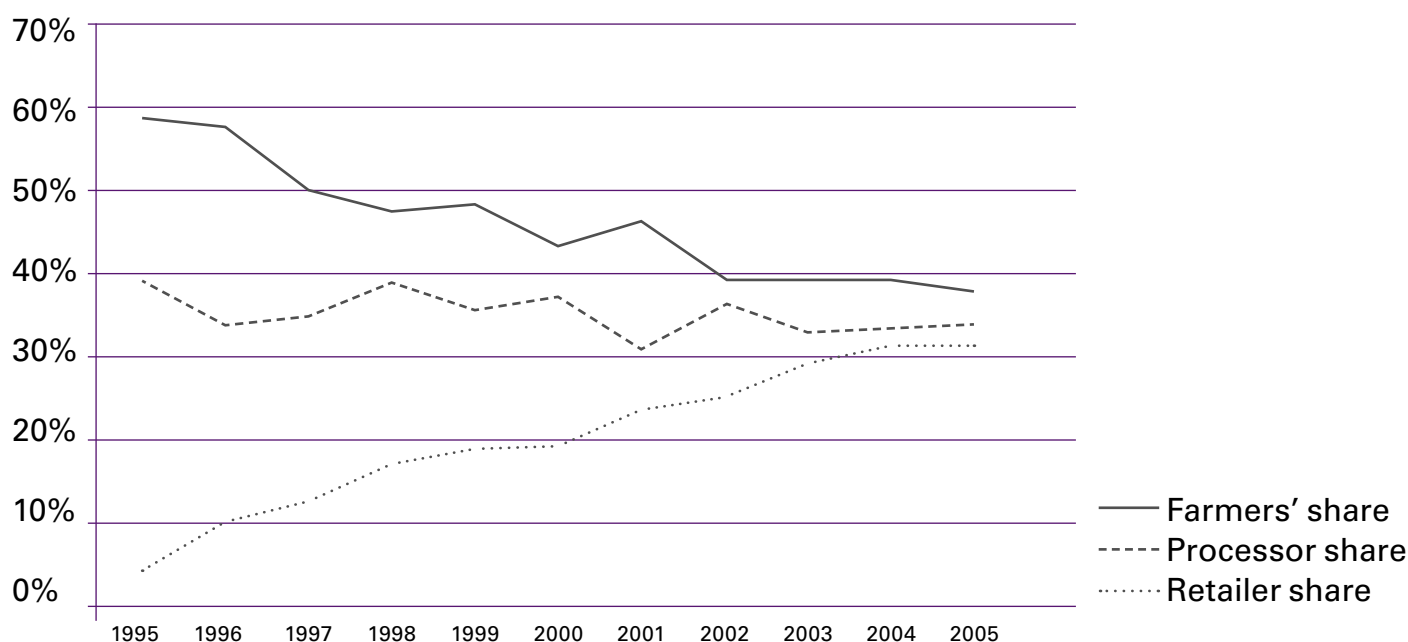
from 58% of the retail price to just over a third (36%), and this during a period of relative product price inflation. Over the same period retailers have taken a larger overall share of the retail price from a little under 3% in 1995 to 31% in 2005. This is evident in the graph (overleaf), which clearly demonstrates the erosion of the share of milk price from the producer; processors have remained broadly flat over the decade, and the substantial increase in the retailers’ share.

At 18.5p a litre, many farmers tell us they either just break even or make a loss; clearly margins at their current level for a quality fresh product are not sustainable, hence the exit of so many from dairy farming. This is illustrated in the following graph when decline in the number of dairy farmers is mapped against the relative decline in the percentage of milk price going to the producer over the same period.

	1995	1998	2001	2004	2005
Retail Price	42p	41p	43p	48p	51p
Farm-gate Price	24.5p	19.3p	19.4p	18.5p	18.5p
Farmer Share	58%	47%	45%	39%	36%
Processor Margin	16.4p	15.6p	13.3p	15.9p	16.8p
Processor Share	39%	38%	31%	34%	33%
Retail Margin	1.3p	15p	24p	31p	31p
Retail Share	3%	15%	24%	31%	31%

Source: Dairy Industry Newsletter November 7, 2005, Vol 18, No 13; MDC

## The share in the milk price between farmers, processors and retailers



Source: Dairy Industry Newsletter November 7, 2005, Vol 18, No 13

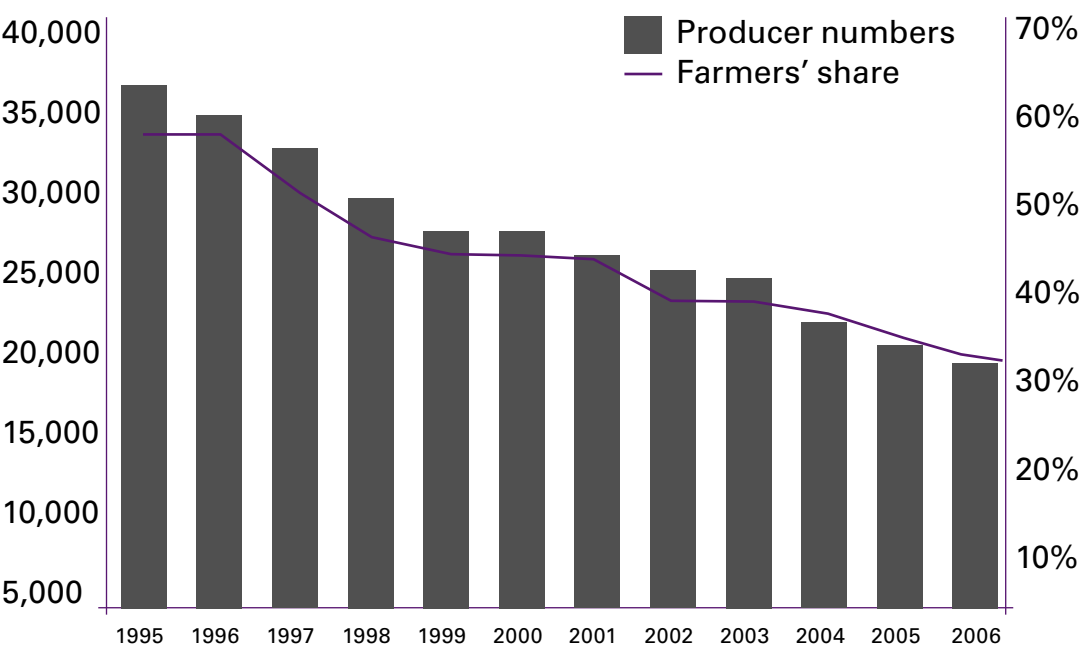
Anecdotal, much has been claimed against the processors, squeezed themselves within a highly competitive market, and so allegedly paying lower prices to the farmers who supply them. In our view this cannot be substantiated from the price evidence, clearly demonstrated in the graphs. Dairies have done well to retain their overall margin by driving down costs and building diversified businesses in dairy related products (cheese, spreads, milk drinks and yoghurts etc). The three main processors (Dairy Crest [22%], Arla, [43%] and Robert Wiseman [35%]) which supply the seven major food retail chains, have themselves had to adjust to retailers consolidating their supplier base (Dairy Crest losing

the contract to supply Asda and Tesco to Arla, whilst increasing the supply to Morrison from 30% to 50%). Farmers, for the most part, rely on the dairies for a fair price and to provide a market for their product. Those in the industry we have spoken to have all eluded to fair practices from the dairies, recognising that they are businesses that need themselves to make a profit; rather the concerns raised with us in terms of being squeezed, focused on the supermarkets.

Farmers we spoke to represent a commendable cross section of innovative and deeply committed business men and women. They had invested in new technology to increase yields and diversified where this made sense. One

At 18.5p a litre, many farmers tell us they either just break even or make a loss

Milk producer numbers (lhs) vs farmer's share of price (rhs)



Source: CCLA IM, Dairy Industry Newsletter; Milk Development Council

farmer was working in partnership with a major food retailer to turn his herd organic, being guaranteed a premium during the transition period and a price premium thereafter. There were instances of commendable practice observed, especially where a differentiating product or premium good is produced. At the same time, there were stories of poor pricing practices from the retailers and with this, an uncertain future for many involved in the production of a staple commodity – milk. There is undoubtedly fear for the future among many we spoke with, reflecting that without public will to improve the price farmers receive, more and more herds will go out of production.

The implications for our farming communities, for our landscape and our food security are profound.

Milk producers are being driven to larger production operations in order to remain viable. With this may come, as some have suggested, a reduction in animal welfare standards, which are so valued by the British consumer.

We therefore welcome some recent moves by the food retailers to recognise the genuine economic hardship farmers find themselves in through no fault of their own. If the supermarkets are serious about corporate responsibility and the place they take within the communities they serve, part



of this is a responsibility to pay a fair price for a fair product. We welcome the announcements by Tesco and Sainsbury to increase the retail price of milk asking that this increase be passed back to farmers via the processors. We note Waitrose has also done the same. Since then, Tesco has announced it is to create its own pool of 850 farmers supplying local milk exclusively to the chain for which a premium of up to 22p a litre would be paid, thereby restoring the farm-gate price to where it was in 1997. This is the model adopted by the niche supermarkets that do not compete on price; both Waitrose and M&S are seen among farmers as an “ideal partner” regularly paying well above the mass retail players. For instance in December 2006, Dairy Crest was paying 23.73p to its farmers contracted to supply M&S compared to the average liquid price it supplies into the

market of 19.92p. Similarly Arla was paying 19.63p on average in December to supply Asda, compared to Dairy Crest’s 21.97p supplying to Waitrose.

Supermarket promises are encouraging and we commend them. These need to be sustained over time as some dairy farmers have suggested that price increases do not always reach the producer for some reason or another. The supermarkets may “win” through good PR at the expense of the farmer. With this in mind, the recent promises made will be empty ones without audited trails of these increases being passed on and a visible restored vibrancy in our dairy industry.

Clearly there is still some way to go before margin differentials are again healthy, fair, and in particular, encourage investment in the sector.

Farmers we spoke to represent a commendable cross section of innovative and deeply committed business men and women

---

<b>Dairy Crest (1400 farms) -</b>	Sainsbury (50%) Waitrose M&S (100%) Wm Morrison (50%)
<b>Arla Foods (1600 farms) -</b>	Asda (100%), Wm Morrison (50%); Tesco (40%)
<b>Robert Wiseman -</b>	Tesco (60%); Sainsbury (50%)

---

Source: Dairy Crest Annual Report 2006, Arla Foods Annual Report 2006,  
Robert Wiseman Annual Report 2006

---







# Implications of a diminishing UK agriculture industry

It is beyond the scope of this review to examine in detail all of the complex reasons for the malaise in British farming, beyond our brief of examining the supply chain relationships with food retailers. However, the implications for British agriculture as a whole are profound, and are worth a comment.

It was put to us on numerous occasions that there has been a silent collusion between the food retailers and government over many years, as the former have been key to delivering low price inflation for over a decade and have contributed significantly to economic priorities that have resulted in a disconnect to self sufficiency in food production. Part of the consequence is an apparent acceptance that food security and self sufficiency are no longer policy priorities. This has been seen in the reduction in self sufficiency in milk for instance with imports coming to the UK from France, Poland and elsewhere in particular, and beef (another industry in crisis) from Brazil, Argentina and Portugal.

Without a commitment to a high level of self sufficiency in

produce traditional to the UK, the consequences will be profound; a loss of jobs, livelihoods, a threat to the landscape as we understand it and no guarantee that the highest standards in animal welfare can be maintained. It has also been put to us that without a policy change on food security, the threat from global warming may itself have untold consequences. Drought may well lead to a shortage of wheat in those countries used to exporting their surplus; rising world prices in wheat will put at risk livestock farmers of all hues who will simply be unable to afford the rising cost of animal feed and go out of business, with a concomitant threat to the supply of fresh meat.

We contend that none of this is either necessary or inevitable; a commitment to a vibrant, sustainable farming community should be something to celebrate in all of its wonder and diversity. For thousands of years, the landscape of these islands have been cultivated and tilled to provide food for our people; we contend it would be a profound sadness and an irreversible loss if this were to be reduced to only a memory within a generation.



# Summary

Farmers just want a fair price for their produce

Farmers are not asking for special treatment but there is inequality and dysfunction within the supply chain requiring attention

In summary, farmers just want a fair price for their produce. All those we spoke to recognise that supermarkets are businesses, operating to make a profit within the confines of the law.

Many farmers are producing goods below cost, which ultimately results in an unsustainable business, evident by the number of farmers going out of business. This is the reason for the title of this report "Fairtrade begins at home".

Tenant farmers are at a disadvantage to those who own their own land as they are unable to diversify without significant financial costs which may ultimately not pay off. Those who can diversify are using accommodation letting, leisure opportunities etc, as a way to subsidise their farming operations.

There were examples of good practices from supermarkets, however ultimately the big four have such a monopoly over the

food chain that they are able to squeeze farmers indirectly through the squeezing of the middlemen. The margins they are able to demonstrate are often, and inevitably, at the expense of food producers.

Consumers do not appear to be aware of the full extent of the supermarkets' monopoly and power. Through their major marketing machines, the supermarkets operate very effective branding and PR which appears to us to obscure this reality.

In conclusion, farmers are not asking for special treatment but there is inequality and dysfunction within the supply chain requiring attention. It is evident that this chain does not operate in a truly free market, but one that is dominated by a few large players that are able to exert exponential pressure in the imbalance of power. Without a change to this imbalance, the UK agriculture industry will diminish with profound implications for all.



# Who We Are, Acknowledgements & Thanks

## The Ethical Investment Advisory Group

The Church of England's Ethical Investment Advisory Group (EIAG) was originally established in 1994 as the Ethical Investment Working Group. The Group includes representation from the Church Commissioners for England, the CBF Church of England Funds, The Church of England Pensions Board, the General Synod, the Archbishops' Council, and the Mission and Public Affairs Council.

The EIAG develops and co-ordinates ethical investment policy for the Church of England investing bodies through a process of research and consultation. It offers practical advice in a theological context and seeks to promote high standards of corporate behaviour and the principles of integrity, accountability and transparency in corporate life. The Group aims to provide assurance to the investing bodies and to the wider church of a robust process of developing an appropriate ethical investment policy for the Church of England.

Currently the Group meets 3 times a year at Church House to discuss ethical investment dilemmas and research projects. The Socially Responsible Investment (SRI) Unit, based at CCLA Investment Management Ltd and made up of 3 analysts, conducts the main body of research. The SRI Unit also supports the secretariat function of the Group.

The EIAG also has a brief to communicate its work to the wider church which it does through a range of publications, and by offering ethical investment advice to parishes, dioceses, cathedrals and other Church of England agencies direct. Since 1996, the Group has produced an annual report, which is presented to the July Synod, either through a debate, or a fringe meeting. This process provides a forum for discussion and a platform for introducing areas of concern from the wider church. This process is often a catalyst for future projects and research undertaken by the SRI Unit. The annual report is publicly available from the SRI Unit at CCLA following the meeting at Synod.

## Acknowledgements & Thanks

There are many to thank for making this project possible.

First and foremost, we should like to thank CCLA for the support it has given to the SRI Unit to enable this work. Without this, a project of this nature and cost would not have been possible.

Dr Jill Hopkinson, the Church of England's National Rural Officer gave unwavering support, and we thank her for her ideas and for making these discussions possible.

The individual convenors of the meetings we thank for their time and hospitality; the Rev Elizabeth Clark, the Rev Canon Dr Jean Coates and Mr Keith Ineson gave unfailing help and picked us up from various railway stations in sun and rain.

We offer grateful thanks to the Church Commissioners for England, who have taken a lively interest in this project and provided introductions to many of their tenant farmers with whom we had subsequent illuminating conversations. The

Commissioners support has given undoubted weight to the importance the Church attaches to a vibrant rural economy.

Finally we offer our grateful thanks to all the farmers we met individually and in groups for their time and trust, and the unfailing hospitality we received everywhere. We undoubtedly emerged with heightened admiration and pride for all that is being achieved every day by our farming community.

To those who felt unable to speak to us, you also provided eloquent testimony to a sense that all is not well in the relationship between farmers and supermarkets, and this too proved an invaluable, silent witness.

**On behalf of the Ethical  
Investment Advisory Group**

**It should be noted that this report reflects conversations and research that were undertaken during the first half of 2007 and does not incorporate changes to the industry that have occurred following this work.**



For further information about this report, please contact the authors in the SRI Unit at CCLA:

Neville White, Secretary, Ethical Investment Advisory Group  
neville.white@ccla.co.uk  
0844 561 5047

Amanda Young,  
Senior SRI Analyst  
amanda.young@ccla.co.uk  
0844 561 5048

This publication is printed on a paper stock derived from 75% recovered fibre. It is also a CarbonNeutral® paper.

## About CCLA

Owned entirely by its charity, faith and local authority customers, CCLA has managed investments for charities, large and small, since 1958.

Our unique ownership allows us to help the not-for-profit sector without having to consider the interests of outside shareholders.

We have developed a range of funds which provides great flexibility and choice to meet the varied and often complex needs of our 45,000\* client charities - a number far higher than any other fund manager in the UK.

As pioneers of socially responsible investment (SRI), we are committed to a constructive engagement with companies and other organisations to achieve a positive agenda for change. Our award winning team provides SRI and corporate governance services to our funds and works on a consultancy basis for a number of external funds.

For further information visit [www.ccla.co.uk](http://www.ccla.co.uk)

CCLA Investment Management Limited is authorised and regulated by the Financial Services Authority.

\*Source: CCLA November 2007

