THE FEASIBILITY OF A DAIRY PRODUCER ORGANISATION IN WALES

Prepared for AHDB LLAETH / DAIRY
ACKNOWLEDGEMENTS

This report was produced by Promar consultants, based on our own internal knowledge, desk research and analysis. We also interviewed over 15 producer and processor leaders from across the Welsh and wider UK dairy industry. We very much appreciate their openness and willingness to share thoughts and opinions on this topic.

We would also like to thank the members of the project Working Group for their guidance and feedback during this project.

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<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>AHDB</td>
<td>Agriculture &amp; Horticulture Development Board</td>
</tr>
<tr>
<td>CBG</td>
<td>Collective Bargaining Group</td>
</tr>
<tr>
<td>DCD</td>
<td>Dairy Crest Direct</td>
</tr>
<tr>
<td>DEFRA</td>
<td>Department for Environment Food &amp; Rural Affairs</td>
</tr>
<tr>
<td>DPO</td>
<td>Dairy Producer Organisation</td>
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<tr>
<td>EFRA</td>
<td>Environment, Food and Rural Affairs Committee</td>
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<td>EU</td>
<td>European Union</td>
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<td>FFA</td>
<td>Farmers for Action</td>
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<tr>
<td>NSW</td>
<td>New South Wales (Australia)</td>
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<tr>
<td>OMSCo</td>
<td>Organic Milk Suppliers Co-operative</td>
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<tr>
<td>PDO</td>
<td>Protected designation of origin</td>
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<tr>
<td>PGI</td>
<td>Protected geographical indication</td>
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<tr>
<td>PPL</td>
<td>Pence per litre</td>
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<td>PO</td>
<td>Producer Organisation</td>
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<td>RPA</td>
<td>Rural Payments Agency</td>
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<td>SADA</td>
<td>South Australia Dairy Farmers’ Association</td>
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<td>SCC</td>
<td>South Caernarfon Creameries</td>
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<td>SME</td>
<td>Small Medium Enterprise</td>
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<tr>
<td>SFA</td>
<td>Suitability, Feasibility and Acceptability</td>
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<td>SWOT</td>
<td>Strengths, Weaknesses, Opportunities and Threats</td>
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<td>UK</td>
<td>United Kingdom</td>
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## MANAGEMENT SUMMARY

<table>
<thead>
<tr>
<th>Dairy Producer Organisations (DPO) could address market challenges</th>
<th>The focus of this report is about gaining a better understanding of how a Dairy Producer Organisation (DPO) structure could work for the benefit of dairy farmers and processors(^1) in Wales. Milk prices are currently highly volatile – as a result, there has been a concentration of processors and retailers, farmers are more exposed to global forces. These factors led to the EU encouraging the establishment of DPOs.</th>
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<tbody>
<tr>
<td>This report aims to assess the potential of DPOs in Wales</td>
<td>The aims of this study were to: undertake a SWOT analysis of a DPO in Wales; define and understand the potential of different DPO structures, including governance issues and to draft an action plan for implementation of a DPO in Wales.</td>
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<tr>
<td>Increased milk production in Wales has made the industry more exposed to global markets</td>
<td>Milk production has been growing steadily in Wales since 2009. Consumption of dairy products in Wales is roughly equal to one third of Welsh production. Nearly half of Welsh milk is converted into products by processors located in England. Dairy processing in Wales is mainly focussed on cheese production. There is currently a disconnection between what processors need, and believe they can market, and the level and pattern of farm production. Milk pricing is highly volatile for farmers who are not positioned in aligned contracts. Many dairy products are commodities which makes it difficult to insulate producers supplying these markets from global volatility.</td>
</tr>
<tr>
<td>Producers in Wales are reliant on the UK market</td>
<td>Around 45% of Welsh milk is processed in England alongside milk produced by farmers there. Approximately 50% of the milk is purchased by co-operatives, with the remainder by private companies. Eighteen milk buyers purchase 99% of Welsh milk.</td>
</tr>
</tbody>
</table>

\(^1\) NB, There are also other entities in the supply chain, such as milk brokers, that could also benefit from development of DPO structures.
The main role of a DPO is to negotiate terms and conditions of supply, including price, with one or more processors. They are immune from some aspects of competition law. DPOs are specific entities set up primarily to negotiate prices and terms and conditions of supply with one or more processors. They are exempted from some aspects of competition law. Established under the EU's 2012 Milk Package, they exist to increase the bargaining power of producers in the supply chain.

Farmers cannot belong to more than one group and they cannot be members of a co-operative.

To be formally recognised, they must have at least ten members or at least two providing together they supply more than six million litres.

They can negotiate different prices for different members, the duration of the contracts can vary and they do not have to take ownership of the milk.

The Government has not made the formation of DPOs mandatory, nor is there any obligation on processors to recognise them, even if they are formed.

Negotiation of contracts in the UK has been agreed between the farming unions and Dairy UK under a voluntary agreement. Part of this agreement is that the purchaser puts in place a mechanism to engage in dialogue with the producers or the producers democratically accountable representatives.

DPOs are common in Germany as well some other parts of Europe. There are also DPOs in Australia. DPOs are an integral part of the German dairy industry and they dominate the milk supply to non co-operative processors. Although we were unable to find any clear evidence that confirms the scale or value of their impact, POs continue to be supported by many German farmers. Moves to increase the size of POs is seen as a positive step in increasing their negotiating power.

There are relatively few CBGs in Australia and the performance of existing CBGs has been mixed. The CBGs that appear to have been most successful are where the farmers and processors have tried to approach the issue as a partnership.
### Three main types of DPO exist

There are several structural options which can be subdivided into three main types (A, B and C) as follows:

- **Dedicated DPO (A)** - supplying one processor – here the DPO acts exclusively on behalf of producers supplying one processor.
- **Multi Processor DPO (B)** - here the DPO acts on behalf of producers supplying different processors. The producers dedicate their supply or a proportion of their supply to named processors.
- **Price Pooling DPO (C)** – this type acts as principal and is analogous to a milk broking business. Any DPO doing this is indistinguishable from a farmer owned dairy co-operative.

### They can act as agent or principal

DPOs can act as an agent of producers, simply negotiating terms and conditions with processors on their behalf. Alternatively they can become the farmers’ customer, or principal, buying milk directly from the farmers and selling it on their behalf.

### They could perform other functions

There is also potential for a DPO to provide other services to its members, including price insurance, marketing, input buying or even to become involved in milk processing.

### Our research identified 7 major (but not insurmountable) challenges DPOs need to overcome to be successful

1. Recognition – not all processors will want to recognise and work with DPOs. They have no legal obligation to do so.
2. Cohesion – the less producers have in common, including geography, scale, systems, the harder it becomes to get them to work together.
3. Funding – the cost of establishing and running a DPO.
4. Skills – the knowledge and skills to run a DPO and carry out its functions.
5. Leadership – there is a need for a person with transformational leadership skills to motivate and nurture the development of any new initiative.
6. Share of supply – any POs ability to improve the returns of members will be proportionate to how important it is to a purchaser. If it has a low share and there are alternative suppliers, its influence is likely to be weak.
7. Patience and confidence – farmers won’t join a PO unless they have confidence it will deliver and make a difference. This is very difficult to achieve for something that has no track record. It may not be easy to make immediate or measurable improvements which could cause producers to lose interest and enthusiasm for remaining as members or joining in the first place.

### Processor

Processors might be sceptical about this type of development, but they
## Recognition of a DPO is critical, but not impossible to achieve

Need a milk supply and this means they have to work with farmers. Key points to note include:

- The recognition barrier may not be as high as it appears
- Several processors already work with producer groups
- Concerns over their threat to security of supply of milk remain
- Without processors recognising a DPO, there is no game

## Setup and running costs should not be a barrier

A DPO is not cost free, but the additional amount that has to be recovered from the market to cover these costs is relatively low. This might be perhaps not more than 0.6% of the milk price. However, persuading farmers that even this amount is recoverable will not be an easy task.

## There are potential DPO leaders in Wales

Feedback from the project Working Group suggests that there are potential leaders in Wales that could be encouraged to ‘step up’ to the challenge of driving development of one or more DPOs in Wales.

## A high share of supply creates influence

It should be easier to gain some level of market influence by representing a large share of a single processors milk supply, rather than trying to achieve market power through setting up a national organisation.

## Farmer confidence in the organisation is key

We see that the biggest barrier to establishing a DPO is a general lack in confidence that they will actually achieve anything. There is a deficit of ambition in the industry around what could be achieved by more collaborative working.

### Glanbia, Tomlinson’s and Dairy Partners (Dansco) as well as Freshways, Medina and Meadow Foods could be potential processors where a Welsh

- Glanbia, Tomlinson’s and potentially Dairy Partners (Dansco) were perceived as being the highest potential processors for a Welsh DPO
- Processors such as Freshways and Medina along with ingredients processors like Meadow Foods were seen as having some potential for a Welsh DPO
- Existing co-operatives are seen as already being very close to a broker DPO model, rather than as a potential DPO, therefore the
### DPO could add value

The potential for new broker DPO is considered to be low.

### Building a DPO in Wales is a change management challenge

Developing a DPO in Wales is unlikely to be a straightforward process that can be described in a mechanical set of steps as you would do so for building a house. The key parts of the process will be far more intangible and require flexibility, innovation and persistence. The process will be more of a change management issue. In this report, we have suggested using a change management model as the basis for creating a DPO in Wales. The model, developed by former Harvard Business School Professor John Kotter, provides a proven “8 Step” process for leading change.

### The Project Steering Group can do more to facilitate development of a DPO(s) in Wales.

The Working Group of this project can play a key role in creating the environment that will facilitate the development of one or more DPOs in Wales. This will involve communicating the findings of this report widely and facilitating others to find out more about DPOs are key activities.
**SWOT ANALYSIS**

**STRENGTHS**

DPOs are a tool that can improve the efficiency of the producer/processor relationships, creating benefits for both parties.

This report identifies three types of DPO model that could work in Wales – Type A, B and C. A DPO acting as an agent and having a high share of a single processors milk intake (Type A) is the simplest and most likely model to be successful in Wales.

There are a small number of milk processors, where a Type A model could be applied.

There are a number of organisations in the UK that could provide training or contract the expert services required by a DPO.

Feedback from the Working Group suggests that there are ‘potential leaders’ in the Welsh industry that could be encouraged to lead development of a DPO in Wales.

There is likely to be funding and additional support available for groups wanting to set-up DPOs.

**WEAKNESSES**

Farmer collaborative groups have a relatively poor track record in the UK. There is significant distrust and lack of confidence in these organisations. Convincing farmers to join a DPO will be challenging.

Both farmers and processors have a poor understanding of what a good DPO could do – this leads to apathy or unrealistic expectations from producers and a lack of interest or irrational fears from processors.

Setting up and successfully running even the simplest DPO model (Type A) requires specific skills and expertise – negotiation, legal knowledge etc. Other more complex models, such as Type B and Type C, require even greater expertise to run.

Setting up and running a DPO will take exceptional leadership skills and enthusiasm. Identifying the right people to do this is critical.

A DPO model will not fit all Welsh milk buyers.

Funding – there are costs associated with setting up and running a DPO, but this study suggests the costs are relatively low, especially for a larger DPO group. A greater barrier is likely to be around perceptions of effectiveness and value for money.
## Opportunities

Market volatility provides an incentive for both parties (producer and processor) to work much better together and a DPO could contribute to improving supply chain efficiency and creating real benefit for both parties.

Most see DPOs as a tool for increasing producer prices, but there are many other areas that a DPO could contribute to improve supply chain efficiency.

Many DPOs already exist across Europe, including the UK’s first DPO, Dairy Crest Direct (DCD), and similar organisations exist in Australia. There are opportunities to learn from others.

Implementing a DPO is about change management – the Kotter model provides a workable template that any group could use to develop a DPO.

Communicating the findings of this report to industry would build greater understanding of DPOs and their potential. The report could be used as a catalyst to encourage action and change.

## Threats

Processor opposition or failure to recognise a DPO is an obvious issue, but our research suggests this should not be a major barrier, particularly if the DPO is built on the basis of creating benefits for both parties.

A rapid return to high global demand for dairy products (considered unlikely at this stage) could lessen farmers’ interest in forming a DPO.

Expansion of co-ops or other aligned milk supply groups could reduce the number of possible supply chains where a DPO could operate.

The financial collapse of a major co-operative could decrease farmers’ trust in farmer controlled businesses even further.
SECTION 1. INTRODUCTION

1.1 Background

It is often argued that due to their position in the supply chain, farmers are in a weak position and get a raw deal. It is certainly true that UK producers are more exposed to global price volatility and the concentration of downstream processors like never before.

The ending of EU milk quotas and a move to world market integration has resulted in EU milk prices becoming more volatile. Prices in the first decade of the millennium were very stable, but have risen and fallen by a far wider magnitude since 2010. There have been emergency market interventions to limit price falls, albeit at low levels, in 2009, 2012, 2014 and more of these are expected in 2015.

In spite of this volatility, the EU Commission have proceeded with the agenda of market liberalisation and have focussed their efforts on ensuring the market works properly and to address any imbalances in terms of power. One initiative they have supported is to encourage producers to establish Dairy Producer Organisations (DPOs).

These are not registered co-operatives, but are alike because they are owned, controlled and used by farmers and exist for a similar purpose; to increase returns to farmers. The terms Producer Organisation (PO) and Bargaining Association can be used interchangeably, with the latter perhaps providing a sharper definition of the exact purpose of these entities.

Industry representatives started to meet and discuss the potential of DPOs in Wales in May 2013. Continued discussions saw the group grow and open up to members from across Wales. The group progressed further, under the support of Agrisgop, which is part of the Farming Connect programme. The group’s interest and focus from the outset was about gaining a better understanding of how a DPO structure could work for the benefit of dairy farmers, processors and wider supply chain partners.

The group gained more knowledge of how a DPO works through their own investigations and from seeking expertise on the subject matter. In spring 2015, the group accessed funding through the ‘Improving the Welsh Dairy Supply Chain’ project, via AHDB Llaeth/Dairy, to commission a consultant group to carry out a more formal evaluation.
1.2 Study Purpose

The main purpose of the study is to:

a. Undertake a SWOT analysis of a DPO in Wales

b. Define and understand the potential of different PO structures, including governance issues

c. Draft an action plan for implementation in Wales

The study takes into account Welsh specific information, including the number of processors, milk buyers and dairy producers who could be involved (not currently part of a farmer co-operative processing company) and the volume of milk that could be affected by a Welsh DPO.

The main questions addressed as part of the study are:

i. Which model would offer the best option for Welsh milk producers?

ii. What scale of DPO would be required to make a difference?

iii. Should the DPO be negotiating with one or more buyersprocessors?

iv. What other roles could the DPO have (e.g. marketing, promotion of Welsh products)?

v. What would be the benefits of being a member of a DPO?

vi. Is there the right mindset/appetite for this in Wales from producers, processors and other key stakeholders?

In the action plan, the following has been addressed:

i. What would be the process of establishing a DPO?

ii. What resources are required to establish and run a DPO (including potential avenues of funding)?

iii. Who needs to be ‘on board’ to get the concept up and running?
SECTION 2. THE INDUSTRY & ITS CHALLENGES

For a host of reasons, it is unlikely that all milk produced in Wales will in the future be negotiated or contracted via a dairy producer organization (DPO). Therefore the purpose of this section is to estimate the potential volumes that could in future be negotiated via a DPO. It contains background information on producer numbers and how they are trending in Wales. Detail is provided on milk volumes, milk markets and milk utilization. The final part of the section is based around synthesis of the qualitative information collected and from discussions with producers and processors.

2.1 Producers

As with almost all other developed countries, producer numbers in Wales have followed a long history of gradual decline. Between 2005 and 2015, producer numbers fell in total by 31% or 3.6% per annum. This is consistent with the rest of the UK, but slower than Denmark and Poland, where producer numbers have fallen by 9% (2005-13) and 8% (2006-16) respectively.

2.2 Milk Production

Despite falling producer numbers, milk production in Wales has increased significantly since 2009, when milk production slumped to a low of approximately 1.4 billion litres. In 2013/14, Welsh milk production reached 1.67 billion litres which was the highest in 20 years.
Apart from a drop in 2012/13, due to a particularly poor season, milk production in Wales has shown a consistent upward trend over the last 5 years. If it continues at the current rate of increase of 3.67% per annum, Wales will be producing over 2 billion litres by 2020.

Research from DairyCo and the National Farm Survey, shows that concentration is occurring in the industry with the bigger farmers continuing to grow and to produce a greater share of Welsh milk output. There does not appear to be an appreciable difference in the distribution of herd size when comparing England and Wales (see Figure 3).

Milk production is concentrated in five main areas of Wales. In order of volume produced, these are the South West, North East, North West, Welsh Borders and the South East. Hardly any milk is produced in Snowdonia and the upland areas of Brecon and in Central Wales. Herd sizes are evenly distributed, apart from the North West where herds tend to be slightly smaller (see Figure 4).

Figure 4: Distribution of Welsh Dairy Herds by Volume
2.3 Milk Utilisation

Around 1.6 billion litres of milk is produced in Wales and more milk is produced in the country than is needed for consumption by the population or that can be physically processed into products. A previous study by Promar estimated that in 2013 around 700 million litres of raw Welsh milk was exported mainly into England.

This is entirely logical, as it is generally more efficient to move bulk-milk closer to the final consumption point, than package products near to the place of production. The exception to this is cheese and milk powder, because they have lower moisture content than raw milk. Around 800 million litres of milk is processed in Wales. Most of this (88%) was converted into cheese. Welsh cheese production is dominated by cheddar and mozzarella with a 60/40 split between the two.

Liquid milk for the local drinking market is the next largest product sub-group, with production of over 70 million litres or 8% of milk processed in Wales. Total demand for liquid milk in Wales is approximately 300 million litres. Wales processes just 1.3% of UK liquid milk, yet consumes nearly 6% of the total UK demand. The main liquid milk processing dairies in the UK are shown in Figure 5 on the following page. Generally, liquid milk commands a higher price than milk for manufacturing. This partly explains why milk prices are historically lower in the country because a relatively low proportion of Welsh milk is utilised for this market.

\[^2\] Based on consumption of 103 litres liquid & 11.2Kg Cheese per person per annum (Source DairyCo Dairy Statistics 2014)
The remaining 4% of milk processed in Wales is converted into a wide range ‘other’ dairy products, including yogurts, clotted creams, ice cream and butter.

Unlike most dairy producing and exporting countries, Wales has no milk powder processing capacity. Some Welsh milk producers do have relatively close access to the UK’s largest powder driers at Westbury, in Wiltshire, England.

2.4 Processors

The Welsh dairy processing industry is made up of around 45 milk processing establishments. These range from small niche manufacturers to large globally competitive processors.
Almost 50% of these processors are primarily based around cheese manufacture. Ice cream and cream processors account for the next largest group of producers, with 10 plants operating in Wales. Wales also has two specialist yogurt processors, as well as seven liquid milk processors and one whey processor.

Despite having around 45 processors in Wales, the industry is dominated by four large processors, Glanbia Cheese, Dairy Crest, First Milk and Arla Milk Link, which account for around 1 billion litres or 62% of milk produced in Wales.

Wales also imports a very small amount of milk for processing, particularly in areas of North Wales, where Welsh processing plants are close to the border. This movement of milk from Wales to England has increased in recent years, particularly when English milk buyers such as Meadow Foods, started to look for additional suppliers of milk around 2012.

**Figure 6: Welsh Milk Utilisation, Imports and Exports in 2013**

![Bar chart showing milk utilisation, imports, and exports in 2013.]

2.5 Welsh Milk Buyers

In this section, we describe the complex nature of milk purchasing in the region, especially the overlap between English and Welsh producers.

The recent DairyCo survey of Welsh farmers (2014) identified over 27 buyers purchasing Welsh milk; approximately 98% of which was purchased by the 16 companies listed on the next page. Half of the top 16 Welsh milk buyers have processing facilities in Wales or are Welsh based organisations. The largest Welsh milk buyers are made up of a mix of ownership structures. Around 60% of the milk is purchased by 10 private/publicly owned companies, six co-operatives account for the remaining 40%.
Promar estimates that around 50% of the milk produced in Wales is purchased by co-operatives or organisations that already have suppliers with DPO status\(^3\).

The remaining 50% of milk is mainly purchased by a mix of plc and private companies, often using both Welsh and English milk. The majority of these companies supply liquid milk markets in both England and Wales. The next largest group of buyers supply cheese to the UK and international markets. Finally, a small percentage of milk is purchased by dedicated cheese manufacturers or by specialist dairy processors.

It is extremely unlikely that all of these processors will be persuaded to convert into or deal with a DPO. The appetite they have for doing so will vary and this depends on a complex interplay of factors. These factors, or challenges, are outlined in the following section of the report. In Section 6, estimates of the likely volumes of milk that could realistically be marketed via a DPO are set out.

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\(^3\) It should be noted that County Milk Products is not a milk processor per se but is a privately owned milk broker, albeit with shareholdings in various milk processing businesses in the UK. It is a major supplier to Meadow Foods and Peninsula Milk Ltd.
Milk buyers tend to buy milk closer to the places where the milk is needed. Figure 8 illustrates where the main Welsh milk purchasers source their milk.

**Figure 8: Distribution of Welsh Milk Fields**

NB - this diagram is representative of the distribution of farms in Wales based on the 2014 DairyCo survey of Welsh farmers. It does not show the location of all Welsh milk producing holdings.
2.6 Industry Challenges

2.6.1 Supply and Demand Imbalance

The Welsh and indeed global dairy industry is currently facing an uncertain future. The main challenge appears to be supply and demand imbalances around the world leading to high levels of price volatility. An impartial economist would probably conclude that dairy is an industry lacking cohesion between processors making and marketing products and farmer suppliers producing the raw ingredients for them. On the other hand, milk products possess all of the hallmarks of a commodity in that when it comes to milk derivatives, like butter and powder, it is very difficult to differentiate products across markets. Even cheddar cheese often has the characteristics of a commodity, unless it is strongly branded. Today’s oversupply challenges are as much of a symptom of this malaise, as were the price peaks witnessed in late 2013 and early 2015.

Many processors consider ‘lack of demand’ in the UK and ‘over supply’ as the main current issues the industry needs to address. We were told “farmers produce unplanned or extra milk that is not needed.” and one warned “do not produce milk that is not wanted and pay attention to time of year, volume of supply etc..” and we were often reminded “milk is traded as a commodity and there is currently a world surplus, we need less over production and a match of demand and supply”.

When milk is in short supply, it is assumed that processors wish to build long-term partnerships with suppliers. When the opposite is true and the market is oversupplied, there is a perception that processors are only interested in buying milk as cheaply as possible. Conversely, it is argued that farmers are no different and seek to quickly switch buyers when prices are high and want to develop long-term contractual arrangements when prices are low.

2.6.2 Aligned Contracts

Some of the people interviewed claimed the industry today appears to be divided between the have and have-nots, with those fortunate enough to have aligned retailer contracts representing the have, with the rest considered to be the have-nots.

“aligned and non aligned contracts are a challenge. Aligned will be OK and make money - for the rest, it will be a roller coaster of a ride and these will be the farmers to most readily fall by the wayside”.

Presumably if more farmers are able to position themselves in aligned contracts or are able to exploit another mechanism that delivers price stability, this problem of extremes would be dissipated. In many regards, producers in aligned contracts overcome most of the challenges
identified in this report with regard to the establishment of DPOs (challenges are covered in detail in Section 5).

2.6.3 Perceived Value of Milk

Several other significant problems were identified, including the image of milk in the market place and the need for producers to address their productivity.

“milk is not seen as valuable by consumers: more needs to be done to address this”.

“farmers need to seriously look at cost structures - make sure they are running the right system for the contract and they invest in the right areas”.

Almost everyone we spoke to felt aggressive pricing strategies used by retailers with milk undermined the value of it.

Some believed product mix was crucial and that the industry needed to focus efforts to create more value.

2.6.4 Future Milk Supply

Declining farm numbers is seen as a problem, because it will make it harder for processors to source milk.

“we will be down to 5,000 (dairy farmers in the UK) sooner than we think or care to imagine – but milk production will stay the same regardless”.

A key issue mentioned by a number of respondents (mainly processors) was the belief that the “pattern of (milk) production in Wales is creating problems in the marketplace”.

“as soon as the spring flush starts the market goes into free fall”.

“I loathe spring calving herds”.

One thing everyone across the industry seems to agree on is that “producers and processors could work better together”.
2.7 Section Summary/Conclusions

- Consumption of dairy products in Wales is roughly equal to one third of Welsh production.

- Nearly half of Welsh milk is converted into products by processors located in England.

- Dairy processing in Wales is mainly focussed around cheese production.

- There is clearly a disconnection between what processors need, believe they can market, and the level and pattern of farm production.

- Milk pricing is highly volatile for farmers who are not positioned in aligned contracts.

- Many dairy products are commodities which makes it difficult to insulate producers supplying these markets from global volatility.

- Competition between retailers for market share has reduced the market value of liquid milk.

- Managing costs will remain important.

- Processors do not consider supply shortages are likely to be an issue in the foreseeable future.

- Less than two years ago, processors were desperate to obtain more milk in order to meet growing demand.
SECTION 3. DAIRY PRODUCER ORGANISATIONS

3.1 Background to POs

A "Producer Organisation" (PO) is defined in Article 122 of Council Regulation (EC) No 1234/2007, of 22 October 2007. A PO pursues specific aims which may include: ensuring that production is planned and adjusted to demand, particularly in terms of quality and quantity; concentration of supply and the placing on the market of the products produced by its members; and optimising production costs and stabilising producer prices.

Most European Dairy Producer Organisations (DPOs) have been formed in the last ten years. Other sectors, such as fruit and vegetables have a longer history of POs. There are, to our knowledge, no detailed empirical studies on Dairy POs. Despite this, the European Commission is committed to supporting the restructuring of the sector following EU quota removal, by encouraging the creation of voluntary producer organisations.

In the dairy industry, as with many of other agricultural industries, there are already a number of organisations and structures that involve groups of farmers that could be described as having some of the characteristics of a PO. These range from simple focus/discussion groups to groups of farmers operating together to buy inputs or sell their milk collectively.

In this report, we refer to a Dairy Producer Organisation (DPO) as specific entity setup for one or more of the purposes listed in the EU Milk Package i.e. primarily to negotiate prices and to terms & conditions of supply with one or more processors.

3.2 The EU Dairy Package

Partly in response to the major cyclical slump in market prices encountered in 2008/09, the EU Commission presented proposals for the dairy sector in October 2010 called ‘the Milk Package’. The Milk Package is made up of three core components, based around POs, Interbranch Organisations and strengthening the regulation of supply of PDO/PGI cheese. The overall objectives of the Milk Package are to increase the bargaining power of producers in the supply chain. It was finally published on the 30th March 2012^4.

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^4 Regulation (EU) No 261/2012
^4 Regulation (EC) No 1234/2007
The main features of the EU Milk Package for producers are that it:

- Provides for the operation of POs in the dairy sector to negotiate contracts for the delivery of raw milk to processors on behalf of their members

- Provides an exemption from some aspects of competition law. Rules on market share will allow POs to grow to up to 33% (4.55 billion litres) of national milk production or not more than 3.5% (4.8 billion litres) of EU production

- Gives Member States the option of legislating for certain provisions to be included in contracts between producers and milk buyers. If the option was taken up, contracts may have to address price, volume, timing of deliveries and duration

### 3.3 Membership

Under the rules of the EU Milk Package, any milk producer is able to join a DPO if they so wish. Farmers can, however, only join one group. Furthermore, farmers who are already members of a dairy co-operative should not be allowed to negotiate with the company that they own, hence the regulation only applies to non-co-operative farmers.

### 3.4 Implementation in the UK

In the UK, only the mandatory elements of the EU Milk Package are being implemented. The government implemented formal recognition of POs and this was published by the RPA on 31st March 2014.

Once formed, POs will be required to furnish the RPA prior to initiating each negotiation and once per year, by 31st January, the volumes delivered in the previous year. This will enable authorities to consider if the negotiation could result in the exclusion of competition or serious damage to SME processors.

The government have decided that to be formally recognised a PO should have at least ten members, or at least two members, providing together they supply more than 6 million litres.

The government’s current position is not to stipulate the nature of dairy contracts. Instead, they would prefer to leave sufficient time for existing voluntary industry agreements to take shape. *They do not intend to introduce legislation to make contracts compulsory.*

The government has not endorsed the proposals to allow any group of producers to manage the supply of PDO goods onto the market. This effectively excludes the possible role of a Welsh DPO to place any Welsh PDO/PGI type products into the market. We are not aware
any dairy product originating in Wales has PDO/PGI status which makes this a somewhat irrelevant issue for the time being.

DPOs will be required to meet certain conditions in order to maintain their formal recognition by the RPA. A persistent failure by a DPO to supply the RPA with information in a timely manner about membership, volumes negotiated and volumes supplied would result in de recognition.

3.5 Impact on the UK

POs are most likely to exist to concentrate supply, negotiate contracts and co-ordinate the volume, seasonality and quality of milk delivered to the supply chain. Their formation must be initiated by producers and the RPA require any PO formed to be a legal entity. Co-operatives and companies owned and controlled by the farmers who supply the milk to the PO will satisfy this requirement.

POs will be able to negotiate contracts in the following circumstances:

- Whether or not ownership of the milk is transferred to the PO

- Whether or not the price negotiated is the same as regards to the joint production of some or all of the farmer members

- Provided that the farmer members belong to only one PO that negotiates their contracts

- Provided that the milk is not covered by an obligation to deliver arising from the farmer’s membership of a co-operative

The duration of any negotiated contract is not stipulated. The DPO is not required to negotiate the sales of all volumes supplied by its members.

3.6 Latest Thinking

The dairy sector was subject to an EFRA enquiry into dairy prices in 2014. This was reported on in January 2015. The Committee concluded that “action to encourage the spread of Producer Organisation could assist a struggling industry”. The report felt the role of the Grocery Code Adjudicator could be expanded to include the interests of primary producers who, currently, are secondary suppliers that do not fall under the remit of the adjudicator.

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The DEFRA Minister, George Eustice, supports the development of POs, but distances the government from taking an active role in their formation. He told the committee: “….really it is not for us to prescribe that farmers should work together. The role is for us to facilitate it and remove any legal barriers to them coming together”… we have done that but we cannot actually do it for them”.

3.7 Legislation on Contracts

Contracts between producers and milk buyers are already the norm in the UK and highly advanced compared to many EU countries. Regulation of contracts by DEFRA and the devolved administrations could have unforeseen consequences, as the requirements of the EU Milk Package in respect of contract clauses are still open to interpretation. However, existing contracts have been criticised as being one sided, with farmers themselves having little say in how they are constructed or negotiated.

Historically, dairy contracts have been designed by the milk buyer and rarely contain any clauses that permit farmers to negotiate milk prices. In order to address concerns over current industry contractual arrangements and obviate the need for regulation, the farming unions and Dairy UK agreed a voluntary Code of Best Practice for contracts in 2012.

According to DEFRA, about 85% of farmers are signed up to the code, with the remaining producers thought to be suppliers of small processors. The Regulation, EU 261/2012, allows Governments to make the code compulsory for all producers, if required. To date, there has not been any push from either farmer representative bodies (NFU, FUW, FFA etc.) or the dairy processors (represented by Dairy UK) to make this happen.

A key clause in the code relating to POs states: “it is acknowledged that Producer Organisations must be able to either resign some or all of producer contracts, or adapt volume sales to alternative producers if the Producer Organisation is not satisfied with the outcome of the negotiation”.

Most purchasers have adopted Option B – “pricing at purchasers discretion”.

This agreement has been criticised for a number of reasons:

- The code does not deal directly with milk prices, instead it concentrates on contractual relationships
- The ability for farmers to leave a contract and switch to another buyer is severely limited for small producers and those in remote areas
• Even 100% compliance with the code would not necessarily make a difference to current farm gate milk price, which are ostensibly driven by global markets

• Several large buyers (those with more than 250 producers) do not offer producers more than one pricing option

Perhaps more importantly, there does not appear to be widespread adoption of the requirements that processors [2.2c of the DIC]

“……state that the purchaser undertakes to put in place a mechanism to engage in dialogue with the producer(s) or the producer’s democratically accountable representatives (where such a mechanism has been agreed by the purchaser with those producer representatives), or a mechanism to formally consult with the producer(s) or the producer’s democratically accountable representatives (where such a mechanism has been agreed by the purchaser with those producer representatives) in advance of any variations to pricing”.

3.8 Competition Law

Although some collective negotiation is permitted under current competition rules, there is still a lack of legal certainty so the EU Milk Package provides for a legal basis in agricultural law to permit POs to negotiate contracts including price, in order to ensure competition is not excluded.

Our understanding is that the competition law surrounding negotiating activities of producer groups is uncertain and will depend on the activities concerned and their relative size. It is partly because of these uncertainties that EU law concerning POs, including DPOs, were introduced, giving a broad relaxation from competition law, subject to the market share levels previously described.

One factor, perhaps less well understood, is that it is the restriction on the producer which is pertinent rather than what is commonly thought to be a need to restrict market dominance of a group of producers. It is the ability (or inability) of a producer to exercise his/her freedom to contract that is the area of legal uncertainty. The PO legislation removes this. Becoming a DPO provides much clearer comfort on such issues and enables it to more readily and freely enter into contracts on behalf of members and so develop a stronger negotiating platform for the future.

The OFT are the regulatory body who would decide if a DPO is in breach of competition law and would consider a number of factors to determine if a DPO was harming competition, including:
● Terms which restrict the ability of buyer and seller to contract with other parties for the purchase or sale of milk

● Market share in the defined market. They may wish to consider the particular area of the UK covered by a negotiation. This would mean that a DPO covering a large proportion of Welsh milk might be challenged by the competition authorities

● The level of competition between the DPO and other sellers of milk

● The availability of other sources of supply

● Impact on SME business costs and hence their ability to compete in the market

● The impact on buyer power

It is important to note the extent of OFT powers, although they do not appear to have the ability to arrest the activity of a DPO. Instead, they can ask for a negotiation to be re-run or prevent it from going ahead. This leaves open the opportunity for a DPO to amend its approach, rather than preventing it from negotiating with a processor.

The proposals do not affect dairy co-operatives where the raw milk is covered by an obligation to deliver arising from the farmer’s membership (of a co-operative) in accordance with the conditions set out in the co-operative’s statute.

3.9 Dairy Producer Organisations in Other Countries

3.9.1 The German Experience - Price Setting and the MEG Milchboard

In Germany, some 80,000 dairy farmers sell to roughly 100 dairies of which 2/3 are co-operatives. Dairy farm numbers have fallen 20% since 2008, which is similar to the UK.

POs are well established in Germany with around 140 individual POs in existence. The majority of these were formed before the EU Commission’s Milk Package came into effect, although around 13 new POs have been formed in the last 2 years. Industry sources suggest POs account for almost all milk deliveries to non-co-operative processors. In 2013, German DPOs were estimated to cover around 11.2 bn litres or 33% of German milk deliveries.

In addition to individual POs, the German industry has two over arching ‘associations’ of DPOs. The largest of these associations is the Deutsche Milcherzeugergemeinschaften’ Milch Board (MEG), which was formed in 2007.
The aim of MEG is to achieve a “fair” price for farmers. This is based broadly around the producer cost of production not overall demand in the market. 18,000 German farmers are members and the organisation is divided into 10 regional sub divisions. The regions elect representatives and an advisory board. Fees for membership are currently set at €10 per 100 tonnes of milk per year (equivalent to £80 per million litres).

Increasing scale by bundling milk is seen as a key strategy for MEG to arrive at a better bargaining position. The performance of MEG has not enabled it to achieve its aims as they claim they do not have sufficient volume to influence prices. They believe the limits to further milk bundling are currently set by the “aggressive behaviour” of larger processors. Until now, MEG has not been involved in direct price negotiations with dairies, which begs the question what can they hope to achieve without doing this. Presumably, this current position represents the start of a journey with a long term aim of building power and influence.

Longer term, MEG want to control the flow of physical product to dairies, both co-operatives and private companies. This is seen as an important step to building credibility with both processor and members. The MEG feel the EU Milk Package is a welcome step, although it does not go further than was currently permitted under German law and restricts the permissible bundled share of producer rights. MEG is critical of the practice of insisting all milk from a farm is delivered to one dairy. They see this practice as anti-competitive and claim that it constrains the effectiveness of a PO to improve returns.

In 2012, the German anti-trust authorities decided that publishing price data of spatially proximate dairy companies should cease, as they found evidence it was being used for illegal collusive practices at the expense of producers. Price information can have positive effects as it allows farmers to compare the performance of different contracts and to base decisions on this information, such as whether to find a new contract or to attempt to influence existing arrangements.

The development of the EU’s PO legislation has received criticism from German farmers because it limits bundling (the upper limit) to 33% of the national market, whereas the previous German legislation allowed for up to 50% of the respective national market share.

These bundling limits would permit a PO to have 100% market share in a region (for example, in the German South) whilst still staying within the national limit ceiling of 33%. On the other side of the coin, some processors are able to gain a sizeable market share of production in a specific area.

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6 This is similar to the UK’s Competition and Markets Authority
3.9.2 The Australian Experience

Collective Bargaining Groups (CBGs) have existed in the Australian dairy industry since 2001. Prior to this, two or more farmers working together to negotiate prices with a buyer would have risked breaching the Australian Competition and Consumer Act, which required competitors to operate independently of each other.

Changes to the ACC were made following deregulation of the dairy industry and the recognition that, in some situations, collective bargaining could encourage vigorous competition by ‘levelling the playing field’ between small operators (such as individual dairy farmers) and large milk buyers (like multinational processors and retailers).

Despite the legislation allowing CBGs to form existing for more than 15 years, there are relatively few CBG’s in Australia (according to Dairy Australia, there are around 20 CBG’s operating today). There are many reasons for this, including the strong position of cooperatives in the Australian industry, particularly in the export side of the business.

The track record of existing CBGs in the dairy industry has been mixed. Groups such as Manning Valley in NSW and SADA in South Australia have been able to secure better prices for their collective milk supply. In both of these cases, the reality was that the big supermarkets pushed the processors into the deals (at the time, supermarkets had recently dropped the price of house brand milk to A$1 per litre (approximately 50 pence per litre) and they were keen to deflect consumer and media concerns about the impact on farmers).

The CBGs that appear to have worked best in Australia are where the farmers and processors have tried to approach the issue as a partnership (i.e. we make it easier for you to get guaranteed volumes of milk in return for some certainty over pricing and supply structures). CBGs that have expected bargaining to automatically yield a better price tend to have been less successful and sustainable.

As with other farmer based collective bargaining groups, there are a range of factors that contribute to success. Having a strong foundation document and plan, gaining buy-in from members – even by just paying membership dues can build a sense of commitment. Building cohesion by forming groups with members who have similar outlook, risk profile and expectations is also important. Strong leadership and absolute persistence were also seen as critical success factors.

In 2013, Dairy Australia renewed efforts to encourage collective bargaining by publishing a guide book and promotion campaign to help Australian farmers for CBGs. The idea was to renew farmers’ awareness of CBGs and to increase the chances of success for those groups deciding to form a CBG.
3.10 Section Summary/Conclusion

- Dairy Producer Organisations (DPOs) are specific entities set up primarily to negotiate prices and terms and conditions of supply with one or more processors. They are exempted from some aspects of competition law. Established under the EU’s Milk Package, they exist to increase the bargaining power of producers in the supply chain.

- Farmers cannot belong to more than one group and they cannot be members of a co-operative.

- To be formally recognised, they must have at least 10 members or at least two providing together they supply more than 6 million litres.

- They can negotiate different prices for different members, the duration of the contracts can vary, and they do not have to take ownership of the milk.

- The Government have not made the formation of DPOs mandatory, nor is there any obligation on processors to recognise them even if they are formed.

- Negotiation of contracts in the UK has been agreed between the farming unions and dairy UK under a voluntary agreement. Part of this agreement is that the purchaser puts in place a mechanism to engage in dialogue with the producers or the producers democratically accountable representatives.

- DPOs are an integral part of the German dairy industry and they dominate the milk supply to non-co-operative processors. Although we were unable to find any clear evidence that confirms the scale or value of their impact, POs continue to be supported by many German farmers. Moves to increase the size of POs is seen as a positive step in increasing their negotiating power.

- There are relatively few CBGs in Australia and the performance of existing CBGs has been mixed. The CBGs that appear to have been most successful are where the farmers and processors have tried to approach the issue as a partnership.
SECTION 4. POTENTIAL DPO STRUCTURES & FUNCTIONS

Configurations of DPOs offer a high degree of flexibility. It is possible that a wide variety of these organisations will develop across Europe, as farmers seek innovative ways to increase their returns.

The main variations in DPO are based around three factors, including:

- Overall Type
- Business Model
- Business Function

4.1 Overall Type

Several possible configurations of DPO exist, but they fall broadly into two main types: One to One and One to Many. A One to One DPO negotiates exclusively on behalf of its dedicated member supply pool with one processor. The One to Many type of DPO bundles the supply of members milk and arranges for it to be sold to different buyers. There are two main variations of this model:

- **One to Many – Dedicated Suppliers** (1-2M_DS) - in this model, the DPO negotiates terms and conditions on behalf of dedicated suppliers and deals with multiple processors. It searches for better terms and advises members if it is in their interest to switch to a new contract with the existing buyer or another

- **One to Many – Broker Model** (1-2M_BM) - here, the DPO operates in a way that is similar to a traditional dairy co-operative. It may act as a Principal or Agent. As a Principal, it can achieve pool pricing

At an 'entity level', there are really only two options regarding types of DPO. These are shown as Options A and B below (i.e. the DPO either represents suppliers providing milk to a single buyer or it represents suppliers providing milk to multiple buyers but with a dedicated group of suppliers).

In other words, the same farm milk goes to the same factory every day.

Option C is broadly the same as B, except the buyer does not have a dedicated supply. In this instance, the discretion to deliver milk is determined by the pooled producer DPO.
4.1.1 Dedicated DPO Supplying a Single Processor (A)

This processor aligned group format is likely to be the most common configuration. It would be a legal entity (co-op or company) with an elected or appointed group of individuals who negotiate with the milk processor. This would be very similar to the arrangement that currently exists between Dairy Crest Direct (the PO) and Dairy Crest (DC) plc.

The details of this arrangement are confidential between DCD and DC. However, a number of broad principles apply and are in the public domain.

There are agreements in place that trigger a negotiation. These vary depending on the contract. DC will not unilaterally impose any changes to pricing on variable contracts, unless it has held a formal negotiation with DCD. It will not adjust any of the components of formula contracts without entering into a negotiation with DCD.

DCD themselves can trigger a negotiation with DC under certain conditions. These are generally by reference to movements in the milk market.

Negotiations will proceed through various rounds. At any time, both parties can walk away from a negotiation. DCD are able to trigger the three month notice period for members in the event that they believe their producers could achieve better returns by selling to other buyers. This “notice to trigger” would send a strong signal to the dairy and wider industry, that negotiations had broken down.
Farmers within the DPO may have different terms and conditions depending on the functional attributes of the milk they supply.

4.1.2 Multiple Processors DPO with Dedicated Suppliers (B)

This could be a group of farmers from a region or perhaps involved in particular method of farming (e.g. Channel Island) who would empower the DPO to negotiate on their behalf. It would be a registered legal entity as in A above. It would negotiate prices with a range of buyers. This model is similar to private milk brokering businesses, except ownership and control is vested in the farmers supplying it.

In this case, the price the farmer receives is dependent on the terms and conditions agreed with the processor. Farmers within the DPO may have different terms and conditions, depending on the functional attributes of the milk they supply so that different groups of farmers in the DPO would be paid independently of one another depending on how the DPO had negotiated on their behalf.

4.1.3 Price Pooling DPO (C)

A DPO that secures contracts with multiple buyers and places farmers with these contracts would invariably end up with producers earning a range of prices. This could become a source of frustration or division amongst members. To get around this, unless purchasers all agree to pay the same price, it requires the pooling of returns.

This is how a milk broker co-operative model works. Doing business this way spreads risk and also avoids accusations that a particular sub group is treated more favourably: there is nothing to prevent a PO doing this.

However, once pooling takes place the DPO has to fulfil various functions such as accounting, invoicing, payments, banking and reconciling the milk volumes invoiced with the volumes delivered.

A variation of Option B in the UK could be a Retailer Aligned Group. Farmers who are part of a retail aligned group may wish to form a PO to collectively negotiate and build a relationship with the retailer directly, rather than through their processor. Although we have yet to see officially registered POs fulfilling this function, the existing practice of retailers and producer groups working together appears to achieve similar ends. To all intent and purpose, they behave and achieve the same ends as a DPO, although they may not wish to officially register as one with the RPA.

Within a market place more than one of these business groupings could exist. There could be several dozen POs across the UK competing with one another for a loyal supplier. In so
doing, they would need to compete for both producers and customers. This is no different to the current situation, whereby processors, co-ops and retailer groups tussle to secure a milk supply.

4.2 Business Model – Principal or Agent

In addition to the above four options for overall DPO type, there are a number of potential forms for a DPO, based on the business model adopted by the organisation. In our view, there are two main business model formats for any DPO. In one, the DPO acts as principal and takes ownership of milk. Alternatively, the DPO operates as an agent of the farmer by negotiating the terms and conditions of his contract.

4.2.1 DPO as Principal

The group could take ownership of the milk in which case farmers would be paid for their milk by the DPO. Following this route would allow the PO to pool returns and may make it easier to move producers between milk purchasers. This model is almost identical to the role filled by a broker co-operative, such as Llaith Cymraeg.

4.2.2 DPO as Agent

Alternatively, the DPO could operate as an agent, with a remit to negotiate milk prices on behalf of members. Here, farmers would be paid for their milk by the principal processor, but the PO would have the ability to direct this milk to another purchaser, if it was unable to secure satisfactory terms with the principal processor. In practice, it could be possible for farmer suppliers to supply different purchasers with milk delivered to different buyers on different days of the week.

Under this structure, the DPO could rely on its own staff to conduct negotiations on members’ behalf, or it could outsource these skills and use specialist negotiators/lawyers to conduct the negotiations as and when they were needed.

The difference in operating functions between a PO operating as Principal or one operating as Agent is set out on the following page.
### Functions in common
- Recruit producers
- Conduct negotiations with milk processors
- Monitor contract performance
- Comply with DPO regulations, as required by the RPA

### Functions unique to a DPO operating as principal
- Co-ordinate the collection, testing and delivery of milk
- Collect payments from customers and pay suppliers in accordance with contractual terms and conditions
- Maintain and operate an information system for all milk movements, milk quality and financial transactions, along with a producer and processor database
- Negotiate and sell milk effectively to deliver a competitive milk price and collect and deliver it efficiently
- Manage the supply of milk to accommodate daily and monthly fluctuations in demand and supply
- Manage credit risk and, in order to provide security to producers, provide insurance or self insure via reserves

### Functions unique to a DPO operating as agent
- None

It may also be possible to invent models which are hybrids of these. For example, the DPO might decide to sell milk at the farm gate, leaving the processor with the cost of transporting milk to the factory. Alternatively, the DPO could arrange for some of the milk produced by members, especially that not needed by the contracted processor, to be toll processed into product that could be marketed by the DPO.
4.3 Business Functions

The primary role of a DPO, as set up under the framework of the EU Milk Package, should be to negotiate terms and conditions for its members. The purpose of doing this being to increase returns and/or to deliver a more stable milk price.

Dimensions of the negotiation may include:

<table>
<thead>
<tr>
<th>Constituency values</th>
<th>Seasonality</th>
<th>Indexation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Volume bonuses</td>
<td>Level profile</td>
<td>Two tier pricing</td>
</tr>
<tr>
<td>Forward selling</td>
<td>Transport charges</td>
<td>Production system (e.g. Organic or grazing)</td>
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<tr>
<td>Assurance</td>
<td>Hygiene payments</td>
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</tbody>
</table>

An example of this, we were told, relates to milk collection. Giving processors access to a farm to collect milk 24 hours a day, seven days a week could be worth ½p per litre saving, but farmers and processors are not very good at implementing this type of change. It is an obvious negotiation issue.

However, DPOs could also engage in other activities, such as group purchasing or activity to improve farm efficiency. The following paragraphs describe ‘other’ potential functions that could be performed by a DPO.

4.3.1 Price Insurance

In future, we may see the PO offering farmers price insurance. This could be co-ordinated through a derivative trader using futures and options. Selling milk at a future price provides a buffer against falling prices, whereas taking an option to purchase milk (or a derived milk product like butter) would allow a farmer the opportunity to take advantage of upward movements in price. This type of activity is common in the grain sector. Although many observers have proposed that it will be more common in the dairy sector in the future, it is still not happening.
4.3.2 Potential for DPO to Promote Consumption of Welsh Milk

A DPO could engage in promoting and marketing farmers’ milk with the overall aim of increasing demand, and therefore potentially price, for the milk.

This marketing could target milk buyers themselves, but would more effectively target final consumers of the milk to build up consumer demand for the products and ‘consumer-pull’ demand from milk buyers/processors.

Milk marketing could be structured as generic marketing (i.e. previous and current efforts to promote milk in order to stimulate general demand), or as more specific marketing, where producers promote the provenance of a specific region or brand.

For milk buyers with a majority of Welsh customers, the value of Welsh provenance is high although some recent DairyCo research found only 47% of consumers in Wales could name a Welsh milk brand. The majority of people buy the brand of milk offered by their retailer. Where there is a choice, Welsh milk is preferred, but cost is an important factor. This suggests there is limited scope to charge more simply based on milk origin. Companies such as Tomlinson’s base their business around being able to supply ‘genuine’ Welsh milk.

To other milk buyers with English and other international customers, Welsh provenance is less important. England based ingredient suppliers or even liquid milk suppliers would place a low importance on sourcing milk, solely because it came from Wales.

“in reality, there is no power in a Welsh brand, it does not drive value for most of the milk produced; only the small amount of milk sold in Wales. There is no premium for Welsh milk in the UK, even Welsh Cheddar struggle to get a premium”.

Even large Wales based processors, such as Glanbia tend to view Welsh provenance of their milk supply as a ‘nice to have’, rather than a ‘must have’ purchase criteria.

4.3.3 Input Buying

POs could also fulfil other functions, such as buying inputs. We do not, however, believe this would be a principal reason for creating one. Many such organisations exist already. Creating new ones is unlikely to deliver benefits not already accessible to farmers. The fact more farmers do not join them is unlikely to be because they do not exist.

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7 http://dairy.ahdb.org.uk/media/698622/welsh_dairy_products_consumer_study_report.pdf
4.3.4 Vertical Integration

This could take place at a simple level, where for example, the DPO organises for some of its members milk to be turned in cheese or powder. This would need to be financed, but milk products could be diverted from the peak supply months to the trough months, or a period where returns are becoming more profitable.

4.4 Section Summary/Conclusion

- Configurations of DPOs offer a high degree of flexibility. It is possible that a wide variety of these organisations will develop across Europe. There are several structural options which can be sub divided into three main types (A, B & C) as follows:
  
  o Dedicated DPO (A) supplying one processor – here the DPO acts exclusively on behalf of producers supplying one processor
  
  o Multi Processor DPO (B) – here the DPO acts on behalf of producers supplying different processors. The producers dedicate their supply or a proportion of their supply to named processors
  
  o Price Pooling DPO (C) – this type acts as principal and is similar to a milk broking business. Any DPO doing this is indistinguishable from a farmer owned dairy co-operative

- DPOs can act as an agent of producers, simply negotiating terms and conditions with processors on their behalf. Alternatively, they can become the farmer’s customer, or principal, buying milk directly from the farmers and selling it on their behalf

- There is also potential for a DPO to provide other services to its members including: price insurance, marketing, input buying or even to become involved in milk processing. In the remainder of the report, we have focussed on the three models shown in the table in figure 9 on the following page
### Figure 9: Potential DPO Models

<table>
<thead>
<tr>
<th>Model Summary</th>
<th>Processor Aligned (Type A)</th>
<th>Contracts Agency (Type B)</th>
<th>DPO Broker (Type C)</th>
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</table>
SECTION 5. CHALLENGES AROUND ESTABLISHING A DPO

Our research and interviews with producer representatives and processors identified a wide range of challenges that they believed would be critical to developing any form of DPO in Wales. We have divided these into seven categories as set out in Figure 10 below:

Figure 10: Challenges Around Establishing a Welsh DPO

Note – Challenges shaded blue concern the acceptability of establishing a DPO to key stakeholders. Challenges shaded brown with a dark border concern the feasibility of establishing a DPO.

5.1 Recognition

Processors are not obliged to recognise a PO. So even if one is established, it does not follow that a processor will want to enter into negotiations with one. Any willingness to do so will be determined by its assessment of what it can achieve from the relationship. This is likely to be based around a perception that over the longer term, it will achieve more by dealing with a PO than not.
Table 1: Factors Likely to Support or Inhibit a Processors Willingness to Negotiate with a PO

<table>
<thead>
<tr>
<th>Recognition Drivers</th>
<th>Recognition Barriers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Security of supply</td>
<td>Erosion of supply security</td>
</tr>
<tr>
<td>Improves efficiency e.g. through improvements to supply profile, quality etc.</td>
<td>Creates additional costs</td>
</tr>
<tr>
<td>Reputation effects – corporate social responsibility</td>
<td>Increase buyer strength</td>
</tr>
<tr>
<td>Reduces supply chain costs</td>
<td>Uncertainty</td>
</tr>
<tr>
<td>Increased communication</td>
<td>Reduce flexibility</td>
</tr>
<tr>
<td>Increased flexibility</td>
<td>Customer reaction</td>
</tr>
<tr>
<td>Improves goodwill of the business</td>
<td></td>
</tr>
<tr>
<td>Increases responsiveness e.g. in the event of a disease outbreak or other supply chain failure</td>
<td></td>
</tr>
<tr>
<td>Customer reaction</td>
<td></td>
</tr>
</tbody>
</table>

It is worth noting that all of the negative factors identified can be reversed into positive factors. For example, erosion of supply security could be overcome if the DPO offered a secure supply in return for other undertakings by the processor. This might include price indexing.

**Recognition Drivers**

Some processors are already working closely with producer groups demonstrating, on past performance, they are not totally averse to working with such groups. Some processors are used to dealing with POs in other European states.
Providing a “focus on buyers’ needs” and not expecting processors to “take milk we do not have a home for” was a common concern.

On the other hand, concern about the power of large buyers does imply that security of supply could easily become the dominant challenge for all medium sized processors in which they may be more willing to engage with a DPO.

There was widespread acceptance that a DPO has potential to “help us to achieve secondary benefits”, this might include: “better planning of production and communication between farmer and processor”, “use of financial tools”, it could “perhaps facilitate more long term agreements and “managing the supply base could reduce costs for the processor”.

Another idea was that a PO could “encourage differentiation to add value”.

One buyer, as an example, was finding it difficult to source organic milk which opens up potential for a small group of suppliers to present their own proposal through a DPO. Another buyer recognised “the need to demonstrate sustainability credentials to major customers - Nestle, Cadbury, Unilever etc.”.

A DPO in a position to solve these customer problems would have negotiating power in the marketplace. One purchaser told us “we would be surprised if a DPO could be formed but would not be necessarily opposed to working with such a group”.

Processors complain about poor supply chain communication, but this is potentially a role that a DPO could help address. For example, we were told about one producer was about to double his herd from 400 to 900 cows, but had not really spoken to his buyer about the planned increase.

**Recognition Barriers**

Milk intake security appears to be the biggest concern from processors regarding acceptance of a DPO. A DPO was seen by many processors as effectively creating one big supplier. This created risks by having placing all eggs in one basket regarding milk supply.

> “having many small suppliers, may result in a higher cost base, but it provides a form of milk intake security

One processor told us “…there is no benefit to us of having a big supplier – too risky – and a PO model in effects creates this.” Another recognised “the risk of having all your eggs in one basket regarding suppliers”. Another buyer believed.”
Others processors were simply sceptical of DPOs – citing that the market was fairly simple and transparent already and that there was little processors or producers could do to influence price. It’s a global market - prices are set by global force – not a PO in Wales.

Some processors though a DPO could act as a barrier to communicating and building relationships with their suppliers.

Many farmers tend to talk market price when the market is rising, but talk about their costs when the market is falling - you can’t have it both ways”. Another processor thought too many fellow processors were overly defensive, by claiming they are doing all they can already even though, to his business, it was obvious much more could be achieved through more collaborative working with producers.

Discussions regarding DPOs also highlighted some of the lack of trust and differences in opinion and beliefs that have often existed between producers and processors.

“Many farmers tend to talk market price when the market is rising, but talk about their costs when the market is falling - you can’t have it both ways”.

In conclusion, the recognition barrier is perhaps not as high as it appears with several processors admitting they already work with producer groups in other countries and some work with producer groups here. On the other hand, it is also very clear that some processors fear them because of the threat they pose to their supply security.

Threatening to withdraw supply may well be the “trump card” of a DPO, but the game may need to be played in a different way, if processors are willingly going to participate. Without them participating, there is no game.

5.2 Share of Supply

A PO with a high proportion of supply in a geographic area and where alternative sources of supply are scarce will clearly have a stronger negotiating position than where the opposite is true. However, the cost of moving milk will always put an upper limit on what a processor will be prepared to pay to secure a milk supply. In essence, this is why milk from West Wales is always going to be worth less than milk in central England from farms located near to a processing plant.

DC was prepared to negotiate to establish a PO with DCD because it did not threaten to undermine its supply pool. In exchange, the producers (represented by the DCD PO) now have a mechanism to hold discussions around contractual terms and conditions. And so, even though DCD have 100% of DCs direct supply pool, DC was sufficiently comfortable with the undertakings offered by DCD to recognise it as a DPO.
The key question here is how easy it would be for a DPO to secure a large share of either a processor’s supply or the supply in a relevant market.

Based on the conversations we have had with processors, we believe the ease of attracting suppliers can be ranked from low to high. Those ranked high will be more difficult to entice than those ranked low. Observations in italics are derived from the stakeholder interviews:

**Hard to Attract**

- Supermarket aligned contracts – “we have a large number of high proportion of aligned contracts”.

- Strong personal relationships with the purchaser and its representatives – “we recently held a series of 22 supplier meetings – attracted 83% of suppliers to attend with the aim of developing better communications and mutual understanding”. “Our producers are happy with current arrangements”.

- Easy to move: “we offer a simple contract, 12 months notice, Red Tractor, pricing has volume and butterfat bonus”. “Currently delivers around 22-23ppl, we offer 3 months notice from producer following a price movement”.

- A processor who wants a new sourcing arrangement – “sourcing through agents left us very exposed in late 2013 and early 2014 when milk prices rocketed – we could not recover the cost of milk in the market”.

- Poorly performing milk purchaser: “what will happen to first Milk – they are haemorrhaging producers”.

**Easier to Attract**

One existing group told us: “we are unable to enter into negotiations with a milk purchaser on a 1:1 basis, because the members of the group sell to different milk processors. They are not in a position to negotiate collectively, because they only make up a small proportion of an individual milk purchasers business”.

Competition from other purchasers will also dictate the extent to which a producer will be prepared to join a DPO. What we mean by this is that in the minds of a great many farmers, a DPO will be perceived to be just another milk buyer. If it performs well, it will be attractive. People will not want to join a DPO which does not perform well or hold out the prospect of being successful.

Our conclusion in relation to share of supply is that as a general rule, it will be easier to achieve a larger share or a processor’s milk supply than by trying to achieve market power
through setting up a national organisation. Whilst processors might appear to be nervous and sceptical about this type of development, they do need a milk supply. This means they have to find ways to work with farmers.

5.3 Funding

A PO will need funds to establish itself as a legal entity and create any contractual agreements. Once it has been established, it will need funds to cover running costs.

The costs of doing this are not likely to exceed £15,000 and could be considerably less providing any agreements and contracts drawn up relatively straightforward.

It is difficult to be precise about the running costs, but these three examples give an indication of the range of costs.

If a new PO is formed a business plan using the technique of activity based costing would be needed to establish the likely costs of establishment and operating the business.

**Indicative Running Costs**

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Cost Areas</th>
<th>Amount £</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Llaeth Cymreag</strong></td>
<td>Negotiating</td>
<td>£150 per year 0.03ppl</td>
</tr>
<tr>
<td><strong>(from published</strong></td>
<td>Payments administrator</td>
<td>c. £13,500 per year</td>
</tr>
<tr>
<td><strong>accounts)</strong></td>
<td>Office costs</td>
<td></td>
</tr>
<tr>
<td><strong>DCD</strong></td>
<td>Negotiating</td>
<td>£1 per producer per day</td>
</tr>
<tr>
<td></td>
<td>Secretary and administrator</td>
<td>£365 per yr 0.03ppl</td>
</tr>
<tr>
<td></td>
<td>Board costs</td>
<td>c. £350,000 per year</td>
</tr>
<tr>
<td></td>
<td>Office costs</td>
<td></td>
</tr>
<tr>
<td><strong>German MEG Milchboard</strong></td>
<td>Euro per 10t</td>
<td>€10 per 10t</td>
</tr>
<tr>
<td></td>
<td></td>
<td>£80 per year 0.008ppl</td>
</tr>
<tr>
<td></td>
<td></td>
<td>c. £1.44m per year</td>
</tr>
</tbody>
</table>
Cost was seen by many of the processors we spoke with as being a major stumbling block that would inhibit development of new DPOs.

“...the attractiveness of a DPO would depend on the terms of membership and the cost of running one.”

Others struggled to see how the costs of running a DPO would be recovered through the market.

“...regardless of how they are set up a DPO, will incur costs, in the setup and in the running. It is difficult to see how these costs can be recuperated through a high milk price. Supply and demand determines price and there is not a huge margin in the processor side that can easily be given up.”

In conclusion, while we acknowledge a DPO is not cost free, the additional amount that has to be recovered from the market to cover these costs should be relatively low. This might be perhaps not more than 0.6% of the milk price. This is not a high proportion of income to be spending on marketing in any industry. However, persuading farmers that even this amount is recoverable will not be an easy task.

5.4 Skills

To be successful, those who work in the organisation will need to be equipped with the right mix of skills in order to deliver increased and/or more stable returns to members of the DPO. In this context, we deliberately make the distinction between knowledge and skills. Knowledge refers to learning concepts, principles and information regarding a particular subject(s) by a person through books, media, academic institutions and other sources. Skill refers to the ability of using that information and applying it in a context.

We believe there are 7 key skill areas required to run a successful DPO including:

1. **The UK and International Milk Market** – extending to knowledge of markets, businesses, individuals, trends, risk, products, how milk is used, the dairy supply chain, the relationship between commodity prices and farmgate milk price. We were reminded of this need by a processor who told us producer representatives need to have “*more understanding of UK and international milk markets*”.

2. **Information Systems** – operation of data base, basic computer programs like Word and Excel. If the PO acts as principal, skill sets will be required to operate software operating systems that record milk collections, quality, payments etc.
3. **Dairy Producer Organisations** – the registration of a DPO and the required administration to comply with RPA guidance must be adhered to. Someone will need to have a working knowledge of these requirements.

4. **Governance of Farmer Owned Business** – there are functional requirements around running a board, such as running (board) meetings, selecting and appointing directors, by laws and company constitution, the role and responsibility of directors, directors legal duties, company law, responsibility for health and safety, avoiding conflicts of interest and a host of skills around decision making. Knowledge of these areas does not automatically make someone an effective director. Director, and by extension, board effectiveness is driven by having the right “character”, individuals who are proactive, prepared to listen, suspend judgement, have a balanced outlook, can handle conflict and can manage their emotions. It is also important to create and lead an appropriate strategy for achieving the goals of the organisation. This requires a sound understanding of the environment the business operates in and of the needs of the various groups of stakeholders the business relates to.

5. **Negotiation Skills** – undertaking contractual negotiations effectively requires highly developed negotiation skills. We have worked with people who have developed these skills through experience or by attending specialised negotiation training. These skills come more naturally to some, and counter intuitively, the tough uncompromising individual, is often less effective than someone who is prepared to make concessions. A good negotiator is well organised, well prepared, and has a thought out strategy for approaching a negotiation designed to achieve their end goals.

Professional negotiators can be employed on a contract or ad-hoc basis to deliver training or to advise and support any negotiation. This is common practice in some industries.

In our discussions with key stakeholders, it was evident that there were many areas to explore and the need to develop constructive working relationships. For example, we were told “farmers need to up their game and be more professional”, and that “currently there are no real mechanisms for farmers to tell processors of what they will do next” and that “processors also need to provide the information to farmers about what they are doing and the milk they will require”.

On this evidence, both producers and processors would probably benefit from improving their negotiating skills. It is not obvious that either side is looking particularly hard at how opportunities could be exploited by working more closely. If the challenges of seasonal peaks and winter troughs are as damaging as processors say they are, then surely the time has come to sit around the table to come up with a plan to deal with this problem.
Whilst some welcomed the idea behind “more dialogue between processor and producers” and “collective bargaining” most of the producer representatives thought “price discussions are typically a one way street – there is some discussion, but not much - especially in the current market environment”.

Notwithstanding the difficulties around negotiation in the market, there are some welcome clues that processors would be prepared to negotiate so long as basic ground rules are observed. We were told “farmers must learn to see the processor as the customer and not the devil in disguise” and by showing “a willingness to see the processors side of the argument and to have realistic expectations”.

In our opinion, and based on the interviews we have carried out in this study, processors also need to consider the skills they employ in dealing with farmers. We were told several times that “terms & conditions are really neither here nor there it is price that is the biggest issue”.

In our view, price is only one element of terms and conditions and to narrow the scope of a negotiation to this one single factor precludes the potential for achieving mutually beneficial outcomes.

6. **The Basics of Contract Law** – business contract law is becoming increasingly complex, and in some way or another, it now affects every type of commercial arrangement across all industries and sectors. It is now increasingly important for everyone involved in a commercial arrangement to have a grasp of the basic fundamentals of business contract law and also to have an in depth understanding of the components of dairy producer and dairy supplier contracts.

This is important, because the people involved representing farmers need to negotiate from a position of strength at all times. This means a need to recognise and reduce the risks involved in a contract and dramatically reduce the need for escalation and costly legal advice which may arise.

Some buyers recognised the need for farmers to become more contract savvy. For example, we were told “milk is sold in various ways – different terms – may include basket pricing” and so anyone negotiating on behalf of farmers must be prepared to come up with creative ideas to structure a contract and to appreciate how it can be defined.

7. **Business Skills** – any PO will have to be accountable to its owners and run in accordance with prevailing legislation. Therefore those entrusted with running the business need to have competence in planning, budgeting, accounting, and as required, in managing and employing staff.
In conclusion, we see both sides of the debate becoming entrenched around price and all too often a narrow view is taken by both sides. We cannot diminish the importance of price, but there are so many other challenges that need to be addressed in order to deliver a more efficient and effective supply chain and to meet customer needs in the most efficient way.

The reality is that under “business as usual” there may not be any scope for a processor to pay more for the milk they need, but other choices may be available if a more open and co-operative climate is created. Improving skills of the individuals involved so that they can achieve win-win outcomes is essential, if both parties are going to work constructively together. The skill sets we have identified probably need to be improved by both farmer representatives and by processor representatives.

5.5 Leadership

To some extent leadership is an extension of skills, but we believe it deserves its own chapter for no other reason other than to avoid understating its importance. To be successful, an individual or group of individuals with the leadership skills will be needed to take the initiative off the drawing board and into the real world. These transformational leadership skills needed include:

- High levels of influence
- Self confidence
- Commitment
- Motivation
- Initiative
- Optimism
- An instinct for organisational politics

You would need to find someone who takes this as a mission (and not just a job) and who would be passionate about the change. In periods of intense change, a charismatic and inspiring leader is called for. It is not enough to promote someone just because they have proved to be a competent manager in a stable environment. The person needed would be able to rouse people with their infectious enthusiasm for the project and by inspiring a shared vision of what the future will look like.
The leader will need to be committed to nurturing relationships with the individuals they lead. This means they not only need to be visionary and energetic, but also have empathy and trust building competencies to create a snowball effect that grows enthusiasm and belief in the project.

Several of the competencies we have described above were picked up, unprompted, by the stakeholders we interviewed. We were informed that the individual chosen to lead a PO would need “a strong leader with a big personality to get it off the ground” and be prepared to “work tirelessly on behalf of members”, “be open and transparent”, and provide a “clear idea about how it would function and be funded”.

One processor told us that he believed “there is plenty of latent talent in the industry with farmers capable of leading groups – they just aren’t doing it yet. The challenge is how we identify those people and give them a voice”.

5.6 Cohesion

Cohesion amongst a group of producers is difficult to achieve unless a group of suppliers trust one another and share common goals, timelines and good communications. Cohesion is more easily achieved with a homogenous group. Producers with similar herd sizes, type of milk, location and production system share common attributes making it easier for them to work together.

Lack of cohesion between the members of the collaboration can soon undermine the unity that is needed to stand together and utilise any potential bargaining power. Cohesion is easily eroded by poor communication and weak leadership. In addition, four key problems that bedevil co-operatives and may well equally haunt the performance of a PO. These problems are:

- **Free Rider Problem** – caused by members who do not contribute equally to the establishment or operation of the organisation. This can lead to resentment and, over time, weaken the enthusiasm and engagement of more committed members

- **Horizon Problem** - this problem arises when a members expectation of returns from the collaborative venture run ahead of other producers or when they are unwilling to invest time up front to earn returns in the future

- **Portfolio Problem** – This is where the member is unable to diversify their individual investment portfolios according to their personal wealth and preferences for risk taking. For example, the PO may wish to restrict expansion equally to all members and this may not fit with the desire of some members to expand. There has been criticism in the past of dairy co-operatives allowing unfettered expansion by producers, but it is a difficult
situation because applying limits is likely to deter expansionist and progressive producers from joining

- **Unequal Returns Problem** – most co-operatives pay producers the same amount for equivalent quality and quantity. A few pay members a rate that relates to the end use of their milk. First Milk is a good example of this – if you are a liquid supplier, you are paid the liquid price and so on for manufacturing or other grades. The problem with this approach is that members on the lower grades feel as though they are not being looked after

A number of respondents felt that there was significant diversity amongst Welsh farmers that would make forming an “all Wales” DPO difficult.

“even more unlikely that an all Wales DPO could be formed. Farmers in West Wales would no doubt be keen, but unsure whether farmers closer to England would want to lower their price to share it with other West Wales produces”.

Others felt that UK farmers were too independent and not co-operatively minded to want to work together with other farmers.

“UK farmers are not co-operatively minded - it is not in our DNA”.

“the co-operatively minded people are already in co-operatives and others are just not interested”.

The price volatility of the last 1 – 2 years led some respondents to believe that farmers would increasingly value working together.

“maybe the larger producers that acted independently over the last two years to sell their milk, will stand as an example - many of these farmers have been badly burnt - this might encourage some farmers to work together rather than going off on their own”.

### 5.7 Patience and Confidence

Is it realistic to expect a DPO to be immediately transformative? Unfortunately, a PO is unlikely to achieve its long term goals overnight. It will need to take a long term strategic perspective of building its farmer support base, whilst simultaneously enhancing its bargaining position with processors.

Setting or holding unrealistic expectations of a PO is problematic for two main reasons. Firstly, if the PO underperforms against the targets, it will be perceived to be failing, which
could lead to reduction in support. Secondly, by not setting out a clear and convincing case for joining a PO by describing very clearly the benefits of membership, it is likely to make it very difficult to recruit members.

This final component also concerns confidence. This would be driven by a DPOs track record and to a large extent, the degree to which it overcomes the other challenges described above. Unfortunately, a new start business has no track record and so both processor and producer viewpoints will be strongly shaped by the attitudes and beliefs they have about producer co-operation in general.

Welsh and UK farmers lack of confidence in farmer controlled businesses is also likely to create particular headwinds for those wishing to set up DPOs in the UK and Wales. Many respondents felt that a DPO would just be seen as another type of co-operative.

“even an organisation formed for the purpose of collective bargaining would be tarnished by the co-operative image”.

The conservative nature of many farmers was another issues raised as being a barrier to setting up DPOs in the UK and Wales.

“farmers are inherently conservative and would not move to something that was untried and untested”.

“few farmers would put this reliable (monthly milk cheque) payment at risk unless there was a considerable return.”

Timing of start-up was also seen as a critical issue. In our discussions with processors many felt now was not the “right” time to try and set up a DPO.

“forming a DPO would have been easier 18 months ago when prices were high and processors were looking for milk”.

“maybe the concept of a DPO could be sold to farmers once milk prices and demand start to recover - once we are out of this mess. In the current environment, too few farmers would want to rock the boat by joining or supporting a DPO”.

However, in 2013, when we spoke to producer groups across the UK about forming DPOs the appetite for them was low, because producers thought the market was working well and most had the option to sell to several buyers all offering tempting deals.

This begs the question: is there ever going to be a “perfect time to form a DPO?”
Most of the top of mind comments we recorded, which were mostly from processors, took a negative stance towards the formation of any sort of DPO.

5.8 Section Summary/Conclusion

- There are 7 major challenges that have to be overcome in order to create a successful DPO:

1. Recognition – not all processors will want to recognise and work with DPOs. They have no legal obligation to do so.

2. Cohesion – the less producers have in common, including geography, scale, systems, the harder it becomes to get them to work together.

3. Funding – the cost of establishing and running a DPO.

4. Skills – the knowledge and skills to run a DPO and carry out its functions.

5. Leadership – there is a need for a person with transformational leadership skills to motivate and nurture the development of any new initiative.

6. Share of supply – any POs ability to improve the returns of members will be proportionate to how important it is to a purchaser. If it has a low share and there are alternative suppliers its influence is likely to be weak.

7. Patience and confidence – farmers will not join a PO unless they have confidence it will deliver and make a difference. This is very difficult for something that has no track record. It may not be easy to make immediate or measurable improvements which could cause producers to lose interest and enthusiasm.

- In conclusion, we see that the biggest barrier to establishing a DPO is a general lack in confidence that they will actually achieve anything. The disappointing track record of farmer collaboration, particularly some of the large milk co-operatives, looms large and adds fuel to increase this lack of confidence.

- The processing industry has a limited understanding of DPOs and what they could achieve. For many processors the initial reaction is to be defensive and to seek to protect control of their or their supply pool. However, many processors readily acknowledge that the industry has deep seated problems that need to be resolved. There is a deficit of ambition in the industry around what could be achieved by more
collaborative working. This manifests itself through a lack of confidence in the future and a belief that most things bedevilling the industry are outside the control of both farmer and processor.
SECTION 6. ASSESSING FEASIBILITY FOR A DPO IN WALES

This section synthesizes the preceding sections of this report with the objective of determining the suitability, feasibility, and acceptability (SFA) of establishing one or several DPOs in Wales.

Johnson, Scholes and Whittington (2011) suggest evaluating strategic options based on three key criteria: suitability, feasibility and acceptability.

- **Suitability** refers to the overall rationale of the strategy and its fit with the organization’s mission or project goal

- **Feasibility** refers to whether or not the resources necessary to implement the strategy can be obtained

- **Acceptability** is concerned with stakeholder expectations and the expected outcomes of implementing the strategy. Stakeholders in this context include farmers, processors and to a lesser degree of importance, consumers, authorities and NGOs

Excluding milk buyers with intake less than 5 million litres per year, leaves 16 milk purchasers currently procuring milk from Welsh producers. In the section that follows, we assess the likelihood that farmers supplying these businesses would want to become members of a DPO. To make the analysis easy to follow, the buying entities have been grouped into the categories shown in Table 2 on the following page.

The categories of DPO were described in detail in Section 5.1, but briefly they are:

- **Dedicated DPO (A)** supplying one processor – here the DPO acts exclusively on behalf of producers supplying one processor

- **Multi Processor DPO (B)** – here the DPO acts on behalf of producers supplying different processors. The producers dedicate their supply or a proportion of their supply to named processors

- **Price Pooling DPO (C)** – this type acts as principal and is similar to a milk broking business
### Table 2: Categories of Potential DPO organisations

<table>
<thead>
<tr>
<th>Buyer</th>
<th>Likelihood Farmers would switch to a PO</th>
<th>Likelihood the existing buyer would recognize a DPO</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Type A</td>
<td>Type B</td>
</tr>
<tr>
<td><strong>Co-operatives</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ARLA</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>First Milk</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>OMSCO</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Calon Wen</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Llaeth Cymreig</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>SCC</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Private companies</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Glanbia</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>Dairy Partners (Dansco)</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>Tomlinson</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Private UK companies</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Muller Wiseman</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>Dairy Crest</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Freshways</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Meadow Foods</td>
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<td>Medium</td>
</tr>
<tr>
<td>Medina</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>Peninsula</td>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>County Milk Products</td>
<td>Medium</td>
<td>Medium</td>
</tr>
</tbody>
</table>

### 6.1 Appetite for Dedicated DPO (Type A)

Set out below is an assessment of the likelihood farmers supplying different buyer types will want to become members of a DPO, and whether or not, individual processors will have an appetite to recognize a DPO.
6.1.1 Farmer Co-operatives

Collectively this group represent about 42% of Welsh milk supply. Farmers who sell milk to a co-operative cannot be members of a DPO (See Section 3.3), as this breaches the EU Milk Package regulations. Farmers could leave the established co-operatives and join a DPO instead.

6.1.2 National UK Processors

The two largest privately owned processors, Muller Wiseman and Dairy Crest, process approximately one quarter of UK milk. They are currently negotiating a merger which when complete would leave Dairy Crest without liquid milk processing facilities and its only milk field would be the dedicated group of farmers supplying its Davidstow Factory in Camelford, Cornwall. The merger of these businesses may bring about a lessening of competition for milk procurement in Wales.

A high proportion of the farmers supplying these businesses are members of retailer aligned supply pools. Waitrose, Marks & Spencer’s, Tesco’s and Sainsbury’s all have special arrangements with producer groups. Included in these arrangements are matters relating to pricing, auditing, seasonality, and certain restrictions on inputs. These groups may choose, at sometime in the future, to become DPOs, and to some extent they are already act as though they are.

Dairy Crest producers are already members of a DPO, Dairy Crest Direct, and, because of this, it is difficult to understand why Dairy Crest would want to recognise a Welsh specific DPO or, indeed, why the Welsh members of it would choose to set up a new organisation that duplicates the functions of DCD.

Muller Wiseman already has a democratically elected farmer group with whom it discusses pricing and other contractual matters. Welsh farmers can be represented on this committee. It appears to lack motivation to change these existing arrangements. Furthermore, it is difficult to see how a Welsh specific DPO would be in a position to negotiate better terms for Welsh producers than English producers. Dividing the returns between these two regions is more likely to lead to lower prices for Welsh farmers as they are furthest from Muller Wiseman’s processing plants. In any case, Welsh producers make up a relatively small proportion of Muller Wisemans’ milk requirements.

A number of middle ground medium-sized processors located in England acquire milk from Wales. They include Meadow Foods, Medina, Freshways, Peninsula and Cotteswold Dairy. The indications from interviews with industry experts suggest that this group are unlikely to encourage the formation of DPOs to supply them. This is founded on a fear that it would shift power towards producers and they would be vulnerable to losing supply when market
conditions are buoyant. These processors are strongly anchored to their current buying positions.

6.1.3 Welsh Private Processors

Between them Glanbia, Dairy Partners (Dansco) and Tomlinson’s account for approximately 18% of Welsh milk. They all operate within relatively tight milk fields acquiring the vast majority of their raw milk throughout Wales.

The largest of these processors, Glanbia, collects milk across a wide area to manufacture pizza cheese. There may be scope to improve efficiency in milk collection, improve the milk supply profile, and improve cheese yield by influencing the balance of milk constituents. Furthermore, it could be possible to arrange end to end supply chain contracts so that more of the supply and price is safeguarded and less volatile.

Establishing a producer owned and controlled DPO aligned exclusively to supply any of these processors would require funding, appropriate skills and leadership. Currently producers may lack confidence and belief that such an arrangement would be of benefit to them. However, as they have much in common, and more to unite than divide them they are in an ideal position to work collectively with Glanbia to deliver mutually beneficial outcomes.

6.2 Appetite for Multi Processor DPO (Type B)

Bringing together producers who supply different processors in order to negotiate their terms and conditions would be challenging. Firstly, these producers will lack cohesion. Unless they can be brought together in large numbers, they are unlikely to be able to have sufficient share of supply to warrant a processor offering them better terms and conditions than they could achieve by supplying direct. It would require extraordinarily powerful leadership and a large marketing budget to galvanise sufficient producers to sign up to it.

A professional umbrella organisation with specialised skills (e.g. negotiating) and good knowledge of dairy markets could be developed to fulfil these roles on behalf of dedicated producer groups. This is similar to the role of MEG Milchboard described in Appendix 1. It would require a good deal of confidence and patience amongst Welsh producers. It would also need a willingness to fund it over many years, as it would be unlikely to achieve meaningful co-ordination of supply and credibility with processors quickly.

With the presence of suppliers who are aligned to retailers and a large proportion dedicating their supply to co-operatives, the difficulties of recruiting enough suppliers to make a difference into an umbrella organisation or a "Type B" negotiating DPO cannot be underestimated.
Nonetheless, were such an organisation to be established that had under its control a large proportion of the remaining volumes of milk produced in Wales, it could have a positive impact on improving producer returns.

6.3 Appetite for Milk Broker Type DPO (Type C)

As previously described, a milk broker DPO is similar to existing milk co-operatives which bundle milk, sell it to processors, pool returns and administrate the entire process. Such co-operatives already function in the organic milk market. It has traditionally been the role of large broker co-operatives to try to exercise countervailing power in the marketplace. They perform a useful role in balancing uneven demand from processes and uneven supply from members. With some exceptions, the track record of these businesses is a concern to farmers and their share of overall supply is diminishing. Processors purchasing direct from farmers have tended to pay more to their suppliers than the co-operatives have been able to pay out.

Although we expect large, vertically integrated European co-operatives, and some niche co-operatives to grow and consolidate, the formation of new broker type co-operatives or broker type DPOs is highly unlikely.

6.4 A Note About Countervailing Power

The change management scenario imagined above is predicated mainly upon processors and producer organisations working collaboratively to create more value. Some people argue that DPOs need to be established to exercise countervailing power in the market. Only by issuing such threats and being prepared to act on them, is it possible to shift the balance of power from processors to producers. If it was achievable, creating monopolistic supplier power would undoubtedly tip the negotiating scales towards the producer.

It is true farmers could exercise countervailing power in a negotiation with a processor by threatening to remove supply unless it meets certain conditions. This is similar to a trade union threatening to strike, unless its demands are met. There are a number of difficulties in adopting such a strategy:

i. It only works when the market is in an under supply situation. A processor operating in a dairy market where returns are depressed because of surplus milk is not likely to be too concerned, apart from a reputational standpoint, about the loss of some of its supply base

ii. If the demands are outrageous, the processor will go out of business. This is, in effect what happened to many businesses in the 1970's, who were unable to contain unions’
demands to such an extent that whole industries, like car making, became unprofitable

iii. It only works if, and this is a big if, a large number of suppliers are prepared to act in unison and withhold milk as and when they are ordered to do so

iv. Whilst diverting milk to another buyer is an option, the greater the volume of milk being bargained, the harder it will be to find another buyer with the spare capacity to utilise it

v. When the market is under supplied and returns are high, it may be possible to move the milk to a higher value home, but if this further erodes the sustainability of a processing business then it could be one less customer to deal with the next time the market is in an oversupply situation

6.5 Section Summary/Conclusion

- It should be easier to achieve a larger share of a processors milk supply than by trying to achieve market power through setting up a national organisation

- Processors might be sceptical about this type of development but they need a milk supply and this means they have to work with farmers

- The recognition barrier may not be not as high as it appears
  - several processors already work with producer groups
  - concerns over the threat to processors of the security of supply remain
  - without processors recognising a DPO, there is no game

- A DPO is not cost free, but the additional amount that has to be recovered from the market to cover these costs is relatively low. This might be perhaps not more than 0.6% of the milk price. However, persuading farmers that even this relatively small amount is recoverable will not be an easy task

- The biggest barrier to establishing a DPO is a general lack in confidence that they will actually achieve anything. There is a deficit of ambition in the industry around what could be achieved by more collaborative working
• Glanbia is perceived as being the highest potential processor for a Welsh DPO followed by Tomlinson’s and Dairy Partners (Dansco)

• Processors such as Freshways and Medina along with ingredients processors like Meadow Foods, were seen as having some potential for a Welsh based DPO

• Existing co-operatives are seen as already being very close to a broker DPO model, and therefore the potential for new broker DPO is considered to be low

• The potential for an umbrella organisation that works on behalf of producers to negotiate terms and conditions is considered to be promising
SECTION 7. BUILDING A DPO IN WALES

This section is divided into two parts. The initial one sets out the steps for forming a DPO. Doing so requires attention to winning hearts and minds, as well as pulling certain administrative elements, such as forming a company and registering the business with the RPA.

The second part of this section deals with what the sponsoring body of this report could do, by acting as a catalyst, to support the formation of a DPO in Wales or beyond.

7.1 A Structured Roadmap for Creating a DPO

The main steps required for the establishment of a DPO are set out below along with the outcomes for each one. Each step is dealt with separately and in more detail in the sections that follow.

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<td>• Examine market and competitive realities</td>
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<td>• Identify and discuss threats and opportunities</td>
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<th>Build a task force</th>
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<td></td>
<td>• Put together a group with enough power to lead the change</td>
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<td>• Get the group to work together as a team</td>
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<th>Step 3</th>
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<td></td>
<td>• Create a realistic vision to help direct the change effort</td>
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<td>• Develop strategies for achieving the vision</td>
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<th>Step 4</th>
<th>Communicate the change vision</th>
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<td></td>
<td>• Use every vehicle possible to constantly communicate the new vision and strategies</td>
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<td>• Have the Task Force role model the behaviour expected of members</td>
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THE FEASIBILITY OF A DAIRY PRODUCER ORGANISATION IN WALES

Building a DPO

<table>
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<th>Step 5</th>
<th>Empower producer and processor engagement</th>
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<td>• Getting rid of obstacles</td>
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<td>• Change systems or structures that undermine the change effort</td>
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<td>• Encourage risk taking and innovative approaches</td>
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<th>Step 6</th>
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<td>• Plan for visible improvements in performance or “wins”</td>
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<td>• Create those wins</td>
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<td>• Visibly recognising and rewarding people who made wins possible</td>
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<th>Step 7</th>
<th>Consolidate gains and produce more wins</th>
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<td></td>
<td>• Use increased credibility to change all systems and procedures</td>
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<td></td>
<td>• Hire, promote and develop people who can implement the change vision</td>
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<td>• Keep reinvigorating the process</td>
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<th>Step 8</th>
<th>Anchor new approaches in the culture</th>
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<td>• Do not stop rewarding and encouraging better performance</td>
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<td>• Show why the change is working and of benefit</td>
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<td>• Develop means to ensure leadership development and succession</td>
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7.1.1 Establish a Sense of Urgency

The work of building a DPO requires great co-operation, initiative and willingness to make sacrifices from many people. Establishing a sense of urgency is crucial to gaining needed co-operation. With urgency low, it is difficult to put together a group with enough power and credibility needed to create and communicate the desired change.
Visible crises can be enormously helpful in catching people's attention and pushing up urgency levels. There needs to be an assault on complacency from both farmers and processors.

"if we do nothing, other than moan, to improve the terms and conditions of our contracts…. don’t be surprised if things stay the same".

"don’t think someone else is going to solve our problems".

"there is so much inefficiency in our supply chain - if we don't address it someone else is going to steal our markets".

"what sane processor wants to have a group of un-co-operative, dissatisfied and unsustainable businesses supplying them with their core raw ingredient".

"if you are not consistently in the top 25% for milk price payment, you're either going to lose a lot of suppliers or a lot of money when there's an upturn".

Whilst fictitious, these quotes provide a way to kick-start honest and frank discussions about the insanity of accepting the status quo. Unless people honestly believe that considerable change is essential, inertia is always the winner. It is common to hear that acting now is not the ideal time to act, but timing issues inevitably become just another excuse for inaction and delay in addressing deep seated challenges for farmers and processors.

7.1.2 Creating the Task Force

Major transformations are often associated with one highly visible individual. This is a very dangerous belief. Because major change is so difficult to accomplish, a powerful force is required to sustain the process, no one individual is ever able to develop the right vision, communicate it to large numbers of people, eliminate all the key obstacles, generate short-term wins, manage dozens of tasks, and build the desired culture.

Weak committees are even worse: the ones where people turn up but do not actually do or contribute anything. A strong task force is always needed - one with the right composition, level of trust and shared objectives. Building such a team is an essential part of any desired change effort.

Four key characteristics seem to be essential to effective task forces:

1. **POSITION POWER** - are enough key players on board, especially farmers who are prepared to listen, be adaptable, creative and, most importantly, are prepared to roll up their sleeves to drive things forward.
2. **EXPERTISE** - are the skills that are needed (see Section 6.4) adequately represented so that informed intelligent decisions will be made.

3. **CREDIBILITY** - are there enough people with good reputations in the group so that its pronouncements will be taken seriously by other farmers and the processors.

4. **LEADERSHIP** - does the group include enough proven leaders to be able to drive the change process (see Section 6.5). The leader must be capable of working in tandem, teamwork style with the other members of the coalition.

Skills that are missing can be brought in from outside, but these outsiders should always be in the minority, or else the credibility of the effort to deliver change will be eroded. Change may start with only two or three people and then grow relative to workload demands. Expert facilitation may be needed to build trust and create teamwork through lots of talk and joint activities. Having a neutral third party also helps to avoid or manage any conflicts between members of the group.

Joint activities could involve visiting other POs, even in other sectors/countries to establish what can be achieved. The most important outcome of the group’s initial engagement is to develop a common goal that is both sensible to the head and appealing to the heart.

In an ideal world, at this stage and in those that follow, the processor(s) should be involved in discussion with the objective so that they lend their support to the development of a DPO. The power of collaboration comes from inclusion, not exclusion.

7.1.3 **Developing a Vision and Strategy**

Issuing an authoritarian decree to farmers to join a DPO will not be effective. It is equally true that farmers cannot be micromanaged into joining one. If one is needed, some force is needed to motivate perhaps many hundreds of farmers to participate, even if the initial steps are difficult, in a relatively fast and efficient way. Creating a sensible and appealing picture of the future, or vision, is vitally important.

With the clarity of direction, members will be less confused and more prepared to sacrifice short-term term interests to achieve long term goals. Initially, the price premium from belonging to a PO could be low, but a compelling vision will help to overcome natural resistance and scepticism.

In most cases, the vision will need to balance the interests of both farmers and processors. Everyone needs to be served well. Arguing over who gets the biggest slice of the pie only leads to entrenched positions. It is far better for both parties to find ways to create more value, or bigger pies and more secure markets.
Developing a compelling vision takes time and effort. It is not something that can sensibly be delegated to some industry experts. Instead it is going to need the task force to think long and hard about the sort of future they want to create for the members of the producer organisation. However, expert facilitation by individuals who are skilled at helping a group to develop their vision could prove to be useful, particularly if no one in the task force has this skill.

The compelling vision is unlikely to be created in one meeting, or perfectly formed even after the third draft. When teams create a vision, they may need to explore more widely what other similar organisations, in their own and in other industries, are achieving. These insights help to shape the type of future the PO should strive to accomplish.

7.1.4 Communicating the Change Vision

The power behind a great vision is unleashed only when those involved in the activity have a common understanding of its goals and direction. Achieving this is often difficult, because communicating a consistent and appealing message to farmers, who more often than not are working in isolation, is an enormously challenging undertaking.

If the urgency is not high enough, the task force sufficiently committed, or if the vision is too blurry, the momentum needed to engage with farmers will be lost. This is often the point at which great ideas grind to a halt as putting the communication together and delivering it takes a lot of time and a willingness to adapt the message to appeal to farmers who may have different priorities.

Always bear in mind that although the task force are aware of the problem situation and how they want to address it, everyone else knows little about the topic, and needs to be informed and convinced.

Whilst there is no one right way to communicate the change vision, several principles appear to be closely associated with successful transformations. They include: keeping the message simple; using examples that demonstrate success; using many different forums (e.g. web, mail, meetings, phone calls); continually repeating the message; leading by example; and listening and responding to people’s concerns.

Relying solely on one-way communication is rarely successful. Two-way communication with farmers in meetings and in conversation helps them to feel as if their own personal needs and concerns are being attended to. If people won’t accept the vision, all other efforts and activity to create the producer organisation will fail.
7.1.5 Empowering Broad-Based Action

Building a broad base of support and including people who really understand the problem and have relevant expertise increases the power needed to make progress. Effectively completing stages one through to four already does a great deal to empower people. The purpose of this stage is to consolidate what support has been achieved and remove barriers to the implementation of the change vision.

It is at this point where getting to grips with structures, skills, systems and governance lay the foundations for the PO that will carry out the activity to deliver over many years the benefits promised in the vision. Promising, but not delivering is a sure-fire way to lose support.

Key information needed to be captured, developed and incorporated into forward plans for the DPO will include most of the following:

1. Articulate the purpose of the organisation – this needs to be congruent with the vision and written in a way that conveys benefits to the main stakeholder.

2. Describe who will benefit – farmers, investors, other stakeholders. Who is expected to benefit the most? What type of benefits will the various stakeholders seek to earn?

3. Who will advise and who will any advisors be acting for? What are the potentials for conflict of interest and how they will be avoided?

4. What level of commitment is expected from members: all or some of the produce they produce? Is commitment conditional on meeting standards? Will commitment be contractual – this may help to secure business cashflow.

5. What capital is needed to finance the business? Start-up capital for company formation; What are working capital requirements? What fixed capital is needed? What security can be offered? What is the extent of investor liability? Will farmers provide loan capital? Is a joining fee or participation fee to be levied? Is grant funding available?

6. How will the business be funded – via levies based on volume, farm area, a flat rate, a commission? Will all members have access to the same markets? Will all members pay the same amount for membership?

7. How will decision making be co-ordinated? Who will be on the Board of Directors, how will voting be carried out – one member one vote or controlling shares for large producers? What decisions are limited for member approval, delegated to the board and or delegated to managers/agents?
8. How will initial members be recruited? - Is membership open to new producers? How will the organisation create demand for and recruit members? Gain written commitment from prospective members.

9. Business plan and risk management - to include market assessment; budgets, cashflows, etc. There will also need to be consideration of the business model which is essentially about deciding what will activity will be carried out using company resources and what will be outsourced. There is a need to consider the contractual arrangements and risks associated with outsourcing (develop this plan into the prospectus).

10. Choose organisation structure - Who will own the business? How will income be distributed ownership options: by shares, by guarantee, CIC, co-op, (consider taxation and rating issues here). Step 1 will be to gain board/task force approval. Step 2 will be to gain approval from members/potential members. If not already engaged, will need legal advice at this stage?

11. Draw up member agreements to cover: parties to the agreement; products/services; interpretation; basis of the agreement; funding; membership of company/co-op; duration/notice; default; insolvency; consequences of termination; force majeure; disputes.

12. Who will co-ordinate the establishment of the business: provisional financial commitments, constitution, banking arrangements, VAT registration, Inland Revenue registration, insurances etc. all need to be organised.

13. Governance: what will be the make up of the board, size, tenure, non executive director (NEDS), executive director (EDS) appointments, approval of members etc. Are individuals trained to fulfil roles they are expected to carry out? Is strategic management and risk management adequately covered?

At this point of the process, it is common to find the sceptics, doom mongers and naysayers weighing down and objecting to any proposed solution. Discouraged and disempowered farmers are never likely to become winners in a globalising economic environment. Honest dialogue with these individuals is usually the best solution to this kind of problem. If they are not prepared to come on board once you have done this, a judgement needs to be made if progress can be made without them.

7.1.6 Generating Short-Term Wins

To build credibility for the DPO to achieve the long term goals, the farmer members will need to see convincing evidence that all the effort is paying off. Without some short-term wins under its belt, the DPO will struggle to maintain their support. Improvement should be
quickly visible and tangible. They will need to have the potential to improve the bottom line of both the processor and the farmer.

Quick improvements undermine the efforts of cynics and sceptics and build necessary momentum. Section 5.3 sets out a variety of factors that could be influenced to improve farmer and processor returns.

Achieving a breakthrough in one or two of these areas is all that is needed. Clearly, nothing can be achieved without positive engagement with the processor. Skilful negotiation and engagement is needed to bring this about.

7.1.7 Consolidating Gains and Producing more Change

Setting up a DPO, holding a press briefing, and conducting the first successful negotiation with the milk processor is worthy of congratulations, but it does not mean the job is complete. It only heralds the start of the long and difficult journey of creating more value for members.

The need to hone skills will continue and information will have to be gathered to make sure that real progress is being made. Resistance to change and apathy never fully dissipate and the only way to overcome this is to continue to generate more wins.

The pace of progress may be annoyingly slow due to the reluctance of a few members to make the changes that have been agreed or because the processor is finding it difficult to make changes in their part of the supply chain.

One way to overcome this inertia is to put in place rewards for those who co-operate or penalties for those who do not. This may result in a two tier producer organisation in which some members achieve better returns than others: it becomes a reward for their flexibility.

Take for example, a reward for those farmers who are prepared to extend collection hours on their farms, in exchange for lower milk collection charges. It's also pointless having a PO organisation whose every move can be stymied by two or three producers. To address this, there need to be bylaws in the member agreements allowing the board of the PO to resign some of its members.

At the extreme, this stage of the process may take many years, even decades and everyone will need to be reminded on a continual basis how the gains delivered by a PO are of benefit. This requires excellent leadership.
7.1.8 Anchoring New Approaches in the Culture

After years of work, the results delivered by the PO will be evident and impressive. The old ways of negotiating terms and conditions with farmers will have been forgotten. The way in which processor and farmer work together with shared values to improve the sustainability at all stages of the supply chain become the new normal.

This should mean farmers respond quickly to processor requests, farmers are involved in decision-making, everyone cares about customers, everyone is trying to be innovative, and everyone appreciates how important each and every one of them is to satisfying the end customer.

The culture has changed from being farmer versus processor towards then being more co-operative in order to be more successful. Most alterations in norms and shared values come at the end. They only sink into the culture after it is clear they work and are better than old methods.

7.2 Next Steps for the Steering Group

To take forward the findings of this report, there are a range of actions the Working Group of this project should consider. The most important activity, initially at least, will be to act as a catalyst for change by promoting and disseminating the report and highlighting problems with the status quo. Some initial ideas are to:

- Summarise this report and publicise its main findings and make this available on the AHDB Dairy website
- Make sure key opinion formers across the industry and in government are aware of this report
- Negotiate with government to make pump priming funding available to nurture the formation of new dairy producer organisations. Ideally ensuring all 8 Steps of the change process can be resourced
- Organise a workshop(s) for producers and processors to explore the potential of DPOs
- Encourage the provision of coaching and training for individuals who can spearhead the development of DPOs
- Co-ordinate opportunities to observe and learn from what is happening across Europe
• Produce a directory of individuals who have requisite skills and experience to support the development and operation of DPOs

This is not an exclusive list. There may be other activities that would usefully help to promote DPOs in Wales or to support the development of more collaborative working between producers and processors.

7.3 Section Summary/Conclusion

• Developing a DPO in Wales is unlikely to be a straight forward process that can be described in a mechanical set of steps as you would do so for building a house. The key parts of the process will be far more intangible and require flexibility, innovation and persistence

• The process will be more of a change management issue. In this report we have suggested using a change management model as the basis for creating a DPO in Wales. The model, developed by former Harvard Business School Professor John Kotter, provides a proven 8 Step process for leading change

• The Working Group of this project can play a key role in creating the environment that will facilitate the development of one or more DPOs in Wales. Communicating the findings of this report widely and facilitating others to find out more about DPOs are key activities