Summary of the hearing with NFU Scotland September 2006

Introduction

1. NFU Scotland represents 9,000 members, who are predominantly farmers and growers. It also represents some other small, rural businesses. It is a separate entity to NFU England and Wales.

The market

2. NFU Scotland told us that the 2003 CAP reforms had had a significant impact on the market; farmers needed to sell at a price which would allow the business to grow or at least to reinvest and could no longer rely on a cushion from subsidies.

3. NFU Scotland told us that it believed that farming was at a crossroads. Farmers were experiencing rises in input costs but farm-gate prices were depressed.

Relations between suppliers and retailers

4. NFU Scotland told us that its members did not generally deal directly with the retailers, but through intermediaries. In most cases, it was food and drink processors that dealt directly with the retailers. So, it did not determine the end price to retailers.

5. NFU Scotland told us that it had recently consulted with 14 of the major supermarket suppliers in Scotland. NFU Scotland told us that it sensed that this group was under great pressure from the retailers which, it believed, was feeding back to the farmer as the primary producer in the form of unsustainable prices.

6. NFU Scotland told us that over the past 10 to 15 years the supermarkets had increasingly abused their competitive position. It was aware of specific abuses such as back payments, lump sum payments, up-front promotional payments, 'by one get one free' and changes in payment terms with no notice. NFU Scotland told us that such abuses squeezed the processors who in turn passed the pressure down the line to the primary producer.

7. NFU Scotland told us of an example of the effect of such abuse on the milk market sector. Ten years ago, the price of milk paid to the farmer was 24 to 25p per litre and to the consumer from the retailer 42 to 44p. The farm gate price is now 18.5p per litre and the consumer is paying 51p. The farmgate share of the shelf price had reduced from 58 to 36 per cent. The retailer share of the shelf price had risen from 3 to 31 per cent. Over this ten-year period, the processors share of the shelf price had remained broadly static. According to the NFUS, this demonstrated an imbalance in the supply chain, with retailers increasing their margins at the expense of farmers.

8. NFU Scotland told us that some major suppliers had expressed concern to it that any representations they might make under the Supermarket Code may result in de-listing, or other reprisals by supermarkets in retaliation.

9. NFU Scotland told us that while there were some direct farmer-to-retailer outlets, which tended to be for products in short supply, the vast majority of supply was conducted via the processor intermediary. NFU Scotland provided an example in the Soft Fruit sector where two major suppliers did deal directly with the retailers, which was enabled by the local nature of this sector and the minimal processing involved.

The NFU believed that this afforded these suppliers an advantage and demonstrated that this aspect of the supply chain was working well.

10. NFU Scotland told us that its members felt frustration with the Supermarket code, which required evidence to accompany a complaint. It said that the Code's effectiveness was further undermined by OFT audits which were rendered meaningless as a result of the absence of hard evidence, despite the OFT referring to a 'fear factor' among suppliers.

11. NFU Scotland told us, based on its recent discussions with its member intermediaries, that it believed that anti-competitive practices were increasing. NFU Scotland told us that some of the 14 major food processors revealed examples of exploitation which included one processor being informed by a major retailer that the cost of a new 'buy one get one free' initiative was to be borne by it. One of the major supermarkets was specifically criticized for bad practices. NFU Scotland said that similar complaints were increasing and that it believed that this was owed to processors being unable to absorb all the costs that were being passed back from retailers any longer. NFU Scotland said that processors were unable to pass the cost back up to retailers due to the increasing pressure from them, so the primary producers were forced to absorb the costs instead.

12. NFU Scotland cited a further example where a processor had won a major contract to become sole supplier. Within three months, the retailer demanded a back payment in the vicinity of a few hundred thousand pounds.

Imports

13. NFU Scotland did not believe that importing cheaper products would be a feasible proposition for retailers. It considered consumer demand for locally produced food and the increasing awareness around carbon footprints rendered this proposition unlikely. Local produce benefited from a higher quality, higher welfare image and there was an increasing reluctance to import from overseas where the standards of production, welfare and traceability were lower.

Competition

14. NFU Scotland told us that prices had deflated since CAP reform, which the NFU believed to be a direct result of the increased competition between the four main supermarkets.

15. NFU Scotland told us it had seen retailers respond to a price cut in milk with a drop in their own price offering. When it itself has sought a price rise for the primary producer, it had been told that any increase would be dependant on Tesco moving upward on price first.

16. NFU Scotland told us it envisaged that some primary processors would exit the industry in response to the present climate but that others might expand. Most, however, in its view would dramatically reduce their production, with far less investment in innovation, which would impact severely on the entire market, but with particular effect on consumers.

17. NFU Scotland told us that some suppliers, who had been squeezed by the supermarkets, had caused a 'waterbed effect'; where they sought to obtain some of the lost margin from smaller retail outlets. NFU Scotland told us that the customers of

such smaller retail outlets were then forced to pay more to subsidize the supply to the retailers.

18. NFU Scotland told us that it believed the competition problem existed because there was no check in the system and the inherent balance of power in favour of the supermarkets; that one supermarket has secured one-third of throughput and the rest was distributed among the other three; with one being smaller than the other two. NFU Scotland considered the imbalance in the supply chain, which ultimately led to unsustainable producer prices, to be to the detriment of product innovation and investment and consumer choice.

19. NFU Scotland told us it believed that an independent retail auditor was necessary to enforce the Supermarket Code, to whom complaints could be addressed and who would be empowered to proactively spot-check retailer-supplier relationships. It would like to see the Code outline minimum content of the contracts which govern these relationships as an evidential aid or indeed require that such supply contracts were in writing.