

Working paper on supply chain profitability

Introduction

1. This paper provides a preliminary assessment of profitability in the grocery supply chain based on a review of the overall financial performance of those firms supplying directly to grocery retailers and a more detailed look at the entire supply chain in two specific sectors: milk and pig meat.
2. The overall picture arising from this review is that the economic viability of grocery suppliers, as a group, does not appear to be in question. We have not identified any ongoing decline in margins or return on capital for these firms as might be expected if this was the case. In our own survey of suppliers, only 4 per cent of respondents indicated that it was either fairly unlikely or very unlikely that they would be in business in five years' time.
3. There may, however, be greater pressures in certain parts of the grocery supply chain, including for upstream producers. Our review of the financial performance of firms in each component of the milk and pig meat supply chains represents a first step in looking at those sectors where concerns have been raised with us.
4. In relation to milk, prices for dairy farmers have increased slightly since 1999, which, when combined with improved productivity, has led to increased incomes for dairy farmers over that period. However, at the same time, the number of dairy farmers has declined significantly, indicating that many individual dairy farmers may have experienced difficulties. Moreover, it is not clear that any increase in average incomes is consistent with an increased return on capital for dairy farmers. Dairy processors, however, have experienced a slight decline in prices and a declining return on capital employed (ROCE) for much of this period. Much of the nearly 15 per cent increase in the average retail price of milk since 1999 has been retained by

grocery retailers, increasing their share of total milk revenues compared with dairy farmers and processors.

5. In relation to pig meat, improved pig meat prices since 1999 have, on the whole, resulted in improved incomes for pig farmers. Pig farmers also appear to have earned an increasing share of the retail price for pig meat during this period. Pig meat processors have experienced fluctuating margins and returns since 1999. Without processor pricing data, movements in the share of the retail price earned by retailers and processors are not clear. However, on the basis of the evidence that we have reviewed, it does not appear that grocery retailers have increased their share of the retail price for pig meat in the period since 1999.
6. Going forward, we will look at profitability in other parts of the grocery supply chain where concerns are raised with us. We will welcome suggestions from third parties on the specific sectors that should be analysed further, and submissions and data that would assist us in this regard.
7. This working paper is set out as follows:
 - (a) a review of profitability data for grocery suppliers;
 - (b) a review of insolvency trends in the grocery supply sector;
 - (c) a review of profitability in the milk supply business; and
 - (d) a review of profitability in the pig meat supply business.

Overview of grocery suppliers' profitability

8. In considering profitability in the grocery supply chain overall, we review three data sources, namely:
 - (a) responses to a survey of suppliers to grocery retailers conducted on behalf of the CC by GfK;

- (b) the Investec Food Producers Margin Survey; and
- (c) the Grocer/OC&C Index.

9. These three data sources cover the manufacturing and processing components of the grocery supply chain that primarily supply direct to grocery retailers. These data sources do not, however, cover suppliers that may be one step removed from grocery retailers, such as primary producers.

CC supplier survey

10. A survey of suppliers was conducted by GfK on behalf of the CC in October/November 2006. Interviews were conducted with 456 suppliers of grocery products to UK grocery retailers. A copy of the survey report is available on our website.

11. As part of the survey, a number of questions were asked regarding suppliers' profit margins and related matters. Key points arising from the survey were that:

- More than 80 per cent of respondents reported gross profit margins of 10 per cent or greater, including 20 per cent that reported gross profit margins exceeding 40 per cent. However, 17 per cent of respondents reported gross profit margins of less than 10 per cent, including 4 per cent of respondents that reported gross margins of less than 5 per cent.
- More than 60 per cent of respondents described themselves as very satisfied or fairly satisfied with their price negotiations with grocery retailers compared with 14 per cent that described themselves as fairly dissatisfied or very dissatisfied.
- In terms of trends, however, only 14 per cent of respondents described gross margins as having increased over the past five years. 16 per cent considered that gross margins had stayed the same, while 67 per cent considered that gross margins had decreased over this period.

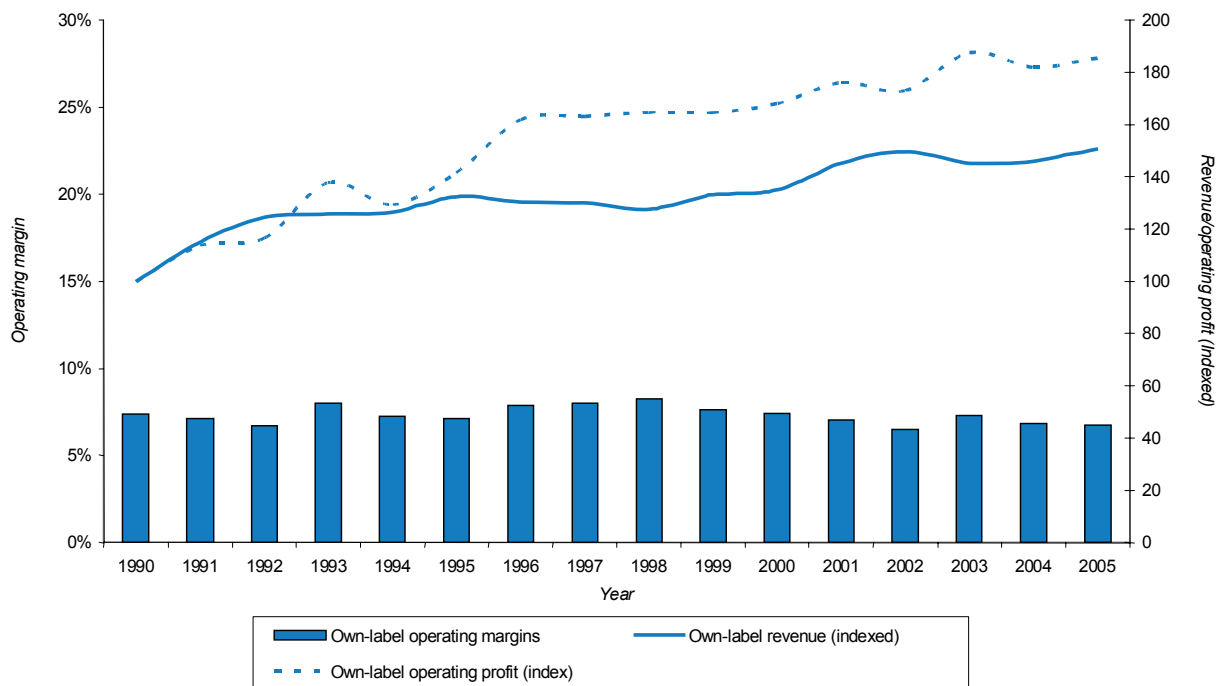
- Interestingly, 55 per cent of respondents considered that competition from non-UK suppliers had increased over the past five years, while 39 per cent considered that it had stayed the same. Further, 29 per cent of suppliers of food products considered that CAP reform had had a negative impact on profitability.
- Finally, when asked how likely or unlikely they were to still be in business in five years' time, 73 per cent of respondents considered that it was very likely that they would still be in business, while a further 21 per cent indicated that it was fairly likely. Only 4 per cent indicated that it was either fairly unlikely or very unlikely that they would be in business at this time.

Investec Food Producers Margin Survey

12. The Food Producers Margin Survey produced by Investec Securities, a broking firm, contains data on revenues, profits and operating margins for branded and own-label food and drink manufacturers. It covers a 15-year period since 1990 and uses a sample of 45 UK grocery suppliers (see Annex A).
13. Suppliers of own-label food and drink have experienced relatively constant operating margins at around 7.0 per cent, with minor fluctuations, over the past 15 years (see Figure 1). During this period the average operating margin reached a high of 8.3 per cent in 1998 and a low of 6.5 per cent in 2002. Suppliers of branded food and drink have experienced growth in operating margins from about 8.6 per cent (average 1990 to 1993) to a peak of 15.3 per cent in 2003 before declining slightly to 12.7 per cent in 2005 (see Figure 2).

FIGURE 1

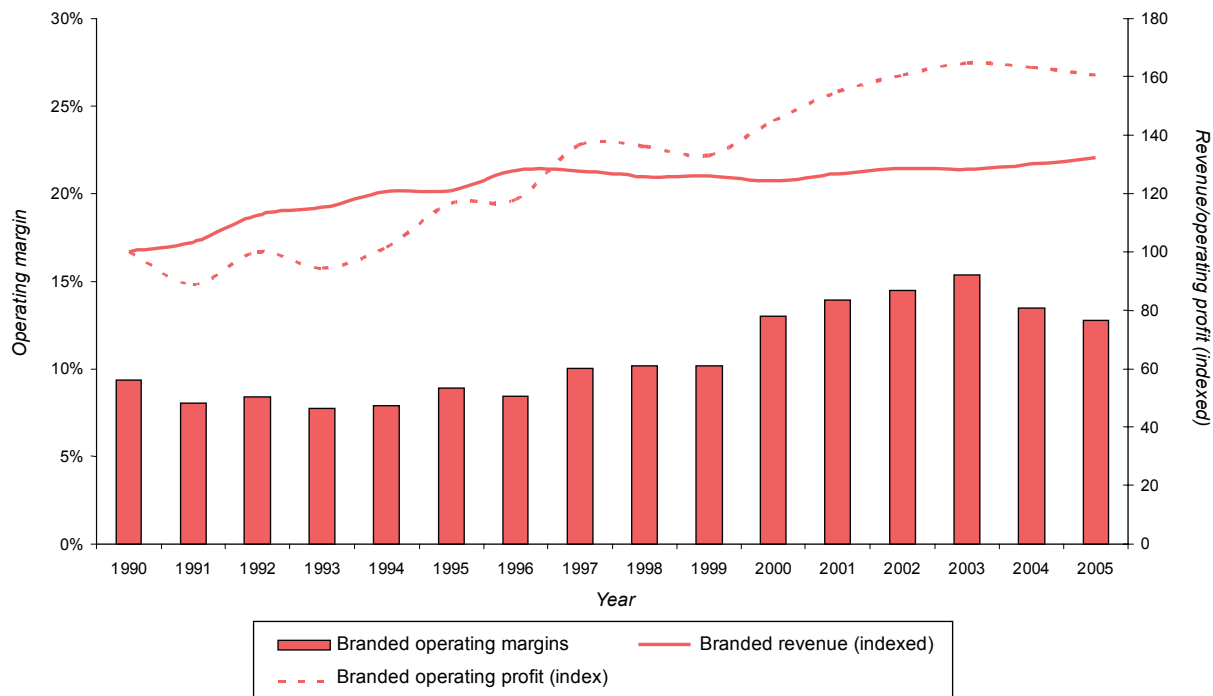
Own-label food and drink manufacturers: margins, revenue and profits



Source: CC analysis of Investec data.

FIGURE 2

Branded food and drink manufacturers: margins, revenue and profits



Source: CC analysis of Investec data.

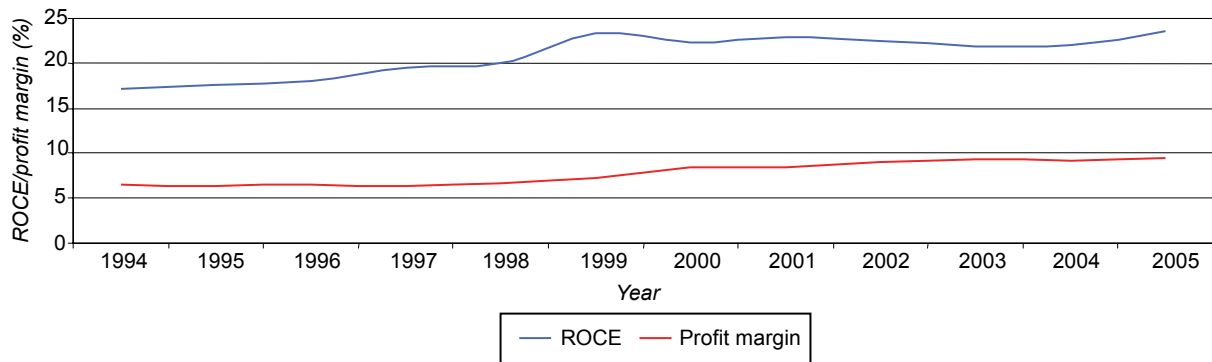
14. Revenue for both branded and own-label food and drink manufacturers showed steady growth since 1990. However, Figure 1 suggests that own-label manufacturers could be accepting lower prices in return for increased sales volumes and increased absolute profits. That is, growth in revenue for own-label manufacturers has coincided with stable or falling operating margins for much of period.
15. Indexed operating profits rose faster than indexed revenues for both branded and own-label producers over the period, which suggest that producers have become more operationally efficient. In relation to branded manufacturers, the recent decline in operating margin has caused only a small decline in the total profits, suggesting that higher revenues have partly offset lower margins.
16. The picture provided by the Investec data, however, is only partial as it makes no allowance for the cost of investment. Profits have relatively little meaning without the context of the asset base that was required in order to make the return. However, ROCE data from the OC&C sample (see paragraph 18 below) indicates that it is likely that capital costs are being successfully recovered.

OC&C Index

17. The OC&C index was produced by OC&C Strategy Consultants for *The Grocer* and analysed the finances of the 150 largest food manufacturers and 25 largest drink manufacturers in the UK.
18. The report shows increasing operating margins and ROCE for grocery suppliers over the period 1994 to 2005. Profit margins increased from 6.5 per cent in 1994 to 9.5 per cent in 2005, while ROCE increased from 17.2 to 23.5 per cent over the same period.

FIGURE 3

Sample of food and drink manufacturers: ROCE and profit margin

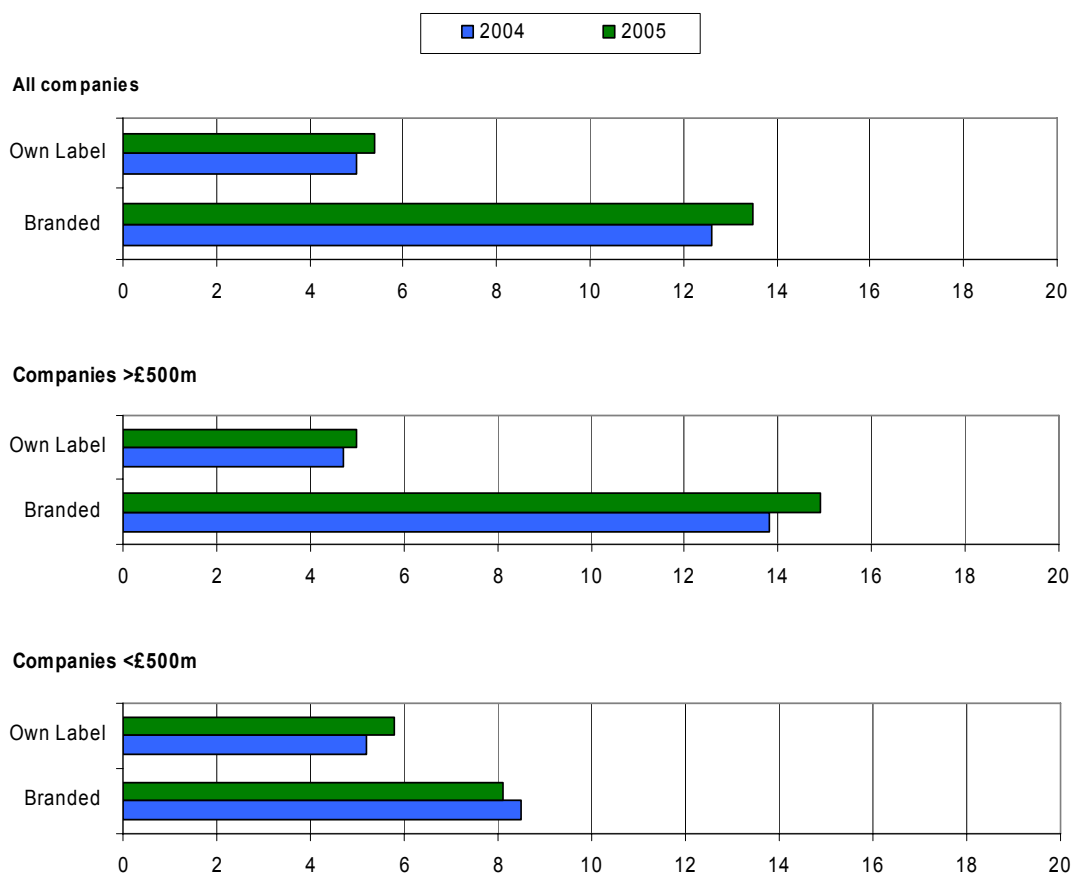


Source: *The Grocer/OC&C Index, 'Rising to the Challenge'*.

19. The OC&C report examines differences between manufacturers of branded and own-label food and drink for the past two years, and in addition, segments the results between companies with turnover above and below £500 million a year. This analysis is shown in Figures 4, 5 and 6.

FIGURE 4

Operating margins, food and drink manufacturers, 2004 and 2005



Source: *The Grocer/OCC&C Index*, 'Rising to the Challenge'.

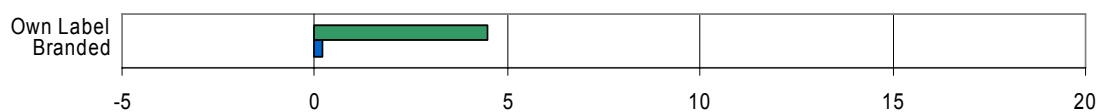
20. With the exception of the smaller suppliers of branded products, the report shows that margins have increased over the past year. This appears to conflict with the data from the Investec report, but seems likely to result from methodological differences between the two studies.¹

¹As an example, for Cadburys Schweppes, the data in the main table of the OC&C study includes global revenues and discontinued operations, whereas the Investec study uses UK figures and appears to have adjusted for discontinued operations. It is unclear if this was adjusted for the graphs and charts in the OC&C report.

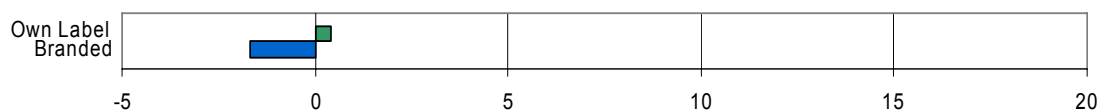
FIGURE 5

Revenue growth, food and drink manufacturers, 2005 vs 2004

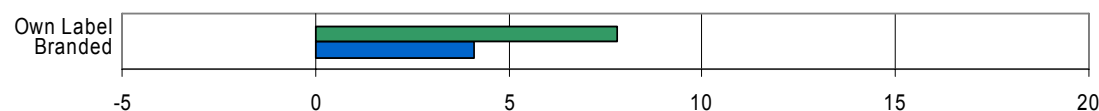
All Companies



Companies >£500m



Companies <£500m



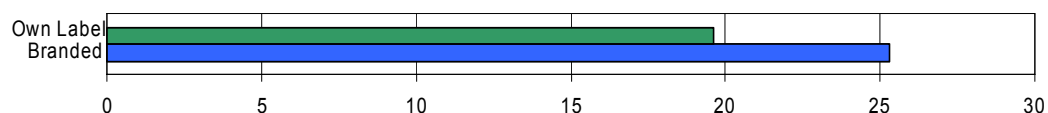
Source: *The Grocer/OCC&C Index, 'Rising to the Challenge'.*

21. According to OC&C, revenue for own-label manufacturers grew significantly faster than revenues for branded manufacturers in the most recent year for which data is available. This is generally consistent with the Investec report.

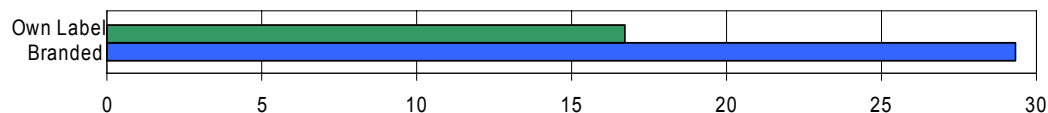
FIGURE 6

Return on capital employed, food and drink manufacturers, 2004/05

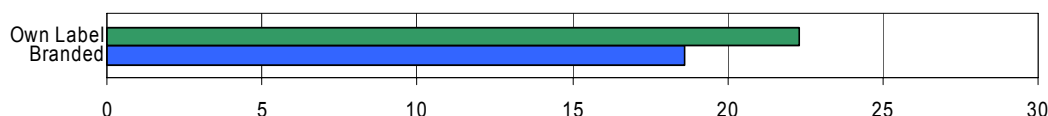
All companies



Companies >£500m



Companies <£500m



Source: *The Grocer/OCC&C Index, 'Rising to the Challenge'.*

22. OC&C's analysis of ROCE, as set out in Figure 6, shows that for branded suppliers the larger firms performed better than smaller firms, while the reverse is true for own-label suppliers. However, as this calculation excludes intangibles, which make up a relatively greater portion of assets for larger branded companies, this leads to the ROCE for these companies being exaggerated in comparison with own-label and smaller branded companies.

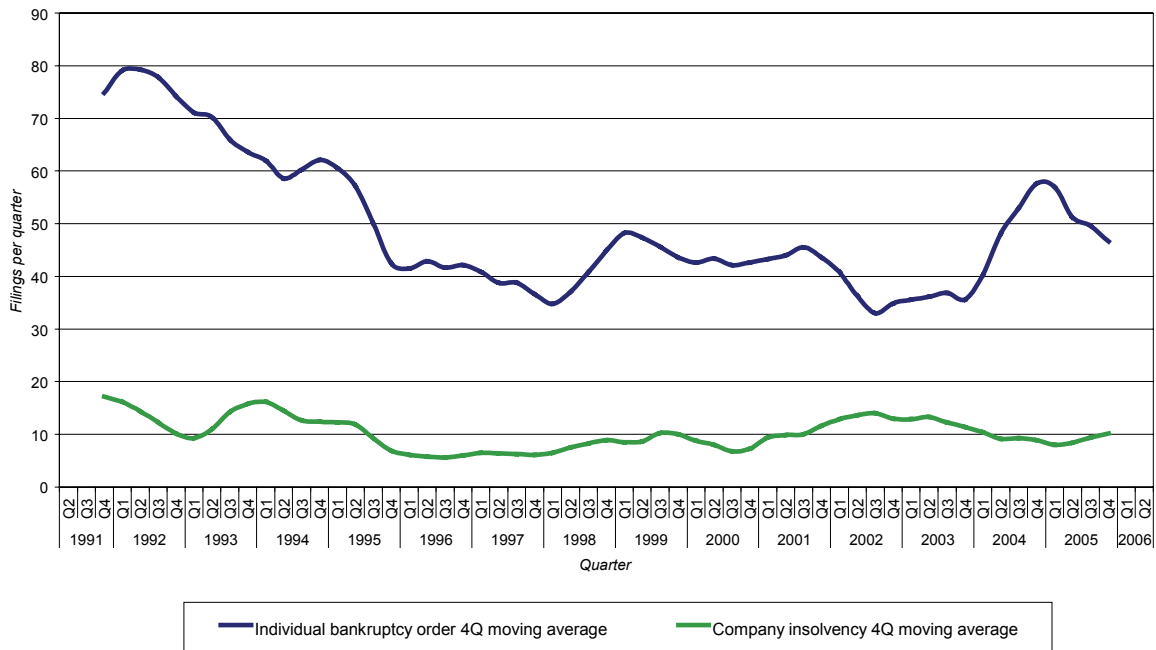
Insolvency trends for grocery suppliers

23. Insolvency filings in England and Wales in the insolvency trade classifications of Agriculture and Manufacture of Food, Drink and Tobacco² show that there has been a downward trend in the number of filings since the early 1990s (see Figures 7 and 8).
24. There was, however, a spike in the number of personal bankruptcy orders in the agriculture sector in late 2004 to early 2005, which was not replicated among corporate insolvency filings for agricultural companies. This suggests that the cause of the fluctuation was not common across the agriculture sector.

²They are based on, but not identical to, the UK pre-2003 version of the two digit Standard Industrial Classification (SIC) codes.

FIGURE 7

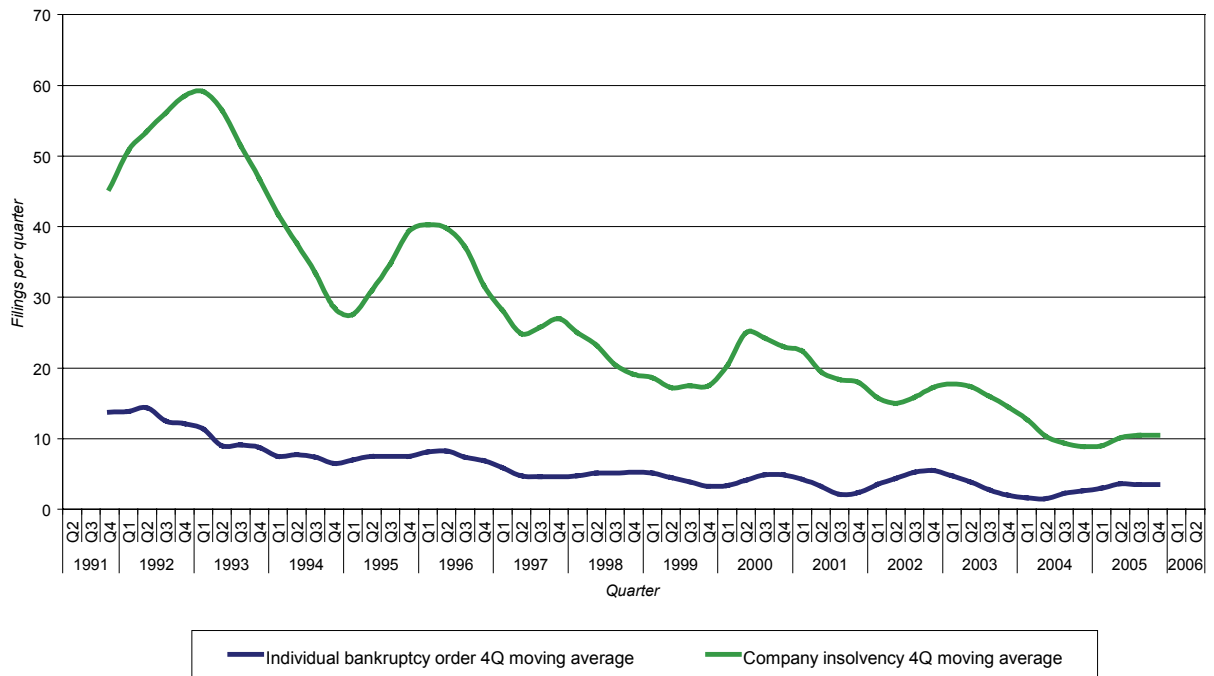
Insolvency Service statistics on the agriculture sector



Source: CC analysis of Insolvency Service data.

FIGURE 8

Insolvency Service statistics on manufacturers of food, drink and tobacco



Source: CC analysis of Insolvency Service data.

Milk supply chain profitability

25. The supply chain for fresh milk consists of three stages: primary production by farmers; processing, where the milk is pasteurized, homogenized, processed and graded into different fat contents, and bottled; and wholesale/retail. In the paragraphs below, we review profitability trends for firms active in each these components of the supply chain.

Background

26. Dairy farming is the single largest agricultural sector in the UK accounting for 19 per cent of total UK agricultural output.³ The number of dairy farms has declined from around 35,000 in 1995 to less than 20,000 in 2005. This reflects some consolidation, however, with average herd sizes increasing by around 30 per cent over this period. Improvements in feeding, management and genetics have resulted in total milk production remaining relatively stable, as shown in Table 1, as both average herd sizes and yields per cow have increased.⁴

TABLE 1 UK production of liquid milk

	2000	2001	2002	2003	2004	2005	% change 2000–05
Liquid milk (m litres)	13,801	14,007	14,178	14,364	13,956	13,883	0.6
Farmgate prices (ppl)	16.9	19.1	17.0	18.0	18.4	18.4	8.9
Value of production (£bn)	2.3	2.7	2.4	2.6	2.6	2.6	9.5

Source: Defra.

27. Historically, the UK milk industry has been highly regulated with specific arrangements governing the supply and marketing of milk. Milk industry deregulation, however, took place in 1994 and more recently CAP reform has changed the arrangements under which payments are made to farmers.⁵ The total value (in

³www.defra.gov.uk.

⁴*MDC Dairy statistics: an insider's guide*.

⁵According to Defra, the CAP reform package of 2003 was designed to give farmers greater freedom to farm to the demands of the market as the bulk of subsidies were decoupled from production.

farmgate prices) of raw milk produced in the UK in 2005 was £2.6 billion.⁶ About 45 per cent of the milk is processed for consumer consumption; the other 55 per cent is sold for manufacturing into products such as cheese, milk powder and butter.

28. Of the raw milk used for manufacturing, there has been a steady shift of use towards non-commodity fresh products such as yoghurt, and a shift away from commodity products such as skim milk powder. Dairy UK told us that demand for pro-biotic yoghurts and other added-value products have followed the consumer drive for more healthy eating and balanced diets, and that these are among the most profitable products generated from raw milk. There has also been a fundamental demand change from whole milk to semi-skimmed and skimmed milk.
29. For customers, a significant trend over the past two decades has been the substantial decline in doorstep bottle milk deliveries and a corresponding increase in supermarket purchases of milk.

Dairy farming profitability

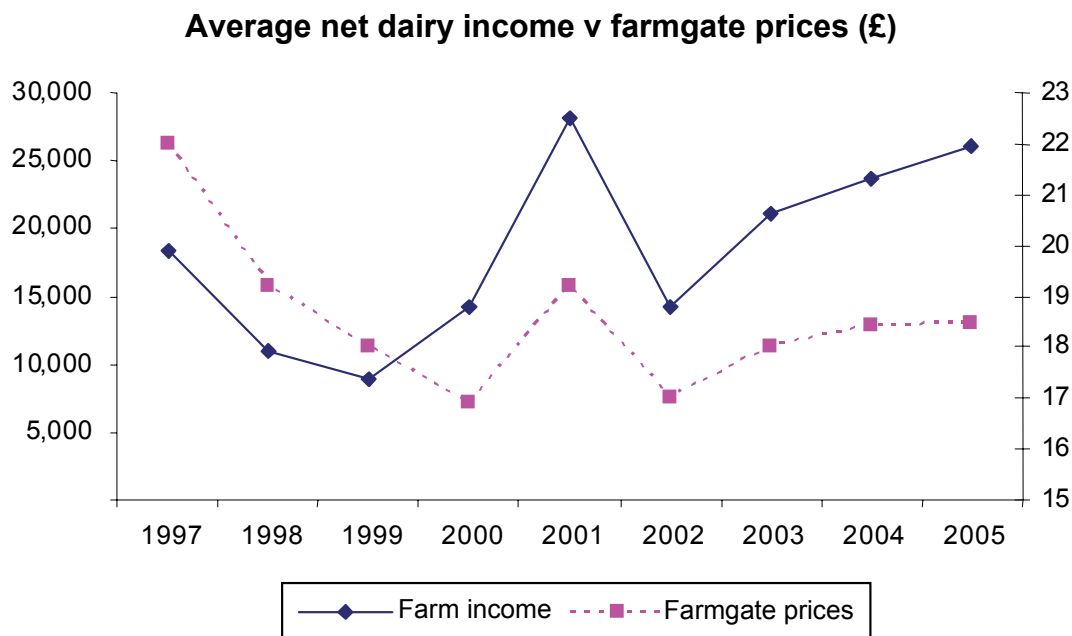
30. In five of the past six years dairy farms have had higher incomes than average farm incomes.⁷ However, we understand that these income levels may be lower than those historically earned in the period prior to milk industry deregulation.
31. The financial pressures experienced by dairy farmers over the past ten years have resulted principally from the weakness in milk commodity prices over this period. Since deregulation, farmgate prices have been driven largely by the commodity markets, which have in turn been driven by intervention prices during this period. Although intervention prices have remained constant in Euro terms, they have fallen

⁶Defra, *Agriculture in the United Kingdom 2005*, p48.

⁷Defra, *Agriculture in the United Kingdom 2005*, p11.

in sterling terms (by 5p to 6p a litre)⁸ due to the strength of the sterling. This accounted largely for the fall in farm incomes up until 1999 (see Figure 9) when average farm net income fell to about £10,000 per farm.⁹

FIGURE 9



Source: Defra.

32. Net farm income more than doubled in 2001 as a result of both higher milk prices and increased yields. In 2002, net farm income fell again in line with milk prices with yield increases being insufficient to offset the fall in price. Since then, there has been a steady, albeit slight, nominal increase in farmgate prices.
33. There appears to be a close correlation between net farm incomes and farmgate prices. Figure 5 shows that average net farm income fell to its lowest point in 1999 as the price of raw milk continued to fall, but then rose roughly in line with the increase in farmgate prices.

⁸Milk Development Council, Dairy Supply Chain Margins, 2003–04.

⁹Net farm income includes most costs, including depreciation and a notional rent cost for any owned land, but does not take account of any unpaid labour or interest costs.

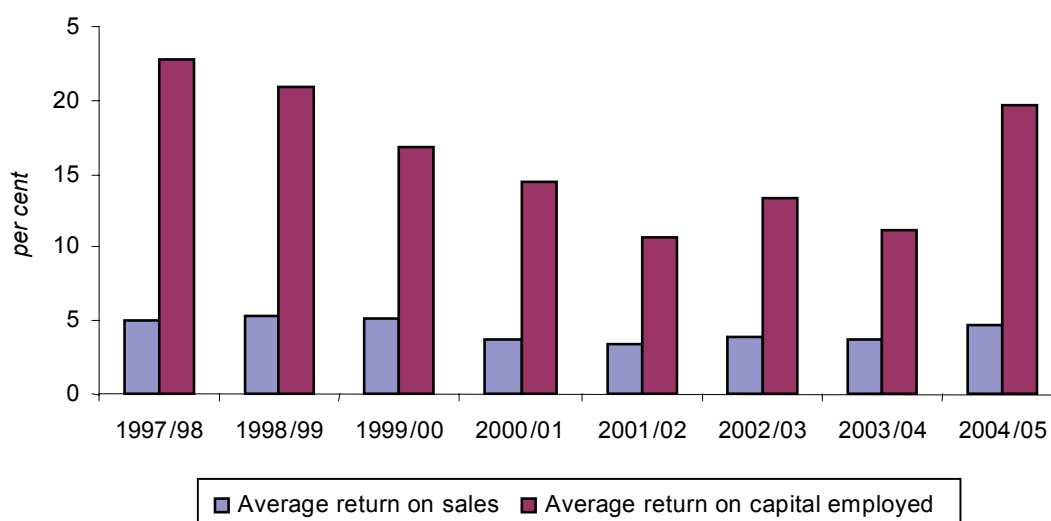
34. It is worth noting that the farmgate price for 2005 was at the same level as the price in 1999, but average farm incomes have increased over twofold since then, reflecting in part cost efficiencies realized from larger herds and increased cow yields. However, the consolidation of milk farms has also resulted in larger average farm sizes, which would have increased the capital employed at each farm. To the extent that these capital costs have risen faster than farm incomes, the ROCE for milk farms may have declined in recent years.

Milk processor profitability

35. The largest UK milk processors are Arla UK, Dairy Crest and Wiseman and these are the main suppliers to the UK grocery retailers. They account for over 90 per cent of total processed liquid milk sold to grocery retailers in the UK.
36. During the past ten years, returns for liquid processors have not changed significantly in terms of pence per litre (averaging around 15/16ppl) or operating margins (see Figure 6). There has, though, been significant investment in the sector, including in new technology, during this time. However, against a backdrop of steady profits, this increased investment has resulted in falls in ROCE. Figure 10 shows average operating margins and ROCE for the three largest processors, Arla, Dairy Crest and Wiseman combined for the period 1997/98 to 2004/05.

FIGURE 10

UK milk processors: return on sales and capital employed, 1997/98 to 2004/05



Source: Company accounts (Arla UK, Dairy Crest and Wiseman).

*The increase in average operating margins and ROCE for the year 2004/05 is largely the result of the cost efficiencies derived from the merger of Arla and Express Dairies.

Grocery retailers' share of the retail milk price

37. Based on Milk Development Council (MDC) estimates, farmers currently derive about a 37 per cent share of the retail price of milk, with the remainder split between processors and retailers (see Table 2).

TABLE 2 Share of retail price in the milk supply chain, 2003 to 2005

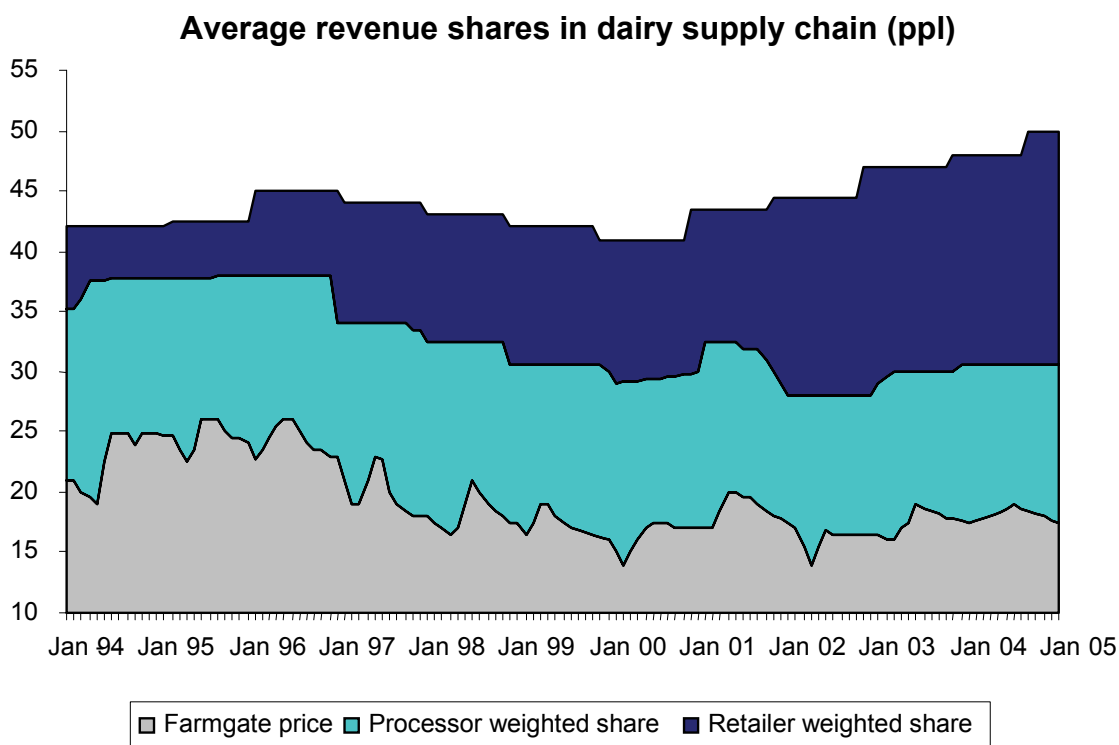
	2003		2004		2005	
	ppl	Share %	ppl	Share %	ppl	Share %
Farmgate milk price	18.1	38.8	18.5	38.9	18.4	36.7
Operating cost and processor margin	<u>15.6</u>	33.5	<u>15.9</u>	33.5	<u>16.1</u>	32.1
Processing selling price	33.7		34.4		34.5	
Operating costs and retail margin	<u>12.9</u>	27.7	<u>13.1</u>	27.6	<u>15.6</u>	31.1
Retail price	46.6		47.5		50.1	

Source: MDC.

38. Figure 11 shows the average share of revenue across the three stages of the milk supply chain (in ppl) for the 11 years to January 2005. The retail price of milk has increased throughout the period, and in recent years, there has been relatively steady prices for processors and farmers. The benefit of increases in the retail price

of milk since 1999 has generally been retained by grocery retailers, increasing their share of milk revenues compared with dairy farmers and processors, and we are concerned to understand why this has been the case. These asymmetric price movements suggest that grocery retailers' pricing power has increased relative to farmers in recent years. However, these movements could also result from variations in value added at different levels of the supply chain.

FIGURE 11



Source: MDC.

Pig meat supply chain profitability

39. The pig industry is a major sector in UK agriculture and, unlike many other sectors, it is not supported by subsidies at the national or EU level. Accordingly, pig meat farmers have been unaffected, relative to other farmers, by the CAP reform process. However, pig meat farmers have benefited from the reduction in cereals prices resulting from CAP reforms in 1993 and 1999 as this has lowered feed costs.

40. The supply chain¹⁰ for pig meat typically involves:
- Livestock production: carried out by local farmers who account for 95 per cent of the pigs supplied in the UK.
 - Livestock marketing: the marketing of pigs from farm to abattoir, either through a producer marketing group (similar to a co-op) or via buyers' agents direct to the abattoir (the farmer has a supply contract with an abattoir and the stock is purchased on a deadweight basis).
 - Integrated processing: including slaughter, cutting, retail packing, and delivery to retailers' central distribution depot for onward transfer to supermarkets.
 - Grocer retailers: these accounted for 76 per cent of pork and 81 per cent of bacon sales in 2005. From 1995 to 2005, the grocery retailers' share of fresh pork sales increased from 60 to 76 per cent and from 67 to 81 per cent for bacon. Conversely, the butchers' share of pork and bacon sales halved for both products over this period.
41. Production of UK pig meat has fallen sharply in the last six years as shown in Table 3. According to the British Pig Executive (BPEX), increased production in high welfare production systems, a number of disease outbreaks and pressure from the rapid growth in imports have all combined to contribute to this decline.¹¹

TABLE 3 UK production of pork and bacon products

	'000 tonnes						
<i>Production</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>% change 2000–05</i>
Pork	721	596	621	578	584	583	–19.1
Bacon	224	216	215	214	211	217	–3.1
Total	945	812	836	792	795	800	–15.3

Source: MLC.

¹⁰Further details can be found at www.redmeatindustryforum.org.uk/supplychain/.

¹¹BPEX, *The road to recovery 2006–2009*, p5.

42. The following paragraphs look at profitability in the three major components of the pig meat supply chain, ie farming, processing and retailing.

Pig farming profitability

43. The volume of pigs farmed in the UK has fallen significantly in the past ten years, as the total number of home-fed pigs that were sold to producers fell from 14.7 million to 8.7 million. This is reflected in the reduction of pig farm holdings over the period, which fell from 17,100 to about 10,000, continuing a long-term downward trend that had been occurring for at least 40 years.¹²
44. According to BPEX, the decline in pig holdings has been much greater than for cattle and sheep because the pig industry has not operated under a subsidy system and has therefore been more exposed to market price pressures.¹³ The availability of cheaper imports of pig meat (due to the strength of the sterling against other European currencies) and increased production costs in the UK due to tighter animal welfare standards have contributed to this decline.
45. Table 4 shows average pig meat farm incomes and prices for the ten years to 2005. Farm incomes have fluctuated significantly over the period, due to movements in pig meat and feed prices. The outbreak of swine fever in the Netherlands in 1997 led to a significant reduction in supply across Europe and combined with strong demand, boosted in 1996 by the BSE crisis, meant that the UK pig meat sector remained profitable for much of 1996 and 1997.
46. However, in 1998, European pig meat production increased by 6.5 per cent as the effects of the swine fever outbreak were reversed and producers increased their herds in response to the high prices of the previous two years. In addition, the

¹²Structural changes in the Pig Industry BPEX Economic and Policy Analysis Group, November 2004.

¹³Structural changes in the Pig Industry BPEX Economic and Policy Analysis Group, November 2004.

Russian financial crisis and the loss of this important export market (accounting for 36 per cent of EU exports) put downward pressure on prices, which ended the year around 40 per cent lower than the equivalent periods in 1996. This decline in prices was then reflected in substantially lower profitability.

TABLE 4 UK pig meat farm incomes and prices

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Net farm income (£'000)	54.1	14.4	-40.0	-10.9	37.6	20.0	23.5	32.1	25.1	30.5
Prices per kg deadweight (p)	137.7	110.8	80.7	78.5	94.4	97.8	93.3	102.6	102.8	102.7

Source: Defra and BPEX.

47. Pig meat prices improved in the six years to 2005, albeit with a small decline in 2002. These higher prices coincided with improved farm incomes over the period. Higher feed costs in 2004 pushed farm income downwards in that year, but this situation was reversed in 2005 when feed costs eased again.
48. The British Meat Processors Association (BMPA) told us that pig meat prices had increased significantly since the end of 2005, which should result in higher pig farm income for 2006.

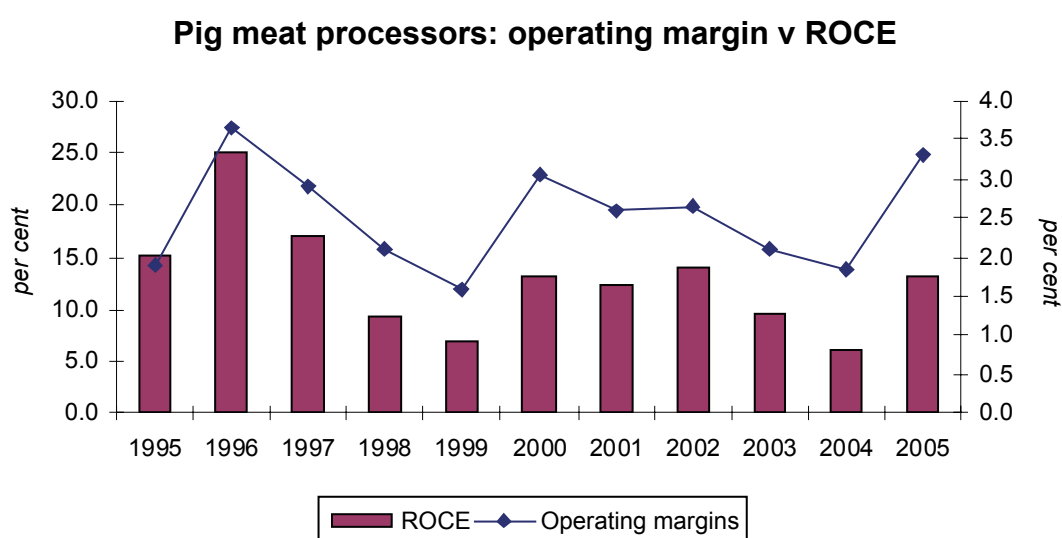
Pig meat processing profitability

49. Between farm gate and retailer, pigs pass through abattoirs and meat processing and packing plants. The abattoir sector has undergone major restructuring and consolidation over the past 20 years, changing from a situation in which there were many small pig processors in a very fragmented industry into one in which a small number of specialist abattoirs account for the majority of pigs slaughtered. In 2005, there were only six integrated pig processing companies in the UK.
50. The decline in pig-farming volumes is also reflected in the processing sector. UK pig slaughtering reached a peak of 16 million head in 1998 as a result of breeding pigs

being slaughtered to reduce numbers. This reduced to a low of 8.7 million head in 2005 and, despite an increase in average carcass weight over this period, net production of pig meat has fallen by 33 per cent since 1998.

51. According to BPEX, competitive pressure in the processing sector has been severe as the reduction in pig numbers has resulted in excess slaughter capacity.¹⁴ The loss of export markets in the wake of foot and mouth disease and swine fever has also resulted in abattoir closures and the merger of a number of processors.

FIGURE 12



Source: Companies House.

52. Our own analysis of the profitability of the seven largest UK pig-processing firms indicates that from 1995 to 2005 operating margins fluctuated between 1.6 and 3.7 per cent. ROCE has varied with operating margins over this period, ranging from 6 to 35 per cent. The downward trend in ROCE in the three years to 1999 was attributable to a number of factors, according to the companies, including exchange rate fluctuations moving in a direction which made local pork processing less competitive relative to processing plants from Denmark; and increased price competition in the retail sector.

¹⁴The British Pig Executive—The Road to Recovery 2006–2009, p5.

53. Improvements in processor efficiency arising from restructuring and consolidation improved ROCE for the three years to 2002. It was during this period that Grampian, already one of the largest pig processors in the UK, acquired its largest rival Malton Foods.¹⁵ Increases in raw material costs for this combined entity, which impacted on its distribution and packaging activities, contributed to the overall fall in ROCE in 2003 and 2004.

Grocery retailers' share of the retail pig meat price

54. Retail prices for pork and bacon have increased by 19 and 21 per cent respectively in nominal terms since 1999 (see Table 5). During this period farmgate prices for pork and bacon increased by 29 and 26 per cent respectively,¹⁶ implying an increasing share of the retail price for farmers over this period.

TABLE 5 Share of retail price in the pig meat supply chain, 1997 and 2006

	<i>Pork</i>		<i>Bacon</i>	
	1999	2006	1999	2006
Farmgate price	78.8	101.4	80.9	101.7
Processor costs and retail margin	317.8	371.8	368.7	442.6
Retail price	396.6	473.2	449.6	544.4

Source: PBEX, Defra and Companies House.

55. This may not fully reflect the underlying situation given that farmgate prices are for whole pig carcasses—by contrast, the retail price is biased towards a selection of more expensive cuts (eg pork chops and steaks), while cheaper cuts, such as legs, shoulders and bellies, may be sent to food manufacturers or exported. However, we have not seen evidence of movements in the price of these surplus cuts that questions the overall picture of increasing returns to farmers compared with processors and grocery retailers since 1999.

¹⁵This merger was cleared by the OFT in February 2002.

¹⁶Revenues for retailers and processors, as a group, increased by 17 per cent for pork and 20 per cent for bacon over this period. More detailed data on farmgate and retail pork and bacon prices is contained in Annex B.

56. Given the data that is currently available to us, we are unable directly to compare retail prices for pork and bacon with the prices paid by grocery retailers to processors. Our analysis of the profitability of pig meat processors in paragraphs 49 to 53 showed fluctuating operating margins and ROCE in the period since 1999. We might, however, have expected to see declining margins or returns for processors had grocery retailers increased their share of the retail price for pig meat at the same time as farmers. Given this, it seems reasonable to imply, on the basis of the evidence that we have reviewed, that grocery retailers have not increased their share of the retail price for pig meat over this period.
57. In summary, there is little evidence to suggest that retailers have undermined the viability of pig meat farming. Evidence from the BMPA (see paragraph 48) suggests that pig meat farm incomes will increase further in 2006. The picture for processors, however, is less clear. In the absence of processor pricing data it is difficult to determine whether any changes in profitability are the result of a decline in prices charged to grocery retailers or increases in input costs. We will seek to look at further pricing data in this area in the period leading up to provisional findings.

UK food and drink manufacturers included in the Investec Food Producers Margin Survey*Branded manufacturers*

AG Barr
Britvic Corona
Danone Water
Cadbury Confectionery UK
CCE
Campbells UK
Walkers Group Limited
Heinz Company Limited
Kellogs UK
Kraft
Mars UK
McCain Foods
Muller Dairy UK
Nestle Holdings UK
Premier Foods
Quaker Oats
Tate & Lyle
Tetley Group
UB
Unilever
Whitworths
Weetabix

Own-label manufacturers

British Sugar
Cranswick
DairyCrest
Express Dairies
Geest
Gerber Foods
Glanbia Consumer Foods (UK&Ireland)
Grampian Country Food Group
Greencore UK
Kerry Consumer Foods
McBride
Arla Foods/MD Foods
Matthews B
Nichols Vimto
Northern Foods
Princes Ltd
RHM
Samworth Brothers
Sun Valley
Treatt
UNIQ UK
Wisemans
Youngs Bluecrest

Financial data

TABLE 1 Milk processors: financial summary

	1997/98	1998/99	1999/2000	2000/01	2001/02	2002/03	2003/04	2004/05
<i>Return on sales</i>								<i>per cent</i>
Arla UK	5.0	5.4	5.3	3.8	3.4	4.0	3.8	4.8
Dairy Crest								
Wiseman								
<i>Return on capital employed</i>								
Arla UK	22.7	21.0	16.9	14.5	10.7	13.3	11.1	19.7
Dairy Crest								
Wiseman								

Source: Companies House.

TABLE 2 **Meat processors: financial summary**

	<i>£ million</i>										
	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Turnover	578,793	789,596	996,657	1,113,040	1,301,511	1,400,687	1,548,443	1,946,002	2,318,793	2,801,768	3,036,926
Gross profit	71,136	92,978	142,979	159,781	224,515	255,664	296,967	365,972	451,375	499,631	512,834
Operating profit	13,051	14,940	36,519	32,508	27,374	22,038	47,224	50,292	61,068	59,081	56,099
Fixed assets	90,289	95,947	143,567	207,817	273,152	292,826	296,449	386,192	407,362	575,243	906,608
Capital employed	95,779	98,691	146,405	190,251	294,732	317,101	356,681	407,532	436,035	617,361	936,781
Gross margin	12.3	11.8	14.3	14.4	17.3	18.3	19.2	18.8	19.5	17.8	16.9
Operating margin	2.3	1.9	3.7	2.9	2.1	1.6	3.0	2.6	2.6	2.1	1.8
ROCE	13.6	15.1	24.9	17.1	9.3	6.9	13.2	12.3	14.0	9.6	6.0
Fixed assets as % of turnover	15.6	12.2	14.4	18.7	21.0	20.9	19.1	19.8	17.6	20.5	29.9

Source: Companies House.

TABLE 3 Quarterly farmgate, processor and retail milk prices

		<i>ppl</i>		
		<i>Farmgate</i>	<i>Processor</i>	<i>Retailer</i>
1994	Q1	21	35	42
	Q2	20	38	42
	Q3	24	38	42
	Q4	24	38	42
1995	Q1	25	38	42
	Q2	24	38	43
	Q3	25	38	43
	Q4	25	38	43
1996	Q1	24	38	43
	Q2	25	38	45
	Q3	26	38	45
	Q4	24	38	45
1997	Q1	22	35	45
	Q2	20	34	44
	Q3	22	34	44
	Q4	19	34	44
1998	Q1	18	33	43
	Q2	17	33	43
	Q3	20	33	43
	Q4	19	33	43
1999	Q1	17	31	42
	Q2	19	31	42
	Q3	18	31	42
	Q4	17	31	42
2000	Q1	16	30	41
	Q2	15	29	41
	Q3	17	29	41
	Q4	17	30	41
2001	Q1	17	31	44
	Q2	19	33	44
	Q3	20	32	44
	Q4	19	31	44
2002	Q1	17	28	45
	Q2	15	28	45
	Q3	19	30	47
	Q4	16	28	45
2003	Q1	16	29	47
	Q2	17	30	47
	Q3	19	30	47
	Q4	18	30	47
2004	Q1	18	31	48
	Q2	18	31	48
	Q3	19	30	47
	Q4	18	31	50
2005	Q5	18	31	50

Source: MDC.

TABLE 4 Quarterly farmgate and retail pig meat prices

		<i>p per kg</i>			
		<i>Farmgate</i>		<i>Retail</i>	
		<i>Pork</i>	<i>Bacon</i>	<i>Pork</i>	<i>Bacon</i>
1995	Q1	109.0	110.1	413.8	361.9
	Q2	118.5	119.8	424.8	371.5
	Q3	118.6	120.2	420.2	389.0
	Q4	128.7	129.7	427.9	408.6
1996	Q1	136.9	138.8	439.0	424.2
	Q2	143.5	145.7	486.1	448.6
	Q3	144.2	146.7	487.1	474.5
	Q4	121.4	123.5	484.4	465.1
1997	Q1	104.4	106.2	457.3	454.9
	Q2	125.7	127.7	466.0	463.9
	Q3	112.2	114.8	458.0	466.1
	Q4	98.5	101.0	451.3	442.7
1998	Q1	92.5	94.5	430.2	436.7
	Q2	92.9	95.2	429.5	427.1
	Q3	71.2	73.9	411.2	427.2
	Q4	66.2	67.8	396.2	426.0
1998	Q1	71.9	73.8	396.7	435.8
	Q2	84.3	86.7	397.1	438.4
	Q3	83.2	85.8	394.1	449.2
	Q4	75.6	77.4	398.5	442.7
1999	Q1	81.4	83.2	405.5	443.0
	Q2	94.7	96.5	395.7	446.5
	Q3	100.6	102.5	402.0	466.1
	Q4	101.6	103.2	410.3	467.5
2000	Q1	96.1	97.6	425.8	504.6
	Q2	97.3	99.4	449.7	531.3
	Q3	96.5	98.3	455.3	520.8
	Q4	97.8	99.6	451.3	504.2
2001	Q1	91.3	92.9	455.0	484.1
	Q2	100.7	102.4	455.8	510.8
	Q3	90.1	91.9	455.0	509.3
	Q4	89.5	90.8	463.9	511.6
2002	Q1	100.0	101.3	467.9	503.2
	Q2	108.9	109.7	462.1	516.6
	Q3	100.3	101.0	451.9	532.3
	Q4	104.8	105.6	456.4	515.2
2003	Q1	102.9	103.6	459.7	522.3
	Q2	109.2	110.0	474.0	529.2
	Q3	103.3	104.3	491.0	531.7
	Q4	100.1	101.1	484.0	523.5
2004	Q1	102.5	103.5	465.7	523.6
	Q2	106.1	106.8	467.3	539.7
	Q3	105.0	105.7	461.3	536.5
	Q4	101.9	102.7	473.3	548.2

Source: BPEX.